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U.S. Department of Labor Issues Final Rule on Calculating FLSA's 'Regular Rate' of Pay

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The Department of Labor (DOL) has issued its Final Rule revising the regulations governing the calculation of the "regular rate" of pay, used to calculate overtime, under the Fair Labor Standards Act (FLSA). The Final Rule, which becomes effective on January 15, 2020, generally adopts the proposed rule published in March 2019, with some additional clarification and examples.

Background of the Regular Rate

The FLSA generally requires employers to pay non-exempt employees overtime pay at one-and-one-half times their "regular rate" for all hours worked over 40 in a given workweek. In other words, to determine the proper overtime rate, an employer must first determine the employee's "regular rate" of pay. When an employee's compensation consists of only hourly pay, the overtime rate is easily calculated; it is simply 1.5 times the hourly rate. But things get more complicated when employees receive additional forms of compensation.

The general rule is that *all* compensation received by an employee must be included in determining the regular rate, as the regular rate is defined as all "remuneration for employment paid to, or on behalf of, the employee" divided by the total number of hours worked during that week. There are exceptions. For example, must an employee's reimbursed business expenses be included in the regular rate? No, generally. What about vacation or holiday pay when the employee is not actually working, or extra pay for working more than eight hours in a day; must those be included in the regular rate? Again, typically no. In fact, the FLSA includes eight categories of compensation, set forth in Section 7(e) of the Act, that may be excluded from calculation of the regular rate of pay. The Final Rule clarifies and modernizes these exclusions, many of which have not been updated for more than 60 years.

The Final Rule

Following is a summary of the most significant new revisions, highlighting the differences between the proposed regulations and the final version.

Vacation, Sick Time, and other Paid Time Off (PTO)

Section 7(e)(2) of the FLSA allows an employer to exclude from the regular rate of pay "payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause."

The Final Rule clarifies that payment to employees for *unused* vacation, holiday, sick pay, *or other forms of paid time off,* may be excluded from the regular rate. The existing regulation expressly identified only vacation and holidays as excludable, with no mention of sick pay. The DOL acknowledges that many employers no longer provide separate categories of leave based on an employee's reason for taking leave, instead using a single category of PTO, and that all such pay for non-working time, whether paid when used or upon termination (as to unused time), need not be included in the regular rate. The Final Rule expressly rejects the holding in *Chavez v. City of Albuquerque*, 630 F.3d 1300 (10th Cir. 2011). *Chavez* held that payments for unused sick time must be included in the regular rate. The DOL favorably cites *Balestrieri v. Menlo Park Fire Protection District,* 800 F.3d 1094 (9th Cir. 2015), which held that payments for sick leave did not need to be included in the regular rate.

The Final Rule does not make any substantive additions to the language proposed in the Notice of Proposed Rulemaking (NPRM) published in March, but it adds a fourth example in Section 778.219(a) to illustrate holiday pay for emergency responders and others who work on a holiday and receive holiday pay in additional to their regular wages for working that day.

The Department's response to comments also includes helpful language for employers. For example, the DOL indicates that payouts of unused PTO or vacation time are excludable even if the leave time is accrued

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based on hours worked.

"Bona Fide" Meal Periods

The Final Rule clarifies that payment for bona fide meal periods are excluded from the regular rate.

In the NPRM, the DOL noted an apparent contradiction between 29 C.F.R. § 778.218(b) and 29 C.F.R. § 778.320 as to whether pay for "bona fide meal periods" is excludable from the regular rate. Section 778.218 provides that when payments made for occasional periods when no work is performed "are in amounts approximately equivalent to the employee's normal earnings," they are not compensation for hours of employment and may be excluded from the regular rate. Section 778.218(b) further states that this clause "deals with the type of absences which are infrequent or sporadic or unpredictable," not with lunch periods or days of rest that are regularly scheduled. That would suggest that payments for meal periods must be included. However, Section 778.320(b) appears to contradict this conclusion, stating that payment for "time spent in eating meals between working hours" may be excluded even when such time is compensated.

In light of both the courts' and the DOL's own recognition that Sections 778.218(b) and 778.320(b) "may not be compatible," the Final Rule amends the regulations to remove the reference to "lunch periods" in Section 778.218(b) to "eliminate any uncertainty about its relation to [Section] 778.320 concerning the excludability of payments for bona fide meal periods from the regular rate." Payments for such periods need only be included in the regular rate when the parties have paid for a meal period and have treated it as hours worked.

Reimbursement for Reasonable Expenses

The Final Rule clarifies that an employer's payment to employees to reimburse them for reasonable business expenses may be excluded from the regular rate.

