ASAP™ A Littler Mendelson **Time Sensitive** Newsletter

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New York's highest court holds that departing employees seeking to challenge forfeiture of post-employment compensation for violating a restrictive covenant must satisfy a stringent "constructive discharge" standard.

East Coast Edition

A Littler Mendelson East Coast-specific Newsletter

A "Constructive" Decision: The Employee Choice Doctrine Is Alive and Well in New York

By Michael P. Pappas and David S. Warner

Employers frequently condition the payment of post-employment compensation on an employee's compliance with a restrictive covenant, such as a noncompete agreement. For example, many deferred compensation plans provide that an employee who resigns and goes to work for a competitor automatically forfeits any nonvested deferred compensation. Such provisions have long been enforceable in New York under the "employee choice" doctrine, which holds that an employee who chooses to resign and violate his or her noncompetition obligations can be deemed to have waived any legal right to such compensation - regardless of whether the noncompete agreement is reasonable. This doctrine is based on the notion that the employee is effectively given a choice to either preserve his right to such compensation by refraining from engaging in competitive employment, or lose that right if he chooses to resign and compete with his former employer. Conversely, if the *employer* terminates the employment relationship without cause, no forfeiture may be imposed because the employee is essentially deprived of the opportunity to make a choice.

The New York Court of Appeals' recent decision in *Morris v. Schroder Capital Management*, 2006 N.Y. Slip Op 08638, has made it significantly more difficult for employees to challenge forfeiture provisions linked to restrictive covenants. The plaintiff in *Morris* was employed as Senior Vice President and head of domestic equities at Schroder Capital ("Schroder"). A portion of his annual year-end bonus was deemed a "deferred compensation award," which did not vest until three years after the date of issue. The company's deferred compensation plan expressly provided that if an employee resigned and accepted employment with a competitor prior to the end of the three-year vesting period, all nonvested deferred compensation would be forfeited. When Morris resigned to open a hedge fund in competition with Schroder, he was notified that his deferred compensation was deemed forfeited.

Morris sued for breach of contract, claiming that Schroder had forced him to resign by significantly diminishing his job responsibilities. Specifically, Morris claimed that the company had reduced the amount of investment assets over which he had control from $7.5 billion to $1.5 billion. Morris argued that the standard for determining whether a resignation was voluntary or involuntary for forfeiture purposes should be whether the employer "was willing to employ the employee in the same or comparable job" for which he was hired. The trial court disagreed, holding that an employee who resigns and seeks to avoid forfeiture must satisfy the same stringent "constructive discharge" standard applied by federal courts in employment discrimination cases where the voluntary nature of the termination is in dispute. To establish a constructive discharge, an employee must prove that the employer deliberately made his or her working conditions so intolerable that a reasonable person in the employee's situation would have felt compelled to resign. Typically, actions such as a demotion, failure to promote, transfer, or change in assignments are not sufficient to establish a constructive discharge. The court of appeals in *Morris* upheld the trial court's application of the constructive discharge standard, and held that Morris's mere dissatisfaction with the change in his job responsibilities did not

render his resignation "involuntary". As such, the employee choice doctrine controlled, and the forfeiture provision in Schroder's deferred compensation plan was deemed valid and enforceable as applied to Morris.

The *Morris* decision significantly raises the bar for employees seeking to violate post-employment restrictive covenants without forfeiting their nonvested compensation and benefits. By requiring such employees to overcome the higher hurdle of establishing a constructive discharge, the court of appeals has clearly signaled that the employee choice doctrine is alive and well in New York.

Morris also serves as a useful reminder that, under New York law, forfeiture provisions in deferred compensation and benefit plans can create a powerful disincentive for departing employees to engage in unfair competition, disclose confidential information, solicit customers, and/or raid the former employer's workforce. Because these forfeiture provisions are generally enforceable without regard to the "reasonableness" of the post-employment restriction, they can be a highly effective supplement to conventional noncompetition/nonsolicitation agreements and policies, and a valuable tool for protecting an employer's business interests. New York employers seeking to bolster their protection against unfair competition by former employees may wish to consult with experienced employment counsel to see whether their compensation and benefit plans are, or can be, drafted to contain forfeiture provisions that may help to deter the violation of post-employment restrictive covenants.

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