Why Employees Win Bonus Claims

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Pay Plans Can Create Contract Rights

It is late November and your Senior Vice President, Marketing, has resigned to take an exciting new position. Your initial warm feeling for your colleague, together with regret at the company's loss, are soon eclipsed when you receive a telephone call from her lawyer asking the amount of her 1998 bonus. The question had not occurred to you. Bonuses at your company are determined in January and, while they constitute an increasingly significant part of total compensation, had always been viewed as discretionary. You tell the lawyer that the company's bonus policy does not provide for partial-year bonuses. He responds that his client relied on the bonus for a significant part of her compensation, had performed well and deserved a significant 1998 bonus. Besides, nothing in the policy foreclosed a partial-year bonus.

Disputes like this one occur with increasing frequency as bonuses become a more significant part of executive compensation packages. For employers, bonuses motivate top performers and keep compensation systems flexible. For employees, bonuses can be significant, if not the largest, components of their compensation. Implicitly recognizing its growing importance, New York courts have become more tolerant of contractual and quasi-contractual claims for bonus compensation. Looking past the imprecision of many bonus agreements and plans, courts now frequently allow claims to proceed to trial where there is any written or oral indication that bonus compensation is part of the employment relationship, together with some reasonable basis to compute the bonus amount.

Claims typically arise when an employee resigns or is terminated and the employer refuses to pay a bonus. Employees argue that the bonus was a contractual term of employment. Employers deny the contract or argue that they retained absolute discretion to determine a bonus amount, which could be zero. Although normal contract principles apply, unique features of the employer and employee relationship will often effect a court's analysis. Frequently, the interactions that occur in an employment relationship can give

rise to expectations which may or may not be contractually enforceable. As a result, decisions in this area are usually heavily fact-based.

Written employment contracts, employee handbooks or bonus plans are usually the first source considered in resolving these disputes. In their absence, courts consider express oral promises to pay a bonus, or in some cases, the course of dealing between the parties. If courts find a contractual obligation to pay a bonus, payment will be enforced so long as there is a reasonable basis to calculate the amount. In certain circumstances, courts have allowed quasi-contractual claims, both where employees have failed to establish contract rights and as an elected remedy where the contract was breached by the employer.

Employers can defeat bonus claims based on policies adopted subsequent to an employee's hiring because the policy was not part of the original employment contract. Summary judgment is inappropriate, however, when the employee introduces evidence that he or she continued employment in reliance on the policy. To enforce bonus policies created after the commencement of the employment relationship, courts implicitly require a form of detrimental reliance by the employee as consideration. Similarly, if an employer adopts a more restrictive bonus policy subsequent to an employee's hiring, the employer may not be able to rely on the new policy unless it can prove that the parties' intent was to modify the earlier agreement.

Written Provisions

A well-drafted, written contract or bonus plan is obviously the best way to establish a bonus claim. Such a writing, from the employer's perspective, is also the best way to foreclose a claim by clearly stating that the parties did not intend bonus compensation to be a term of employment. If an employment contract does not mention bonus compensation and provides that it constitutes the entire agreement and that no modifications will be binding unless they are reduced to a signed writing, subsequent oral promises to pay a

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bonus may be unenforceable.\(^8\) If the employment contract does not preclude oral modifications, however, an employee may argue that his employment contract has been orally modified by a promise to pay a bonus.\(^9\) Similarly, an employment contract or bonus plan may preclude the payment of a bonus if the employee is terminated.\(^10\) Others provide that the bonus plan may be terminated without the employee's consent.\(^11\) Bonus plans also may eliminate claims for bonuses by preventing bonus rights from vesting until bonus payments are formally announced.\(^12\)

Even if an employee establishes a written bonus right or policy, the employer may prevail if the bonus provision unambiguously gives the employer absolute discretion over the granting or payment of bonuses.\(^13\) Where such an argument is made, however, any ambiguity about the parties' intent precludes dismissal of the employee's claim.

In *Culver v. Merrill Lynch & Co.*,\(^14\) for example, Judge Sand held that in order to grant a motion to dismiss a claim, the bonus plan must make it "absolutely clear that [the employer] was to have complete discretion in determining whether to award any compensation." The court distinguished Merrill Lynch's plan, which created a bonus pool and then provided that "[d]istribution of pools will be determined by the Division Director and Group Manager, with input from Trading Desk Managers," from bonus provisions which "gave the employer 'discretionary power to do anything he deem[ed] appropriate for any reason' as to the payment of the bonus."\(^15\) Judge Sand found that the Merrill Lynch plan did not contain "magic words" vesting complete discretion with the employer.\(^16\)

In a subsequent case reviewing the enforceability of an oral contract, Judge Trager wrote that "where contractual provisions assign the employer absolute discretion to grant and pay bonuses, those provisions may be enforced. ... [H]owever, such discretion will not

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\(^13\) *See Foss v. American Tel. and Tel. Co.*, 605 N.Y.S.2d 143 (3d Dep't 1993).

