Mr. McCONNELL. Mr. President, I ask unanimous consent that the sponsors' statement of legislative intent be printed in the RECORD.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

JOINT STATEMENT OF LEGISLATIVE INTENT BY THE SPONSORS OF S. 2323, THE WORKER ECONOMIC OPPORTUNITY ACT

I. INTRODUCTION AND PURPOSE

The purpose of S. 2323, the Worker Economic Opportunity Act, is to allow employees who are eligible for overtime pay to continue to share in workplace benefits that involve their employer's stock or similar equity-based benefits. More working Americans are receiving stock options or opportunities to purchase stock than ever before. The Worker Economic Opportunity Act updates the Fair Labor Standards Act to ensure that rank-and-file employees and management can share in their employer's economic well being in the same manner.

Employers have provided stock and equity-based benefits to upper level management for decades. However, it is only recently that employers have begun to offer these programs in a broad-based manner to non-exempt employees. Historically, most employees had little contact with employer-provided equity devices outside of a 401(k) plan. But today, many employers, from a broad cross-section of industry, have begun offering their employees opportunities to purchase employer stock at a modest discount, or have provided stock options to rank and file employees; and they have even provided outright grants of stock under certain circumstances.

The Federal Reserve Board of Governors recently estimated that 17 percent of large firms have introduced a stock options program and 37 percent have broadened eligibility for their stock option programs in the last two years.[1] The Employment Policy Foundation estimates between 9.4 million and 25.8 million workers receive benefits through some type of equity participation program.[2] The trend is growing, and given the current state of the economy, it is likely to continue.

The tremendous success of our economy over the last several years has been largely attributed to the high technology sector. One of the things that our technology companies have succeeded at is creating an atmosphere in which all employees share the same goal: the success of the company. By vesting all employees in the success of the business, stock options and other equity devices have become an important tool to create businesses with unparalleled productivity. The Worker Economic Opportunity Act will encourage more employers to provide opportunities for equity participation to their employees, further expanding the benefits that inure from equity participation.

II. BACKGROUND AND NEED FOR LEGISLATION

A. Background on stock options and related devices

Employers use a variety of equity devices to share the benefits of equity ownership with their employees. As the employer's stock appreciates, these devices provide a tool to attract and retain employees, an increasingly difficult task during a time of record economic growth and low unemployment in the United States. These programs also foster a broader sense of commitment to a common goal—the maintenance and improvement of the company's performance—among all employees nationally and even internationally, and thus provide an alignment between the interests of employees with the interests of the company and its shareholders. They can also reinforce the evolving employer-employee relationship, with employees viewed as stakeholders.

Employer stock option and stock programs come in all different types and formats. The Worker Economic Opportunity Act focuses on the most common types: stock option, stock appreciation right, and employee stock purchase programs.

Stock Option Programs.—Stock options provide the right to purchase the employer's securities for a fixed period of time. Stock option programs vary greatly by employer. However, two main types exist: nonqualified and qualified option programs.[3] Most programs are nonqualified stock option programs, meaning that the structure of the program does not protect the employee from being taxed at the time of exercise. However, the mechanics of stock option programs are very similar regardless of whether they are nonqualified or qualified. Some of these characteristics are described below.

Grants. An employer grants to employees a certain number of options to purchase shares of the employer's stock. The exercise price may be around the fair market value of the stock at the time of the grant, or it may be discounted below fair market value to provide the employee an incentive to participate in the option program.

Vesting. Most stock option programs have some sort of requirement to wait some period after the grant to benefit from the options, often called a vesting period. After the period, employees typically may exercise their options by exchanging the options for stock at the exercise price at any time before the option expires, which is typically up to ten years. In some cases, options may vest on a schedule, for example, with a third of the options vesting each year over a three-year period. In addition to vesting on a date certain, some options may vest if the company hits a certain goal, such as reaching a certain stock price for a certain number of days. Some programs also provide for accelerated or automatic vesting in certain circumstances such as when an employee retires or dies before the vesting period has run, where there is change in corporate control or when an employee's employment is terminated.

Exercise. Under both qualified and nonqualified stock option programs, an employee can exchange the options, along with sufficient cash to pay the exercise price of the options, for shares of stock. Because many rank-and-file employees cannot afford to pay the cost of buying the stock at the option price in cash, many employers have given their employees the opportunity for "cashless" exercise, either for cash or for stock, under nonqualified option plans. In a cashless exercise for cash, an employee gives options to a broker or program administrator, this party momentarily "lends" the employee the money to purchase the requisite number of shares at the grant price, and then immediately sells the shares. The employee receives the difference between the market price and the exercise price of the stock (the profit), less transaction fees. In a cashless exercise for stock, enough shares are sold to cover the cost of buying the

Footnotes at end of article.

shares the employee will retain. In either case, the employee is spared from having to provide the initial cash to purchase the stock at the option price.

An employee's options usually expire at the end of the option period. An employee may forfeit the right to exercise the options, in whole or in part, under certain circumstances, including upon separation from the employer. However, some programs allow the employee to exercise the options (sometimes for a limited period of time) after they leave employment with the employer.

