

105TH CONGRESS }
 2d Session } HOUSE OF REPRESENTATIVES {
 REPORT
 105-558

SALES INCENTIVE COMPENSATION ACT

JUNE 3, 1998.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. GOODLING, from the Committee on Education and the Workforce, submitted the following

R E P O R T

together with

MINORITY AND ADDITIONAL VIEWS

[To accompany H.R. 2888]

[Including cost estimate of the Congressional Budget Office]

The Committee on Education and the Workforce, to whom was referred the bill (H.R. 2888) to amend the Fair Labor Standards Act of 1938 to exempt from the minimum wage recordkeeping and overtime compensation requirements certain specialized employees, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Sales Incentive Compensation Act".

SEC. 2. EXEMPTION.

Section 13(a) of the Fair Labor Standards Act of 1938 (29 U.S.C. 213(a)) is amended by striking the period at the end of paragraph (17) and inserting a semicolon and by adding at the end the following:

"(18) any employee employed in a sales position if—

 "(A) the employee has specialized or technical knowledge related to products or services being sold;

 "(B) the employee's—

 "(i) sales are predominantly to persons who are entities to whom the employee's position has made previous sales; or

 "(ii) position does not involve making sales contacts;

 "(C) the employee's position requires a detailed understanding of the needs of those to whom the employee is selling;

"(D) the employee's position requires the employee to exercise discretion in offering a variety of products and services;

"(E) the employee receives—

“(i) base compensation, determined without regard to the number of hours worked by the employee, of not less than an amount equal to one and one-half times the minimum wage in effect under section 6(a)(1) multiplied by 2,080; and

“(ii) in addition to the employee's base compensation, compensation based upon each sale attributable to the employee;

“(F) the employee's aggregate compensation based upon sales attributable to the employee is not less than 40 percent of one and one-half times the minimum wage multiplied by 2,080;

“(G) the employee receives a rate of compensation based upon each sale attributable to the employee which is beyond sales required to reach the compensation required by subparagraph (F) which rate is not less than the rate on which the compensation required by subparagraph (F) is determined; and

“(H) the rate of annual compensation or base compensation for any employee who did not work for an employer for an entire calendar year is pro-rated to reflect annual compensation which would have been earned if the employee had been compensated at the same rate for the entire calendar year.”.

SEC. 3. CONSTRUCTION.

The amendment made by section 2 may not be construed to apply to individuals who are employed as route sales drivers.

PURPOSE

The purpose of H.R. 2888, the Sales Incentive Compensation Act, is to amend the Fair Labor Standards Act to provide that certain specialized “inside” sales employees may be exempt from minimum wage, overtime compensation, and record-keeping requirements.

COMMITTEE ACTION

During the 104th Congress, the Subcommittee on Workforce Protections held a hearing on the treatment of inside sales employees under the Fair Labor Standards Act. The following individuals testified at the hearing, which was held on October 25, 1995: Mr. Chris Lute, President of Lute Plumbing Supply, Inc., Portsmouth, Ohio; Mr. Kevin M. Priest, Vice President of the Cleveland Plant and Flower Company, Cleveland, Ohio; and Ms. Deborah Dietrich, Senior Legislative Representative, Service Employees International Union.

A second hearing was held on the issue during the 105th Congress by the Subcommittee on Workforce Protections on May 13, 1997. Testimony was heard from the following individuals: Mr. Anthony L. Williams, Sales Associate, Ferguson Enterprises, Incorporated, Baltimore, Maryland; Ms. Leronda Lucky, Inside Sales Associate, the Berry Company, Ohio; and Ms. Deborah Siday, Vice President of Human Resources, Atlantic Food Services, Inc., Manassas, Virginia. On November 7, 1997, Representatives Harris W. Fawell and Robert E. Andrews introduced H.R. 2888, “The Sales Incentive Compensation Act.”

On March 5, 1998, the Subcommittee on Workforce Protections approved H.R. 2888, as amended, by voice vote and ordered the bill favorably reported to the Full Committee. On April 1, 1998, the Committee on Education and the Workforce approved H.R. 2888, as amended, by voice vote, and ordered the bill favorably reported.

COMMITTEE STATEMENT AND VIEWS

BACKGROUND

The Fair Labor Standards Act (FLSA),¹ which was enacted in 1938, is the primary federal statute regulating the wages and hours of work. The Act covers employees who are (1) engaged in interstate commerce, or (2) engaged in the production of goods for travel for interstate commerce, or (3) employed in an enterprise engaged in commerce or in the production of goods for commerce. For covered or “nonexempt” employees, the FLSA sets a minimum wage of \$5.15 per hour and requires, as a general rule, that hours of work by nonexempt employees in excess of 40 hours in a seven-day period be compensated at a rate of one-and-one-half times the employee’s regular rate of pay. In addition, the FLSA requires employers to maintain records which reflect the employees’ hours of work and wages received. There are, however, a number of exemptions from the minimum wage and/or overtime requirements under the FLSA for specific groups of employees, including certain employees who work in sales.

For example, the FLSA contains an exemption from minimum wage and overtime for “any employee employed * * * in the capacity of outside salesman.”² Whether or not a sales employee can qualify for the exemption depends on where the work is performed and whether the employee is employed to sell.³ The employee must customarily and regularly work away from the employer’s place of business for the purpose of selling tangible or intangible items, or obtaining orders or contracts for services or use of facilities. In addition, the hours of work in activities unrelated to sales can not exceed 20 percent of the hours worked in the workweek by non-exempt employees of the employer.⁴

The FLSA also contains an exemption from overtime for certain sales employees of retail or service (but not wholesale) establishments. Three conditions must be met in order for an employee to qualify for the exemption: (1) the employee must be employed by a retail or service establishment, as defined by the Department of Labor; (2) the employee’s regular rate of pay must exceed one-and-one-half times the applicable minimum wage for every hour worked in a workweek in which overtime hours are worked, and (3) more than half the employee’s total earnings in a representative period (not less than one month) must consist of commissions on sales of goods or services.⁵

A third category of sales employee—whose importance in many businesses is growing as technology advances and the marketplace becomes ever more global in scope—is an individual who works primarily at the employer’s facility, using phone, fax, and computer connections to communicate with non-retail customers. These sales employees may deal with sophisticated products or function as both consultant and salesperson to customers, yet neither of the existing

¹ 29 U.S.C. § 201–219.

