STATE OF CALIFORNIA GRAY DAVIS, Governor

DEPARTMENT OF INDUSTRIAL RELATIONS
DIVISION OF LABOR STANDARDS ENFORCEMENT
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H. THOMAS CADELL, *Of Counsel*

April 30, 2003

Jerry Schreibstein
Kelly, Herlihy & Klein LLP
44 Montgomery Street, Ste. 2500
San Francisco, CA

Re: **Post Termination Commissions** (909)

Dear Mr. Schreibstein:

Your letter of March 20, 2003, addressed to the San Francisco Legal Section has been forwarded to this office for a reply on behalf of the Division of Labor Standards Enforcement.

In your letter you state that your client has a compensation system that includes quarterly payout of commissions on sales. The program requires current employment at the time of the quarterly commission payouts. In other words, if the employee is not currently employed at the time the quarterly payments are made, there is no payment on a pro rate or any other basis after employment terminates.

According to your letter, you feel that this procedure is consistent with California law and point to the case of *Lucien v. Allstate Trucking* (1982) 116 Cal.App.3d 972 to support your analysis. As you point out, the *Lucien* case involved former employees who voluntarily terminated their employment who had been denied their share of a plan "which clearly stated that the <u>bonus</u> was based on profits and was not determined or payable until the end of a fixed period." *Lucien, supra*, at 975.

If we understand your letter correctly, your client's plan involves "<u>commissions</u> on sales", not a bonus. The commissions on sales, as a matter of fact, are wages calculated and owed upon the completion of the sale and must be paid in accordance with the provisions of Labor Code § 204. That provision of the law requires that wages earned are due and must be paid twice during each calendar month on days designated in advance by the employer as the regular paydays.

Thus, initially, the plan your client has implemented which pays the commissions on sales on a quarterly basis does not meet

the requirements of the California Labor Code even if there were no forfeiture clause such as you describe involved.

The other case which you cite is *American Software, Inc. v. Ali* (1996) 46 Cal.App.4th 1386, which, as you state, upheld an employer policy which stated that sales representatives would be paid commissions on orders only if currently employed at the time of customer payment. However, unless there are facts involved in the sales program you describe which you have not mentioned in your letter, the case is not on point. In the *American Software* case the court noted:

> "Our survey of case law indicates that the contract provision challenged here is commonplace in employment contracts with sales representatives, such as Ali, who have ongoing responsibilities to 'service' the account once the sale is made." *Id.*, at 1393

There is no mention in your letter that the salespeople had any on-going duties to service the accounts upon which the commissions were based as was the case in *American Software*.

Also, absence of the unique facts found in *American Software* concerning the termination of the right to the commissions only on those accounts for which payment was not received[1] within 30 days after severance of the employment would, we are sure you would agree, have an impact on the question of whether the contract shocked the conscience of a reasonable person. Our understanding of the pay program used by your client is that any commissions earned during the quarter when the termination occurred would be forfeited. If that is not correct, please advise.

In addition, the unique facts in the *American Software* case indicate that the employment contract provided for a salary plus a draw on the commissions which, in the event of termination, was not recoverable by the employer. The court discussed this feature and explained that in the court's view, "American Software took the risk that at the time of Ali's termination, she would not have earned sufficient commissions to cover the substantial draws 'credited' to her." This risk by the employer was in the nature of a *quid pro quo* for Ali's risk that some of her commissions would be lost as a result of the fact that payment was received by the employer more than thirty days after termination. (*Id.*, at 1395)

Clearly, the case of *American Software v. Ali* is distinguishable as a result of its unique facts from most employment contracts. The *American Software* court recognized this when it noted: "In short, this case [American Software] is a far cry from those cases where fine print, complex terminology, and presentation of a contract on a take-it-or-leave-it basis

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[1] Reasonable conditions may be placed upon the right to recover commissions. For instance, it is sometimes permissible to require that the contract upon which the commissions are based is not complete until payment of the contract price to the employer. Again, however, those facts are not discussed in your description of your client's plan.

constitutes the groundwork for a finding of unconscionability." (*Id.*, at 1392)

To summarize then, we would first point out that commissions earned on a sale must be paid within the pay period pursuant to the provisions of Labor Code § 204. Withholding payment of earned commissions until the end of a three-month period would be a violation of California's Labor Code.

Additionally, any earned commissions may not be forfeited. As pointed out above, reasonable conditions may be placed on the vesting of the commissions; but once vested, the commissions may not be forfeited as a result of the fact that the employee terminates the employment. We might also point out that common law contract doctrines (prevention) would prevent an employer from forfeiting commissions which would have been earned by discharging the employee before those commissions vest.

We hope this adequately addresses the issues you raised in your March 20th letter. Thank you for your interest in California labor law.

Yours truly,

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