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REPRINTED FROM
agency sales® magazine
may 2009 · vol.39, no.05

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WHEN A PROMISE IS *NOT* A PROMISE

EDITORIAL | NICOLE M. LUNDRIGAN AND CHARLES H. MELVILLE

I would venture a guess that many employers and employees reading this article have seen one or more proposed employment or related agreements containing the language, **"Employer reserves the right to amend or terminate this agreement at any time and for any reason."**

These provisions are especially prevalent in agreements between sales representatives and principals, where the sales representative is compensated at least in part by commissions.

Employees and their counsel typically hate these provisions, which are usually offered as part of an agreement on a "take it or leave it basis." Although employers typically include reservation of rights provisions to protect themselves, it just may backfire, and the employers may run the risk of being held accountable to an employee for the payment of more compensation than intended. The other side of the coin, of course is that employees may actually benefit from these provisions.

First, a couple of basic concepts in the common law of contracts. Contracts between an employee and an employer are "bilateral contracts." That means nothing more than that there are two parties to the contract, each of whom make certain promises to the other. For example, the sales representative promises to solicit purchase orders, and the principal promises to pay a commission on orders received. The mutual promises of the principal and the sales representative form what the law calls "consideration." Every contract must have consideration from each party. The law does not attempt to value the consideration, so long as some consideration is present. In the typical bilateral contract, the consideration from each party is its promise to do something or not to do something the party would otherwise be permitted to do.

Now back to the reservation of rights provision. If the employer promises to pay a certain compensation, but then reserves the right to amend or terminate the agreement at any time and for any reason, exactly what has the principal promised to do? One possible answer is, absolutely nothing!

This is precisely the result that was reached by an Ohio Appellate Court. *Quesnell v. Bank One Corp.,* Case No. 01AP-792, 2002 WL 500506 (Ohio 10th Dist. 2002), involved a suit by an employee against her employer under an incentive compensation plan on theories of breach of contract and unjust enrichment. The employee had been compensated under the incentive plan for relationship managers. However, after the employee brought in to her employer new accounts worth more than $1 million, and it became apparent to the employer that it was going to have to make large payments to the employee under the incentive plan, the employer unilaterally changed to a different incentive plan which provided for a significantly lower incentive payment.

In the lawsuit, the employee argued that her employer had retroactively changed the terms of her incentive pay after she had secured significant new business, and that she was entitled to be paid under the terms of the original incentive compensation plan.

The company countered that under the original incentive compensation agreement, it had the right to terminate or amend the plan "at any time." Its reservation of the right to amend or terminate the agreement at any time made all the promises in the agreement "illusory" — that is, there was really no promise at all, there was no consideration for the contract by the employer, and the original contract was unenforceable. The company had in fact amended the plan, and asserted that the employee had been paid everything she was due under the amended plan, and she wasn't entitled to anything further.

The court agreed with the employer that the original incentive compensation plan was illusory, and the employee therefore could not enforce the original contract to obtain the additional incentive compensation to which she believed she was entitled. The specific language of the court was, "[A] contract is illusory only when by its terms the promisor retains an unlimited right to determine the nature or extent of his performance; the unlimited right, in effect, destroys his promise and thus makes it merely illusory."

However, once the court threw out the contract, the door was opened for the employee to urge her claim for equitable relief under an unjust enrichment theory. An unjust enrichment claim rests upon the principle that a person should not be permitted to unjustly enrich himself at the expense of another without paying just compensation. In other words, it would be unfair to permit the employer to retain a benefit - the value of the sale -- without payment of fair compensation. An employee seeking to recover under this theory must prove (1) that he conferred a benefit upon the employer, (2) the employer had knowledge of the benefit, and (3) that it would be unjust for the employer to retain the benefit under the circumstances without payment.

The equitable theory of *quantum meruit* is really the other side of the same coin. It gives a party who provided a service the right to recover the reasonable value of the service provided. *Quantum meruit* as a legal theory requires that (1) one party render a service to the other with the other's knowledge and for their benefit, (2) under circumstances where the other party knows or should have known that the

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party rendering the service expected to be paid the reasonable value of that service.

In *Quesnell*, the court found that the employee had conferred a benefit upon her employer by bringing in new accounts worth nearly $100 million, and that the employer was aware of the benefit it was receiving. The company argued that it had already paid the reasonable value of the employee's services, and was not unjustly retaining any benefit. The appellate court rejected the argument that the employee had been adequately compensated for the benefit conferred upon the company by virtue of her salary, which was separate and distinct from the incentive compensation. There was evidence that the employee would have been entitled to additional compensation in excess of $150,000 under the original incentive compensation plan. So the court sent the case back to the trial court for an equitable determination of the amount of additional compensation to which the employee was entitled.

The question that was not addressed in *Quesnell* is how the fair value of an employee's services, or the value of the benefit conferred by the employee, should be determined. Since an illusory contract is not enforceable, these determinations are not necessarily limited by the commission rates specified in the employment agreement, and will typically be left for a jury to decide. Nor will an employer necessarily be protected from paying compensation in addition to the salary and commissions it has already paid.

These principles may also apply where a sales representative is terminated on the eve of receipt of a large order on which the representative has been working for some time, where the employment agreement contains a reservation of rights provision and specifies that no commission will be paid on orders received and accepted *after* the effective date of termination. Under these equitable theories, if the representative proves that he was the "procuring cause" of the order, the representative may be entitled to commissions on the entire order.

In the case of an employee such as *Quesnell,* how might a jury react to evidence that the employee conferred a benefit of more than $1 million upon her employer, only to be paid $60,000 in compensation? What if the industry standard is 25% commission on all sales? These open questions present significant risks to the employer, who may end up owing the employee substantial additional compensation; and a potential "pot of gold" for the employee.