² 29 U.S.C. § 213(a)(1).

³ “Executive, Administrative, Professional and Outside Sales Exemptions Under the Fair Labor Standards Act,” WH Publication 1363, U.S. Department of Labor, Employment Standards Administration, Wage and Hour Division.

⁴ 29 C.F.R. § 541.500–508.

⁵ 29 U.S.C. § 207(i).

sales employee-specific FLSA exemptions reaches them. These are “inside sales” employees to whom H.R. 2888 is addressed.

Many of these inside sales employees have been considered exempt under the general exemption for “administrative” employees in section 13 (a)(1) of the FLSA. Unfortunately, section 13 (a)(1) is a general exemption written many years ago without today’s professional sales person in mind, and the result is a confusing situation as to whether these sales persons qualify for the “administrative” exemption.

Two recent cases demonstrate the problem. In *Martin v. Cooper Electric Supply Co.*,⁶ the Third Circuit Court of Appeals considered whether an electrical products wholesaler’s inside sales persons were “administrative” employees within the FLSA exemption. Adopting language from the Department of Labor’s regulations, the Court of Appeals said that “administrative” operations of a business must be distinguished from “production” activities.⁷ Cooper Electric Supply, the Court of Appeals said, is a wholesale business whose “primary business purpose is to produce sales of electrical products.”⁸ Thus, the court reasoned, the company’s sales employees were “production” employees rather than “administrative” employees.

A different result was reached in *Reich v. John Alden Life Insurance Co.*⁹ In that case, the U.S. Court of Appeals for the First Circuit found that marketing representatives for John Alden Life Insurance Company fit within the “administrative” employee exemption. The Court of Appeals distinguished the *Cooper Electric* case by citing the fact that John Alden Life Insurance Company’s “principal production activity [is] the creation of insurance policies.” Thus, the Court of Appeals found, John Alden’s sales employees were engaged in servicing the employer’s business, rather than in “production.”

These two cases point out the difficulty of relying on the “administrative” employee exemption for inside sales employees. Although many professional sales employees do qualify for the “administrative” employee exemption, the application of the exemption is unpredictable and not very logical.¹⁰ Without disturbing the “administrative” employee exemption, the Committee believes that a complementary and more direct exemption written for professional, inside sales employees is needed.

An exemption written specifically for inside sales employees is also appropriate and necessary because of changes in the manner in which the commercial world works in 1998 as compared to 1938, when the FLSA was written. The FLSA’s provisions and regulations regarding sales employees have not been updated to reflect various technological changes—such as the increased use of computers, modems, facsimile machines, and the Internet—which have

⁶ *Martin v. Cooper Electric Supply Co.*, 940 F.2d 896, (3rd Cir.1991).

⁷ *Ibid.*, at 902.

⁸ *Ibid.*, at 903.

⁹ *Reich v. John Alden Life Insurance Co.*, 126 F.3d 1, (1st Cir.1997).

¹⁰ For example, the combination of the *Cooper Electric* and *Alden* cases would appear to favor large, integrated companies in which inside sales personnel sell products produced in whole or in part by the company itself, as compared to smaller, more entrepreneurial firms that primarily market other companies’ products.

dramatically altered the way in which sales employees perform the duties of their job.

Outside sales employees, many of whom perform the same duties as their inside sales counterparts, are exempt from the FLSA's minimum wage and overtime provisions because they sell from outside of their employer's place of business, traveling to the customer's business establishment. While this may have been a typical way of conducting business in years past, technological advances in communication have enabled many outside sales employees to become more productive by working from within their employer's business establishment. However, once the sales employee is working primarily from within the employer's business establishment, the individual no longer qualifies for the exemption from minimum wage and overtime.

In today's highly-competitive global marketplace, many individuals earn a living by selling goods and services to customers across the continent or across the globe. The pay structure of many of these sales employees is determined, in part, by how much they sell and many are compensated through bonuses, commissions or incentive pay. Thus, for some individuals the FLSA has the ironic effect of preventing them from reaching their full income potential. For example, a sales employee may be restricted from working more than 40 hours per week because of the additional overtime cost to the employer. Yet, this has the unintended effect of placing a ceiling on the employee's income because he or she is prevented from working additional hours to generate additional sales and increase earnings.

Ms. Deborah Siday, Vice President of Human Resources for Atlantic Food Services, articulated the problem to the Subcommittee on Workforce Protections:

Under the Fair Labor Standards Act as currently written, these inside sales people, who operate from within our facility primarily by phone, fax, or computer, must be paid overtime for all hours worked over 40 in 1 week. While this requirement might at first glance appear to be the most profitable method of compensation for these employees, in practice it merely serves to reduce their actual earnings potential.¹¹

Mr. Anthony L. Williams, an employee who works as an inside sales associate with Ferguson Enterprises, told the Subcommittee on Workforce Protections why he would like to see changes made to the FLSA:

Number one, I consider myself a professional salesman and would like to be treated as such. Number two, the law as it currently stands is antiquated and does not reflect employee needs as we approach the 21st century.¹²

¹¹ "Hearing on the Treatment of Inside Sales Personnel and Public Sector Volunteers under the Fair Labor Standards Act," The Subcommittee on Workforce Protections, Committee on Education and the Workforce, U.S. House of Representatives, 105th Congress, First Session, May 13, 1997, Serial No. 105-30, p. 22.

¹² *Ibid.*, p. 18.

Mr. Williams testified in favor of changing the application of the 1938 Fair Labor Standards Act as it relates to inside sales employees. In his view,

. . . the inside sales force is certainly every bit as professional, knowledgeable and well trained as the outside sales force. We deserve to be seen as such by the wage and hour laws.

. . . consider that the inside salesperson of today didn't exist when these laws under which we operate were initially written. Just as the office environment of today with faxes, beepers, telephones, PCs, voice mail and everything else was inconceivable in 1938, so was the aspect of the inside sales profession in which I operate.

