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Employment Agreements Under (Dis)stress

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Many businesses are facing sharply lower revenue and the need to reduce costs as a result of the coronavirus and social-distancing mandates. For some businesses, that pressure means cutting salaries and laying off or furloughing employees. For an employee at will without an employment contract or offer letter that specifies compensation or benefits, the employee likely has no choice but to accept the cut or look for another job. But, for an individual with an employment contract which specifies compensation levels, a cut in pay would ordinarily implicate rights under that contract.

On the most basic level, if an agreement sets a compensation amount, a reduction in compensation could give rise to an employee's claim of breach of contract. The employee and employer would need to consider the merits of renegotiating their agreement or possibly engaging in litigation. For an employer and employee who wish to maintain a good relationship, litigation would not make sense.

However, when faced with a substantial cut in pay, an employee may regard the cut as so severe that it amounts to a de facto or constructive termination of the agreement. Depending on the definition of termination and other provisions in the contract, termination—constructive or actual—could in turn trigger rights of employees such as severance, vesting of equity or options, and other benefits, and impose added obligations on employers.

> Under what circumstances will a cut in pay amount to a de facto termination which supports a claim for benefits under an employment agreement?

In this article, we consider a question that may have great salience during the present strained economic conditions: Under what circumstances will a cut in pay amount to a de facto termination which supports a claim for benefits under an employment agreement?

Employment Agreements And Constructive Dismissal

To answer this question, we look to a body of law concerning the doctrine of "constructive dismissal" or "constructive discharge." Although the doctrine comes up most often in employment discrimination cases (to address circumstances when working conditions become so intolerable as to justify resignation), federal and state courts in New York have relied on the doctrine to decide claims of de facto termination under employment agreements—in particular, claims for benefits that are contingent on termination of the agreement. See, e.g., *Scott v. Harris Interactive*, 851 F. Supp. 2d 631, 645 (S.D.N.Y. 2012), aff'd in part, vacated in part, remanded, 512 F. App'x 25 (2d Cir. 2013) (mem.); *Robinson v. Kingston Hosp.*, 55 A.D. 3d 1121, 1122-23 (3d Dept. 2008).

Morris v. Schroder Capital Management International, 859 N.E.2d 503 (N.Y. 2006), is the only New York Court of Appeals case to address application of the constructive discharge doctrine in the context of an employment agreement. In that case, the court answered in the affirmative a certified question which asked whether the constructive discharge test, as developed under federal law in the context of employment discrimination, also governed the state-

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law question of whether an employee was bound by a non-competition agreement triggered by resignation. Id. at 507-08. This application of the constructive discharge doctrine is consistent with holdings of other courts that have considered the issue. See *Scott v. Harris Interactive*, 851 F. Supp. 2d 631, 645 (S.D.N.Y. 2012) (citing cases); see also *Aslin v. Univ. of Rochester*, 2019 WL 4112130, at *16-17 (W.D.N.Y. Aug. 28, 2019) ("Much of the case law regarding the constructive discharge doctrine deals with Title VII, but the theory can apply equally to breach of contract.").

The Constructive Dismissal Doctrine

As a threshold matter, to pursue a constructive dismissal claim, an employee must resign—as evidence that the terms of employment were so intolerable as to amount to a de facto termination. However, a delay between the creation of the intolerable circumstances and the resignation may not be determinative, for example, if an employee stays in an effort to improve conditions without resigning or collect additional compensation or benefits. See, e.g., *Stokes v. City of Mount Vernon, N.Y.*, 2015 WL 4710259, at *7 (S.D.N.Y. Aug. 4, 2015); see also *Green v. Brennan*, 136 S. Ct. 1769, 1778 (2016); see generally *Fogarty v. Near N. Ins. Brokerage Co.*, 1997 WL 799112, at *2 (S.D.N.Y. Dec. 30, 1997) ("[T]his Circuit has not adopted any time limits within which a plaintiff must have left a defendant's employ."), aff'd on other grounds, 162 F.3d 74 (2d Cir. 1998).

To establish constructive discharge, an employee must prove that the employer "deliberate[]ly and intentional[ly]" created a workplace "atmosphere … so intolerable as to compel a reasonable person to leave. *Morris v. Schroder Capital Mgmt. Int'l*, 859 N.E.2d at 507; see *Robinson v. Kingston Hosp.*, 55 A.D.3d at 1123; *Romano v. Basicnet*, 238 A.D.2d 910, 911 (4th Dept. 1997); accord *Terry v. Ashcroft*, 336 F.3d 128, 151-52 (2d Cir. 2003). The central question of whether the conditions were intolerable is thus an objective test: "working conditions are intolerable when, viewed as a whole, they are so difficult or unpleasant that a reasonable person in the employee's shoes would have felt compelled to resign." *Morris v. Schroder Capital Mgmt. Int'l*, 859 N.E.2d at 507 (quotation and citation omitted).