Under existing regulations, an employer reimbursement of expenses incurred by an employee for his or her *own* benefit (such as commuting expenses, meals, rent, and so on) must be included in the regular rate, while expenses incurred on behalf of the employer may be excluded. Section 778.217, however, states that the exclusion applied if the expenses were incurred "solely" in the interest of the employer. Yet, the FLSA itself does not include this limitation, excluding, instead, all expenses incurred "in the furtherance of [the] employer's interests." Because neither the courts nor the DOL have abided by the "solely" language, the DOL proposed removing that word from Section 778.217. Thus, an expense, such as a hotel room, that benefits both the employee and employer, may be properly excluded.

Along these same lines, the Final Rule provides guidance on what constitutes a "reasonable" expense within the meaning of 29 C.F.R. 778.217(b) and excludable from the regular rate. Only reimbursements for reasonable expenses are excluded; overpayments may be considered wages. In the NPRM, the DOL stated that it would consider an expense to be per se reasonable if it is "at or beneath the maximum amounts reimbursable or allowed for the same type of expenses under the Federal Travel Regulation[.]" In response to comments, the Final Rule expands that safe harbor to include the reimbursement amounts set forth by the IRS in 29 C.F.R. § 1.274-5(g) or (j), which are commonly used by employers for calculating mileage and other reimbursements. While reimbursements exceeding these amounts will not necessarily be deemed *"unreasonable,"* they will not be considered *per se* reasonable and must be evaluated on a case-by-case basis. In addition, the Final Rule expands the examples of reimbursable expenses in Section 778.217(b) to include reimbursement for "cell phone plans" and "organization memberships dues or credentialing exam fees where relevant to the employer's business."

"Other Similar Payments"

In addition to those set forth above, Section 7(e)(2) of the FLSA also excludes from the regular rate "other similar payments to an employee which are not made as compensation for his or her hours of employment." Courts generally have held that the "similar payments" exclusion applies to any compensation paid based on an individual's general status of being an employee and not on the quality or quantity of his or her work.

The Final Rule expressly provides that to fall under the 7(e)(2) "similar payments" exclusion, the payments must not "depend on hours worked, services rendered, job performance, or other criteria that depend on the quality or quality of the employee's work."

The Final Rule clarifies the NPRM by adding that payments made to employees that might limit eligibility on the basis of geographic location or job position (*e.g.,* a discretionary bonus to employees who work in certain cities or who hold certain titles) would still be excluded from the regular rate, as these payments are not based on hours, quality, or quantity of work.

Furthermore, the Final Rule adopts from the NPRM the following additional examples to the non-exhaustive list of excludable benefits currently in the regulations and includes "conveniences furnished to the employee":

- Treatment provided on-site from specialists such as chiropractors, massage therapists, physical

therapists, personal trainers, counselors, or Employee Assistance Programs;
- Gym access, gym memberships, fitness classes, and recreational facilities;
- Modern "wellness programs" such as health screenings, vaccinations, smoking cessation support, and nutrition classes;
- Discounts on employer-provided retail goods and services; and
- Tuition benefits.

The Final Rule also includes "parking benefits," such as parking space fees, as excludable from the regular rate, while distinguishing such benefits from actual commuting costs, which must be included in the regular rate. Likewise, the Final Rule expands the breadth of excludable employee wellness programs to include "financial wellness programs or financial consulting, and mental health wellness programs." The Final Rule makes clear that these benefits, however, cannot be tied to the "employee's hours worked, services rendered, or other conditions related to the quality or quantity of work" (except that an employer may require an initial waiting period for benefit eligibility or require repayment if the benefit is misused).

The Final Rule also clarifies the requirements for a "tuition benefits" policy to be excludable from the regular rate, while adding that they are excludable regardless of whether paid directly to the employee (likely as a reimbursement for tuition), paid directly to an education provider, or paid to a student loan program. While the DOL declined to add language regarding initial waiting periods and other eligibility requirements, the Department states in its comments that tuition benefits "must generally not be tied to hours worked, services rendered, job performance or other criteria linked to the quality or quantity of the employee's work," but that "[m]inimum employment requirements (*e.g.,* requiring employees to be employed for six months prior to becoming eligible for tuition reimbursement) would be a permissible condition that would not affect the excludability of the tuition benefit from the regular rate."

"Show Up" Pay

Existing DOL regulations provide that payments given by employers to employees for "show-up" pay (a minimum payment given to employees who report to work and are sent home because of lack of work) is excludable from the regular rate of pay under Section 7(e)(2). For example, if an employee reports to work, works one hour, and is sent home, some employers voluntarily provide show-up pay for a minimum number of work hours. In fact, under some state laws, such minimum pay is required. These payments are excluded under Section 7(e)(2) as payments for occasional periods when no work is performed.

