



Calculating Overtime for Non-Exempt Employees and the FLSA Regular Rate

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CALCULATING OVERTIME FOR NON-EXEMPT EMPLOYEES AND THE FLSA REGULAR RATE

I. Introduction.

“The genesis of the FLSA lay in a desire to improve the welfare of unorganized, low-wage employees, but as is true with so many statutes the scope of the FLSA far outruns its original justification.” *Reich v. Interstate Brands Corp.*, 57 F.3d 574, 578 (7th Cir. 1995) (citation omitted). Indeed, from 2001 to 2005, the broadened scope of the FLSA led to a 153% increase in the number of FLSA collective actions filed. The majority of these actions involved alleged off-the-clock and misclassification violations. Issues surrounding the calculation, or miscalculation as the case may be, of the regular rate of pay have largely flown under the radar screen. That may soon change.

On January 25, 2007, Judge Robert Dawson in the United States District Court for the Western District of Arkansas approved the largest settlement in Wage and Hour Division history against a private employer. Pursuant to the settlement, Wal-Mart Stores Inc. agreed to pay \$33,484,499 for alleged FLSA violations primarily involving how Wal-Mart calculated the “regular rate of pay,” specifically how it treated incentives and other premium payments.

Associate Solicitor Steven Mandel said that the pay practices involved in the Wal-Mart case were “not particularly unusual violations” and that “unfortunately, the failure to pay overtime and include incentives is common.” Michael R. Triplett, *Wal-Mart to Pay More Than \$33 Million in Settlement with DOL Involving Overtime*, DAILY LAB. REP. Jan. 26, 2007, at AA-1. The DOL later characterized the settlement as the “gold standard” for future settlements. Michael R. Triplett, *DOL’s Wal-Mart Settlement Is “Gold Standard” for Agreements in Future*, DOL Official Says, DAILY LAB. REP. Feb. 23, 2007, at C-1. And it may very well spark a new wave of FLSA litigation, as more plaintiffs’ attorneys uncover “large amounts of similar miscalculations.” See Michael R. Triplett, *Wal-Mart/DOL Pact May Prompt More Claims Involving Overtime Calculation*, Attorneys Say, DAILY LAB. REP. Feb. 8, 2007, at C-1 (“I don’t think the claims are a huge source of litigation right now,” said Tammy McCutchen, the former head of the DOL’s Wage and Hour Division, “but I think the regular rate cases are something employers

need to pay attention to. The plaintiffs bar will become interested in the cases and then employers need to be prepared.”).

To avoid miscalculations of the regular rate, employers must navigate through a complex statutory and regulatory maze, which can sometimes be confusing and contradictory. Beginning with the basics, the FLSA requires employers to pay employees one and one-half times their “regular rate of pay” for all work performed in excess of 40 hours in a week. 29 U.S.C. § 207(a)(1). Many believe that the regular rate of pay is an employee’s hourly rate regardless of any other compensation the employee may receive. This is simply not the case. In fact, all remuneration paid to the employee – such as performance bonuses and shift differentials – must be included, subject to several statutory exceptions.

Determining the scope of these statutory exceptions is crucial. Bonuses, for example, may be excluded from the regular rate if they are discretionary. But an employer who simply reserves discretion in an employee handbook or a collective bargaining agreement should not rest on its laurels; such a reservation may not be enough to qualify for this exception. Indeed, a court will consider all facts and circumstances in determining whether an implied agreement to pay the bonus exists or if the employees have an expectation that the bonus will be paid. As a result, employers who pay discretionary bonuses regularly may be required to include the bonus amounts in the regular rate.

Depending on conditions attached to signing bonuses, and how they are paid, signing bonuses may also raise regular rate issues. If an employer either (1) reserves the right to recoup some or all of a bonus payment unless the employee works a specific minimum period of time or (2) delays part of a bonus until after some period of employment has elapsed, some or all of the bonus may be challenged as being tied to performance of services for the employer. On the other hand, bonuses paid unconditionally in a lump sum before employment begins should be immune from such a challenge.

Another burgeoning area relates to “extra compensation” or premium payments. In today's competitive economic climate, employers often face the pressures of satisfying their clientele at non-traditional hours. Many of these employers have designed compensation programs that incentivize non-exempt employees to work these hours by paying them premiums for doing so. Such premiums may be excluded from the regular rate if, but only if, they must meet specific criteria.

In addition to addressing these issues, this paper provides an overview regarding calculating the regular rate of pay under the FLSA. It also addresses specific problems relating to accounting for the following forms of compensation: commissions; bonuses and gifts; payments for non-work hours; reimbursements for business expenses; profit sharing, employee benefit, and stock options/purchase plans, and voluntary extra compensation. Finally, it provides tips for complying with the FLSA's regular rate requirements.

II. General Overview.

The FLSA requires employers to pay an employee one-and-one-half times his or her “regular rate” for all work performed in excess of 40 hours per week. 29 U.S.C. § 207(a)(1) (2004). The regular rate is not simply an employee's hourly wage or salary. It generally includes “all remuneration for employment paid to, or on behalf of, the employee,” including commissions, performance bonuses, and shift differentials. *Id.* § 207(e). In other words, everything of value that employers provide to employees must be included, with some statutory exceptions.

Congress implemented these statutory exceptions to encourage employers to provide certain forms of compensation without undermining employees' fundamental right to overtime pay. 146 CONG. REC. S2577 (daily ed. Apr. 12, 2000) (Joint Statement of Legislative Intent by the Sponsors of S. 2323 the Worker Economic Opportunity Act). These exceptions, discussed in some detail below, include the following:

- Gifts, including payments in the nature of gifts made at Christmas time or on other special occasions.
- Payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient

work, or other similar cause; reasonable payments for traveling expenses, or other expenses, incurred by an employee in the furtherance of his employer's interests and properly reimbursable by the employer; and other similar payments to an employee which are not made as compensation for his hours of employment.

- Discretionary bonuses, payments made pursuant to profit-sharing or savings plan, or talent fees.
- Contributions to bona fide plans for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees.
- Premium pay for hours worked by the employee in excess of eight in a day or in excess of the maximum workweek applicable to such employee or in excess of the employee's normal working hours or regular working hours.
- Premium pay for work on Saturdays, Sundays, holidays, regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in nonovertime hours on other days.
- Premium pay pursuant to an applicable employment contract or CBA for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday or workweek where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek.
- Certain stock options, stock appreciation rights, and bona fide employee stock purchase programs.

29 U.S.C. § 207(e)(1)-(8). All compensation paid to employees that does not fall within one of these exceptions must be included in the regular rate of pay calculation. 29 C.F.R. § 778.200(c).