Reductions in Compensation

A cut in pay, under some circumstances, may make further employment intolerable and amount to constructive dismissal. A mere delay or one-time reduction would not ordinarily constitute constructive dismissal, but a substantial, ongoing reduction in compensation very well could. While the case law is sparse, we would expect a spectrum of results, with a very large cut (say, 50 percent or more) likely to be seen as a constructive dismissal, and a smaller cut (say, 25 percent or less) not likely to support such a claim absent other adverse circumstances.

In specific cases, courts have found reductions in pay of more than one-third—especially when combined with other circumstances such as a reduction in rank or duties—to be sufficient to defeat summary judgment and go to a jury. The claims and defenses in *Scott v. Harris Interactive*, 851 F. Supp. 2d 631 (S.D.N.Y. 2012), aff'd in part, vacated in part, remanded, 512 F. App'x 25 (2d Cir. 2013) (mem.), illustrate how a court is likely to view a constructive dismissal claim based on a substantial cut in pay.

In that case, the plaintiff was hired at a salary of $220,000. His offer letter entitled him to severance of six months' salary upon termination without cause. After a relatively brief time, Scott was demoted and his salary reduced to $150,000. He subsequently resigned and brought a claim for damages based on his employer's failure to pay the severance and continued health insurance benefits set out in his offer letter based on a theory of constructive dismissal. Applying New York law, the district court dismissed the claim, in part on the basis that an employee paid a salary of $150,000 in such circumstances could not genuinely face "intolerable" conditions. Id. at 649.

The Second Circuit reversed in a summary order, holding that "the percentage of a reduction and the reasonable expectations of the parties are also relevant to the factual determination whether an employee was forced into an involuntary resignation." 512 F. App'x 25, 28. The court looked to both the documents showing that Scott had a reasonable expectation his salary and duties would remain constant for at least a year, and suggestions in the record that the company had in fact wanted him to resign. On this basis, the court held that Scott had established a genuine issue of material fact as to whether he had been constructively terminated. Id.; see also *Fogarty v. Near N. Ins. Brokerage Co.*, 1997 WL 799112, at *2 (declining to set aside a jury verdict that an employee had been constructively discharged and was entitled to severance under an employment agreement when the employer had "unreasonably" withheld a portion of a bonus equivalent to about one-half the total compensation and the facts, including a reduction in duties and title,

suggested the plaintiff was likely to be terminated soon).

In contrast, in *Robinson v. Kingston Hosp.*, the Appellate Division held that a plaintiff was not entitled to summary judgment when she claimed that she had been constructively discharged by being asked to accept a position with reduced responsibilities at 75 percent of her former salary. 55 A.D.3d at 1122. The court held that the plaintiff had not shown as a matter of law that the employer had "deliberately made her working conditions so intolerable that she was forced into an involuntary resignation." Id. at 1123 (quotations and citation omitted). In holding that the case should go to a jury, the court pointed to a lack of any "evidence that the working conditions associated with the new position were so difficult or unpleasant that a reasonable person … would have felt compelled to resign." Id. (quotations and citations omitted).

As the decisions in *Scott* and *Robinson* suggest, a reduction in pay of one-third or less—without more—may not be sufficient to make out a constructive dismissal claim. At a minimum, the reduction must be a large proportion of the plaintiff's compensation. But even if the reduction is substantial, courts have also looked to additional circumstances contributing to an "intolerable" environment, such as diminished responsibilities and changes to title and job prospects. See *Butts v. New York City Dept. Of Hous. Pres. and Dev.*, 2007 WL 259937, at *20 (S.D.N.Y. Jan. 29, 2007) (stating, with respect to discrimination claim, that "[a] single reduction in pay, without additional evidence of malicious intent, is insufficient to establish a claim of constructive discharge"), aff'd on other grounds, 307 F. App'x 596 (2d Cir. 2009).

In short, the viability of a constructive discharge claim based on a pay cut will likely depend chiefly on following considerations: (1) contract language that bears on when an event of termination has occurred; (2) the size of the pay cut; and (3) the presence of other factors suggesting a material worsening of the employer's job and prospects.

The Employer's Intent

While the central issue in a constructive dismissal claim is an objective one—whether a reduction in pay and other conditions rendered further employment intolerable—the law also requires a claimant to prove that an employer "intentionally" created the intolerable conditions. Some jurisdictions have done away entirely with an inquiry into an employer's intent, but under New York (and Second Circuit) law, courts continue to require plaintiffs to show the employer "deliberately" or "intentionally" created the intolerable conditions that they allege.

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The precise meaning of "deliberate" in this context is not well defined. In some cases, courts have required proof that an employer had an improper specific intent to procure resignation, but courts have also stated that a lesser showing, one focused on whether the employer deliberately caused the changed circumstances, e.g., pay cut or changed responsibilities, leading to resignation, was sufficient.

