Outside Counsel

Employment Contracts: Three Counterintuitive Appellate Decisions

True or false:
• Once an employment agreement expires, employment is terminable at will.
• Where a contract for a definite term states that employment can be terminated immediately for “any reason,” employment is at will.
• Damages for breach of an employment contract are limited to the benefits that the employee could have expected to receive had the contract been performed.

If you answered unequivocally “yes” to each of these questions, you’d be in good company among employment lawyers. And you’d be wrong.

Oliver Wendell Holmes observed that “it is the merit of the common law that it decides the case first and determines the principle afterwards.”

Later in his career, Justice Holmes would challenge his Supreme Court colleagues to provide him with a rule, however obscure or distant from the issue at hand, and he would contort the rule to support his opinion. Justice Holmes’s penchant for legal gymnastics seems to have woven its way into New York contract law over the last century and half.

This article examines three quirky and arguably counter-intuitive decisions in New York contract law that are difficult for practitioners to reconcile with their basic understanding of the common law, but equally difficult for them to ignore. Advocates involved in drafting, interpreting, or challenging employment contracts would be well advised to study these decisions.

Automatic Renewal

The doctrine of at-will employment can be traced to former Supreme Court Justice Horace Gray Wood’s 1877 treatise on master-servant relations. The rule, in its modern form, provides that absent an express agreement to the contrary, either employer or employee may terminate their relationship for any or no reason, and without advance notice.

These opinions continue to have precedential value, and attorneys on both sides of the employment law bar are therefore well-advised to remain familiar with them.

The Appellate Division’s opinion in Borne Chemical Company Inc. v. Dictrow examines one exception to the rule. Borne, similar to case law in other jurisdictions (and finding support in New York decisions dating back to the 1800s), holds that a presumption exists for the automatic renewal of an employment contract of a stated duration if the employee continues to work for the employer following the expiration of the initial term of employment. This presumption of automatic renewal of contracts—akin to the holdover rule in landlord-tenant law—creates an obvious tension with the at-will doctrine.

In Borne, the employee (Herman Dictrow) entered into an employment contract in 1972; the contract expired in 1978. Mr. Dictrow continued to work for his employer, Borne, until he eventually was discharged in 1979, following which a dispute arose between the parties regarding the enforceability of a covenant not to compete in the contract. In remanding the case for further litigation, the Appellate Division held that the covenant not to compete, like the balance of the contract, was automatically renewed by Mr. Dictrow’s continued employment following expiration:

[It] is the rule that when, upon the expiration of a contract of employment for a definite term, the employee continues to render the same services as he rendered during the term of the contract without expressly entering into a new agreement, it will be presumed that he is serving under a new contract having the same terms and conditions as the original one[.]

This doctrine of automatic renewal is subject to an important caveat, however, dictated by the Statute of Frauds. As the Appellate Division noted in Borne, “where the original term of an employment is for more than one year, a continuance in employment will not, because of the Statute of Frauds, support a presumption of a renewal for the full period of the initial term, but only of employment from year to year thereafter.”

Fret not employers: the presumption of automatic renewal is rebuttable. Management-side practitioners would be well-advised to include in employment agreements language making clear that upon expiration of any stated period of employment, employment will be “at will” and the contract will not automatically renew absent the written agreement of the parties. But employers who do not negotiate such language into their agreements—and who are not mindful to terminate the employment relationship upon the expiration date of a contract—remain exposed to employee claims of contract renewal.

‘At Will’ Language

In Rothenberg v. Lincoln Farm Camp Inc., the U.S. Court of Appeals for the Second Circuit discussed another exception to the employment at will doctrine: that in a contract for a definite
term that contains both an at-will termination provision and a “for cause” termination provision, the employer may be obligated to terminate the employee only for cause.

In July 1983, William Rothenberg entered into a one-year contract of employment to serve as the assistant director of the Lincoln Farms Camp. The contract appeared to allow the camp to terminate Mr. Rothenberg at will, on penalty of two weeks’ severance pay:

If for unfor[e]seen condition, circumstance, war, epidemic, governmental restriction, administrative decision, Act of God or any other reason the Camp should find it advisable to terminate this agreement before…the contract expiration date, either party shall provide the other party with two weeks’ notice, salary for which period shall constitute severance pay in full discharge, release and settlement of any and all claims.11

A separate clause in the agreement gave the camp the right to terminate the agreement “for cause,” and made no provision for notice or severance pay.12

In August 1983, Lincoln gave Mr. Rothenberg notice that it was terminating his employment (as it later admitted, for poor performance) effective five days later, together with a check apparently designated as severance pay.13 Mr. Rothenberg sued for $19,000—the balance of the salary that he would have received had he remained employed through the stated one-year term of employment.

