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Commission Payment Disputes Before and After Termination: Payability, Calculation and Timing

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When Commissions Disputes Are Not So Straightforward

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Overview of Presentation

- Sources of Commission Obligations
- Methods to Calculate Commission Disputes
- Termination of Agreements
- Contractual and Statutory Provisions
- Examples and Recommendations

Commission Disputes

Source of Commission Obligations:

- Written Contracts:
  - Employment Agreements vs. Independent Contractor Agreements.
  - Key provisions:
    - Method of calculating commissions.
    - Termination.
      - Grounds for termination.
        - For cause vs. at-will.
      - Termination notice.
      - Post-termination rights and obligations.

Written Contracts: Employee v. Independent Contractor

- Distinction of Employee v. Independent Contractor matters
  - This distinction (and employers should make this distinction clear in ALL written contracts) matters because some states only allow for enhanced penalties if the terminated party was an employee.
    - **Oregon**: Or.Rev.Stat. § 652.150(1) provides for a penalty if, on termination of employment, "an employer willfully fails to pay any wages or compensation of any employee whose employment ceases."
      - Penalties can be sharp:
        - Oregon law provides that as a penalty for non-payment of employees wages or compensation (including commissions), "the wages or compensation of the employee shall continue from the due date thereof at the same hourly rate for eight hours per day until paid or until action therefor is commenced." Or.Rev.Stat. § 625.150(1).
  - Generally, employees have more rights than independent contractors in terms of statutory penalties during unpaid commission disputes.

Methods of Calculating Commissions

- Various methods of calculating commissions in a written contract
  - **WHEN the commission is earned**
    - Written agreement should clearly spell out exactly when the sales representative earns his or her commissions
      - Easy example: do you credit the sales rep with commissions when an order is BOOKED or when the order is ACTUALLY PAID FOR?
  - **WHEN the commission is paid**
    - Written agreement should clearly lay out exactly when the commission is to be paid
      - Easy example: clearly spell out the date up to when the amount of each payment is calculated. Agreement might state that the commissions are to be paid on the fiteenth of every month and that each commission payment includes all commissions earned as of the seventh of each month

Methods of Calculating Commissions (Cont.)

- Various methods of calculating commissions in a written contract
  - **<u>The consequences of refunds, cancellations or default of payment</u>**
    - Not every sale is final; every sale can, in theory, become a “non-sale”
    - Events that can cause non-sales:
      - Returns for refunds
      - Cancellation of an order
      - Customer defaulting on payment
    - Make sure your agreement clearly lays out what happens in these “non-sale” situations and the impact they have on commissions

Methods of Calculating Commissions (Cont.)

- The Commissions Formula
  - Obvious: Make the formula as detailed and as clear as possible
  - Agreement should fully detail all aspects of the commission structure, regardless of whether sales representative is being paid a salary plus commissions or is under a commission-only compensation plan.
  - Details should include not only the amount the sales rep is to be paid for each sale they make but also the equation used to determine the sales amount on which that commission is calculated.
  - Easy example
    - If a commission is to be paid on sales net of taxes or shipping costs, make this CLEARLY stated in the agreement.
    - The less ambiguity the better

Methods of Calculating Commissions (Cont.)

- Performance Incentives
  - Can include bonuses on reaching a specific number of sales
  - Can include a commission structure where the percentages paid out are “stepped” or “tiered”
- Methods in Litigation
  - *Mytych v. May Dept. Stores Co.*, 793 A.2d 1068 (Conn. 2002). Connecticut Supreme Court upheld a commission formula that “calculated the commissions earned by individual salespersons, taking into account factors such as identified and unidentified returns that alter the total amount of gross sales for which the individual sales person can claim responsibility.”
  - In *Cohan v. Medline Industries, Inc.*, 843 F.3d 660 (7th Cir. 2016), the Seventh Circuit held that the employer’s accounting for negative growth in its sales representatives’ overall territory sales in calculating their commissions did not violate New York and California wage payment statutes.

Methods of Calculating Commissions (Cont.)