. . . Today's inside sales position was just unknown in 1938. Just as telecommunications and about everything else in our world has changed in 60 years, it is time for this area of the law to adapt to today's marketplace as well, to reflect reality.¹³

Ms. Leronda Lucky, an employee who works as an inside sales associate with the Berry Company in Ohio, also testified in favor of changing the FLSA to classify commissioned inside sales employees as exempt. As Ms. Lucky told the Subcommittee—

I am in this business because I am a salesperson. My motivation to sell is the earning potential that I have. My choice is to be paid on a commission basis. I would like to be able to work as many hours as possible and earn as much money as possible for me . . .

Unless I have prior approval, I am restricted to working 40 hours per week due to a law passed in 1938, a time when people did not have telephones, let alone conducted sales over the telephone.

There is also a very important customer service component to my job. My clients do not necessarily have 9-to-5 work hours. Many start their day early in the morning and work until late in the evening. I need the flexibility to determine when I need to meet with the customers on their hours. Being an exempt employee would provide for that flexibility.¹⁴

Many employees who are classified as exempt under the FLSA are less restricted by law and often are permitted by their employers to have much more flexibility in their schedules than non-exempt employees. This very issue was highlighted by Ms. Lucky, who told the Subcommittee how her experience and job duties as a nonexempt inside sales employee compares with that of many of her exempt colleagues who work outside of the office:

. . . I feel that I should not be treated any differently than my co-workers who sell the same product, receive the same training, and use the same marketing techniques as I do, but do so outside the employer's office. We do the

¹³ Ibid., p. 20.

¹⁴ Ibid., p. 21.

exact same things, but because of a law established 60 years ago, prior to advancements in technology, I am treated differently. I do not believe this is fair or right. I am motivated by the same things as these employees.¹⁵

The Committee recognizes that the constraints under current law frequently work against many highly-trained, highly-skilled sales employees by restricting their ability to achieve greater earnings. Thus, the Committee believes that the FLSA should be updated to more accurately reflect the duties and functions of inside sales employees and to provide employees who are highly motivated with the opportunity to increase their wages.

LEGISLATION

H.R. 2888 amends section 13(a) of the FLSA¹⁶ to exempt certain specialized sales employees from the FLSA's minimum wage and overtime compensation and record-keeping requirements. The exemption consists of a two-prong test: first, the employee must meet the requirements in the bill which outline specific functions and duties of the job; second, the employee's pay structure must meet the minimum requirements in the bill for a specified amount of base compensation in addition to compensation which is based on sales made by the employee.

The bill applies to employees whose principal activity is making sales. In order to qualify for the exemption, an individual employed in a sales position must possess specialized or technical knowledge related to the products or services being sold. The employee would have to possess more than a general familiarity with the products or services being sold. A sales employee who offers different services or products to customers based on the varying needs of each customer using the employee's own training or experience would have a specialized knowledge of the products or services being sold in order to make appropriate recommendations to the customer. This exemption is not intended for employees who merely take orders over the telephone or utilize a prepared script, such as, telemarketing sales employees. This type of an employee would not meet the requirement for possessing specialized or technical knowledge about the products or services being sold.

Several additional requirements for the exemption are included in the bill in order to ensure that it is limited to sales employees who work with and advise customers on behalf of the employer, rather than to persons engaged in mass "cold calling" of businesses or residences. The bill requires that either the employee's sales be made predominately to persons or entities to whom the employee's position has made previous sales; or that the employee does not initiate sales contacts.¹⁷ During the Committee markup, an amendment offered by Representative Andrews was accepted which further requires that the employee have a detailed understanding of the needs of those to whom he or she is selling and requires that

¹⁵ Ibid., p. 22.

¹⁶ 29 U.S.C. § 213(a).

¹⁷ The amendment adopted during the Committee on Education and the Workforce's markup inadvertently substituted the words "who are" for the word "or" and the word "make" for the word "initiate."

the employee must exercise discretion in offering a variety of products and services to various customers.¹⁸

With regard to compensation, in order to qualify for the exemption the employee must receive a base compensation amount, determined without regard to the number of hours worked by the employee, of not less than an amount equal to one-and-one-half times the minimum wage in effect under section 6(a)(1) of the FLSA,¹⁹ multiplied by 2,080. Currently this would require that the employee be paid at least \$16,068, without regard to hours worked. The bill provides that if the employee does not work for the employer for an entire calendar year, the base compensation can be prorated to reflect the compensation which would have been earned if the employee had been compensated at the same rate for the entire calendar year.

In addition to receiving base compensation as described in the preceding paragraph, in order to qualify for the exemption the employee must receive compensation-commission income-based upon each sale attributable to the employee. The Committee is aware of the fact that sales commission arrangements vary tremendously among different industries and employers, and may vary by type of product or cost of product. For example, an employer may set a higher commission rate for new products as a way of encouraging their introduction into the marketplace. Similarly, in some companies, sales employees are paid commissions on the value of all sales by the employee or a group of sales employees. The bill does not attempt to "straitjacket" these various sales and commission arrangements, but the employer must have a reasonable method of assigning sales to each employee and allocating commissions to each sale made.

The bill requires that the total amount of compensation from these commissions, or sales attributable to the employee, must be at least 40 percent of one-and-one-half times the minimum wage in effect under section 6(a)(1) of the FLSA multiplied by 2,080. Currently, this requires that the sales employee receive a minimum commission compensation of \$6,427.20.

¹⁸The type of discretion which the Committee believes appropriate to professional sales employees for purposes of H.R. 2888 is similar to that exercised by the sales employees in *Reich v. John Alden Life Insurance Co.*, 126 F.3d 1, (1st Cir. 1997): "It is undisputed that these employees have discretion in choosing which agents to contact on any given day, and concerning which products to discuss with each agent. In addition, the marketing representatives rely on their own knowledge of an agent's business to help tailor proposals for the agent's end-customers. Further, they must be able to anticipate the competing products that the agent's customers might be considering, and distinguish John Alden's offerings from those of competitors." 126 F. 3d at 13. The Secretary of Labor argued that since Alden's marketing representatives operated within certain parameters and applied sales techniques given them by the company, they were "merely skilled workers." The Court of Appeals rejected the Secretary's argument that sales employees who operate within the employer's instructions do not exercise the requisite level of discretion: "These employees do not use prepared scripts or read from required verbatim statements, nor do they operate within the contours of a prescribed technique or 'sales pitch.' On the contrary, the content of a given conversation with an agent is dictated by the needs or customer base of that agent, or by the particular information sought by the marketing representative during that phone call. Further, to the extent that the marketing representatives receive guidance about products to emphasize and suggested points to make with agents, they nonetheless exercise discretion in applying this instruction—for instance, in determining which agent may have an interest in that product, or in fashioning bid proposals that meet the needs of the agent's customers. (citing case) In light of all this, we concur that the marketing representatives 'are not merely skilled workers who operate within a strict set of rules. Rather, they exercise significant discretion in their daily contacts with various insurance agents.' " 126 F.3d at 14.

