Employment Law Advisor: Commission Pay

Payment of Commissions to Terminated Employees

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In recent years, many employers have faced the challenge of defending claims by current and former employees under the federal and state wage and hour laws. In fact, such claims are currently at an all-time high. The wage and hour laws create a complex web of rules that are not always entirely clear. Many wage and hour claims arise from the distinction between "exempt" and "non-exempt" classification of employees, and alleged misclassification of workers as independent contractors. One type of claim in this area that is becoming more prevalent is based upon an employer's obligation to pay commissions to sales employees after the termination of employment.

Most employers that pay commissions to sales employees do so under the terms of a sales compensation plan or other written arrangement. In such plans, an employer may attempt to define when a commission is "earned," or under what circumstances a commission may be "forfeited." For example, an employer may define that in order to "earn" a commission the employee must be employed at the time the employer receives revenue for the commissionable order from the employer's customer or client. Unfortunately for employers, such definitions may not pass muster under the governing state wage payment law.

In Massachusetts, for example, the state wage payment law provides that a terminated employee is entitled to be paid his/her "wages" on the date of termination. That law, called the Massachusetts Payment of Wages Act, M.G.L. c. 149 §148 (the "Wage Act"), states that it applies to "the payment of commissions when the amount of said commissions, less allowable or authorized deductions, has been definitely determined and has become due and payable to such employee." The question of when a commission has been "definitely determined" and has become "due and payable" will be answered by the terms of the commission agreement.

Massachusetts-based employers should also be aware that one Massachusetts Superior Court decision has ruled that, depending on the circumstances, the Wage Act may apply to employees not based in Massachusetts. *Dow v. Casale*, (10-1343-BLS1). In determining that the employee had sufficient contacts with Massachusetts, the court paid special attention to the fact that (1) the employee used a Massachusetts business mailing address on his business card; (2) his telephone and fax numbers were Massachusetts numbers; (3) he had many customers in Massachusetts whom he frequently visited; (4) he was in almost daily contact with his employer in Massachusetts; and (5) all of the paperwork for his sales was completed in Massachusetts. Accordingly, multi-state employers should ensure that their sales compensation plans are compliant with Massachusetts law as well as with the laws of other jurisdictions in which they do business.

The majority of other states that have wage payment laws provide that commissions are deemed to be "wages." In a minority of states, however, laws provide that commissions may be forfeited under certain circumstances. For example, under the North Carolina Wage & Hour Act, N.C. Gen.Stat. §95-25.13(3), commissions may be forfeited once an employee's employment has terminated provided that the employer has a written forfeiture clause in it sales compensation plan. Similarly, in Ohio, an employer is permitted to include in its sales compensation plan terms

which limit or eliminate the payment of post-termination sales commissions, even for a sale for which a contract has been executed, but for which delivery and payment has not yet occurred, pre-termination. *Ullmann v. May*, 147 Ohio St. 468 (1947). Alabama, Florida, Georgia, Indiana and certain other states appear also to permit similar "forfeiture" clauses.

The *Fortune* Case

Even where a "forfeiture" clause is permitted, however, employers should be careful when deciding to terminate an employee who is soon due for a large commission payment. The decision of the Massachusetts Supreme Court in *Fortune v. National Cash Register Co.*, 373 Mass. 96 (1977), was the first Massachusetts decision to adopt a common law exception to the doctrine of employment at-will. The court in *Fortune* held that inherent in any at-will employment relationship is a "covenant of good faith." This covenant of good faith and fair dealing is violated when the employer terminates an employee in order to avoid payment to the employee of compensation (or commissions) earned or "almost earned." 373 Mass. at 105.

The premise of *Fortune* is that the employer has been "unjustly enriched" by such conduct, and is therefore liable for the compensation owed to the employee. As a result of the *Fortune* decision, a terminated employee may seek a commission payment even when the commissionable amount may not be "due and payable" under the Wage Act, where that employee has done all the work to obtain the commission and alleges he has been fired in bad faith to avoid payment. Other jurisdictions have adopted the principle set forth in *Fortune*. As such, employers should be prudent in making termination decisions regarding employees who may be due commissions, bonuses, or similar compensation.

Practical Considerations

Commission disputes are quite common, especially following termination of employment. These disputes can be complicated by a lack of clarity in the drafting of compensation plans. Employers should therefore review their compensation plans carefully and try to eliminate potential doubt about the eligibility for commissions. In particular, employers should ensure that their compensation plans are clear, written documents.

Compensation plans should plainly spell out (1) what triggers the right to a commission payment, (2) how commission "splits" are handled when more than one employee is responsible for the sale, (3) who bears the risk for non-payment by a customer, (4) whether the commission is paid on amounts billed or revenue received, (5) what is the process for post-termination commissions where a sale has not been entirely completed, and (6) any formula for calculating the commission amounts. Finally, as with other aspects of the employment relationships, employers should consider the inclusion in the compensation plan of an alternative dispute resolution process, which may avoid the time and expense of litigation.

Please contact any member of Morse's Employment Law Group for more information.