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Adam C. Abrahams
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Re: Commission Pay Plans And Overtime

Dear Mr. Abrahams:

This is in reply to your letter of March 5, 2002, directed to Arthur Lujan, State Labor Commissioner, requesting DLSE's position concerning an employer, subject to Wage Order 2, employing commissioned inside salespersons. These salespersons receive a monthly "base salary" greater than one and one-half times the minimum wage¹ and are paid bi-monthly. In addition to the base salary, the employees receive commissions paid on a monthly basis. We must admit, however, that the explanation of the commission schedule is not clear to us.

Your first question is whether DLSE would find any issues with the commission plan you describe. As stated, we can make no determination on that point inasmuch as we don't have sufficient facts to evaluate the plan. We assume that the "par" amount upon which the commission depends is some objective figure and that the calculation is not one which would fall within those prohibited by such cases as *Quillian v. Lion Oil* (1979) 96 Cal.App.3d 156; 157 Cal.Rptr. 740, *Kerr's Catering Service v. Department of Industrial Relations* (1962) 57 Cal.2d 319, 19 Cal.Rptr. 492, 369 P.2d 20, or *Hudgins v. Neiman Marcus* (1995) 34 Cal.App.4th 1109. However, in order to specifically opine on the plan, we must have all of the facts.

Your second question asks whether the employer is required to pay overtime to the salespersons when they work over eight hours in a day and/or 40 hours in a workweek.

You do not indicate any type of exemption you may be relying upon, and, quite frankly, we are at a loss to understand why the question is asked? Obviously, unless there is some exception to the rule, the employees must be paid the appropriate premium for overtime.

¹It is not clear why you mention this wage amount unless you feel that the employees, covered by Order 2, may be eligible for exemption under the commissioned sales exemption. That would not be correct, however, because the exemption is limited to workers covered by Orders 4 and 7. We mention this only to alleviate any misunderstanding.

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As an adjunct to the second question, you ask what would happen if the employees fail to report or attempt to conceal² their overtime?

It is, of course, axiomatic that it is the employer's obligation to keep accurate time records. (See Labor Code § 1174, IWC Orders, Section 7) In addition, the law requires that the employee be paid for all hours the employee is "engaged, suffered or permitted" to work. Consequently, it is up to the employer to develop a system which accurately keeps track of the hours worked by the employees.

Your third question asks whether the employer needs to include the commissions when determining the regular rate of pay or can it figure the regular rate based on the base salary?

The regular rate of pay under California law (as it is under federal law) includes "all remuneration for employment paid to, or on behalf of, the employee." (29 USC § 207(e)) In determining what payments are to be included in or excluded from the calculation of the regular rate of pay, California law adheres to the standards adopted by the United States Department of Labor to the extent that those standards are consistent with California law. This includes, of course, any sum paid for hours worked or performing a duty (i.e., "on-call" time, selling a product, etc.)

It has been the long-established enforcement policy of the DLSE (which closely tracks the federal regulations in this regard) to include such indirect wages as housing, meals, etc. These sums are added to the cash wage paid for purposes of determining the "regular rate" of pay. The federal courts have addressed this issue and the U.S. Supreme Court in the case of *Walling v. Youngerman-Reynolds Hardwood Co* (1945) 65 S.Ct. 1242, 1245 noted:

"The regular rate by its very nature must reflect all payments which the parties have agreed shall be received regularly during the workweek, exclusive of overtime payments. It is not an arbitrary label chosen by the parties; it is an actual fact. Once the parties have decided upon the amount of wages and the mode of payment the determination of the regular rate becomes a matter of mathematical computation, the result of which is unaffected by any designation of a contrary 'regular rate' in the contracts." (See also, *Walling v. Alaska Pacific Consolidated Mining Co.* (9th Cir.1945) 152 F.2d 812, 815)

²In the experience of the DLSE, the fact that California law requires an employer to pay a premium for overtime actively discourages employees from surreptitiously concealing the fact that they have worked overtime.

Your third question asks: "If the employer needs to include commissions, how would the employer determine the regular rate of pay, especially in light of the fact that the commissions are determined monthly?"

The method of calculating the regular rate for piece workers, production bonus workers or commission workers has been discussed in a number of Opinion Letters issued by the DLSE³. Either of the following two methods may be used to determine the regular rate for purposes of computing overtime compensation:

1. Compute the regular rate by dividing the total earnings for the week, including earnings during overtime hours, by the total hours worked during the week, including the overtime hours. For each overtime hour worked, the employee is entitled to an additional one-half the regular rate for hours requiring time and one-half and to an additional full rate for hours requiring double time. This is the most commonly used method of calculation.
2. Using the piece or commission rate as the regular rate and paying one and one-half this rate for production during overtime hours. This method is rarely used.

It is recognized that the method outlined in alternative 1, above, resembles the computation used in the illegal fluctuating workweek plans. However, there is a distinct difference: Under that federal fluctuating workweek method the salaried employee is not given the opportunity to increase his or her basic rate; in fact, it is always the case that the longer the employee on a fluctuating workweek works, the lower the basic hourly rate of the salaried employee becomes. Under the DLSE method for piece workers, production bonus workers or commission workers, it is recognized that these employees are actually given additional time to make more pieces or earn more commission in the overtime hours so that the basic hourly rate may increase. Therefore, the *Skyline* analysis for computing the regular rate of pay is inapplicable to computing the regular rate for piece rate and commission employees. The *Skyline* court recognized this at 165 Ca.App.3d 239, 254.

As an alternative, (see 2, above) piece work performed during overtime periods may be paid by paying for each piece made during the overtime period at the appropriate rate, *i.e.*, time and a half (1½) for 8 to 12 hours, or double time (2) over 12 hours.

In the situation you describe, the regular rate for the commissions would be determined by dividing the total amount

³See O.L. 1993.02.22, 1993.02.22-1, of 1988.06.15, 1988.03.28, 1994.06.17-1, 1988.07.14, 1987.02.17

received in commissions for the month by the total number of hours worked in that month. The payment, however, would have to be based on the weekly payroll, not the monthly payroll. The overtime payment would have to compensate the employees at the appropriate premium rate for the overtime hours worked.

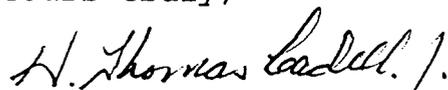
Finally, you ask: "If the employer has not been properly paying overtime, what process does the employer need to take to make its policy conform and make its employees whole?"

As you know, Order 2 has always required the payment of overtime on a daily as well as a weekly basis. Consequently, the payment of the overtime based on the commission income was an obligation of the employer since 1980.

The employer must make the affected employees whole by paying the past due overtime compensation. This would include present as well as past employees. We have not been told whether there is a written policy or agreement concerning this commission program so we cannot comment on the length of the statute of limitations which might be involved. We do note that the payment of overtime, being a statutory obligation, has a three-year statute of limitations even absent a written contract or policy.

We hope this adequately addresses the issues you raised in your letter of March 5, 2002. Please excuse the delay in responding to your inquiry. However, the information we have furnished herein is not new or unique; it has been the DLSE enforcement policy since at least 1980.

Yours truly,



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