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Litigating 'Cause' Under New York Employment Contracts

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Employment contracts typically guarantee employment for a definite period of a time absent "cause," "good cause," "just cause," or the like. Sometimes the "cause" standard specifies particular misconduct and a minimum level of culpability, such as "gross negligence" or "recklessness." Sometimes the "cause" standard is left undefined. Either way, these provisions leave open a critical issue: the relevance, if any, of the employer's honesty, good faith and even-handedness in applying the "cause" standard.

Surprisingly, the New York case law on this point is a mixed bag. This article analyzes the conflicting case law to help employer-side and employee-side counsel avoid a blind spot.

Objective Versus Subjective 'Cause' Standards

The Restatement of Employment Law describes "cause" for termination as an objective standard. Section 2.04 states that "an employer has a cause for early termination of an agreement for a definite term of employment if the employee has materially breached the agreement, including by persistent neglect of duties; by engaging in misconduct or other malfeasance, including gross negligence."

To enforce a "cause" termination provision, the Restatement requires the employer to prove "factual cause"—*i.e.*, a showing that the employee *actually engaged in misconduct*. When an employment contract

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has a "cause limitation on power to terminate," Comment (d) of the Restatement provides that "the reasonable assumption is that the parties . . . do not intend also to permit termination based on the employer's reasonable, good-faith but erroneous belief that there was cause for termination." According to the Restatement, this assumption keeps with the "conventional views of cause as an objective concept."

The Restatement's approach treats a "cause" provision like a typical termination provision in a services contract. If a party lacks grounds to terminate a services contract, the fact that the party has a reasonable, good faith belief that grounds exist is insufficient to establish "cause" for termination. Likewise, if a party "had cause to terminate, it is legally irrelevant" whether the decision to terminate "was also motivated by reasons which would not themselves constitute valid grounds for termination of the contract." *PRCM*

Advisers v. Two Harbors Investment, No. 20-CV-5649, 2021 WL 2582132, at *6 (S.D.N.Y. June 23, 2021).

In either case, the inquiry is objective: whether the employee's conduct was "cause" to terminate the contract.

Many jurisdictions, most notably California, apply a subjective standard that is more deferential to the employer. Under this standard, a termination is for "cause" if the employer acted reasonably and in good faith in deciding there was "cause" for termination. Whether the employee actually committed misconduct is irrelevant; rather, the issue is whether the employer responded reasonably and in good faith to allegations of misconduct. The California Supreme Court describes the standard as, "Was the factual basis on which the employer concluded a dischargeable act had been committed reached honestly, after an appropriate investigation and for reasons that that are not arbitrary or pretextual?" *Cotran v. Rollins Hudig Hall International*, 17 Cal. 4th 93, 107 (1998).

The employer's managerial interests are said to warrant a deferential standard. A "standard permitting juries to reexamine the factual basis for the decision to terminate for misconduct—typically gathered under the exigencies of the workaday world and without benefit of the slow-moving machinery of a contested trial—dampens an employer's willingness to act, intruding on the 'wide latitude'…recognized as a reasonable condition for the efficient conduct of business."

Scrutiny of Employer Motive

Although a subjective good faith standard favors the employer when the parties dispute whether the employee engaged in the alleged misconduct, the subjective standard can favor the employee by allowing scrutiny of the employer's motivation. Even the Restatement, which adopts an objective "cause" standard, suggests that an employer violates a "cause" provision by acting dishonestly or in bad faith. Comment (d) states that a "cause" provision "normally requires the employer to give reasons for the dismissal," and "also requires the employer *to apply the grounds for termination in a regular and even-handed manner.*"

The Restatement gives the example of an employee with an alcohol abuse problem that adversely affects her performance. Assume the employee's conduct would ordinarily constitute sufficient cause for termination of the employment agreement. Comment (d) indicates that employer's inconsistent treatment of similarly situated employees can change the outcome of a "cause" dispute. Suppose that "several of [the employee's] colleagues . . . appear to have a similar problem, known to [the employer,] but their employment has not been terminated." The Restatement states that the employer's "tolerance of comparable conduct by other employees is relevant to whether there is cause to terminate . . . and raises an issue for the trier of fact."

