

The Legal Side of Comp Plans By MEREDITH SENTER

Whatever compensation plan you choose for your sales people – a plan that pays commissions on billings, subject to chargebacks, or a plan that pays commissions only on collections – three things are critical.

- Put the plan in writing.
- Have the plan signed by both the employer and the salesperson.
- Make clear in the plan that a salesperson does not “earn” a commission until the account has paid.

A written agreement is not only a good idea; in some states it’s the law. For example, under New York law, a compensation plan with a commissioned salesperson must be in writing and must be signed by both the employer and the salesperson. The agreement must also include explanations of how commissions are calculated, earned and paid; whether and how the employer will pay advances or draws against unearned commissions; how often draws or advances will be reconciled with earned commissions, and what happens to commissions when an employee is terminated.

If you are in a dispute with a salesperson over the terms of a compensation plan, and you cannot produce a written explanation of the compensation plan – signed by both the employer and the salesperson – then the New York Commissioner of Labor will presume that the salesperson’s description of the compensation plan is the correct version.

No matter what state your business is in, one of the most important purposes of a written compensation plan is to make clear when commissions are earned. The default rule, at least under New York law, is that a commission is earned when a salesperson delivers a “ready, willing and able buyer” – for example, when a client commits to buy advertising. In this case, an employer may not charge back the salesperson at a later date for an uncollected account. Therefore, the first

thing that a written agreement should do is state that a commission is not earned until payment from the client has been received.

The written agreement should also make clear that payments made before a commission is earned are merely draws or advances subject to reconciliation. When a commission is “earned,” it becomes “wages,” and there are strict limits on the deductions that an employer may take from wages. Advances against future commissions, however, are not considered to be wages, and both a New York court and a California court have ruled that chargebacks against such advances are permissible if previously agreed to by the salesperson.

When a commission is earned is also critical in determining the payments due to a terminated salesperson. In California, for example, all earned wages are due and payable at the termination of employment. A written, signed agreement that clearly states that a commission is not earned until the account has been paid will go a long way towards minimizing disputes over amounts owed at termination of employment.

So, whether you pay commissions on billings, subject to chargebacks for uncollected accounts, or whether you pay commissions only upon collections, you should have a written sales compensation plan – signed or acknowledged by each salesperson – that explicitly provides that a commission is not earned until payment has been received and that any payments to the salesperson prior to the commission being earned are merely advances. This way, you and your salesperson will be on the same wavelength that “It’s not a sale until it’s paid for.”



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