

July 15, 2014

California Supreme Court Clarifies Requirements of Commissioned Employee Exemption

By Stacey E. James and Joshua D. Levine

In recent years there has been substantial litigation regarding whether and how employers may satisfy California minimum wage requirements for compensation plans involving commissions. In *Peabody v. Time Warner Cable, Inc.*, the California Supreme Court cleared up at least one source of confusion by concluding that employers must *actually pay* sufficient wages *each pay period* to satisfy the state's minimum wage requirements and the minimum compensation requirements for California's commission sales exemption. Employers may not allocate commissions paid in one pay period to satisfy minimum compensation shortfalls in prior pay periods.

Background and Procedural History

The plaintiff is a former account executive for Time Warner Cable whose primary responsibility was selling advertising time. The company compensated the plaintiff through an annual base salary of \$20,000, paid proportionately through bi-weekly pay periods, and commissions, paid once per month. The company did not pay the plaintiff overtime wages because it had classified her as exempt under the commission sales exemption. Certain employees who are covered by California Wage Order 4 (Professional, Technical, Clerical, Mechanical, and Similar Occupations) or Wage Order 7 (Mercantile Industry) qualify for the commission sales exemption if their earnings exceed 1.5 times the minimum wage, and more than half of their total compensation represents commissions.

The plaintiff worked for the company for only 10 months. During that time, she received \$74,464 in total compensation, including \$57,134 in commissions. Despite her relatively high overall compensation, the plaintiff filed a putative class action alleging overtime and minimum wage violations, as well as derivative claims for late payment of wages and wage statement violations. Her lawsuit relied on the fact that during pay periods when she received only her bi-weekly salary, her salary was insufficient to cover the company's minimum wage obligations and/or the minimum compensation requirements of the commission sales exemption. Specifically, the plaintiff claimed that when she worked 48 hours or more, her bi-weekly salary did not amount to at least \$8 per hour for every hour worked, and even when she worked only 40 hours per week, her bi-weekly salary did not amount to more than \$12 per hour (1.5 times minimum wage) for the commission sales exemption.

The company removed the plaintiff's case to the U.S. District Court for the Central District of California and filed a motion for summary judgment. The company argued that the plaintiff's salary alone was enough to satisfy minimum wage obligations for all hours worked by the plaintiff each pay period. The company argued further that it could lawfully allocate commissions paid during the second pay period of each month to all hours worked in both the current and prior pay periods to satisfy the minimum compensation requirements of the commission sales exemption.

In November 2010, the district court granted the company's motion, concluding the plaintiff's minimum and overtime wage claims improperly disregarded the tens of thousands of dollars she earned from commission payments.

The plaintiff appealed to the Ninth Circuit which, in turn, certified the following question to the California Supreme Court: "May an employer, consistent with California's compensation requirements, allocate an employee's commission payments to the pay period for which they were earned?"

The Decision

The California Supreme Court issued its decision in *Peabody* on July 14, 2014, unanimously concluding that an employer may not attribute commission wages paid in one pay period to prior pay periods in order to satisfy California's compensation requirements.

Under *Peabody*, an employer must pay more than 1.5 times minimum wage for every hour worked *each pay period* to employees classified as exempt under the commission sales exemption. An employer cannot satisfy this minimum compensation obligation by allocating commissions paid in later pay periods to wage shortfalls in earlier pay periods. This is true even when work done to help earn the commissions was completed in the earlier pay periods.

The court also confirmed that an employer may not satisfy its minimum wage obligation by allocating commission payments in later pay periods to minimum wage shortfalls in earlier pay periods. Rather, an employer must pay at least minimum wage for every hour worked *each pay period*.

The California Supreme Court's decision rested largely on Labor Code section 204, which states that all wages earned are due and payable *at least twice each calendar month*, and on the commission sales exemption, which states that an employee must earn more than 1.5 times the minimum wage to qualify for the exemption. While the court acknowledged employers need not pay unearned commissions each pay period, the court held that an employer must pay wages in excess of 1.5 times minimum wage for every hour worked *each pay period* in order to satisfy the commission sales exemption. Similarly, the court concluded that an employer must pay at least the minimum wage (\$8 per hour during the plaintiff's employment) for every hour worked each pay period to satisfy its minimum wage obligations because the Wage Order (Wage Order No. 4, subd. 4(B)) requires employers to "pay to each employee, *on the established payday for the period involved*, not less than the applicable minimum wage for all hours worked in the payroll period"

The court also distinguished the federal commissioned employee exemption in 29 U.S.C. section 207(i), holding that California law differs from federal law on this issue because federal law does not require an employee to be paid semimonthly.

Complying With California Law Post-*Peabody*

Employers that classify employees as exempt under the California commission sales exemption should carefully review their pay policies in light of *Peabody* to ensure compliance with California's minimum compensation requirements. Employers should also consider reviewing their payment amounts to employees covered by the exemption to ensure they are actually receiving in excess of 1.5 times the minimum wage for every hour worked each pay period regardless of how often commissions are earned.

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