III. Accounting for Various Forms of Compensation.

A. Commissions.

Commissions must be included in the regular rate, with the exception of certain commissions paid to retail and service establishment employees (discussed *infra* Section III.A.5.). Calculating overtime pay for commission-based employees can be tricky, particularly depending on the frequency with which the employees receive the commissions. Weekly commissions require a relatively simple calculation. When commissions are paid on some basis other than weekly, however, they must be allocated

over the time in which they were earned for purposes of calculating the regular rate and any additional overtime pay. 29 C.F.R. § 778.119.¹

1. Calculating Overtime Pay for Commissions Paid on Weekly Basis.

When an employee is paid weekly commissions, the employer must add the commissions to other earnings (except overtime premiums and other exclusions) and then divide the total by the total number of hours worked in the workweek. *Id.* § 778.118. The employee must then be paid one-half of that rate for each hour worked in excess of 40 hours. *Id.* For example, if an employee making \$10 an hour works 50 hours in one week and receives \$100 commission for that week, his regular rate of pay is \$12/hour ($\$10 \times 50 = \$500 + \$100 = \$600/50 = \12). He would thus be entitled to \$120 – or an additional \$20 of overtime pay as a result of the commission – for his work in excess of 40 hours that week. *See id.*

2. Calculating Overtime Pay for Deferred Commissions Equally Allocated Amongst the Weeks in Which It Was Earned.

Frequently, employers pay commissions to employees on some basis other than weekly. Until the time the commission is actually paid, the employer may pay the employee for overtime at a rate not less than one and one-half times the hourly rate paid to the employee, exclusive of the commission. *Id.* § 778.119. When the commission can be computed and paid, the employer must then calculate any additional overtime that is owed by apportioning it back over the workweeks of the period during which it was earned. *Id.* The employee must then be paid additional overtime for each week during the period in which he worked in excess of the applicable maximum hours standard. *Id.*

If an employee earns commissions on a monthly basis, the commission payment must be multiplied by 12 and then divided by 52 to get the amount of commission allocable to a single week. *Id.* § 778.120(a)(1). If an employee earns commissions based on a specific number of weeks, such as every 4 weeks, the commission payment must be

¹ There are some exceptions to this general rule, such as when there are delays in crediting sales or debiting returns or allowances. If such a delay occurs, the commissions may be added to the total commission earnings of the employee during the period in which they were actually paid. 29 C.F.R. § 778.121.

divided by the total number of weeks for which it represents additional compensation to get the amount of commission allocable to each week. *Id.* Once the amount of commission allocable to each week has been ascertained, the commission for that week must be divided by the total number of hours worked in that week, to get the increase in the hourly rate. *Id.* § 778.120(a)(2). Additional overtime due is computed by multiplying one-half of this figure by the number of overtime hours worked in the week. *Id.*

For example, Employee A earns a monthly commission of \$416. The amount of commission allocable to a single week for Employee A is \$96 ($\$416 \times 12 = \$4,992 / 52 = \96). If Employee A works 48 hours in one week during the month he was earning these commissions, he would be due additional overtime pay of \$8 for that week ($\$96 / 48 = \$2 / 2 = \$1 \times 8 = \8). *Id.* § 778.120(a)(2)(i). Similarly, if Employee B receives \$384 in commissions for a 4-week period and worked 44, 40, 44, and 48 hours during this period, he would be due an additional \$4.36 in overtime pay for the first and third weeks ($\$96 / 44 = \$2.18 / 2 = \$1.09 \times 4$ overtime hours = \$4.36), no extra compensation for the second week, and \$8.00 for the fourth week ($\$96 / 48 = \$2.00 / 2 = \$1.00 \times 8 = \8.00). *Id.* § 778.120(a)(2)(ii).

3. Calculating Regular Rate for Deferred Commissions Allocable to Each Hour Worked.

There may be situations where it is “inappropriate to assume equal commission earnings for each workweek,” such as when the number of hours vary significantly in each week. *Id.* § 778.120(b). In such instances, it is “reasonable to assume that the employee earned an equal amount of commission in each hour that he worked during the commission computation period.” *Id.* Thus, the commission payment should be divided by the number of hours worked in the period in order to determine the amount of the increase in the regular rate allocable to the commission payment. *Id.* One-half of this figure should then be multiplied by the number of statutory overtime hours worked by the employee in the overtime workweeks of the commission computation period to get the amount of additional overtime compensation due for this period. *Id.*

For example, Employee A was given a \$192 commission for a period in which he worked a total of 96 hours, including 16 overtime hours. *Id.* Dividing \$192 by 96 gives

a \$2 increase in the hourly rate. Thus, the employee is due an additional \$16 for the commission computation period. *Id.*

4. Basic Rate.

Overtime pay for employees paid wholly or partly on a commission basis may be computed on an established “basic rate,” in lieu of the methods described above. 29 C.F.R. § 778.122. The regulations set forth several methods of calculating a basic rate. These methods generally amount to an average of the employees’ earnings (except overtime premiums) over the course of a specified period of time. *See, e.g., id.* § 548.3. There are several conditions that must be satisfied before an employer may pay employees overtime pay based on a “basic rate,” including that the rate be agreed upon as a result of collective bargaining before the performance of the work. *Id.* § 548.2(a). Employers may also ask the Department of Labor to approve a “basic rate” that is agreed to as a result of collective bargaining. *Id.* § 548.4.

5. Retail or Service Establishment Exception.

Certain commissions paid to retail or service establishment employees need not be included in the regular rate. 29 U.S.C. § 207(i). Retail or service establishments qualify for this exception with respect to employees who work in excess of 40 hours if (1) the regular rate of pay is in excess to one and one-half times the minimum wage and (2) more than half of his compensation for a representative period (not less than one month) represents commissions on goods or services. *Id.* What constitutes a “retail or service establishment” has been the subject of much debate.

In *Gieg v. DDR, Inc.*, the court held that the exception applied to commissions earned by finance and insurance managers employed by automobile dealerships applied. 407 F.3d 1038, 1053 (9th Cir. 2005). The court noted that the relevant inquiry was not whether the particular transactions on which the plaintiff worked should be deemed retail. *Id.* at 1047. Rather, the issue was whether the dealership’s sale of automobiles was considered retail under the statute. *Id.* Thus, the focus was on the retail sales of the “establishment” as a whole and not on the individual activity of a particular employee. *Id.*

Clearly, automobile sales were retail sales. *Id.* Even though finance and insurance managers did not sell cars, they were an integral part of the dealerships' business. *Id.* at 1052-53. As a result, they did not fall outside the scope of the exemption, and the commissions they earned could be excluded from their regular rates of pay. *Id.*; *see also Schwind v. EW & Assocs., Inc.*, 371 F. Supp. 2d 560, 565 (S.D.N.Y. 2005) (noting that the retail exemption extended in some measure beyond consumer goods and services to embrace certain products almost never purchased for family or noncommercial use and holding that training and consulting firm is a retail or service establishment because the services it provides meet "the everyday needs of the community, stand at the end of a system of distribution, and serve the community at large"); *cf. Martin v. Refrigeration Sch., Inc.*, 968 F.2d 3, 9 (9th Cir. 1992) (holding that trade school that provides specialized training was not a retail establishment under section 207(i)).