For example, in *Robinson*, discussed above, the Appellate Division noted the absence of evidence that the defendant had specifically sought to provoke resignation, and held that the plaintiff-employee was not entitled to summary judgment, partly on that basis. 55 A.D.3d at 1123 (assessing evidence of both the "nature of the new position and the employer's motivation for offering such position"); see also *Shultz v. Congregation Shearith Israel of City of New York*, 867 F.3d 298, 308 (2d Cir. 2017) (noting, in context of Title VII claim, that constructive dismissal requires "evidence of the employer's intent to create an intolerable environment that forces the employee to resign").

In *Petrosino v. Bell Atlantic*, one of the leading Second Circuit cases applying the constructive dismissal test—albeit to a discrimination claim—the court acknowledged that its precedent showed it "ha[d] not expressly insisted on proof of specific intent," but that plaintiffs "must at least demonstrate that the employer's actions were deliberate and not merely negligent or ineffective." 385 F.3d 210, 229-30 (2d Cir. 2004) (citing *Whidbee v. Garzarelli Food Specialties*, 223 F.3d 62, 74 (2d Cir. 2000)); see also *Morris v. Schroder Capital Mgmt. Int'l*, 859 N.E.2d at 507 (citing *Whidbee* for proposition that "actions of the employer in creating the intolerable workplace condition must be deliberate and intentional").

Courts in the Southern District of New York often quote *Petrosino*'s language to the effect that an employer's conduct must be more than "merely negligent or ineffective" and apply that test, see, e.g., *Creacy v. BCBG Max Azria Grp.*, 2017 WL 1216580, at *12 (S.D.N.Y. March 31, 2017), but the case law has not yielded great clarity about

the meaning of "deliberate." In recent years, judges in the Southern District have applied both a specific intent and a more general "deliberateness" test.

The constructive dismissal test can seem ill-suited to a contract claim which, unlike a discrimination claim, typically does not turn on proof of intentional misconduct by the employer. Consequently, we believe that in the context of a contract dispute, a court would be more likely to apply a general standard of deliberateness rather than the higher standard of specific intent. However, discussion of the nuances of intent in different contexts, including alleged breach of contract, have been rare.

Constructive Dismissal During Economic Stress

The present economic stress prompts an additional, important question: how will reductions in compensation necessitated, or at least greatly influenced, by the coronavirus and social distancing mandates likely be viewed by courts?

Under a strict specific intent standard, it may be more difficult for plaintiffs to establish the required intent when an employer can reasonably argue that its reductions were reluctant steps taken in order to avoid job losses and other hardship. Cf. *Criscuolo v. Joseph E. Seagram & Sons*, 2003 WL 22415753, at *7-8 (S.D.N.Y. Oct. 21, 2003) (in context of "disarray" associated with sale of company, employer did not act "intentionally" and did not constructively terminate employee when it modified severance and other benefits to encourage plaintiff to remain); *IDG USA v. Schupp*, 2010 WL 3260046, at *14 (W.D.N.Y. Aug. 18, 2010) (in context of TRO, rejecting former employee's claim that he was constructively dismissed and hence not bound by noncompetition obligations, noting that "[m]ost of the conduct of which [the plaintiff] complains … were [sic] company-wide actions that were not specifically directed toward him"), aff'd in part, vacated in part on other grounds, remanded, 416 F. App'x 86 (2d Cir. 2011).

Under a more general "deliberate" action standard, a plaintiff should find it easier to establish constructive termination, even when an employer's actions were caused by genuine financial distress, since the reduction in compensation would be deliberate, regardless of the circumstances that necessitated the cut. At the same time, what is objectively intolerable is likely to depend on the broader economic circumstances. Given the relevance of both objective and subjective elements, a court's judgment is likely to be intensely fact-dependent, turning on contract language, economic circumstances and practical effects on a particular employee.

Further complicating the analysis is the potential applicability of defenses based on such concepts as impossibility or force majeure. While these defenses apply to all business relationships, not just employment, and the nuances of the subject are beyond the scope of this article, we would simply note here that under New York law, such defenses are generally construed narrowly in the employment context. See *Ebert v. Holiday Inn*, 628 F. App'x 21, 23-24 (2d Cir. 2015) (mem.) (employer bound by employment contract despite closure of location in which employees were to work); *Bierer v. Glaze*, 2006 WL 2882569, at *7 (E.D.N.Y. Oct. 6, 2006) (employer bound by contract despite loss of key business relationship); cf. *Kel Kim v. Cent. Markets*, 519 N.E.2d 295, 296 (N.Y. 1987) (mem.) ("Ordinarily, only if the force majeure clause specifically includes the event that actually prevents a party's performance will that party be excused."). Whether the crisis caused by this virus meets these high standards remains to be seen, but employers asserting such arguments will likely face an uphill battle.

Conclusion

In the current crisis, employers and employees are no doubt focused on the immediate and pressing concerns of maintaining businesses and performing jobs. But as the country returns to work, both employees and employers are likely to be considering the legal consequences of decisions made under the pressure of the coronavirus. In the process, they should look to their employment agreements and consider whether the doctrine of constructive dismissal is relevant to their legal rights and obligations.