New Section 778.200(c) of the regulations clarifies that recent state and local laws requiring "reporting pay" for employees who are unable to work their scheduled hours, because the employer reduced hours from a regular shift before or after the employee reports to duty, will be treated as "show-up" pay under existing regulations and do not need to be included in the regular rate of pay when such payments are made on an infrequent and sporadic basis.

Call-Back Pay

Under Section 778.221 of the current regulations, if an employee is called back to work after his or her normal shift ends, the employee's pay for the number of additional hours actually worked is included in the regular rate calculation. However, any additional pay the employee receives simply for being recalled to work may be properly excluded from the regular rate. For example, if an employee returns to work for an emergency and works one hour, but is paid a minimum of four hours, the three additional hours may be excluded from the regular rate.

The Final Rule revises Section 778.221 to eliminate the requirement that call-back payments be received only on an "infrequent" or "sporadic" basis for the exclusion to apply (thus, arguably broadening the exclusion), but explains that if the payments are "prearranged," they may not be excluded from the regular rate.

To illustrate the point, the Final Rule provides an example of an employee who is called in to help clean up a store after a roof leak and then, three weeks later, is called in to cover for a coworker who left for a family emergency. If the employee is given minimum call-back pay, the pay in excess of hours actually worked may be excluded, as these incidents were not prearranged. However, if the employee is called in for "emergency" help during a busy period for six out of eight weeks, the NPRM provided that the call-back pay would be deemed "so regular" that it is, in effect, "prearranged" and cannot be excluded. The Final Rule modifies this point, eliminating any reference to "regularity," providing instead that simply because an employee is called in for six out of eight weeks does not necessarily mean the payments are "prearranged," as each (or some) of the occasions may have been for unrelated and unanticipated issues and, therefore, are still excludable. "The key inquiry for determining prearrangement is whether the extra work was anticipated and therefore reasonably could have been scheduled," the Final Rule explains. Thus, simply because an employee has been called in regularly does not necessarily establish prearrangement, but, conversely, the *absence* of regularity does not establish a lack of prearrangement. This new requirement may well result in litigation involving whether an employee's call-back was "anticipated."

Predictability Pay or Schedule Change Premiums

Several local jurisdictions, including New York City and Seattle, have enacted laws requiring employers to pay employees a schedule change premium or penalty when an employer fails to provide employees with sufficient notice (*e.g.,* less than 14 days) prior to the beginning of their shift or cancels a shift without sufficient notice to an employee. As with call-back pay, the Final Rule provides that these extra payments may be excluded from the regular rate of pay under Section 207(e)(2) of the FLSA, so long as they are not prearranged. The Final Rule states that "extra payments made to employees for failure to give the employee sufficient notice to report to work on regular days of rest or during hours outside of his regular work schedule," or "predictability pay" provided by state or local law, can be excluded.

"Clopening" Pay

Like predictability pay, the Final Rule provides that extra payments given by employers to employees solely because the employees are called back to work before the expiration of a specified number of hours between shifts need not be included in the regular rate of pay. This form of compensation is sometimes referred to as "rest period" or "clopening" pay, because an employee is required to work both a closing shift and the following opening shift without sufficient rest time between the shifts. Again, to be excludable, such payments cannot be prearranged.

Discretionary Bonuses

An employer providing a bonus to non-exempt employees must determine whether the bonus should be included or excluded from the regular rate of pay. The general rule is that non-discretionary bonuses must be included, while discretionary bonuses may be excluded. Discretionary bonuses are defined in the regulations as those where the fact and the amount of the bonus are determined at the sole discretion of the employer at or near the end of the period to which the bonus corresponds.

The NPRM sought to "elaborate" on the types of bonuses that are, and are not, discretionary, purportedly to add "clarity" for employers and employees. The Final Rule adopts the proposed rule and reiterates, in new Section 778.211(d), that the label assigned to a bonus is not determinative. It also lists additional examples of bonuses that may be considered discretionary:

1. Bonuses to employees who made unique or extraordinary efforts which are not awarded according to pre-established criteria (citing a case where employees were given "spot bonuses" for extraordinary contributions);
2. Severance bonuses;
3. Bonuses for overcoming challenging or stressful situations;
4. Employee-of-the-month bonuses; and
5. "Other similar compensation."

