New for 2013 – Commission Plan Requirements

By January 1, 2013 all California employers must be in compliance with new State law covering commission plans. The good news is that by following the law employers will be forced to take a fresh look at commission plans, make sure they are compliant, and in the process document policies that can help protect against claims for unpaid commissions.

Under the new law, all commission plans have to be in writing and set forth the method by which commissions will be calculated and paid. A signed copy of the written plan must be given to the employee and the employee must sign a receipt for the plan. Prudent companies will keep a signed copy of the receipt in each employee's personnel file. The new law also provides that even if the contract expires, if the parties keep working under its terms, the terms remain in full force and effect until the contract is superseded or the employment ends.

Interestingly, the law explains that bonuses are not covered by the law unless the "bonus" is a fixed percentage of sales or profits offered to the employee for work performed (sounds like a commission!). Bonuses are not the same as commissions, which are typically one form of compensation for employees such as sales representatives, and are based on the number of products or amount of services sold. If offered, bonuses are best if based solely on the company's discretion and on several well-defined, objective factors. This enables the employer to avoid paying a bonus that shouldn't be paid by considering defined, transparent criteria and avoids a situation where employees feel entitled to a bonus no matter how they or the company perform.

Back to the commissions. When drafting a commission plan, there are some basic rules to follow.

1) Keep it simple. Imagine you are sitting in court or before a government agency and have to explain how the commission is calculated and paid. Assume the judge, jury, or deputy Labor Commissioner is unfamiliar with your business and products or services you offer. You should be able to explain the plan easily, in terms anyone can understand.

2) In California, commissions that have been "earned" are considered wages and must be promptly paid to the employee. So it is crucial that you define, in writing, exactly when the commission is earned. Different companies have different practices, so determine when your company wants the commission to be triggered. Is it when the invoice or purchase order is received? Perhaps it's when the client or customer pays. Or maybe it's after payment <u>and</u> after the employee has continued to provide certain services to that client. Whichever trigger the employer decides is appropriate should be communicated to the employee and spelled out in the written plan description. It's also smart to require that the employee still be employed in order to be eligible for commissions. Once the employment relationship ends, the entitlement to any future commission should be cut off.

3) Speaking of former employees … if a recently departed employee is arguably entitled to additional commission, the commission should be paid as soon as the amount can be calculated.

Expensive litigation and waiting time penalties can follow an initial hesitancy to pay relatively small amounts of commission simply because there’s a quibble about how much is owed.

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