The Resurgence Of The Hourly Rate To Recognize Performance

Insights
3.31.17

The minimum wage is here to stay, but it has become more complicated to apply to some classes of employees. Until this century, the issue of whether employees are adequately paid at the applicable minimum wage in California generally followed federal law. It consisted of a simple formula requiring the employer to divide total applicable compensation for (or attributable to) the workweek by all hours worked during the workweek, then making sure the resulting average rate of pay satisfies at least the applicable minimum wage.

This all changed with a flurry of decisions by state and federal courts interpreting California law in a more rigid manner. These decisions aimed to fix new rules for compensating those employees receiving incentive pay, or a combination of hourly pay and incentive pay, so they are compensated fully at the applicable minimum wage for each hour worked.

The Balkanization Of The Work Day Increases Expenses And Risk
Some cases, as in the February 28, 2017 decision of *Vaquero v. Stoneledge Furniture LLC*, have addressed the requirement that piece-rate and commissioned sales employees on hybrid or 100-percent incentive compensation plans must receive paid rest periods separate from their incentive-based pay. Otherwise, time spent on such rest periods, even if the employee has not clocked out, are deemed unpaid.

Other cases, and a recent statute passed by the California legislature, have addressed the requirement that certain employees receiving piece rates must be compensated fully for all non-productive time, including rest periods and "other" non-productive time.

At least for certain employees, this has created three potential zones of accountability for timekeeping and minimum wage compliance, each evaluated independently of the other: (a) productive time, (b) non-productive time, and (c) rest and recovery period time. In the worst cases, this could mean separate timekeeping for each of these zones of compliance, even when an employee's average rate of pay under the traditional federal formula vastly exceeds the applicable minimum wage.

Balkanizing timekeeping and compensation for each category of work either puts the employer at risk for getting the math wrong, or forces the employer to merge compensation for all categories of work into a single base hourly rate for all hours worked (usually at the minimum wage). This leaves much less money available for incentive pay.

Some employers complain that using a base hourly rate, plus adding incentives for productive employees, may be a workable solution in theory. However, these same employers are starting to recognize that such a method depletes the potential reservoir of funds historically allotted to productive activity, thereby tending to reduce an employee's motivation to maximize efficiency in productive activity. Employees may actually wind up earning less in the end, and employers could suffer from diminished profits.

Additionally, paying a base hourly wage plus some incentives does not eliminate the need to pay non-exempt employees overtime for any incentives paid, nor the special pay rate for rest and recovery periods for piece workers. Thus, in many respects, compensation and related pay statements remain complicated. This complexity subjects employers to risks of liability if uncorrected errors occur systematically over time, which may result in expensive class actions, private Attorneys General claims, and other state enforcement actions.

Revisiting The Pure Hourly Rate

Splitting the allocation of labor funds between base compensation and a modest bonus or commission may address the timekeeping difficulties for incentive-based employees, but this accounts for only one area of risk and fails to address other potential difficulties. Some employers are therefore considering the viability of paying employees a pure hourly rate for all hours worked to address the risks that remain with hybrid pay or base-plus-incentive compensation systems.

Employers implementing these systems are able to offer hourly rates above minimum wage to those employees who demonstrate higher levels of performance and competence over a period of time. One benefit of implementing a pure hourly rate is the elimination of separate pay requirements for rest periods and other non-productive time, including rules imposed by AB1513 for employees formerly paid by piece rate. Applying a pure hourly rate of pay that may fluctuate based upon an employee's past productivity and other contributions should be done with caution and input from legal counsel.

Conclusion

There is much room for creativity if you decide to move to a pure hourly rate system. For example, you can develop multiple tiers of hourly pay that will open promotional opportunities for employees who reach or exceed performance expectations. If you monitor these levels periodically and adjust accordingly, they can provide a basis for sustainable employee motivation. And because you will ideally spend less money for expenses in timekeeping and litigation, you will have more to allocate to labor and opportunities for promotion.

One word of caution: the pure hourly rate is not a panacea. Hourly rates, that do not fluctuate as a function of productivity during a pay period, are prospective and not retroactive. Therefore, you bear some risk that employees will see the increasing pay rates as badges of honor and become less productive after receiving them. You also should address carefully whether to use pure hourly rates of pay for employees previously exempt from overtime based on the commission salesperson exemption.

exemption.

For more information, contact the author at JSkousen@fisherphillips.com or 949.798.2164.

Related People

John K. Skousen
Senior Counsel
214.220.8305
Email

Service Focus

Wage and Hour