Mr. Rothenberg argued that the first termination clause should be read, in accordance with the principle of ejusdem generis,14 as allowing termination only for any unstated force majeure reason, and not merely for “any other reason” (as a plain reading of the contract would seem to permit). Read as such, the contract did not permit Lincoln to discharge Mr. Rothenberg for performance reasons.15

The district court declined to adopt Rothenberg’s narrow reading of the first termination clause and granted the camp’s motion for summary judgment, finding that Mr. Rothenberg was employed at will and that the camp could therefore discharge him at any time without any obligation to continue to pay his salary. The Court of Appeals vacated the judgment and remanded the case for further proceedings, concluding that there were triable issues of fact as to whether the parties intended that a discharge under the first termination provision could be effected at will or only for a force majeure-type reason.

But the court didn’t stop there. It held that the “general rule under New York law” is that “[a] contract of employment for a definite term may not lawfully be terminated by the employer, prior to the expiration date in the absence of just cause.”16

This rule, the court noted, applies “even where the employment contract, by its terms, purports to reserve to the employer the right to terminate the contract at will.”17

At first blush, the Rothenberg opinion would appear to abrogate the at-will employment rule. The court did provide employers with a safe harbor, however:

Where the contract provided unequivocally that the employer could terminate the contract without cause, but was thereupon obligated to pay a penalty to the employee, termination without cause was held not to constitute a breach if the penalty was paid.18

The court noted that it could not determine from the record before it if this exception was met, explaining that if the severance provision was “notice in lieu of severance” that required Mr. Rothenberg to work for the two-week period, “we doubt that New York law would consider the employer’s payment a ‘penalty.”’19

If Rothenberg is controlling, employers that include termination “for cause” provisions in their contracts with employees would be well-advised to make clear in such agreements that a “penalty” will be paid to the employee if he is terminated without cause. This “penalty”—which presumably could take the form of a separation or severance payment—should be more than mere salary continuation through the employee’s last date of work.

Quantum Meruit

Quantum meruit (literally, “as much as he deserves”) is often referred to as a “claim of last resort.” The claim can be used as a potent weapon by an employee with a valid breach of contract claim, as illustrated by Carvatt v. Lippner.20 In Carvatt, the Appellate Division held that an employee under contract who is wrongfully discharged may either treat the contract as terminated and sue for damages for the breach, or rescind the contract and sue for the value of his services actually rendered.21 Recovery in quantum meruit is not capped by the value of the contract, and therefore may exceed—or fall short of—the expectation damages that the plaintiff would otherwise be entitled to on a breach claim.

In Carvatt, the plaintiff entered into a contract pursuant to which he would manage David Lippner’s company in exchange for a one-year irrevocable option to purchase the company at a discounted price. The duration of the contract was one year or until Thomas Carvatt earlier exercised his purchase option.

Mr. Lippner discharged Mr. Carvatt four months into the contract, and Mr. Carvatt never exercised his option to purchase the company. Instead, he sued Mr. Lippner for breach of contract or, alternatively, in quantum meruit for the value of services rendered. The case was presented to a jury on the latter claim. At the conclusion of the trial, the jury found that Mr. Carvatt had been wrongfully discharged and awarded him $500,000 in damages for his services.

On appeal, the Appellate Division noted that “[a] quantum meruit recovery is proper where the defendant wrongfully has prevented the plaintiff’s performance of a written agreement. Under such circumstances, the agreement is effectively terminated by the wrongful act of the defendant, thereby entitling plaintiff to [rescind the contract and recover] damages equal to the reasonable value of the services rendered.”22 Employers seeking to mitigate against the risk of a Carvatt-type claim should consider including a provision in their contracts expressly permitting them to terminate early, and agreeing in advance upon the remedy. It would be difficult for an employee to argue frustration of a contract that contains no guarantee of continued employment.

Conclusion

Borne, Rothenberg, and Carvatt present exceptions to hornbook law, and are seemingly incongruous with precedent. One can only wonder whether, as Justice Holmes posited, the reasoning in those cases was contorted to achieve the desired result. Nonetheless, these opinions continue to have precedential value, and attorneys on both sides of the employment law bar are therefore well-advised to remain familiar with them.

2. Id. 217 et seq.
5. See 53 American Jurisprudence 2d, Master & Servant §23.
6. See Adams v. Fitzpatrick, 125 N.Y. 124 (1891) (noting that the [plaintiff] employee “claims to support this allegation [of renewal] from an implication arising from his continued service, without objection, after the expiration of the term of service under an express contract”).
7. 85 A.D.2d at 649.
8. Id.
9. Id. (noting that “[t]he presumption is one of fact and may be rebutted”).
10. 755 F.2d 1017 (2d Cir. 1985).
11. Id. at 1018 (emphasis added).
12. Id.
13. Id.
14. Literally “of the same kind,” the principle of ejusdem generis holds that general words that follow a list of particular things will be construed as applicable only to things of the same general nature or class as the particular things listed. See, e.g., United States v. Salen, 235 U.S. 237, 249 (1914).
15. Mr. Rothenberg also argued that the camp consistently opposed his performance, creating at best an issue of fact as to whether “cause” existed to terminate his employment under the second termination clause. 16. Id. at 1020-21.
17. Id. at 1021.
18. 755 F.2d at 1021.
19. Id.
21. 82 A.D.2d at 648.
22. Id. (citations omitted).