WEB EXCLUSIVE: California Auto Dealers Beware: Commission-Paid Dealership Employees Entitled To Separate Rest Period Pay

Insights
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A California appellate court ruled on February 28, 2017, that employees paid on a commission basis must be separately compensated for legally required rest periods (*Vaquero v. Stoneledge Furniture LLC)*. Although this decision did not specifically involve automobile dealerships, this decision could impact any dealerships in California compensating individuals completely or partially on a commission basis (e.g., salespersons, finance managers, service advisors). If your dealership is in this category, you should review this decision to determine whether you need to immediately adjust your pay practices.

Until Now: Rest Period Wages For "Commission Salespersons" Were Uncertain

Under the Wage Orders promulgated by the Industrial Welfare Commission, California employers have long been required to provide non-exempt employees working at least 3.5 hours in a workday with a paid 10-minute duty-free rest period for each four hours of work or major fraction thereof. Historically, commissioned employees were "paid" for their rest period time because it counted as hours worked "for which there shall be no deduction from wages."

For employees paid by piece rate, California courts have interpreted this to mean that piece-rate employees must be paid separately for non-productive time, including rest periods. In fact, recent court decisions sent the message to dealerships that, in the fast-paced auto dealership environment, strict requirements exist to account for every hour worked for many workers, including commission-paid employees who may be partially exempt from overtime. In 2013's *Bluford v. Safeway Stores, Inc.*, for example, the California Court of Appeals concluded that a piece-rate compensation formula that does not compensate separately for rest periods does not comply with California minimum wage law. And in *Gonzalez v. Downtown LA Motors*, decided that same year, the court held service technicians paid on a piece-rate basis were entitled to separate pay for non-productive time worked, but left open the question of rest period compensation.

Following these decisions, separate hourly pay became required for rest period pay for piece-rate employees (technicians). Last year, the California Labor Code section 226.2 (effective January 1, 2016) established a special rate of pay to be provided to piece-rate employees on rest and recovery periods: the greater of the applicable minimum wage or the average productive rate which excludes time and pay for rest and recovery periods. These amounts were paid in addition to compensation for "other non-productive time" at no less than the applicable minimum wage.

Although auto dealerships were expressly excluded from the safe harbor provisions of the statute, the special rate of pay for rest and recovery periods applies to piece workers employed by auto dealers. On the other hand, there is absolutely no mention in the statute regarding commission-paid employees. In fact, the California Labor Commissioner's enforcement position is that AB1513 applies only to piece-rate – not commission-paid – employees. It is uncertain whether similar legislation for commission salespersons will follow.

Until now, there was no case law extending separate rest period pay requirements to other forms of incentive pay paid to auto dealer employees including commissions, and no California appellate court had specifically ruled that commission-paid employees were to be compensated separately for rest period time. Tuesday's decision changed all of that.

Commission Salesmen Not Compensated For Rest Periods
In *Vaquero*, the plaintiffs were commission-paid salespersons at Stoneledge Furniture who earned commissions based on a "percentage of sales" or a guaranteed draw against those commissions bringing pay to at least $12.01 for each hour worked in the pay period. The draw was designed to compensate them to satisfy California's commission-sales exemption, which requires that employees be principally engaged in sales, earn more than 50 percent of their total compensation in commissions, and receive an average hourly rate from total compensation that *exceeds* 1.5 times the applicable minimum wage (then $10.00 per hour). Any draws paid were recouped from future commissions.

The commission agreement did not compensate the salespersons separately for any "non-selling time, such as time spent in meetings, on certain types of training, and during rest periods." Nonetheless, the time employees spent taking rest periods was recorded and accounted for, but the source of all earnings of the salespersons was limited to the draws and commissions provided for in the agreement. In determining whether an employee received at least $12.01 per hour, the employer averaged all hours worked, including time spent on rest breaks, to calculate the amount to be paid for commissions (or draws against those commissions).

California Court Of Appeals Alters Rest Period Compensation Structure
The plaintiffs challenged this method of pay, but the trial court rejected their claim and ruled the commission agreement adequately compensated them for all hours worked, including rest periods. On appeal, however, the appellate court reversed this ruling. In the February 28, 2017 written opinion, the appeals court decided that because the draw was recouped from future commissions, it could not constitute a separate payment for rest periods. As the court said, this is because it was "not compensation at all. At best they were interest-free loans."

