Button Up Those Commission Plans

Insights
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An employer recently found itself in the unenviable position of defending a lawsuit brought by a former sales employee, who alleged that the employer owed him a commission of 20% on a $12 million deal he brokered with AT&T. After three and a half years of litigation, an appellate court ruled in the employer's favor because the salesperson's employment agreement contained two critical provisions. Would your company's commission plan pass the same test? *Nein v. HostPro, Inc.*

It All Started Out So Well . . .

HostPro, a California web-hosting company, hired Randy Nein as a sales representative in 1999. The written employment agreement stated, among other things, that Nein would receive a salary plus commissions of 4% "on all direct initial sales," Nein would be eligible for these commissions "so long as [he] remains employed with the Company as a Sales Representative," and that the employment agreement "may be amended only by a written agreement executed by each of the parties." So far, so good.

In April 2001, Nein was promoted to "Channel Manager." In an oral agreement, the parties agreed to triple his salary and that Nein would receive a commission of "20% of the up front costs' revenues" on all accounts brought in by Nein or through his contacts or efforts. The employer fired Nein in December 2001.

Before his termination, Nein had discussions with a contact at AT&T that led to HostPro acquiring all of AT&T's small-to-medium-sized web-hosting clients in an asset-purchase agreement. HostPro consummated the transaction with AT&T on January 14, 2002, one month after Nein's termination. Nein then sued to recover a 20% commission on the deal.

During the extensive litigation that followed, HostPro asserted several reasons why Nein was not entitled to the claimed commission. All of these arguments failed but one. What saved the day for the employer was the fact that the original employment agreement – which provided only a 4% commission and required Nein to be employed to receive the commission – could only be amended in writing. Nein and HostPro never reduced their later oral agreement to writing. Nein argued that the oral agreement for a 20% commission validly modified the written agreement that provided only a 4% commission, but the court rejected that argument.

Oral Commission Agreements Are As Good As The Paper They're Written On
Savvy employers protect themselves from these nightmarish scenarios by insisting on clearly written commission plans and by refusing to allow any oral modifications. A commission plan should specify all of the terms and conditions required for a salesperson to earn a commission, when the commission is actually "earned," and any provisions that may disqualify an employee from earning that commission. California wage-and-hour law has many quirks, but commission agreements are largely enforced, so long as the agreement covers all these bases.

A good commission agreement should address these questions:

- What goods or services are eligible for commission payments?
- What is the commission rate? Is it the same for all goods and services? Is there a cap on the total commission possible?
- When does the employee earn the commission – when the sale is booked, invoiced, shipped, paid, after the expiration of a specified chargeback period, or at some other time?
- Must the employee be employed on the date the commission is "earned" under the contract to be paid?
- What happens when two or more employees participate in the sale? Is the commission split between them, or does it go to the employee who actually closes the sale? If there is a split, who gets how much of the commission?
- Will the employee get a draw against commissions? If so, how much, and how is the draw reconciled against commissions? (Any draw should at least be sufficient to cover the employer's minimum wage obligation to the employee for the pay period when the draw is paid.)
- What happens if an employee's draw exceeds the commissions for one or more pay cycles?
- If the customer cancels the sale or returns the item after a commission has been paid, how and when are returns, cancellations and chargebacks reconciled against future commissions?
- Are there any other conditions required to earn the commission, and if so, does the employee have control over these conditions? (If not, the conditions are likely to be closely scrutinized by the Labor Commissioner and the courts.)

When a commissioned employee changes jobs (whether by promotion or a change in responsibilities), be sure to review the agreement to see if it still makes sense in light of the employee's new position. If necessary, revise or replace the agreement. Don't rely on or permit oral modifications.

Also, be mindful of this maxim of California law: "He who shakes the tree, gathers the fruit." In some instances, courts have held that an employee who is the procuring cause of a sale, but is prevented by the employer from completing that sale, may be entitled to a commission anyway. But if according to the written sales agreement an employee must do more than achieve the "point of sale" to earn a to the written sales agreement an employee must do more than achieve the "point of sale" to earn a commission, the "procuring cause" argument may evaporate if those other conditions have not been satisfied. Thus, compensation plans must clearly articulate all conditions precedent to earning a commission, such as servicing the account, achieving eligibility thresholds, or satisfying other benchmarks to qualify for the commission.

Finally, remember that commissions must be paid immediately upon termination of employment if they have been earned and are reasonably calculable at that time. Don't wait to pay commissions on the next regular payroll cycle unless the departing employee's commissions truly cannot be calculated before then. Otherwise, you risk owing up to thirty days' additional wages in waiting-time penalties.

Conclusion

Like many other things in California, commission agreements are fairly technical, so it's best not to let your sales force draft their own agreements on cocktail napkins. The good news is that you are in the position to take control of this potential problem area and draft clear and unambiguous commission agreements that prevent or reduce the risk of exposure from frivolous commission claims. In short, a well-written commission agreement, done right, can save employers untold trouble in the future.

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