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Department of Labor Issues Two New Wage and Hour Rules

Two new rules issued by the U.S. Department of Labor (DOL) could bring changes for employers who use the retail sales exemption or the fluctuating workweek compensation method. The retail sales rule withdraws outdated lists, streamlining the analysis to determine eligibility for exemption from overtime compensation. The fluctuating workweek rule permits bonus payments for employees who are paid overtime compensation based on that method.

More Employees May Now Be Eligible for Commission-Based Retail Overtime Exemption

The first new rule, effective May 19, simplifies the exemption from overtime compensation for certain commissioned employees of retail or service establishments. It sheds light on whether certain businesses are considered retail or service establishments for purposes of that exemption.

Section 7(i) of the Fair Labor Standards Act (FLSA) relieves retail and service employers of the obligation to pay overtime compensation to certain employees paid primarily by commission. To qualify for the exemption, three criteria must be met: an employee's regular rate of pay must exceed one and one-half times the minimum wage; more than half of the employee's compensation for a representative period (not less than one month) must be commissions on goods or services; and the employee must be employed by a retail or service establishment, which is defined as "an establishment 75 per centum of whose annual dollar volume of sales of goods or services (or of both) is not for resale and is recognized as retail sales or services in the particular industry." The DOL interprets the "retail or service establishment" criterion as requiring an establishment to have a "retail concept," meaning that it typically sells goods or services to the general public, serves the everyday needs of the community, is at the very end of the stream of distribution, disposes its products and skills in small quantities, and does not take part in the manufacturing process. Unless all three criteria are met, the Section 7(i) exemption does not apply, and employees must be paid one and one-half times their regular rate of pay for all hours worked over 40 in a workweek.

The new rule withdraws the DOL's list of establishments that, in its view, lacked a retail concept and therefore were ineligible for the Section 7(i) exemption. That list included establishments such as dry cleaners, tax preparers, laundries, and travel agencies. Those establishments may now assert that they have a retail concept and may be able to qualify as retail or service establishments.

The DOL also withdrew its list of establishments that, in its view, "may be recognized as retail" and therefore may be eligible for the Section 7(i) exemption. That list included establishments such as coal yards, fur repair and storage shops, household refrigerator service and repair shops, and taxidermists. The DOL withdrew that list because it did not necessarily impact the analysis as to whether any particular establishment was retail, as establishments may still qualify for the exemption, or fail to qualify, regardless of whether they were on the list.

The DOL withdrew the lists to promote consistent treatment when evaluating Section 7(i) exemption claims by treating all establishments under the same standards, and permitting the reevaluation of an industry's retail nature as developments progress over time. Going forward, the DOL will apply the same analysis to all establishments for purposes of the Section 7(i) exemption, including those establishments previously listed as lacking a retail concept and those previously listed as "may be recognized as retail." The DOL clarified that nothing in the new rule should be construed to suggest that any particular type of establishment previously listed in the withdrawn rules is or is not a retail establishment.

Employers that believe they may qualify for the Section 7(i) exemption should review their compensation practices to determine whether any of their commission-based employees qualify for the exemption. Some employers that previously viewed themselves as ineligible for the exemption based on the withdrawn list of establishments that lack a retail concept may now be eligible.

Fluctuating Workweek Employees May Receive Bonuses

A separate rule, effective August 7, provides clarity for employers who rely on the fluctuating workweek method. In that rule, the DOL stated that employees who are paid overtime compensation based on the fluctuating workweek method may receive bonuses, premiums, commissions, hazard pay, and other incentive compensation. The fluctuating workweek is a method for calculating overtime payments for salaried, nonexempt employees who are paid a fixed amount each week but whose hours vary from week to week. The fluctuating workweek method is just one example of how to properly compute overtime pay owed under the FLSA.

Under the fluctuating workweek method, a non-exempt employee is paid a fixed salary as compensation for whatever hours the employee is called upon to work in a week. Like other non-exempt employees, employees compensated via the fluctuating workweek method must receive overtime pay for all hours over 40 worked in a week. A fluctuating workweek employee's "regular rate" is calculated each week by dividing the employee's salary by the number of hours worked in the week. Thus, an employee's regular rate will vary from week to week depending on the number of hours worked. For employees paid on the fluctuating workweek method, each hour of overtime pay is calculated as one-half times the employee's regular rate (since the employee's straight time pay for the overtime hours was included in the employee's regular salary).

There are five circumstances that must be met for an employer to use the fluctuating workweek method to compute an employee's regular rate and overtime pay: (1) the employee's hours must fluctuate from week to week; (2) the employee must be paid a fixed salary that does not vary with the number of hours worked (though the new rule states that employers using the fluctuating workweek method may take occasional disciplinary deductions from an employee's salary for willful absences or tardiness or for infractions of major work rules); (3) the fixed salary must satisfy the minimum wage; (4) the employer and employee must have a clear mutual understanding that the fixed salary is compensation (apart from overtime premiums) for whatever hours the employee works each week; and (5) the employee must receive overtime compensation for all overtime hours worked in a week at a rate of not less than one-half the employee's regular rate for that week.

Before the new rule, the DOL's position on the fluctuating workweek method had shifted over time, and courts took varying positions. Some concluded that any supplemental payments to an employee above the employee's salary are incompatible with the fluctuating workweek method because that would violate the requirement that the employee be paid a "fixed amount" each week. Other courts concluded that supplemental payments based on an employee's productivity (such as commissions) are compatible with the fluctuating workweek method, but supplemental payments based on an employee's hours worked (such as night-shift premiums) are not. Still other courts ruled that the fluctuating workweek method is available only to employees who sometimes work less than 40 hours in a week, which the new rule disavows.

If a fluctuating workweek employee receives a bonus or other incentive compensation, such payments must be included in calculating the employee's regular rate for overtime purposes, unless the payment qualifies for exclusion under the FLSA.

The fluctuating workweek rule should make it easier for employers to use flexible work schedules, particularly as many employers seek to promote social distancing during the COVID-19 pandemic by staggering employees' shifts or otherwise varying work schedules.

As these rules demonstrate, the DOL Wage and Hour Division has been very busy. Employers should ensure that their compensation practices continue to comply with the law as it evolves.

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