Compensation programs at retail and service establishments do not always have to be specifically designated as commission-based in order to qualify for this exception. For example, *Klinedisnt v. Swift Investments, Inc.*, the Eleventh Circuit held that mechanics and other employees in an auto repair shop who are compensated on a "flat rate" or "flag rate" system are commission-based employees. 260 F.3d 1251, 1256 (11th Cir. 2001). The defendant in *Klinedisnt* was an auto repair and body shop that paid its painters based on the number of "flag hours" worked in a forty-hour work week. *Id.* at 1253. For each job, plaintiff, a painter, was compensated based on a specific number of predetermined "flag hours" that were derived from a database used by auto repair shops and insurance adjusters. *Id.* These hours did not necessarily reflect the actual time the plaintiff worked on the job. *Id.* If he worked more than or fewer than the predetermined number of hours, he would nevertheless receive the flat rate hours assigned to the job (at between \$12 and \$15 per flag rate hour). *Id.* The court held that this pay scheme was a commission-based one and, thus, could qualify for the exemption found in section 207(i). *Id.* at 1255-56 (citing Field Operations Handbook, Section 21h04(d) and 29 C.F.R. § 778.413(b), among other things). Because the plaintiff's pay in this case was derived 100% from the flat rate system, the court held that second requirement of the exemption was met, *i.e.*, that more

than half of the compensation was derived from commissions. *Id.* at 1256. However, the employer failed to set forth evidence proving that plaintiff's compensation did not fall below the one and one-half times the minimum wage threshold and remanded the case to the district court for further proceedings. *Id.* at 1257.

B. Bonuses and Gifts.

Bonuses are generally includable in the regular rate. Of course, there are several exceptions. For example, gifts and payments in the nature of gifts on special occasions are generally excludable. 29 U.S.C. § 207(e)(1). Discretionary bonuses, contributions by the employer to certain welfare plans and payments made by the employer pursuant to certain profit-sharing, thrift, and savings plans should also be excluded. *Id.* § 207(e)(3)(a). Finally, bonuses given as a percentage of total earnings are excludable, unless they are used as a device to evade the FLSA's overtime requirements. 29 C.F.R. § 778.210.

1. Gifts.

To qualify as a "gift," the payment must actually be a gift or in the nature of a gift. *Id.* § 778.212(b). If it is measured by or dependent on hours worked, production, or efficiency, or if it is paid pursuant to a contract, it falls outside the realm of this exception and must be included in the overtime pay calculations. 29 U.S.C. § 207(e); 29 C.F.R. § 778.212(b). Furthermore, if the payment is "so substantial that it can be assumed that the employees consider it a part of the wages for which they work, the bonus cannot be considered to be in the nature of a gift." 29 C.F.R. § 778.212(b).

These parameters are loosened a bit for Christmas bonuses or "special occasion" bonuses. These types of bonuses may still be excluded even though they are paid with regularity, such that the employees are led to expect it, and even though the amounts paid may vary within the employer with the salary or regular hourly rate. *Id.* § 778.212(c). "A Christmas bonus paid (not pursuant to a contract) in the amount of two weeks' salary to all employees and an equal additional amount for each 5 years of service with the firm, for example, would be excludable from the regular rate under this category." *Id.*

2. Discretionary Bonuses.

a. General Rules.

To qualify as a discretionary bonus, the employer must “retain discretion both as to the fact of payment and as to the amount until a time quite close to the end of the period for which the bonus is paid.” 29 C.F.R. § 778.212(b). “The employee has no contract right, express or implied, to any amount. If the employer promises in advance to pay a bonus, he has abandoned his discretion with regard to it.” *Id.* Any bonus promised to employees upon hiring or as a result of collective bargaining (such as, in most cases, longevity payments) must be included in the employees’ regular rates. *Id.* § 778.211(c); *O’Brien v. Town of Agawam*, 350 F.3d 279, 295-96 (1st Cir. 2003) (holding that annual lump sum payment based on length of service cannot be excluded, noting “[b]onuses that are explicitly promised to employees – as longevity payments are in the CBA – must be included in the employees’ regular rate.”); *Theisen v. City of Maple Grove*, 41 F. Supp. 2d 932, 938 (D. Minn. 1999) (holding that longevity payments must be included in regular rate); *Local 359 Gary Firefighters v. City of Gary*, No. 2:87-cv-20, 1995 WL 934175, at *7 (N.D. Ind. Aug. 17, 1995) (holding that longevity payments were not discretionary – nor were they gifts – and were to be included in the regular rate); *cf. Moreau v. Klevenhagen*, 956 F.2d 516, 521 (5th Cir. 1992) (holding that annual longevity pay need not be included in regular rate where there was no policy or promise to make the payments and the amount of the payments were determined annually). Likewise, bonuses announced to employees to motivate them to work more steadily or more rapidly or more efficiently or to remain at the employer should be included in the regular rate of pay. 29 C.F.R. § 778.211(c); *see also Haber v. Americana Corp.*, 378 F.2d 854, 856 (9th Cir. 1967) (holding that bonus provided to employees for collecting 51% or more of the accounts assigned to them was not discretionary and, thus, had to be included in the regular rate); *Wang v. Chinese Daily News, Inc.*, 435 F. Supp. 2d 1042, 1056-57 (C.D. Cal. 2006) (holding that annual bonus based on objective criteria was not discretionary and was to be included in regular rate). Thus, “[a]ttendance bonuses, individual or group production bonuses, bonuses for quality and accuracy of work, bonuses contingent upon

the employee's continuing in employment until the time the payment is to be made and the like are in this category. They must be included in the regular rate of pay." 29 C.F.R. § 778.211(c); *Landaas v. Canister Co.*, 188 F.2d 768, 771 (3d Cir. 1951) (holding that attendance bonus provided for in collective bargaining agreement must be included in regular rate of pay).

Merely reserving the "discretion" to pay a bonus in an employee handbook, or even in a collective bargaining agreement, is generally not sufficient for an employer to remove the bonus from the regular rate of pay calculation. In applying the discretionary bonus exception, courts consider all of the facts and circumstances to determine whether there is an implied contract or whether the employee has a reasonable expectation that the bonus will be received. In *Herman v. Anderson Floor Co.*, for example, the DOL sued Anderson over an efficiency bonus. 11 F. Supp. 2d 1038, 1039 (E.D. Wis. 1998). Anderson, a construction company, calculated a "job labor figure" for each job. *Id.* at 1040. It then sent crews to the job site to perform the work and a crew foreman tracked the workers' hours. *Id.* After the work was completed and the employees were paid their regular hourly wages, the company – as a bonus – divided any money remaining from the job labor figure among employees who worked on the project. *Id.* Although the efficiency bonus was beneficial for all parties, the court found that it violated the FLSA because it was not discretionary. *Id.* at 1046-47. Even though the CBA said that the crew foreman had "discretion" to pay and split up the bonus, the evidence showed that from 1994-97, the workers received this efficiency bonus 76-90% of the time. *Id.* at 1046. Thus, the court found that the labor agreement "created an expectation of 'premium pay' on a regular basis." *Id.*; see also *Wang*, 435 F. Supp. 2d at 1056 (holding that defendant's assertion that bonus was discretionary was not supported by the evidence where plaintiff received annual bonus every year for 18 years except one; thus, providing bonuses on an annual basis was a "custom").