Stock Appreciation Rights.—Stock appreciation rights (SARs) operate similarly to stock options. They are the rights to receive the cash value of the appreciation on an underlying stock or equity based security. The stock may be publicly traded, privately held, or may be based on valued, but unregistered, stock or stock equivalent. The rights are issued at a fixed price for a fixed period of time and can be issued at a discount, carry a vesting period, and are exercisable over a period of time. SARs are often used when an employer cannot issue stock because the stock is listed on a foreign exchange, or regulatory or financial barriers make stock grants impracticable.

Employee Stock Purchase Plans.—Employee stock purchase plans (ESPPs) give employees the opportunity to purchase employer stock, usually at up to a 15 percent discount, by either regularly or periodically paying the employer directly or by having after-tax money withdrawn as a payroll deduction. Like option programs, ESPPs can be qualified or nonqualified.

Section 423 of the Internal Revenue Code[4] sets forth the factors for a qualified ESPP. The ability to participate must be offered to all employees, and employees must voluntarily choose whether to participate in the program. The employer can offer its stock to employees at up to a 15 percent discount off of the fair market value of the stock, determined at the time the option to purchase stock is granted or at the time the stock is actually purchased. The employee is required to hold the stock for one or two years after the option is granted to receive capital gains treatment. If the employee sells the stock before the requisite period, any gain made on the sale is treated as ordinary income.

Nonqualified ESPPs are usually similar to qualified ESPPs, but they lack one or more qualifying features. For example, the plan may apply only to one segment of employees, or may provide for a greater discount.

B. The Fair Labor Standards Act and stock options

The Fair Labor Standards Act of 1938[5] (FLSA) establishes workplace protections including a minimum hourly wage and overtime compensation for covered employees, record keeping requirements and protections against child labor, among other provisions. A cornerstone of the FLSA is the requirement that an employer pay its nonexempt employees overtime for all hours worked over 40 in a week at one and one-half times the employee's regular rate of pay.[6] The term "regular rate" is broadly defined in the statute to mean "all remuneration for employment paid to, or on behalf of, the employee."[7]

Section 207(e) of the statute excludes certain payments from an employee's regular rate of pay to encourage employers to provide them, without undermining employees' fundamental right to overtime pay. Excluded payments include holiday bonuses or gifts,[8] discretionary bonuses,[9] bona fide profit sharing plans,[10] bona fide thrift or savings plans,[11] and bona fide old-age, retirement, life, accident or health or similar benefits plans.[12] By excluding these payments from the definition of "regular rate,"[13] Congress recognized that certain kinds of benefits provided to employees are not within the generally accepted meaning of compensation for work performed.

Thus, by excluding these payments from the regular rate in section 207(e) of the FLSA, Congress encouraged employers to provide these payments and benefits to employees. The encouragement has worked well—employees now expect to receive from their employer at least some of these benefits (i.e., healthcare), which today, on average, comprise almost 30 percent of employees' gross compensation./14/ For similar reasons, Congress decided that the value and income from stock option, SAR and ESPP programs should also be excluded from the regular rate, because they allow employees to share in the future success of their companies.

C. The Department of Labor's opinion letter on stock options

The impetus behind the Worker Economic Opportunity Act is the broad dissemination of a February 1999 advisory opinion letter[15] regarding stock options issued by the Department of Labor's Wage and Hour Division, the agency charged with the administration of the FLSA. The letter involved an employer's stock option program wherein its employees would be notified of the program three months before the options were granted, and some rank-and-file employees employed by the company on the grant date would receive options. The options would have a two-year vesting period, with accelerated vesting if certain events occurred. The employer would also automatically exercise any unexercised options on behalf of the employees the day before the program ended.[16]

The opinion letter indicated that the stock option program did not meet any of the existing exemptions to the regular rate under the FLSA, although it did not explain the reasons in any detail. Later, the Administration's testimony before the House Workforce Protections Subcommittee explained that the stock option program did not meet the gift, discretionary bonus, or profit sharing exceptions to the regular rate because, among other reasons, it required employees to do something as a condition of receiving the options—to remain employed with the company for a period of time.[17] Such a condition is not allowed under the current regular rate exclusions. The testimony also noted that the program was not excludable under the thrift or savings plan exception because the employees were only allowed to exercise their options using a cashless method of exercise, and thus the employees could not keep the stock as savings or an investment.[18]

The opinion letter stated that the employer would be required to include any profits made from the exercise of the options in the regular rate of pay of its nonexempt employees. In particular, the profits would have to be included in the employee's regular rate for the shorter of the time between the grant date and the exercise date, or the two years prior to exercise.[19]

Section 207(e)'s exclusions to the regular rate did not clearly exempt the profits of stock options or similar equity devices from the regular rate, and thus from the overtime calculation. Thus, the Department of Labor's opinion letter provided a permissible reading of the statute. A practical effect of the Department of Labor's interpretation was stated by J. Randall MacDonald, Executive Vice President of Human Resources and Administration at GTE during a March 2 House Workforce Protections Subcommittee hearing on the issue: "[i]f the Fair Labor Standards Act is not corrected to reverse this policy, we will no longer be able to offer stock options to our nonexempt employees."[20]

As the contents of the letter became generally known in the business community and on Capitol Hill, it became clear that the letter raised an issue under the FLSA that previously had not been contemplated. It further became clear that an amendment to the FLSA would be needed to change the law specifically to address stock options.

