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California Supreme Court Ruling Limits Commission Wage Allocation

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On June 14, 2014, the California Supreme Court held that employers could not satisfy California's compensation requirements for the commission sales exemption by attributing commission wages paid in one pay period to other pay periods. This decision may have substantial impact on employers who pay employees on a commission basis, especially those employers who pay commission sales employees a base salary which is close to minimum wage.

Supreme Court decision in *Peabody*

In *Peabody v. Time Warner Cable, Inc.*, Case No. S204804, Time Warner contended that a former account executive was not entitled to overtime pay because she fell into the California's "commissioned employee" exemption. The exemption requires, among other things, that the employee's earnings exceed one and one-half times the minimum wage. The exemption also requires that more than half of the employee's compensation be commissions. Here, Plaintiff's hourly wages were only $9.61 an hour so they alone did not satisfy the requirement the employee be paid one and one-half times minimum wage. These hourly wages were paid every other week. Plaintiff's total compensation exceeded one and one-half times minimum wage when the hourly wages were combined with commissions paid the employee. However, commissions were paid only once a month. The commissions paid were earned throughout the proceeding one month period.

As a result, it was undisputed that, during some pay periods, the employee's earnings fell short of one and one-half times the minimum wage. In addition, it was undisputed that the Plaintiff regularly worked 45 hours per week and was paid no overtime. Time Warner claimed that the employee's commission payments should be reassigned from the biweekly pay periods in which they were paid to earlier pay periods in which they were earned. Time Warner argued that attributing commission wages in this manner would satisfy the exemption's minimum earnings prong and therefore free Time Warner of the obligation to pay overtime. The California Supreme Court rejected this argument and concluded that it was impermissible for Time Warner to attribute commission wages in this fashion.

First, the Court held that absent an express exception created by the legislature,[1] all wages, including commissions, must be paid no less frequently than semi-monthly. While there is no obligation to pay unearned commissions in any pay period (for example, commissions are not earned until receipt of client payment, which occurs only once a month), earned commissions, like all other wages, must be paid at least semi-monthly unless the payment falls within an exception.

The Court went on to hold that "whether the minimum earnings prong is satisfied depends on the amount of wages *actually paid* in a pay period," and that "an employer may not attribute wages paid in one pay period to a prior pay period to cure a shortfall." The Court explained that permitting wages paid in one pay period to be attributed to a different pay period was inconsistent with several labor code provisions and that the DLSE's enforcement policy requires payment of more than one and one-half times minimum wage in each pay period.

Responding to arguments based on federal wage and hour law, the Court differentiated federal and state law stating that, unlike state law, "federal law does not require an employee to be paid semimonthly," and "permits employers to defer paying earned commissions so long as the employee is paid the minimum wage in each pay period." Given these differences, the Court cautioned employers against reliance on federal authorities when construing state regulations.

Implications for California Employers

As a result of the decision, California employers seeking to rely on the commission sales exemption need to ensure that employees are paid at least one and one-half times minimum wage each pay period. Minimum wage is currently $9.00 per hour (going up to $10.00 per hour January 1, 2016) meaning that total compensation under the commissioned sales exemption must be at least $13.50 per hour in every pay period. Because the exemption only applies if more than half the employee's compensation is commissions, increasing the base wage may be an unappealing option. Paying commissions in the pay period (at least semi-monthly) in which they are earned, as *Peabody* requires, will help resolve this issue. This will add to the administrative burden, but is now clearly required.[2]

If there are still pay periods in which total earnings do not reach one and one-half times minimum wage, the best alternative may be to allow employees to draw against future commissions so as to guarantee the minimum required semi-monthly payment. However, if employees regularly fail to actually earn the required commission, this methodology may be viewed as a subterfuge to avoid overtime.

Employers should also remember that Federal law only allows the commission sales exemption if the employee works for a retail or service establishment. Thus many employers are not eligible for use of the exemption under Federal law and overtime will need to be paid unless another Federal exemption applies.

[1] The Court explained that exceptions include certain executive, administrative and professional employees and commissioned care salespersons.

[2] The DLSE's enforcement policy allows commission wages to be paid in the pay period when they are reasonably calculable. This supports payment of commissions in the following pay period if they cannot reasonably be calculated and paid in the pay period in which they are earned as when, for example, commissions are earned on receipt of payment from the customer and payment is received on the last day of the pay period after payroll has been submitted. The Court did not address this specific issue in *Peabody*.

Employers should also remember that the California commission sales exemption only exempts employers from paying overtime. For employees covered by the commissioned sales exemption, the employer is still required to record the clock times of the start and stop of each work period, provide the employees with meal and rest breaks (and pay premium pay if it fails to do so) and otherwise comply with legal requirements applicable to non-exempt employees.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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