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California Supreme Court Establishes Overtime-Calculation Formula for Employees Receiving Flat-Sum Bonuses

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Under both federal and state law, overtime compensation owed to a nonexempt employee must be based on the employee's "regular rate of pay." That regular rate includes not only the employee's standard hourly rate but also an incremental portion of any nondiscretionary bonus paid to the employee for the period of time that includes the overtime work. There are, however, several different ways to apportion a bonus amount among a nonexempt employee's working hours for purposes of calculating the employee's regular rate of pay. On March 5, 2018, the California Supreme Court unanimously held in *Alvarado v. Dart Container Corp.* that, under California law, the overtime rate for workers who receive a flat-sum bonus must be based on their *non-overtime* hours actually worked, and not their total hours worked.

The Court's Decision in *Alvarado v. Dart Container Corp.*

The question before the court was how overtime rates should be calculated for employees who receive a flat-sum bonus. (In *Alvarado*, the employees received a flat $15 bonus for each weekend shift that they completed.) California law generally requires employers to pay nonexempt employees 1.5 times (and, in some instances, double) their "regular rate of pay" for each overtime hour they work. The law requires employers to factor flat-sum bonuses into the calculation of the regular rate, but is silent on whether the bonus should be spread across all hours worked or just the non-overtime hours. The employee in *Alvarado* urged the court to adopt the method proposed by the California Division of Labor Standards Enforcement (DLSE) policy manual, which ignores overtime hours in calculating the overtime rate. The DLSE policy manual, which the court found to be persuasive but not binding authority, advises that the overtime rate is determined by dividing the employee's hourly pay and bonuses by the non-overtime hours worked, rather than including the overtime hours in the calculation. On the other hand, the employer pressed the court to embrace the federal formula under the Fair Labor Standards Act, which divides the amount of the bonus by

the total number of hours worked. Thus, the key distinction between the two formulas was whether the bonus is allocated to *all* hours worked, or only to the *non-overtime* hours worked in determining the regular rate of pay. The employee's formula is more favorable to workers because it divides the bonus by fewer hours (no more than 40) in determining the overtime rate.

In accepting the employee's argument, the court recognized that including overtime hours in the formula would result in a progressively decreasing regular rate as the amount of overtime increases, thus undermining California policy to discourage overtime work. The court therefore held that in calculating the regular rate of pay for a California employee who receives a flat-sum bonus, the employer must divide the bonus amount by the number of non-overtime hours actually worked by the employee during the relevant time period and add the resulting hourly increment to the employee's straight-time hourly pay.

Practical Implications

Although the *Alvarado* decision will have a direct impact on employers with employees in California, it serves as a reminder to all employers that nondiscretionary bonuses of any kind must be included in the calculation of nonexempt employees' regular rate of pay for overtime compensation purposes. Purely discretionary bonuses do not have to be factored into the calculation of the regular rate, but discretionary bonuses are limited to those whose amounts are not predetermined and that are not communicated in advance to employees by any prior contract, agreement, policy, or promise.

California employers that offer flat-sum bonuses to non-exempt employees should examine their pay practices to ensure that their calculation of the regular rate of pay for overtime purposes follows the formula set forth in *Alvarado*. The use of a different formula that results in an underpayment of overtime compensation can result in substantial liability for an employer. Although the amount of the underpayment may be small, it can generate claims under California law for inaccurate pay statements, waiting time penalties for underpayment of final wages to a terminated employee, unfair business practices, and penalties available under the Private Attorneys General Act in addition to the claim for the unpaid overtime compensation itself.

Related People



Susan W. Pangborn
t 404.815.6305
spangborn@ktslaw.com



James Smith
t 415.273.4317
james.smith@ktslaw.com