¹⁹29 U.S.C. § 206(a)(1).

With regard to the employee's compensation which is based upon each sale attributable to the employee beyond that required to attain the previous requirement of 40 percent of one-and-one-half times the minimum wage multiplied by 2,080, the employer must continue to pay the same rate of compensation as that which was paid to the employee to meet the bill's requirement for aggregate compensation based upon the employee's sales. In other words, the employer cannot reduce the inside sales employee's commission rate or rates once the employee has earned \$6,427.20 (based on the current minimum wage) in commission income.

Finally, an amendment offered by Representative Carolyn McCarthy was accepted which stated that the exemption in the bill does not apply to individuals who are employed as route sales drivers.²⁰

The Committee believes that H.R. 2888 will give many sales employees who are highly motivated and highly skilled, the opportunity to increase their earnings by removing them from the confines of the 40-hour workweek and allowing them to increase their earnings by increasing their sales. Many of these employees could earn more income from generating additional sales than could otherwise be made through overtime compensation.

In a letter to the Chairman of the Education and Workforce Committee dated March 31, 1998, the Secretary of Labor listed several objections to H.R. 2888. Most of the Secretary's objections have to do with the alleged burden on employers of meeting the bill's conditions for the inside sales exemption. Of course, the exemption is not mandatory and an employer may choose not to make employees eligible for the exemption. The Secretary also argues that the bill will subject employees to long hours of work with little or no additional pay. The Committee believes that the specter of employers forcing their professional and skilled sales force to spend long hours in the office, against the employee's wishes, when they are not making additional sales (and thus increasing their income) is simply not realistic. The Committee believes that H.R. 2888 allows these sales employees to perform their jobs more effectively by allowing them to schedule their work hours in such a way as to maximize sales and increase their own earnings.

SUMMARY

H.R. 2888 would create a new exemption from minimum wage and overtime for any employee in a sales position if the employee has specialized or technical knowledge related to the products or services being sold; if the sales are made predominately to persons or entities to whom the employee has made previous sales, or if the employee's position does not involve initiating sales contacts; if the employee has a detailed understanding of the needs of those to whom he or she is selling; and if the employee exercises discretion in offering a variety of products and services.

In addition, H.R. 2888 would require that the employee receive base compensation—determined without regard to the number of

²⁰ H.R. 2888 does not address or affect in any way the existing exemptions under the FLSA for "outside sales" employees under section 13(a)(1) or for sales employees of retail and service establishments under section 7(i).

hours worked by the employee—of not less than one-and-one-half times the minimum wage in effect under section 6(a)(1) of the Fair Labor Standards Act, multiplied by 2,080; and an additional amount of compensation equal to at least 40 percent of the employee's base compensation which is based on each sale attributable to the employee.

The employee must receive additional compensation based on each sale, beyond that which is necessary to meet the previous requirement for 40 percent of the employee's base compensation. The amount of additional compensation must be determined at the same rate or rates which was used to determine the portion of the employee's compensation which is equal to at least 40 percent of the employee's base compensation. The exemption made by H.R. 2888 shall not be construed to apply to individuals who are employed as route drivers.

SECTION-BY-SECTION ANALYSIS

Section 1

“The Sales Incentive Compensation Act”.

Section 2

Amends section 13(a) of the Fair Labor Standards Act of 1938 to provide an exemption for any employee employed in a sales position if:

- (A) the employee has specialized or technical knowledge related to the products or services being sold;
- (B) the employee's sales are made predominately to persons who are entities to whom the employee's position has made previous sales; or the employee's position does not involve making sales contacts;
- (C) the employee's position requires a detailed understanding of the needs of those to whom the employee is selling;
- (D) the employee's position requires the employee to exercise discretion in offering a variety of products and services;
- (E) the employee receives base compensation, determined without regard to the number of hours worked, of not less than one-and-one-half times the minimum wage, in effect under section 6(a)(1) of the Fair Labor Standards Act, multiplied by 2,080; and an additional amount of compensation based upon each sale attributable to the employee;
- (F) the employee's aggregate compensation based upon sales attributable to the employee is not less than 40 percent of one-and-one-half times the minimum wage multiplied by 2,080;
- (G) the employee receives a rate of compensation, based upon each sale attributable to the employee, which is beyond sales required to reach the compensation required by (F) and which is not less than the rate on which the compensation required by (F) is determined; and
- (H) the rate of annual compensation or base compensation for any employee who did not work for an entire calendar year is prorated to reflect annual compensation which would have been earned if the employee had been compensated at the same rate for the entire calendar year.

Section 3

The amendment made by section 2 may not be construed to apply to individuals who are employed as route sales drivers.

EXPLANATION OF AMENDMENTS

The Amendment in the Nature of a Substitute is explained in the body of this report.

APPLICATION OF LAW TO THE LEGISLATIVE BRANCH

Section 102(b)(3) of Public Law 104-1 requires a description of the application of this bill to the legislative branch. This bill amends the Fair Labor Standards Act by exempting certain inside sales personnel from the overtime pay requirements of the Fair Labor Standards Act. The bill does not prevent legislative branch employees from receiving the benefits of this legislation.

CONSTITUTIONAL AUTHORITY STATEMENT

The Fair Labor Standards Act has been held to be a constitutional use of the Commerce power under *United States v. Darby* (S. Ct. 1941) and *Garcia v. The San Antonio Metropolitan Transit Authority* (S. Ct. 1985). This bill's creation of an exemption to certain of the Act's provisions would not further extend the reach of the Fair Labor Standards Act, and as such is constitutional.

