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In This Issue:

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Third Circuit Holds that Flat-Rate Commissions May Qualify for Retail Commission Exception to FLSA's Overtime Requirements

By Matthew Hank

In *Parker v. NutriSystem, Inc.*, No. 09-3545 (Sept. 8, 2010), a divided panel of the Third Circuit held a system of flat-rate compensation for each sale that an employee makes may qualify for the retail commission exception to the overtime requirements of the federal Fair Labor Standards Act. In so ruling, the majority rejected the Department of Labor's argument that commissions must be linked to the sales price.

Background

The federal Fair Labor Standards Act (FLSA or "the Act") generally requires that employers pay their employees one and one-half times their regular rate of pay for any hours worked in excess of 40 hours per week. Under the retail commission exception of Section 7(i), however, employees of retail establishments are excepted from the Act's overtime requirement if their regular rate of pay is above a statutory minimum and more than half of their compensation represents "commissions on goods or services." The Third Circuit in *Parker* needed to decide whether a flat rate paid for each sale constituted "commissions on goods or services."

The plaintiffs in *Parker* were a class of sales associates who sold prepackaged meals directly to consumers, via telephone, on behalf of NutriSystem. Each meal program was priced between $293 and $372 per month, depending on the customer's dietary needs and shipping method. The plaintiffs were compensated through flat-rate payments of $18, $25, or $40 per sale, with higher rates paid for outgoing (as opposed to incoming) sales calls and for calls made during less desirable shifts. The flat rates were not linked to the cost of the particular meal plan sold, sales associates paid on a flat-rate basis did not receive overtime compensation, and there was no change in the flat rates when a sales associate worked more than 40 hours per week. Reasoning that the flat rates were "commissions" within the meaning of the retail commission exception, the district court entered summary judgment for the employer on the plaintiffs' claim for overtime compensation under the FLSA.

Third Circuit Holding

A divided panel of the Third Circuit Court of Appeals agreed with the district court and found that flat-rate commissions may qualify for the retail commission exception. The majority began its analysis by observing that "commission" is defined neither by statute nor regulation. It then turned to a series of Opinion Letters issued by the U.S. Department of Labor, which the plaintiffs, supported by the Department of Labor as *amicus curiae*, relied on for the proposition that, to qualify for the retail commission exception, compensation must be linked to the sales price, and thus may not be a flat rate. Because NutriSystem's flat-rate payments were not based on a percentage of sales price, and did not vary based on the amount of each sale, argued the plaintiffs, those payments did not qualify for the retail commission exception.

In rejecting that argument, the majority first reasoned that the Opinion Letters were entitled to no deference because the letters were insufficiently reasoned, inconsistent and factually dissimilar to the payment scheme at issue in *Parker*. The court then considered the FLSA's purpose and case law interpreting the retail commission exception.

According to the majority, the FLSA's purpose is threefold: (1) to prevent workers who, perhaps out of desperation, are willing to work abnormally long hours from taking jobs away from workers who prefer shorter hours, including union members; (2) to spread available work among a larger number of workers and thereby reduce unemployment; and (3) to compensate overtime workers for the increased risk of workplace accidents they might face from exhaustion or overexertion. As to case law, the majority observed that the few cases applying the retail commission exception provide limited guidance, but distilled from Seventh Circuit precedent the principle that "[t]he essence of a commission is that it bases compensation on sales."

In light of those considerations, the majority concluded that NutriSystem's flat-rate payments passed muster as commissions for four reasons. *First*, the flat rates ranged from 5% to 14% of the price charged the consumer, and were therefore proportional to that price. *Second*, the flat rates were based on sales, not time worked. *Third*, the majority deemed its result to be good policy, reasoning that the flat rates encouraged sales staff to take undesirable shifts and to work harder to close outgoing sales calls. *Fourth*, the majority concluded that the flat rate plan did not offend the FLSA's purposes, because: (1) NutriSystem's sales associates were "not the lower-income-type employees contemplated to be protected by the overtime provisions;" (2) forcing NutriSystem to pay overtime would not likely induce the hiring of additional sales associates, because "the only sales associates working an excess of forty hours per week are the top sales associates;" and (3) call center associates do not face an increased likelihood of health problems or accidents when they work overtime.

The dissenting opinion would have deferred to the Department of Labor's Opinion Letters and concluded that the flat-rate payments were not commissions because they did not correspond to the price paid by the consumer.

Practical Implications for Employers

Employers can distill one clear conclusion from *Parker*: a payment scheme does not necessarily have to be based on a percentage of sales price to qualify as a commission under the retail commission exception. Flat-rate payments tied to the number of sales may also pass muster. Under *Parker*, employers considering a flat-rate commission plan should take several steps to qualify for the retail commission exception.

- Ensure that the flat rate is not disproportionate to price. Although *Parker* enunciated no bright-line rule of proportionality, under *Parker's* analysis a flat rate valued at 5% of the price of the goods or services, or higher, will not likely be regarded as disproportionate. *Parker* suggests that, at some undefined point below 5%, the flat rate would be so disproportionate to price that it would not qualify as a commission.
- Be prepared to explain why your flat-rate commission plan encourages your sales staff to work more efficiently or accept undesirable working hours. The *Parker* majority considered these incentives to be good policy and weighed them in the employer's favor.

- Apply any flat-rate commission plan only to higher-income employees. The FLSA flatly prohibits application of the retail commission exception to employees whose regular rate of pay is not "in excess of one and one-half times the minimum hourly rate," and *Parker* suggests that, above that bare minimum, the higher the income of the employees, the more likely that a court is to conclude that the retail commission exception applies to flat-rate payments tied to the number of sales.
- Be prepared to explain why your flat-rate commission plan does not reduce hiring incentives. In *Parker*, the majority thought that forcing the employer to pay overtime to the plaintiffs would not promote the FLSA's goal of reducing unemployment because it would not lead NutriSystem to hire additional sales associates. *Parker's* reasoning suggests that, had the practical effect of the flat-rate plan in Parker been to reduce hiring incentives, the employer might have been found to be in violation of the FLSA.

Finally, employers should understand that *Parker* is binding only in federal courts in the Third Circuit including courts in Pennsylvania, Delaware and New Jersey. In administrative proceedings, the Department of Labor may still contend that, to qualify for the retail commission exception, a payment must be linked to price.

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