FLSA Exemption Changes: A Possible "Plan B" For Retailers

Insights
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Expectations are that the U.S. Labor Department's proposed regulations re-defining the federal Fair Labor Standards Act's executive, administrative, professional, outside-sales, and derivative exemptions will be released in the next few weeks, if not within days. As we have said, these provisions will probably include (i) a substantial increase in the minimum salary amount, and (ii) a significant narrowing of the duties-related requirements.

Employers in retailing who treat store managers or assistant store managers as exempt under the FLSA (typically under the "executive" exemption) are concerned that these changes will force them to convert the employees to non-exempt status. But there might be an alternative.

The "Commission" Exception To The Rescue?

The FLSA's Section 7(i) provides an *overtime* exception for certain employees paid under a bona fide commission pay plan. It applies to an employee:

- Of a "retail or service establishment" (meaning a location 75% of the annual dollar volume of sales of which (i) is not for resale and (ii) is recognized as retail sales in the particular industry); *and*
- *More than* half of whose compensation for a "representative period" (of not less than one month) represents commissions on goods or services; *and*
- Whose regular hourly rate of pay for each overtime workweek is *more than* 1.5 times the FLSA's minimum wage.

"Commissions" are of course typically thought of as a percentage of sales. However, Section 7(i) does not require that a commission be figured this way. The payment can be of some other nature, so long as it is based upon or directly keyed to the goods or services the establishment sells. Management has some leeway for creativity in designing commission payments, but it must be sure that the pay plan is one that generates the requisite payments resulting from the application of a bona fide commission rate.

An Illustration

As a very simple example, assume that a pay plan calls for store managers to receive for each workweek 3% of a store's first $20,000 in gross weekly sales, plus 1.5% of the gross weekly sales over $20,000. The employer has selected and documented a representative period of one month.

A hypothetical store's gross sales for a particular workweek come to $30,000, and the store's manager works exactly 50 hours. For the most-recent representative period, the manager met the over-half-in-commissions test. The manager's total compensation for the workweek is [(3% × $20,000) + (1.5% × $10,000)] = $750. The manager's regular hourly rate for the workweek is ($750 ÷ 50 hrs.) = $15 per hour, which is more than 1.5 times the current FLSA minimum wage.

By virtue of Section 7(i), the FLSA does not require the employer to pay this manager any overtime compensation for the workweek.

Careful Forethought And Design

There are multiple ways to construct a pay plan that is intended to take advantage of Section 7(i). For instance, an employer might consider whether the plan should include some kind of a draw or guarantee; what to do if a manager's regular hourly rate is not high enough to satisfy Section 7(i) for a particular overtime workweek; whether or how to deal with manager absences under the plan, and so on. But every feature and component could affect the prospects that the requirements of Section 7(i) will be met, so management should thoroughly consider these possibilities in advance.

Also, management must have a record showing which employees are paid under Section 7(i); must have a written description of the agreement or understanding under which the employee is paid; and must document the "representative period" selected. Moreover, it is still necessary to maintain accurate records of each such employee's daily and weekly hours worked. In addition, the employer must keep a separate record of any non-commission earnings paid to the employee.

Furthermore, it is essential to determine whether the applicable overtime laws of a state or another jurisdiction include any exception like Section 7(i), or whether any similar provision is different from Section 7(i) in important ways. Employers must also evaluate whether such a plan complies with all other applicable laws, including (among others) those regulating when and how wages are to be paid.

The Bottom Line

It is likely that one or more aspects of the final exemption revisions will create serious difficulties for many retailers. Section 7(i) might provide a lifeline, but developing the underlying compensation system will take some time and planning so as to strike the best balance between legal requirements and business goals and needs.

Now is the time to think about what to do.