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Overtime: Retail or Service Establishment Exemption

Among the exemptions to its overtime requirements, the Fair Labor Standards Act (FLSA) includes an exemption for certain employees of retail or service establishments, i.e., the retail or service exemption (RSE).

> No employer shall be deemed to have violated subsection (a) of this section by employing any employee of a retail or service establishment for a workweek in excess of the applicable workweek specified therein, if
> (1) the regular rate of pay of such employee is in excess of one and one-half times the minimum hourly rate applicable to him under section 206 of this title, and
> (2) more than half his compensation for a representative period (not less than one month) represents commissions on goods or services. In determining the proportion of compensation representing commissions, all earnings resulting from the application of a bona fide commission rate shall be deemed commissions on goods or services without regard to whether the computed commissions exceed the draw or guarantee.

29 U.S.C. §207(i).

In short, an employer must demonstrate that an employee meets three requirements in order to qualify for the RSE:

1. The employee works for a retail or service establishment;
2. The regular rate of pay for the employee is at least 1½ times the minimum wage; and
3. More than half of the employee's earnings are from commission on goods or services.[1]

This article discusses the first and third requirements, i.e., that the employee works for a retail or service establishment and that more than half the employee's earnings represent commissions on goods or services. The second requirement, that the employee's regular rate of pay is at least 1½ times the minimum wage, will not often be in dispute and thus is not discussed.

By **Jeffrey D. Pollack**

Retail or Service Establishment

The FLSA does not define the term "retail or service establishment," so in *English v. Ecolab Inc.*, 2008 WL 878456 (SDNY March 31, 2008), the court looked to the former retail or service exemption previously codified at §213(a)(2), which defined a retail or service establishment as "an establishment 75 [percent] of whose annual dollar volume of sales of goods and services (or of both) is (1) not for resale and (2) is recognized as retail sales or services in the particular industry." See generally id. at 2, 4.[2] See also 29 C.F.R. §779.411 (continuing use of that definition despite repeal of §213(a)(2)).

> Whether or not a compensation structure includes 'commission' is often not as clear as it might seem.

Plaintiffs in *Ecolab* worked as service specialists (exterminators) for defendant's commercial extermination division. They maintained office space in their respective homes, and travelled to customer locations to provide extermination services as assigned by Ecolab.

The court rejected plaintiffs' argument that the sale of pest control services to commercial customers was for resale.

> [T]he retail character of goods sold to industrial or commercial customers depends on the customers' use of such goods. For instance, coal sold for the production of electricity is a raw material used in the production of a specific product to be sold and is therefore considered "for resale." By contrast, coal sold to businesses such as bakeries for purposes of fuel and/or heat is not "for resale." [I]ce used to keep perishable items cold is not for resale, while ice cubes sold for use in drinks are for resale. The distinction turns on whether the good is sold to the end consumer in either in its original or altered form or consumed by the commercial or business entity for general uses.

Id. at 11 (citing 29 C.F.R. §779.333).

The court found that the services defendant provided to its commercial customers were not for resale because plaintiffs did "not fumigate goods that are then sold to the end consumer by the retailer." Id. at 10-11. See also 29 C.F.R. §779.329 (discussing effect of type of customer and type of goods or services); §§779.330-336 (discussing sales not made for resale).

Next, the court examined whether defendant's services are recognized as retail in that industry, noting that sales to commercial customers are not necessarily wholesale. The court found that the sale of pest control services was retail because they "serve the everyday needs of the community and are at the end of the stream of commerce." In doing so, the court rejected the argument that because the services were sold in bulk they were not retail. Id. at 14. See also 29 C.F.R. §779.328 (distinguishing retail and wholesale).

Relying on 29 C.F.R. §779.23, which provides that an "establishment" is a "fixed physical location," plaintiffs had preliminarily argued that they could not be employed by a retail or service "establishment" because they performed services not at a fixed location, but at different customer locations. The court rejected the argument,

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finding that the plaintiffs' respective home offices sufficed. The court also found that telephone and internet access to those home offices satisfied the requirement in §779.319 that the establishment be available to the general public.

Thus, the court found that Ecolab was a retail or service establishment.

Defendant in *Schwind v. EW & Associates Inc.*, 371 F.Supp.2d 560 (SDNY 2005), provided computer training services to commercial clients. The court found that such services were not for resale because training defendant's clients' employees "places defendant's services at the end of the stream of distribution…."

The fact that defendant's customers were businesses did not matter because the RSE "extend[s] in some measure beyond consumer goods and services to embrace certain products almost never purchased for family or noncommercial use." Id. at 566-67 (citing *Idaho Sheet Metal Works v. Wirtz*, 383 U.S. 190, 203 (1966)).

In *Gieg v. DDR Inc.,* 407 F.3d 1038 (9th Cir. 2005), plaintiff served as the finance and insurance manager at defendant's automobile dealership, earning commissions on the financing and insurance he sold. The court held that defendant's leasing of cars to retail customers constituted sales that are not for resale. Id. at 1048-49.[3]

Further, the court held that the exemption is not limited to those employees that sell the actual retail goods or services; it can apply to any employee of the establishment who satisfies all of the RSE's requirements. Accordingly, the court ruled that plaintiff could fall within the RSE.

