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California Appellate Court Approves Employer Commission Plan with a Year-Long Chargeback Period

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Pursuant to the newly amended California Labor Code section 2751, all California employers who pay employees by commission must have a written contract specifying the terms of the commission compensation at issue by January 1, 2013. Against that backdrop, a California Court of Appeal has provided another helpful decision regarding the enforceability of California commission agreements.

In *Deleon v. Verizon Wireless,* the California Court of Appeal for the Second District analyzed whether an employer violates Labor Code section 223, which prohibits secretly paying a lower wage than agreed to by contract, by charging back commissions for sales when certain conditions subsequent to the sale were not satisfied. In *Deleon*, the condition subsequent was for a customer to keep Verizon's wireless cellular service for a designated period of time. In other words, Verizon advanced commissions for the sale of a cellular telephone service contract at the time the customer signed up for the service, but if the customer canceled the service within the designated time frame, Verizon would chargeback the commission it had advanced for the contract. The court affirmed summary judgment for Verizon, holding: (1) Verizon's commission payments were advances, not wages; and (2) an employer may lawfully chargeback commission advances if the required conditions subsequent to earning the commission are not met.

The Commission Plan

In the commission plan at issue in *Deleon*, Verizon spelled out precisely when and how the commissions would be earned and paid.[1] Specifically, Verizon's commission plan stated that employees would not earn commissions on sales unless and until the "chargeback period" had expired and the customer did not cancel its service. In the meantime, Verizon would advance commissions on the sales so that employees would have the benefit of the commissions before they were actually earned. If a customer canceled its service during the chargeback period, the value of the commission previously advanced for the sale would be charged back from future commission advances (not from base wages). The commission plan also spelled out different chargeback periods for different types of contracts: 365 days for postpaid price plans; 150 days for prepaid price plans; and 120 days for enhanced services.

1 Although Verizon paid its sales employees both a base wage and commissions, the decision focused only on the commission aspect of the compensation plan.

Under the commission plan, employees accepted the terms of the plan either by signing the document or by continuing employment with Verizon (none of the commission plans before the court had been signed, and so acceptance was expressed through continued employment).

Verizon provided its employees the written commission plan, as well as monthly commission statements that indicated the amount of commissions being advanced, and, when applicable, the amount of commissions being charged back. Verizon's paychecks also reported the payment of commissions via a line item labeled "Commissions."

The Claims

The plaintiffs asserted class action claims for violations of California law: Labor Code sections 510 and 1198 (alleged failure to pay overtime wages); Labor Code section 223 (the secret underpayment of wages); Labor Code sections 201 and 202 (failure to timely pay wages at termination); Labor Code section 204 (failure to timely pay wages during employment); and Labor Code section 226 (failure to accurately report wages on pay stubs).

Verizon's Motion For Summary Judgment

Verizon moved for summary judgment, arguing: (1) it paid its employees commission advances, not commission wages, and consequently it was free to chargeback those commission advances if the commission was not ultimately earned; (2) its chargeback policy was published in its commission plan, and consequently there was nothing secret about the chargeback policy; and (3) paying commissions pursuant to the chargeback policy was not paying a lower wage than had been agreed upon by contract.

The plaintiffs opposed summary judgment by arguing that there were triable issues of fact regarding whether: (1) the advances were in fact earned wages; (2) the employees understood the chargeback policy; and (3) the 365-day chargeback period was reasonable.

Key Holdings

In resolving the dispute, the *Deleon* court confirmed that the right to commission wages is a matter of contract and commissions are not earned until all of the conditions of the contract are satisfied.

Relying on *Steinhebel v. Los Angeles Times Communications, LLC,* 126 Cal. App. 4th 696 (2005), the *Deleon* court held that Verizon employees could not earn a commission unless the customer kept the service for the time period designated by the contract. It was irrelevant whether employees had ongoing responsibilities between the date the customer signed the contract and the expiration of the chargeback period because the contract dictated when commissions would be earned. Further, because Verizon paid commissions to employees before the expiration of the chargeback period, the commission payments were advances, not wages. Consequently, because Verizon paid commissions pursuant to the commission plan terms, it did not violate section 223. Since all other claims were derivative of the alleged section 223 claim, the court held there were no other Labor Code violations.

Key to the court's decision was that the chargeback provision at issue was not a secret. Moreover, Verizon was not underpaying "wages" because it charged back commission advances that had not yet been earned from future commission advances.

Although the plaintiffs argued otherwise, the court also held it was unnecessary for an employee to sign the commission agreement in order to authorize a deduction from wages under Labor Code section 224. The chargeback of commission advances did not constitute a deduction of wages since the commission payments were advances and not wages. Given this, an express authorization in writing under Labor Code section 224 was not required.

The court further found that there was no triable issue of fact regarding whether Verizon employees understood the terms of the commission plan because: the terms of the plans were clear and unambiguous; Verizon provided training at the inception of employment regarding how commissions would be calculated and paid; Verizon provided annual training regarding how commissions would be calculated and paid; and the plans all stated continued employment constituted acknowledgment of an understanding of the commission plan terms and acceptance of them. Moreover, the employees' failure to express a lack of understanding of the plan terms during employment demonstrated they did understand how commissions would be calculated and paid.

Finally, the court held that the 365-day vesting period for commissions was not unconscionable. The plaintiffs argued that a one-year vesting period was unreasonably long and effectively passed business losses on to employees. The appellate court rejected that argument because: (1) the vesting period set by Verizon did not shock the conscience (the court specifically rejected the plaintiffs' request that it apply a reasonableness – rather than a shock the conscience – standard); and (2) the chargeback was tied to an individual employee's sales.

Implications for Employers

Deleon confirms the benefits of having a written commission compensation plan that precisely defines when and how a commission is earned and will be paid to employees. If employers pay commissions prior to the commission being earned, employers should use clear terminology to specify that the payments are actually advances on future commissions, and are not wages unless and until the defined chargeback period expires without certain conditions occurring (*i.e.*, the customer cancelling the contract or returning the item previously sold).

The decision in *Deleon* shows that, regardless of how the commission plan is structured, employers should ensure that their commission contracts are clear, unambiguous and transparent to employees. *Deleon* also underscores the value of providing training and consistent communications to employees about the commission plan.

Finally, the *Deleon* decision provides employers with additional comfort regarding the permissible length of time for a chargeback period, as it upheld a 365-day chargeback period.

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