

Bonuses and the Fluctuating Workweek Method of Overtime Pay

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On April 5, 2011, the U.S. Department of Labor issued a final rule on the fluctuating workweek (or "half-time") method of overtime pay, 29 C.F.R. §778.114 (see May 2011 newsletter, p. 9).

DOL rejected a proposed revision to Section 778.114 that would have expressly permitted bonus or premium payments for working undesirable hours, such as night shifts, weekends or holidays.

The agency's rejection of this modification has resulted in confusion concerning the impact of bonus payments on overtime pay to those employees paid under the fluctuating workweek method. In essence, DOL left the law "as is" concerning bonuses under Section 778.114. But that raises the question: Where is the law?

The Fluctuating Workweek Method

The Fair Labor Standards Act permits employers to pay overtime pay to salaried, nonexempt employees whose work hours vary from week to week under the fluctuating workweek or "half-time" method (see ¶532 of the *Guide*).

With this method, a fixed weekly salary compensates the employees for the straight-time portion of their com-

ensation for all hours worked, and the employees receive an additional "half-time" overtime premium payment for all hours worked in excess of 40 during the workweek.

Generally, four conditions must be satisfied before an employer may pay overtime under the fluctuating workweek method:

- (1) the employee's hours must fluctuate from week to week;
- (2) the employee must receive a fixed salary that does not vary with the number of hours worked during the week (excluding overtime premiums);
- (3) the fixed amount must be sufficient to provide compensation every week at a regular rate that is at least equal to the minimum wage; and
- (4) the employer and employee must share a clear mutual understanding that the employer will pay that fixed salary regardless of the number of hours the employee worked.

The Proposed Change to the 'Half Time' Method

In 2008, DOL (under the Bush administration) proposed a modification to Section 778.114. The modification would have expressly permitted employers to pay nonexempt salaried employees under Section 778.114 a bonus or premium for certain activities, such as working undesirable hours.

Such bonuses or premium payments are typically shift differentials or premium pay for hours worked on holidays or weekends. The proposed modification included an example in which the employer pays an employee a nightshift differential in addition to a fixed salary.

On April 5, 2011, DOL (under the Obama administration) issued a final rule on Section 778.114 that did not include the proposed modification on hourly bonuses or premiums.

Instead, the agency rejected the modification as violating the fixed salary requirement of Section 778.114. Consequently, the state of the law as to bonuses and their effect on the fluctuating workweek basis of payment also remains unchanged.

The State of the Law

DOL cited four cases in its comments when it rejected the proposed modification on bonuses: *O'Brien v. Town of Agawam*, 350 F.3d 279 (1st Cir. 2003); *Adeva v. Intertek USA*, No. 09-1096(SRC), 2010 WL 97991 (D.N.J. Jan. 11, 2010); *Dooley v. Liberty Mutual Ins. Co.*, 369 F. Supp. 2d 81 (D. Mass. 2005); and *Ayers v. SGS Control Services, Inc.*, No. 03 Civ. 9077 RMB, 2007 WL 646326 (S.D.N.Y. Feb. 27, 2007). Those four cases support the proposition that bonus or premium payments based on the hours of work (for example, hourly shift premiums or shift differential payments) or premium payments for days worked (for example, Saturday or holiday premium pay) violate the salary requirement under Section 778.114.

None of those cases, however, addressed bonuses based on criteria other than hours of work, such as merit bonuses, profit sharing bonuses, or percentage of earnings' bonuses.

O'Brien v. Town of Agawam, Mass.

In *O'Brien*, current and former police officers sued for back overtime pay. Under the officers' collective bargaining agreement, each officer received a salary each week as base pay, regardless of the number of hours worked. Additionally, the officers received, among other payments, shift-differential pay based on the hours worked and extra hourly pay for any hours worked over eight in a day and when required to work during "off-duty" time.

The 1st U.S. Circuit Court of Appeals concluded that the additional hourly pay violated Section 778.114's requirement that the officers receive a fixed amount as straight-time pay for whatever hours they work. The officers, to the contrary, had received more or less straight-time pay depending on how many hours they worked each week. Consequently, the officers were owed additional overtime pay.

