STATE OF CALIFORNIA

GEORGE DEUKMEJIAN, Gov

DEPARTMENT OF INDUSTRIAL RELATIONS

DIVISION OF LABOR STANDARDS ENFORCEMENT

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1988.04.01

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IN REPLY REFER TO:

Legal Section

April 1, 1988

Ms. Karen Y. Teragawa
Epstein, Becker Stromberg & Green
1875 Century Park East
Los Angeles, CA 90067

Re: Bonus Program

Dear Ms. Teragawa:

The Labor Commissioner has asked me to respond to your letter of March 23, 1988, regarding the "administrative bonus" which you describe.

It is our understanding that the employees in question are paid a base salary and, in some cases, receive additional commission. You then briefly describe two different bonus plans: (1) one based upon the pre-tax profit of the particular manager's division, and (2) a bonus based upon the productivity of the particular individual. You do not detail these two plans and we assume that your question does not regard these plans.

The "administrative bonus" which you describe in some detail would be based upon a fixed percentage of the annual production volume of a specific office or division. The bonus is paid in three annual installments with the first installment being paid as soon as the calculation on the base year's production can be made. It is not clear if the installments are equal. The two subsequent installments are to be paid on the anniversaries of the end of the base year conditioned on the employee being in the employ of the company on those subsequent anniversary dates. It is not clear, however, whether the employee has to be in the employ of the firm on the date of the payment of the first installment. You state in the letter that the payments are made on the anniversary dates "provided that the individual remains in the company's employ <u>on those subsequent dates</u>." This language would seem to indicate that the condition precedent (or subsequent) regarding employment on the date of the payment is only operative for the subsequent payments - not the first payment.

You explain that the employee who is terminated involuntarily "prior to the eligibility date for installment" will be paid on a prorata basis. You fail to make clear whether the prorata payment would include the total of the remaining bonus or only that portion to be paid during that "subsequent" year. The letter provides that the employee who terminates voluntarily prior to the "eligibility date" will not receive any portion of the administrative bonus. As mentioned above, it is not clear what the eligibility date is with regard to the first payment of the bonus.

You describe the plan as a "golden handcuff" and explain that it is designed to act as an inducement for the individual to remain in the company's employ.

The case of Lucian v. All States Trucking Co. (1981) 119 Cal.App.3d 972 is the latest case which discusses the situation of an employee's right to a bonus which contains a condition precedent that the employee be on the payroll at the time of the "payment" of the bonus. The court in Lucian explained that:

> "a specific bonus program normally becomes binding as a unilateral contract when the employee begins performance, in the sense that the plan then cannot be revoked by the employer. It does not follow, however, that the employee thereupon becomes entitled to the bonus payment where, as here, the bonus did not become payable until a certain date and the employee voluntarily left his position before that date."

Clearly, then, basing the payment of a bonus on continued employment is acceptable. However, the Lucian court was faced with a different situation from the one which you are proposing. In Lucian the court stated "an employee who voluntarily leaves his employment before the bonus calculation date is not entitled to receive it." In the situation you are proposing, the bonus would be calculated and liquidated and, presumably, earned; but unpaid pending the happening of the condition precedent (or subsequent): that the employee be on the payroll when the subsequent anniversary date arrives.

When faced with a similar question, the California Supreme Court in the case of Suastez v. Plastic Dress-Up (1982) 31 Cal.3d 774 at 781 held that vacation benefits which were earned could not be divested as a result of the failure of the employee to be on the employer's payroll on an anniversary date. The court held, in effect, that such a requirement was, at most, a condition subsequent which effects a forfeiture. The Court in

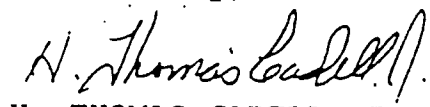
Suastez held that such a forfeiture was illegal because of the express language in Labor Code §227.3 which prevents such forfeitures. The Court did state, however, that "[I]f vacation pay served simply to induce employees to remain on the job for a certain period of time, then interpreting eligibility requirements as a condition precedent to the vesting of vacation pay would not be unreasonable."

In light of the Court's language in Suastez, and in the absence of any statute which preclude such vesting, it would appear that the California courts would find that the requirement that the employee be on the payroll on the subsequent anniversaries in order to be eligible for payment of the installment to be a condition precedent to payment and not a condition subsequent which provides a forfeiture.

Your letter of March 23rd does not explain the program in detail and, as pointed out above, there are questions left unanswered. Inasmuch as the contract will meet the test as a contract of adhesion (See Graham v. Scissor-Tail (1981) 28 Cal.3d 807 at 817) any ambiguity in the terms of the contract will, of course, be most strictly construed against the employer, and will be subject to the other limitations imposed on contracts of adhesion. (Graham, supra, at 820)

I hope this adequately answers the questions you raise in your letter of March 23rd. If you have any further questions please feel free to call on the undersigned.

Yours truly,



H. THOMAS CADELL, JR.
Chief Counsel

c.c. Lloyd W. Aubry, Jr.