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Written Sales Representative Agreement Succeeds in Limiting Commissions of Terminated Representative

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It is common for manufacturers and sellers of products to use independent sales representatives to generate sales. These arrangements can be "win win" situations, in which a manufacturer or seller limits its risk, since a sales representative is generally paid commission on actual sales. In addition, a successful sales representative can do quite well financially by finding and cultivating good customers to generate sales and receiving a percentage of the sales. But a supplier also wants to avoid having to pay commission to a sales representative after termination, simply because the sales representative at one point in time contributed to securing a particular customer. Rather, the supplier will want the ability to terminate commissions after the relationship is terminated. This is especially critical because of the number of states that have laws permitting a sales representative to claim double or three times unpaid commissions and attorneys' fees if a sales representative is not paid commissions that are due.

Most state laws that protect sales representatives from withholding of commissions that are due will still honor the written agreement between the supplier and the sales representative. So a well-drafted sales representative agreement can protect a supplier from the risk of paying commission after the relationship ends and even, in some cases, in perpetuity.

This is well illustrated in a recent Pennsylvania case applying North Carolina law. (Hughes Industrial Sales, LLC v. Diamond Manufacturing Company, U.S. District Court, Middle District, Pennsylvania No. 3:12-cv-0497, November 19, 2012) Diamond is a manufacturer of perforated metal, plastic, and other materials used in OEM applications such as clothes washers and dryer drums, speaker covers, automotive grills, exhaust components, airplane engine silencers, grain dryers, microwave ovens, and computer cabinets. Diamond had entered into a written Agency Sales Agreement with Hughes, which included North Carolina as part of Hughes' exclusive territory. Diamond tried to terminate the agreement, first by telephone on August 26, 2011. Diamond terminated the agreement again in writing on April 13, 2012. Of course, Diamond argued the August telephone termination was effective and Hughes argued the termination was not effective until April, 2012.

But Hughes went even further. It sought commission in perpetuity for customers solicited by Hughes. Said the court, "[Hughes] maintains that it is entitled to commission on every order/shipment made by [Diamond] that may have been procured by [Hughes] in the sense that such sale is a product of [Hughes'] original solicitation efforts on [Diamond's] behalf, which created the buy-sell relationship between [Diamond] and [Diamond's] customers, and that the provision of such commissions should continue in perpetuity."

For this purpose, Hughes sought all records of Diamond's sales, up to and including the present, suggesting that it was entitled to commission on sales after termination and into the future. So the case was unusual in that it wasn't to ultimately decide the commission to which Hughes was entitled. Rather, it was to decide what records Hughes could obtain to support its claim for commission – only records applying to the August 2011 termination, records applying to the April, 2012 termination or records up to the present and even into the future?

Diamond could be criticized for its clumsy efforts to terminate the agreement by telephone in August, 2011. But Diamond's written agreement with Hughes was critical for Diamond to limit its exposure.

The written agreement between Hughes and Diamond provided that Hughes would earn commissions "upon acceptance and/or delivery of the order by Principal [i.e., Diamond]." The agreement entitled Hughes to receive commissions on all orders Hughes could show that Hughes solicited during the thirty day period after the written notice of termination was given and for shipments resulting from such orders for 90 days after the date of notice. Noted the court, "The agreement does not provide that solicited orders made thirty days after termination give rise to claims for additional post-termination commissions if they are discrete orders from the same customer for the same product for which orders were solicited by [Hughes]. . . [Hughes] thus appears entitled to all commissions that '[Hughes] can demonstrate were solicited during the thirty (30) days of the termination period.' "

The court looked at the North Carolina Sales Representative Act ("Act") which was the basis of Hughes' claim. The Act provided that the principal (in this case, Diamond) had to pay the sales representative (in this case, Hughes) "all commissions due under the contract within 30 days after the effective date of the termination and all commissions that become due after the effective date of termination within 15 days after they become due." (North Carolina General Statutes, Section 66-191) The court found support in North Carolina cases that commissions due under the Act are based on the underlying agreement. The underlying agreement between Diamond and Hughes was clear in providing an end date for the payment of commissions to Hughes.

The court did not decide whether the August 2011 telephone termination or the April 2012 written termination was effective. But the court did limit Hughes ability to obtain records of sales beyond the 30 day period following the April termination notice and the 90 day period following the April termination notice as it related to shipments of those sales.

So Diamond was successful in limiting its exposure to commission claims by Hughes because of its written agreement. But the implications go beyond the financial exposure of the claim. Suppose Hughes had a viable claim for long-term commissions or even commission in perpetuity? How would Diamond find a new sales representative to increase business to these customers for which the new sales representative could not obtain commission? How could Diamond control its costs and margins to these customers knowing that a fixed percentage would be applied to commission? What if Diamond wanted to use a distributor to sell to these customers – would it continue to pay commission or would it be stuck with commission to a former sales representative?

Disputes with sales representatives are quite common and, as noted, many states have laws that protect sales representatives from improper withholding of commissions. So it is even more important to have a well-drafted written agreement with a sales representative to establish the terms and conditions of commission payment. Such an agreement will protect the supplier from unlimited commissions and will, most likely, be honored by the courts.