In *Chao v. Port City Group*, a similar assertion of "discretion" in an employee handbook was not enough at the summary judgment stage to render the bonus discretionary. No. 1:04-cv-609, 2005 WL 3019779, at *3 (W.D. Mich. Nov. 10, 2005).

The employer in *Port City Group* compensated its employees based on, among other things, an hourly wage and a quarterly bonus. *Id.* at *1. The employer disputed that the quarterly bonus should be included in the regular rate of pay. *Id.* It contended that such bonus was discretionary, relying on statements it made in its employee handbook: “If the company is able to give out any type of bonus, it will be solely at the discretion of the President. ANY AND ALL BONUSES ARE DISCRETIONARY. This means that you should not count on a bonus as part of your income.” *Id.* at *3. Despite the conspicuous and uncompromising reservation of discretion, the court found that there was a material fact issue as to whether the employer truly retained it. *Id.* Indeed, the evidence showed that the quarterly bonus was paid out during 27 of the 28 quarters under investigation, which could equate to a loss of discretion. *Id.*; *see also Walling v. Richmond Screw Anchor Co.*, 154 F.2d 780, 784-85 (2d Cir. 1946) (“[The] [c]rucial fact . . . is that in fact they were regularly paid. Although the employees knew they could not legally compel the company to make those payments, no one can doubt that the employees assumed that, in the normal course of events, the employees would receive them. That seems to us to be enough to constitute them part of ‘the regular rate at which’ the men were employed.”).

b. Signing Bonuses.

An argument can be made that signing bonuses should be excluded from the regular rate. Indeed, a lump-sum payment to an employee may be excluded from the employee’s regular rate if the payment is not tied to “hours of employment or service.” *Minizza v. Stone Container Corp. Corrugated Container Div. East Plant*, 842 F.2d 1456, 1462 (3d Cir. 1988). Because a signing bonus paid at the time the employee is hired is not contingent upon the employee’s hours of employment or service (*i.e.*, the employee can quit immediately after having received the bonus and still retain the payment), employers may be able to argue that it should be excluded from the employee’s regular rate. In contrast, any part of a signing bonus that is deferred, where payment is contingent upon length of service, must be considered in the employee’s regular rate. “[B]onuses which are announced to employees to induce them . . . to remain with the firm are regarded as part of the regular rate of pay . . . [and] bonuses contingent upon the

employee's continuing in employment until the time the payment is to be made and the like are in this category." 29 C.F.R. § 778.211(c).

3. Bonuses Given As a Percentage of Total Earnings.

If a bonus is tied to the percentage of total earnings – including overtime pay – then the bonus need not be included in the regular rate. 29 C.F.R. § 778.210. For example, an agreement that the employee receive a bonus at the rate of 10% of the employee's straight-time and 10% of his overtime earnings satisfies the overtime provisions of the FLSA. *Id.* Some courts have even held that the "percentage bonus rule" may be satisfied even when no specific percentage is assigned under the employment arrangement, although such an arrangement must be carefully designed and may only apply in unique situations. *See, e.g., Brock v. Two R Drilling Co., Inc.*, 789 F.2d 1177 (5th Cir. 1986).

In *Brock*, the employer offered a bonus to each employee who worked 84 hours in a week. *Id.* at 1780. Even though the employer did not assign a specific percentage to the bonus, it was calculated as fifteen hours (one component of ten hours and another of five) of pay and, was payable only to those who worked the full eighty-four-hour regularly scheduled workweek, and met other enumerated conditions. *Id.* "Thus, as to every employee receiving the bonus, it was always the same constant percentage or fraction of each employee's total wages for the eighty-four-hour (eighty-seven with travel time) regularly scheduled workweek, namely, in each case and for every such employee, 13.57466 percent or 15/110 .5ths." *Id.* at 1180-81. Although some employees worked in excess of 84 hours on occasion, the evidence showed that these occasions were unexpected and infrequent. *Id.* at 1181. Thus, the Fifth Circuit remanded the case to the district court and allowed it to consider more evidence on this issue, but noted that the percentage-bonus rule likely allowed the employer to exclude the payment from the regular rate. *Id.*

4. Calculation Issues.

When calculation of a bonus may be deferred over a period of time longer than one week, "the employer may disregard the bonus in computing the regular hourly rate

until such time as the amount of the bonus can be ascertained.” 29 C.F.R. § 778.209.
 “When the amount of the bonus can be ascertained, it must be apportioned back over the workweeks of the period during which it may be said to have been earned.” *Id.*

For bonuses that accrue for two years or more, it is possible that such a bonus may only be apportioned back over the prior 104 weeks during which the bonus was earned because of the FLSA’s statute of limitations. In a February 12, 1999 opinion letter, the DOL stated that an employee’s profit after exercising stock options must be allocated over the period of time in which it was earned, ending with the workweek in which the option was exercised and going back to the date of the employee’s right to purchase the shares. (Op. Letter No. 2112, Op. Letter of the Wage and Hour Administrator (Feb. 12, 1999)). However, the profit may not be allocated over more than the previous two years (or 104 workweeks) due to the FLSA’s statute of limitations. *Id.* The seminal holding in this DOL opinion letter, *i.e.*, that profit made via the exercise of stock options must be included in the regular rate, was later abrogated by the Worker Economic Opportunity Act (discussed *infra* III.C.3). But the opinion indicates that the DOL believes deferred compensation of any kind cannot be spread out over a period longer than two years. *Id.*

C. Profit-Sharing, Employee Benefit, and Stock Option Purchase Plans.

1. Profit Sharing, Thrift, or Savings Plans.

The term “regular rate” shall not include “sums paid in recognition of services performed during a given period if . . . the payments are made pursuant to a bona fide profit-sharing plan or trust or bona fide thrift or savings plan” that meets the requirements of parts 547 and 549 of Chapter 29 of the Code of Federal Regulations. 29 U.S.C. § 207(e)(3)(b); 29 C.F.R. § 778.213. According to the regulations, a thrift or savings plan is bona fide if the following requirements are met:

- The thrift or savings plan constitutes a definite program or arrangement in writing, adopted by the employer or by contract as a result of collective bargaining and communicated or made available to the employees, which is established and maintained, in good faith, for the purpose of encouraging voluntary thrift or savings by employees by providing an incentive to employees to accumulate regularly and retain cash savings for

a reasonable period of time or to save through the regular purchase of public or private securities.

