Proskauer

Employment Law Counseling & Training Tip of the Month

December 2008

Tip of the Month

Bonuses and the FMLA: What Should Employers Do?

Tip:

As the year draws to a close, many employers will consider awarding employees with bonus payments either for performance, attendance, and/or safety records. This raises the question whether an employee who has taken a protected leave of absence pursuant to the Family and Medical Leave Act ("FMLA") is entitled to receive any bonus covering the period during which the employee took leave, and, if so, whether the employer can lawfully prorate the employee's bonus to account for the employee's absences. Because the FMLA prohibits employers from penalizing employees in wages and benefits accrued prior to the leave, this question has often vexed employers. Adding to the bonus quandary this year, new regulations become effective January 16, 2009.

If the bonus is to be paid *before* January 16, the employer must first determine whether the award is based on *production* or an *absence of occurrence*. If the bonus is based on *production*, the employer can probably prorate the bonus to account for the FMLA absence. If the bonus is based on the *absence of occurrence*, the bonus may *not* be prorated for any leave taken under the FMLA.

However, if the bonus is to be paid *on or after* January 16, the employer can prorate the bonus regardless of whether it rewards *production* or the *absence of occurrences*, *provided* the bonus is based on the achievement of some goal (*e.g.*, hours worked, productivity, perfect attendance). An employer can also deny a bonus to an employee who has taken FMLA leave if the bonus is based on achievement of a goal but only *so long as* the employer also denies the bonus to other employees on an equivalent leave status for non-FMLA reasons.

Current FMLA Regulations

Under the current regulations, employers are expressly prohibited from using FMLA leave as a means to disqualify employees from receiving certain types of bonuses. The regulation, 29 C.F.R. § 825.215, provides:

> Many employers pay bonuses in different forms to employees for job-related performance such as for perfect attendance, safety (absence of injuries or accidents on the job) and exceeding production goals. Bonuses for perfect attendance and safety do not require performance by the employee but rather contemplate the absence of occurrences. To the extent an employee who takes FMLA leave had met all the requirements for either or both of these bonuses before FMLA leave began, the employee is entitled to continue this entitlement upon return from FMLA leave, that is, the employee may not be disqualified for the bonus(es) for the taking of FMLA leave . . . A monthly production bonus, on the other hand does require performance by the employee. If the employee is on FMLA leave during any part of the period for which the bonus is computed, the employee is entitled to the same consideration for the bonus as other employees on paid or unpaid leave (as appropriate).

Based on the current regulations, therefore, bonuses based on safety and attendance (referred to frequently as the *absence of occurrences*) could not be denied to an employee who met the standard prior to taking FMLA leave and who, after returning, continued to meet the qualification standards. To deny the employee a bonus for attendance or safety in this scenario, based on a protected FMLA leave, would penalize and interfere with protected rights.

The current regulations, however, do not specifically address whether employers may prorate bonuses for employees to reflect the period of the FMLA leave. The only federal appellate court to address this issue was the Third Circuit and it concluded that an employer could prorate a production bonus by the amount of lost production or hours attributable to the FMLA. *Sommer v. Vanguard Group*, 461 F.3d 397 (3d Cir. 2006).

In *Vanguard*, the employee took 8 weeks of short-term disability leave under the FMLA. Subsequently, Vanguard prorated the employee's bonus, measured by satisfying an hours-worked threshold, to account for the leave period. The employee brought suit claiming that Vanguard unlawfully interfered with his rights under the FMLA by prorating the bonus. The Third Circuit found that proration of the employee's bonus did *not* violate the FMLA, reasoning the award constituted a bonus based on "*production*" and not an "*absence of occurrence.*"

Reading the current regulations, the Third Circuit defined a *production* bonus as one which rewards some form of "positive effort" on the part of the employee. Conversely, the Court defined *an absence of occurrence* bonus as one which merely rewarded employees for compliance with an employer's rules, *e.g.*, attendance or safety.

Relying on these distinctions, the Court ruled that an employer could prorate a *production* bonus by the amount of any lost production over the leave period reasoning, among other things, that this protected the employee from the loss of any employment benefit accrued prior to the date of the leave, as required by the FMLA, but did not award an employee with benefits that s/he could not accrue while on leave. Notably, the Court made clear that bonuses which reward an *absence of occurrence* may not be prorated at all. If an employee qualifies for an *absence of occurrence* bonus *before* taking FMLA leave, and then after returning continues to satisfy the standard through the end of the bonus period, proration of the employee's bonus would be tantamount to penalizing the employee for invoking FMLA rights, and, according to the Court, this was not permissible.