\(^14\) 94 Civ. 8124 (LBS), 1995 WL 422203 (S.D.N.Y. July 17, 1995), slip op. at 3.


be implied when such language is absent.” Judge Trager distinguished between instances where an employer retains discretion over whether a bonus will be paid at all and instances where an employer retains discretion to determine the amount of the bonus. In the latter case, an employee may have a contract claim if the employer reneges on payment after the bonus amount is fixed.

Judge Larimer held that conflicting terms in the plaintiff’s employment contract precluded summary judgment on the issue of whether the employer was contractually obligated to make a bonus payment. In Thomson v. Saatchi & Saatchi Holdings, the employer argued that a contract provision stating that the plaintiff “shall receive such Salary increases and bonuses, if any, as may, from time to time, be approved by the management of Saatchi & Saatchi Advertising Affiliates (USA)” indicated that it retained discretion over bonus payments. Another section stated that if the plaintiff were terminated he would not receive any bonuses “except as had been earned but not paid at termination.” The court held that summary judgment was inappropriate because this language implied that bonuses were not purely discretionary.

In light of the contract’s ambiguity, the court considered that executives consistently received bonuses when the company met profit targets. The court found that there was a system for determining bonuses, and that the plaintiff’s bonus had been calculated. The course of dealing between the parties established that (1) each year a bonus pool amount was fixed based upon the company’s profits in excess of previously set targets and (2) the plaintiff, who was the company’s CEO, made recommendations for the apportionment of the pool among the executives based on their individual performances. While these recommendations were subject to review and approval, they were generally accepted in practice. The court held that a factfinder might conclude that the parties intended that the employee “would be entitled to a bonus if [the company] reached its financial target, and if his own performance had contributed to that of [the company’s].”

Even when the plan gives the employer complete discretion, an employee may have a cause of action for failure to follow the proper procedure for determining the bonus. In Sathe v. Bank of New York (“Sathe I”), Judge Sand denied a motion to dismiss a claim alleging breach of bonus provisions even though the bonus plan gave the Chairman of the bank discretionary power concerning the bonus. The plaintiff had alleged that the

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18 Id.
20 Id. at 825.
21 Id. at 825.
22 Id. at 825.
23 Id. at 825.
24 Id. at 826.
employer violated the terms of the bonus plan because someone other than the Chairman
made the final bonus determination.

**Oral and Implied Contracts**

Courts have held that oral employment agreements to make bonus payments are
enforceable. In *Giuntoli v. Garvin Guybutler Corp.*, Judge Ward denied a motion to
dismiss a bonus claim based on allegations that the employee's terms of employment upon
commencing work for the defendant included a semi-annual bonus based on profitability,
with a minimum semi-annual payment of $15,000. The complaint also alleged that the
employer later expressly agreed to match an offer she later received from a competitor that
included minimum bonus payments. The court also held that the course of dealings
between the parties "evidence[d] an implied promise that semi-annual bonus payments
constituted a term of plaintiff's employment." The First Department reached a similar
conclusion where a plaintiff orally was offered a compensation package that included a
"substantial" bonus and had received a substantial bonus throughout the term of his
employment. The court held that the course of dealing between the parties could establish
an implied promise that bonus payments were part of the plaintiff's compensation.

Such agreements have been deemed to escape the Statute of Frauds if they may be
performed in one year or are terminable at will. However, if a contract cannot be
terminated within one year unless a party breaches, the Statute of Frauds will apply. If
the agreement is evidenced by a writing, such as a letter confirming the amount of the
bonus to be paid or a computer record of the bonus amount, the Statute of Frauds may be
inapplicable.

**Proving Bonus Amount**

It may be difficult to prove that the plaintiff is entitled to a specific amount without
an express contract or bonus plan. However, the fact that the parties have entered into a
contract to pay an amount to be determined at a later time does not prevent enforcement of
the contract. Further, inability to prove the exact amount of the bonus due is not fatal to

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27 *Id.* at 508.
(1st Dep't 1958).
29 *See Mircel*, 613 N.Y.S.2d at 878; *Canet*, 917 F. Supp. at 984.
aff'd, 60 F.3d 1001 (2d Cir. 1995).
31 *Id.* at 878.
the plaintiff's claim. Courts may enforce a contractual obligation to pay a bonus so long as there is some reasonable basis for calculation. In determining the obligation, the court may consider commercial practices or other custom or usage.

Here as well, in determining the bonus amount, courts look to bonus history to flesh out the parties' agreement. In Harden v. Warner Amex Cable Communications Inc., the plaintiff's bonus and salary had increased the last two years despite the company's large losses. In light of this history, the court decided that the 1983 bonus would have been $125,000, a $25,000 increase, because the employee received a $15,000 salary increase and a $25,000 bonus increase the previous year. Because the plaintiff received another $15,000 salary increase for 1983, the court determined that his bonus would have gone up by the same amount as well. The court then prorated the 1983 bonus based upon the portion of the year the employee actually worked.

In addition, plaintiffs may prove a bonus amount by showing that a bonus figure had been determined through the normal bonus procedure or that the employer had already disclosed a bonus amount.