The Final Rule adds employee "referral bonuses," for employees not primarily engaged in recruiting activities, as an additional example of a type of discretionary bonus. It declines to specifically include sign-out bonuses in the regulatory text (though such bonuses, depending on the circumstances, may be excluded from the regular rate of pay).

Contributions Pursuant to a Bona Fide Benefit Plan

Section 7(e)(4) of the FLSA excludes from the regular rate "contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees." Section 778.215(a)(2)) further explains that, to be excludable, "[t]he primary purpose of the plan must be to provide systematically for the payment of benefits to employees on account of death, disability, advanced age, retirement, illness, medical expenses, hospitalization, and the like."

In the Final Rule, the DOL adds more examples of the types of modern benefit plans that may be excludable from the regular rate of pay, such as "accident, unemployment, and legal services," but makes clear that these additional examples would have to satisfy the other requirements outlined in Section 778.215.

The Final Rule expands the scope of § 778.215(b), which provides that when a benefit plan or trust has been approved by the IRS as satisfying the requirements of Section 401(a) of the Internal Revenue Code, absent evidence to the contrary, the plan or trust will be considered to have met the conditions specified in paragraphs (a)(1), (4), and (5) of Section 778.215. The Department expands the scope of this section in three ways:

1. In light of the IRS's decision to change its determination letter procedures, the Section states, absent evidence to the contrary, a plan "maintained pursuant to a written document that the plan sponsor reasonably believes satisfies the requirements" of Section 401(a) of the Internal Revenue Code will be considered to meet certain requirements of § 778.215(a);
2. The Section states that a Section 401(a) plan may be presumed to satisfy Section 778.215(a)(2) in addition to Sections 778.215(a)(1), (4), and (5); and
3. The Section extends the presumption of satisfaction under the Section to plans that meet the requirements of Sections 403(a), 403(b), 408(k), or 408(p) of the Internal Revenue Code and to governmental plans that satisfy the requirements of Section 457(b) of the Internal Revenue Code

(governmental Section 457(b) plans).

The Department declined, however, to create a new presumption for employee benefit plans governed by and in compliance with ERISA, as compliance with ERISA does not address all requirements for excludability under Section 207(e)(4) of the FLSA and Section 778.215(a) of the regulations. The DOL further addresses several other benefit plans in the Final Rule, including cafeteria plans, cash payments in lieu of plan participation, contributions to IRAs or HSAs, and discretionary contributions to retirement plans.

Voluntary Premium Payments

Section 207(e) of the FLSA permits employers to exclude from the regular rate certain overtime premium payments for hours of work on special days or in excess or outside of specified daily or weekly standard work periods. In particular, premiums may be excluded:

- For "hours worked in excess of eight in a day or in excess of the maximum workweek applicable to such employee [under Section 7(a)] or in excess of the employee's normal working hours or regular working hours, as the case may be," Section 207(e)(5);
- "[F]or work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in non-overtime hours on other days," Section 207(e)(6); or
- "[I]n pursuance of an applicable employment contract or collective-bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not exceeding eight hours) or workweek (not exceeding the maximum workweek applicable to such employee under subsection [7(a)], where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek." Section 207(e)(7).

Additionally, Section 207(h)(2) provides that extra compensation of the types described in Sections 7(e)(5), (6), and (7) is creditable toward overtime compensation owed under Section 7(a). These are the only types of compensation excludable from the regular rate that also are creditable toward overtime compensation.

Existing DOL regulations (*i.e.,* 29 CFR §§ 778.202, 778.203, 778.205, and 778.207) set forth the requirements for excluding from the regular rate the overtime premiums described in Sections 207(e)(5) and (6). In the NPRM, the DOL proposed amending the regulations to remove any references to "employment agreements" or "contracts" to eliminate any confusion that the overtime premiums described in Sections 207(e)(5) and (6) may be excluded only under written contracts or agreements. After receiving conflicting comments on this proposal, the DOL in the Final Rule adopts the suggestion to replace the terms "employment contracts" in Section 778.202 and "agreement of employment" in Section 778.205 with "written or unwritten employment contract, agreement, understanding, handbook, policy, or practice." The DOL concluded that this language achieves the original objective of clarifying that overtime premiums do not need to be made pursuant to a written contract or agreement to be excluded under these sections, while recognizing that they must still be paid pursuant to some form of legitimate agreement or understanding.

What Happens Next

The Final Rule becomes effective on January 15, 2020. While unlikely to eliminate all problems stemming from the oft-confounding regular rate determination, the revised regulations should provide some much-needed clarity and updated guidance to employers in their efforts to comply with the FLSA.

If you have any questions about the new regular rate regulations or about any other wage and hour issues, please consult with a Jackson Lewis attorney.

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