UNFUNDDED MANDATE STATEMENT

Section 423 of the Congressional Budget and Impoundment Control Act requires a statement of whether the provisions of the reported bill include unfunded mandates. This bill amends the Fair Labor Standards Act by exempting certain inside sales personnel from the overtime pay requirements of the Fair Labor Standards Act. As such, the bill does not contain any unfunded mandates.

STATEMENT OF OVERSIGHT FINDINGS AND RECOMMENDATIONS OF THE COMMITTEE

In compliance with clause 2(l)(3)(A) of Rule XI and clause 2(b)(1) of Rule X of the Rules of the House of Representatives, the Committee's oversight findings and recommendations are reflected in the body of this report.

STATEMENT OF OVERSIGHT FINDINGS OF THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

With respect to the requirement of clause 2(l)(3)(D) of Rule XI of the Rules of the House of Representatives, the Committee has received no report of oversight findings and recommendations from the Committee on Government Reform and Oversight on the subject of H.R. 2888.

COMMITTEE ESTIMATE

Clause 7 of Rule XIII of the Rules of the House of Representatives requires an estimate and a comparison by the Committee of the costs that would be incurred in carrying out H.R. 2888. How-

ever, clause 7(d) of that rule provides that this requirement does not apply when the Committee has included in its report a timely submitted cost estimate of the bill prepared by the Director of the Congressional Budget Office under section 403 of the Congressional Budget Act.

**BUDGET AUTHORITY AND CONGRESSIONAL BUDGET OFFICE COST
ESTIMATE**

With respect to the requirements of clause 2(l)(3)(B) of Rule XI of the House of Representatives and section 308(a) of the Congressional Budget Act of 1974 and with respect to requirements of 2(l)(3)(C) of Rule XI of the House of Representatives and section 403 of the Congressional Budget Act of 1974, the Committee has received the following cost estimate for H.R. 2888 from the Director of the Congressional Budget Act:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, April 9, 1998.

Hon. WILLIAM F. GOODLING,
Chairman, Committee on Education and the Workforce,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2888, the Sales Incentive Compensation Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Christina Hawley Sadoti.

Sincerely,

JAMES L. BLUM
(For June E. O'Neill, Director).

Enclosure.

H.R. 2888—Sales Incentive Compensation Act

H.R. 2888 would amend the Fair Labor Standards Act of 1938 to exempt certain specialized sales employees from provisions governing minimum wage record-keeping and overtime compensation. The bill would exempt employees working in specialized sales positions whose base salary and commissions total at least \$22,495 per year. CBO estimates that enactment of H.R. 2888 would have no significant impact on the federal budget. Because the bill would not affect direct spending or receipts, pay-as-you-go procedures would not apply.

H.R. 2888 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act of 1995 and would impose no costs on state, local, or tribal governments.

This estimate was prepared by Christina Hawley Sadoti (federal cost), Marc Nicole (impact on state, local, and tribal governments), and Bruce Vavrichek (impact on the private sector).

This estimate was approved by Robert A. Sunshine, Deputy Assistant Director for Budget Analysis.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

**SECTION 13 OF THE FAIR LABOR STANDARDS ACT OF
1938**

EXEMPTIONS

SEC. 13. (a) The provisions of sections 6 (except section 6(d) in the case of paragraph (1) of this subsection) and 7 shall not apply with respect to—

(1) * * *

* * * * * * * *
(17) any employee who is a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker, whose primary duty is—

(A) * * *

* * * * * * * *
who, in the case of an employee who is compensated on an hourly basis, is compensated at a rate of not less than \$27.63 an hour[.];

(18) any employee employed in a sales position if—

(A) the employee has specialized or technical knowledge related to products or services being sold;

(B) the employee's—

(i) sales are predominantly to persons who are entities to whom the employee's position has made previous sales; or

(ii) position does not involve making sales contacts;

(C) the employee's position requires a detailed understanding of the needs of those to whom the employee is selling;

(D) the employee's position requires the employee to exercise discretion in offering a variety of products and services;

(E) the employee receives—

(i) base compensation, determined without regard to the number of hours worked by the employee, of not less than an amount equal to one and one-half times the minimum wage in effect under section 6(a)(1) multiplied by 2,080; and

(ii) in addition to the employee's base compensation, compensation based upon each sale attributable to the employee;

(F) the employee's aggregate compensation based upon sales attributable to the employee is not less than 40 percent of one and one-half times the minimum wage multiplied by 2,080;

(G) the employee receives a rate of compensation based upon each sale attributable to the employee which is beyond

sales required to reach the compensation required by subparagraph (F) which rate is not less than the rate on which the compensation required by subparagraph (F) is determined; and

(H) the rate of annual compensation or base compensation for any employee who did not work for an employer for an entire calendar year is prorated to reflect annual compensation which would have been earned if the employee had been compensated at the same rate for the entire calendar year.

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ADDITIONAL VIEWS

The product of significant bipartisan cooperation, H.R. 2888 represents a positive modernization of the FLSA and will bring practical and significant improvements to workers and employers alike. As originally introduced, the bill achieved the intended goal of benefiting inside salespeople while not harming other workers who deserve to retain their overtime rights. In doing so, it did not disturb the important protections and philosophy of the FLSA. Instead, it proposed reform based on the principles of fairness and opportunity, and we were glad to offer our support as cosponsors.

Following its introduction, H.R. 2888 has been subsequently amended in a bipartisan fashion to provide even more clarity about who it affects and who it does not. These amendments serve to further improve the bill, making it a product which deserves the support of the full House.

In specific, two amendments to the bill provided additional guidance about the range of affected employees. First, Ms. McCarthy's amendment made crystal clear the understanding that the bill's exemption does not apply to individuals who are employed as route sales drivers. This understanding was and continues to be widely-held; the amendment simply reinforces beyond doubt the inapplicability of the bill to these employees.

Similarly, the amendment offered by Mr. Andrews simply clarified that the employees to be exempted must indeed be professional salespeople; as such, the employees must be well-versed in the specific characteristics of both the products and the clients. In order to exercise independent and autonomous judgment and to provide consultative advice, the salesperson must know a great deal about the clients' needs. This type of client-specific information cannot be gained through cursory contact, but rather results only through ongoing and regular contact with the client.

