New York Court of Appeals Settles Important Issues Regarding Commissions and Wage Law Coverage

BY ALLAN S. BLOOM

Employers throughout New York breathed a collective sigh of relief on June 10 as the New York State Court of Appeals settled a thorny issue in their favor. In *Pachter v Bernard Hodes Group, Inc.*, New York’s highest court confirmed that an express or implied agreement between an employer and its employee will determine when a commission is “earned” and becomes a “wage” for purposes of New York’s wage payment law. The Court of Appeals also held that prior to the agreed-upon earning point, the employer is free to make deductions and other adjustments to the gross commission in accordance with the parties’ agreement. The decision erased years of skepticism as to whether employer and employee could, without violating New York’s wage deduction law, enter into a compensation arrangement that not only defines when commissions are earned, but also permits deductions that – if made from earned wages – would be unlawful.

**Section 193 and Earned Wages**

Section 193 of the New York Labor Law prohibits an employer from making all but a narrow range of deductions from an employee’s earned wages. One crucial question for employers who pay their workers through commission or other compensation plans that reward productivity – but who also expect the workers to bear certain costs, expenses, or risks (for example, a customer’s failure to pay) – has always been: *When is the commission “earned”?* In 1980, New York’s intermediate level appellate court, sitting in Manhattan, held in *Dean Witter Reynolds, Inc. v. Ross* that an employer’s practice of deducting certain expenses from commissions prior to paying them, in accordance with its written compensation plan, did not constitute a prohibited deduction from “wages” under Section 193 provided the employees also received a guaranteed salary or draw against commissions.

Under the Dean Witter plan, commissions were paid at the end of a pre-defined production period after adjustments were made for certain job-related expenses, including long distance telephone calls and losses due to errors. The court held that such an arrangement did not violate Section 193 because the employee’s receipt of a salary rendered the additional income “incentive pay” that “did not become earned until the end of the production period. In other words, [the plaintiff] had no vested interest in the additional compensation until the end of the production period, when all appropriate adjustments had been made in conformity with the incentive production plan.”

Since 1980, numerous state and federal courts in New York have agreed with the reasoning of...
**Dean Witter**, and employers have relied on the decision and its progeny for the proposition that they are at liberty, provided they also pay a salary or draw, to make deductions to commission income prior to a pre-defined “earning” point.5

In 2005, Judge Robert Patterson of the federal district court in Manhattan held that the defendant in *Pachter v. Bernard Hodes Group, Inc.*6 violated Section 193 by making deductions from the plaintiff’s gross commissions for unpaid client debts, errors, the salary of plaintiff’s assistant, and other miscellaneous costs for travel, entertainment, marketing, and out-of-pocket expenses, notwithstanding the parties’ course of dealing permitting such deductions prior to payout for more than ten years. Judge Patterson distinguished *Dean Witter* on the ground that the plaintiff in *Pachter* did not receive any salary, and thus her sole form of compensation was through commissions. In essence, the *Pachter* court held that an employer could not make deductions from commissions, even pursuant to an implied contract, if those deductions were impermissible under Section 193. The grave implication of *Pachter*, however, was that parties were not free, through an employment agreement or otherwise, to define when commissions vest or are earned, at least if such commissions are the employee’s sole form of compensation.

**Pachter on Appeal**

The employer in *Pachter* appealed the district court ruling, and, in October 2007, the Second Circuit Court of Appeals panel assigned to the case certified two questions to the New York State Court of Appeals: (1) Whether an “executive” is considered an “employee” for purposes of Section 193 of the Labor Law (and thereby subject to the protections of that provision rendering most wage deductions unlawful); and (2) In the absence of a governing written agreement, when are commissions “earned” and therefore considered “wages” under the Labor Law (including Section 193)?8

**The State Court of Appeals Decision**

On June 10, 2008, the State Court of Appeals answered the two certified questions, holding first that executives are indeed protected by Section 193 and by the other provisions of Labor Law Article 6 that do not expressly exclude them from coverage.9 While it ended years of lively debate on the issue, the determination was not unexpected by practitioners.

On the second question, regarding when commissions are “earned,” the Court of Appeals first recited the common law presumption that a commissioned employee who produces a buyer ready and willing to enter into a contract upon his employer’s terms has earned his commissions on the transaction.10 The court noted, however, that parties to a transaction are free to depart from the common law by entering into a different arrangement. Specifically, the court held, they are “free to add whatever conditions they may wish to their agreement,” including “that the computation of a commission will include certain downward adjustments from gross sales, billings, or receivables.” In the event compensation is subject to such agreed-upon conditions, the court concluded, it will not be deemed “earned” or vested until computation of the agreed-upon formula.

Having confirmed that parties are free to agree upon when commissions are earned, the Court of Appeals next concluded that the agreement need not be in writing, but could – as in *Pachter* – be implied from the parties’ course of conduct.11 Applying these principles to the facts before it, the court concluded “that neither [S]ection 193 nor any other provision of [A]rticle 6 of the Labor Law prevented the parties...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. Consequently, we answer the second certified question by stating that, in the absence of a governing
written instrument, when a commission is ‘earned’ and becomes a ‘wage’ for purposes of Labor Law [A]rticle 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.”