A legislative solution was not only supported by employers at the House hearing, it was also supported by employees and unions. Patricia Nazemetz, Vice President of Human Resources for Xerox Corporation, read a letter from the Union of Needlework, Industrial and Textile Employees (UNITE), the union that represents many Xerox manufacturing and distribution employees, in which the International Vice President stated:

"Xerox's UNITE chapter would strongly urge Congress to pass legislation exempting stock options and other forms of stock grants from the definition of the regular rate for the purposes of calculating overtime. . . . It is only recently that Xerox has made bargaining unit employees eligible to receive both stock options and stock grants. Without a clarification to the FLSA, we are afraid Xerox may not offer stock options or other forms of stock grants to bargaining unit employees in the future."[21]

At the House hearing, the Administration also acknowledged that the problem needed to be fixed legislatively in a flexible manner. "Based on the information we have been able to obtain, *there appears* to be wide variations in the scope, nature and design of stock option programs. There is no one common model for a program, suggesting the need for a flexible approach. Given the wide variety and complexity of programs, we believe that *the best solution* would be to address this matter legislatively."[22]

The general agreement on the need to fix the problem among these diverse interests led to the development of the Worker Economic Opportunity Act.

III. EXPLANATION OF THE BILL AND SPONSORS' VIEWS

Congress worked closely with the Department of Labor to develop this important legislation. The sections below reflect the discussions between the sponsors and the Department of Labor during the development of the legislation, and the sponsors' intent and their understanding of the legislation.

A. Definition of bona fide ESPP

For the purposes of the Worker Economic Opportunity Act, a bona fide employee stock purchase plan includes an ESPP that is (1) a qualified ESPP under section 423 of the Internal Revenue Code;[23] or (2) a plan that meets the criteria identified below.

1. Qualified employee stock purchase plans

Qualified ESPPs, known as section 423 plans, comprise the overwhelming majority of stock purchase plans. Thus, the intent of the legislation is to deem "bona fide" all plans that meet the criteria of section 423.

2. Nonqualified employee stock purchase plans

As described above, section 423 plans are considered bona fide ESPPs. Further, those ESPPs that do not meet the criteria of section 423, but that meet the following criteria also qualify as bona fide ESPPs:

(a) the plan allows employees, on a regular or periodic basis, to voluntarily provide funds, or to elect to authorize periodic payroll deductions, for the purchase at a future time of shares of the employer's stock;

(b) the plan sets the purchase price of the stock as at least 85% of the fair market value of the stock at the time the option is granted or at the time the stock is purchased; and

(c) the plan does not permit a nonexempt employee to accrue options to purchase stock at a rate which exceeds $25,000 of fair market value of such stock (determined either at the time the option is granted or the time the option is exercised) for each calendar year.

The sponsors note that many new types of ESPPs are being developed, particularly by companies outside the United States, and that many of these companies may also intend to apply them to their U.S.-based employees. These purchase plans have several attributes which make them appear to be more like savings plans than traditional U.S. stock purchase plans, such as a period of payroll deductions of between three and five years, or an employer provided "match" in the form of stock or options to the employee.

Further many companies are developing plans that are similar to section 423 plans. The sponsors believe that it is in the best interests of employees for the Secretary of Labor to review these and other new types of plans carefully in the light of the purpose of the Worker Economic Opportunity Act—to encourage employers to provide opportunities for equity participation to employees—and to allow section 7(e), as amended, to accommodate a wide variety of programs, where it does not undermine employees' fundamental right to overtime pay. It is the sponsors' vision that this entire law be flexible and forward-looking and that the Department of Labor apply and interpret it consistently with this vision.

B. "Value or Income" is defined broadly

The hallmark of the Worker Economic Opportunity Act is that section 7(e)(8) provides that any value or income derived from stock option, SAR or bona fide ESPP programs is excluded from the regular rate of pay. For this reason, the phrase "value or income" is construed broadly to mean any value, profit, gain, or other payment obtained, recognized or realized as a result of, or in connection with, the provision, award, grant, issuance, exercise or payment of stock options, SARs, or stock issued or purchased pursuant to a bona fide ESPP program established by the employer.

This broad definition means, for example, that any nominal value that a stock option or stock appreciation right may carry before it is exercised is excluded from the regular rate. Similarly, the value of the stock or the income in the form of cash is excluded after options are exercised, as is the income earned from the stock in the form of dividends or ultimately the gains earned, if any, on the sale of the stock. The discount on a stock option, SAR or stock purchase under a ESPP program is likewise excludable.

C. The act preserves programs which are otherwise excludable under existing regular rate exemptions

The Worker Economic Opportunity Act recognizes two ways that employer equity programs may be excluded from the regular rate. Such equity programs may be excluded if they meet the existing exemptions to the regular rate pursuant to Section 7(e)(1)-(7), which apply to contributions and sums paid by employers regardless of whether such payments are made in cash or in grants of stock or other equity based vehicles, and provided such payment or grant is consistent with the existing regulations promulgated under Section 7(e). Employer equity plans also may be excluded under new section 7(e)(8) added by the Worker Economic Opportunity Act.

This is reaffirmed in new section 207(e)(8), which makes clear that the enactment of section 7(e)(8) carries no negative implication about the scope of the preceding paragraphs of section (e). Rather, the sponsors understand that some grants and rights that do not meet all the requirements of section 7(e)(8) may continue to qualify for exemption under an earlier exclusion. For example, programs that grant options or SARs that do not have a vesting period may be otherwise excludable from the regular rate if they meet another section (7)(e) exclusion. This would be true even if the option was granted at less than 85% of fair market value. This language was not intended to prevent grants or rights that meet some but not all of the requirements of an earlier exemption in 7(e) from being exempt under the newly created exemption.

