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California Court of Appeal Approves Variable Hourly-Based Compensation Plan

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In recent years, California courts have complicated the lives of employers that utilize commission and piece rate compensation systems (*i.e.*, “activity-based compensation”). Federal and state courts have repeatedly found activity-based compensation plans to be unlawful under California law, even when they result in per-pay-period compensation that exceeds the minimum wage. Courts reasoned that these plans violate California law because they do not separately compensate employees for each hour worked, such as time spent performing non-commission or non-piece-rate earning tasks (*e.g.*, waiting for work, cleaning, attending meetings, etc.). See, *e.g.*, *Vaquero v. Stoneledge Furniture LLC*, 9 Cal. App. 5th 98 (2017); *Gonzalez v. Downtown LA Motors, LP*, 215 Cal. App. 4th 36 (2013).

However, the California Court of Appeal recently gave its stamp of approval to a variable hourly-based compensation system that could permit employers to closely approximate the wages paid using traditional commission/piece rate plans while complying with California law. In *Certified Tire and Serv. Ctrs. Wage and Hour Cases*, 2018 WL 4815544 (Cal. Ct. App. Sep. 18, 2018) (“*Certified*”), the employer compensated automotive technicians as follows:

[A] technician is paid an hourly wage for all work performed ..., which ... exceeds the legal minimum wage. ... [T]he hourly rate paid to a technician during any given pay period may be higher than the guaranteed minimum hourly rate based on a formula that rewards the technician for work that is billed to the customer

[E]ach billed dollar of labor charged to a customer as a result of the technician’s work during the pay period is referred to as the technician’s “production dollars.” *Certified Tire* ... multipl[ies] the technician’s production dollars by 95 percent, multiplying that amount by a fixed “tech rate” ..., and then dividing by the total hours worked by the technician during the pay period. By applying this formula, *Certified Tire* determines the technician’s “base hourly rate” for the pay period. If the base hourly rate exceeds the technician’s guaranteed minimum hourly rate, the technician is paid the base hourly rate for all time worked during the pay period. If the guaranteed minimum hourly rate is higher than the base hourly rate, the technician is paid the guaranteed minimum hourly rate for all time worked during the pay period.

Id. at *1. Put simply, a technician’s hourly rate was the higher of a pre-set minimum, or a rate derived from the technician’s average hourly “production.” The court provided this illustration of the plan’s operation:

[A] technician with a “tech rate” of 30 percent who generated \$5,000 of production dollars in an 80-hour pay period, would achieve a base hourly rate for that pay period of \$17.81 (based on \$5,000 multiplied by .95, multiplied by .30, divided by 80). Assuming that base hourly rate is higher than the technician’s guaranteed minimum hourly rate, the technician would be paid \$17.81 multiplied by 80 hours for the pay period, for a total payment of \$1,424.80.

Id. at *1 n.4.

The plaintiffs alleged this compensation method violated California law because the employer required employees to perform work that could not generate production dollars (*e.g.*, tire rotations, oil changes, cleaning, attending meetings, etc.) and thus “could not *increase* the base hourly wage[.]” *Id.* at *2 (emphasis in original).



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As such, time spent performing these non-productive activities was “all uncompensated[.]” *Id.* at *3 (“[A]ccording to [plaintiffs], technicians earn ‘no wages’ when performing work that does not generate production dollars, and therefore ‘the [plan] violates the minimum wage requirements by failing to provide the required separate compensation’ for each hour worked.”). To bolster this point, plaintiffs compared the compensation of two hypothetical technicians:

[A]ssume one technician generates \$2,000 of production dollars in a 30-hour pay period working solely on tasks that generate production dollars. A second technician generates \$2,000 of production dollars in a 40-hour pay period, devoting 10 hours of the 40 hours to tasks that do not generate production dollars. Further assume both technicians have a “tech rate” of 30 percent. The base hourly rate for the first technician is \$19 per hour ($\$2000 \times .95 \times .30 \div 30 = \19). The base hourly rate for the second technician is \$14.25 per hour ($\$2000 \times .95 \times .30 \div 40 = \14.25). For 30 hours of work the first technician gets paid \$570 during the pay period ($\$19 \times 30 = \570). For 40 hours of work the second technician also gets paid \$570 during the pay period ($\$14.25 \times 40 = \570).

Id. at *7. According to plaintiffs, this example illustrates that “because both technicians are taking home the same amount in their paychecks (*i.e.*, \$570) even though the second technician worked 10 hours more than the first technician while involved in tasks that did not generate production dollars, the second technician is not compensated *at all* for the last 10 hours of the pay period.” *Id.* at *8 (emphasis in original). The court rejected the plaintiffs’ argument.

First, the court noted that the technicians’ pay plan was an hourly-based compensation system, not an activity-based compensation system. “Although the hourly rate differs from pay period to pay period because technicians have the opportunity to increase their guaranteed minimum hourly rate based on the generation of production dollars, the technicians are always paid on an hourly basis for all hours worked at a rate above minimum wage regardless of their productivity, and regardless of the type of activity in which they were engaged during those hours.” *Id.* at *7.

Second, the court found “no merit to plaintiffs’ contention that the second technician is receiving no wages ... for the time spent on tasks that do not generate production dollars[.]” *Id.* at *8. Because the plaintiffs received an hourly wage for all hours worked – albeit a variable one – the court “reject[ed] the plaintiffs’ argument that [the employer] must make a separate additional payment to the technician” for unproductive time to comply with California law. *Id.* Accordingly, the court concluded that the variable hourly rate compensation was lawful.

The court’s decision in *Certified* provides a roadmap for employers struggling to create compensation plans that incentivize production while complying with recent decisions invalidating traditional commission and piece rate plans. Employers with questions regarding their compensation plans should consult with competent counsel.

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