- The plan specifically shall set forth the category or categories of employees participating and the basis of their eligibility. The eligibility may not be based on hours of work, production or efficiency, although hours of work may be used to determine eligibility of part-time or casual employees.
- The amount any employee may save shall be specified in the plan or determined in accordance with a definite formula specified in the plan, which formula may be based on one or more factors such as the straight-time earnings or total earnings, base rate of pay, or length of service.
- The employer's total contribution in any year may not exceed 15% of the participating employees' total earnings during that year. In addition, the employer's total contribution in any year may not exceed the total amount saved or invested by the participating employees during that year; *provided, however*, that a plan permitting a greater contribution may be submitted to the Administrator and approved by him as a "bona fide thrift or savings plan" if (1) the plan meets all the other standards of this section; (2) the plan contains none of the disqualifying factors; (3) the employer's contribution is based to a substantial degree upon retention of savings; and (4) the amount of the employer's contribution bears a reasonable relationship to the amount of savings retained and the period of retention.
- The employer's contributions shall be apportioned among the individual employees in accordance with a definite formula or method of calculation specified in the plan, which formula or method of calculation is based on the amount saved or the length of time the individual employee retains his savings or investment in the plan; *provided, however*, that no employee's share determined in accordance with the plan may be diminished because of any other remuneration received by him.

29 C.F.R. § 547.1(a)-(f). The thrift or savings plan may be disqualified if any employee's participation in the plan is not voluntary, any employee's wages or salary is dependent upon or influenced by the existence of such thrift or savings plan or the employer's contributions thereto, or the amounts any employee may save under the plan, or the amounts paid by the employer under the plan, are based upon the employee's hours of work, production, or efficiency. *Id.* § 547.2.

A profit-sharing plan or trust is bona fide if the following requirements are met:

- The profit-sharing plan or trust constitutes a definite program or arrangement in writing, communicated or made available to the

employees, which is established and maintained in good faith for the purpose of distributing to the employees a share of profits as additional remuneration over and above the wages or salaries paid to employees which wages or salaries are not dependent upon or influenced by the existence of such profit-sharing plan or trust or the amount of the payments made pursuant thereto.

- All contributions or allocations by the employer to the fund or trust to be distributed to the employees are: (1) derived solely from profits of the employer's business enterprise, establishment or plant as a whole, or an established branch or division of the business or enterprise which is not recognized as such for general business purposes and for which profits are separately and regularly calculated in accordance with accepted accounting practice and (2) made periodically but not more frequently than is customary or consonant with accepted accounting practices to make periodic determinations of profit.
- Eligibility to share in the profits extends (1) at least to all employees who are subject to the minimum wage and overtime provisions of the Act, or to all such employees in an established part of the employer's business; *provided, however*, that eligibility can be determined by factors such as length of service or minimum schedule of hours or days of work and, further, eligibility need not extend to officers of the employer or (2) to such classifications of employees as the employer may designate with the approval of the Administrator upon a finding, after notice to interested persons, including employee representative, and an opportunity to present their views either orally or in writing, that it is in accord with the meaning and intent of the provisions of Section 207(e)(3)(b) of the Act
- The amounts paid to employees are determined in accordance with a definite formula or method of calculation specified in the plan or trust. The formula or method of calculation may be based on any number of factors such as straight-time earnings, total earnings, base rate of pay, straight-time hours or total hours worked by employees, or length of service, or distribution may be made on a per capita basis.
- An employee's total share may not be diminished because of other remuneration received by him.
- Provision is made either for payment to the individual employees of their respective shares of profits within a reasonable period after the determination of the amount of profits to be distributed, or for the irrevocable deposit by the employer of his employees' distributive shares of profits with a trustee for deferred distribution to such employees of their respective shares after a stated period of time or upon the occurrence of appropriate contingencies specified in the plan or trust; *provided, however*,

that the right of an employee to receive his share is not made dependent upon his continuing in the employ of the employer after the period for which the determination of profits had been made.

29 C.F.R. § 549.1. The profit-sharing plan will be disqualified if (a) the share of any individual employee is determined in substance on the basis of attendance, quality or quantity of work, rate of production, or efficiency; (b) if the amount to be paid periodically by the employer into the fund or trust to be distributed to the employees is a fixed sum; (c) if periodic payments of minimum amounts to the employees are guaranteed by the employer; (d) any individual employee's share is set at a predetermined fixed sum or is so limited as to provide in effect for the payment of a fixed sum or is limited to or set at a predetermined specified rate per hour or other unit of work or worktime; or (e) the employer's contributions or allocations to the fund or trust to be distributed to the employees are based on factors other than profits such as hours of work, production, efficiency, sales or savings in cost. *Id.* § 549.2.

2. Benefit Plans.

The “regular rate” does not include contributions made to a “bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees.” 29 U.S.C. § 207(e)(4). In order to qualify for this exclusion, several conditions must be met. First, the contributions must be made pursuant to a specific plan or program, or by contract as a result of collective bargaining, and communicated to the employees. 29 C.F.R. § 778.215(a)(1). Second, “[t]he primary purpose of the plan must be to provide systematically for the payment of benefits to employees on account of death, disability, advanced age, retirement, illness, medical expenses, hospitalization, and the like.” *Id.* § 778.215(a)(2). Third, in a plan or trust, either:

- The benefits must be specified or definitely determinable on an actuarial basis;
- There must be both a definite formula for determining the amount to be contributed by the employer and a definite formula for determining the benefits for each of the employees participating in the plan; or
- There must be both a formula for determining the amount to be contributed by the employer and a provision for determining the individual

benefits by a method which is consistent with the purposes of the plan or trust under Section 207(e)(4) of the Act.

Id. §. 778.215(a)(3)(i)-(iii). The requirements for a “formula” for determining the amount to be contributed by the employer may be met by a formula “which requires a specific and substantial minimum contribution and which provides that the employer may add somewhat to that amount within specified limits.” *Id.* § 778.215(a)(3)(iv). Fourth, the employer’s contributions must be paid irrevocably to a trustee or third person pursuant to an insurance agreement, trust or other funded arrangement. *Id.* § 778.215(a)(4). The trust or fund must be set up in such a way that the employer cannot recapture any of the contributions paid or in any way divert the funds to his own use or benefit, although the employer may recover funds accidentally paid in error or when such excess payments resulted from the necessity of marking payments to cover the estimated cost of contributions. *Id.* Fifth, the plan must not give an employee the right to assign his benefits under the plan nor the option to receive any part of the employer’s contributions in cash instead of the benefits under the plan. *Id.* § 778.215(a)(5). However, a plan may provide for the payment to an employee in cash of all or a part of the amount standing to his credit (i) as severance pay due to causes other than retirement, disability, or death, (ii) upon proper termination of the plan, or (iii) under circumstances specified in the plan and not inconsistent with the general purpose of the plan. *Id.*

3. Stock Options.

a. The Basics.