D. Basic communication to employees required because it helps ensure a successful program

For grants made under a stock option, SAR or bona fide ESPP program to qualify for the exemption under new section 7(e)(8), their basic terms and conditions must be communicated to participating employees either at the beginning of the employee's participation in the program or at the time of grant. This requirement was put into the legislation to recognize that when employees understand the mechanics and the implications of the equity devices they are given, they can more fully participate in exercising meaningful choices with respect to those devices. As discussed below, this is a simple concept, it is not intended to be a complicated or burdensome requirement.

1. Terms and conditions to be communicated to employees

Employers must communicate the material terms and conditions of the stock option, stock appreciation right or employee stock purchase program to employees to ensure that they have sufficient information to decide whether to participate in the program. With respect to options, these terms include basic information on the number of options granted, the number of shares granted per option, the grant price, the grant date or dates, the length of any applicable vesting period(s) and the dates when the employees will first be able to exercise options or rights, under what conditions the options must be forfeited or surrendered, the exercise methods an employee may use (such as cash for stock, cashless for cash or stock, etc.), any restrictions on stock purchased through options, and the duration of the option, and what happens to unexercised options at the end of the exercise period. Pending issuance of any regulations, an employer who communicated the information in the prior sentence is to be deemed to have communicated the terms and conditions of the grant. Similar information should be provided regarding SARs or ESPPs.

2. The mode of communications

The legislation does not specify any particular mode of communication of relevant information, and no particular method of communication is required, as long as the method chosen reasonably communicates the information to employees in an understandable fashion. For example, employers may notify their employees of an option grant by letter, and later provide a formal employee handbook, or other method such as a link to a location on the company Intranet. Any combination of communications is acceptable. The intent of the legislation is to ensure that employees are provided the basic information in a timely manner, not to mandate the particular form of communication.

3. The timing of communications

The legislation specifies that the employer is to communicate the terms and conditions of the stock option, SAR and ESPP programs to employees at or before the beginning of the employee's participation in the program or at the time the employee receives a grant. It is acceptable, and perhaps even likely, that the relevant information on a program will be disseminated in a combination of communications over time. This approach allows flexibility and acknowledges that types of participation vary greatly between stock option and SAR programs, on the one hand, and ESPPs on the other.

For example, under an ESPP, an employee may choose to begin payroll deductions in January, but not actually have the option to purchase stock until June. By contrast, with an option or SAR program, employees are given the options or rights at the outset, but those rights may not vest until some year in the future.

The timing of the communication is flexible, because often it is difficult to have materials ready for employees at the beginning of a stock option or stock appreciation right program, immediately following approval by the Board of Directors, because of confidentiality requirements. Thus, within a reasonable time following approval of a stock option grant by the Board of Directors, the employer is required to communicate basic information about the grant employees have received. For example, an initial letter may notify the employees that they have received a certain number of stock options and provide the basic information about the program. More detailed information about the program may precede or follow the grant in formats such as an employee handbook, options pamphlet, or an Intranet site that provides options information.

E. Exercisability criteria applicable only to stock options and SARs

As discussed above, a common feature in grants of stock options and SARs is a vesting or holding period, which under current practice may be as short as a few months or as long as a number of years. For a stock option or SAR to be excluded from the regular rate pursuant to the Worker Economic Opportunity Act, new section 7(e)(8) requires that the grant or right generally cannot be exercisable for at least six months after the date of grant.

For stock option grants that include a vesting requirement, typically an option will become exercisable after the vesting period ends. Some option grants vest gradually in accordance with a schedule. For example, a portion of the employee's options may vest after six months, with the remaining portion vesting three months thereafter. Options may also vest in connection with an event, such as the stock reaching a certain price or the company attaining a performance target.

In addition, the sponsors recognize that a grant that is vested may not be currently exercisable by the employee because of an employer's requirement that the employee hold the option for a minimum period prior to exercise. In other words, there may be an additional period of time after the vesting period during which the option remains unexerciseable. An option or SAR may meet the exercisability requirements of the bill without regard to the reason why the right to exercise is delayed.

Further, if a single grant of options or SARs includes some options exercisable after six months while others are exercisable earlier, then those exercisable after the six month period will meet the exercisability requirement even if the others do not. The determination is made option by option, SAR by SAR. In addition, if exercisability is tied to an event, the determination of whether the six-month requirement is met is based on when the event actually occurs. Thus, for example, if an option is exercisable only after an initial public offering (IPO) and the IPO occurs seven months after grant, the option shall be deemed to have met the provision's exercisability requirement.

However, section 7(e)(8)(B) specifically recognizes that there are a number of special circumstances when it is permissible for an employer to allow for earlier exercise to occur (in less than 6 months) without loss of the exemption. For example, an employer or plan may provide that a grant may vest or otherwise become exercisable earlier than six months because of an employee's disability, death, or retirement. The sponsors encourage the Secretary to consider and evaluate other changes in employees' status or circumstances.

