Now you see it, now you don't

Protecting the rights of commissioned employees

BY SARAH ABRAHAM AND WILLIAM JHAVERI-WEEKS

Commission pay is ripe with potential: potential for a salesperson to reap the rewards of hard work and successful sales efforts, and potential for disputes when those rewards differ from the salesperson's expectations. Because they provide their work efforts up front and bear the risk of not being paid at the end of the process, commissioned employees are particularly vulnerable to the risks of broken promises or misaligned understandings.

Areas in which disputes are common include the impact of termination of employment on the commissions an employee is owed, "chargebacks" of commission payments if a sale later falls through or goods are returned, and the alteration of a commission agreement after work on a sale has already taken place. The outcome of such disputes is generally highly fact dependent. This article lays out the basic laws that govern commissions, discusses common disputes that arise, and describes some recent developments in California case law on commissions.

Commissions and bonuses distinguished

Commissions are defined as "wages" that are "paid to any person for services rendered in the sale of [an] employer's property or services based proportionately upon the amount or value thereof." (Lab. Code, §§ 200, 204.1; see also *Ramirez v. Yosemite Water Co.* (1999) 20 Cal.4th 785, 803 [although Cal. Lab. Code § 204.1 is specific to vehicle dealers, "the statute's definition of 'commission' is more generally applicable."].) The conditions which give rise to commission pay must be specified in a written contract under the statutory regime described below.

Bonuses are "wages" under California law. (Lab. Code, § 200; *Neisendorf v. Levi Strauss & Co.* (2006) 143 Cal.App.4th 509, 522.) Unlike commissions, bonuses may be discretionary (i.e., no contractual right to a bonus). In *Pfeister v. IBM* (N.D. Cal. 2017) U.S. Dist. LEXIS 170970, *6-16, the court distinguished enforceable commission contracts from discretionary bonus plans, concluding that the plan at issue was discretionary because the plan expressly stated that it was not a contract and "reserved [to the employer] the right to determine the amount of the bonus or incentive pay it would pay to [plaintiff]." On the other hand, a promise to pay a bonus may be an enforceable contract where there is mutual assent to form a contract and the contract terms are sufficiently definite. (*Id.* at *14-16.)

Labor Code section 2751

The main source of statutory law on commission pay is Labor Code section 2751. Among other things, the statute requires that commission agreements be in writing and signed by the employer. The employer must also obtain a signed acknowledgment of receipt of the agreement from the employee. The agreement must state how commissions will be "computed and paid." When, as often happens, a commission agreement expires (e.g., an agreement states that it covers a particular year) and the employee continues to perform services for the employer after the expiration, the terms of the agreement remain in effect unless and until a new contract is executed or the employment is terminated by either party. (See Lab. Code, § 2751.)

The section 2751 provision carries no private right of action, but it is enforceable through the California Private Attorneys General Act of 2004 ("PAGA"), Labor Code section 2698 et seq. It may also serve as a predicate violation for an Unfair Competition Law claim. (Bus. & Prof. Code, § 17200 et seq.)

Certain *non-employee* salespersons – e.g., independent contractors – are afforded different protections under Civil Code section 1738.10 et seq. The provisions require that "independent wholesale sales representatives" be provided with a written contract that includes how commissions will be "computed and paid," among other requirements. This section is enforceable through a particularly potent private right of action: Willful failure to provide a written contract or to pay commission allows independent contractors to recover treble damages and attorney's fees. (Civ. Code, § 1738.15-16; see *Reilly v. Inquest Tech.* (2013) 218 Cal.App.4th 536; see also *Baker v. American Horticulture Supply, Inc.* (2010) 186 Cal.App.4th 1059, 1072 [nonwillful violation gives rise to a claim for compensatory damages, but not treble damages].)

Contract law, with protections for "wages"

Commission agreements are contracts, so they are governed by contract law and principles of contract interpretation. For example, contract rules concerning modification, the canon of interpreting ambiguities against the drafter, and general contract defenses, such as unconscionability, all come into play. Extrinsic evidence may be important to resolve ambiguities in the contract.