Employees sometimes argue they have lost earned wages when a promised bonus is withheld. New York has a "long standing policy against the forfeiture of earned wages." If an employee can establish that the lost bonus constitutes earned wages, rather than incentive compensation, the employee may sue to recover the bonus, attorneys fees and a statutory penalty under a New York labor law statute.

New York Labor Law §191 limits the period an employer can withhold wages after the wages have been earned. It also provides that "[i]f employment is terminated, the employer shall pay the wages not later than the regular pay day for the pay period during which the termination occurred, as established in accordance with the provisions in this section." The statute covers all types of employees, including executives and highly paid professionals. The statute also provides that "In any action instituted upon a wage claim by an employee or the commissioner in which the employee prevails, the court shall allow

33 Giuntoli, 726 F. Supp. at 508.
35 Giuntoli, 726 F. Supp. at 508.
37 Id. at 1098.
38 Thomson, 958 F. Supp. at 826; Canet, 917 F. Supp. at 986.
39 Mirchel, 613 N.Y.S.2d at 878.
40 NY Labor Law § 191(3).
41 See Daley v. Related Companies, 581 N.Y.S.2d 758, 760 (1st Dep't 1992); Schutty v. Pino, 95 Civ. 1526 (LMM), 1997 WL 363812 (S.D.N.Y. July 1, 1997), slip op. at 3.
such employee reasonable attorney's fees and, upon a finding that the employer's failure to pay the wage required by this article was willful, an additional amount as liquidated damages equal to twenty-five percent of the total amount of the wages found to be due."  

Incentive compensation generally is not covered by the Labor Law, but bonus payments may be deemed "wages" in certain situations. The statute defines wages as "the earnings of an employee for labor or services rendered, regardless of whether the amount of earnings is determined on a time, piece, commission or other basis." In Schutty v. Pino, the court held that bonus payments which were determined by a fixed formula based on gross fees constituted wages under the statute. The court noted that "[a]lthough the amount that Schutty would receive could not be predetermined at the time of the agreement, the amount of that bonus, and the date it was to be paid, were not within [the employer's] discretion."  

In determining whether bonus payments are incentive compensation or wages within the meaning of the statute, courts look to see if the bonus is based on factors outside the scope of the employee's actual work. Compensation based on factors other than an employee's actual work is not covered by the wage statute. Bonus payments are not considered "wages" where the employer retains discretion concerning the bonus amount, or where the bonus is tied to the overall production rate of the department and pay is not deemed to be earned until the end of a given production period.  

Employees who successfully bring statutory claims in addition to contractual or quasi-contractual claims can benefit from the attorneys fee and liquidated damage provision. However, they will only be able to recover the portion of their fees attributable to the statutory claim.  

Quasi-Contract Claims  

Where an employer has breached an employment contract, the employee also can try to recover a "bonus" if the value of the employee's services exceeded the salary he or she was paid. The mechanism for pursuing this strategy is to sue in quasi contract, rather

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42 N.Y. Labor Law § 198 (1-a).
44 Id. at 3; Westheim v. Elkay Industries, Inc., 560 N.Y.S.2d 779 (1st Dep't 1990) (oral promise to pay bonus equal to 2% of sales above quota).
46 Tischmann, 882 F. Supp. at 1370.
47 Dean Witter Reynolds v. Ross, 429 N.Y.S.2d 653, 658 (1st Dep't 1980).
than on the contract itself. Based on the breach, the employee elects to rescind the contract rather than suing for damages under its terms. Having rescinded the contract, the employee can sue in quantum meruit for the value of his or her services over and above the amount of salary paid.

Of course, quantum meruit recovery is not available if there is an express contract covering the subject of the dispute which precludes the relief sought. A quantum meruit or unjust enrichment claim, however, may be available where an oral agreement is deemed unenforceable because of the Statute of Frauds. The plaintiff may also seek to recover where there is no valid contract or the contract is too vague to be enforced. However, the employee still will need to provide evidence that his or her salary alone was insufficient to constitute reasonable value for the services performed.

Although an express contract will generally preclude quasi-contractual relief if it covers an employee's compensation for his or her services, an employee may have a quantum meruit or unjust enrichment claim for compensation in addition to normal salary where he or she performs "services outside the scope of the employment agreement if 'the additional services are so distinct from the duties of the employment that it would be unreasonable for the employer to assume that they were rendered without expectation of further pay.'" This principle can apply where an employee does work for an affiliate of his or her employer and performs duties outside the scope of his or her employment contract.

Conclusion

New York courts have provided numerous mechanisms for departing employees to recover lost bonus compensation. Employees should consider these doctrines in assessing their rights, and employers should give them careful attention in designing employment agreements and bonus and compensation policies that may unintentionally confer valuable contractual rights on employees.

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52 See Zaitsev, slip op. at 4; Mirchel, 613 N.Y.S.2d at 879.
53 Zaitsev, slip op. at 4.
56 See Lumet, slip op. at 6-7.