Earlier exercise is also permitted in connection with a change in corporate ownership. The term change in ownership is intended to include events commonly considered changes in ownership under general practice for options and SARs. For example, the term would include the acquisition by a party of a percentage of the stock of the corporation granting the option or SAR, a significant change in the corporation's board of directors within 24 months, the approval by the shareholders of a plan of merger, and the disposition of substantially all of the corporation's assets.

The sponsors believe it important to allow employers the flexibility to construct plans that allow for these earlier exercise situations. However, this section is not intended to in any way require employers to include these or any other early exercise circumstances in their plans.

F. Stock option and SAR programs may be awarded at fair market value or discounted up to and including 15%

Stock options and SARs generally are granted to employees at around fair market value or at a discount. New section 7(e)(8)(B) recognizes that grants may be at a discount, but that the discount cannot be more than a 15% discount off of the fair market value of the stock (or in the case of stock appreciation rights, the underlying stock, security or other similar interest).

A reasonable valuation method must be used to determine fair market value at the time of grant. For example, in the case of a publicly traded stock, it would be reasonable to determine fair market value based on averaging the high and low trading price of the stock on the date of the grant. Similarly, it would be reasonable to determine fair market value as being equal to the average closing price over a period of days ending with or shortly before the grant date (or the average of the highs and lows on each day). In the case of a non-publicly traded stock, any reasonable valuation that is made in good faith and based on reasonable valuation principles must be used.

The sponsors understand that the exercise price of stock options and SARs is sometimes adjusted in connection with recapitalizations and other corporate events. Accounting and other tax guidelines have been developed for making these adjustments in a way that does not modify a participant's profit opportunity. Any adjustment conforming with these guidelines does not create an issue under the 15% limit on discounts.

G. Employee participation in equity programs must be voluntary

New section (8)(C) of the Worker Economic Opportunity Act states that the exercise of any grant or right must be voluntary. Voluntary means that the employee may or may not choose not to exercise his or her grants or rights at any point during the stock option, stock appreciation right, or employee stock purchase program, as long as that is in accordance with the terms of the program. This is a simple concept and it is not to be interpreted as placing any other restrictions on such programs.

It is the intent of the sponsors that this provision does not restrict the ability of an employer to automatically exercise stock options or SARs for the employee at the expiration of the grant or right. However, an employer may not automatically exercise stock options or SARs for an employee who has notified the employer that he or she does not want the employer to exercise the options or rights on his or her behalf.

Stock option, SARs and ESPP programs may qualify under new section 7(e)(8) even though the employer chooses to require employees to forfeit options, grants or rights in certain employee separation situations.

H. Performance based programs

The purpose of new section 7(e)(8)(D) is to set out the guidelines employers must follow in order to exclude from the "regular rate" grants of stock options, SARs, or shares of stock pursuant to an ESPP program based on performance. If neither the decision of whether to grant nor the decision as to the size of the grant is based on performance, the provisions of in new section 7(e)(8)(D) do not apply. For example, grants made to employees at the time of their hire, and any value or income derived from these grants, may be excluded provided they meet the requirements in new sections 7(e)(8)(A)-(C).

New section 8(D) is divided into two clauses. The first, clause (i), deals with awards of options awarded based on pre-established goals for future performance, and the second, clause (ii), deals with grants that are awarded based on past performance.

1. Goals for future performance

New section 7(e)(8)(D)(i) provides that employers may tie grants to future performance so long as the determinations as to whether to grant and the amount of grant are based on the performance of *either* (i) any business unit consisting of at least ten employees *or* (ii) a facility.

A business unit refers to all employees in a group established for an identifiable business purpose. The sponsors intend that employers should have considerable flexibility in defining their business units. However, the unit may not merely be a pretext for measuring the performance of a single employee or small group of fewer than ten employees. By way of example, a unit may include any of the following: (i) a department, such as the accounting or tax departments of a company, (ii) a function, such as the accounts receivable function within a company's accounting department, (iii) a position classification, such as those call-center personnel who handle initial contacts, (iv) a geographical segment of a company's operations, such as delivery personnel in a specified geographical area, (v) a subsidiary or operating division of a company, (vi) a project team, such as the group assigned to test software on various computer configurations or to support a contract or a new business venture.

With respect to the requirement to have ten or more employees in a unit, this determination is based on all of the employees in the unit, not just those employees who are, for example, non-exempt employees.

A facility includes any separate location where the employer conducts its business. Two or more locations that would each qualify as a facility may be treated as a single facility. Performance measurement based on a particular facility is permitted without regard to the number of employees who are working at the facility. For example, a facility would include any of the following: a separate office location, each separate retail store operated by a company, each separate restaurant operated by a company, a plant, a warehouse, or a distribution center.

The definitions of both a business unit and a facility are intended to be flexible enough to adapt to future changes in business operations. Therefore, the examples of business units set forth above should be viewed with this in mind.

Options may be excluded from the regular rate in accordance with new section 7(e)(8)(D)(i) under the following circumstances:

Example 1—Employer announces that certain employees at the Wichita, Kansas plant will receive 50 stock options if the plant's production reaches a certain level by the end of the year (note that in order to fit within this subsection, the grant does not have to be made on a facility wide basis);

Example 2—Employer announces that it will grant employees working on the AnyCo. account 50 stock options each if the account brings in a certain amount of revenue by the end of the year, provided that there are at least 10 employees on the AnyCo. account.

