ASAP™ A Littler Mendelson **Time Sensitive** Newsletter

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The Third Circuit in a case of first impression holds that in certain circumstances an employer can reduce employee bonuses by a *pro rata* amount to account for employee absences due to FMLA leave. To avoid potential liability, including potential class action liability, employers should ensure their bonus plans are consistent with the Third Circuit's ruling before making any *pro rata* bonus reductions.

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East Coast Edition

A Littler Mendelson East Coast-specific Newsletter

FMLA Protected Leave May Reduce Bonus

By Gregory B. Reilly and Orit Goldring

In a recent decision of first impression, the Third Circuit Court of Appeals held that an employer may reduce an employee's bonus because of absences protected by the Family Medical Leave Act. *Sommer v. Vanguard Group*, No. 05-4534 (3d Cir. Aug. 24, 2006), holds that an employer may pro-rate a bonus to reflect that an employee was on FMLA leave. The Third Circuit's decision binds employers in Pennsylvania, New Jersey, Delaware and the Virgin Islands and, because it is the only appellate court decision on the subject, is likely to be persuasive authority in other circuits.

Factual Overview

In *Sommer*, under the Vanguard Group's bonus plan, the amount of the bonus depended on the job level, length of tenure and "hours of service." The bonus plan measured "hours of service" by "the actual hours for which an employee is paid or entitled to be paid by the Company for the performance of duties or for vacation, holidays, sick time, or an approved leave of absence (including bereavement leave, court duty leave, and military leave)." The bonus excluded from hours of service time spent on short and long term disability leaves or absences. The plan further provided that employees working less than 1,950 hours per year would have their bonus prorated.

Plaintiff, Robert Sommer, took eight weeks of FMLA leave. The employer awarded Sommer his year-end bonus, but reduced the bonus for the time he was on FMLA leave. Sommer challenged this reduction claiming it violated the FMLA's prohibition against interfering with an employee's receipt of FMLA leave. In other words, Sommer claimed he was entitled to a full bonus even though he was absent from work on FMLA leave for two months.

Not All Bonus Plans Are the Same

The Third Circuit began its analysis by distinguishing between "production" and "occurrence" bonus plans. Production bonuses "require some positive effort on the employee's part." A production bonus can be a bonus for billing a certain number of hours or selling or producing a particular number of products. In contrast, occurrence bonus plans reward "an employee for compliance with the rules." An occurrence bonus can be a bonus for not having any safety violations or a bonus for perfect attendance. Relying on Department of Labor opinion letters, the Third Circuit found as a matter of law that employers could prorate production bonuses, but not occurrence bonuses, for absences resulting from FMLA leave.

Employers Beware

According to a recent Hewitt Associates survey, the number of employers offering bonuses has soared in the past fifteen years from 51% to 88%. Providing bonuses helps employers stay competitive by allowing them to manage fixed costs, keep a strong bottom line and motivate their employees. The growing use of bonus compensation makes the distinctions between production and occurrence bonuses of serious practical consequence. If an employer wants the option of prorating bonuses it should ensure that its bonus plans are drafted such that they can be successfully defended as production bonuses. The *Vanguard* case makes clear why this is important. In *Vanguard*, a single employee

sued for the modest amount of $1,788.22. However, plaintiff's attorneys had sought class certification. A class action lawsuit, especially against a large employer, based on the difference between prorated bonuses and full bonuses could result in hundreds of thousands of dollars in potential liability.

What's An Employer To Do?

Considering the above, employers who want the capability of prorating employee bonuses to reflect FMLA leave must ensure that their bonus plans will, if reviewed by a court, be found to be a production bonus plan. The Third Circuit relied upon the following factors in determining that Vanguard's plan was a production bonus:

- it was designed to recognize an employee's contributions to the employer's growth and success;
- during the time employees are on leave, they were not actively contributing to the Employer's overall performance;
- qualifying bonus amounts were based on hours worked and were prorated for every hour that employees were below an annual goal;
- the bonus payment was always prorated for the leave time no matter how short the amount of time the employee was on leave, from a few hours to a few months;
- a numerical target had to be met, *e.g.*, number of hours worked, dollar amount of sales reached or number of products to be produced; and
- the bonus was prorated for other leaves, not just FMLA leave (*e.g.*, long-term disability, workers' compensation, personal leave and unpaid court leave).

It might seem self-evident that an employer has the right to prorate a bonus based on an employee's absence from work for FMLA leave. The Third Circuit's decision is consistent with this conventional wisdom, but it also makes clear that the FMLA does prohibit some reductions. As the court cautioned, "it is often difficult to sift through the jargon-laden terms of a company's bonus plan documents to ascertain 'whether a bonus constitutes a production or occurrence bonus.'"

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