



September 21, 2004

FLSA2004-11

Dear *Name**,

This is in response to your request for an opinion concerning whether a particular incentive program requires the employer to include any incentive payments to nonexempt employees in the calculation of the regular rate for overtime purposes under the Fair Labor Standards Act (FLSA).

You ask that we assume the following: (1) the employees' base rate of pay is \$9.00 per hour; (2) the employer advises the employees they may earn up to an additional \$3.00 per hour under a combination of individual and group-based qualifiers; (3) the employer establishes a minimum level of productivity or output for a group of employees, i.e. 600 widgets; (4) the employer establishes and informs the employees of the production goal at the beginning of each month, i.e. 1000 widgets; (5) the incentive plan provides incentive pay of up to \$3.00 per hour based on one of four percentage achievement levels over the minimum 600 widget production requirement, i.e., 25%, 50%, 75% or 100% of achievement multiplied by the \$3.00; and (6) the resulting incentive payment is multiplied by each employee's total hours worked, regular and overtime hours, to arrive at the monthly incentive payment.

For example, the employer would inform the employees on January 1, 1999, that the January production goal will be 1000 widgets and the minimum production is 600 widgets. If the group produces 600 widgets or less, the employer pays no incentive. If the group produces 1000 widgets, then the group has reached 100% of the production goal. Accordingly, each employee receives 100% of the \$3.00 per hour incentive on actual hours the employee worked. This additional \$3.00 is multiplied by the regular hours and overtime hours each employee worked during the month. If the group produces 800 widgets, then the group achieves 50% of the productivity goal (1000 goal-600 minimum = 400; $200 \div 400 = 50\%$). Accordingly, each employee receives 50% of the maximum \$3.00 per hour incentive, \$1.50, multiplied by the regular and overtime hours worked. If the group produces less than 1000 widgets but 900 or more widgets, the group achieves 75% of the productivity goal and each employee receives 75% of the maximum \$3.00 per hour incentive or \$2.25.

You present the following questions for which our responses follow:

Q.1. Does this plan for payment of an incentive applied to regular and overtime hours satisfy the requirements under the FLSA? In other words, does the above method satisfy in full the overtime provisions of the FLSA and require no re-computation of overtime?

A.1. No. Where an employer's payments under an incentive plan are based on a percentage of the total earnings of a participating employee, the payments may be excluded from the regular rate of pay if the conditions prescribed in 778.210 of 29 CFR Part 778 are met. Under the method of allocation discussed in this section, where a bonus is paid as a predetermined percentage of an employee's total compensation, including straight-time, overtime, bonuses, and commissions, the overtime pay due under the FLSA is automatically included and no additional computation or payment of overtime is required. However, the employer must pay the same percentage of the straight time and overtime earnings. Paying \$3.00 an hour (or any other straight dollar amount) for both the straight time and overtime results in a smaller percentage of the overtime being paid than the percentage of the straight time. For example, \$3.00 an hour for a \$9.00 an hour employee is 33 1/3% of the straight time but only 22% of the overtime (\$13.50 an hour). This is inconsistent with §778.210.

- a. Would the incentive plan meet the FLSA requirements, if the resulting incentive payment was multiplied by hours worked, excluding overtime hours? For example, if the group achieves 75% of the productivity goal by producing 900 widgets, may the employer multiply the resulting \$2.25 incentive by each employee's standard hours, excluding overtime hours worked, and not apply the incentive to the overtime hours?



A.1.a. No. The FLSA provides that all remuneration for employment paid to an employee, with the exception of the payments specified in Section 7(e), must be included in the regular rate of pay on which overtime compensation is computed. Bonus payments that are promised to employees as an incentive for increased or sustained productive efforts are not the types of payments that may be excluded from the regular rate. See sections 778.208 through 778.210 of the Regulations.

In order for an incentive plan to qualify for exclusion as a discretionary bonus under section 7(e)(3)(a), the bonus must be paid without prior contract, promise or announcement, and the decision as to the fact and the amount of payment must be determined near the end of the period at the employer's sole discretion. See section 778.211 of the Regulations.

Q.2. Does the analysis change if the following individual qualifiers reduce or eliminate an employee's incentive?