At the same time, because commissions for employees are "wages," commission pay is protected by numerous provisions of the California Labor Code. For example, an employee seeking commission pay is entitled to one-way attorneys' fee shifting under Labor Code section 218.5. (See, e.g., *Verdugo v. Alliantgroup, L.P.* (2015) 237 Cal.App.4th 141, 150; see also *Kempf v. Barrett Bus. Servs., Inc.* (9th Cir. 2009) 336 Fed. Appx. 658, 662.)

Failure to pay commission owed at the time of discharge can give rise to waiting-time penalties under Labor Code section 203. The application of section 203 can be complicated in the commission context because it may not be clear how much commission (if any) is due at the time of discharge. The California Department of Labor Standards Enforcement ("DLSE") takes the position that earned commission must be paid immediately after it can be calculated. (DLSE Opn. Letter No. 1999.01.09 (January 9, 1999), p. 3.) The DLSE also takes the view that if a commission has been earned by the day of termination, Labor Code sections 201-203 require the employer to pay earned wages at the time of discharge as stated in those provisions, even if the contract calls for paying commissions at a later time (e.g., end of the fiscal quarter). (*Ibid.*) Further, the DLSE's view is that, if at the time of termination, the payment of commissions is awaiting the completion of a legal condition precedent, such as receipt of a customer's payment, then commissions are due to the terminated employee immediately upon completion of the condition. (*Ibid.*) Thus, the DLSE's view is that waiting-time penalties may begin running at multiple times for the same terminated employee – e.g., if commissions fall due under the foregoing principles at various times after the termination – although the total penalties cannot exceed thirty days. (*Id.* at p. 4.)

Issues surrounding termination: Breach of contract

Some commission disputes turn on interpretation of key contract terms, such as when a sale is "booked" for the purpose of earning commissions. In *Lopez v. Smiths Detection, Inc.* (S.D. Cal. 2021) U.S. Dist. LEXIS 14211, *21-22, the court denied the defendant's motion to dismiss where the parties had "competing interpretations of the term 'booked,'" and the plaintiff's interpretation of the term was "plausible and reasonable." The court reasoned that "so long as the pleading does not place a clearly erroneous construction upon the provisions of the contract," the court "must accept as correct plaintiff's allegations as to the meaning of the agreement" in determining whether plaintiff adequately pleaded the complaint. (*Id.* at *23 (internal citations omitted) (*cf. Teague v. BioTelemetry, Inc.* (N.D. Cal. 2018) U.S. Dist. LEXIS 183506, *23-24 [granting summary judgment of plaintiff's claim for breach of contract, finding that plaintiff's "interpretation of the agreement is untenable" because it "wip[ed] out" express contract terms and "[gave] them no effect"].)

An employee who is terminated before he or she earns the commission

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under the contract terms may potentially recover lost commissions if the employee has performed the actions necessary to earn commission and is merely waiting for a legal condition precedent to occur before he or she receives payment. In addition, an employer may not prevent a condition precedent from occurring for the purpose of denying the employee commission. (DLSE Opn. Letter No. 1999.01.09 (January 9, 1999), p. 3 ["If the commission has not yet been earned at the time of termination, and is awaiting the completion of some legal condition precedent .... the commission must be paid to the terminated employee immediately upon the competition of the conditions precedent."]; *Wood v. IGATE Techs.Inc* (N.D. Cal. 2015) U.S. Dist. LEXIS 189105, at *8-9 [when "[n]o further action was required on Plaintiff's part to complete the deals leading to the delivery of the commission . . . except performing the condition precedent of remaining employed," employee stated claim for breach of the agreement].)

