New York's Assault on Commission Pay: Employers must follow the rules now, or pay later

By Ari Karen

Many employers continue paying their sales forces without regard to, or knowledge of, several new rules affecting pay practices for commissioned employees. Although not especially difficult to follow, these legal requirements can impose extensive liabilities against employers -- even those who are unaware of the laws.

There are three significant issues facing employers: (i) 100% commission pay; (ii) the requirement of written commission agreements; and (iii) forfeitures and deductions in calculating commission. To begin, in most cases, only employees who are considered "outside sales" may receive the entirety of their compensation through commission. Employers cannot pay inside sales workers on 100% commission. Rather, those employed as inside salespersons require both minimum wage and overtime pay in addition to, or in lieu of, commission. Obviously, this creates substantial risks for employers, who now have to invest salaries on sales workers who may not earn a return for the business. The alternative is risking exposure to minimum wage and overtime lawsuits that will often cost employers hundreds of thousands of dollars, collecting on a class basis for all unpaid overtime and minimum wages going back six years for every employee working during that period, as well as all of the employees' attorneys' fees.

While many employers jump to the conclusion that a draw agreement avoids the problem, in fact, draws will not be considered to satisfy the minimum wage component. Moreover, because New York now limits the ability of employers to "deduct" costs in calculating commission, employers cannot deduct a salary in computing the commission. Finally, because overtime is calculated based upon the amounts earned in a particular week, depending on the hours worked during a week when commission is paid, the cost of overtime could be exorbitant. Fortunately, through creative structuring of the employment relationship and the compensation scheme, most employers can avoid overtime and the costs associated with minimum wage pay. The keys to accomplishing this are components of an employment agreement containing limitations on hours worked, indemnification provisions, and commission structures including initial dead zones where commission is not earned on certain levels of sales. Of course, employers should consult competent counsel in drafting such agreements, as even minimal mistakes can have serious repercussions.

Employers must also face the prospect of now having written agreements for all employees primarily engaged in sales and paid commission. Such agreements must specify, among other things, the manner in which commission is calculated, how often it is paid, and employees' rights to commission post termination. The failure to include these and other elements in the employment agreement leaves the employer vulnerable, as the absence of such written provisions creates the presumption that the employees' rendition of the relationship is controlling. Hence, absent a written agreement, an employee can dictate many of the terms of the employment relationship. Accordingly, an employer must provide and retain written agreements.

In connection with such written agreements, employers must also account for new laws that prohibit certain forfeitures and/or deductions in paying commission. For instance, a commission agreement that provides that an employee does not receive commission post termination is unlikely to be enforced, allowing the employee to collect said commission. Indeed, once "earned," a commission is payable after termination, and employees can even be entitled to recurring commissions in perpetuity if contracts are not properly drawn. Similarly, contracts that cut off or terminate the right to earned commission for violations of the terms of the agreement (including

violations of non-competition provisions) will not be enforced. In all cases, courts view earned commissions the same as hourly pay. Once the right to such compensation is secured through the predicate actions, the right to receive the compensation cannot, under any circumstance be forfeited. The key, therefore, is properly defining when the commission is earned.

Related to the forfeiture of commission are the limitations on how it is calculated. New York labor laws prohibiting employers from deducting from employees' wages are now being read by some courts as prohibiting any form of deduction. For instance, employers providing that unauthorized expenses or accommodations be deducted from commissions, or requiring the deduction of certain employer fees or costs from commission will not be enforced. In essence, only deductions directly for the benefit of the employee (e.g., health insurance) may be taken from commission. Accordingly, when calculating commission, an employer must develop a structure that focuses on what is included in amounts on which commissions are based rather than on deductions and must develop percentages accounting for the inability to deduct amounts from commission calculations.

In most cases, notwithstanding these challenges, employers can continue their operations with little substantive change. However, employers must take the time to develop and implement commission pay plans and employment agreements that comply with these legal standards. A small investment now can help employers to greatly minimize exposure to tremendous future costs stemming from the failure to develop and implement such agreements.

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