U.S. Department of Labor
Employment Standards Administration
Wage and Hour Division
Washington, D.C. 20210

April 27, 2006 **FLSA2006-5NA**

Dear **Name*:**

This is in response to your letter requesting an opinion regarding whether payments to employees under your client's bonus plan may be excluded in the calculation of the regular rate of pay for overtime purposes under section 7(e)(3)(a) of the Fair Labor Standards Act (FLSA) (copy enclosed). It is our opinion that the bonus must be included in the regular rate.

According to your letter, your client operates used car sales lots. It has a Team Bonus Plan (Plan) for all nonexempt, hourly-paid employees. The criteria for bonus eligibility are set at the beginning of each year. The criteria depend on a number of factors such as the size of the sales lot, location, number of personnel, meeting certain delinquency and account loss standards, having a minimum of two hundred active customer accounts, financial independence from the parent company, and meeting monthly growth projections. If a sales lot meets the minimum criteria, you consider the lot for a bonus. Bonus amounts are determined based on the sales lot's overall performance for the month. For instance, if the sales lot achieves 100% of its monthly growth projection, each employee receives $100; at 150% of the monthly projection, each employee receives $150. If the lot does not meet its monthly projection, no bonuses are paid. The employees are aware of the bonus eligibility criteria for their sales lot and the amount of bonus each may receive if they meet the criteria. Bonuses are determined at the end of each month and paid on the first scheduled payday immediately following the bonus period.

Your client reserves the right to withhold payment of a team bonus and, in extraordinary circumstances, has withheld such payment. Such extraordinary circumstances resulting in nonpayment of bonuses have included sales personnel artificially inflating performance numbers to attempt to meet their monthly projections or a significant violation of a major company policy. In practice, however, your client pays bonuses to teams whose sales lots meet the performance criteria in the absence of serious employee misconduct.

You ask whether the bonus paid under the Plan qualifies as a discretionary bonus under 29 C.F.R. § 778.211 (copy enclosed) and, if not, how to calculate overtime to include the bonus payment, as well as how far back your client should look in providing back pay.

The FLSA includes in the regular rate of pay all remuneration for employment paid to, or on behalf of, the employee except payments specifically excluded by section 7(e). One such exclusion, recognized in section 7(e)(3)(a), is for discretionary bonuses. As indicated in 29 C.F.R. § 778.211(b), "[i]n order for a bonus to qualify for exclusion as a discretionary bonus under section 7(e)(3)(a) the employer must retain discretion both as to the fact of payment and as to the amount until a time quite close to the end of the period for which the bonus is paid. The sum, if any, to be paid as a bonus is determined by the employer without prior promise or agreement. The employee has no contract right, express or implied, to any amount. If the employer promises in advance to pay a bonus, he has abandoned his discretion with regard to it. Thus, if an employer announces to his employees in January that he intends to pay them a bonus in June, he has thereby abandoned his discretion regarding the fact of payment by promising a bonus to his employees. Such a bonus would not be excluded from the regular rate under section 7(e)(3)(a). Similarly, an employer who promises to sales employees that they will receive a monthly bonus computed on the basis of allocating 1 cent for each item sold whenever . . . the financial condition of the firm warrants such payments, has abandoned discretion with regard to the amount of the bonus though not with regard to the fact of payment. Such a bonus would not be excluded from the regular rate."

As further explained in 29 C.F.R. § 778.211(c), "[t]he bonus, to be excluded under section 7(e)(3)(a), must not be paid 'pursuant to any prior contract, agreement, or promise.' . . . Bonuses which are announced to employees to induce them to work more steadily or more rapidly or more efficiently are regarded as part of the regular rate of pay. Attendance bonuses, individual or group production bonuses, bonuses for quality and accuracy of work . . . are in this category." *See also* 29 C.F.R. § 778.208 (copy enclosed). After reviewing the information provided, it is our opinion that the team bonus payments provided by the Plan cannot be considered discretionary under 29 C.F.R. § 778.211(a)-(b), because the bonus payments are promised to employees, including both the fact of payment and the amount, as an incentive for increased or sustained productive efforts and thus are not the type of payments that may be excluded from the regular rate. *See* WH Opinion Letters January 23, 1997 and September 21, 2004 (copies enclosed). The fact that your client may choose to withhold payment of the bonus due to certain extraordinary

circumstances discussed above would not by itself signify that the bonus is discretionary under 29 C.F.R. § 778.211(a)-(b). Bonuses under the Plan lose their discretionary character because the employer announces both the fact and amount of the bonus in advance and pays it with sufficient regularity and consistency to establish an understanding on the part of the employees that they will receive it, absent serious employee misconduct, even if the employer reserves the theoretical right to withhold payment of the bonus for any reason. *See* WH Opinion Letter November 5, 1999 (copy enclosed).

We also believe that because the employees under the Plan are paid an hourly rate coupled with the prospect of earning a bonus, the overtime computation in this case should follow the method described in 29 C.F.R. §§ 778.110(b) and 778.209 (copies enclosed).

Please note that under section 6(a) of the Portal-to-Portal Act (copy enclosed), a two-year statute of limitations applies to the recovery of back pay, except in the case of willful violation, in which case a three-year statute applies. *See* section 16(b) of the FLSA and 29 C.F.R. §§ 790.20-.22 (copies enclosed). Should you need further assistance in this matter, please feel free to contact your local Wage and Hour District Office.

This opinion is based exclusively on the facts and circumstances described in your request and is given based on your representation, express or implied, that you have provided a full and fair description of all the facts and circumstances that would be pertinent to our consideration of the question presented. Existence of any other factual or historical background not contained in your letter might require a conclusion different from the one expressed herein. You have represented that this opinion is not sought by a party to pending private litigation concerning the issues 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 this letter is responsive to your inquiry.

Sincerely,

Barbara R. Relerford
Fair Labor Standards Team
Office of Enforcement Policy

Enclosures:

Sections 7(e) and 16(b) of the FLSA
Section 6(a) of the Portal-to-Portal Act
29 C.F.R. §§ 778.110, 778.208, 778.209, 778.211, 790.20-.22
WH Opinion Letters January 23, 1997; November 5, 1999; and September 21, 2004

Note: * The actual name(s) was removed to preserve privacy in accordance with 5 U.S.C. § 552(b)(7)