- Example
  - T. T. FINRA Example
    - Complex
  - Katie Williams FINRA
    - Simpler

Termination of Sales Representatives and Impact on Commissions

- Often litigated area of law. Classic scenario: rep is terminated with sales pending or commissions outstanding.
- Survey of Examples:
  - *APJ Associates, Inc. v. North American Philips Corp.*, 317 F.3d 610 (6th Cir. 2003) held that a manufacturer's representative could not recover commissions for post-termination sales, despite the application of the Michigan Sales Representatives Act
    - Court found that contractual provisions were "clear and unambiguous" and that those provisions barred payment of post-termination commissions
      - Caveat: CHECK. STATE. LAW. Mich. Sales Rep Act. arguably allowed payment of post-termination commissions but Court found that terminated rep was "not the procuring cause of subsequent sales."

Termination of Sales Representatives And Impact on Commissions (Continued)

- Survey of Examples (Continued):
  - In *Vander Veur v. Groove Entertainment Technologies*, 436 P.3d 109 (Utah Ct. App. 2018), the Utah Court of Appeals, for the first time, found that an employer of an at-will employee violated the implied covenant of good faith and fair dealing by terminating employee's employment in bad faith to avoid paying employee a commission of less than $3,000.00
    - Important case since it expands on case law that says that even in a state lacking a termination statute, an employer may not be able to terminate an employee to avoid paying commissions
    - Note this may not apply to independent contractors (which would be beneficial for manufacturers/employers/or their parallel).
  - In *Lapponese v. Carts of Colorado*, 422 S.W.3d 396 (Mo. Ct. App. 2013), the Missouri Court of Appeals held that an employee's voluntary resignation from a sales position was a "termination" of a contract with the employer under Missouri's Merchandising Practices Act, and that the Act was not limited to involuntary terminations; this allowed the employee to recover statutory damages and attorneys' fees since the employer failed to timely pay commissions upon employee's resignation
- Real World Examples:
  - Katie Williams FINRA Termination Dispute regarding commissions
  - Ron Robinson Dispute (federal court in Minnesota)

Commission Disputes

- Key provisions (continued):
  - **Choice of law.**
    - Whose law governs interpretation of the contract?
  - **Venue.**
    - Where is the dispute venued?
  - **Court or Arbitration?**
    - What are the pros and cons of trial vs. arbitration?
  - **Prevailing Party/Fee-shifting.**
    - Contractual fee-shifting.
    - Statutory fee-shifting.

Choice of Law in a Written Contract

- Contracts with Specific Choice of Law
  - Normally, a contract that specifies which jurisdiction's law controls, is honored, BUT NOT ALWAYS. Check applicable state laws before sending demand letters claiming that certain contractual language/choice of law provisions apply.
- Example- Minnesota Termination of Sales Representative Act (Minn. Stat. § 325E.37.)
  - MTSRA **prohibits** manufacturers from including any term or provision that chooses the law of another state in a covered sales representative agreement
  - MTSRA **prohibits** companies from including terms in a covered sales representative agreement that waive any provision of the MTSRA.
  - The MTSRA covers any sales rep who is a resident of MN or who maintains a principal place of business in MN; OR
  - Whose geographical territory specified in sales rep agreement includes part or all of Minnesota.

Court or Arbitration for Commission Disputes?

- Normally, contractual provisions control venue of action, and dictate whether lawsuit can be filed or if arbitration is mandatory
  - That is the straightforward situation
- Pro-employee/Pro-representative situation:
  - Minnesota Termination of Sales Representative Act:
    - Manufacturers are statutorily limited to arbitration in bringing claims against representatives
    - BUT, sales representatives with claims against manufacturers have the OPTION to bring a lawsuit in state court **OR** to initiate arbitration
- Before filing suit (or threatening suit) check to see if state law limits your client to arbitration, court or both.
  - Never want to make threats or allege facts that your client has to walk back because you did not spend extra time to research applicable law.

Prevailing Party and Fee-Shifting Considerations Before Litigating

- Contractual fee-shifting provisions
  - Contract provision says that the "prevailing party" is entitled to costs and fees. Usually straightforward to determine <u>who</u> the prevailing party is, but not always.
    - State Examples
      - **California**: Courts are to "compare the relief awarded on the contract claim with the parties' demand on those same claims and their litigation objectives as disclosed by the pleadings, trial briefs, opening statements and similar sources." *Hsu v. Abbara,* 9 Cal. 4th 863 (1995)
      - **Florida:** Courts must look to "the substance of litigation outcomes- not just procedural maneuvers- in determining the issue of which party has prevailed in an action." *Tubbs v. Mechanik Nuccio Hearne & Wester, P.A.*, 125 So.3d 1034, 1041 (Fla. Dist. Ct. App. 2013)
- **BEFORE** litigating (or arbitrating), check contract to see if there is a prevailing party provision. Can be costly if you do not check.
- Oftentimes, an award of costs and/or attorneys' fees can be much larger than the actual "damage" award.