Adeva v. Intertek USA

The plaintiffs in *Adeva* were oil, gas and chemical inspectors who alleged that their employer did not comply with the requirement of a "fixed amount as straight time pay" under Section 778.114. In addi-

tion to a salary, plaintiffs were paid "day off pay," "off shore pay" and "holiday pay." These hourly or day-based payments were added to their salary. The federal district court found such payments violated Section 778.114 and thus, the employees were owed additional overtime pay.

Dooley v. Liberty Mutual Ins. Co.

In *Dooley*, current and former auto damage appraisers brought an FLSA action for back overtime pay. The appraisers received a fixed amount per week and also received additional *per diem* pay for Saturday work. During the period at issue, the employer had changed the *per diem* pay to an hourly premium for Saturday work hours. The federal court in *Dooley* ruled that the *per diem* pay and extra hourly pay for Saturday work precluded the employer's use of the "half-time" method for computing overtime pay.

Ayers v. SGS Control Services

In *Ayers*, current and former car inspectors brought suit for overtime pay. The federal district court found that several requirements of Section 778.114 were breached.

First, during some workweeks, some employees' earnings fell below the minimum wage. During other workweeks when an employee's pay fell below minimum wage, the employee received "bump up" pay to bring the salary to at least minimum wage. They also were paid extra hourly pay for working on days off and a piece-rate bonus for every car they inspected during their first 40 hours of the workweek.

The court found that the "bump up" pay, the hourly-based payments and the piece-rate incentive payments breached Section 778.114's requirement of a fixed amount as straight time for all hours worked.

Accordingly, the four cases cited by DOL stand for the proposition that bonuses and premiums paid for working undesirable hours or days, or producing so much during the first 40 hours, are incompatible with the requirement of a fixed weekly salary under Section 778.114.

Those four courts ruled that the employer was not permitted to pay its employees a "half-time" overtime premium, but would be required to compensate the employees 150 percent of their regular rates for each hour worked in excess of 40 during each workweek.

No federal court in a reported opinion has held that the payment of a bonus unrelated to hours worked is inconsistent with Section 778.114.

See *Workweek*, p. 3

Workweek (continued from p. 2)

Though DOL indicated that bonuses and premiums that are related to hours worked are incompatible with the salary requirement of Section 778.114, the agency has not directly addressed the effect of performance bonuses that are not related to hours worked, such as merit bonuses, profit-sharing bonuses or percentage-of-earnings' bonuses.

Section 778.114's language may help explain the distinction between bonuses based on work hours and bonuses not related to work hours.

When describing the required salary, Section 778.114 states that it is to be a "fixed amount as straight time pay for whatever hours [the employee] is called upon to work in a workweek." Therefore, according to DOL, the salary must be the sole compensation for whatever hours are worked.

Merit bonuses, profit-sharing bonuses, and percentage-of-earnings' bonuses, however, are not pay for whatever hours the employee is called upon to work, but instead appear to be additional compensation to recognize the quality of the work or the success of the work.

Consequently, there is no prohibition in Section 778.114 for additional pay based on something other than hours.

However, DOL under the current administration does not favor or support the expansion of the use of the fluctuating workweek method. The agency expressly said so in its comments when rejecting the 2008 proposed modification:

[T]he Department is cognizant that this method of pay results in a regular rate that diminishes as the workweek increases, which may create an incentive to require employees to work long hours. The Department does not believe that it would be appropriate to expand the use of this method of computing overtime pay beyond the current regulation.

Thus, for now, it appears that bonuses not related to hours or days worked *may* be consistent with Section 778.114. Such bonuses include:

- merit bonuses, which are usually based on the quality of the work rather than on when the work was accomplished;
- profit-sharing bonuses, which are based on the employer's profits rather than hours or days of work; and
- percentage-of-earnings' bonuses, which effectively give a percentage increase in compensation. 🏠



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