Court of Appeals Holds that Executives are not Categorically Excluded from the Protections of the Labor Law and Addresses When a Commission Becomes a Wage

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A recent decision by the New York Court of Appeals resolved the previously unsettled question whether "executives" qualify as "employees" for purposes of certain protections provided under the New York Labor Law, or whether executives are exempt from those Labor Law prohibitions against making unauthorized deductions against wages. In *Pachter v. Bernard Hodes Group, Inc.*, the Court held that "executives are employees for purposes of Labor Law Article 6, except where expressly excluded", and found the wage deduction prohibitions applicable to all employees, including executives. *Pachter v. Bernard Hodes Group, Inc.*, No. 86, 2008 N.Y. LEXIS 1481, at *5 (N.Y. June 10, 2008). The decision also addressed the application of Article 6 to employees paid on a commission basis, and recognized that employers and employees may agree to compensation arrangements that include downward adjustments to commissions prior to them being deemed to be earned "wages" subject to statutory protection. *Id*. at *6–7.

PACHTER'S SECTION 193 CLAIM

Elaine Pachter was employed by the Bernard Hodes Group, Inc. ("Hodes") for eleven years as an account executive with the title of Vice President, Management Supervisor. In this role, she prepared, placed and serviced advertisements on behalf of Hodes's clients. Pachter was paid on a commission basis and her commissions were calculated based on billings to clients and a service fee Hodes charged its clients for Pachter's services. *Pachter v. Bernard Hodes Group, Inc*., 505 F.3d 129, 131 (2d Cir. 2007).

After resigning, Pachter filed suit in federal court alleging that Hodes unlawfully deducted certain fees and expenses from her gross monthly commissions in violation of Labor Law Section 193. [1] That section provides that:

> "[n]o employer shall make any deduction from the wages of an employee," except for certain narrowly described deductions required by law or which are for the benefit of the employee (e.g., insurance premiums, health and welfare benefits, pension contributions, charitable contributions and dues to a labor organization).

N.Y. LAB. LAW § 193(1)(a)-(b) (McKinney 2008); *see also Pachter*, 505 F.3d at 132.

[1] These deductions were for certain finance charges, a portion of an assistant's salary, late fees, uncollectible advances and debts, and miscellaneous work-related costs including travel and entertainment expenses.

In its defense, Hodes argued that "executives" such as Pachter are not "employees" within the meaning of the wage payment provisions contained in Article 6 of the Labor Law and that Pachter was, accordingly, not entitled to protections against unauthorized deductions. *Pachter*, 505 F.3d at 131. In this regard, Hodes relied upon the express exclusions of "executives" from certain definitions of categories of workers, such as "Commission Salesman" and "Clerical and other Workers", in Labor Law Section 190.[2] Alternatively, Hodes argued that even if "executives" are not categorically excluded from the statute's protections, the deductions were not from Pachter's wages because "[they] were used to calculate [her wages] in the first instance." *Id*.

The District Court held that executives are covered by Labor Law Section 193 and that the deductions made from Pachter's gross commissions were unlawful. *See Pachter v. Bernard Hodes Group, Inc.*, No. 03 Civ. 10239, 2005 WL 2063838, at *4, *7 (S.D.N.Y. Aug. 25, 2005). The District Court awarded Pachter $153,817.51 for the amounts deducted, "statutory interest and the attorney's fees mandated by the Labor Law." *Pachter*, 505 F.3d at 131. Thereafter, Hodes appealed to the United States Court of Appeals for the Second Circuit.

The Second Circuit observed that courts in New York disagreed whether executives are covered by Article 6 because of "varying interpretations" of certain language that had been used by the New York Court of Appeals in its 1993 decision in *Gottlieb v. Laub & Co. Inc. Id.* at 132. The troublesome language used was:

> Except for manual workers, all other categories of employees entitled to protection under Labor Law §191 are limited by definitional exclusions of one form or another for employees serving in an executive, managerial or administrative capacity" and "[c]ertainly nothing in the language of [Article 6] suggests that it was intended to provide any remedy whatsoever for the successful prosecution of a common-civil action for contractually due remuneration on behalf of employees who *in all other respects are excluded from wage enforcement protection under recodified article 6 of the Labor Law*.

Gottlieb v. Laub & Company, Inc., 82 N.Y.2d 457, 461, 462 (N.Y. 1993) (emphasis added).

Believing that by this language the New York Court of Appeals meant to exclude executives categorically from Article 6, some courts in New York—both federal and state—have concluded that

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[2] Several of the definitions of categories of employees set forth in Section 190 exclude "executives": (a) the definition of "Railroad worker" in Section 190(5) "shall not include a person employed in an executive capacity"; (b) the definition of "Commission Salesman" in Section 190(6) "does not include an employee whose principal activity is of a supervisory, managerial, executive or administrative nature"; and (c) the definition of "Clerical and other Worker" in Section 190(7) excludes "any person employed in a bona fide executive, administrative or professional capacity whose earnings are in excess of nine hundred dollars a week."

executives are exempted from those protections. *See, e.g., Kaplan v. Aspen Knolls Corp.*, 290 F.Supp. 2d 335, 340 (E.D.N.Y. 2003) (relying on *Gottlieb* and declaring that "employees serving in an executive capacity are excluded from the protection of Labor Law Article 6"); *Davidson v. Regan Fund Management*, 13 A.D.3d 117, 118, 786 N.Y.S.2d 47, 49 (1st Dep't 2004) (citing *Gottlieb* and affirming dismissal of plaintiff's claim under the Labor Law because he was employed in an executive capacity).

