

# CAUTION! CONSTRUCTION ZONE: A Piece-Rate Compensation System Can Be An Effective Tool For Construction Businesses, But What About Overtime?

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If your business involves construction, then you may be familiar with the concept of piece-rate compensation. Under this system, employees are paid based on the number of units, or pieces, they complete, rather than on the number of hours they work. For example, a plumbing subcontractor may pay employees based on the number of sink faucets installed in an office building, rather than on the number of hours it took to install the faucets during a particular workweek. Although this is an entirely permissible and legal way to pay employees, and is quite

common in the construction industry, it is not a cure-all. Employees paid on a piece-rate basis are not exempt from the various requirements of the Fair Labor Standards Act ("Act"), including minimum wage, overtime, and record-keeping obligations.

## The Problems with a Piece-Rate Compensation System

This unfortunate reality may come as a surprise to employers who have successfully used a piece-rate compensation system for years. After all, the entire concept behind piece-rate compensation is that the time it takes an employee to complete a task is not relevant. This is generally a true statement so long as:

- The employee does not work more than 40 hours in a workweek; and,
- The employee's total compensation for the week averages at least the applicable minimum wage.

However, even assuming the above standards are satisfied, it still is essential for employers to maintain accurate daily and weekly time records for employees paid on a piece-rate basis. Otherwise, without such records, the employer has no way to prove that the minimum wage and overtime pay requirements have been properly satisfied if a complaint is filed or government investigators come looking. To make matters worse, the method for properly calculating overtime compensation for employees compensated on a piece-rate basis can become a mathematical nightmare for some employers. As you can imagine, a piece-rate compensation system is a breeding ground for wage and hour problems, which can result in substantial penalties for violations.

## Why Have a Piece-Rate Compensation System?

At this stage, you may be asking yourself: "*Why would an employer ever choose to pay piece-rate?*" Paying

on a piece-rate basis can be advantageous for both employees and employers. Employers find it attractive because the compensation scheme motivates employees to work more efficiently which, in turn, helps the employer's bottom line. In theory, piece-rate compensation provides an employee the ability to earn more in less time than the employee would have earned with regular hourly pay. At the same time, the employer creates a work atmosphere that promotes and rewards productivity.

There are downsides, of course, one being that employees can be overly "incentivized" to work too quickly, which could jeopardize the quality of the job performed. And, for the employer, piece-rate compensation does not come without a few administrative headaches, as discussed below.

Piece-rate is not a new or novel compensation technique; however, in recent years, the U.S. Department of Labor has dedicated substantial resources to investigating, penalizing, and prosecuting employers who misuse the piece-rate system. This undesired scrutiny has caused many employers to revisit how to properly and legally implement a piece-rate payment program.

### **How to Make the System Work**

So what must an employer do if it wants to pay its employees by the piece rather than by the hour? The Act contains three basic requirements to which an employer must adhere regardless of whether its employees are paid hourly or by the piece:

- Minimum wage;
- Overtime compensation; and,
- Record-keeping.

These basic requirements are summarized below.

#### ***Minimum Wage on Piece-Rate***

Even under a piece-rate compensation scheme, employers must pay employees at least the applicable minimum wage for each hour of work (currently, \$7.25 per hour). This does not mean that employers are required to pay a certain rate per piece; rather, employers must ensure that at the conclusion of each workweek, all nonexempt employees have received at least \$7.25 for each hour of work performed during the workweek.

As an example of the mathematics involved, suppose a piece-rate employee was paid \$10.00 for each faucet installed. In a workweek, the employee installed 38 faucets and, thus, received \$380.00. It took the employee 40 hours to install the 38 faucets. By dividing the employee's total compensation for the week (\$380.00) by the number of hours worked (40), the employee's effective hourly rate for the week was \$9.50. Therefore, the employee received at least minimum wage for that particular workweek.