Most financial and insurance sales, however, fall outside the RSE. In *Mitchell v. Kentucky Finance Co.*, 359 U.S. 290, 295 (1959), the Court held that companies that made small personal loans were not engaged in the sale of goods or services.

In *Ebersole v. American Bancard, LLC*, 2009 WL 2524618 (S.D. Fla. Aug. 17, 2009), plaintiff sold defendant's factoring services to commercial customers. The court found that defendant was not a retail or service establishment because it sold its services to merchants, not to the general public.

Similarly, in *Underwood v. NMC Mortgage Corp.*, 2009 WL 1269465 (D. Kan. May 6, 2009), where plaintiffs worked with defendant's clients to help them complete their respective mortgage applications and obtain residential loans, the court found that the company was not a retail establishment because it was in the financial industry. Even if defendant was not in the financial industry, it still would not be a retail or service establishment because it was not selling to the general public and was not at the end of the distribution stream.

The regulations provide examples of "establishments lacking [the] retail concept," including: lawyers' offices, HVAC contractors, vending machine companies, and plumbing contractors, 29 C.F.R. §779.317; along with examples of "establishments whose sales or services may be recognized as retail," including: automobile dealers, beauty shops, clothing stores, hotels, and restaurants, 29 C.F.R. §779.320. See also 29 C.F.R. §779.318 (discussing characteristics of retail or service establishments).

Commissions

"'The essence of a commission is that it bases compensation on sales, for example a percentage of the sales price….'" *Ecolab*, 2008 WL 878456 at 4 (quoting *Yi v. Sterling Collision Centers Inc.*, 480 F.3d 505, 508 (7th Cir. 2007)). "That is how commissions work: they are decoupled from actual time worked." *Yi,* 480 F.3d at 509. Whether or not a compensation structure includes "commission" is often not as clear as it might seem.

As with all of the Fair Labor Standards Act's exemptions, the employer must prove that the employee in question falls squarely within the retail or service establishment exemption's requirements in order for that exemption to apply.

One factor courts look for is the existence of a relationship between the amount charged to the customer and the amount paid to the employee. For example, in *Parker v. Nutrisystem Inc.,* 2009 WL 2358623 (E.D. Pa. July 30, 2009), sales associates earned a varying flat rate per sale depending, inter alia, on what product they sold. The court found that they were paid under a bona fide commission plan because there was proportionality between the "flat rates earned by workers and the prices paid by customer."

In *Horn v. Digital Cable & Communications Inc.*, 2009 WL 4042407 (W.D. Ohio Feb. 11, 2009), the court held that plaintiff cable installers who received a percentage of what defendant charged its customer (the cable company) were paid a commission. See also *Cantu-Thacker v. Rover Oaks Inc.*, 2009 WL 1883967, 4 (S.D. Tex. June 30, 2009) (plaintiff who worked at dog grooming facility and was paid 50 percent of the amount charged customer was paid a commission).

In contrast, in *Wilks v. The Pep Boys*, 2006 WL 2821700 (M.D. Tenn. Sept. 26, 2006), aff'd, 2008 WL 2080551 (6th Cir. May 15, 2008), the court denied defendant's summary judgment motion because there was no proportionality between employee compensation and customer price.

Another factor courts consider is whether the compensation structure incentivizes the employee. In *Yi*, automobile mechanics assigned to work on a car were paid "book hours" regardless of the actual time they spent on a particular job. The court held that the payment system was a commission because it provided an incentive to work faster. 480 F.3d at 509. See also *Klinedinst v. Swift Investments Inc.*, 260 F.3d 1251, 1256 (11th Cir. 2001) (same). But see *Wilks*, 2006 WL 2821700 at 15 ("defendant has not cited one statute, rule, or administrative interpretation that bolsters its 'incentive-to-hustle'-based theory…. Support for this notion stems only from judicially created overlay to the FLSA that is non-binding on this court").

If an employee "seldom or never" exceeds the guaranteed one and one-half times the minimum wage the commission plan is not bona fide. In *Herman v. Suwanee Swifty Stores Inc.*, 19 F.Supp.2d 1365 (M.D.Ga. 1998), store managers were paid a percentage of their respective store's sales, less the cost of payroll for the store's clerks. The company supplemented the percentage payments in any week in which such payments did not equal one and one-half times the minimum wage.

The court held that as a matter of law if a manager never exceeded the guarantee or exceeded it only once per year the plan would not be bona fide, but rejected the Department of Labor's argument for a bright-line rule that exceeding the guarantee "fewer than five" times in a year rendered the plan non-bona fide. See generally 29 C.F.R. §779.416 (discussing what constitutes commission).

Conclusion

As with all of the Fair Labor Standards Act's exemptions, the employer must prove that the employee in question falls squarely within the retail or service establishment exemption's requirements in order for that exemption to apply.

1. As with all exemptions, the employer bears the burden of proving the RSE applies. *Klinedinst v. Swift Investments Inc.*, 260 F.3d 1251, 1254 (11th Cir. 2001).

2. The court noted, however, that the analogy is imperfect because §§213(a)(2) and 207(i) have different purposes. See id. at 4.

3. The FLSA provides a separate exemption for retail car salesmen. See 29 USC §213(b)(10)(A).