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Easy Come, Easy Go: State Rules on Post-Termination Forfeitures of Bonuses and Commissions

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Many employers have a compensation plan in which an employee may qualify for commissions or a bonus as of December 31 to be paid in the following year. These plans often provide that if the employee is no longer employed by the date on which the bonus is scheduled to be paid, the bonus is not earned, and consequently the employer need not pay it. Are there any problems with this?

The answer is: yes and no. In many states, an employer may legally require an employee to forfeit a bonus or commission if the employee is no longer employed on the date the bonus or commission is to be paid. In other states, these types of forfeiture provisions are expressly prohibited. Whether a forfeiture provision is legally permissible will vary based upon many factors, including: (i) the state in which the employee is employed; (ii) whether the compensation being forfeited is a commission (based on sales made) or a bonus (based upon company or individual performance); (iii) how and when the commission or bonus is calculated, earned, and paid; and (iv) when, why, and how the employee’s employment terminates. This article addresses just some of these factors, but not all state laws regarding bonus or commission forfeiture provisions. Because the rules vary widely from state to state, one-size-fits-all plans may not be enforceable everywhere an employer has employees. Employers should consult with counsel to confirm that a specific forfeiture provision is lawful in a particular state. Below is a snapshot of some state rules applicable to post-termination forfeitures of bonuses and commissions.

Georgia

Generally, absent a contract that provides otherwise, at-will employees in Georgia are entitled to bonuses and commissions “earned” while they were employed. Forfeiture provisions are disfavored in Georgia, but they are not unlawful. Where a bonus or commission plan in unmistakable terms provides that the compensation will not be paid if the employee is no longer employed on a certain date (and has no other legal problems), Georgia courts will uphold the forfeiture provision. Georgia law does not distinguish between bonuses and commissions in the forfeiture context, and have enforced forfeiture of both.

Forfeiture provisions must be carefully worded, because any confusion in the language will be resolved in favor of paying the bonus or commission. Employers also should be careful to comply with all other terms in the bonus or commission plan. A carefully worded forfeiture provision that is clear and unmistakable in its terms is likely to be enforceable in Georgia.

Virginia

In Virginia, courts treat forfeiture provisions in much the same way as they are treated in Georgia: they are disfavored but not unlawful. Virginia treats a provision stating that an employee must be employed when the bonus or commission is to be paid as a requirement for vesting of the bonus or commission and generally essential to the right to compensation. Virginia, like Georgia, requires clear, unambiguous language setting forth the terms of the compensation plan.

New York

New York courts treat bonuses, incentive plans, and commissions differently in the forfeiture context. Bonuses or incentive payments may be forfeited under the terms of the compensation plan, but commissions are considered earned wages, which cannot be forfeited. Thus, the key determination is whether the compensation to be forfeited is properly characterized as a bonus, incentive payment, or commission.

Under New York law, earned wages – which are defined to include commissions – are not subject to forfeiture. Bonuses, however, may be forfeited because they are paid at the discretion of the employer. New York law states that an employee's entitlement to a bonus is governed by the terms of the employer's bonus plan, and courts in New York have regularly upheld forfeiture where employees left or were discharged from their jobs before a bonus became payable under the employer's bonus plan. Similarly, compensation owed under incentive compensation plans may be forfeited. Compensation is part of an incentive compensation plan where it is supplemental income based on the employee's individual achievement as well as overall business performance or other factors outside of the employee's control.

Whether a particular type of compensation is an earned commission or a forfeitable bonus or incentive compensation turns on various factors. A bonus or incentive compensation must supplement the employee's base salary. If the compensation plan has ambiguous or contradictory language, or there is conflicting evidence as to the nature of the payments, a question of fact may arise regarding whether the compensation is a bonus or a commission, potentially rendering the forfeiture clause unenforceable.

California

California also draws a critical distinction between a bonus and a commission, and different rules apply depending on the nature of the payment. Forfeiture of a bonus generally is permissible where the employee resigns or is terminated with good cause. Where an employer terminates an employee without good cause, however, forfeiture is unlawful, and the employer must pay the bonus. The forfeiture clause should carefully define what grounds will constitute good cause, such as poor performance or misconduct. Commissions are seen as earned, vested wages and generally may not be forfeited.

What Should Employers Do?

There are certain steps an employer can take to increase the likelihood that forfeiture provisions in its compensation plans will be enforced:

- The language providing for forfeiture must be completely clear and unambiguous.

- The provision should state not only that the employee will not receive the compensation if he or she is not employed on a certain date, but also whether the employee will receive compensation if he or she resigns, is terminated for cause, or is terminated without good cause.
- For commission payments, the employer should state that the commission is not earned or vested until certain specific conditions are met, including that the employer has received payment from the customer and that the employee must be employed on the date of payout (specifying what the date is).
- All employees should sign an acknowledgment that they have read the compensation plan and agree to its terms. Consider having employees initial the forfeiture provision.
- Where a compensation plan includes both bonuses and commissions, distinguish between the bonus portion of the compensation and the commission portion of the compensation, with different forfeiture rules for each.

Taking the steps listed above will increase the likelihood that post-termination forfeiture provisions will be enforced, but even with these precautions, some states will not permit the forfeiture of earned commissions. As an employer grows and expands its ranks to new states, it is crucial to review compensation plans with counsel for compliance.

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