Statutory Fee Shifting in Commission Disputes

- Statutory Fee Shifting Examples in Commission Disputes
  - Back to the MTSRA (Minn. Stat. § 325E.37, Subd. 5(b).
    - Provides that an arbitrator may award "reasonable attorneys' fees and costs to a prevailing sales representative"; BUT
    - An arbitrator may ONLY award reasonable attorneys' fees and costs to a prevailing manufacturer "if the arbitrator finds the complaint was frivolous, unreasonable, or without foundation."
  - **New Jersey**: N.J.S.A. 2A:61A-3a renders a "principal liable to the sales representative for all amounts due the sales representative and all attorney's fees actually and reasonably incurred by the sales representative in the action and court costs."
  - Before litigating and exchanging demand letters, conduct thorough research to properly advise clients in commission disputes if the state/controlling statutes are "employee" or "employer" friendly, since fee-shifting provisions can SIGNIFICANTLY impact litigation analysis

Unpaid Commission Statutes

- In **Florida**, unpaid commissions are considered wages for purposes of statute authorizing an award of attorney fees to the prevailing party in an action for unpaid wages. *Hingson v. MMI of Florida, Inc.*, 8 So.2d 398 (Fla. Ct. App. 2009).
  - IMPORTANT: failure to pay commissions to employees may trigger liability under state (or federal) wage and hour laws, which include prevailing party attorneys' fees, which can further expose employer to liability
- In **Texas**, a principal (not just an employer, but a *principal*) that fails to comply with the Texas Sales Representative Act (by failing to pay commissions) is liable to the representative for three (3) times the unpaid commission due AND reasonable attorneys' fees and costs. Tex. Bus. & Com. Code § 54.004.
  - In a very recent case, the Texas Supreme Court held that a plaintiff is <u>still</u> entitled to attorneys' fees even if the representative does not obtain a treble damage award under the statute. *JCB, Inc. v. Horsburgh & Scott Co.*, 2019 WL 2406971, -- S.W.3d – (Tx. 2019).
  - This simply continues the trend of very "plaintiff friendly" commission statutes.

Commission Disputes- Ancillary Issues

- Oral Agreements:
  - Legal theories to enforce an oral agreement:
    - Breach of Contract.
      - Elements: Formation of contract; performance of all terms of contract by non-breaching party; breach; and damages.
    - Promissory Estoppel.
      - Elements: Clear and definite promise; intended to induce reliance; that actually induced reliance; to promise's detriment.
    - Quantum Meruit.
      - Elements: Someone confers a benefit, that is knowingly accepted by another party, under such circumstances as to make it inequitable to permit retention without payment.
    - Unjust Enrichment.
      - Elements: A person knowingly receives something of value to which he or she was not entitled, and to retain it would be unjust.

Commission Disputes- Ancillary Issues

- Oral Agreements (continued):
  - Legal Defenses:
    - Statute of Frauds.
      - Generally, contracts that cannot be performed within one (1) year must be evidenced by a writing
      - However- courts seem loathe to apply statute of frauds to bar oral commission claims
        - Appears to be a trend of plaintiff-friendly commission decisions and statutes throughout the country
    - Statute of Limitations.
      - Limited (normally) to breach of contract statute of limitations, which are generally longer
        - Example: Breach of oral contract under California law has a two (2) year statute of limitations
        - Minnesota law provides a six (6) year statute of limitations regardless of whether contract is oral or written
        - However, Minnesota provides that the statute of limitations runs for two years from the date the commissions are due but not paid. Minn. Stat. § 541.07(5).
    - Offsets.