In contrast, the federal district court in *Miteva v. Third Point Mgmt. Co.* held that the language used by the Court of Appeals in *Gottlieb* was not meant to "hold the broad exclusion of executives" from the protections of Article 6 generally but rather was intended to point out that executives are not protected by Section 191.[3] *Miteva v. Third Point Mgmt. Co.*, 323 F.Supp.2d 573, 585 (S.D.N.Y. 2004); *Gennes v. Yellow Book of N.Y., Inc.*, 23 A.D.3d 520, 521, 806 N.Y.S.2d 646 (2d Dep't 2005) (holding account "executives" entitled to protection under Section 193).

Noting that the outcome in this case was dependent upon "unsettled and significant" questions of law, the Second Circuit certified two questions to the New York Court of Appeals:

(1) Whether an "executive" is an "employee" within the meaning of the Labor Law or categorically excluded from its protections; and

(2) When is a commission an earned "wage" that is subject to the statutory proscription on deductions?

EXECUTIVES ARE NOT CATEGORICALLY EXCLUDED FROM LABOR LAW, ARTICLE 6

In *Pachter*, the Court of Appeals held that the statutory language made clear that executives are not categorically exempt from the protections of Article 6. The Court held that the general definition of a "covered" employee contained in Section 190(2) does not exclude executives ("'Employee' means any person employed for hire by an employer in any employment"), whereas certain other provisions of Article 6 utilize definitions of specific categories of employees, which definitions contain that express carve-outs of coverage for executives, such as Section 191 dealing with the frequency of wage payments.[4] In the absence of an explicit carve-out, the Court refused to infer that executives were not meant to be included in the broad definition of "employee," finding that such an inference would render "wholly superfluous" explicit statutory exclusions. *Pachter*, 2008 N.Y. LEXIS, at *4.

[3] Section 191 mandates the frequency of wage payments for specific categories of employees. These are manual and railroad workers, commission salesmen and clerical and other workers. *See* N.Y. LAB. LAW § 191(1)(a)-(d) (McKinney 2008).

[4] *See supra* footnote 2.

WHEN COMMISSIONS BECOME EARNED

Having determined that executives are "covered employees" and, accordingly, that they are entitled to protection from wage deductions prohibited by Section 193, the Court considered whether the expense deductions at issue in the case were unlawful.

The Court held that in the absence of a written agreement, the common law determines when a commission becomes an "earned wage," unless the parties depart from the common law by agreeing to an alternative express or implied arrangement for calculating commissions. *Id*. at *6–7. The Court began its analysis by noting that a "commission" is a "wage" and that the legality of the deductions about which Pachter complained depended upon whether her commissions were "earned" at the time of the deductions, since the deductions at issue were not of the type authorized by statute. The Court explained: "If the adjustments were made before the commissions were earned, section 193 did not prohibit them; but if the charges were subtracted after her commissions were earned, Hodes engaged in impermissible practices under the statute." *Id*. at *5.

The common law rule provides that a commission is earned when a broker "produces a person ready and willing to enter into a contract upon his employer's terms…." *Id*. The Court explained, however, "that parties to a transaction are free to depart from the common law by entering into a different arrangement" with whatever conditions they wish, and such arrangement may include a formula for determining commissions that provides for downward adjustments from gross commissions for expenses. *Id*. at *6. In sum, the Court concluded that where parties have agreed to a commission arrangement that differs from the common law, "the commission will not be deemed 'earned' or vested until computation of the agreed upon formula." *Id*.

The Court found that Pachter and Hodes had agreed to an implied arrangement that departed from the common law rule through their more than eleven year course of conduct. Specifically, the Court stated: "[T]he written monthly compensation statements issued by Hodes and accepted by Pachter—provide ample support for the conclusion that there was 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." *Id*. In the Court's view, by accepting and deriving substantial benefit from this arrangement, Pachter had acquiesced to its terms. Accordingly, the deductions made by Hodes were not from Pachter's earned "wages" and therefore did not violate Section 193 of the Labor Law.

CONCLUSION

The *Pachter* decision has settled finally the question whether executives are entitled to protection under the New York Labor Law from employers making deductions from their wages. Although this result is not favorable to employers, it does rest on sound analysis of the statutory language, and the law is now clear that deductions from the earned wages of all employees must be made only pursuant to the rules of Labor Law Section 193.

The Court of Appeals decision does, however, provide New York employers with an opportunity to avoid claims alleging unlawful deductions from commissions through careful drafting of the commission agreement. In this fashion, employers can establish a commission formula that provides for adjustments prior to the commissions being deemed "earned wages" within the meaning of the Labor Law. Although employers are advised to memorialize all commission arrangements, the *Pachter* decision does recognize that the practical "course of conduct" between the parties, establishing a practice of having made such deductions from gross commissions without complaint from the employee over a period of years, may also be available for an employer to establish a defense from liability under Section 193.

For further information about this ruling, please feel free to contact members of the Firm's Labor and Employment Law Group, including:
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