Employer 3—Employer announces that certain employees will receive stock options if the company reaches specified goal.

New section 7(e)(8)(D)(i) also makes clear that otherwise qualifying grants remain excludable from the regular rate if they are based on an employees' length of service or minimum schedule of hours or days of work. For example, an employer may make grants only to employees: (i) who have a minimum number of years of service, (ii) who have been employed for at least a specified number of hours of service during the previous twelve month period (or other period), (iii) who are employed on the grant date (or a period ending on the grant date), (iv) who are regular full-time employees (i.e., not part-time or seasonal), (v) who are permanent employees, or (vi) who continue in service for a stated period after the grant date (including any minimum required hours during this period). Any or all of these conditions, and similar conditions, are permissible.

2. Past performance

New section 7(e)(8)(D)(ii) clarifies that employers may make determinations as to existence and amount of grants or rights based on past performance, so long as the determination is in the sole discretion of the employer and not pursuant to any prior contract. Thus, employers have broad discretion to make grants as rewards for the past performance of a group of employees, even if it is not a facility or business unit, or even for an individual employee. The determination may be based on any performance criteria, including hours of work, efficiency or productivity.

Under new section 7(e)(8)(D)(ii), employers may develop a framework under which they will provide options in the future, provided that to the extent the ultimate determination as to the fact of and the amount of grants or rights each employee will receive is based on past performance, the employer does not contractually obligate itself to provide the grant or rights to an employee. Thus, new section 7(e)(8)(D)(ii) would allow an employer to determine in advance that it will provide 100 stock options to all employees who receive "favorable" ratings on their performance evaluations at the end of the year, and it would allow the employer to advise employees, in employee handbooks or otherwise, of the possibility that favorable evaluations may be rewarded by option grants, so long as the employer does not contractually obligate itself to provide the grants or in any other way relinquish its discretion as to the existence or amount of grants.

Similarly, the fact that an employer makes grants for several years in a row based on favorable performance evaluation ratings, even to the point where employees come to expect them, does not mean in itself that the employer may be deemed to have "contractually obligated" itself to provide the rights.

Some examples of performance based grants that fit within new section7(e)(8)(D)(ii) are as follows:

Example A—Company A awards stock options to encourage employees to identify with the company and to be creative and innovative in performing their jobs. Company A's employee handbook includes the following: "Company A's stock option program is a long-term incentive used to recognize the potential for, and provide an incentive for, anticipated future performance and contribution. Stock option grants may be awarded to employees at hire, on an annual basis, or both. All full-time employees who have been employed for the appropriate service time are eligible to be considered for annual stock option grants."

Company A provides stock options to most nonexempt employees following their performance review. Each employee's manager rates the employee during a review process, resulting in a rating of from 1 to 5. The rating is based upon the manager's objective and subjective analysis of the employee's performance. The rating is then put into a formula to determine the number of options an employee is eligible to receive, based on the employee's level within the company, the product line that the employee works on, and the value of the product to the company's business. Employees are aware a formula is used. The Company then informs the employee of the number of options awarded to him or her.

Managers make it clear to employees that the options are granted in recognition of prior performance with the expectation of the employee's future performance, but no contractual obligation is made to employees. This process is repeated annually, with employees eligible for stock options each year based on their annual performance review. Most employees receive options annually based upon their performance review rating and their level in the company.

Example B—Company B manages its program similarly to company A, with some notable exceptions. Company B has a very detailed performance management system, under which all employees successfully meeting the expectations of their job receive options. The employee's job expectations are more clearly spelled out on an annual basis than under Company A's plan. Once a year, the employee undergoes a formal, written, performance review with his or her manager. If work is satisfactory, the employee receives a predetermined but unannounced number of options. Unlike Company A, which provides different amounts of options to employees based upon a numeric performance rating, Company B provides the same number of options to all employees who receive satisfactory employment evaluations. Over 90 percent of Company B's employees receive options annually, and in many years, this percentage exceeds 95 percent.

In both Example A and Example B, the employers set up in advance the formula under which option decisions are made; however, the decisions as to whether an individual employee would receive options and how many options he or she would receive was made based on past performance at the end of the performance period, but not pursuant to a prior contractual obligation made to the employees. The fact that the employer determines a formula or program in advance does not disqualify these examples from new section 7(e)(8).

I. Extra compensation

The Worker Economic Opportunity Act also amends section 7(h) of the FLSA (29 U.S.C. § 207(h)) to ensure that the income or value that results from a stock option, SAR or ESPP program, and that is excluded from the regular rate by new section 7(e)(8), cannot be credited by an employer toward meeting its minimum wage obligations under section 6 of the Act or overtime obligations under section 7 of the Act. The language divides section 7(h) into two parts, 7(h)(1) and 7(h)(2). Section 7(h)(1) states that an employer may not credit an amount, sum, or payment excluded from the regular rate under existing sections 7(e)(1-7) or new section 7(e)(8) towards an employer's minimum wage obligation under section 6 of the Act. When section 7(h)(1) is read together with section 7(h)(2), it states that an employer may not credit an amount excluded under existing sections 7(e)(1-4) or new section 7(e)(8) toward overtime payments. However, consistent with existing 7(h), extra compensation paid by an employer under sections 7(e)(5-7) may be creditable towards an employer's overtime obligations. This change shall take effect on the effective date but will not affect any payments that are not excluded by section 7(e) and thus are included in the regular rate.

