Advances Exceeding Commissions Earned: Making Sure They Can't Take It With Them

by JOHN M. RICCIONE and PAUL A. GREENBERG

The practice of allowing sales representatives to draw against their commissions is extremely common and generally uneventful. A "draw" is an arrangement whereby a sales representative is paid a predetermined amount of money each pay period. The purpose of a draw is to stabilize a salesman's monthly income so that in a month where a sales representative earned few commissions, he would receive the set amount of pay, and in a month where commissions exceeded the draw, the excess would be retained by the agent to repay any deficit incurred during months where draws exceeded commissions. This type of arrangement can, however, become complicated where a sales representative ends his relationship with the agent at a time when the sales representative's draw exceeds his commissions earned. When this occurs, the manufacturer's agent often seeks to recover the deficit from the sales representative only to find out that it is not entitled to do so.

For example, in 1984, ACME Company, which sells individualized promotional material to businesses throughout the southeast portions of the United States, hired John Smith to serve as its sales representative. During his first year as a sales representative, Mr. Smith was paid a base salary plus commissions. After his first year, Mr. Smith was compensated solely on a commission basis.

During his second year at ACME, Mr. Smith requested that he be allowed to draw against his commissions. ACME agreed. The draw was set at $1,950.00 per two-week pay period. Along with his monthly paycheck, Mr. Smith received a monthly statement which advised him of his commissions for that month vs. the draw he was receiving. In months where his commissions exceeded his draw, the excess was applied to any deficits which had accrued.

Refusal to Pay

Three years after joining ACME, Mr. Smith resigned to form a business which would compete with ACME. At the time of his resignation, and on several occasions thereafter, Mr. Smith assured ACME

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that he would repay the deficit in his draw account. Ultimately, however, Mr. Smith refused to do so, prompting ACME to file suit against him.

Upon reading the foregoing set of facts, many manufacturers' agents (and attorneys) would incorrectly assume that ACME prevailed in its lawsuit. However, in ACME's case, which was based on an actual case out of the State of North Carolina, the court held that Mr. Smith was not obligated to reimburse ACME for the deficit in his draw account. In doing so, the court first noted that in virtually all jurisdictions, it is presumed that when advances are made to a sales representative and charged against his commissions earned, the sales representative is not personally liable to repay any excess advances over commissions earned unless the sales representative either expressly or impliedly agreed to repay the deficit. (Please note that in Alabama and Pennsylvania, courts have taken the opposite view and held that unless it is agreed to the contrary, when advances exceed commissions earned, the amount of the deficit becomes a personal obligation of the sales representative.) Thus, the Court found that ACME failed to prove that Mr. Smith had agreed, either expressly or impliedly, to repay the excess draw, despite Mr. Smith's post-employment promise to repay ACME and the fact that Mr. Smith's commissions were applied to offset any deficit in his draw account during his employment.

Establishing Liability

As the ACME case demonstrates, the presumption courts apply in favor of sales representatives is difficult to overcome. Therefore, to ensure that a sales representative will be personally liable for excess advances, it is imperative that the sales representative clearly, unequivocally and expressly promise to reimburse the agent. Merely using words suggestive of indebtedness, such as "loan," "debt," "charge" or "obligation" is generally insufficient to establish the sales representative's personal liability.

Instead, the agreement should provide something to the effect that:

- the funds advanced to the sales representative are a loan and not salary,
- the sales representative agrees to repay the agent for advances from his earned commissions and
- any balance due upon termination of the agency relationship would be a debt of the sales representative and would be repaid personally by him.

It is also a good idea to have the sales representative sign a receipt for each advance acknowledging that it is a loan and promising to personally repay it. However, to best protect your interests, you should always have an attorney review your agency agreements.

Finally, it bears mentioning that if a sales representative breaches the agency agreement or otherwise breaches his fiduciary obligations to the agent, the sales representative may be found liable to repay advances from his draw account irrespective of whether he agreed to do so. In fact, in some states, where a fiduciary, such as a sales representative, breaches his fiduciary obligations, the agent may be able to recover all compensation paid to the sales representative during the period of time in which he breached his fiduciary obligations. ❐