Breach of the duty of good faith and fair dealing

In any contract, there is an implied duty of good faith and fair dealing. "Where a contract confers one party with discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing." (*McCollum v. Xcare.net, Inc.* (N.D. Cal. 2002) 212 F. Supp. 2d 1142, 1152 (internal citations omitted).) The covenant is breached when discretionary authority is exercised "in bad faith for the purpose of frustrating the other party's legitimate expectations and denying the other party the actual benefits of the agreement. (*Ibid.*) In *McCollum*, the court denied summary judgment on plaintiff's claim for breach of the covenant of good faith and fair dealing because there were triable issues related to whether the employer terminated plaintiff's employment to avoid paying commission. (*Id.* at 1153.) In that case, the employer reassigned an account that plaintiff had been working on, then terminated Plaintiff's employment less than two weeks prior to the deal's closing. (*Id.* at 1142. See also *Teague v. BioTelemetry, Inc.* (N.D. Cal. 2018) U.S. Dist. LEXIS 183506 [denying motion for summary judgment of breach of duty of good faith and fair dealing claim where there was evidence that the employer "steered contracts" to "thwart (the employee's) claim to commission" and timed the decision to fire plaintiff to avoid paying commission, citing *McCollum*].)

Unconscionability of forfeiture provision

Often litigation involves "forfeiture provisions" under which the employee loses the right to a commission if the commission has not been paid by the date of the employee's termination. There are varying outcomes on such provisions, often involving the defense of unconscionability. (See, e.g., *Ellis v. McKinnon Broadcasting Co.* (1993) 18 Cal.App.4th 1796,1803-07 [unconscionable to condition payment of commissions on continued employment when contract terms are overly harsh and when employee lacked meaningful choice in negotiating contract terms]; *cf. American Software Inc. v. Ali* (1996) 46 Cal.App.4th 1386 [not unconscionable for payment of commission to be conditioned on continued employment].) These cases are not "irreconcilable" but "turn on the question of what each of the courts viewed as unconscionable." (DLSE Enforcement Policies and Interpretations Manual (2002 Rev.), 34.5; see also *McCollum v. Xcare.net, Inc.* (N.D. Cal. 2002) 212 F.Supp. 2d 1142, 1152 [denying motion for summary judgment because of disputed facts as to whether contract term providing for forfeiture of commissions was unconscionable]; *Sako v. Wells Fargo Bank, N.A.* (S.D. Cal. 2016) U.S. Dist. LEXIS 3171, at *22-26, 36 [granting plaintiff's motion for summary judgment on issue of unconscionability where contract was adhesive and where employer had "unfettered discretion" to enforce "vague" contract terms concerning employee misconduct that resulted in forfeiture of commission].)

Wrongful termination in violation of public policy

An employer is prohibited from terminating an employee to avoid paying a benefit that she has earned. (*Gould v. Maryland Sound Industries, Inc.* (1995) 31 Cal.App.4th 1137 [terminating an employee to avoid paying commissions violates the fundamental public policy to promptly pay wages when due]; *Lopez v. Smiths Detection, Inc.* (2021) U.S. Dist. LEXIS 14211, at *15-16 (same).) In *King v. U.S. Bank N.A.* (2020) 53 Cal.App.5th 675, the Court of Appeal affirmed a jury verdict of damages of $2.5 million for wrongful termination in violation of public policy where, among other things, an employer had terminated the employee for the purpose of depriving him of a bonus he had earned.

Likewise, it is against public policy to terminate an employee because she complained about being denied commission. (See, e.g., *Lopez v. Smiths Detection, Inc.* (S.D. Cal. 2021) U.S. Dist. LEXIS 14211, at *16-17 [denying motion to dismiss claim for wrongful termination in violation of public policy where plaintiff complained about the employer's failure to pay commissions]; see also *Phillips v. Gemini Moving Specialists* (1998) 63 Cal.App.4th 563, 571 ["[I]s there a fundamental public policy against an employer's retaliation for its employee having asserted a right to be free from the employer's withholding of pay, as alleged to have occurred in this case? We conclude there is such a fundamental public policy."]; *Belk v. Electra Cruises* (2010) Cal.App.Unpub. LEXIS 5618, at *19-20 [affirming jury award and punitive damages for sale representative terminated for complaining about being denied commissions owed].)