Commission Disputes- Ancillary Issues

Sources of Commission Disputes

- Typical reasons why commissions disputes arise:
  - No written contract.
    - Usually results in a he-said / she-said case involving extrinsic evidence.
    - Very hard to resolve prior to trial (and usually involves a costly appeal)
    - With courts loathe to deny an employee or representative his or her day in court regarding unpaid commission disputes, most fact-intensive trials seem bound for trial.
- Example
  - In *Lee v. Thermal Engineering Corp*., 572 S.E.2d 298 (S.C. Ct. App. 2002), the South Carolina Court of Appeals found that a sales representative's employment contract was orally amended to included commissions for all sales.
    - Court found South Carolina law allow amending written contracts orally, and that evidence demonstrated that parties orally amended contract to pay rep commissions for ALL sales made in territory (regardless of whether rep made the sale personally).

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Commission Disputes-Ancillary Issues

- Ambiguities in written contracts
  - Method of calculating commissions.
    - Profits vs. sales.
      - See previous slides regarding "Methods".
  - When are commissions due?
    - Contract signed, services performed, products supplied or invoice / contract paid.
    - Any ambiguity in contract provides ample ammunition for representatives' attorney to bring case to trial and deny summary judgment
  - Client complaints / refunds.
    - What happens when a commission is paid, but a customer subsequently demands a refund?
      - See previous slides.
  - Indemnification and other "claw backs"
    - Regulatory investigations or enforcement actions.
    - Internal investigations.
    - Customer / client complaints.
    - **Example**: FINRA Investigations

Commission Disputes- Ancillary Issues

- Other alleged wrongdoing by employee/contractor.
  - What happens when the person who is due commissions broke the law?
    - Internal policies and procedures
    - Permissible? State law intensive and state law dependent.
      - Some state statutes allow for withholding; some do not.
  - What happens when the person who is due commissions has lost, destroyed or stolen company property?
    - Minn. Stat. §181.79 (Wages Deductions for Faulty Workmanship, Loss, Theft or Damage), states that commissioned salespeople can have wages and commissions withheld "where the rules are used for purposes of discipline, by fine or otherwise, and in cases where errors or omission in performing their duties exist."

Commission Disputes

Related issues in commission disputes:

- Restrictive covenants.
  - Non-compete agreement.
  - Non-solicit agreement.
  - Non-circumvention agreement.
  - Confidentiality agreement.
- Wrongful termination claims.
  - Potential EPLI Insurance for defense?
- Harassment/discrimination claims.
- EEOC claims.
- Unemployment claims.

Commission Disputes- the Litigation Path

What does a typical commission dispute suit look like?

- Pleadings.
- Discovery.
  - Written discovery.
  - Depositions.
- Motions.
- Mediation.
- Trial/arbitration.
- Appeals.

How Much Does a Commission Dispute Cost?

- Varies on case by case basis
- Parties incur significant fees in
  - Pre-suit research
    - Fact research and legal research
  - Early mediation
  - Discovery
    - Can be very fact-intensive
      - What does the contract say? What do the witnesses say?
      - Potential forensic accounting regarding accrued commissions, when commissions were earned
  - Trial
    - Many commission disputes are very fact-specific, making trial more likely than in other cases

Commission Disputes

Common issues litigated in commission dispute cases:

- What was the date of departure for the person due commissions?
  - And, was the termination “voluntary” or “involuntary”
    - May not matter. *See Lapponnese*
- Were the commissions actually earned?
  - Check contract but <u>also</u> check applicable state law
- When were the commissions actually earned?
- What about trail commission?
  - Defined period of time for post-termination commissions?
  - Perpetuity?
- Can commissions be withheld for any reason?
  - Contractually allowed
  - But remember- may not be able to fire an employee or terminate an independent contractor to avoid payment of commissions (*see Vander Veur*).

Commission Disputes

- How are damages calculated in commission dispute cases?
  - Monetary damages.
  - Liquidated damages.
    - What's the difference and why does it matter
  - Important- check applicable to state laws to see what damages are permitted
    - Many states (like Texas) have treble damage statutes that may be above and beyond what the contract permits.
- Can you be penalized for not paying commissions?
  - Punitive damages.
  - Statutory penalties.
    - Statutory penalties exist for failure to pay commissions in nearly every state
    - Must check to see if penalties are covered under wage and hour laws OR if they are covered under unpaid commission/sales representative statutes (depending on legal status of individual- whether employee or contractor)
- What about injunctive relief?

Thank You

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