

NEWSSTAND

Executive's Agreement to Defer Salary Violates Massachusetts Wage Act

Fall 2009

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A recent Massachusetts federal court decision voided a common practice used by companies, including many start-up companies, to defer the salary of executives and other top level managers until the company achieves certain financial milestones. In *Stanton v. Lighthouse Financial Services, Inc.*, the U.S. District Court for the District of Massachusetts ruled that a salary deferral provision in an executive's employment contract violated the Massachusetts Weekly Wage Act.

In *Stanton*, John Stanton, the co-founder of a start-up company, Lighthouse Financial Services, Inc., entered into a one-year employment agreement to serve as the company's president. The employment agreement contained a provision allowing Stanton's salary to be deferred at the election of the board for the first year of employment, but required any deferred salary be paid to Stanton before any distribution of profits. Stanton left the company after 14 months, without having been paid the majority of his salary.

Stanton sued the company for, among other things, violating the Wage Act. The company argued that Stanton was not an employee subject to the Wage Act because as a co-founder of Lighthouse, he was an employer. The court disagreed, reasoning that a person can be both an employee and an employer for purposes of the Wage Act, and as president, Stanton was an employee of the company. Further, the court held that Stanton's unpaid salary constituted "wages" under the Wage Act because the salary payments were not contingency-based compensation, such as commission or bonuses. Noting that the Wage Act specifically states no person shall "by special contract with any employee or by any other means exempt himself" from the provisions of the Wage Act, the court determined that the salary deferral provision in Stanton's employment agreement was void as a matter of law.

The *Stanton* decision makes clear that certain salary deferral arrangements, even those initiated by the employee, may result in liability under the Wage Act, possibly imposing treble damages and an award of attorney's fees on the company and individual liability on the company's officers and directors for failing to pay the wages. However, Stanton may not preclude a company from paying executives nominal base salaries (as long as such salaries meet or exceed the minimum wage rate, or at least \$455 per week if exempt) and providing larger amounts of compensation in the form of bonuses or other payments contingent on the company's financial performance. It is important that any compensation deferral agreement be carefully drafted to ensure compliance with the applicable payment of wages statute, the deferred compensation provisions of Section 409A of the Internal Revenue Code and other laws.