Disputes over chargebacks

Sometimes employers attempt to claw back commission payments – for example, when the customer returns the goods that generated the commission. Although an employer is generally

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prohibited from recovering earned wages under California Law (Lab. Code, § 221), if the commission is paid before it is "earned" under the terms of the agreement, the employer may be able to recoup the advance commission payment (subject to minimum wage obligations for non-exempt employees). Such "chargeback provisions" in commission agreements are generally lawful if agreed to in writing by the employee. (See *Marr v. Bank of Am., NA* (9th Cir. 2013) 506 Fed. Appx. 661, 661.) A chargeback on *earned* commission may also be lawful if it has been 1) agreed to in writing by the employee and 2) does not deduct from the employee's base pay. (Lab. Code, § 224; see *Steinhebel v. Los Angeles Times Communications, LLC* (2005) 126 Cal.App.4th 696, 7007; *Koehl v. Verio, Inc.* (2006) 142 Cal.App.4th 1313, 1337-38.)

Chargebacks are subject to limitations. For example, an employer cannot deduct its own cost of doing business from an advance. (See *Sciborski v. Pacific Bell Directory* (2012) 205 Cal.App.4th, 1152, 1171; see also *Tessitore v. Macy's W. Stores* (2022) Cal.App.Unpub. LEXIS 34, at *16 ["[A]n employee cannot be made the insurer of an employee's business losses."].) The employer may, however, deduct other types of costs that *relate* to the sale, such as the costs of purchase incentives, like free shipping or free products. (See *Davis v. Farmers Ins. Exchange* (2016) 245 Cal.App.4th 1302, 1332.) In addition, in the case of returned goods, no chargebacks are permitted where there are "unidentified returns" – i.e., returns that cannot be traced back to the original salesperson through adequate documentation – even if such chargebacks are agreed to in writing by the employee. (See *Hudgins v. Neiman Marcus Group* (1995) 34 Cal.App.4th 1109, 1115-17, 1124; *Aguilar v. Zep Inc.* (N.D. Cal. 2014) U.S. Dist. LEXIS 120315, *45 ["An employer may not require its employees to consent to unlawful deductions from their wages."] (internal citations omitted).)

Changes in the commission agreement over time

Commission agreements are often drafted to last for only one year, with a new agreement to be adopted each year. When an employee has spent significant time working on a sale under one agreement but the employer changes the commission rate before the sale closes, this may result in potential claims.

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"Commission plans contain[ing] a clause reserving to [the employer] the right to unilaterally change the plans is contrary to California law if applied *retroactively*." (*Mathews v. Orion HealthCorp Inc.* (N.D. Cal. 2014) U.S. Dist. LEXIS 120916, *31 (emphasis added); see also *Lucas v. IBM* (N.D. Cal. 2020) U.S. Dist. LEXIS 86086, at *14-18 [commission plan was an enforceable contract where court interpreted the right to modify or cancel as allowing "only prospective changes"].) Whether an employer's change is prospective or retrospective and whether a change could violate the employer's duty of good faith and fair dealing or give rise to other contracts defenses are fact-intensive questions.

For employees who have put in the time and effort to earn a large sale for their employer, nothing stings like being denied the fruits of their labor. Particularly in Northern California, where major software deals generate enormous commissions, it is critical that employees paid on commission receive effective representation in protecting their rights.

Abraham

Sarah Abraham is an associate at The Jhaveri-Weeks Firm, P.C. *She is a civil litigator, with a focus on employment law. Ms. Abraham previously was an attorney fellow at Community Legal Services in East Palo Alto, where she practiced employment law and housing law. She earned her J.D. from Harvard Law School in 2017.*

Jhaveri-Weeks

Bill Jhaveri-Weeks, is the founder of The Jhaveri-Weeks Firm, *a San Francisco-based law office representing organizations and individuals in civil litigation, including class actions, employment claims, commercial disputes, and appeals. Mr. Jhaveri-Weeks frequently speaks and writes on developing issues in litigation, particularly in the areas of class actions and employment law. He clerked for a U.S. Court of Appeals judge and graduated from Yale College and New York University School of Law.*