Retailers Might Want To Consider The FLSA's "Commission" Exemption

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More than ever, retailers are being squeezed between rising costs (including labor expense) and sagging revenue. What if there was a lawful way to compensate retail employees that gives them a stake in working to increase sales while at the same time eliminating the need to pay overtime? There *is* such an alternative, but many employers are overlooking it.

The federal Fair Labor Standards Act's Section 7(i) provides an overtime exception for certain employees paid under a bona fide commission pay plan. The exception applies to:

1. Employees of a "retail or service establishment";
2. Who receive *more than* 50% of their earnings in a "representative period" from commissions; and
3. Whose regular hourly rate of pay for each overtime workweek is *more than* 1.5 times the FLSA minimum wage.

For Section 7(i) purposes, a "retail or service establishment" is a location 75% of whose annual dollar volume of sales (i) is not for resale and (ii) is recognized as retail sales in the particular industry. The "representative period" may be any timeframe of one month or longer (although U.S. Labor Department's interpretations suggest an upper limit of one year).

"Commissions" are typically computed 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, if it is otherwise based upon or directly keyed to the goods or services the establishment sells. Recent court decisions indicate that management has at least some leeway for creativity in designing its commission payments.

Even if it applies, Section 7(i) does not relieve an employer from every FLSA obligation. For one thing, management is required to 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. The employer is also required to keep a separate record of any noncommission earnings paid to the employee, such as bonuses or pay supplements not based upon or keyed to sales.

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Of course, in today's supercharged wage-hour litigation environment, it is vitally important to be careful in setting up and maintaining a Section 7(i)-based pay plan. For instance, a compensation system calling for a regular payment keyed to a percentage of sales which an establishment can always be expected to make, and under which the employee rarely if ever receives any more than a slight additional commission amount, might be found not to be based upon a "bona fide commission rate". This would also be a danger if an employer pays a periodic draw which the employee's computed commissions rarely or never exceed.

It is also essential to find out whether the applicable laws of a state or other jurisdiction will permit an employee to be paid in a way that complies with Section 7(i). Some states have no exception analogous to Section 7(i). Others have overtime exemptions that are similar to but different from Section 7(i) in important ways; in this situation, the employer must follow the tougher exemption rules if it wants to avoid paying overtime to employees subject to that jurisdiction's requirements.

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