California Financial Advisors Lacking Fixed And Predetermined Salary Not Subject To Administrative Salaried Exemption

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In California, all employees are presumed to be entitled to overtime, meal periods, and other wage-and-hour regulations unless an employer can prove that its employees "plainly and unmistakably" fall within the terms of an exemption. A recent appellate case addressed for the first time whether a compensation plan based solely on commissions, with a recoverable draw against future commissions, qualifies as a "salary" for purposes of the administrative exemption. The appellate court, reviewing the pay system in question, reversed a trial court decision on November 9 and concluded that it did not. What do California employers need to know about the *Semprini v. Wedbush Securities, Inc*. decision?

California Wage And How Law Basics

The California salaried exemptions for employees working in professional, administrative, and executive capacities provide for an exemption from, among other things, overtime, minimum wage, timekeeping, and meal and rest periods. To gain this exemption, these workers must satisfy specified duties requirements and are paid a fixed and predetermined salary that complies with the "salary basis" rules which is no less than two times the state minimum wage for full time employment, which is defined as 40 hours per week.

That means that, if the minimum wage is $14 per hour, then the minimum weekly salary must be no less than $1,140 per week and $4,940 per month. Although the general rule is that an employee is entitled to a full week's salary for any week in which they work, however minimal, the "salary basis" rules provide for certain deductions in full-day increments for time off, such as personal leave or sick leave when the benefit bank is empty. The salary is not otherwise subject to reduction. With a few exceptions, the California "salary basis" rules track the federal rules.

What Did Recent Appeals Court Decision Conclude?

In the *Semprini* case, the employer was a securities broker-dealer firm that provided financial planning and investment products through its commissioned employees designated as financial advisors, who were classified as exempt under the administrative exemption. Although these employees performed duties that the parties stipulated complied with the duties requirements for administratively exempt employees, the issue was whether they received the required salary on a "salary basis."

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The appellate court noted that neither the California Labor Code nor the applicable Wage Order 4-2001 defined a salary or what is meant by being paid on a "salary basis." The court reasoned, however, that the regulations indicated that an employee is paid on a salary basis if the employee "regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed." 29 C.F.R. § 541.602(a) (2019).

Notably, although the employees in the case received draws each month which were sufficient to bring their pay to the minimum salary level required by the regulations, what happened in reality is that it was actually a 100% commission pay system. For example, if commissions actually earned by the financial advisors were less than the draws paid for the month, the difference would be carried forward and owed like a debt until repaid. Indeed, the employer designated its financial advisors as "commission-only employees." Following a bench trial, the trial court ruled that the employees were administratively exempt employees who had, among other things, received the requisite salary under the salary basis rules.

The employees appealed and the appellate court reversed, finding that the employees, as "commission only," were not paid on a salary basis even though a recoverable draw had been paid periodically in an amount that would meet the required salary amount. Among other things, the court noted that the employer's own documents stated, "Nothing in this policy shall be interpreted to mean that production and commissioned personnel are paid a salary; they are paid on a commission basis only, and draws are advances against earned or unearned commissions." Although the employer argued that such language should be disregarded, the appellate court disagreed.

The court noted that there was "conflicting evidence in the record as to what happens if a financial advisor's employment is terminated before he or she has repaid all draws." The appellate court reasoned that, if the draws had to be repaid on separation, situations could arise where these employees may have essentially worked for free, which would be a violation of both minimum wage and the salary basis requirement for the exemption.

The court surmised using a hypothetical that, if a financial advisor sold no products for the first three months of their employment despite working 50 hours per week, then earned zero commissions, the employer would have "advanced the employee the equivalent of twice the monthly minimum wage for those first three months." If the financial advisor were terminated at the end of the three-month period and forced to repay all of the commissions advances, "that employee would receive net zero compensation for the time he or she worked."

In any event, what was required to defeat the salary basis was only that the employees had not received, clear and free, the fixed and predetermined salary or guarantee. The appellate court recognized in a footnote that the regulations did provide that "an employer may provide an exempt employee with additional compensation without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum

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weekly-required amount paid on a salary basis," citing 29 C.F.R. § 541.604(a) (2019). But the court recognized that the problem with the employer's 100% commission system was that there was no such guarantee, or fixed salary-basis payment, that was paid even when commissions were less than the guarantee, not subject to recapture or charge backs in future pay periods when commissions were less than the draws paid.

Being Paid In Part Based On Incentives Does Not, Standing Alone, Destroy The "Salary Basis"

Although the *Semprini* court rested its analysis in part on the fact that salaried employees cannot be paid simply based on production without a guaranteed salary element, it's clear that the mere fact that employees are paid additional incentives beyond the guaranteed salary will not destroy the "salary basis." For example, in the 1997 case of *Boykin v. Boeing Co.,* the 9th Circuit Court of Appeals ruled that an employer's payment of additional compensation to salaried exempt employees beyond the fixed salary level, including overtime payments, would not destroy the salary basis. Indeed, the court reasoned that the "extra compensation may be paid … to an exempt employee on any basis."

The California Labor Commissioner's guidance manual, although not binding regulation, still flags *Boykin* for the proposition that "additional compensation besides the required minimum weekly salary guarantee may be paid to exempt employees … without affecting the salary basis of pay." Division of Labor Standards Enforcement Policies and Interpretations Manual ¶ 51.6.20 (June 2002) (citing *Boykin* 128 F.3d at pg. 1281).

What Should Employers Do?

Clearly, in the *Semprini* case, the court had many facts upon which to assert that the employer's 100% commission plan – which disclaimed any suggestion that it was a salary, created recoverable draws, and possibly pushed indebtedness after separation of employment – did not support a salary basis element.

The easiest way to avoid a challenge similar to *Semprini* is to simply pay a salary in addition to commissions and avoid any pay scheme that creates an indebtedness that would negate the requirement of a fixed and predetermined salary.

However, many employers may prefer structuring pay in ways that were not expressly problematic in *Semprini*. This could include maintaining an incentive plan whereby you pay a qualified executive or administrative employee a salary-basis guarantee beyond which employees may receive additional incentive compensation to reward them for their efforts, whether for extra hours or sales production, without destroying the salary basis. You could argue that, during periods when the guarantee amount is greater than calculated commissions, the employees would receive the salary-basis guarantee which would not be subject to chargeback, in whole or in part, in future pay periods, nor create a debt for repayment upon separation of employment.

The *Semprini* decision may spur additional decisions and distinctions not before the appeals court at the time it rendered this opinion. Employers therefore should exercise caution and seek legal counsel when drafting hybrid salary and commission pay plans.

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counsel when drafting hybrid salary and commission pay plans.

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