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CONGRESSIONAL HEARING ON INCLUDING STOCK OPTION GAIN IN BASE RATE FOR OVERTIME PAY MAY LEAD TO NEW LEGISLATION - TESTIMONY SUGGESTS INTERIM SOLUTIONS ARE AVAILABLE

A Department of Labor (DOL) letter that recently came to the attention of the human resources community[(1)] has raised concerns about whether companies would continue to grant stock options to non-exempt employees. The opinion letter was addressed to an anonymous company that planned to grant 100 option shares to all employees except those already receiving awards under their Stock Incentive Plan. The grants would vest in two years and be exercised through a cashless exercise program. The DOL stated that, under their interpretation of the Fair Labor Standards Act (FLSA), stock option gains under the company's proposed program would have to be added to the base rate for purposes of calculating overtime pay. Complicated, retroactive calculations would have to be performed in order to comply.

At a March 2 hearing of the House Subcommittee on Workforce Protections, several representatives from the human resources community testified about the types of equity grants being broadly used and how company stock programs operated. They also stated that, because compliance would be so complex, companies would likely stop granting options to non-exempt employees. They urged the Subcommittee to consider legislation that would exempt a variety of equity awards from overtime pay calculations under FLSA.

> The DOL representative who spoke at the hearing stated that the Administration would support an amendment of the FLSA to remove barriers to stock and stock option programs for hourly workers. This comment was applauded by the company and association representatives in attendance. The DOL representative's testimony elaborated on the reasoning behind their original opinion and offers companies possible solutions to ensure that their stock grants could be exempt from overtime calculations until new legislation is passed

The DOL representative described several potential exemptions that the inquiring company's stock grants might have received under FLSA:

1. The grant could be a gift. The DOL stated that the inquiring company's program did not qualify because employees were required to work for a period of time before they could exercise the options.

   ⇒ Most programs would not qualify under this exemption, nor would companies want to award options with immediate vesting.

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(1) See our January 4, 2000 letter

2. The grant could be a discretionary bonus. Because there was future service required during the vesting term at the inquiring company, the DOL viewed the grant as a reward for the employee to stay with the company and not as a discretionary bonus.

   ⇒ Viewed in this light, most companies would not have exemptions under this provision, either; however reasonable arguments could be made that these grants are discretionary.

3. The grant could be a profit-sharing program. The DOL determined that the option grant being considered would not be profit sharing because the program was not funded wholly out of the profits of the company.

   ⇒ Again, most companies could not have an exemption here.

4. The grant could be part of a thrift or savings plan. However, the program as understood by the DOL caused the options to be automatically cashed out and employees did not have the opportunity to keep the stock. Therefore, the program could not qualify under this exemption because it did not encourage savings.

   ⇒ It appears that companies could obtain this exemption by allowing employees to keep the stock if they so chose.

   Also, under this same section, the DOL commented that participation in this program was not completely voluntary because the options would automatically be cashed out if they were not exercised within five years.

   ⇒ While this provision was clearly put into the inquiring company's program to protect an employee from simply forgetting to exercise the option, it could easily be left out of other companies' programs.

   And, finally, under this same section, the DOL stated that the letter "did not demonstrate that the program would satisfy the FLSA regulations applicable to employer contribution levels under a thrift or savings program."

   ⇒ This obstacle probably cannot be overcome.

All parties have called for a quick resolution to this issue because many companies have put their plans on hold. Preliminary legislation has been drafted that would exempt stock options, stock appreciation rights and stock purchase plans having up to a 15% discount. Performance options are still being reviewed.

The Coalition to Promote Employee Stock Ownership, chaired by Thom Stohler of the American Electronics Association is interested in receiving information from companies on how their broad-based stock programs work to help with the education process. Thom can be contacted at thom_stohler@aeanet.org.

It appears that the process is moving quickly and that all parties are interested in a fair and expeditious conclusion.

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General questions may be addressed to Beverly Aisenbrey in our New York Office at (212) 986-6330. Specific questions should be referred to counsel. Copies of this letter and other published materials are available on our web site, www.fwcook.com.