

# Don't Forget: Commission Agreements Deadline

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Employers must put all commission agreements in writing starting on January 1, 2013.

With the compliance date for AB 1396 on the horizon, now is a good time for employers to review their commission arrangements for compliance with California law.

The law itself is short, and appears simple and straightforward. However, it contains a number of potential pitfalls that could result in wage-and-hour claims filed against employers.

## Summary of the New Law

AB 1396, passed in 2011, amended Labor Code Section 2751, which previously applied only to employers with no fixed California location. AB 1396 applies to employers located inside and outside California.

After January 1, 2013, any employee hired to perform work for commissions in California must receive a written contract that includes the method for calculating and paying the commissions.

The employer must give the employee a copy of the contract and obtain a signed acknowledgment from the employee that he/she received the contract.

If the contract expires but is not replaced, it is presumed to remain in effect until replaced or the employee's employment ends.

## What Is a "Commission"?

Employers are required to provide written agreements only to those employees paid on "commission."

Borrowing from section 204.1 of the Labor Code, AB 1396 defines commission as: "compensation paid to any person for services rendered in the sale of such employer's property or services and based proportionately upon the amount or value thereof."

Therefore, the new law applies only to those employees who make sales and covers only compensation that is calculated as a proportion of the "amount or value" of the product or service sold.

The statute excludes "short-term productivity bonuses such as are paid to retail clerks." This means that employers may hold sales contests or offer other short-term incentives to employees not ordinarily paid on commission without providing a written contract.

The statute also excludes "bonus and profit-sharing plans," but there is an important stipulation: If a bonus plan is based on "a fixed percentage of sales or profits as compensation for work to be performed," then the law applies and the plan must be included in the written contract.

## Procedures for Compliance

Employers that are required to comply with AB 1396 should ensure the employee signs commission agreements and acknowledges receipt of those agreements.

Nothing in the law explicitly prohibits or permits the use of electronic versions of the agreement and the acknowledgment of receipt. However, employers that distribute commission agreements electronically must ensure there is a method for recording the employee's receipt of the agreement. The agreement and the receipts should be stored so they may be retrieved in case of a claim or dispute.

Employers should be mindful that stated expiration dates are invalid if the agreement is not replaced. Employers who want to make changes to commission plans should calendar the expiration dates of existing plans.

Employers also should keep copies of the commission agreements and acknowledgments of receipt in employees' personnel files so they may be inspected or copied as required by law. These agreements should be preserved for up to four years following separation of employment for any reason.

## **Employer Pitfalls**

Employers must be aware of what compensation arrangements will and will not qualify as "commissions" in California. Employers often use the term "commission" for payments that are more properly considered bonuses, which would be excluded from AB 1396's written contract requirement.

The hallmark of a "commission" is that it's a payment that varies in proportion to the value or number of units sold. Only employees who sell may earn a "commission." A commission does not necessarily have to be a straight percentage of gross sales, but must vary based on sales volume.

Earned commissions are a form of wages. Once earned, wages cannot be forfeited. The definition of an "earned" commission also affects when a commission must be paid. Earned commissions must be paid with the next regular paycheck. They also are due to employees who leave the employer with their final pay.

Courts and the Division of Labor Standards Enforcement will enforce reasonable, well-defined criteria setting forth how a commission is earned. For example, employers may explain that a commission is earned when:

- A contract is signed
- The goods are paid for
- The financing is complete

Employers seeking to limit employees' right to commissions when sales are returned or discounted after the sale, or to cut off commissions when employment is terminated, must specifically define when the commission is "earned."

Finally, many employees earning commissions (e.g., outside sales or certain retail sales employees) are exempt from minimum wage and overtime requirements. Other commission-based workers, however, are nonexempt.

Overtime calculations for nonexempt employees must include commission payments because commissions are included in the calculation of the regular rate of pay for overtime. So when commission payments are delayed, the employee may be entitled to retroactive overtime. Employers also should ensure that nonexempt employees receive at least minimum wage for every hour worked (whether via commission, hourly wage, or draw).

## **Best Practices**

Commission agreements should:

- Be in writing, signed and include an acknowledgment of receipt for the employee to sign.
- Set forth eligibility criteria, such as which employees are covered, length of service, etc.
- Define when a commission is "earned."
- Explain that "advances" of unearned commissions are loans that must be reconciled against later, earned commissions.

- Lawfully define “commission” to avoid formulas that may be held invalid.
- Explain the formula for computing commissions, including commission rates, and whether the rate is applied to gross sales, net sales, gross margin, etc.
- Explain how “splits,” changes in territory or reassigned customers are treated under the plan.
- Address how returns and refunds affect commissions, if applicable.
- Address termination of employment and its effect on unearned or unpaid commissions.
- Avoid language that may sound like a “forfeiture” of an otherwise earned commission.
- Include the term of the agreement, and how commissions will be paid on sales made before and after the effective date of the plan.
- Explain the employer’s discretion to interpret, modify or discontinue the terms of the plan.

### **CalChamber Can Help!**

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