

Client Alert

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California Supreme Court Limits Commissioned-Salesperson Overtime Exemption

By Lloyd W. Aubry, Jr.

On Monday, the California Supreme Court issued an important decision for employers who pay salespersons on commission but don't pay them overtime because they believe these salespersons qualify for the commissioned-salesperson exemption in the IWC Orders. In its decision, the California Supreme Court held that the requirements for the commissioned-salesperson exemption must be met for each workweek and pay period, and that wages earned in different pay periods could not be allocated back over prior pay periods to ensure that the minimum pay requirements of the commissioned-salesperson exemption are met. The court also made clear that California's requirements that employees be paid semi-monthly, bi-weekly, or weekly for earned wages applies to commissions, though when those commissions are deemed earned can be defined under the terms of the commission plan. In other words, for employers with semi-monthly pay periods, under Labor Code § 204(a) commissions deemed earned before the 15th of the month have to be paid by the 26th, and commissions deemed earned between the 16th and last day of the month must be paid by the 10th of the following month.¹

FACTS

In *Susan J. Peabody v. Time Warner Cable, Inc.* (S. 204804, filed July 14, 2014), the California Supreme Court reviewed the payroll history of Susan Peabody, a commissioned salesperson for Time Warner Cable (TWC), to determine whether TWC was exempt from paying her overtime for excess hours worked. Peabody received bi-weekly paychecks, which included her regular wages in every pay period, commission wages approximately every other pay period. She was not paid overtime when she worked beyond 40 hours in a week because TWC claimed that the commissioned-salesperson exemption applied under California's Wage Orders. In order to be exempt from overtime, a commissioned salesperson must be paid 1.5 times the minimum wage for each hour worked, and more than half the salesperson's earnings must be based on commissions.²

The court, in reviewing Peabody's paychecks, determined that in some workweeks and pay periods she was not paid 1.5 times the minimum wage for all hours worked. TWC claimed that it paid commissions to her on an approximately monthly basis, and when those commissions were allocated back over the work weeks of the month in which they were earned, she was in fact paid 1.5 times the minimum wage for all hours worked during each pay period and workweek.

The case was litigated in federal court, and the Ninth Circuit Court of Appeals certified the issue to the California Supreme Court so that the court could rule on it as an issue of first impression: Is allocating commission wages

¹ Labor Code Section 204 also permits wages to be paid on a weekly or bi-weekly basis, but the principle is the same: Once commission wages are deemed earned, they must be paid on the next paycheck.

² This provision appears in Section 3 of Wage Orders 4 and 7.

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back over prior pay periods legal under California law? The California Supreme Court reframed the question as follows:

May an employer, consistent with California's compensation requirements, allocate an employee's commission payments to the pay periods for which they were earned?

Under federal law the answer to the question would be yes, and the issue for the California Supreme Court was whether the answer is the same under state law.

DECISION

The California Supreme Court began its analysis by noting that "we narrowly construe exemptions against the employer, and their application is limited to those employees plainly and unmistakably within their terms."

While TWC paid regular wages every two weeks, it paid commissions based on a roughly monthly basis. TWC noted that the Labor Commissioner had observed in an opinion letter "commission programs which calculate the amount owed once a month (or less often) are common." The Supreme Court noted that the statement in the Labor Commissioner's letter did not connote approval of monthly pay periods, and pointed out that under Labor Code § 204 all wages once earned must be paid. The California Supreme Court pointed out:

If a client routinely pays its bills on the 15th of each month, commissions will be earned and owed once a month. Yet this does not create a monthly pay period in contravention of section 204(a). To summarize, section 204 establishes semi-monthly pay periods but there is no obligation to pay unearned commissioned wages in any pay period. Commissions are owed only when they have been earned even if it is on a monthly, quarterly, or less frequent basis.³

The court went on to hold that under the commissioned-salesperson exemption in California law, the payment of earnings of more than 1.5 times the minimum wage must be paid in each pay period. Thus, unlike under federal law, employers in California who utilize the commissioned-salesperson exemption must pay 1.5 times the minimum wage for each hour worked in each pay period as well as meet the other requirements of the exemption.

One unstated but ironic implication of the decision is that TWC might well have qualified for the commissioned-salesperson exemption in all work weeks and pay periods if it had paid commissions in each of the pay periods when the commissions were earned.

LESSONS FOR EMPLOYERS

The position taken by the California Supreme Court with regard to the commissioned-salesperson exemption and the requirement of paying 1.5 times the minimum wage for each pay period has always been the position of the Labor Commissioner, and thus is not all that surprising, though it is inconsistent with federal law. In any case, many employers already ensure that their employees are being paid more than 1.5 times the minimum exemption wage for each hour worked during each pay period even if commissions are not calculated and paid until a later

³ Many commission plans provide that the commissions are not deemed earned until the customer has paid. When commissions are deemed earned is generally based on the terms of the commission plan.

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date. Thus, for those employers, the decision does not change anything with regard to meeting the requirements of the exemption. The decision may have some effect on employers whose commissioned salespersons are not making much more money than 1.5 times the minimum wage and may on certain occasions dip below that threshold, especially if commissions are calculated and paid on a less frequent basis than the payroll period.

Potentially more significant, the California Supreme Court made clear that nothing exempts commission payments from the requirements of Section 204 that employees must be paid for all wages earned on a semi-monthly, bi-weekly, or weekly basis once those commissions are deemed earned. Thus, employers would be wise to review their commission plans and make sure that commissions that are paid on a less frequent basis than the payroll period are truly earned in the payroll period in which they are paid. The implication of the California Supreme Court's decision is that commissions that are deemed earned before the 15th of the month under Labor Code Section 204(a) need to be paid by the 26th of the month; an employer should not wait until the monthly calculation of all commissions and then pay all earned commissions over the last month on a monthly basis.

Contact:

Lloyd W. Aubry, Jr.
(415) 268-6558
laubry@mofo.com

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