Are "Draws" Against Commissions Unlawful "Kick-Backs"?

Insights
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Media reports have mistakenly suggested that a recent decision by the 6th Circuit U.S. Court of Appeals (Kentucky, Michigan, Ohio, and Tennessee) found the federal Fair Labor Standards Act to prohibit recouping a draw or advance from future earnings. However, a closer reading of the opinion proves that you can't judge a ruling by its headings.

Stein v. hhgregg Inc. involved an FLSA "collective action" against a seller of appliances, furniture, and electronics. The plaintiffs were retail-sales employees paid solely on a commission-basis. They received what they called a "draw" when their commissions failed to meet the FLSA's minimum-wage requirements.

Employees who received such a draw had to repay the sum in later weeks for which their commissions exceeded that minimum wage. They were required to "immediately pay the Company any unpaid Deficit amounts" at the end of their employment. The plaintiffs claimed that these policies violated the FLSA (and state law). The lower court dismissed the FLSA claims, finding that these practices were not inconsistent with that law.

However, the 6th Circuit reversed the dismissal and sent the case back for further proceedings. Although a heading in the court's opinion said that the employees "alleged sufficient facts to demonstrate that the draw policy violates the FLSA", the court in fact held that requiring the draw to be repaid from *future earnings* did *not* violate the FLSA.

Draws/Advances And The Minimum Wage

Employers who pay on a commission-basis commonly make advances against future commissions. One approach involves a salesperson's receiving each payday the greater of (i) the commissions he or she is due, or (ii) an amount that is at least equal to the FLSA's minimum wage for all of the salesperson's hours worked (plus any necessary FLSA overtime premium, of course). Under this kind of plan, if the salesperson's commissions come to less than the minimum wage, the employer supplements them in an amount sufficient to make up the shortfall.

This supplement is carried-forward to be recouped from commissions in future pay periods, at least to the extent that those later commissions exceed the FLSA minimum wage then due. If it is necessary for the employer to supplement commissions frequently and/or in substantial amounts, then the salesperson might accumulate a substantial supplement total that persists unless and until he or she earns enough in more-than-minimum-wage commissions to offset it. In some instances, this could mean that there is still a deficit when the salesperson's employment ends.

Is This A "Kick-Back"?

The claimants asserted that hhgregg's approach amounted to a kick-back, such that the FLSA minimum wage had not been paid "free and clear". The 6th Circuit largely rejected this argument, noting first that the phrase connoted a return of money already paid. The court concluded that, on the contrary, for the most part hhgregg's policy sought only to recover the supplement from "future earned commissions that have not yet been paid", a state of affairs that the court found to be consistent with a long line of U.S. Department of Labor interpretations.

On the other hand, two of the three panel judges ruled that the policy *did* violate the FLSA by requiring post-termination deficit repayments. In their view, such payments would amount to surrendering FLSA minimum wages already paid. Although hhgregg pointed out that it had never actually collected deficits after termination (including from the plaintiffs), did not plan to do so, and had eliminated this aspect of the policy, those judges determined that the mere articulation of such a *possibility* had "far-reaching practical implications for individuals" that somehow transgressed the FLSA. The third panel judge dissented from this ruling, observing that the plaintiffs had failed even to assert that they had actually been paid less than the FLSA-required wages as a result of the post-termination provision.

The Bottom Line

Notwithstanding misleading news reports, the court's decision reaffirms the longstanding view that properly-handled recoupments of minimum-wage supplements advanced against future commission earnings are lawful under the FLSA. The ruling also rests upon principles that support the legality under the FLSA of many other draw/advance-against-commissions pay plans that are designed to satisfy that law's requirements. But the case illustrates that employers should proceed more-carefully with respect to how to handle outstanding deficits at employment's end.

It is also important to take into account the requirements of states and other jurisdictions where these matters are concerned. Those provisions might impose greater or different restrictions and limitations than those presented by the FLSA.