Labor and Employment Alert: Ninth Circuit Shows High Costs of Failing to Properly Calculate the Regular Rate

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In a case of first impression, the Ninth Circuit Court of Appeals recently considered whether an employer violated the Fair Labor Standards Act (FLSA) because it failed to include cash-in-lieu of benefits payments when it calculated employees' regular rate of pay. The Court concluded this violated the FLSA, and the employer's failure to divine the proper treatment of these payments from non-existent case law made the violation willful as well.

In *Flores v. City of San Gabriel*, the city provided its employees with a flexible benefits plan. Under the plan, the city designated a monthly amount of money for each employee to use for medical, dental and vision benefits. Employees were required to use part of the monthly allowance for those benefits, and could decline to use the remainder if they had alternate medical insurance. Instead of forfeiting the remainder, the employee would then receive the unused portion as a cash payment – which ranged from $1,000 to $1,300 per month. The city designated these monthly cash-in-lieu of benefits payments as "benefits" and so did not include them in calculating the employee's regular rate of pay (resulting in a lower regular rate than if the payments were included and so lower overtime compensation). Proving that no good deed goes unpunished, a group of employees sued the city under the FLSA claiming their overtime compensation had been underpaid.

Under the FLSA, certain payments may be excluded from the regular rate, including payments to an employee which are not made as compensation for his or her hours of employment. The city argued this exception permitted excluding payments that do not depend on when or how much work the employee performs like its cash payments that were not tied to the employees' hours of work. The Ninth Circuit disagreed, noting the focus is "on whether a given payment is properly characterized as compensation, regardless of whether the payment is specifically tied to the hours an employee works." Because the city's payment of unused benefits was "compensation," the payments must be included in the regular rate of pay and thus in the calculation of any overtime rate.

The court recognized that "[t]his a question of first impression in this and other circuits" and "a close question." Nevertheless, the Court found that the city willfully violated the FLSA because it "took no affirmative steps to ensure that its initial designation of its benefits payments complied with the FLSA." It's not clear how the city would have deduced this given that, as the Court noted, "there was no case authority on the proper treatment of cash-in-lieu of benefits payments under the FLSA in this circuit." But according to the Court, "the absence of controlling case authority cannot be dispositive when the city has put forth no evidence that it ever looked to see whether such authority existed." The Court concluded that the city's willful violation meant that the plaintiffs were entitled to a three-year statute of limitations and liquidated (double) damages.

The *Flores* decision reminds employers of the high cost of noncompliance with the FLSA. First, failing to include payments when calculating the regular rate can lead to costly collective actions under the FLSA and class actions under state law. Second, employers must be prepared to explain and defend why a type of payment was excluded from the regular rate. An inadequate justification can lead to a finding of willfulness, thereby extending the statute of limitations and mandating liquidated damages. Ultimately, this decision may prove costly for employees too. The Court noted that "[t]he city warns us that a ruling in favor of the Plaintiffs in this case will encourage municipalities to discontinue cash-in-lieu of benefits payment programs due to the consequent increase in overtime costs to the detriment of municipal employees."

Contact your Vorys lawyer if you have questions about the FLSA and which payments to include when calculating employees' regular rate of pay.