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Is Your Bonus Plan Unlawful?

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As an employer, you want to encourage your employees to increase the company's profitability. Many employers attempt to motivate employees by instituting bonus plans designed to both maximize revenue and minimize expenses. The California Court of Appeal recently called into question many profit-based bonus plans.

In particular, in Ralphs Grocery Co. v. Superior Court, 112 Cal. App. 4th 1090 (2003), an employee sued Ralphs Grocery Company claiming that Ralphs' bonus plan violated California law because the plan based the bonus on the net earnings of the store. In other words, Ralphs' bonus plan took into account not only the store's revenue, but also the store's expenses. The Court of Appeal allowed the employee to pursue his claims on behalf of himself and other exempt and non-exempt employees of Ralphs. The appellate court concluded that Ralphs' inclusion of workers' compensation expenses in the bonus calculation violated the California Labor Code, which "prohibits employers from directly or indirectly holding its employees accountable for workers' compensation costs." The appellate court further concluded that, with respect to non-exempt employees, Ralphs' inclusion of costs associated with cash and merchandise shortages also violated California law, although inclusion of cash and merchandise shortages in the bonus calculation was permissible for exempt employees.

Ralphs appealed the ruling to the California Supreme Court. Recently, however, the Supreme Court denied Ralphs' request to review the ruling. In addition, while efforts are currently underway in the Legislature to overturn portions of the Ralphs decision, no bill has made it to the floor of the Legislature. Until the Supreme Court or the Legislature overturns the Ralphs decision, it is final and binding on all trial courts in the state.

In light of the Ralphs decision, employers should review any profit-based bonus plans and make necessary modifications to ensure compliance with the current state of the law. When reviewing bonus plans, employers should consider the following general guidelines:

Exempt Employees

- Cannot include costs or losses associated with workers' compensation.
- Can include deductions for losses beyond the employee's control (e.g., cash and merchandise shortages, breakage, and loss of equipment).
- Bonus plan can be profit based, with the exception of workers' compensation costs and other costs the Labor Code prohibits employers from passing along to employees.

Non-Exempt Employees

- Cannot include costs or losses associated with workers' compensation.
- Cannot include deductions for losses beyond the employee's control (e.g., cash and merch-andise shortages, breakage, and loss of equipment).
- Bonus plan should generally be performance based or based on revenues, as opposed to profits.

Employers structuring bonus plans in the above manner should avoid the potential exposure faced by many employers who base their bonus plans on the company's net profits.