New FMLA Regulations

Based on the current regulations, and in the wake of *Vanguard*, many employers found the distinction between production bonuses and attendance bonuses confusing. Even many employees complained that the regulation was unfair because it gave the same attendance or safety bonus to employees who did not miss any days of work as to those who were absent up to 12 weeks on FMLA leave. Thus, the DOL received "extensive feedback" that the *production* vs*. absence of occurrence* distinction resulted in the elimination of many incentive programs. Consequently, the DOL sought a solution that would encourage employers to offer attendance bonuses, while not unfairly benefiting employees who take FMLA leave.

Based on its receipt of dozens of Comments in the course of rulemaking, the DOL promulgated a new Section 825.215(c)(2) that provides in pertinent part:

> …if a bonus or other payment is based on the achievement of a specified goal such as hours worked, products sold or perfect attendance, and the employee has not met the goal due to FMLA leave, then the payment may be denied, *unless* otherwise paid to employees on an equivalent leave status for a reason that does not qualify as FMLA leave. For example, if an employee who used paid vacation leave for a non-FMLA purpose would receive the payment, then the employee who used vacation leave for an FMLA protected purpose also must receive the payment.

(Emphasis added).

The most significant change is the DOL's abandonment of the *production – absence of occurrence* distinction. Effective January 16, 2009, an employer may disqualify an employee from a bonus based on the achievement of a specified goal, such as hours worked, products sold, *or* perfect attendance, notwithstanding the employee's protected FMLA leave period, *so long as* all employees on an equivalent leave status, for non-FMLA reasons, are also disqualified. 75 Fed. Reg. 67934 at 67984 (Nov. 17, 2008).

Under the new regulations, therefore, employers "are free to prorate" bonuses premised on the achievement of a goal, whether it be production-based, attendance-based or safety-based, to account for employee absences, so long as it is done in "a non-discriminatory manner." 73 Fed. Reg. 67934 at 67985. Such goals may include, for example: number of hours worked, accrued earnings, commissions, sales, quality standards, attendance, safety records, and/or overall company performance. In contrast, bonuses "not premised on the achievement of a goal, such as a holiday bonus awarded to all employees, may not be denied to employees because they took FMLA leave." The DOL defends these changes by emphasizing that, under the new regulation, "employees taking FMLA leave neither lose any benefit accrued prior to taking leave, nor accrue any additional benefit which they would not otherwise be entitled," providing a "fairer result for all."

In qualifying employees for, and/or calculating bonus payments under the new regulations, employees who take FMLA leave must receive the same treatment as those who are on "an equivalent leave status for a reason that does not qualify as FMLA leave." Thus, if an employer permits attendance bonuses for those who take paid vacation leave, paid time-off, or paid sick leave, the employer cannot deny the bonus to an employee who substitutes paid vacation leave for an FMLA reason. If, on the other hand, an employer disqualifies employees who take leave without pay (*e.g.*, personal leave or unpaid disability leave) from receiving such bonuses, the employer may deny the bonus to an employee who takes unpaid FMLA leave, while still offering the bonus to employees who take paid vacation or other forms of paid leave.

Practical Application

To understand how the new regulation plays-out in practice, consider the following hypothetical: Sarah, an employee at XYZ Company, took 3 months of unpaid FMLA leave over the course of the year. Jim, another employee at XYZ took leave on several occasions throughout the year, including 8 weeks of unsupplemented workers' compensation leave, 5 days of paid sick leave, and 5 days paid vacation. Both Sarah and Jim had good performance evaluations for the year and were being considered for a year-end bonus.

If it is the employer's policy to prorate year-end production bonuses based on the number of unpaid absences an employee accumulates over the 12-month period, Sarah would receive a 23% reduction in her bonus due to her 12-week unpaid FMLA absence. Jim, on the other hand, would receive only a 15% reduction because, under the company's policy, only his unpaid workers' compensation leave (that's right, workers' compensation leave is considered unpaid leave for FMLA purposes), which totaled 8 weeks, would be considered for proration. Both his sick days and vacation days were paid forms of leave and not included in the calculation. If, however, instead of prorating year-end bonuses, XYZ Company maintained a policy that rewarded only those employees with perfect attendance records (defined as not having any unpaid absences), neither Jim nor Sarah would qualify since both took unpaid forms of leave. 73 Fed. Reg. 67934 at 67985.

If you have any questions regarding your bonus programs, please feel free to contact any of the members of Proskauer's Employment Law Counseling and Training Practice Group, who are listed below.

Related Professionals

- **Anthony J. Oncidi**
  Partner
- **Mark W. Batten**
  Partner
- **Harold M. Brody**