The inconsistent treatment of similarly situated employees supports an inference that the employer terminated the singled-out employee for an unstated, improper reason, or acted arbitrarily. The Restatement suggests that, even if an employee engages in conduct that constitutes "cause" for termination, the employee can still prevail if the employer's application of a "cause" provision smacks of bad faith.

New York Law

New York case law on the standard for a "cause" termination is inconsistent, with case law supporting both the objective and subjective standards. A line of cases going back to an old First Department decision, *Carter v. Bradlee*, 245 A.D. 49 (1st Dep't 1935), holds that "the employer was entitled to discharge the employee prior to the expiration of the contract term *only for a reasonable ground that must be attended with good faith*." *Rothenberg v. Lincoln Farm Camp*, 755 F.2d 1017, 1021 (2d Cir. 1985) (cleaned up). The "good faith" requirement arguably invites a subjective inquiry into the employer's motivation, which some courts have undertaken.

In *Tischmann v. ITT/Sheraton*, No. 92 CIV 2505, 1997 WL 195477, at *3-4 (S.D.N.Y. Apr. 22, 1997), the court stated that, "[u]nder governing New York law, the determination as to whether a termination was for cause requires substantial deference to the employer's good-faith decision," and thus the

question was whether the employment decision was "arbitrary or in bad faith," or "pretextual."

Another line of authority, going as far back as the Court of Appeals decision in *Getty v. Roger Williams Silver*, 221 N.Y. 34, 39, 116 N.E. 381, 382 (1917), supports the proposition that an employer's motivation is irrelevant to the application of a "cause" termination provision. In a case involving an employee terminated for losing trunks filled with silverware, the court stated: "It is beside the main question that [the employer] had decided before the trunks were lost to discharge plaintiff on July 1, without cause, because he would not agree to a reduction of salary. *Bad motive for strict insistence on legal rights, or even ignorance as a sufficient cause at the time of discharge, does not preclude defendant from justifying its act*."

In 2016, the Second Department cited *Getty* for the proposition that existence of an improper "financial motive for termining [the plaintiff's] employment did not mean that it did not validly terminate her employment for cause on another ground." *Prince-Vomvos v. Winkler Real Estate*, 140 A.D.3d 1043, 1045 (2nd Dep't 2016). Under these authorities, what matters is the existence or non-existence of "cause" as an objective matter—not what the employer was thinking about when it terminated the employee.

After-Acquired Evidence

Although New York cases support both a subjective and objective approach to a "cause" determination, New York law is clear that an employer may rely on after-acquired evidence—that is, "evidence unknown to them at the time of the termination." This facet of New York law is consistent with the objective approach to "cause" termination. If what matters is the existence or non-existence of "cause" when an employee is terminated, it should not matter whether the employer was aware of the factual basis for the "cause" at time of the termination.

By contrast, under the anti-discrimination laws, which focus squarely on the employer's intent, an employer cannot use after-acquired evidence to escape liability. Such evidence can be used only to limit damages. *See McKennon v. Nashville Banner Publishing*, 115 S.Ct. 879 (1995).

The relevance of after-acquired evidence under New York law, however, does not necessarily overrule case law requiring a "cause" termination to be "for a reasonable ground that must be attended with good faith." *Rothenberg*, 755 F.2d 1021. There is an arguable difference between using after-acquired evidence to shore up an insufficient but good faith basis for termination, and using after-acquired evidence to paper over a bad faith or pretextual termination.

Additionally, New York precedent holds that "if the employer knew of conduct by the employee that would have justified termination, but failed to act on that information in a timely fashion, it may be deemed to have waived that basis for for-cause termination." *Fitzpatrick v. American International Group,* No. 10 CIV. 142, 2013 WL 709048, at *29 (S.D.N.Y. Feb. 26, 2013). This limitation is inconsistent with a purely objective "cause" standard, suggesting that the employer's good faith is relevant.

Conclusion

In litigation over a "cause" termination provision in an employment contract, conflicting New York case law may give judges and arbitrators leeway to apply an objective or subjective standard. Counsel should be aware of, and take advantage of, this messy terrain when negotiating contract language and advocating for clients.

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