WASHINGTON UPDATE

Incentive Federation, Inc.
August 15, 2017

George B. Delta, Esq.
(202) 393-0041
gdelta@deltalaw.net

Federal and California Labor Laws That May Affect Awards Programs

Tax reporting and compliance issues are familiar to incentive companies and their clients who use reward and recognition programs. Although tax issues are important for all reward and recognition programs, compliance with federal and state labor laws is often overlooked, even though sometimes it can be just as important for the overall success of a reward and recognition program. Often, the parties using the program are not aware of labor law issues, and, occasionally, they may turn a blind eye to them.

One such important issue that is often unrecognized arises when awards are paid solely in merchandise, gift cards (physical or virtual), reloadable prepaid bank cash or debit cards, travel, event tickets, and other non-cash awards. The awards are based on points that employees earn and which are redeemable for the various non-cash items. In such cases a question arises whether the reward and recognition program would violate the Fair Labor Standards Act (the "FLSA") unless the employer also offers a cash option in lieu of the other awards under the program. If the program is used to reward employees in California, the same issue would arise under California labor law

An example of a non-cash reward and recognition program that could violate the FLSA and/or California labor laws is when a client ("Client") of an incentive company gives the employees in its retail operations, fulfillment centers, call centers, and corporate offices "points" for achieving certain targets or other metrics. The "points" could be discretionary or earned automatically when such targets are reached. The program does not incorporate a system where each employee can opt for the cash value of an award instead of merchandise, gift cards, cash or debit cards, travel or other awards when redeeming the points earned.

Federal Law

This type of a reward and recognition program does not appear to violate the FLSA. The FLSA regulates the payment of overtime and what compensation and/or benefits are used to calculate the base rate for such overtime. The regulations issued by the U.S. Department of Labor (29 C.F.R. § 778.331) state that, "Where a prize is awarded for the quality, quantity or efficiency of work done by the employee during his customary working hours at his normal assigned tasks . . . it is obviously paid as additional remuneration for employment. Thus . . . [those prizes] are part of the regular rate of pay." The regulations continue by outlining how that remuneration is to be calculated. Specifically, the FLSA provides that, "When the prize is merchandise, the cost to the

employer is the sum which must be allocated (as part of the regular rate of pay). Where the prize is either cash or merchandise, with the choice left to the employee, the amount to be allocated is the amount (or cost) of the actual prize he accepts."

To the best of my knowledge, there are no reported cases citing these regulations. Regardless, the reference to "merchandise" prizes in the regulations does not support the conclusion that the FLSA requires cash only prizes/bonuses. I could not find any specific authority within the FLSA that would preclude a non-cash (for example, merchandise, gift cards, cash or debit cards, or travel) only incentive award. While these awards must be included in calculating the base rate of pay for overtime purposes (which most employers already do, where appropriate), they may be payable in merchandise, gift cards, cash or debit cards, travel or other such awards. As a result, the FLSA would not prohibit non-cash only awards and prizes for performance.

California Law

While federal law is relatively straightforward and would not prohibit a reward and recognition plan from providing non-cash only programs, California law is a bit less clear. There are three statutes unique to California that are of concern. California Labor Code § 212(a) states that "No person, or agent or officer thereof, shall issue in payment of wages due, or to become due, or as an advance on wages to be earned: …. (2) any scrip, coupon, cards, or any other thing redeemable, in merchandise or purporting to be payable or redeemable otherwise than in money." This language would create obvious problems if the awards that employees receive under the program that the Client intends to operate were deemed to be a form of "wages."

Under California Labor Code § 200(a), "'Wages' includes all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation." This rather broad definition focuses on wages having an "amount" and being ascertained by a "method of calculation." In addition, California Labor Code § 450 provides that an employer may not "compel or coerce any employee ... to patronize his employer, or any other person, in the purchase of any thing of value." It is unclear if a gift card would be deemed to be a purchase of anything of value from "any other person" under § 450.