On the other hand, if the employee had worked 40 hours, but managed to install only 28 faucets and received \$280.00 for that particular workweek, then the employee's effective rate for the week was only \$7.00 per hour (\$280.00 divided by 40). In that situation, the employer must make up the difference to ensure that the employee receives the minimum wage. Therefore, the employer must pay the employee an extra \$10.00 to bring the employee's total compensation for the week to \$290.00, which represents 40 hours of work at minimum wage.

#### ***Overtime Compensation on Piece-Rate***

Now, let's suppose that the nonexempt employee worked 45 hours during a particular workweek. Under the Act, irrespective of whether the employee is paid hourly or on a piece-rate basis, the employer must pay the

employee one and one-half times the employee's regular rate of pay for all hours worked in excess of 40 hours in a workweek. Unlike regular hourly pay (where an employer simply multiplies the hourly rate by one and one-half), calculating overtime compensation for piece-rate work can be somewhat tricky. Under a piece-rate system, an employer must perform the following calculation for each workweek that the employee works over 40 hours.

First, similar to the minimum wage determination discussed above, the employer must determine the employee's effective hourly rate for the workweek based on the number of hours worked. It is important to understand that the piece-rate is not the regular rate of pay; rather, for a piece-rate employee, the regular rate of pay is calculated by taking the total compensation for the week (including piece-rate compensation, as well as any bonuses or commissions) and dividing it by the total number of hours worked. In our above example, if the employee worked 45 hours during a workweek, installed 45 faucets, and earned \$450.00, then the employee's effective regular rate of pay for that workweek was \$10.00 per hour. This is sometimes referred to as the "straight time" pay.

Second, after calculating the regular rate of pay for the workweek, or straight time pay, the employer must determine the additional overtime compensation due. The key here is to remember that, in our example, the employee already received straight time pay of \$10.00 per hour for each hour worked, including the hours of overtime. Thus, the employee is entitled to receive only an additional one-half of the employee's regular rate of pay (not the full one and one-half) for all hours worked in excess of 40.

In our example, the employee worked 45 hours and, thus, had five hours of overtime. Since the employee already received \$10.00 per hour for all 45 hours, the employee is entitled to only an additional \$5.00 (i.e., half of the employee's regular rate of pay) for each of the five hours of overtime. Therefore, for the week, the employee should receive overtime compensation of \$25.00 on top of the \$450.00 received as straight time compensation. In total, the employee is paid \$475.00 for that particular week.

There is another, perhaps less complicated, way to pay overtime compensation when using a piece-rate system; however, the employee must agree to this method before any work is performed. If the employer and employee agree beforehand, the employer may pay the employee one and one-half times the employee's regular piece-rate for all pieces completed during overtime hours. Again, however, the minimum wage requirements are still present, meaning the employee must receive at least one and one-half times the minimum wage ( $\$7.25 + 50\% (\$3.63) = \$10.88$ ), or \$10.88 per hour for each hour of overtime.

### ***Record-Keeping Requirements***

As you have probably gathered at this point, it is imperative for an employer to maintain an accurate record of the hours the employee actually works, regardless of how the employee is paid. These records are vitally important in ensuring that employees are properly paid under the Act. If an employer fails to keep accurate records, or worse, fails to keep records at all, then the above calculations would be impossible to perform.

Even more damaging, failing to create and retain accurate time and pay records will place an employer in the crosshairs of the U.S. Department of Labor. Without proper time records, an employer will be significantly handicapped in its efforts to defend itself against alleged violations of the Act. Although keeping records may be time-consuming and tedious (and, in many instances, difficult, as a practical matter), the penalties for violating the Act are far too serious to ignore these responsibilities.

### **Conclusion**

Don't become the Department of Labor's next victim. If you are paying your employees on a piece-rate basis, make sure you continue to fulfill your obligations under the Act. If you are unsure of your obligations, consult

legal counsel well-versed on what the Act requires and how to comply.

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