J. The legislation includes a broad pre-effective date safe harbor and transition time

In drafting the Worker Economic Opportunity Act, the sponsors hoped to create an exemption that would be broad enough to capture the diverse range of broad-based stock ownership programs that are currently being offered to non-exempt employees across this nation. However, in order to reach a consensus, the new exemption had to be tailored to comport with the existing framework of the FLSA. The result is a series of requirements that stock option, SAR and ESPP programs must meet in order for the proceeds of those plans to fit within the newly created exemption.

Because of the circumstances that give rise to this legislation, the pre-effective date safe harbor is intentionally broader than the new exemption. The sponsors did not want to penalize those employers who have been offering broad-based stock option, SAR and ESPP programs simply because these programs would not meet all the new requirements in section 7(e)(8). Thus, the safe harbor in section 2(d) of the Act comprehensively protects employers from any liability or other obligations under the FLSA for failing to include any value or income derived from stock option, SAR and ESPP programs in a non-exempt employee's regular rate of pay. The safe harbor applies to all grants or rights that were obtained under such programs prior to the effective date, whether or not such programs fit within the new requirements of section 7(e)(8). If a grant or right was initially obtained prior to the effective date, it is covered by the safe harbor even though it vested later or was contingent on performance that would occur later. In addition, normal adjustments to a pre-effective date grant or right, such as those that are triggered by a recapitalization, change of control or other corporate event, will not take the grant or right outside the safe harbor.

On a prospective basis, the sponsors realized that many employers would need time to evaluate their programs in light of the new law and to make the changes necessary to ensure that the programs will fit within the new section 7(e)(8) exemption. Consequently, the sponsors adopted a broad transition provision to apply to stock option, SAR and ESPP programs without regard to whether or not they meet the requirements for these plans set forth in the legislation. Specifically, section 2(c) of the legislation contains a 90-day post enactment delayed effective date. The sponsors believe that the vast majority of employers who offer stock option, SAR and ESPP programs to non-exempt employees will be able to use the transition period in section 2(d)(1) to modify their programs to conform with the requirements of the legislation.

In addition, the sponsors felt that there were two circumstances where a further extension of this broad transition relief was appropriate. First, the legislation recognizes that some employers would need the consent of their shareholders to change their plans. Section 2(d)(2) provides an additional year of transition relief to any employer with a program in place on the date this legislation goes into effect that will require shareholder approval to make the changes necessary to comply with the new requirements of section 7(e)(8). Second, the legislation extends the transition relief to cover situations wherein an employer's obligations under a collective bargaining agreement conflict with the requirements of this Act. Section 2(d)(3) eliminates any potential conflict by allowing employers to fulfill their pre-existing contractual obligations without fear of liability.

V. REGULATORY IMPACT STATEMENT

The sponsors have determined that the bill would result in some additional paperwork, time and costs to the Department of Labor, which would be entrusted with implementation of the Act. It is difficult to estimate the volume of additional paperwork necessitated by the Act, but the sponsors do not believe that it will be significant.

VI. SECTION-BY-SECTION ANALYSIS

Sec. 2. (a) Amendments to the Fair Labor Standards Act—The legislation amends Section 7(e) of the Fair Labor Standards Act of 1938 (29 U.S.C. § 207(e)) by creating a new subsection, 7(e)(8), which will exclude from the definition of the regular rate of pay any income or value nonexempt employees derive from an employer stock option, stock appreciation right, or bona fide employee stock purchase program under certain circumstances. Specifically, the legislation adds the following provisions to the end of Section 7(e) of the Fair Labor Standards Act:

(8) The new exclusion provides that when an employer gives its employees an opportunity to participate in a stock option, stock appreciation right or a bona fide employee stock purchase program (as explained in the Explanation of the Bill and Sponsor's Views), any value or income received by the employee as a result of the grants or rights provided pursuant to the program that is not already excludable from the regular rate of pay under sections 7(e)(1-7) of the Act (29 U.S.C. § 207(e)), will be excluded from the regular rate of pay, provided the program meets the following criteria—

(8)(A) The employer must provide employees who are participating in the stock option, stock appreciation right or bona fide employee stock purchase program with information that explains the terms and conditions of the program. The information must be provided at the time when the employee begins participating in the program or at the time when the employer grants the employees stock options or stock appreciation rights.

(8)(B) As a general rule, the stock option or stock appreciation right program must include at least a 6 month vesting (holding) period. That means that employees will have to wait at least 6 months after they receive stock options or a stock appreciation rights before they are able to exercise the right for stock or cash. However, in the event that the employee dies, becomes disabled, or retires, or if there is a change in corporate ownership that impacts the employer's stock or in other circumstances set forth at a later date by the Secretary in regulations, the employer has the ability to allow its employees to exercise their stock options or stock appreciation rights sooner. The employer may offer stock options or stock appreciation rights to employees at no more than a 15 percent discount off the fair market value of the stock or the stock equivalent determined at the time of the grant.

(8)(C) An employee's exercise of any grant or right must be voluntary. This means that the employees must be able to exercise their stock options, stock appreciation rights or options to purchase stock under a bona fide employee stock purchase program at any time permitted by the program or to decline to exercise their rights. This requirement does not preclude an employer from automatically exercising outstanding stock options or stock appreciation rights at the expiration date of the program.

