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Management Alert

California Supreme Court Construes "Commissioned Employee" Exemption To Favor Employees

By Vamsi Vemuru and David D. Kadue

Once again, California's highest court has reminded California employers that the law they face is more onerous than the federal law that applies generally. At issue in *Peabody v. Time Warner Cable, Inc.* was the breadth of California's exemption for commissioned salespersons. Under certain Wage Orders, California employees generally are not eligible for overtime pay if they earn more than 150% of the minimum wage and receive more than one-half of their earnings from commissions.

When an issue arose in a Ninth Circuit case as to how those standards apply, the Ninth Circuit asked the California Supreme Court for an advisory ruling. The response was this: employers may *not* attribute the commission wages paid in one pay period to other pay periods in order to satisfy California's compensation requirements. More generally, the Supreme Court's advice was that an employer may not use the wages paid in one pay period to cure a shortfall existing in a prior pay period.

The Supreme Court thus narrowly construed the "commissioned employee" exemption against employers, holding that the exemption's minimum earnings prong may be satisfied only by the amount of wages *actually paid* in a pay period, and not by commissions attributed to that pay period that are paid weeks, or months, after the pay period has ended. The Supreme Court's literal statutory reading creates challenges for employers that want to follow traditional commission pay practices.

The Facts

The Plaintiff, Susan Peabody, was a Time Warner account executive who sold advertising on the company's cable television channels. Every other week, Time Warner paid Peabody $769.23 in hourly wages—or $9.61 per hour for a 40-hour week—an amount that was less than 150% of the then-current California minimum wage of $8 per hour. Meanwhile, on a monthly basis, Time Warner paid Peabody her commissions under a compensation plan.

Peabody sued Time Warner for unpaid minimum and overtime wages. First, she asserted that during some weeks she worked so many hours that the $769.23 payment did not meet the $8 minimum wage. She also asserted that the commissioned salesperson exemption did not apply during the pay periods in which she received only hourly wages, because during those periods she was not receiving more than one-half of her earnings from commissions.

The Lower Court Decisions

After Time Warner removed the case to federal court, the district court granted Time Warner's motion for summary judgment. The district court recognized that although Time Warner issued Peabody a paycheck every two weeks, Time

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Warner permissibly used a monthly pay period for her commissions, which, when allocated over periods for which Peabody was earning the commissions, enabled Time Warner to satisfy the requirements for the commissioned salesperson exemption.

On appeal, the Ninth Circuit, finding no controlling California precedent, asked the California Supreme Court to rule on whether Time Warner could allocate Peabody's commissions over the course of the month for which she earned the commissions, or whether instead the payment of commissions could be considered only for the bi-weekly pay period in which they were paid.

The California Supreme Court's Holding

Rejecting Time Warner's contention, the California Supreme Court ruled that, to see if the employer has met the minimum-earnings requirement, one can consider only the wages *actually paid* in a given pay period. Therefore, an employer may not cure a "shortfall" in one pay period by applying the wages paid in a later pay period.

The Supreme Court justified this conclusion by relying on a mechanical reading of Labor Code section 204, which requires employers to pay "wages" to most employees (excepting only certain exempt employees not relevant here) on a semi-monthly basis. The Supreme Court observed that the Labor Code elsewhere defines "wages" to include commissions. Thus, all earned commissions must be paid on a semi-monthly (or more frequent) basis.

The Supreme Court noted that its interpretation narrowly construes the commissioned salesperson exemption's language against the employer. The Supreme Court reasoned that the purpose of the minimum earnings requirement is to ensure that employers pay the required minimum wages in each pay period, and this requirement would be undermined "if an employer could simply pay the minimum wage for all work performed … and then reassign commission wages weeks or months later in order to satisfy the exemption's minimum earnings prong." The Supreme Court declined to follow the rules for the analogous federal exemption for commissioned employees, which permit wage attribution, on the ground that the Fair Labor Standards Act, unlike the California Labor Code, does not require employers to pay employees on a semi-monthly basis.

What *Peabody* Means for Employers

The California Supreme Court's holding that section 204 requires semi-monthly payments of earned commissions will surprise some employers that traditionally have calculated and paid commissions on a monthly or quarterly basis. This shift in the law will encourage employers to define more particularly how and when commissions are earned, and to continue or intensify pay practices that characterize certain regular payments as advances on commissions to be earned in the near future.

In combination with California Court of Appeal decisions such as *Gonzalez v. Downtown LA Motors* and *Bluford v. Safeway Stores Inc.*—which have interpreted California law to impose onerous pay requirements that do not exist in analogous federal law—the *Peabody* decision creates significant challenges to California employers that pay employees through a commission, a piece rate, or some other form of incentive compensation.

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