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Inside-Sales Exemption Jeopardized By Deferred Payment Of Commissions

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On July 14, 2014, the California Supreme Court clarified that an employer may not attribute commissions paid in one pay period to a prior pay period in order to satisfy California's minimum-wage requirement or meet the inside-salesperson exemption. The Court's decision will require employers throughout California to review their commission pay practices. *Peabody v. Time Warner Cable, Inc.*

Facts Of The Case

Under an account-executive compensation plan, Time Warner paid Susan Peabody hourly wages on a semimonthly basis and commissions on a monthly basis. She regularly worked more than 40 hours per week selling advertising and was never paid overtime. Time Warner argued that Peabody fell within the commissioned-employee exemption from overtime, which applies to inside salespersons who earn more than one and one-half times the minimum wage for all hours worked in a pay period and who derive at least half of their compensation from commissions.

In her class action suit, Peabody argued (and Time Warner acknowledged) that her semimonthly paychecks did not meet the minimum-compensation requirements under the exemption and on certain occasions resulted in Peabody earning less than the minimum wage. Time Warner argued that her commissions should be attributed to the pay period in which they were *earned* for purposes of meeting the exemption's minimum-salary requirement and satisfying the minimum-wage obligation.

Finding no controlling authority, the Ninth Circuit asked the California Supreme Court to consider whether Peabody's commissions could be allocated to a prior pay period.

The Court's Ruling

In a unanimous decision, the California Supreme Court held that in order for the inside-sales exemption to apply, the minimum earnings component "must be satisfied in each workweek and paid in each pay period." The court found that allocating commissions as advocated by Time Warner would run afoul of California's requirement that employees be paid all earned wages at least semimonthly.

In addition, the Court noted that an employer's ability to establish, by written agreement, conditions necessary for a commission to be "earned" (which may still occur on a monthly, quarterly, or less-frequent basis) does not override the requirement for at least a semimonthly pay period established by California *Labor Code* section 204(a). Under the same logic, the Court held an employer may not reassign commissions paid in one pay period to cover a minimum wage shortfall in a previous pay period.

The Impact On Employers

Clearly this decision will affect many industries, the most obvious of which may be the retail industry. Given that employers bear the burden of establishing that an exemption from overtime applies, all employers should review their commission-pay plans to ensure that they comply with this decision.

In pay periods when commissions are not paid, take care to ensure that commissioned-sales employees earn more than one and one-half times the minimum wage (currently, $13.51 per hour) for all hours worked during that pay period. Failure to do so could expose your company to class-action litigation involving claims of misclassification and liability for unpaid wages and penalties.

The fact that an employee is highly compensated is not determinative of whether he or she is exempt. Peabody earned roughly $75,000 in ten months of working for Time Warner. Still, based on Time Warner's commission-pay practices, she may have been entitled to overtime during the weeks in which no commissions were paid.

For advice on crafting and implementing a commission plan that complies with the California Supreme Court's recent decision, contact an attorney in one of the California offices of Fisher & Phillips LLP:

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This Legal Alert provides an overview of a specific California Supreme Court case. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

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