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On June 10, 2008 the New York Court of Appeals issued a long-awaited decision confirming that employers may lawfully charge expenses against employee commissions. The court's ruling, in conjunction with the legislature's October 2007 amendment of the commission salesperson provisions of the New York Labor Law, provides employers with a roadmap for how to permissibly structure commission-based compensation arrangements.

East Coast Edition *A Littler Mendelson East Coast-specific Newsletter*

New York's Highest Court Delivers a Win to Employers Paying Employees on a Commission Basis

By Gregory B. Reilly and Adam Malik

The New York Court of Appeals decision in *Pachter v. Bernard Hodes Group Inc.*, should prove beneficial to employers that pay employees on a commission basis. The court held, among other things, that an employer is permitted under New York's Labor Law to structure its commission formula so that expenses are deducted before commissions become earned wages that must be paid to the employee. Combined with the October 2007 amendments to the "commission salesperson" provisions of the New York Labor Law, the decision provides guidance on how employers may fairly and legally develop, implement and maintain commission compensation agreements.

The Former Employee's Claim: My Employer Shortchanged Me

Bernard Hodes Group, Inc. (BHG), a recruitment, marketing and staffing service company, employed Elaine Pachter as an account representative, with the title of "Vice President, Manager Supervisor." It compensated Pachter based upon a commission schedule calculated as a percentage of her monthly billings. BHG determined commissions based on Pachter's monthly billings less finance charges, costs associated with Pachter's assistant, late fees, uncollectible advances and bad debts. BHG made Pachter repeatedly aware of these deductions over the course of her 11 years of employment with the company, and she never formally complained other than sending BHG one letter stating that she had concerns about the company's compensation calculations.

After leaving BHG, Pachter sued claiming that the deductions from her commissions violated section 193 of the New York Labor Law, which only allows employers to make deductions from wages, which include commissions, if there is express written authorization and the deduction is for the benefit of the employee. In its defense, BHG claimed that Pachter was not protected by section 193 because she was an executive and, in any event, that the deductions were permissible because they were made before Pachter "earned" her commissions.

New York's Highest Court Steps in to Resolve the Dispute

The court's June 10th decision addressed two legal questions:

1. Whether an "executive" is considered an "employee" for purposes of New York Labor Law Article 6, and, thereby, subject to the protections of Article 6, including the law's prohibitions on deductions from wages by employers; and

2. In the absence of a governing written agreement, when are commissions deemed "earned" and, therefore, considered "wages" under sections 191 and 193 of the New York Labor Law, thereby rendering subsequent deductions unlawful?

The Court of Appeals Rules that an "Executive" Is an "Employee" Unless the Legislature States Otherwise

The court considered the text and structure of Article 6 of the Labor Law to determine whether executives are covered "employees" as defined in section 190(2) of that Article. While other portions of the definition provisions of the Labor Law (in particular sections 190(5), (6) and (7)) carve out specific exemptions for executive employees, the court noted that the law contains no such carve out in its definition of an employee under section 190(2). Similarly, the court found that the legislature's failure to enact an express exemption for executives from coverage under section 193 demonstrated its intent to protect executives from certain employer-implemented pay deductions. Accordingly, the court found that executives are entitled to the benefit of section 193's prohibitions on employer wage deductions or, otherwise, the other express executive exemptions in Article 6 would be rendered superfluous.

Because the court determined that executives are protected by section 193 of the Labor Law, employers must ensure they are not violating that law by making improper deductions from an executive's earned wages, including commissions.

Executives Are Protected, But Employers Can Make Adjustments When Calculating Commissions

Having rejected BHG's argument that an executive lacks standing to assert a claim for unlawful wage deductions, the court addressed whether BHG's deductions were permissible. Because the types of deductions taken by BHG were not "for the benefit of the employee" the court found that the success of this argument would turn on when Pachter "earned" her commissions, because section 193 prohibits deductions from commissions only after they are earned. To complicate matters, there was no written commission agreement between Pachter and BHG defining when she earned her commissions.

In the absence of an express agreement between the parties, and because Article 6 of the New York Labor Law does not address when a commission is earned, the court turned to the common law for an answer. Under the common law, a commission is earned upon the production of a ready, willing and able purchaser. However, the court found that, even in the absence of an express agreement as to when commissions were earned, the parties could depart from the common law by entering into an implied agreement providing that the calculation of a commission would include downward adjustments.

Here, the court found that the parties departed from the common law based on their course of dealings over 11 years, which demonstrated commissions were not earned until after BHG subtracted expenses. The court found that Pachter had acquiesced to these deductions, and the parties' implied agreement was to her benefit because her commission compensation was generally greater than that of her coworkers who opted for fixed salaries. Accordingly, the court found that BHG's deductions were permissible because BHG's subtracted expenses before Pachter's commissions were deemed earned.

Get It All in the Agreement: Drafting the Terms of a Commission Agreement

The fundamental lesson from the court's decision is that any confusion (and perhaps the lawsuit itself) likely would have been avoided if BGH had a written agreement expressly stating that commissions were not earned until after the employer made its expense deductions.

In this respect, we note that in October 2007, the legislature modified section 191 of New York's Labor Law to create strong incentives for employers to memorialize their commission agreements into a writing signed by both parties. Although section 191 only applies to a "commission salesperson" and excludes "executives" such as Pachter, the decision, when read in conjunction with the amended section 191, provides valuable guidance to employers who compensate their employees on a commission basis. Indeed, even if an employee is not a "commission salesperson" as defined in the Labor Law, employers are well-advised to memorialize any commission arrangements in a signed agreement.

Section 191, as amended, requires employers to include in their written commissions agreements a description of "how wages, salary, drawing account, commissions, and all other monies earned and payable shall be calculated." If the agreement includes a recoverable draw, then the agreement must include the frequency of reconciliation. The agreement must also state how "wages, salary, drawing account, commissions and all other monies earned and payable" are to be paid when either party ends the employment relationship. Under the amended section 191 of the Labor Law, in the absence of a written agreement, courts will presume that the employee's explanation of the terms and conditions of the commission agreement is correct.

To help minimize the risk of costly litigation, employers, in addition to the section 191 requirements, should include an internal procedure in the agreement for employees to follow if they believe that earned commissions have not been paid correctly. Also, employers should clearly separate previously earned commissions, which have not been paid, from the calculation of a future commission payment if the employer makes deductions when calculating the commission. Commingling earned commissions with unearned commissions may result in a violation of section 193, because a court may rule that the employer is taking impermissible deductions from previously earned commissions. Finally, employers are advised to consult with legal counsel when drafting or amending their commission agreements to ensure compliance with New York's Labor Law.

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