California Supreme Court Issues Two Big Decisions

Insights
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The California Supreme Court ended the summer with a bang by announcing two major decisions which could have far-reaching effects. Here is a brief overview of the implications of each case to California employers.

Bonus Plans Based On Profitability Upheld
In the first case, announced August 23, 2007, the California Supreme Court reviewed a bonus plan that paid to certain employees a percentage of the profits generated by the stores in which they worked. Because incentive-based compensation arrangements are common in today's business environment, employers have been anxiously awaiting the Court's decision in this case. The decision upheld the bonus plan. *Prachasaisoradej v. Ralph's Grocery Co., Inc.*

The primary issue in the case was whether a profit-based bonus plan could permissibly include workers' compensation costs as part of the overhead costs typically deducted from revenues for purposes of calculating profits. The appellate court decision, which was reversed by the Supreme Court, had previously held that this plan impermissibly shifted the costs of doing business to employees in violation of a statute prohibiting the deduction of workers' compensation costs from wages.

The Supreme Court held that the bonus was permissible because it was not part of (nor did it deduct from) an employee's guaranteed compensation. Instead, it constituted a variable-incentive payment determined from a store's profitability, and it was intended to supplement the employee's "regular" pay. Contrasting this bonus plan with compensation plans where an employee's earnings are directly reduced by losses beyond the employee's control, the Court reasoned that the costs factored into profitability from which the bonus was determined did not amount to an unlawful "deduction" from an earned wage.

Rather, the Court noted that Ralph's had actually absorbed the costs in question, and the company considered such costs only in determining profitability under the formula from which the bonus, if any, was calculated after comparing the store's profits against pre-determined targets. Even commission-based plans may lawfully make commissions contingent on various factors or events before they are deemed to be earned wages, and advances against anticipated commissions can be recovered from employees if certain specified conditions are not satisfied, according to the decision.

How Does This Decision Impact You?

This case is good news for employers because it rejected an earlier ruling that profit-based bonuses are automatically violations of State law merely because workers' compensation costs (or other similar overhead costs or losses) may affect the profit calculation. This decision is also a big win for employers because it allows flexibility in structuring bonus plans. By allowing bonuses to be awarded based on overall profitability, such plans can provide incentives for managers to ensure productivity in their workforces.

Nevertheless, employee advocates will be quick to argue that the decision is limited in its scope to bonus plans above and beyond regular wages, although good arguments exist that its impact could extend to some appropriately drafted commission plans. Because the legal implications of this case could be far reaching, it's important to have legal counsel review your bonus plans and other incentive-based compensation arrangements to ensure that they comply with California law. Let us know if you would like our help with your company's commission or bonus plans.

Arbitration Agreements Containing Class-Action Waivers Now Suspect
In a second case announced August 30, 2007, the Court analyzed a class action waiver contained in an arbitration agreement. *Gentry v. Superior Court*.

Circuit City required its employees to sign an arbitration agreement which provided that employees must agree to arbitrate their employment-related claims, but the agreement did not give the arbitrator authority to consolidate claims from different employees into one arbitration proceeding nor to hear a class action. The claim at issue was a demand for unpaid overtime.

In a 4-3 decision, the Supreme Court held, among other things, that the "prohibition of class wide relief would undermine the vindication of the employees' unwaivable statutory rights and would pose a serious obstacle to the enforcement of the state's overtime laws." In reaching this decision, the Court reasoned that an employee's right to receive overtime is unwaivable and that class litigation may be the only effective way to enforce the overtime laws in certain situations.

The Future

What effect will this case have on the California employment law landscape? Among other things, it eliminates one advantage of arbitration agreements for employers. No longer can an employer depend on an arbitration agreement to preclude a case from continuing as a class action. Although the enforceability of class-action waivers in arbitration agreements will be viewed on a case-by-case basis, the language used in the decision makes clear that, in most wage-and-hour cases seeking unpaid overtime, a blanket class-action waiver will not be enforced.

For a more detailed discussion regarding the enforceability of your company's arbitration agreements, advice concerning your company's bonus plan, or to discuss any aspect of these two cases, contact any California office of Fisher Phillips at 949.851.2424 (Irvine), 858.597.9600 (San Diego) or 415.490.9000 (San Francisco).