On February 12, 1999, the DOL issued an opinion letter involving an employer’s stock option program that sent shock waves through the business and political communities. In this controversial letter, the DOL opined that profit made by non-exempt employees who exercise stock options must be included in the regular rate. (Op. Letter No. 2112, Opinion Letter of the Wage and Hour Administrator (Feb. 12, 1999)). The letter prompted people like J. Randall MacDonald, Executive Vice President of Human Resources and Administration at GTE, to testify in a Congressional hearing: “If the Fair Labor Standards Act is not corrected to reverse this policy, we will no longer be able to offer stock options to our nonexempt employees.” 146 CONG. REC. S2577 (daily

ed. Apr. 12, 2000) (Joint Statement of Legislative Intent by the Sponsors of S. 2323 the Worker Economic Opportunity Act). Unions and the Clinton Administration also urged Congress to Act. And Michael Kerr, Administrator of the DOL's Wage and Hour Division, chimed in during a hearing before the House Education and the Workforce Subcommittee on Oversight and Investigations, asking Congress to amend 207(e) to include bona fide stock option programs in the items excludable from overtime calculations. 8 Employer's Guide Fair Lab. Standard Act Newsl. 4 (April 2000). Congress resolved the problem with the Worker Economic Opportunity Act, which was signed into law in on May 18, 2000. The Act amended Section 207(e) and 207(h) of the FLSA to exclude stock options and stock purchase plans from the regular rate if certain minimal criteria are met. And the Act's legislative history promotes a flexible approach, indicating that the statute should be broadly construed to include stock option and similar "equity" based plans that may not technically fit the statute's requirements.

In order to qualify for the exemption, four statutory requirements must be satisfied. First, the employer must provide the employee with information that explains the terms and conditions of the program when the employee begins participating in the program or when the employer grants the employees stock options or stock appreciation rights. 29 U.S.C. § 207(e)(8). According to the legislative history, the timing of the communication is "flexible, because often it is difficult to have materials ready for employees at the beginning of a stock option or stock appreciation right program, immediately following approval by the Board of Directors, because of confidentiality requirements." 146 CONG. REC. S2578 (daily ed. Apr. 12, 2000).

Second, the stock option or stock appreciation rights are not exercisable for at least a six month period after the grant – unless the employee dies, becomes disabled, or retires, or there is a change in corporate ownership – and the options or appreciation rights to offered at not more than a 15% discount off the fair market value of the stock or the stock equivalent determined at the time of the grant. 29 U.S.C. § 207(e)(8)(B).²

² For a publicly traded stock, it is reasonable to determine the fair market value based on averaging the high and low trading price of the stock on the date of the grant or equal to the average closing price over a period of days ending with or shortly before the grant date (or the average of the highs and

Third, the employees' exercise of any grant or right must be voluntary. 29 U.S.C. § 207(e)(8)(C). Fourth, where the stock options or stock appreciation rights program is based on the performance of a business unit or employee, then the determinations of such options or rights must be made:

- Based on future performance meeting previously established criteria (such as hours or work, efficiency or productivity) of a business unit consisting of at least 10 employees, or of an entire facility of any size. An employer may impose certain eligibility criteria on all employees before they may participate in a grant or right based on the performance criteria, including length of service or minimum schedules of hours or days of work; or
- Based on the employee's past performance, so long as the determination remains at the sole discretion of the employer and not according to any prior contract requiring the employer to do so.

Id. § 207(e)(8)(D).

b. Broadly Construed?

As noted, Congress included a detailed statement of legislative intent in the Congressional Record. 146 Cong. Rec. S2576-81 (April 12, 2000). Because the statement was so comprehensive, the DOL decided not to issue any regulations. Instead, it refers those seeking guidance regarding stock options to this statement of legislative intent. *See* U.S. DEPARTMENT OF LABOR, EMPLOYMENT STANDARDS, ADMINISTRATION WAGE HOUR DIVISION FACT SHEET #56: STOCK OPTIONS UNDER THE FAIR LABOR STANDARDS ACT (FLSA) (<http://www.dol.gov/esa/regs/compliance/whd/whdfs56.htm>) (“After the reviewing the clear statutory language and a thorough statement of legislative intent, the Department has determined that rulemaking is not necessary and refers the reader to the statute and Congressional Record for additional information.”). In essence, then, the DOL has adopted the legislative statement.

(continued...)

lows on each day). 146 CONG. REC. S2579 (daily ed. Apr. 12, 2000). For a non-publicly traded stock, any reasonable valuation that is made in good faith and based on reasonable valuation principles must be used. *Id.* Consistent with the theme of flexibility, the sponsors “encourage the Secretary to consider and evaluate other changes in employees’ status or circumstances” when determining whether the exercise of the options meets this criteria. *Id.* at S2578-79.

This is good news for employers and employees. The sponsors of the Act make it abundantly clear that stock option and similar plans should be encouraged, and thus, the provisions of the Act should be flexible and liberally construed. Indeed, they urge the DOL to consider the purposes of the Act when reviewing new stock purchase plans:

The sponsors believe that it is in the best interests of employees for the Secretary of Labor to review these and other new types of plans carefully in light of the purpose of the Worker Economic Opportunity Act – to encourage employers to provide opportunities for equity participation to employees – and to allow Section 207(e), as amended, to accommodate a wide variety of programs, where it does not undermine employees’ fundamental right to overtime pay. It is the sponsors’ vision that this entire law be flexible and forward-looking and that the Department of Labor apply and interpret it consistently with this vision.

146 CONG. REC. S2578 (daily ed. Apr. 12, 2000) (Joint Statement of Legislative Intent by the Sponsors of S. 2323 the Worker Economic Opportunity Act). This overwhelming endorsement of “equity participation” in a “wide variety of programs” could be relied upon to broaden the coverage of the Act to programs that are not traditionally considered “stock option” plans. *See also id.* at S2576 (stating that the purpose of the Act “is to allow employees who are eligible for overtime pay to continue to share in the workplace benefits that involve their employer’s stock or similar equity-based benefits.”). *But see Mitchell v. Ky. Fin. Co.*, 359 U.S. 290, 295-96 (1959) (exceptions from the FLSA are to be narrowly construed against the employer); *Minizza v. Stone Container Corp. Corrugated Container Div. East Plant*, 842 F.2d 1456, 1459 (3d Cir. 1988) (same); *Guthrie v. Lady Jane Collieries, Inc.*, 722 F.2d 1141, 1143 (3d Cir. 1983) (same).

D. Payments for Nonwork Hours.

1. General Rules.

Section 207(e)(2) of the FLSA provides that the term “regular rate” shall not include “payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause . . . and other similar payments to an employee which are not made as compensation for his hours worked.” 29 U.S.C. § 207(e)(2). The logic behind this

exception is that such payments are not made as compensation for the employee's hours worked and should include infrequent, sporadic, and unpredictable types of absences. 29 C.F.R. § 778.218(b). Thus, it does not include lunch periods or regularly scheduled days of rest. *Id.* However, employers may pay employees for meal times and exclude such times from the regular rate if they agree with their employees not to treat such times as hours worked. *Id.* § 778.320(b); *see also Ballaris v. Wacker Siltronic Corp.*, 370 F.3d 901, 909 (9th Cir. 2004) (“We conclude that the payments for the lunch periods constituted an additional benefit for employees and not compensation for hours worked, and thus are properly excluded from the calculation of the regular rate under 29 U.S.C. § 207(e)(2) as interpreted by revised Section 778.320.”); *Reich v. Lucas Enterps., Inc.*, 2 F.3d 1151, 1993 WL 307080, at *3 (6th Cir. Aug. 12, 1993) (holding that employer's voluntary payments to employees for lunch hours should not be included in the regular rate because they were not compensation for hours worked).

