

Management Alert

California Supreme Court Refuses to Hear Case Involving Narrow Definition of Exempt Commissioned Employee and Expansive View of the Unfair Competition Law

On June 28, 2006, the California Supreme Court denied review of *Harris v. Investor's Business Daily, Inc.*, 138 Cal. App. 4th 28 (2006), leaving in place a problematic decision for employers with California employees. Harris was a telemarketer selling newspaper subscriptions. She claimed she was not overtime exempt and filed a class action lawsuit. In it, she sought to certify two classes: (1) on behalf of employees who were misclassified as exempt and denied overtime, and (2) on behalf of employees who were subject to an unlawful commission deduction. The trial court certified a class on the unlawful commission deduction claim, but did not certify the class on the overtime claim. Harris then amended the complaint, adding an unfair competition claim under California law for unpaid overtime under the federal Fair Labor Standards Act (FLSA). The trial court dismissed the new claim and granted summary judgment as to the remaining claims. The court of appeal overturned the trial court and issued a number of troubling rulings.

Payments Received Did Not Constitute Commissions

Under California law, to constitute a commission, two requirements must be met: (1) the employees must be involved principally in selling a product or service, and (2) the amount of their compensation must be a percentage of the price of the product or service. The Court of Appeal held that Harris was not paid on a commission basis because aspects of her compensation plan were not based on a percentage of the price of the product sold, but rather on points earned on sales. The employees could earn additional points for reasons independent of the price of the product sold. This is a narrow construction of what constitutes a commission for purposes of state wage and hour law. This interpretation may impact a number of national employers with commission based compensation programs.

The Jury Must Decide Whether the Chargeback Policy Was Lawful

Next, the court of appeal concluded that the employer failed to prove that its chargeback policy was lawful. California Labor Code section 221 prevents an employer from taking back any wages from an employee after they are earned. Commissions are wages and, thus, an employer cannot take them back after the employee earns them. The court found that the employees were charged back the points earned from a sale if the customer cancelled within 16 weeks. The question is then “at what point the commission is ‘earned’ and therefore vested?” The court sent the issue back to the trial court for a determination on the plan’s validity. Importantly, the employer’s policy did not contain the elements that led the court of appeal to hold lawful a chargeback policy in another leading commission rules case, *Steinhebel v. L.A. Times Communications, LLC*, 126 Cal. App. 4th 696 (2005). The chargeback policies described in *Steinhebel* and *Harris* were similar, except that the policy in *Steinhebel* expressly characterized the payment to the employee as an **advance** on commissions. The compensation plan in *Harris*, by contrast, was silent on whether the payment the salesperson received was an advance. The court held that it was for a jury to decide whether the payments at issue were earned or merely advanced.

An Unfair Competition Claim Can Be Based on an FLSA Violation

The court of appeal held that a California Unfair Competition claim can be based on a federal FLSA violation. Thus, a single state law unfair competition cause of action alleging violations of the FLSA is not preempted by the FLSA’s opt-in requirement for collective actions. This creates the procedural oddity that the federal statutory requirement that claimants opt-into the collective action can be circumvented by California procedure requiring inclusion in the class with an opt-out opportunity.

What the Supreme Court Decision Means for Employers

The California Supreme Court unanimously denied review of the lower courts’ rulings. Unless another court of appeal holds otherwise, the rulings in *Harris* are binding on all trial courts (although not on other appellate courts). That means:

- The definition of “commission” under *Harris* is narrow and specific. If there are aspects of a compensation plan that are not based on a percentage of the price of the product sold, such payments may not constitute commissions for purposes of the Commission Sales Exemption.
- Employers should be cautious in defining terms of performance-based compensation plans that provide for chargebacks. A written plan that is consented to by the employees, characterizing payment as an **advance** on commissions not earned until specific conditions are met, has a much better chance of surviving court scrutiny. Plans that refer to chargebacks or that fail to clearly identify conditions under which the commissions are earned are at risk. This is particularly true if the time period during which compensability is an open question is lengthy.
- An employee can base a California Unfair Competition claim on the FLSA, which has the effective result of extending the statute of limitations to four years and eliminating the opt-in requirement. This extension results from the fact that the ordinary statute of limitations period on an FLSA claim is two years, and an unfair competition claim incorporating the FLSA violation may be subject to a four-year statute of limitations.

If you have any questions or need additional information, please contact the Seyfarth Shaw LLP attorney with whom you work or any California attorney on our website at www.seyfarth.com.