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STATE OF CALIFORNIA Pete Wilson, Governor

DEPARTMENT OF INDUSTRIAL RELATIONS
DIVISION OF LABOR STANDARDS ENFORCEMENT
'egal Section
, Van Ness Avenue, Suite 4400
San Francisco, CA 94102

May 7, 1991

Mary Maloney Roberts, Esq.
Corbett & Kane
88 Kearny Street, Suite 1700
San Francisco, CA 94108

Re: **Authorized Paycheck Deductions**

Dear Ms. Roberts:

Acting Labor Commissioner James Curry has asked me to respond to your letter of April 25, 1991, regarding the above-referenced subject.

In your letter you provide the following fact situation:

> The employer provides a "sign on bonus" to new employees in the amount of, for example, $5,000. The bonus is paid at the start of employment and is explicitly described as a wage advance which the employee earns by remaining employed for a stated period of time, for example, five months. The advance is earned incrementally as the employee continues his or her employment. The employee agrees that if he or she terminates prior to the completion of five months, that portion of the unearned wage advance will be repaid. Prior to receiving the advance, the employee voluntarily executes a written authorization permitting the employer to deduct any unearned portion of the advance from the employee's final paycheck in the event the employee terminates prior to completion of the stated period of time.

You state that based upon your conversation with a Deputy Labor Commissioner it is your understanding that under the above-described circumstances, it is permissible for the employer to deduct the amount of the unearned portion of the wage advance from the employee's final paycheck. You ask for confirmation of that advice.

The leading cases on the issues which are raised by the above set of facts are *Barnhill v. Saunders* (1981) 125 Cal.App.3d 1, and *California State Employees' Assn. v. State of California* (1988) 198 Cal.App.3d 374. In the *Barnhill* case, the court dealt with the question of what remedy an employer has to recover an amount of money advanced to an employee to as a loan. The promissory note carried an interest rate of 10% per annum and was to be repaid "by payroll deduction or upon demand." The *Barnhill* court first noted that the advance, as with any other debt owed (either to the employer or to a third party), would be subject to the provisions of the attachment law. Since the wages of the employee are exempt from prejudgment attachment and, thus, neither the employer (nor any third party) could recover the debt by way of attachment of the employee's final pay, the court reasoned that fundamental due process considerations prevented the employer from engaging in self-help by deducting the debt from the employee's final wages.

The *Barnhill* court explained that "[t]he policy underlying the state's wage exemption statutes is to insure that regardless of the debtor's improvidence, the debtor and his or her family will retain enough money to remain a productive member of the community."

Following the *Barnhill* decision, the First District Court of Appeal addressed the question of recoupment of advances on wages in the case of *California State Employees' Assn. v. State of California, supra*. In the *CSEA* case, the court was confronted with a state law which appeared to clearly allow a claim of money owed to the state to be recouped from the wages of the employees. However, the *CSEA* court, relying in part on the *Barnhill* decision, held that the "wage garnishment law and the attachment law protect wages from creditors. The wage garnishment law provides the exclusive judicial procedure by which a judgment creditor can execute against the wages of a judgment debtor, except for cases of judgments or orders for support." As the *CSEA* court pointed out, "[p]resumably, wages actually earned during the current pay period are due, and the fact that the employee owed a debt [to the employer], even for a prior overpayment, does not 'affect the validity or alter the amount of the [current] claim' for wages earned." It was at this point that the *CSEA* court cited to *Randone v. Appellate Department* (1971) 5 Cal.3d 536, which, of course, relied upon the U.S. Supreme Court decision in *Sniadach v. Family Finance* 395 U.S. 337 (1969) which held that a prejudgment attachment of wages violated the due process clause of the United States Constitution.

As you can see, the law in this area has been clearly defined. An employer may not recover debts owed to the employer by an employee from the wages then due to the employee.

Turning to the plan proposed in your letter, an examination of the facts reveals that the proposal is nothing more than a prepayment of a bonus before the bonus vests. Such a prepayment actually creates a debt owed to the employer. The debt is extinguished upon the happening of a condition subsequent (i.e., employment for the full five-month period); but remains a "debt" until the happening of that condition. To allow the employer to recover the prorata portion of the "debt" upon termination is no different than allowing the employer to recover any other "prior overpayment." The proposal you submit does not provide for payment to the employee of part of the "wage" he or she is to earn in the next five months, but to prepay a bonus (over and above the wage to be earned) which is not owed at the time of the payment. Any part of the unvested bonus then becomes a debt which, under the plan you propose, the employer would recover from the wages the employee earned during the final pay period. As the courts have held, such self-help procedures are not allowed.

The recovery of the prepayment from the final check would violate the public policy considerations underlying the wage exemption statutes. Allowing the recovery from the final pay could lead to a situation where an improvident worker, who had already spent the sizable advance, would be left without "enough money to remain a productive member of the community."

The proposal you submit differs from the situation where an employer makes regular advances as a draw on future commissions. In those circumstances, the "draw" is only recoverable from the commissions as they become due. The employer could conceivably bring an action to recover excess draws if that was the agreement (See *Agnew v. Cameron* (1967) 247 Cal.App.2d 619), but could not recover the excess draws from the employee's final pay unless the final pay constituted commissions.[1] The rationale underlying this relatively common procedure is, of course, that the employee has already been paid part of the commissions due as they were being earned pursuant to the agreement with the employer.

It is also possible to make an advance on wages which have already been earned before the time arrives for the payment. For instance, assume that an employer makes an advance to an employee of a small amount during the first week of a two-week pay period

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[1] Of course, if the final pay represented a minimum sum due (such as a statutory minimum wage or a minimum set by the contract of employment), the overpaid draws could not be recovered from the final paycheck. The <u>minimum</u> (whether it be statutory or contractual) must be paid under all circumstances.

with the understanding that the advance is to be repaid from the employee's check. So long as the advance was made within the pay period, that advance may be recovered from the employee's next pay check (even if the next pay check happens to be the employee's final paycheck).

I hope this adequately addresses the issues you raised in your letter of April 25th. In your letter, you stated that in your conversation with an unnamed Deputy Labor Commissioner you had been left with the impression that the proposal you outlined would be acceptable. I will ask that copies of this letter be circulated to all District Offices of the Division for information and clarification of existing DLSE policy. Hopefully, this will eliminate any misunderstandings in the future.

Yours truly,

H. Thomas Cadell, Jr.

H. THOMAS CADELL, JR.
Chief Counsel

c.c. James Curry
Simon Reyes

1991.05.07