Implications for Employers

The Court of Appeals’ opinion in Pachter is exceptionally useful for employers for several reasons. First, it settles the principle that the Labor Law does not bar an employer and its employee from agreeing on conditions precedent to a wage being “earned.” In doing so, it validates compensation agreements, like the one in Pachter, that allow employers to shift certain costs and risks to employees. Second, the opinion expands the already-helpful precedent in Dean Witter by removing the condition that the employee also receive a salary or draw before such cost-shifting arrangements will survive scrutiny under the Labor Law. While employers will still need to compensate certain employees on a salary, fee, or draw basis to satisfy the requirement for exemption under the overtime laws, the Pachter opinion confirms that an employer need not do so as a prerequisite to building vesting conditions into a commission arrangement. Finally, the opinion restates the common law rule that an agreement, including one regarding compensation, need not be express, but may be implied by the parties’ of course dealing. As a practical matter, however, and especially in light of the recent New York Labor Law amendments requiring compensation agreements with commissioned salespersons to be in writing, employers are well advised to reduce all such arrangements to clear, written documents.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

New York

Allan S. Bloom  
212-318-6377  
allanbloom@paulhastings.com

Stephen P. Sonnenberg  
212-318-6414  
stephensonnenberg@paulhastings.com

Patrick W. Shea  
212-318-6405  
patrickshea@paulhastings.com

Glenn S. Grindlinger  
212-318-6364  
glenngrindlinger@paulhastings.com


2 Section 193 prohibits an employer from making “any deduction from the wages of an employee, except deductions which...are expressly authorized in writing by the employee and are for the benefit of the employee[...]. Such authorized deductions shall be limited to payments 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.”

3 75 A.D.2d 373 (1st Dep’t 1980).

4 Id. at 381.

5 See, e.g., Cantor Fitzgerald Assoc., L.P. v. Mines, 2003 WL 23109714 (N.Y. Sup. 2003) (“When employees voluntarily agree to forego certain compensation, they are ‘held to the bargains made by them with their eyes open,’ irrespective of
the Labor Law prohibitions.

6 Tuttle v. Geo McQuesten Co., 227 A.D.2d 754 (3d Dep't 1996) (finding the “clear and unambiguous language” in an employment agreement dispositive of the issue of whether compensation was “earned” and, therefore, whether the compensation constituted “wage[s]”); Reilly v. Natwest Mkts. Group Inc., 181 F.3d 252 (2d Cir. 1999) (noting that Dean Witter stands for the “unremarkable proposition that incentive pay does not constitute a ‘wage’ until it is actually earned and vested”).

7 The defendant in Pachter argued in the district court that Pachter was, because of her status as an executive, not protected by Section 193 of the Labor Law. The argument was based on language from an earlier New York Court of Appeals decision, Gottlieb v. Kenneth D. Laub & Co., 82 N.Y.2d 457 (1993), which led to years of disagreement in the state and federal courts as to whether certain executive, supervisory, administrative, and professional employees were protected by Section 193 and the rest of Labor Law Article 6.

8 Under New York State law and Second Circuit Rule § 0.27, the federal appeals court may certify a question to the State’s high court where “an unsettled and significant question of state law...will control the outcome of a case pending before this court.” 2d Cir. R. § 0.27; see 22 N.Y.C.R.R. § 500.27 (permitting certification where a case involves determinative questions of state law “for which no controlling precedent of the [State] Court of Appeals exists”).

9 Certain provisions of Article 6, including Section 192 (regarding cash payment of wages) and Section 198-c (including health benefits, expense reimbursements, vacation pay, and severance pay in the definition of wages) expressly state that they do not apply to “any person in a bona fide executive, administrative, or professional capacity whose earnings are in excess of nine hundred dollars a week.” See, e.g., N.Y. Labor L. § 192(2), 198-c(3).

10 This principle, historically applied in real estate and commercial sales contexts, is often referred to as the “ready, willing, and able buyer” rule.

11 The court noted that “the parties’ extensive course of dealings for more than 11 years and the written monthly compensation statements issued by Hodes and accepted by Pachter – 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 nonpayments by customers and the cost of Pachter’s assistant, as well as miscellaneous work related expenses... Pachter understood the adjustments and acquiesced in them... thereby establishing that the parties mutually agreed to depart from the common-law rule. This is not surprising: Pachter reaped substantial benefit from the formula, earning a higher annual income than employees on fixed salaries performing similar duties.” --- N.E.2d ---, 2008 WL 2338595 (N.Y.), 2008 N.Y. Slip Op. 05300, at 11.

12 See, e.g., 29 C.F.R. §§ 100(a)(1), 200(a)(1), 300(a)(1), 400(b); 12 N.Y.C.R.R. §§ 142-2.14(c)(4)(i)(e), (c)(4)(ii)(d). Employers also need to comply with applicable state and federal minimum wage laws.

13 Amendments to Labor Law Section 191(1)(c) effective October 16, 2007 require employers to reduce to writing the “agreed terms of employment” with their commission salespersons. Such written terms must be signed by both the employer and the employee, and must include “a description of how wages, salary, drawing account, commissions, and all other monies earned and payable [are] calculated.” Where the arrangement provides for a recoverable draw, the written description must describe the frequency of reconciliation. The writing must also provide details regarding payments of earned amounts upon the termination of the salesperson’s employment. See http://www.paulhastings.com/assets/publications/775.pdf?wt.mc_ID=775.pdf.