These two amendments remove any doubt about the type of employees covered by the bill. The amended legislation, therefore, represents a well-crafted effort to improve compensation opportunities for workers and employers. By both preserving the FLSA's protections and expanding worker opportunity, H.R. 2888 offers sensible and modernizing reform. We are pleased to offer our full support and to commend the bill for positive consideration by the full House.

ROBERT E. ANDREWS.
HAROLD E. FORD, JR.
CAROLYN McCARTHY.
TIM ROEMER.
RON KIND.

MINORITY VIEWS

The proponents of H.R. 2888 believe that overtime pay requirements limit the number of hours an employee may work. We take an almost diametrically opposed view. By requiring employers to pay time-and-a-half for hours worked in excess of 40 hours a week, the overtime provisions act to ensure that workers have sufficient time off to care for themselves and their families. It also ensures that workers who are required to work extra hours are fairly compensated. Further, we believe that the absence of the protection afforded by overtime would not only result in workers receiving less pay for hours worked in excess of 40 hours a week, but would serve to diminish an employees regular pay as well.

H.R. 2888 has been justified by its proponents on the basis that: (1) outside sales persons are exempt from overtime and therefore inside sales persons should be as well; (2) eliminating the overtime requirement will provide employees greater flexibility in determining their own hours; and (3) eliminating the requirements to pay overtime will enable workers to increase their income. None of these rationales withstands close scrutiny.

I. H.R. 2888 PUNISHES WORKERS FOR ADVANCES IN TECHNOLOGY

Though H.R. 2888 contains no language limiting its applications only to inside sales persons, its proponents have often described the bill as being limited to "inside sales" workers. Outside sales persons are currently exempt from overtime because such individuals typically and necessarily spend a large amount of time in activities that are not directly productive, such as travel. No similar justification is applicable to inside sales persons. Unlike outside sales persons, inside sales persons are directly engaged in making and processing sales during their entire time at work. Since the employer is receiving a direct benefit from the employee's labors throughout the employee's work period, there is no justification for denying the employee fair compensation when the employee is required to work more than 40 hours a week.

We certainly agree with the proponents of the legislation that remarkable advances in communications technology have encouraged more employers to bring the outside sales force indoors and have allowed sales forces to become more efficient. However, we believe that workers, as well as employers, should share the benefits of that efficiency. Technology has enabled employers to ensure that a sales person's entire time at work is spent directly in productive activity and thereby has enhanced an employer's ability to earn a profit. That same technology cannot and should not serve as a basis for diminishing a worker's income or requiring workers to work even longer hours. For more than 60 years, inside sales persons have been entitled to overtime for hours worked in excess of

40 hours a week.¹ The fact that more sales persons are now able to work inside and fewer must work outside is not a justification of eliminating overtime. To claim otherwise is to effectively insist that workers be denied any share of the profits that result from efficiencies brought about by technological advances.

II. H.R. 2888 WILL RESULT IN WORKERS BEING REQUIRED TO WORK MORE HOURS

Proponents of the legislation contend that eliminating the requirement that employers pay overtime will provide employees a more flexible work schedule. However, nothing in H.R. 2888 alters or changes the fact that it is the employer, not the employee, who controls when and how long a worker may be required to work. Other than overtime pay provisions, nothing limits the hours an employee may be required to work.

H.R. 2888 exempts employees from overtime if they receive a base compensation, determined without regard to the number of hours worked, of not less than one and one-half times the minimum wage multiplied by 2,080 (the equivalent of a year's work at 40 hours a week, presently \$16,078.40²), and additional compensation, in the form of commissions or bonuses based upon sales attributable to the employee, of not less than 40% of the minimum required base compensation (which is \$6,431.36³).⁴ Thus H.R. 2888 exempts an employee from overtime pay protection if an employee earns \$16,078.40 a year either in hourly wages or as a salary, and earns an additional \$6,431.36 annually in commissions. An employee who earns these threshold amounts is not entitled to overtime pay, or even additional wages for hours worked. However, an employer must continue to pay commissions for sales attributable to the employee and may not reduce the commission paid per sale below the commission per sale paid for the first \$6,431.36 worth of commissions.

We believe H.R. 2888 not only eliminates the requirement that workers be paid time-and-a-half, thereby eliminating any disincentive an employer may have to requiring excessive hours of work, but it, in fact, encourages employers to require employees to work overtime by permitting employers to pay 60% less in compensation for hours worked in excess of 40 hours a week than an employer is required to pay for the first 40 hours worked. To most employees, increasing workplace flexibility means permitting employees to choose for themselves when they will work. *Requiring workers to work more hours, and to be compensated for those extra hours, if they are compensated for them at all, at only 40% of their normal rate of pay simply serves to exploit workers, rather than enhancing worker flexibility or earning opportunities.*

¹ In other circumstances, exemptions from minimum wage have been justified on the basis that employers could not afford to pay time and a-half. However, since the employees covered by this legislation have been entitled to overtime for more than 60 years, it is hard to contend that employees are unable to financially meet that commitment. Indeed, no one has seriously contended that the exemption is justified on the basis of the financial hardship that overtime imposes on employers.

² See H.R. 2888, Sec. 2, at subparagraph "(C) clause (i)".

³ Id. at subparagraph "(C) clause (ii)" and subparagraph "(D)".

⁴ Id. at subparagraph "(E)".

In order to ensure that employees subject to H.R. 2888 truly had the right to "choose" overtime work without overtime pay, Rep. Owens offered an amendment in Committee to make overtime work voluntary. It stated that such employees could not be required to work more than 8 hours a day, or 40 hours a week. The amendment would have ensured that employees could choose whether they wished to work more hours in order to earn more money. Unfortunately, this amendment was rejected by the Committee.

H.R. 2888 creates a very powerful economic incentive for an employer to require an employee to work as many hours as possible, and thus diminishes rather than enhances workers' flexibility. If the intent of this legislation is to benefit workers, then the choice to work overtime must belong to the worker.

