Insights: Alerts

# DOL Issues Important Overtime Update for Commission-Based Retail and Service Industry Employees

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On Monday, May 19, the Department of Labor ("DOL") withdrew the non-exhaustive lists of establishments that were potentially eligible for or excluded from the retail or service establishment exemption to overtime under Section 7(i) of the Fair Labor Standards Act ("FLSA" or "the Act"). The DOL publication can be found here. The DOL hopes that this change will clarify an area of longstanding confusion regarding employee eligibility and employer obligations for overtime payments in the retail and service industries.

Generally speaking, Section 7(a) of the FLSA requires covered employers to pay non-exempt employees overtime compensation for time worked in excess of 40 hours per workweek at a rate of at least one and one-half times the regular rate at which the employee normally works. For sales employees paid commissions, the only federally available overtime exemptions to this were the outside sales exemption found in Section 13(a)(1) or the retail and service industry exemption found in Section 7(i) of the FLSA. For the outside sales exemption to apply, the employee's primary duty must be making sales or obtaining orders or contracts and must be customarily and regularly working outside the employer's place of business. Sales employees who work from home do not qualify for the outside sales exemption. For inside sales representatives, the only available exemption at the federal level is the retail exemption which is narrowly defined and historically not applicable to most office environments. Satisfying this exemption has often been difficult or impossible for many businesses who are selling products or services but not from a typical retail storefront. (Notably, California is unusually more favorable on this point and has a broader inside sales employee exemption at the state level. However, the same employees may not qualify for the exemption at the federal level and, thus, are still eligible for overtime under federal law).

Under the FLSA, retail or service establishments are defined as establishments wherein 75 percent of the annual volume of sales of goods or services (or both) are not for resale and are recognized as retail sales or services in the particular industry. The DOL has long interpreted "retail or service establishment" as "requiring the establishment to have a retail concept," and such establishment would usually sell goods or services to the general public, serve the everyday needs of the community, be at "the very end of the stream of distribution," sell its products in smaller quantities, and would not be involved in the manufacturing process. This interpretation appears to remain unchanged. However, as noted above, the DOL withdrew from its guidance the non-exhaustive lists published in 1970 and 1971 categorizing the establishments the agency viewed as "having no retail concept" and those that "may be recognized as retail" for purposes of the Section 7(i) exemption to the FLSA. Although a business's inclusion on the "may be recognized" list provided strong support that the business may be in the retail or service sector, the inflexibility of the unchanging and static lists left many businesses uncertain of their standing. This confusion extended to both businesses included in one of the two lists and to businesses left off the lists entirely. These lists

were often criticized, especially by various courts. As just one example, the Seventh Circuit and Ninth Circuit Courts recently described these lists as an “incomplete, arbitrary, and essentially mindless catalog,” and stated that the lists “[did] not appear to flow from any cohesive criteria for retail and non-retail establishments.” Additionally, the “static” nature of the lists failed to account for the technological, developmental, and societal advancements in the nearly 50 years since the lists were last updated. The unchanging nature of the lists left a confusing matrix for modern employers to navigate as they attempted to determine whether they were “retail or service establishment[s]” under the FLSA and whether they were eligible to avail themselves of the Section 7(i) exemptions.

By withdrawing the previously longstanding lists from the Section 7(i) exemption rubric, the DOL has unequivocally opened the door for employers in the retail and service industries to assess and possibly reclassify their inside sales employees compensated on commission as exempt from overtime requirements under the FLSA. Notably, in withdrawing the lists, the DOL did not issue a new final rule that imposed any new requirements or required any additional affirmative measures for regulated entities to satisfy the exemption. The DOL hopes that these changes will promote “consistent treatment when evaluating Section 7(i) exemption claims by treating all establishments equally under the same standards” and that the change will “permit[] the reevaluation of an industry's retail nature as developments progress over time.” The DOL also hopes that the new rule and regulations will “reduce confusion when determining eligibility for claiming the Section 7(i) exemption.”

Moving forward, the analysis under Section 7(i) will allow courts and businesses to consider the fact-specific nature of the individual entity to determine whether the entity is a retail or service establishment under the FLSA, rather than relying on static lists that were last updated nearly 50 years ago. Now that the lists have been withdrawn, businesses wishing to utilize the Section 7(i) exemption for employees earning commissions will need to show that the individual employee is employed in a retail or service establishment (as defined by the FLSA), the worker's regular rate of pay is equal to or greater than one-and-a-half times the applicable minimum wage for the hours worked in a week with overtime, and that at least half of the employee's total earnings in a representative period are paid based on commissions.

Although it is too soon to tell how these developments will impact the various exempt determinations made by courts, the DOL hopes that withdrawing the lists will provide additional clarity to businesses operating in the retail and service industries. We recommend that employers who believe they may meet the statutory definition of retail or service establishments moving forward should conduct an audit of at least their commissioned positions and seek the assistance of counsel to determine whether certain employees (primarily inside sales employees) may be reclassified as exempt from the overtime provisions of the FLSA. Employers should also be cognizant of any state law requirements impacting overtime payment obligations.

As with all DOL regulations and rules, we will continue to monitor the situation and will address any noteworthy updates in subsequent Alerts.

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