2. Regulatory Guidance.

The regulations attempt to shape the parameters of the exception found in Section 207(e)(2) by defining several of its terms and phrases. For example, according to the regulations, the phrase “failure of the employer to provide sufficient work” refers to those times where the employee would “normally be working but for such a factor as machinery breakdown, failure of affected supplies to arrive, weather conditions affecting the ability of the employee to perform the work and similarly unpredictable obstacles beyond the control of the employer.” 29 C.F.R. § 778.218(c). The term does not include reduction in work schedule, ordinary temporary layoff situations, or any type of routine, recurrent absence. *Id.* Moreover, with respect to the term “other similar causes,” the regulations state that it should include absences that are not routine and sporadic such as those due to “jury service, reporting to a draft board, attending a funeral of a family member, [and] inability to reach the workplace because of weather conditions.” *Id.* § 778.218(d).

The regulations also provide illustrations of common themes with respect to Section 207(e)(2). For instance, if an employee (a) works on a holiday or vacation day,

(b) is entitled to vacation or holiday pay, and (c) is paid for work in addition to what he is entitled to, the amount he is paid allocable to holiday or vacation pay is still to be excluded from the regular rate. 29 C.F.R. § 778.219(a). In other words, assume Employee A makes \$5 an hour and usually works a 6-day 48-hour week. *Id.* § 778.219(a)(1). He is also entitled to one week’s paid vacation in the amount of his usual straight-time earnings. *Id.* If Employee A foregoes his vacation and works 50 hours instead, he is owed \$250 as his total straight time earnings. *Id.* He is also entitled to an additional \$240 as his vacation pay. *Id.* His regular rate of \$5 per hour is not increased, however, by his vacation pay. *Id.* Thus, he is entitled to \$25 as overtime premium for the 10 hours he worked in excess of 40. *Id.*

Moreover, employers who provide pay to “show-up,” “reporting,” or “call-back” pay or other payments “similar to ‘call-back’ pay” do not need to include such pay in their employees’ regular rates. *Id.* § 778.220-.222. To illustrate, Employee B is paid \$5 per hour reports to work on Monday and is sent home after being given only 2 hours of work. *Id.* § 778.220(b). He then works 8 hours each day on Tuesday through Saturday, making a total of 42 hours for the week. *Id.* The employment agreement applicable to Employee B says that he is to receive a minimum of 4 hours work or pay for reporting for scheduled work. *Id.* He thus earns not only the \$10 for the 2 hours of work on Monday, but also \$10 for 2 hours of “show-up” pay. *Id.* Because this pay is not regarded as compensation for hours worked, the employee’s regular rate remains \$5. *Id.*

3. Problems Arising from the Phrase “ Other Similar Payments.”

Section 207(e)(2) allows “other similar payments to an employee which are not made as compensation for his hours of employment” to be excluded from the regular rate. 29 U.S.C. § 207(e)(2). According to the regulations, “other similar payments” must be “ ‘similar’ in character to the payments specifically described in Section 207(e)(2).” 29 C.F.R. § 778.224. The regulations then provide the following non-exhaustive list of examples to illustrate the types of payments that may be excluded: (1) sums paid to an employee for the rental of his truck or car, (2) loans or advances made by the employer to the employee, and (3) the cost to the employer of conveniences furnished to the employee

such as parking space, restrooms, lockers, on-the-job medical care and recreational facilities. *Id.* § 778.224(b).

As one might expect, employers have tried to fit numerous types of payments into the “other similar payments” exception, which has led to litigation over the scope of the phrase. In *Featsent v. City of Youngstown*, the employer argued that education bonuses, bonuses for absence of medical claims and nonuse of sick leave, and longevity pay were all payments excepted from the regular rate under Section 207(e)(2). 70 F.3d 900, 904-05 (6th Cir. 1995). The court held that the education bonuses and longevity payments compensated the employees for their services and, thus, did not meet the strictures of the Section 207(e)(2) exception. *Id.* The bonuses for the absence of medical claims and nonuse of sick leave, however, did. *Id.*; see also *Baker v. Barnard Constr. Co.*, 146 F.3d 1214, 1217-19 (10th Cir. 1998) (holding that return travel time associated with refueling and restocking welding rigs was “integral and indispensable” to employees’ principal activities and, thus, could not be excluded from the regular rate as an “other similar payment”); *Utility Workers Union of Am. v. S. Cal. Edison Co.*, 83 F.3d 292, 295-96 (9th Cir. 1996) (holding that supplements to disabled employees’ wages with additional payments when those employees are placed in lower-paying jobs due to disability must be included in the regular rate of pay when calculating the employees’ pay for overtime purposes under the FLSA).

And courts have struggled to determine what “other similar payments” should include, sometimes arriving at contradictory conclusions. Indeed, there is a split in authority regarding whether sick leave buy-back programs are covered by this particular exception. As discussed above, the Sixth Circuit held that bonuses for the absence of medical claims and nonuse of sick leave are unrelated to the compensation for services and hours worked, and thus, qualify for the exemption. *Featsent*, 70 F.3d at 904-05. The Eighth Circuit, on the other hand, takes the opposite view. It rejected *Featsent* and characterized bonuses for the absence of sick leave – aka sick leave “buy-back” plans – as attendance bonuses, which are to be included in the regular rate. *Acton v. City of Columbia*, 436 F.3d 969, 977-79 (8th Cir. 2006).

Another conflict in the circuits centers around lump sum payments for what employers have argued are not tied to hours worked. In *Minizza v. Stone Container Corp. v. Corrugated Container Div. East Plant*, the court held that lump sum bonuses paid to employees who met certain eligibility requirements as an inducement to get the employees to enter into a collective bargaining agreement were “other similar payments” and, thus, could be excluded from the regular rate. 842 F.2d 1456, 1460-61 (3d Cir. 1988). The Seventh Circuit in *Reich v. Interstate Brands Corp.* held that the payments at issue there were not “other similar payments” and distinguished *Minizza*, holding that the Third Circuit essentially treated the payments at issue similar to those received in litigation. 57 F.3d 574, 578 (7th Cir. 1995). *Interstate Brands*, on the other hand, stemmed from a bakery workers’ union strike staged in 1972, in which the union demanded that bakers receive two consecutive days off each week. *Id.* at 575. The strike ended with a compromise. *Id.* The workers received higher wages, and the employers could require bakers to work without two consecutive days off as long as they paid a penalty. *Id.* That penalty required each employer to pay \$12 per worker per week into a fund each time the employer issued a schedule to a baker that did not provide two consecutive days off. *Id.* In November of each year, the employer was then required to distribute these “earned work credits” to all bakers still on the payroll, according to the number of weeks each went without two-day breaks. *Id.*

Unlike the payments in *Minizza*, the Seventh Circuit held that the earned work credits paid to bakers were tied to work schedules that the employees disliked. *Id.* at 578. The word “similar” in Section 207(e)(2) refers to “other payments that do not depend at all on when or how much work is performed.” *Id.* at 578-79 “An extra payment made because the workplace is unpleasant, or the hours irregular, is no different in principle from a higher base rate compensating the employee for smelly or risky tasks, foul-tempered supervisors, or inability to take consecutive days off.” *Id.* at 578-79.