According to the court, the commissions earned for productive selling time similarly did not account for non-selling time spent on rest periods. The court reasoned the commission would be the same regardless of whether rest periods were taken. For these reasons, the court concluded neither a draw nor a commission payment constituted compensation for rest periods.

Rather, the court found that the time spent on rest periods was, in effect, deducted unlawfully because it was unpaid time regardless of how much money was earned for commissions. Such unproductive time, in other words, had to be compensated separately and could not be included or averaged with commissions paid for productive time to satisfy the applicable minimum wage requirements. In reaching this conclusion, the court rejected the employer's argument that commission-paid employees were not similarly situated with piece-rate employees. "Nothing about commission compensation plans," the court said, "justifies treating commissioned employees differently from other employees."

Tips For Dealerships

This appellate court decision does not reject all forms of commission-based pay plans in auto dealerships. "Instead," the court said, "we hold only that such compensation plans must separately account and pay for rest periods to comply with California law." Although Tuesday's decision concluded rest periods and other non-productive (selling) time must be separately compensated from sources other than commissions (i.e., pay for productive time), it did not specify the method by which such employees should be paid separately for such time.

The good news is there are a variety of legally permissible compensation methods that dealers can use to comply with the new legal standard. We have worked with many California dealerships over the last few years to implement various compensation systems which comply with the new standards imposed by the court, but they generally fall within three categories.

Base Hourly Rate For All Hours Worked Plus Commissions Or Other Incentives

After the Stoneledge salesmen challenged their employer's compensation plan, the employer reportedly revised the compensation agreement to provide a base hourly rate of $10.00 per hour (then minimum wage) for all hours worked plus incentives based on a percentage of sales. This revised pay plan was not challenged by the plaintiffs. Although this method could comply with the requirements of *Vaquero,* it dramatically increases labor costs unless the commission rate is reduced.

Such a reduction could destroy the commission sales exemption since base wages would more frequently exceed 50% of total compensation for less productive employees. On the other hand, employers could devote less time to record keeping issues that may arise if they were required to accounting for and paying for rest periods and non-selling time separately.

The *Vaquero* court rejected the employer's argument that paying additional compensation for rest periods would result in "hordes of lazy sales associates" because an employer could impose disciplinary action on salespersons failing to meet minimum sales expectations up to and including termination. However, a good argument may be made that paying a base hourly wage for <u>all</u> hours worked, with less money invested in commissions and bonuses, may well provide less incentive for salespersons to sell cars.

Hybrid Compensation Method #1

Some alternate methods for paying salespersons include (a) paying commissions and bonuses for sales activity and (b) paying separately for non-sales activity and rest period time sufficient to satisfy the applicable minimum wage. This method requires accounting for three types of activity: sales activity, non-sales activity, and legally required rest (and recovery) period time. Many California dealerships already use this method.

The first hybrid method generally provides more funds for incentivizing sales activity consistent with commission plans commonly used by dealerships, but adds additional elements for the separate compensation required by *Vaquero*. Compared to a 100% commission plan used in *Vaquero*, a hybrid plan may increase the labor budget anywhere from $100 to $500 per month, depending on the amount of non-sales activity involved.

This method also makes it easier to satisfy the commission sales exemption at lower levels of productivity because more of the salesperson's total income is commissions. On the other hand, timekeeping and accounting could be more difficult and harder for sales managers to manage, which could lead to expensive litigation.

Hybrid Compensation Method #2

The second alternate plan maintains the commission and bonus structure as above, but only pays hourly compensation for rest and recovery periods and excludes other non-sales activity from hourly pay. While this method would address the direct holding of *Vaquero*, it would not provide cover for further expansion similar to those that encompassed technician pay for non-productive time. In the end, this second hybrid method has a lower immediate cost, but involves greater risk on a go-forward basis.

Conclusion

You should consult with your legal counsel to determine whether your commission compensation plans adequately compensate your salespersons for rest period time and properly disclose the method of calculation on their pay statements, Wage Theft Protection Act Notices, and written pay plans. If you have a hybrid pay plan, you should also make sure you are correctly defining, accounting for, and compensating for selling versus non-selling time including rest periods and other non-productive time, as applicable. Taking effective action to audit current commission pay agreements and related practices could help you avoid expensive litigation and potential liability.

If you have any questions about this decision or how it may affect your organization, please contact any member of our Automotive Dealership Practice Group, your regular Fisher Phillips attorney, or any one of the attorneys in any of our California offices:

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