(8)(D) If an employer's grants or rights under a stock option or stock appreciation right program are based on performance, the following criteria apply.

(1) If the grants or rights are given based on the achievement of previously established criteria, the criteria must be limited to the performance of any business unit consisting of 10 or more employees or of any sized facility and may be based upon that unit's or facility's hours of work, efficiency or productivity. An employer may impose certain eligibility criteria on all employees before they may participate in a grant or right based on these performance criteria, including length of service or minimum schedules of hours or days of work.

(2) The employer may give grants to individual employees based on the employee's past performance, so long as the determination remains in the sole discretion of the employer and not according to any prior contract requiring the employer to do so.

(b) Extra Compensation—The bill amends section 7(h) of the Fair Labor Standards Act (29 U.S.C. 207(h) to make clear that the amounts excluded under section 7(e) of the bill are not counted toward an employer's minimum wage requirement under section 6 of the Fair Labor Standards Act and that the amounts excluded under sections 7(e)(1)-(4) and new section 7(e)(8) are not counted toward overtime pay under section 7 of the Act.

(c) Effective Date—The amendments made by the bill take effect 90 days after the date of enactment.

(d) Liability of Employers—

(1) No employer shall be liable under the FLSA for failing to include any value or income derived from any stock option, stock appreciation right and employee stock purchase program in an non-exempt employee's regular rate of pay, so long as the employee received the grant or right at any time prior to the date this amendment takes effect.

(2) Where an employer's pre-existing stock option, stock appreciation right, or employee stock purchase program will require shareholder approval to make to the changes necessary to comply with this amendment, the employer shall have an additional year from the date this amendment takes effect to change its plan without fear of liability.

(3) Where an employer is providing stock options, stock appreciation rights, or an employee stock purchase program pursuant to a collective bargaining agreement that is in effect on the effective date of this amendment, the employer may continue to fulfill its obligations under that collective bargaining agreement without fear of liability.

(e) Regulations—the bill gives the Secretary of Labor authority to promulgate necessary regulations.

Submitted April 12, 2000 by the Sponsors of S. 2323.

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FOOTNOTES

[1] David Lebow et al., Recent Trends in Compensation Practices, Board of Governors of the Federal Reserve System, Fin. and Econ. Discussion Series, No. 1999-32, July 1999.

[2] Anita U. Hattiangadi, Taking Stock: $470,000 at Risk for Hourly Workers, Employment Policy Foundation, Mar. 2, 2000, at 4, and Fig. 2.

[3] Any stock option program that meets the criteria under section 422 of the Internal Revenue Code (called an Incentive Stock Option) is considered a qualified option. 26 U.S.C. §422.

[4] 26 U.S.C. §423.

[5] 29 U.S.C. §§201, et seq.

[6] 29 U.S.C. §207(a)(1).

[7] 29 U.S.C. §207(e).

[8] 29 U.S.C. §207(e)(1).

[9] 29 U.S.C. §207(e)(3).

[10] Id.

[11] Id.

[12] 29 U.S.C. §207(e)(4).

[13] See e.g., Conference Report on H.R. 5856, H. Rept. No. 1453.

[14] U.S. Dept of Lab, Bureau of Lab. Statistics, Employer Costs For Employee Conpensation—March 1999, available at ftp://146.142.4.23/pub/news.release/ecec.txt.

[15] A wage-hour opinion letter responds to a request for the Department of Labor's view of how the law applies to a given set of facts. The letters are available to the public upon request or through commercial reporting services. Opinion letters have significant practical effects: "[T]he Administrator's interpretation . . . has the characteristic not only of securing 'expected compliance' . . . but of possibly stimulating double damage suits by employees who need not fear that they would be at odds with the Government Officials involved." *National Automatic Laundry & Cleaning Council* v. *Shultz*, 143 U.S. App. D.C. 274 (D.C. Cir. 1971).

[16] Letter from Daniel F. Sweeney, Office of Enforcement Policy, Fair Labor Standards Team, Wage & Hour Division, Feb. 12, 1999.

[17] Hearing on the Treatment of Stock Options and Employee Investment Opportunities Under the Fair Labor Standards Act before the House Committee on Education and the Workforce, Subcommittee on Employment and Training, 106th Cong. 2d Sess. Mar. 2, 2000 (Statement of T. Michael Kerr, at 4-5).

[18] Id. at 5. The testimony also noted that the program's automatic exercise feature prevented the employees' participation from being voluntary, as required under the Division's rules for thrift savings programs.

[19] Letter from Daniel F. Sweeney, Office of Enforcement Policy, Fair Labor Standards Team, Wage & Hour Division, Feb. 12, 1999.

[20] Hearing on the Treatment of Stock Options and Employee Investment Opportunities Under the Fair Labor Standards Act before the House Committee on Education and the Workforce, Subcommittee on Employment and Training, 106th Cong. 2d Sess. Mar. 2, 2000 (Statement of J. Randall MacDonald, at 2).

[21] Id. (addendum to statement of Patricia Nazemetz, Letter from Gary J. Bonadonna, Director & International Vice President, UNITE, February 22, 2000).

[22] Id. (statement of T. Michael Kerr, at 7).

[23] 26 U.S.C. §423.