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THE NEW YORK COURT OF APPEALS RESOLVES ISSUES CONCERNING THE CALCULATION OF EARNED COMMISSIONS

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On June 10, 2008, the New York Court of Appeals issued a decision that is significant for the financial services industry, the real estate and insurance brokerage industries, and any other industry or employer that compensates its New York employees in whole or in part on a commission basis. Specifically, the Court of Appeals decided in *Pachter v. Bernard Hodes Group, Inc.* that New York Labor Law provisions governing the payment of wages and commissions do not prevent an employer from structuring a compensation formula so that an individual's commission is "earned" only after specific expense-related deductions are taken from a gross amount.

In *Pachter*, the plaintiff was a vice president of the company who was compensated on a commission basis, rather than on a salary basis. Each month, plaintiff received a commission statement showing her total billings for that month and the percentage of those billings that represented a "gross commission." The statement also showed the expenses that were attributable to plaintiff's activities and any advances she had drawn, and ultimately stated the net amount of the commission that she earned and received for that period. This compensation practice, including the itemized statements sent to plaintiff, had proceeded over the course of more than a decade.

The Court of Appeals addressed two separate questions in its decision. First, the Court had to determine whether "executives" such as plaintiff were "employees" covered by the relevant wage and hour provisions in Article 6 of the Labor Law, or whether coverage of those provisions exempted those who were bona fide executives. The Court held that executives *are* included within the definition of "employees" to be covered by Article 6 of the Labor Law, since, unlike other specific sections of Article 6 that expressly exempt out executives, the general definition of "employee" in Article 6 did not expressly remove executives from its coverage. Therefore, a company's executives are considered "employees" for purposes of the various wage and hour provisions in Article 6 of the New York Labor Law except where executives are expressly excluded.

The second question addressed by the Court was when, absent a written agreement, a commission is “earned” by an employee and, therefore, becomes a “wage.” The question is important because Section 193 of the Labor Law prohibits the taking of virtually all deductions from an employee’s earned wage, with the limited exception of required taxes, insurance contributions, and certain other agreed-upon items that serve to benefit the employee. In *Pachter*, the plaintiff argued that the company’s practice of deducting business-related expenses from her gross commission before paying her the net amount violated Section 193. Ultimately, the Court rejected plaintiff’s argument and held that when a commission is “earned” and becomes a “wage” for purposes of the Labor Law generally can be determined by the parties’ express or implied agreement.

Specifically, the Court in *Pachter* determined that the nature of the company’s compensation structure with plaintiff was such that the commission was earned only after the calculations and adjustments were made to the gross commission. In other words, the deductions taken from the gross amount constituted calculations to determine the earned commission; they did not constitute improper deductions from an already-earned commission. In reaching its decision, the Court relied primarily on the evidence of the parties’ “extensive course of dealings for more than 11 years and the written monthly compensation statements issued by [the company] and accepted by [plaintiff].” Thus, the Court held that “there was an implied contract under which the final computation of the commissions earned by [plaintiff] depended on first making adjustments for nonpayments by customers and the cost of [plaintiff’s] assistant, as well as miscellaneous work-related expenses.”

While the *Pachter* decision resolves a previously-open question about whether executive employees are covered by New York’s wage and hour provisions, the decision also represents a positive development for those employers who compensate employees on a commission basis and whose policies or practices involve payment of a commission only after certain business-related expenses are adjusted from the gross amount. New York law still does not require an employer to deem a commission or wage “earned” at a specific point. However, the law does impose certain obligations and restrictions when the commission or wage is actually earned. In light of the *Pachter* decision, it is advisable for employers to state in writing, either in a written agreement or in a properly communicated policy statement, when a commission is deemed earned by an employee and what adjustments and calculations will be made before a commission is deemed to be earned. Absent such a writing, the Court of Appeals decision earlier this month confirms that evidence of a course of dealing between an employer and employee together with an employee’s prior understanding and acquiescence of a compensation plan may be sufficient to satisfy the employer’s legal obligations.