Rep cranks out complete victory

by ERA Legal Counsels
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Sales reps who make the difficult decision to take action upon suffering a contract breach oftentimes have to settle for the equivalent of a ground rule double. Perhaps the litigation results in recovering the unpaid sales commissions plus interest, but not the exemplary damages teased under a state statute. Or a rep may hit a long single by recovering commissions on certain sales but not others, or by getting awarded only some of the attorneys' fees claimed.

No such partial victory awaited Offshore Supply Systems LLC (OSS).
OSS hit a veritable grand slam in its action against California distributor CS Industries Inc., an intermediary between Chinese manufacturers and U.S. customers. Taking its case all the way to a jury and then successfully defending the verdict on appeal, OSS recovered about $445,000 in unpaid commissions, then trebled this amount under the California rep statute. In addition, OSS received $250,000 in punitive damages arising from fraud committed by CS and attorneys' fees.

The parties' crankshaft relationship

The contract gave OSS a worldwide territory to solicit orders for products manufactured by CS or its suppliers, including crankshafts used in consumer chainsaws. While the only customer specifically identified in the contract was Husqvarna, an Electrolux spinoff company, OSS enjoyed the right to update the list as it secured additional business, subject to CS's right to reject such new accounts.

Commissions varied based on the gross margins earned by CS, increasing along with profits. Gross margins were generally defined as the CS gross sales price, minus the cost of goods sold, divided by the gross sales price.

Over the years, Husqvarna purchased hundreds of thousands of Chinese-manufactured crankshafts from CS. Commissions were calculated by reference to the CS "invoice price" to Husqvarna to derive the gross sales price, and the manufacturer's invoice to CS to determine the cost of goods sold. CS would then create spreadsheets reflecting the calculation, which were sent to OSS with periodic commission payments.

Shortly after the sales to Husqvarna "cranked up," CS began telling OSS that its manufacturers were regularly raising prices, effectively reducing its gross margins, and greatly reducing OSS's commissions.

Then, adding insult to injury, CS entered into negotiations with a Chinese manufacturer to enable the direct sale of parts to Husqvarna in clear violation of their contract. Accordingly, OSS urged CS to leverage this situation by obtaining commissions of 10-30 percent on these sales.

One year later, OSS learned that Husqvarna was purchasing crankshafts directly from the Chinese manufacturer, which CS never disclosed. When OSS contacted CS about the arrangement, CS asserted it received only a 2 percent commission from the manufacturer, which it then offered to split with OSS.

This substandard commission rate sounded the alarm for OSS, which suspected other commission payments were similarly paid short. Performing some quick investigation work confirmed that CS had misrepresented its costs and that the corresponding commission payments were off.

Understandably, this made OSS cranky, and it filed suit in California state court alleging breach of contract, violations of the California sales rep act and fraud.

The evidence at trial

At trial, OSS introduced certain purchase orders and manufacturer invoices obtained from CS in discovery that were purportedly from different manufacturers but were highly similar in form and layout. Contrary to industry practice in China, the invoices were neither stamped nor signed.

What's more, many appeared to be "commercial invoices," used primarily for customs purposes, not accounting purposes. Such commercial invoices are generated by manufacturers, but these were modified by CS to achieve better treatment by customs officials. It was these suspect invoices that CS relied upon to defend its low commission payments.

OSS presented evidence of damages, by having its founder show the jury the purchase orders CS sent to its manufacturers to obtain the costs of goods sold, rather than the invoices produced by CS. He identified the discrepancy between the price reflected in the POs and the price in the later manufacturer invoice, which he could not explain, and used the price in the POs to determine the amount of commissions due.

Comparing this amount to the commissions actually paid yielded the underpayment awarded by the jury of approx. $445,000. OSS then argued that the CS invoices produced in discovery were fraudulently generated to reduce the commissions due by overstating the amounts paid to manufacturers for the crankshafts.

Under the California sales rep statute, the jury's award for failing to pay commission amounts due was trebled. The jury further determined that two key players at CS had acted with malice, oppression or fraud, and proceeded to award $100,000 in punitive damages against CS, and an additional $150,000 against each of the two CS officials. The total punitive award was thus $400,000.

Not surprisingly, the defendants appealed.

Statutory treble damages were appropriate

In appealing the treble damages award, CS misconstrued California's rep statute, which requires the rep to "solicit orders at least partially within this state."

The parties' contract assigned OSS a worldwide territory. While many Californians equate their state with the whole world, it is beyond dispute that a worldwide territory at least includes California.

OSS presented evidence at trial that it called on automotive customers in California, which was consistent with the contract's provision enabling OSS to identify customers other than Husqvarna. Although these calls ultimately proved unsuccessful, the statute only requires "soliciting orders" in the state, not actually "making sales."

CS also tried to distinguish OSS's California sales calls by pointing out they did not relate to the sales to Husqvarna at issue. However, reps who operate at least partially in the Golden State are entitled to assert a cause of action under the statute for unpaid commissions, and it is not necessary to show the unpaid commissions relate specifically to a California customer.

The jury fairly awarded the contract damages

The appellate court also found ample evidence supported the jury's finding that CS fabricated invoices and used these false records to underpay OSS. While the parties' contract called for determining the CS gross margin based on the cost of goods sold as reflected in the manufacturer invoices, when these invoices proved unreliable, the jury properly accepted OSS's use of the CS purchase orders as evidence of cost of goods sold instead.

As the court stated, "The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation." OSS explained at trial how a purchase order comprises an agreement to buy a product at a set price, and it was reasonable for OSS and the jury to rely on this price to establish the CS cost of goods sold and its gross margin.

Using the purchase orders reasonably enabled the jury to approximate the real invoice price, an approximation fully warranted when "it was CS's own wrongdoing that resulted in the unreliable invoice prices in the first place."

Fraud by CS justified awarding punitive damages

The law defines fraud as a misrepresentation made knowingly and with an intent to defraud another party, who justifiably relies on the misrepresentation and suffers resulting damages. Each of these elements was proven at trial.

By showing that CS fabricated its costs through doctored manufacturer invoices falsely reflecting manufacturer increases, OSS proved CS made intentional misstatements in a scheme to deceive it into accepting lower commissions based on purportedly lower CS gross margins.

The assertion that the conduct proved at trial was insufficient to show intentional misrepresentation was a claim by CS viewed as BS by the appellate court. Pointing to the invoices CS relied upon at trial court, which were manipulated for customs purposes, the court noted how the prices varied from the purchase orders, as well as how they were unsigned and unstamped, produced in electronic format rendering them subject to manipulation, and nearly identical in form though purportedly issued by different manufacturers.

Finally, the appellate court grew cranked up that CS was less than forthright with OSS about its new manufacturing agreement, on its way to upholding the jury's finding that CS defrauded OSS. Thus, the punitive damages awarded were deemed fully consistent with the evidence, and the jury's award was affirmed in full.

For CS, it was bad enough on the losing end of OSS's grand slam judgment. Then, it was forced to endure OSS's metaphorical home run trot when CS was even ordered to pay costs on appeal.