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New York State Court of Appeals Clarifies Scope of State Labor Law

In its much-anticipated decision in *Pachter v. Bernard Hodes Group, Inc.*, the New York State Court of Appeals clarified that company executives are protected under the provision of the state's labor law that prohibits certain wage deductions and addresses when a commission becomes an earned wage for purposes of that law, a ruling that will have a broad impact on employers in New York State.

In *Pachter* (decided on June 10, 2008), the Court of Appeals held that (i) "executives" are "employees" for purposes of Section 193 of the New York State Labor Law ("Section 193"), and are thereby subject to its protections, including its prohibition on certain deductions from earned wages; and (ii) employers can structure commission programs to make deductions for business-related expenses before the commissions are deemed earned and, thus, are considered wages for deduction purposes under Section 193.

The key facts of the case and its significance are discussed below.

Background

Elaine Pachter worked as a vice-president for Bernard Hodes Group, Inc. ("Hodes"), a recruitment, marketing and staffing services firm, for 11 years. She was responsible for arranging media advertisements for Hodes' clients. As an employee of Hodes, she was given the option of being paid a fixed salary or on a commission basis. She chose to be compensated on a commission basis. By opting for this incentive arrangement, Pachter was able to earn between $100,000 and $200,000 annually, while salaried employees doing similar work earned only $40,000 to $75,000 per year.

Pachter's commission earnings were calculated using a formula. When Pachter arranged a media advertisement for one of Hodes' clients, Hodes advanced payment to the media company and then billed its client for that cost as well as a fee for Pachter's services. When the client was billed, Pachter received, as her commission, a percentage of the amount billed, less certain charges – including Pachter's travel and entertainment expenses and other business-related expenses. Each month, Pachter received a commission statement that listed her total billings and the percentage of those billings that represented her gross commission. The

expenses attributed to her business activities were then deducted to reach the net amount of commission income she had earned for that period. Pachter was aware of the charges Hodes subtracted from her gross commissions and acquiesced in the compensation scheme for over a decade.

After Pachter left her job with Hodes, she filed a lawsuit against the company in federal court, claiming that Section 193 – which prevents employers from making certain deductions from an "employee's" wages – prohibited Hodes from subtracting business expenses from her percentage of client billings in arriving at her commission income. Hodes maintained that Pachter was an "executive" at the firm and, as such, was not an "employee" for purposes of Section 190 of the Labor Law ("Section 190") (the definition section of Article 6 of the Labor Law ("Article 6")) or Section 193. Further, Hodes asserted that the deductions were not taken from her commission, but rather were used to calculate her earned commission. After the district court granted summary judgment in favor of Pachter, Hodes appealed to the United States Court of Appeals for the Second Circuit. Given the split in authority among the courts on these issues, the Second Circuit asked the Court of Appeals to clarify whether an executive is entitled to the protections extended to employees in Article 6, and assuming that executives are employees for purposes of Article 6, when, in the absence of a written agreement, a commission is "earned" and becomes a "wage" subject to Section 193's prohibition on deductions.

The Decision

The Court of Appeals began its analysis by examining the text and structure of Article 6, which regulates the payment of wages by employers. It noted that unlike other sections of the Labor Law, Section 190 – which defines the term "employee" as "any person employed for hire by an employer in any employment" – did not carve out executives from its definition of the term employee. Accordingly, the Court of Appeals concluded that executives are employees for purposes of Article 6, and entitled to its protections, except where they are expressly excluded by the statute.

After concluding that Pachter was entitled to the protections of Article 6, the Court of Appeals continued its analysis by noting the following undisputed facts: (i) Pachter's commission was a "wage" for purposes of Section 190; (ii) Section 193 prohibits an employer from making "any deductions from the wages of an employee" unless permitted by law or authorized in writing by the employee for the benefit of the employee; (iii) the deductions Hodes made to determine Pachter's final compensation were not within the categories of permissible deductions delineated in Section 193; and (iv) as such, the legality of the deductions depends on when Pachter's commission was "earned" and became a "wage" that was subject to the restrictions of Section 193.

The Court of Appeals first noted that the lack of a specific written contract was not determinative because the parties' extensive course of dealings, and the written monthly compensation statements, issued by Hodes and accepted by Pachter, demonstrated that the parties had "an implied contract under which the final computation of the commissions earned by Pachter depended on first making adjustments for nonpayments by customers and the cost of Pachter's assistant, as well as miscellaneous work-related expenses." The Court of Appeals continued by explaining that

> neither [S]ection 193 nor any other provision of [A]rticle 6 of the Labor Law prevented the parties in this case from structuring the compensation formula so that Pachter's commission would be deemed earned only after specific deductions were taken from her percentage of gross billings.

Finally, the Court of Appeals held that

> when a commission is "earned" and becomes a "wage" for purposes of Labor Law [A]rticle 6 is regulated by the parties' express or implied agreement; or, if no agreement exists, by the default common-law rule that ties the earning of a commission to the employee's production of a ready, willing and able purchaser of the services.

The Bottom Line

The resolution of these issues provides employers with a good opportunity to review their pay practices. In particular, this decision clears up any ambiguity with respect to whether executives are covered under Section 193, which states that employers may not make any deductions from employees' wages except for deductions in accordance with federal or state law or employee-authorized deductions for insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization and similar payments for the benefit of the employee. Thus, employers must now be sure to treat all employees, including executives, as employees for purposes of Section 193. By way of illustration, if an executive owes an employer money pursuant to a loan, the employer would have to obtain the executive's written authorization prior to attempting to recoup such moneys via payroll deduction and, consistent with the corresponding regulations of the Commissioner of Labor, such deduction would be limited to 10 percent of the gross pay for the pay period.

While the Court of Appeals did indicate that the implied agreement between Pachter and Hodes was enough to establish a lawful commission program, to avoid potential litigation of this issue, we continue to recommend that employers require employees who receive a commission to sign a written agreement. This is particularly important in light of the recent amendment to the Labor Law, which requires a written agreement with certain employees whose earnings are based on commissions, setting forth, among other things, when the commissions are earned, how the employee's commission will be calculated, and all of the deductions that will be made to arrive at the net amount of the employee's commission income (see also October 2007 Client Alert "Important Amendments Reshape Key NY Labor and Employment Laws" at www.ebglaw.com).

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If you have any questions regarding these new developments or any other New York labor or employment law issue, please contact Dean Silverberg at (212) 351-4642 or dsilverberg@ebglaw.com, Jeffrey M. Landes at (212) 351-4601 or jlandes@ebglaw.com, or Rebecca M. Brandman at (212) 351-4652 or rbrandman@ebglaw.com.