

Employment

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Distinct Factors Determine How Wage and Hour Law Views a Salesperson

By Jonathan Fraser Light

Compensation for commissioned salespersons is one of the most misunderstood areas of wage and hour law in California. There are important distinctions between state and federal law and among the California wage orders, key criteria for avoiding minimum wage or overtime payments, and restrictions on commission payment obligations at termination of employment.

In short, depending on several critical factors in the exempt/non-exempt employee analysis, commissioned or outside salespersons need not be paid overtime or minimum wage, and inside salespersons need not be paid overtime, but are subject to other wage and hour requirements typically limited to non-exempt personnel.

What is a salesperson?

The employee must be actively engaged in the sale of a product or service to be classified as a salesperson. For example, car mechanics or equipment installers who do not actively participate in a sale, but receive a commission generated by a service writer or other salesperson, cannot be classified as inside salespersons. Similarly, route drivers who deliver products and only marginally conduct sales cannot be classified as exempt outside salespersons.

What is an outside salesperson?

An outside salesperson is an employee who spends more than 50 percent of the time away from the home or corporate office selling a product or service. If the employee qualifies under this threshold test, then the employer is not obligated to pay minimum wage or overtime compensation to the employee. The form of compensation can be set up in any manner desired by the employer, but the 50 percent rule is a strict, hard-line test that must be met. For example, technical support persons in the field who marginally participate in sales cannot be classified as exempt under the outside salesperson test.

What is an inside salesperson?

Not all California wage orders

treat this designation in the same manner: only Wage Order 4 (an occupational catch-all order, not an industry order) and Wage Order 7 (mercantile) contain the inside salesperson exemption. Wage Order 7 covers retail or wholesale operations. Thus, an inside salesperson working for a manufacturer (covered by Wage Order 1) cannot qualify for the exemption, even if the employee spends all of his time conducting inside sales at the company.

Importantly, the corresponding federal rule only allows the inside salesperson exemption for retail sales operations. In this instance, the federal law is actually more restrictive than California law in favor of the employee, and thus must be followed.

The two key criteria for the inside salesperson exemption under Wage Orders 4 and 7 are: 1) the employee must earn at least one and one-half times the minimum wage during the month; and 2) at least 50 percent of the employee's income for that month must be earned from commissions. This latter criterion is generally the deal-killer. For example, inside salespersons might have a base of \$3,000 a month, but earn commissions of less than that amount each month; thus, they cannot qualify for the exemption. Because of the possibility that an inside salesperson might not meet the commission threshold in a given month, employers are encouraged to have such employees keep track of their time.

It is critical to note that even if an employee qualifies for the inside salesperson exemption and thus does not receive overtime compensation, the employee is still subject to the meal and rest break rules. For this reason, employers are required to maintain records of meal periods taken by exempt inside salespersons. These records will protect the employer from liability in the event of a meal break audit.

When does the employer pay commissions?

Commissions generally are not calculated until the close of a month, quarter or other time frame;



therefore, it is acceptable for the employer to pay commissions in the month following the month or quarter in which they are earned. The Department of Labor Standards Enforcement has opined informally that the commission payment will apply to the month in which the money is paid (not earned) for the purpose of determining whether the 50 percent commission threshold has been met for the inside salesperson exemption that month. If the threshold is not met, the employer would be required to go back and recalculate the employee's compensation for the month to determine the overtime compensation due to the employee. Employers should also remember that commission payments must be added to the base rate of pay before calculating overtime, if overtime is otherwise due. (The same rule applies to non-discretionary bonus payments.)

Can an employer charge back against commissions for bad debt?

Employers sometimes pay commissions before receiving payment

from the customer. Employers may reduce future commission payments based on non-payment by the customer. Employers should have an agreement in writing signed by the employee at the outset of the relationship allowing such charge-backs.

When an employee leaves, how should an employer treat outstanding commissions?

The issue is whether an employee has earned the commissions at the time the employee is separated from employment, regardless of whether the employee has resigned or has been involuntarily terminated. Where the commissions can be deemed to be earned prior to separation from employment, commissions must be paid to the departing employee.

Employers sometimes implement a policy that the employee shall not receive any commissions after the date of termination. This policy may not be enforceable under the

theory that it is procedurally or substantively unconscionable. The law assumes that employees have an unequal bargaining position. Therefore, the typical blanket take it or leave it agreement regarding commissions will probably not be enforced if it calls for the employee to forfeit commissions that may otherwise be due subsequent to termination.

Commissions may be earned at booking, shipping, invoicing or receipt of payment. Regardless of how the employer characterizes the term earned, the Department of Labor Standards Enforcement and the courts will likely take the approach most favorable to the employee in the absence of a fairly bargained-for arrangement. Given that most commission plans are set up by the employer without any meaningful bargaining on the employee's part, employers typically will be required to pay out what are sometimes referred to as tail commissions even after the employee has been terminated.

There is no set time frame for the payment of tail commissions, but the Department of Labor Standards Enforcement will usually apply a "reasonableness" test. We often recommend a 30-90 day payout for commissions on payments that arrive from customers following the employee's separation date. Even those time frames might not be acceptable in circumstances in which payment is routinely delayed because of the company's business model or the nature of the product. A safe rule of thumb is that commissions that are in the pipeline and capable of being calculated, but not received, are likely to be due to the employee.

If the employer can demonstrate that other employees had to service the customer or otherwise participate in facilitating the transaction in some fashion after the originating employee's departure, the employer may be entitled to reduce the departed employee's commission share by some reasonable amount to reflect the work done by the remaining employees. Unless substantial work had to be performed

after the employee left, however, it is safest for employers to simply pay the employee all commissions that are in the pipeline. If the commission is not paid in full, and it is later determined that it was due to the departing employee, the employer could be susceptible to a waiting time penalty equal to 30 days' pay in addition to the unpaid commission. Where there is a good-faith dispute over whether the commissions are owed in the first instance, there is a greater likelihood that the Department of Labor Standards Enforcement would find that there was no "willful withholding" of pay, negating any award of penalties.

Can employers simply call their outside salespeople independent contractors?

Generally, the answer is no. Employers often attempt to characterize their outside salespersons as independent contractors, usually at the request of the worker for tax reasons or other potential financial benefits. If the worker is not representing multiple product lines from different companies, and otherwise is acting in what is essentially an employee role (i.e., not satisfying enough of the IRS or state tests for independent contractor status), the employer would be well-served to simply categorize the worker as an outside salesperson to avoid any penalties associated with miscategorizing the worker as an independent contractor.

The misclassification of an employee as an independent contractor can lead to liability for unpaid taxes, worker's compensation benefits, overtime, meal and rest period violations, and other issues. Employers who wish to designate employees as independent contractors would be well-advised to seek legal advice regarding the classification and to prepare appropriate documentation of the working relationship.

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