



# Appeasing The 3-Headed Monster For Incentive-Paid Employees

Insights

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Many California employers are familiar with the three-headed monster of medical leave questions: family medical leave (state and federal), disability leave and accommodation, and workers' compensation leave. The wage and hour laws of California have evolved to create a three-headed monster of their own when it comes to compensating employees paid in part by certain types of incentive-pay systems (most commonly commissions and piece-rates).

Many employers rely on commissions and piece rates to reward employees and promote productivity at much higher levels than can be provided with simple hourly pay. But employers that desire to continue motivating employees with incentive pay are now required to satisfy a number of prerequisites. California courts and recent legislation have made clear that employees paid in whole or in part by incentive pay must be compensated by systems that separately account for (1) productive pay, (2) nonproductive pay, and (3) rest-heat recovery period pay. For each of these three zones, employers must satisfy certain minimum compensation standards fixed by public policy. This includes establishing a method of tracking incentive compensation, hours worked, rates of pay and/or units produced, and total resulting compensation.

## First Head: Productive Pay

Productive pay, characterized by commissions or piece rates, is deemed to pay only for working time that is considered "productive time." Of course, the distinction between productive time and nonproductive time is a matter of debate, and court decisions on this issue are not always intuitive or in accordance with common understanding. Therefore, unless employees are paid an hourly rate for all hours worked, time spent on this category of work should be outlined in a carefully crafted agreement that is reviewed by legal counsel.

For example, in a recent federal lawsuit brought by piece-work truck drivers, the compensation agreement at issue specifically identified safety inspections performed before and after the deliveries as part of the activities for which they would be compensated by the piece rates. Nonetheless, the drivers contended that their time doing so was nonproductive work that should be separately compensated. Although the piece-work agreement was well drafted, a federal judge determined that the inspections were not productive work under California law and therefore not covered by the piece-rate agreement.

Although this federal decision was not binding on California state courts, state appellate courts soon followed its lead. In 2013, one such court held that piece-rate truck drivers had to be paid separately at least at the applicable minimum wage or contract hourly rate for time spent on rest periods. Another state appellate court later held in 2017 that salespersons paid by commissions had to be paid separately for their rest periods (*Vaquero v. Stoneledge Furniture*).

In 2015, the California legislature passed AB1513 to establish standards for compensating piece-rate workers. The resulting new Labor Code section 226.2 included the pay requirements for three different types of activities: productive work, rest and recovery period time, and “other” nonproductive work. There is no similar statute for commission-paid employees.

Under current state law, employees compensated solely by commissions or piece rates for productive time must be paid the greater of their commissions, piece-rate pay, or the applicable minimum wage (the greater of local, state, federal minimum wage, or contract hourly rate) for such time. In any such situation, it is critically important for employers to keep meticulous and thorough timekeeping records.

## **Second Head: Nonproductive Pay**

Nonproductive pay involves work activities not directly producing the product or service compensated by the incentive pay. Although you might think that nonproductive work logically would include rest and heat recovery periods, Section 226.2 has carved out rest periods separately for piece workers and creates the separate category of “other nonproductive work.”

The statute further details that time spent on “other nonproductive work” can be determined by an employer’s “actual records” or the employer’s “reasonable estimates.” Following a July 26 decision by the California Supreme Court which declined to apply the federal *de minimis* rule to situations where an employee routinely performed quantifiable but unpaid tasks (*Troester v. Starbucks*), a “reasonable” estimate will no longer permit an employer to ignore or overlook work that is routinely performed or subject to reasonable quantification depending upon the applicable facts and circumstances. This recent decision further emphasized California’s strong public policy of ensuring employees are paid for all hours worked. This public policy is further manifest in the evolving compensation requirements for employees paid by piece rates or commissions.

There is an exception, however. If an employee, in addition to the piece rate, is paid an hourly wage at least at the applicable minimum wage for all hours worked, the time spent on nonproductive work is deemed to be included in total compensation and does not have to be separately accounted for. Although Section 226.2 addresses only piece workers, this principle tracks general compensation principles and should apply as well to workers compensated by other forms of incentive pay, including commissions paid to salespersons who also receive a base hourly rate for all hours worked.

## **Third Head: Rest and Recovery Periods**

The third compliance time zone involves rest and recovery periods. In California, an employee must be provided a 10-minute paid rest period for every four hours of work “or major fraction thereof,” which should be taken if practicable in the middle of the work period. Employees working in temperatures of 80 degrees Fahrenheit or greater are also entitled to five-minute paid heat recovery periods in the shade upon request.

*Troester* made clear that exactly 10 minutes of rest period time must be compensated without any reduction under the *de minimis* doctrine. Time spent on recovery periods similarly must be tracked and paid.

For piece workers, Section 226.2 requires that this time (accumulated each week) must be paid at the greater of (A) the average hourly rate determined by all weekly compensation (except for compensation paid for rest and recovery periods and overtime premiums divided by all hours worked in the week except time for legally required rest and recovery periods); or (B) the applicable minimum wage (the greater of local, state, federal minimum wage, or contract hourly rate). For piece workers who are paid a base hourly rate for all hours worked (described above), the difference between that rate and the *average hourly rate* (if greater), can be paid as an additional premium.

In certain situations, an additional pay period is permitted to calculate the rest-recovery period premium. Employees paid commissions or other forms of incentive pay for productive time generally must be paid for this time as set forth by *Vaquero* and other cases.

### **Bonuses And Other Forms Of Pay**

There are other methods of incentive pay that do not fall neatly into the category of piece rate or commissions. Furthermore, in California, the concept of “commissions” is a term of art consisting of proportional incentive payments made only to employees who are regularly engaged in selling an employer’s products and services (Labor Code section 204.1; *Areso v. CarMax* (2011)).

### **Battling The Three-Headed Monster: Where To From Here?**

In summary, the requirements created by the three-headed monster have led compensation plans with multiple pay elements to become increasingly complex, especially given *Troester’s* recent mandate regarding the importance of strict timekeeping. Therefore, although it is no easy task, creating workable and legally compliant compensation plans under the new standards is essential.

Because California monitors for minimum wage compliance in these three zones of working time, employers should take precautions to ensure you stay on the right side of the law. Among other things, you should monitor timekeeping procedures to assure compliance with the new *Troester* decision. Further, you should properly establish the pay intervals required by law, while also determining draws and reconciliation procedures to comply with applicable overtime exemptions (e.g., commission employees under Wage Orders 4 and 7). Finally, it remains vitally important to summarize compensation properly on pay statements.

It follows that, more than ever, you now must conduct internal audits and consult legal counsel when creating incentive pay systems to ensure they comply with all the emerging contours of California wage and hour law. If you haven't done so lately, now would be the perfect time to reach out to knowledgeable wage and hour counsel to ensure compliance.

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