- a. Absences: An employee receives 100% of resulting incentive if no unexcused absences but 25% of the incentive is subtracted for each "late show" to work. For example, if the group achieves the productivity goal of 1000 widgets and is entitled to \$3.00 per hour, but an individual employee has one "late show", the individual employee receives only an additional 75% of the \$3.00 incentive per hour, or \$2.25 per hour for total hours worked. Another employee who had no "late shows" receives the full additional \$3.00 per hour for total hours worked.
- b. Preventable accidents: An employee receives 100% of resulting incentive if he or she has no minor preventable accidents. An employee receives no incentive or 0% if he or she has a minor preventable accident.
- c. Safety policy/procedure violations: An employee receives 100% of resulting incentive if he or she has no violations. If an employee violates a safety policy or procedure, he or she receives no incentive. For example, if the group achieves the productivity goal of 1000 widgets and is entitled to \$3.00 per hour, but an individual employee commits a safety violation, then the individual employee is ineligible for any incentive during the month of the violation.
- d. Uniform/dress code: An employee receives 100% of resulting incentive if he or she does not violate the uniform/dress code, but 25% is subtracted for each violation, i.e., not shaving.

A.2. No. If the employee's bonus is paid as a percentage of total earnings consistent with Section 778.210, it doesn't matter what criteria or combination of criteria are used. However, when paid as an hourly amount and when the incentive is tied to productivity and is not at the sole discretion of the employer, it must be included in the computation of the regular rate.

Q.3. Does the analysis change if the employer adds an additional group incentive qualifier based on group overtime worked as a percentage of total hours? Assume for purposes of this question, the individual meets all individual qualifiers, i.e., no late shows or safety violations. The lower percentage incentive controls the resulting incentive payment. Specifically, does the analysis change if the employer's incentive plan provides the following:

- a. Each employee receives 100% of the resulting productivity incentive if overtime is less than 8% of total standard hours;
- b. Each employee receives 50% of the resulting incentive if overtime is between 8% and 15% of total standard hours, or



- c. Each employee receives no incentive if overtime is over 15% of total standard hours.

For example, if the group produces 900 widgets under the above productivity qualifier, each employee who also meets the individual qualifier would be entitled to 75% of the \$300 incentive (\$2.25 multiplied by total standard and overtime hours he or she worked). However, if during the same month the group overtime is between 8% and 15% of total standard hours, each individual employee receives only 50% of the \$3.00 incentive (\$1.50 multiplied by total standard and overtime hours he or she worked). If the group produces 800 widgets under the above group productivity qualifier and the group overtime is between 8% and 15% of total standard hours, each employee who also meets the individual qualifiers would be entitled to 50% of the \$3.00 incentive (\$1.50 multiplied by total standard and overtime hours he or she worked). If the group produces 1000 widgets, thus achieving 100% of the productivity goal, but overtime is over 15% of total standard hours, the employer does not pay an incentive.

A.3. No. It does not matter what criteria or combination of criteria are used; if the incentive criteria is tied to productivity in any way and is not at the sole discretion of the employer, the amount paid to the employees must be included in the regular rate computation.

Q.4. Does the analysis change if the employer retains the ability to waive or modify the group overtime qualifier based on production needs? For example, the employer determines the company has an unusually high volume of production for a given month causing the overtime to reach over 15% of total standard hours and elects to still pay 100% of the \$3.00 incentive per hour.

A.4. Yes. If the employer chooses to waive its criteria and makes a discretionary bonus payment to the employees, the payment would not be included in the regular rate computation if all of the criteria set forth in section 7(e)(3)(a) are satisfied. A discretionary bonus must be paid without prior contract, promise or agreement causing the employee to expect such payments regularly, and the decision as to the fact and the amount of the payment must be determined near the end of the period at the employer's sole discretion. However, the fact that an employer may use its discretion to award a bonus in one month does not change the character of a bonus earned pursuant to the stated criteria in another month.

Q.5. Does the analysis change if the incentive plan includes another group qualifier which provides that no incentive will be paid if a "major" preventable accident occurs? The term "major" is defined as resulting in over \$100 of damage or a lost workday.

A.5. No. Adding a safety qualifier would not affect whether the bonus qualifies as a discretionary bonus or must be included in the regular rate.

This opinion is based exclusively on the facts and circumstances described in your request and is given on the basis of your representation, explicit or implied, that you have provided a full and fair description of all the facts and circumstances which would be pertinent to our consideration of the question presented. Existence of any other factual or historical background not contained in your request might require a different conclusion than the one expressed herein. You have represented that this opinion is not sought by a party to pending litigation concerning the issue addressed herein. You have also represented that this opinion is not sought in connection with an investigation or litigation between a client or firm and the Wage and Hour Division or the Department of Labor.

We trust that the above information is responsive to your inquiry.

Sincerely,

Alfred B. Robinson, Jr.
Acting Administrator

*Note: * The actual name(s) was removed to preserve privacy.*