Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Wipe Away Those Fears, The 7th Circ. Is Here

Law360, New York (May 18, 2015, 11:27 AM ET) -- Employers today face liability in few areas more than wage-and-hour law. The misclassification of employees as exempt, the hiring of interns and payment of time for "donning and doffing" clothing and equipment are all areas of law significantly interpreted by the courts recently, and only sometimes in favor of employers. In the case of Alvarado v. Corporate Cleaning Service Inc., the Seventh Circuit recently fleshed out an often-ignored exception to an employer's obligation to pay overtime.

Eric E. Hobbs

The Fair Labor Standards Act requires employers pay every nonexempt employee time and a half the employee's regular hourly rate of pay for hours worked in excess of 40 a week. However, the FLSA provides an exception if three conditions are met:

1. the employee's regular pay is more than one and a half times the federal minimum wage;
2. more than half of the employee's compensation for a "representative period" (which may not be less than a month) is comprised of "commissions on goods and services"; and
3. the employer is a "retail or service establishment."

In Alvarado, the Seventh Circuit focused its attention on the last two conditions.

The employer provided window-washing services and the 24 plaintiff employees were window washers. When the employer received a customer order, the employer assigned points to it, depending on the complexity of the job and how long the employer estimated it would take. The points then were used to calculate the cost to the customer and were input into a formula prescribed by the employer's collective bargaining agreement to calculate the window washers' compensation.

The court found that, given the formula upon which the employees' pay was calculated, the irregularity of the employer's business and the employees' work, which were seasonally based on weather, the length of daylight in winter and — notable to the court — the risk of falcon attacks on window washers, the compensation constituted commissions. "The result of these impediments to steady work," the court reasoned, "is that a window washer can't count on working 40 hours each week for an entire year. This is the reason for exempting his employer from the requirement of paying the worker time and half for overtime."

The court also observed that, although the employer's collective bargaining agreement provided for the payment of overtime and never referred to the employees' pay as "commissions," the union had never grieved or objected to the employer's treatment of the pay as subject to the FLSA's commission exception. The union also had not joined in the litigation. Nor had the employer's other 76 window washers. When given the choice of being paid either under the point-based system or overtime, moreover, they had opted to continue to be paid under the point-based system. The court also ignored the employer's own use of the term "piece rate" to describe its compensation system because, the court found, the payment scheme was not a piece-rate scheme at all.

The court also concluded that the employer was a "service establishment," even though it did not have a particular place of business to which the public was invited. A "retail establishment," the court said, "sounds like a store, which [the employer in the case] is not." The term "service establishment is much broader" and does not require a storefront, the court concluded. Furthermore, the court noted, a seller of goods can make up for decreased demand by producing inventory for future sale; a seller of services must simply weather any storm of decreased demand.

Consequently, the court concluded, the compensation the window washers received was "commissions on goods or services" paid by their employer, a "service establishment." And, according to the court, all three elements of the retail commissions exemption therefore were met, and the plaintiffs were not entitled to overtime pay.

The court seemed to go out of its way to note that the union and most of the employer's window washers acted as if satisfied with the way and the amount the employees were being paid. While the window washers worked long weeks during the window washing season, the court observed, this allowed many to visit family during the winter in the single, small town in Mexico from which most of them came.

The Seventh Circuit is known for its "law and economics" approach to cases. Before assuming the bench, Circuit Judges Richard A. Posner and Frank H. Easterbrook of that court served as prominent members of the faculty of the University of Chicago Law School, the "birthplace," the law school contends on its website, of "Law and Economics." That school of thought applies principles of microeconomics to the analysis of legal problems. And Judge Posner, an outspoken advocate of that approach, led the panel of the Seventh Circuit that decided Alvarado.

The court's decision reflected the application of microeconomic principles and, one might suggest, a results-oriented analysis. The opinion, as noted above, emphasized the realities of the economics of the employer's and employees' relationship and work — that the work is seasonal; that the employees, therefore, "can't count on working 40 hours each week for an entire year"; that their pay depends on the point structure prescribed by the collective bargaining agreement that also determines the flat fee charged the customer for the job; that, while the collective bargaining agreement provided for the payment of overtime, neither the employees nor their union had ever complained about the (better) treatment of the weather washers' wages as commissions without overtime; and that both the union and the majority of the employees in the bargaining had not joined in the action because apparently equally happy with their economic arrangement with the employer.

While not every employer can fit within the commissions overtime exception of 29 U.S.C. § 207(i), those who operate retail or service establishments should consider whether their compensation systems for their employees provide or can be reframed to provide for commissions on the sale of goods or services where the employee's regular rate of pay is more than time and a half the federal minimum wage. The exception is a narrow one, but it can be used to a potentially significant advantage by employers who qualify, particularly those in the Seventh Circuit.

Even employers in the Seventh Circuit, however, should beware not to rely too heavily on the court's decision in Alvarado. It is fact-driven and the facts are, at best, odd. Not every seasonal business that sells its services on an adjustable, flat-fee basis and compensates its employees on a related, commission basis will qualify for the exception.

To take safe advantage of the exception, an employer should:

- Insure that at least 50 percent of the compensation it pays its nonexempt employees each workweek is "by the sale," as the court described it, not based on the number of widgets made or windows washed or on the number of hours worked;

- Call the compensation "commissions" so as not to complicate the matter by use of a different label, as in the Alvarado case;

- Insure that, at the end of every workweek, each "commissioned" employee has been paid the hourly equivalent of at least time and a half the federal minimum wage for each hour s/he has worked. That will require the employer to track each employee's time; and

- Insure by careful analysis that it (the employer) is either a "retail establishment" (i.e., a store selling goods) or a "service establishment" (i.e., a seller of services of some kind(s) to an end user), rather than someone who resells them.

—By Eric E. Hobbs, Michael Best & Friedrich LLP

Eric Hobbs is a partner in Michael Best & Friedrich's Milwaukee office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.