

New York High Court Rules that Commission Formulas Can Include Deductions for Business Expenses

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On June 10, the New York Court of Appeals issued a decision in *Pachter v. Bernard Hodes Group, Inc.* explaining that although executives are employees covered by New York’s Wage Payment Law, adjustments or deductions for business-related expenses that are made as part of agreed-upon commission formulas are permissible.

Elaine Pachter worked at Bernard Hodes Group, Inc. (Hodes) as a vice president responsible for arranging for media advertisements for clients. Pachter was compensated with commissions based on her media sales. She brought suit alleging that adjustments made to her pay—including for losses attributable to errors in placing advertisements, for late client payments or nonpayments, for travel and entertainment expenses she incurred, and for the cost of compensation paid to her sales assistant—were deductions that were prohibited by New York Labor Law Section 193. After the district court ruled in favor of Pachter, Hodes filed an appeal to the U.S. Court of Appeals for the Second Circuit. Hodes argued that Pachter was an executive who was not subject to the protections of Section 193 or, alternatively, that the deductions were not to wages, but were part of an agreed-upon commission formula that was used to arrive at vested and payable commissions. Because these arguments raised novel issues of state law, the Second Circuit certified these two issues to the New York Court of Appeals for resolution.

In discussing the first issue, the New York Court of Appeals stated that executives were employees entitled to the protections of the New York Wage Payment Law. Although numerous lower courts had previously ruled to the contrary, the Court of Appeals stated that those prior decisions were based on a misunderstanding of that court’s 1993 ruling in *Gottlieb v. Kenneth D. Laub & Co.* The court ruled that based on the statutory language, executives are considered employees for purposes of the New York Wage Payment Law except where *expressly* excluded. For example, executive employees whose earnings are in excess of \$900 per week are not subject to Section 192 of the New York Labor Law, which requires that such wages be paid in cash.

On the second question, the court ruled:

[W]hen a commission is “earned” and becomes a “wage” for purposes of Labor Law article 6 is regulated by the parties’ express or implied agreement; or, if no agreement exists, by the default common-law rule that ties the earning of a commission to the employee’s production of a ready, willing, and able purchaser of the services.

Significantly, for employers who do not have written and signed commission agreements, the court wrote that the parties' course of dealings and the written monthly compensation statements "provide ample support for the conclusion that there was an implied contract under which the final computation of the commissions earned by Pachter depended on first making adjustments for nonpayment by customers and the cost of Pachter's assistant, as well as miscellaneous work-related expenses." The court went on to write:

We therefore conclude that neither section 193 nor any other provision of article 6 of the Labor Law prevented the parties in this case from structuring the compensation formula so that Pachter's commission would be deemed earned only after specific deductions were taken from her percentage of gross billings.

The court's decision has immediate and significant ramifications for commissioned employees in New York. First, it is now clear that New York employees who are paid on a commission basis can have adjustments made for errors and various other business expenses, as long as those adjustments are made as part of an agreed-upon commission formula. This will allow New York employers and employees to structure compensation arrangements that are mutually beneficial, and that reward both the growth of revenue and the minimization of expense.

While the court did state that even an implied agreement arising through a course of dealing was sufficient to establish an agreed-upon commission formula, we would still recommend a written agreement or compensation plan, acknowledged by both employer and employee, that sets out the commission formula, including all applicable adjustments required to arrive at payable commissions. This is particularly true given the New York Legislature's October 16, 2007 amendment to Section 191 of the New York Labor Law, which provides that if the terms of employment for a "commission salesperson" are not set forth in writing, the Commissioner of Labor will apply a presumption that the terms presented by the salesperson "are the agreed terms of employment."

The court's decision is expected to have significant impact on a large number of pending lawsuits that are claiming unlawful deductions from wages. Financial services firms and insurance companies, for example, have been bombarded recently with lawsuits by financial advisors, loan officers, and insurance agents claiming that their pay has been subjected to unlawful deductions because their commissions and/or incentive compensation formulas include adjustments for such things as trade errors, marketing and promotion expenses, assistant compensation, and other business expenses incurred in the generation of revenue. The highest court in New York, however, has now definitively ruled that such adjustments made as part of an agreed-upon commission formula are permissible, and do not constitute unlawful deductions from wages under New York law.

Morgan Lewis & Bockius LLP represented the Securities Industry and Financial Markets Association *amicus curiae* before the New York Court of Appeals in the *Pachter* case.

Please contact any of the following Morgan Lewis attorneys for more information about the issues discussed in this Morgan Lewis LawFlash, and the implications of this important decision for the employment of commissioned employees in New York and elsewhere:

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