

June 16, 2008

Employee Compensation

Article 6 of the New York Labor Law Applies to “Executives,” But Permits Commission Agreements That Provide for Deductions From Gross Commissions

SUMMARY

On June 10, 2008, the New York State Court of Appeals issued an eagerly-awaited decision concerning the permissibility of commission arrangements that provide for deductions for expenses and similar items. The Court held that: (1) executives are “employees” for purposes of article 6 of the New York Labor Law, the section that governs payment of wages; but that (2) the determination of “when a commission is ‘earned’ and becomes a ‘wage’ for purposes of Labor Law article 6 is regulated by the parties’ express or implied agreement”; thus, employers and employees may enter into commission agreements providing for deductions before the commission is considered “earned” without violating the provision of article 6 that prohibits all but a few limited types of deductions from wages. *Pachter v. Bernard Hodes Group, Inc.*, slip op. No. 86 (N.Y. June 10, 2008).

BACKGROUND

Elaine Pachter was an advertising executive of Bernard Hodes Group, Inc., who arranged media advertisements for her clients. Although she had the option of receiving a fixed salary, Pachter chose instead to receive her compensation through commissions, which were calculated by calculating a designated percentage of Pachter’s client billings and then deducting certain business expenses from that amount before payment to her. After her employment ended, Pachter sued Hodes, claiming that Labor Law section 193 prohibited Hodes from deducting the business expenses in the calculation of her commission. Section 193 prohibits deductions from an employee’s wages, unless specifically authorized by law or by the employee for “insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization, and similar payments for the benefit of the employee.”

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In defense, Hodes argued as a threshold matter that Pachter, as an executive, was not an “employee” under the relevant portions of the Labor Law, and, therefore, did not qualify for the protections of the act, including section 193. Hodes also argued that, even assuming that Pachter was an employee, the business expenses did not represent a deduction from earned wages but rather were simply part of the formula Hodes used to calculate the amount of Pachter’s “earned” commission.

The United States District Court for the Southern District of New York granted summary judgment in favor of Pachter, finding that section 193 covers “executives” and that Hodes illegally deducted expenses from Pachter’s wages. On appeal, the Second Circuit certified two questions of law to the New York State Court of Appeals: (1) whether the definition of “employee” under article 6 of the Labor Law encompasses “executives”; and (2) when is a commission “earned” such that it becomes a “wage” subject to the prohibition on deductions from wages. *Pachter v. Bernard Hodes Group, Inc.*, No. 06-3344 (2d Cir. certified Oct. 12, 2007).

THE COURT OF APPEALS’ DECISION

The Court of Appeals answered the first question affirmatively, holding that the broad definition of “employee” in section 190(2), which defines an “employee” as “any person employed for hire by an employer in any employment,” includes executives. The Court further reasoned that the explicit exclusion of executives in other provisions of article 6—such as sections 192(2) (removing executives who earn more than \$600 per week from the requirement that wages be paid in cash to “any employee”) and 198-c(3) (similar exclusion pertaining to benefits and wages supplements)—would be unnecessary if the definition of “employee” did not include executives. Noting that language in its own decision in *Gottlieb v. Kenneth D. Laub & Co.*, 82 N.Y.2d 457 (1993), had led to a split of authority on this issue, the Court clarified that *Gottlieb* applied only to the availability of attorneys’ fees for a successful common law claim by an executive. As such, the *Gottlieb* decision was not intended to affect the Labor Law’s general applicability to “executives.”

The second question considered by the Court was when a commission becomes “earned” and thus not subject to deductions under the Labor Law. The Court began by acknowledging that commissions qualified as “wages” under section 190(1). As noted, section 193 of the Labor Law prohibits an employer from deducting any amounts from an employee’s wages, unless specifically authorized by law or by the employee for “insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization, and similar payments for the benefit of the employee.” Because the deductions made by Hodes were not of the type listed in section 193, the Court found that the deductions were permissible only if Hodes subtracted the amounts prior to the point at which the commissions were “earned.”

Finding no answer in article 6 itself, the Court turned to the common law principle that an individual earns a commission when that individual “produces a person ready and willing to enter into a contract upon his

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employer's terms." Accordingly, Pachter's commissions could have been deemed "earned" when she produced a willing purchaser of Hodes' services, and, therefore, the deductions made by Hodes in that instance would have been impermissible under the Labor Law. The Court reasoned, however, that parties may enter into an agreement that provides for an alternative method of computing the employee's commission. If the parties so agree, an alternative method of calculation could permit the employer to subtract certain business expenses from the employee's share of the gross sales. In that case, the commission would not be considered "earned" until after the application of the agreed-upon formula.

Although no written commission agreement existed between Pachter and Hodes, the Court reasoned that the parties' course of dealings over an eleven-year period, during which Pachter had not objected to the arrangement, demonstrated that an implied agreement existed to calculate Pachter's commission only after the deduction of her expenses. The Court concluded that the Labor Law did not prevent the parties from agreeing to an alternative compensation formula under which Pachter's commission was deemed "earned" only after Hodes deducted certain expenses from her portion of the gross billings. Thus, the Court held that an express or implied agreement between the employer and employee determines the point at which a commission is "earned wages" from which deductions, other than those set forth in the statute, are not permissible. In the absence of such an agreement, the common-law rule—that a commission is "earned" and becomes "wages" once the employee produces a "ready, willing and able purchaser of the services"—will apply.

IMPLICATIONS

The *Pachter* decision provides welcome certainty, by resolving a split among New York's state and federal courts over the application of New York's Labor Law to executives who are paid on a commission basis. By allowing employers and employees to enter into—and to modify—compensation agreements that designate a method of calculating employee commissions that include deductions before a final, "earned" commission amount is determined, the decision also provides flexibility to parties in structuring their compensation arrangements. Although Pachter did not have a written agreement specifying the compensation arrangement, as we reported in a previous S&C Publication, as of October 16, 2007, an amendment to section 191(a) became effective requiring that the terms of a commissioned salesperson's employment be in a signed, written agreement that includes a description of how wages, salary, draws and commissions are calculated, both during employment and upon termination. As a result, "implied" commission agreements such as the one at issue in *Pachter* are no longer permitted for commissioned salespersons.

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