

# E=MC<sup>2</sup> - WHAT EINSTEIN CAN TEACH YOUR DEALERSHIP ABOUT DRAFTING PAY PLANS

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I bet you've heard of the famous equation  $E=mc^2$ . You may know that Albert Einstein is credited as its developer. You may even know that it's often called the Theory of Relativity. But, like most people, you might not know what all the symbols mean or how to work the equation to achieve the result Einstein promised. Generally speaking, the only people who fully understand the equation, what the symbols represent, and how to perform the calculations are physicists, scientists, and mathematicians—all persons with specialized skills, knowledge, and experience.

By now you're probably thinking: What does this have to do with my dealership? Probably nothing from a physics standpoint. But maybe everything as it relates to your pay plans and how they are drafted, utilized, and understood. Relatively speaking (get it?), dealership pay plans are frequently just as confusing to the average reasonably intelligent person as Einstein's famous equation. In fact, often only a very small group of people—the people who draft them—fully understand dealership pay plans. And, like the symbols used by Einstein, pay plans rely on language unique to retail automotive and only those within the industry understand it.

## THE FRIEND OR NEIGHBOR TEST

If you think your plans are above reproach, ask a friend or neighbor who has never worked in retail automotive to read yours and then explain exactly how your employees earn compensation and how your dealership calculates

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commissions. While you're at it, if your plan uses common terminology such as "gross," "gross profit," or "costs," ask your victim to define those terms.

It's likely your friend or neighbor would have a better chance of explaining Einstein's theory than interpreting the plan as you intended. At this point, it's helpful to remember that, should your pay plans ever face a legal challenge, you can expect they will be scrutinized by folks with experience similar to your friends and neighbors, who do not know the industry buzz words (or the secret handshake, for that matter).

## **CONFUSING PAY PLAN + DISGRUNTLED EMPLOYEES = LAWSUITS**

Recent lawsuits, several of which were class actions, should serve as a wake-up call to review your pay plans and your methods used to calculate compensation according to those plans. Although the specific factual assertions differ in these lawsuits, they all have the same central theme in common: the dealership did not compensate the plaintiffs as promised in its pay plan and as required by law.

Among the legal claims asserted were breach of contract, fraud, wage theft, and wage and hour violations. Several cases alleged that the dealership inappropriately added fabricated costs to deals that were not actual costs. In some cases, plaintiffs alleged that the dealership included costs or deductions when computing commissions that the pay plan had not mentioned. Still other cases included allegations that the dealerships agreed to calculate commissions based on "gross profit," but failed to use the actual gross profit number in the calculation.

While winning a lawsuit is certainly a significant event, the primary goal should be to avoid a pay plan lawsuit altogether. Lawsuits involve risks, disruption, and legal costs, not to mention the possibility you will have to pay damages. Luckily you can take steps to reduce your risk of ending up in a lawsuit by drafting and following better pay plans. With better pay plans, chances are that the dealerships involved in the cases mentioned above would have achieved their compensation goals while avoiding the legal risks.

## **YOU DON'T NEED TO BE EINSTEIN TO CRAFT A GOOD PAY PLAN**

Pay plans should explain how compensation is earned and what will go into the calculations, using the common, everyday definition of terms and phrases or by defining key terms within the context of the pay plan itself (to the extent possible). You should be careful when using terms that are typical to any industry, such as “gross profit” and “costs” because, just as the symbols used in Einstein’s equation are constants subject to the laws of physics, these terms have specific legal meanings that generally cannot be reinterpreted by a pay plan drafter.

Among other components, plans should include language that no prior or subsequent oral representation contrary to the terms of the plan are enforceable, nor are any changes to the plan that are not in writing and signed by the employee and high level manager (e.g., General Manager).

Once a good plan is in place, your dealership must calculate compensation based on the terms of that plan document as written. The document should include a reservation of rights to change the plan *prospectively*. If you decide to make any adjustments to the plan, you should continue to compensate employees under the old plan through the date the change is implemented.

For those who believe that they are not at risk because they have been using the same pay plan forever without a legal challenge (i.e., the if-it-ain’t-broke-don’t-fix-it approach), hopefully your exceptional luck will continue. Keep in mind, however, most of the dealerships involved in the cases mentioned above were in your same situation ... until they weren’t.

## **IT ALL ADDS UP: A SOLID PAY PLAN IS WORTH THE EFFORT**

Pay plans have come a long way from the old days when many resembled ransom notes written on the back of cocktail napkins. There is still work to be done in many cases. A good plan is detailed, thorough and protects both the employee and the dealership. And they should be easy to understand, even by a layman outside of the automotive business. In other words, nobody should need Einstein’s help to figure them out.

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