Legal Update Article

Calculating Overtime Value of Flat-Sum Bonus Must Be Based on Actual Non-Overtime Hours Worked, California High Court Holds

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March 9, 2018

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The California Supreme Court has held that, under state law, when an employee earns a flat sum bonus during a pay period, the overtime pay rate will be calculated using the actual number of non-overtime hours worked by the employee during the pay period. *Alvarado v. Dart Container Corp.,* 2018 Cal. LEXIS 1123 (Cal. Mar. 5, 2018).

In so holding, the Court reversed a lower court of appeal decision that had rejected policy guidance issued by the California Department of Labor Standards Enforcement (DLSE). Instead, the lower court had adopted the more employer-friendly position taken by the U.S. Department of Labor and federal courts that *all* hours worked, including overtime hours, should be used in establishing the overtime rate for such bonuses.

Background

For years, California law has required overtime to be compensated at 1.5 times the "regular rate" of pay for all hours worked in excess of 8 hours a day or (like federal law) 40 hours in a week, and twice the regular rate of pay for hours worked in excess of 12 in a day or 8 on a seventh consecutive day of work. The regular rate must, in addition to the "straight time" rate (for hours less than or equal to 8 per day/40 per week), incorporate shift premiums, non-discretionary bonuses, and other compensation earned during the pay period. What has remained unclear is *how* "flat sum" bonuses — that is, non-formula bonuses not based on the number of hours worked — factor into the equation.

In *Alvarado*, the company paid a flat-sum "attendance bonus" of $15 per day for work on the weekend, regardless of whether those weekend hours caused the employee to exceed either 8 hours per day or 40 hours per week. Representing a putative class of employees, the plaintiff asserted that the company was improperly using the federal formula to determine overtime pay, rather than the formula adopted by the DLSE. Under the agency's formula, the divisor for determining the regular rate is all *non-overtime* hours worked during the (presumptively one-week) pay period — whether that number is 4, 40, or something in between. On the other hand, defendant Dart Corporation asserted that the DLSE's position was void as an "underground regulation" (*i.e.,* adopted informally without following the processes established by the state's Administrative Procedure Act (APA)) and, because no legitimate regulation existed at the state level, the formula used by federal Department of Labor should be followed. Under that formula, all hours (including the overtime hours) are used in the divisor.

For example, suppose that a Dart employee making $12 per hour worked 40 hours during the week and then worked 4 more hours on both Saturday and Sunday. Using the federal formula, Dart would first determine the employee's "base" hourly pay for both the "straight time" and the overtime hours, that is, $12 per hour times 48 hours, or $576. The company then added the $30 attendance bonus to that amount (for a total of $606) and

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divided by the total number of hours worked, including overtime (*i.e.,* 48) to arrive at a "regular rate" of $12.63. Because the base amount of overtime already was included in the calculation, Dart then divided the regular rate in half to arrive at the overtime "premium" rate of $6.315 per hour. Multiplying the premium rate by the number of overtime hours (*i.e.,* 8) resulted in additional overtime pay of $50.52 and a total pay for the week of $656.52.

Using the DLSE's formula, on the other hand, results in a slightly higher amount of overtime pay. Under the agency formula, the employer first calculates the compensation attributable only to the employee's hourly wages, doing so by multiplying the employee's straight-time rate by 40 ($12 x 40 = $480) and 1.5 times the straight-time rate for the overtime hours ($12 x 1.5 x 8 = $144), for a total of $624. Then, the distinguishing factor under the DLSE's formula comes into play. The employer must calculate the overtime compensation attributable only to the bonus. First, the per-hour value of the bonus is determined by dividing the amount of the bonus by the number of non-overtime hours worked and then multiplying that by the 1.5 overtime factor, which results in a value of $1.13 ($30 ÷ 40 x 1.5). Thus, the total overtime value of the bonus is $9.04 ($1.13 x 8 hours worked) and, adding this to the compensation attributable to the hourly wages ($624) and the $30 bonus itself, total pay equals $663.04 — about $6.50 more than would be paid under the federal formula.

Supreme Court Adopts DLSE's Approach — and Applies It Retroactively

The trial court and the court of appeal agreed with Dart that no valid state regulation existed, that the federal formula therefore should apply and, because Dart's formula complied with that formula, the plaintiffs' claim was rightly dismissed.

Reversing the court of appeal, the California Supreme Court held that although the DLSE's regulation was indeed "void," that did not necessarily mean it was incorrect. Rather, the lower courts should have independently determined whether the agency's interpretation of the law was appropriate even if it failed to comply with the APA before implementing it.

In this case, the Supreme Court concluded that the "state policy favoring an eight-hour workday and a six-day 40-hour workweek, and discouraging employers from imposing work in excess of those limits," along with the state's longstanding position that its labor laws are to be liberally construed in favor of the employees, led to the conclusion that only non-overtime hours should be used in the divisor when calculating the value of the flat-sum bonus.

Moreover, the Court held that in the case of the flat-sum bonus, the divisor more appropriately should be *any* number of non-overtime hours worked during the pay period, as this approach better exemplified the principle of pro-employee construction of the labor laws. In support, the Court cited the situation in which a part-time employee, who works substantially fewer than 40 hours per week, but works on the weekend and, therefore, earns the flat-sum attendance bonus. Under these circumstances, the employee would be adversely affected by dividing his pay by 40 rather than his actual hours worked. Doing so would significantly dilute his regular rate of pay and, therefore, his overtime pay rate. Furthermore, the Court noted that using all non-overtime hours worked as the divisor appeared to be the intended interpretation of the Industrial Work Commission (IWC) as set forth in its original findings 55 years ago.

In addition, while noting that it owed no deference to the DLSE's regulation, the Court found its position persuasive in light of the agency's "expertise and competence" and the fact that its interpretation was the product of "considerable deliberation at the highest policymaking level."

Finally, the Supreme Court rejected the company's argument that even if the DLSE's formula was appropriate, it should only be applied prospectively. Reiterating the "liberal construction" principle of the state's labor laws, the Court concluded that retroactive application of its holding was appropriate.

Impact on Employers

Dart could be detrimental to California employers who incorporate these types of flat-sum bonuses into their compensation structure, particularly in light of the retroactive application of the decision. Therefore, employers that have paid such bonuses should review their current practices immediately. This is particularly true for employers with multi-state operations that uniformly have applied the federal formula in the past.

Please contact Jackson Lewis with any questions about the proper calculation of overtime and responsive strategies to the *Dart* decision, or any other wage and hour issues.