New California Law Affects Commission-Paid Employees

Insights
12.13.12

Beginning January 1, 2013, a new California law requires that employees who are paid on commission must be provided a written contract which sets forth the method by which the commission shall be computed and paid. This new law further requires that the employer provide a signed copy of the commission agreement to the employee and obtain a signed receipt for it.

Some Definitions
The definition of "commission" covered by this law is fairly straightforward: a payment for services rendered in the sale of the employer's goods or services that is based on a percentage of the sale price or of the profit made on the sale. Short-term productivity bonuses paid to retail clerks do not qualify as commissions, nor do temporary, variable-incentive payments (sometimes known as "spiffs") that increase, but do not decrease, payment due the employee. Finally, bonus and profit-sharing plans are not covered unless they involve payment to the employee of a fixed percentage of sales or profits.

But the new law is less clear whether employers having existing commission agreements with their employees must implement new agreements on or before January 1 that comply with this new law. Certainly if the terms of a commission agreement are changed in any way after January 1 this law's requirements will have to be met. Likewise, an employee who has only an oral commission agreement should be provided with a written agreement that complies with this law by January 1. The safer approach will be for all employers who pay employees on commission to provide written agreements that comply with this new statute by the first of the year.

Some Specifics
When writing a commission agreement, three provisions are particularly important. First, the method of computing the commission must be described completely. For example, if a commission is based on revenue, is it the amount invoiced or the amount collected? If a commission is based on the

employer's "profit" on a transaction, how is that profit determined? All internal costs assessed against a sale to determine its profit must be disclosed. If chargebacks for returned items are assessed against future commissions this must be disclosed as well.

Second, the agreement must be clear when the commission is "earned," so that the employee's entitlement to commissions upon termination of employment is clear. For example, is the commission deemed earned when the sale is booked, when the product is delivered, or when commission deemed earned when the sale is booked, when the product is delivered, or when payment is received? You will have some flexibility regarding how much of a commission will be paid for sales not yet completed when employment terminates, but the terms must be clearly explained.

Third, the agreement should explain how draws will be applied to commissions. Will the draw be forgiven if it is not met (such that it is essentially a guarantee)? Or will unmet draws be carried forward?

The agreement also should state the period for which commissions will be calculated (e.g., monthly), and when commissions will be paid. Where inside salespersons are involved, the agreement should include language stating that the employee will be provided with required meal and rest breaks, as inside salespersons are not exempt from these breaks even though they may be exempt from overtime in some businesses.

Related Concerns
Speaking of overtime, remember that not all commissioned salespersons are exempt from overtime. Outside salespersons are exempt if they spend more than half their working time out of the office making sales. Inside salespersons are only exempt under Wage Orders 4 and 7, and then only when more than half of their pay is in the form of commissions and their regular rate of pay exceeds one and one-half times the minimum wage.

Inside salespersons for manufacturing companies (Wage Order 1), personal-service businesses (Wage Order 2), hotels and hospitality businesses (Wage Order 5) and transportation businesses (Wage Order 9) are not exempt. Overtime must be paid to inside salespersons in these industries, and commissions paid must be taken into account in determining the employee's "regular rate" from which overtime is calculated.

Finally, any written commission agreement should contain employment-at-will language reaffirming that either the employer or employee may terminate the employment relationship at any time for any reason, with or without prior notice.

Action Needed
If you have commission-paid employees, you should determine now whether to implement a new commission agreement for them before January 1. You must comply with this new law with respect to commission-paid employees who are hired in the new year, or whose pay plans will change in the new year.

For more information about how to implement this new law or how it may affect your business, contact an attorney in one of Fisher Phillips's California offices:

Irvine: (949) 851-2424
Los Angeles: (213) 330-4500

San Diego: (858) 597-9600
San Francisco: (415) 490-9000

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