III. H.R. 2888 WILL DIMINISH, RATHER THAN ENHANCE, WORKERS' INCOME

Proponents contend that by eliminating the requirement that employers pay overtime, H.R. 2888 eliminates the incentive that employers have to restrict the number of hours an employee works and therefore will enhance the earning ability of workers by permitting them to work longer hours and earn more commissions. We agree that enactment of H.R. 2888 will result in workers working longer hours, though not as a consequence of the employee's choice. We dispute whether or not employees will actually earn more money as a consequence.

All that H.R. 2888 literally provides is that an employer may require an employee to work unlimited hours without being required to pay more than a base salary of \$16,078.40 per year and annual commissions of at least \$6,431.36 to the employee. Although it is impossible to tell who is actually covered by H.R. 2888, the employees most likely to be impacted by H.R. 2888 include non-retail sales representatives, of whom the 1996 Occupational Employment Statistics survey by occupation identified 1,485,420 individuals. In 1996, these almost 1.5 million workers had an average hourly wage of \$19.21, \$39,957 a year assuming an individual works 2080 hours a year.⁵ Most of these employees, with the exception of those in the computer industry who have annual incomes in excess of \$57,000, are currently receiving overtime pay. By the terms of H.R. 2888,

⁵The term sales representative encompasses a vast and disparate population in virtually every industry and the disparity in income earned by sales representatives is reflective of this fact. There are sales representatives, such as those who sell communication and computer systems to large employers, who earn annual incomes in excess of \$100,000 a year. For purposes of the Fair Labor Standards Act (FLSA), the Department of Labor typically defines professional in terms of a job requiring a post-graduate college education as a typical condition of employment. While certainly some sales representatives may qualify as professionals under the current rules, others, including some who make substantial incomes, do not. College curriculums do not necessarily conform in a timely manner to technological advances. The Congress took cognizance of this fact in 1990 with regard to the computer industry. At the time, there were many occupations in that industry which clearly required specialized, professional expertise, and which were compensated accordingly, but for which there was no corresponding advanced college degree. While professional status has typically been measured largely by educational achievement, another measure of professional status is reflected by the compensation that the skills and knowledge of the worker are able to command. The Congress, therefore, amended the FLSA to provide that employees in the computer industry making 6.5 times the minimum wage would be deemed professionals and therefore exempt from overtime. (In the last Congress, when the minimum wage was increased, the provision was changed from 6.5 times the minimum wage to 6.5 times \$4.25.) An extension of that provision to sales representatives would likely have attracted much less opposition. However, to contend that employees making as little as \$22,500 a year are earning "professional" salaries is ludicrous.

employees making only 56% of the current annual earnings of sales representatives will be exempted from overtime.^{5.1}

The contention by proponents that \$22,509.76 reflects a “professional” wage or specialized expertise on the part of the employee is also false. In 1996, the median full-time, full-year worker earned \$28,000 and the average annual earnings for workers was \$25,500. In fact, \$22,509.76 is more typical of the starting pay for sales representatives than it is of the average pay earned by most sales representatives. Establishing the guaranteed annual income at such a paltry level guarantees that virtually no sales representative will be excluded from the overtime exemption on the basis of insufficient earnings.^{5.2}

Notwithstanding the assertions of the proponents of H.R. 2888, this legislation does not benefit workers. Rather, the legislation appears to be intended to provide a windfall to employers at the expense of workers. Virtually all reputable economic studies indicate that the income disparity between the wealthy and everyone else continues to increase. Despite the strong labor markets of recent years, both the real average hourly wages and the weekly earnings of non-supervisory workers fell by 1.5 percent between 1989 and 1997. We should be considering legislation, such as legislation increasing the minimum wage, to address and correct these trends. Instead, by permitting employers to require workers to work longer hours for less money, this legislation effectively exacerbates these trends.

IV. H.R. 2888 PROMOTES BURDENOME COMPLIANCE OBLIGATION AND EXCESSIVE LITIGATION

Our strongest objection to H.R. 2888 is the damage it will inflict upon those workers unfortunate enough to be held within the purview of the bill. There are, however, other significant flaws in the legislation. As Representative Owens stated during subcommittee consideration of this legislation, “Among the first questions any Member of Congress should ask in considering this legislation is how many employees will lose the protection afforded by overtime if this legislation is enacted.” In fact, no one can answer that question. Even the most basic questions regarding the scope of this legislation are unclear. By its terms, the bill applies to “any employee

^{5.1} A full-time employee who is paid a salary equal to 1.5 times the minimum wage, \$7.73 per hour, and earns additional commissions equal to a rate of \$3.10 per hour is exempt from overtime under this legislation. An employee who is earning less than \$11.00 an hour is not highly compensated employee and probably needs to be able to earn overtime in order to be able to make ends meet. However, not only does H.R. 2888 deny this employee overtime, but it provides that hours worked in excess of 40 hours a week will only be compensated for in commissions. Whereas the employee normally earns the equivalent of \$10.83 per hour, including commission and base compensation, for the first forty hours worked in a week, for every hour in excess of that the employee will only earn the commission. Assuming the employee is able to make sales at the same rate outside of the normal work day that the employee is able to make during the normal work day, the employee will only earn \$3.10 per hour for hours in excess of 40 hours a week instead of the normal \$10.83 per hour paid to the employee for the first 40 hours worked. If the employee is required to work extra hours, but fails to make any additional sales during that time, the employee is not compensated at all for the extra hours the employee was required to work.

^{5.2} In Committee, Mr. Owens offered an amendment to provide that employees subject to H.R. 2888 must earn at least \$40,000 in total annual income before they can be exempted from overtime. The intent of the amendment was to at least mitigate the effect that H.R. 2888 would have on lower paid workers and decrease the downward pressure H.R. 2888 will otherwise have on workers’ income by ensuring that those making less than the average wage for sales representatives would retain overtime protection.

employed in a sales position.” It would then appear that the bill effectively replaces existing overtime exemptions affecting sales persons, though the sponsors have never indicated that such was their desire. The more prosaic issues raised by the legislation are a litigator’s dream.