The California Labor Commissioner has issued an opinion letter that might be instructive and on point, Opinion No. 1998.09.14. It is worth noting that the Labor Commissioner's opinions usually favor the employees' interpretation of the state's labor laws. The opinion concerns a program in which store employees were provided with incentive bonuses if the store met certain preset financial performance targets. Employees were paid with scrip that was redeemable only through a catalogue published by a solitary vendor. The scrip could not be redeemed for cash, and if the amount of the scrip was insufficient to purchase any of the items in the catalogue at the time the employee separated from employer, the scrip could not be redeemed at all. The Chief Counsel for the Division of Labor Standards Enforcement found that the plan was illegal

because it used scrip, the bonus could only be used to patronize a selected vendor, and the instrument (scrip) was not redeemable in cash.

On the other hand, the Chief Counsel also noted that the practice of providing rewards to top sales personnel by means of trips to Hawaii might be distinguishable because there would be no irrevocable entitlement to the trips based on predetermined percentages or volume of business. This is significant because one of the items for which the employees can redeem points in the program that the Client intends to operate is travel. The Chief Counsel also noted in the opinion letter that without more specific information it would be impossible to determine whether the Hawaii trips were "discretionary bonuses" as opposed to wages subject to the limitations of § 212. Thus, it appears that California applies the federal rule that "discretionary bonuses" are not a form of wages, a result that is sensible and logical.

Discretionary bonuses are defined in 29 C.F.R. § 778.211 as follows: "The employer must retain discretion both as to the fact of payment and as to the amount until the 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 rights, express or implied, to any amount. If the employer promises in advance to pay the bonus, he has abandoned his discretion with regard to it…"

On the other hand, any bonuses that the employer promises to employees upon hiring or due to collective bargaining, or bonuses that are announced to employees to induce them to work more steadily, more rapidly, or more efficiently, or to remain with the company, are regarded as regular pay. Bonuses for quality and accuracy of work are in this category and must be included in the regular rate of pay. (Id. § 778.211.) A similar provision is found in 29 C.F.R. § 778.331, which states that prizes paid for cooperation, courtesy, efficiency, highest production, best attendance, best quality of work, greatest number of overtime hours worked, and the like are part of the regular rate of pay.

There are several ways that the Client's program may be structured to distinguish it from the types of plans covered by California Labor Code § 212(a). The program is not companywide, and the Client should ensure that there is no indication that it is based on financial targets, hours worked, or other similar specific and predetermined measures. As long as the Client makes sure not to promise to pay awards based solely on a specific formula, makes it clear to the employees that they are not contractually entitled to them, and retains discretion, which is exercised systematically and periodically (perhaps towards the end of each quarter), with respect to providing the awards, the awards would appear to be discretionary bonuses under both federal and California law, and they would not be covered by any provision of California Labor Code § 212.

In addition, California Labor Code § 212 clearly does not require that all employee remuneration be provided in the form of cash. Labor Code § 212(a)(1) bars payment through an "order, check, draft, note, memorandum, or other acknowledgment of indebtedness, unless it is negotiable and payable in cash …" Kirby Wilcox, in his definitive text *California Employment Law* notes that "Labor Code § 212 on its face only prohibits payments of wages by certain types of instruments that are not redeemable in cash; it does not prohibit the payment of additional compensation in forms other than cash." (Id., § 4.02[1], at 4-29). Meals, lodging and stock options are examples of non-cash benefits that are clearly legal under California law. See, e.g., Industrial Welfare Comm'n Order 7-2001, ¶ 10; Falkowski v. Imation, 309 F.3d 1123,1132 (9th Cir. 2002).

Each employer like the Client should be able to structure a reward and recognition program so that it retains discretion in determining whether to issue points redeemable solely for non-cash awards by ensuring that an employee would not have an irrevocable entitlement to such points and awards. It can do so by not promising to pay awards based solely on a specific formula, making it clear to the employees that they are not contractually entitled to them, and retaining discretion, which is exercised systematically and periodically (perhaps towards the end of each quarter), with respect to providing the awards. If the Client were to structure its reward and recognition program accordingly, the awards should be discretionary bonuses pursuant to both federal and California law, and they would not be covered by any provision of California Labor Code § 212. Under those circumstances, the program would not be required to provide each employee with a cash option in place of the other non-cash awards.