Labor and Employment Alert: California Supreme Court Changes Overtime Calculation and Gives a Huge Bonus To Employees

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For California employers, no good deed goes unpunished. Dart Container Corporation paid its employees, in addition to their normal hourly wage, a flat sum $15 attendance bonus if they were scheduled to work on a Saturday or Sunday. Under both the Fair Labor Standards Act (FLSA) and the California Labor Code, the attendance bonus must be factored into an employee's regular rate of pay so that the employee's overtime pay rate reflects all the forms of regular compensation that the employee earned. No California statute or regulation explained how to include a flat sum bonus in the regular rate of pay when calculating overtime. So Dart followed the calculation method required by the FLSA. On March 5, 2018, the California Supreme Court held that this wasn't good enough.

Under the FLSA, the employee's regular rate of pay is calculated by dividing the total compensation earned (including a flat sum bonus) by the total hours worked (including any overtime hours) during the entire pay period. This means that the divisor includes both overtime and nonovertime hours, and this is how Dart factored the flat sum bonus into its employees' pay. One of Dart's employees contended that California law requires that the bonus be allocated only over the nonovertime hours, and he brought a class action for unpaid overtime, waiting time penalties, inaccurate wage statements, and civil penalties under the Private Attorney Generals Act.

The lower courts found in Dart's favor, after concluding that no California law or regulation explained how to factor a flat sum bonus into an employee's regular rate of pay for purposes of calculating overtime compensation. Therefore, it was reasonable for Dart to follow the FLSA's method of doing so. When the case reached the California Supreme Court, however, the Court disagreed and rejected the FLSA's approach.

In *Alvarado v. Dart Container Corp.*, the Court explained that the key distinction between the FLSA formula and the formula the employee advocated is whether the bonus is allocated to *all* hours worked, or only to the *nonovertime* hours worked. The Court concluded that the divisor

for calculating the per-hour value of the bonus is only the number of *nonovertime* hours the employee period, regardless of the number of hours actually worked. The Court gave two reasons for this.

First, the employee's formula "turns out to be marginally more favorable to employees." And California employment laws are liberally construed in favor of employees.

Second, the employee's formula is the view of the California Department of Labor Standards Enforcement which it had expressed in its Enforcement Manual. The Court was unconcerned with the fact that – twenty-plus years ago – it declared the Enforcement Manual to be void and not entitled to any deference. According to the Court, "as an underground regulation, the DLSE's policy is not entitled to any special deference, but the interpretation embodied in that policy may still be valid. Therefore, so long as we exercise our independent judgment, we may consider the DLSE's interpretation and the reasons the DLSE proffered in support of it, and we may adopt the DLSE's interpretation as our own if we are persuaded that it is correct."

Given this new interpretation, the Court concluded that "the flat sum bonus at issue here should be factored into an employee's regular rate of pay by dividing the amount of the bonus by the total number of nonovertime hours actually worked during the relevant pay period and using 1.5, not 0.5, as the multiplier for determining the employee's overtime pay rate." The Court limited its decision to flat sum bonuses comparable to attendance bonuses, noting that production bonuses may require a different analysis.

To make matters worse for Dart – and other California employers that calculated flat sum bonuses in this manner – the Court rejected Dart's request to make the decision prospective. According to the Court, Dart's argument that "ordinary people could never have predicted that the law would be interpreted this way" was "meritless" and "simply wrong." Indeed, "the interpretation was published in the DLSE Manual, and so defendant had every reason to predict it." So "although the DLSE's enforcement policies may, in some cases, be void underground regulations, they may nonetheless be accurate interpretations of binding state law." The Court doesn't explain how any employer is supposed to divine when the DLSE's void regulation is actually still be a binding interpretation.

In a concurrence, four Justices acknowledged that "there has been no authoritative construction by a state agency of what a regular rate of pay entails in this context." The concurrence admonished the DLSE for its two decades of inaction on this issue. "Regrettably, more was not done to help employers meet their statutory responsibilities, or to ensure that employees receive the overtime pay they are due." This is likely to be of little consolation to employers.

California law on calculating flat-rate bonuses now departs from the FLSA, and it is also unclear how employers should treat bonuses that are both flat-sum and performance-based. Once again, California employers face significant liability for unpaid overtime, inaccurate wage statements, waiting time penalties and civil penalties under PAGA. Employers should immediately review how they pay and have paid their bonuses. Contact your Vorys lawyer if you have questions about the *Dart Container* decision and its potential effect on your past or current bonus program.