Under the terms of H.R. 2888, to be exempt from overtime, the employee must have “specialized or technical knowledge related to the product or service being sold.”⁶ The Department looks at whether a position typically requires a post-graduate degree to determine whether or not the specialized or technical knowledge required for the position is sufficient to exempt employees from overtime. One of the principal purposes of H.R. 2888 is substitute a different standard with regard to sales positions. However, H.R. 2888 provides no basis for assessing or determining what constitutes specialized or technical knowledge. Nor are the terms sufficiently clear as to lend themselves to a common understanding. H.R. 2888 is, therefore, likely to produce significant confusion and litigation if it is enacted.

Secretary Herman, in a letter to the Committee, stated that the legislation places substantial, almost impossible, burdens on employer record keeping:

Proper application of the exemption will require employers to maintain extensive records, for example: (1) the specialized or technical knowledge required to sell each product and/or service; (2) the amount and timing of training provided to each salesperson on each product and/or service; and (3) the rate of incentive-based compensation paid to each salesperson after the 40 percent of base pay incentive-based compensation requirement has been met.

Further, while exempting some sales representatives for overtime, the bill covers only those employees whose duties “consist of making sales predominantly to persons or entities to whom the employee’s position has made previous sales”⁷ and only if the employee’s position “does not involve initiating sales contacts.”⁸ In addition, employers must be prepared to demonstrate that the employee has a “detailed understanding of the needs of those to whom the employee is selling”⁹ and exercises “discretion in offering a variety of products and services.”¹⁰ There will likely be extensive litigation before what constitutes “entities to whom the employee’s position has made previous sales” is defined, before it is clear what “predominantly” means, or what constitutes “initiating sales contacts” or a “detailed understanding of the needs of those to whom the employee is selling.” Even after the initial round of litigation, the obligation of maintaining records sufficient to demonstrate that employer was justified in withholding overtime pay would seem substantial and the issue of just what records would be sufficient to meet that burden is likely to remain murky.

⁶See H.R. 2888, Sec. 2, at subparagraph “(A)”.

⁷Id. at subparagraph “(B) clause “(i)”.

⁸Id. at subparagraph “(B)” clause “(ii)”.

⁹Id. at subparagraph “(C)”.

¹⁰Id. at subparagraph “(D)”.

CONCLUSION

We are strongly opposed to H.R. 2888. The principal rationale that has been proffered to justify this legislation, that the requirement that employers pay overtime acts to diminish the wages of employees, is as nonsensical as it appears on its face. The assertion that workers will benefit by eliminating the requirement that certain sales persons receive time-and-a-half pay for hours worked in excess of 40 hours a week is absurd. The legislation exempts employees earning as little as \$22,509.76 a year, 12% below American workers' average annual earnings, from overtime on the basis that they are professional employees with specialized expertise. If the employee is, in fact, a professional employee with specialized expertise, then surely the employee would merit a significantly higher income for his or her services.

This legislation is distinct from other existing overtime exemptions. H.R. 2888 not only exempts employers from the requirement that they pay time-and-a-half for hours worked in excess of 40 hours a week, it exempts employers from the requirement that they pay an employee any wage at all for overtime hours. H.R. 2888 requires that employers pay commissions on such sales as are made during the overtime period, but does not require an employer to provide any additional compensation. The consequence H.R. 2888 has for workers was clearly pointed out by the Secretary of Labor.

The overall design of the expanded exemption clearly shifts business risk from employers to employees. Employees who work long hours but are unable, for whatever reason, to make significant sales will receive little or no additional pay for the extra hours they work. The employer can not lose in this situation, but the employees certainly will.

U.S. DEPARTMENT OF LABOR,
SECRETARY OF LABOR,
Washington, DC, March 31, 1998.

Hon. WILLIAM F. GOODLING,
Chairman, Committee on Education and the Workforce,
House of Representatives, Washington, DC.

DEAR CHAIRMAN GOODLING: I am writing to provide you with the views of the Department of Labor on H.R. 2888, the "Sales Incentive Compensation Act," which would amend the Fair Labor Standards Act (FLSA) by providing a minimum wage and overtime exemption to all sales people who meet certain criteria.

H.R. 2888 has no provision requiring additional compensation for sales employees who may be forced to work long hours. This would deny FLSA protection for significant numbers of often low-paid workers who have long received such protection. The Department believes that expansion of the FLSA "sales" exemptions would weaken a basic principle of the FLSA—to limit excessive hours of work by employees and provide them just compensation for working overtime.

H.R. 2888 incorporates several important worker protections and guarantees, and in this regard we believe that the bill represents an improvement over previous bills with such purpose. Our careful

review of the proposal, however, raises several concerns regarding these protections, including:

The overall design of the expanded exemption clearly shifts business risk from employers to employees. Employees who work long hours but are unable, for whatever reason, to make significant sales will receive little or no additional pay for the extra hours they work. The employer cannot lose in this situation, but the employees can.

The requirement that the exempt “employee’s position requires specialized or technical knowledge related to products or services being sold,” whether further defined by regulation or in the legislative history, is so vague and subject to differences in understanding and application that there will undoubtedly be an increase in the already high levels of private litigation involving sales employment.

Determining when and how this complicated, multi-test exemption applies will be very difficult for employers, employees and the Department of Labor. This difficulty too will undoubtedly lead to misunderstandings, disputes and litigation.

Proper application of the exemption will require employers to maintain extensive records, for example: (1) the specialized or technical knowledge required to sell each product and/or service; (2) the amount and timing of training provided to each salesperson on each product and/or service; and (3) the rate of incentive-based compensation paid to each salesperson after the 40 percent of base pay incentive-based compensation requirement has been met.

For these reasons, the Department opposes the bill’s expansion of the FLSA “sales” exemptions to sales employees in all industries. The Office of Management and Budget has advised that there is no objection to the presentation of this report from the standpoint of the Administration’s program.

Sincerely,

ALEXIS M. HERMAN.
 WILLIAM L. CLAY.
 DALE E. KILDEE.
 MAJOR R. OWENS.
 PATSY T. MINK.
 LYNN WOOLSEY.
 CHAKA FATTAH.
 GEORGE MILLER.
 MATTHEW G. MARTINEZ.
 DONALD M. PAYNE.
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 CARLOS ROMERO-BARCELÓ.
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 JOHN F. TIERNEY.
 DENNIS J. KUCINICH.

