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May 21, 2014



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"All that remains is the computation of the damages": Failure to Properly Compensate Commissioned Salespersons Proves Costly to Employer

By Mary Pat Gallagher

A recent decision issued by the United States District Court, Eastern District of New York, although dealing with New York law, emphasizes the importance of reducing to writing the method by which sales commissions are computed and paid - and then adhering to the written plan. As the defendants in *Karic v. Major Automotive Companies, Inc.*, 2014 WL 1508448, learned, failure to do so can lead to costly litigation and damages.

In *Karic*, the plaintiffs were current and former car sales representatives employed by the Major Automotive Company and its affiliated entities ("Major") who, on behalf of themselves and others similarly situated, alleged that Major and three individual defendants, including the chairman/CEO and president, violated the

New York Labor Law ("NYLL") by failing to pay sales representatives proper minimum wage and overtime compensation and by taking impermissible deductions from wages and commissions.

At the crux of the case was the requirement of the NYLL that employers pay employees minimum wage and overtime for each week of work, regardless of the frequency of payments in a pay period or whether the wage is on a commission or other non-hourly basis. Thus, as a 2010 New York Department of Labor opinion memorandum made clear, the commissions earned by an employee during latter or subsequent weeks within a pay period may not be used to satisfy the employer's minimum wage and overtime payment obligations to the employee in earlier weeks. For example, and as the opinion memorandum specifically illustrated, under the NYLL, if a sales representative who is paid on a commission-only basis with settlement occurring at the end of the month fails to sell any cars for the first three weeks of the month but then earns \$5,000.00 in commissions in the last week, the employer cannot use the commissions earned in the last week to satisfy the employer's obligation in the first week. In addition, New York law requires an employer to pay an employee for overtime at a wage rate of one and one-half times the minimum wage for all hours worked in excess of 40 hours per week. This illustrated example, as the *Karic* defendants would find out, proved rather prescient.

In *Karic*, the plaintiff sales representatives worked 45 to 55 hours per week and were paid \$20 per day, plus a commission on any car sold. The plaintiffs were subject to this arrangement regardless of the number of cars sold in a given day. Thus, if a sales representative worked five days in a week and failed to make a single sale, he or she would receive \$100.00 in salary for that week regardless of the number of hours worked. And, if a car was sold, the plaintiffs claimed that Major took deductions out of paychecks purportedly for costs associated with the given sale. The plaintiffs claimed that this salary structure violated the NYLL because on those days the plaintiffs failed to sell a car and thus earn a commission, they received less than the minimum wage.

In response, Major admitted that the average number of hours worked per week generally ranged from 45 to 55 hours and that it was a "regular practice" to pay the plaintiffs just \$100 in weeks where no sales and no commissions occurred. Nevertheless, Major argued that when viewed annually, the plaintiffs earned, on average, \$40,000 to \$50,000 in a year, which is substantially more than a minimum wage employee would earn in a year.

Referring to Major's "annual salary pitch" as "red herring," the Court found that Major was in violation of the NYLL's clear requirement that employers pay employees minimum wage and overtime on a weekly basis, regardless of whether those employees

earn commission in subsequent weeks that would easily exceed the minimum wage. After quickly dispensing with Major's defenses and granting summary judgment for the plaintiffs, the court noted, in words no defendant wants to hear, "All that remains is the computation of damages."

But in arguing about the proper level of damages, the employer fared no better, in large part because it lacked documents reflecting its practices. The plaintiffs alleged that Major improperly deducted monies from their commissions. Under New York law, a commission salesperson must be paid commissions and all other monies earned or payable in accordance with the agreed terms of employment. The plaintiffs alleged that Major violated this provision by adding extra costs to vehicle sales prices, thereby impermissibly reducing the paid commission in contravention of plaintiffs' employment agreements, which provided for only a specified "pack" of deductions could be made from a commission.

Major conceded that it subtracted expenses in addition to the "pack" that was spelled out in its employment agreements, but it contended that such deductions were permitted under the governing contractual documents with the plaintiffs and justified by the parties' course of dealing. Unfortunately for Major, nothing in the contractual documents supported its claim, and under New York law, the history of parties' past dealings is only appropriate in the absence of a written agreement—something that was not the case here.

And, to make matters worse for the employer, the court awarded liquidated damages to the plaintiffs equaling another 25% of the wages owed. In 2006, one of Major's employees complained to the New York Department of Labor about the company's compensation practices. The state investigated and, as the court did here, found the company's policies to violate state law. Yet, despite an order from the state to change the compensation policy and to attend an educational seminar about compliance with the NYLL, the company did nothing except continue its then-existing practices.

There are a number of important lessons to be learned from *Karic*. First and foremost, employers must ensure that all commission salespersons are being paid in accordance with the agreed-upon commission plan that comports with federal and state wage-and-hour laws, and such plans should be clearly specified in writing. *Karic* also illustrates the benefit of a written commission agreement that includes provisions regarding when the commission is earned (versus when it is paid out); what conditions have to be met to earn the commission; what, if any, permissible deductions apply to the commissions; and what happens to unpaid and/or unearned commissions when the employment is terminated. And if practices change over time, any employment agreements or

commissions documents should be promptly updated to reflect the new arrangement.

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