Accordingly, Section 207(e)(2) of the FLSA does not exclude the earned work credits from the regular rate. *Id.* at 579.³

4. No Offsets Allowed.

The issue of whether payments made to employees that are excluded from the regular rate under Section 207(e)(2) can be used as a credit toward overtime frequently arises. The answer is no. Payments for non-work hours under Section 207(e)(2) cannot offset wages or overtime compensation. 29 U.S.C. § 207(h); *Ballaris v. Wacker Siltronic Corp.*, 370 F.3d 901, 913-14 (9th Cir. 2004); 29 C.F.R. § 778.216, 778.320(b). Section 207(h) of the FLSA provides the exclusive list of extra compensation that shall be creditable toward overtime compensation (*i.e.*, payments described in sections (e)(5)-(7)), and payments made for non-work hours do not appear on this list. 29 U.S.C. § 207(h); *see also Wheeler v. Hampton Twp.*, 399 F.3d 238, 245 (3d Cir. 2005) (“Where a credit is allowed, the statute says so.”).

IV. Reimbursements for Business Expenses.

The regular rate of pay shall not include “reasonable payments for traveling expenses, or other expenses, incurred by an employee in furtherance of his employer’s interests and properly reimbursable by the employer.” 29 U.S.C. § 207(e)(2). “Such payment is not compensation for services rendered by the employees during any hours worked in the workweek.” *Id.* § 778.217(a). The central inquiry regarding this exception is whether the reimbursements are made “solely by reason of action taken for the convenience of the employer.” *Id.* The DOL affords a non-exhaustive list of illustrations in which per diem payments “will not be regarded as part of the employee’s regular rate.” *Id.* § 778.217(b). These illustrations include the amount expended by an employee in purchasing supplies, tools, and equipment; the amount expended by an employee for purchasing or laundering uniforms, travel expenses, living expenses away from home; and “supper money.” *Id.* Only the actual or “reasonably approximate amount” of the expense falls within the exception. *Id.* § 778.217(c). “If the amount paid as

³ The court suggested, however, that they may be excluded if the requirements of Section 207(e)(7) are met, as the payments are akin to premium payments excluded under that section. *Id.*

‘reimbursement’ is disproportionately large, the excess amount will be included in the regular rate.” *Id.*

Much of the litigation regarding this exception involves situations where employers make “per diem” payments for which the employer does not require a receipt or proof of purchase for reimbursement. For example, in *Berry v. Excel Group, Inc.*, the employer was an electrical subcontracting firm who hired the plaintiff, an electrician, and paid him \$17 per hour plus a “per diem” of \$100 per week. 288 F.3d 252, 253 (5th Cir. 2002). The employee lived 100 miles from the job-site. *Id.* The travel to and from the job-site was primarily for the employer’s benefit, and the \$100-\$150 per week was “certainly not excessive.” *Id.* at 254. The fact that the employer paid others this “per diem” allowance was irrelevant, as the FLSA requires the expenses to be examined on a case-by-case basis. *Id.* Accordingly, because the per diem paid to the plaintiff was reasonable and appropriate, it was properly excludable from the regular rate. *Id.*; *see also Acton v. City of Columbia*, No. 03-4159-cv-NKL, 2004 WL 2152297, at *6 (W.D. Mo. Sept. 10, 2004) (holding that meal allowance for firefighters was excludable, even though the meal allowance program operated as an advance and not a reimbursement in the traditional sense, because the payment was for the convenience of the employer); *Brennan v. Padre Drilling Co.*, 359 F. Supp. 462, 466 (S.D. Tex. 1973) (holding that per diem of \$1 per hour worked per diem was a “reimbursement” excludable from the regular rate because, among other things, it was a “reasonable approximation of the travel and other expenses incurred by the employee over a period of time, and in traveling varying distances to different rig locations”); *cf. Picton v. Excel Group, Inc.*, 192 F. Supp.2d 706, 713-14 (E.D. Tex. 2001) (refusing to grant summary judgment for the employer regarding per diem reimbursements because employer failed to meet burden with respect to each employee in collective action).

V. Voluntary Extra Compensation

Voluntary extra compensation – also commonly referred to as “premium payments” – is a hot button area for employers seeking to incentivize their employees to work odd hours or otherwise undesirable shifts. Numerous industries are affected by this

particular exception, including the health care, retail, and manufacturing sectors. Some “premium payments” undoubtedly must be included in the regular rate, *e.g.*, extra compensation in the form of shift differentials, extra compensation paid as an incentive for the rapid performance of work, and lump sum premiums paid without regarding to the number of hours worked. 29 C.F.R. § 778.207(b); *see, e.g., Dooley v. Liberty Mut. Ins. Co.*, 369 F. Supp.2d 81, 84-85 (D. Mass. 2005) (holding lump sum premium payment for Saturday work must be included in regular rate). Three types of “extra compensation,” however, must be excluded, (1) premium pay for hours worked in excess of the daily or weekly standard, (2) premium pay for work on Saturdays, Sundays, and (3) other “special days,” and “clock pattern” premium pay. 29 U.S.C. § 207(e)(5)-(7). Moreover, these three types of premium payments may be credited toward overtime compensation due under Section 207(a) for work in excess of the applicable maximum hours standard; no other types of remuneration may be so credited. *Id.* § 207(h)(1)-(2).

A. Premium Pay for Hours in Excess of Daily or Weekly Standard.

Section 207(e)(5) of the FLSA provides that the following form of extra compensation may be excluded from the regular rate:

Extra compensation provided by a premium rate paid for certain hours worked by the employee in any day or workweek because such hours are hours worked in excess of eight in a day or in excess of the maximum workweek applicable to such employee under subsection (a) of this section or in excess of the employee’s normal working hours or regular working hours, as the case may be.

29 U.S.C. § 207(e)(5). Case law generally suggests that section 207(e)(5) applies where the employer pays overtime on a contractual basis for work in excess of eight in a day or a fixed number of hours in a week. *See, e.g., Acton v. City of Columbia*, 436 F.3d 969, 979 (8th Cir. 2006) (“Section 207(e)(5), by its own terms, limits its applicability to payments made for certain hours worked in excess of the employee's normal daily or weekly schedule.”)⁴; *Brennan v. Valley Towing Co., Inc.*, 515 F.2d 100, 108 (9th Cir.

⁴ It should be noted that *Acton* suggested, in what is arguably dicta, that Section 207(e)(5) is applicable only where the employer's premium rate is time-and-one-half the employee's non-premium rate. *See Acton*, 436 F.3d at 479. This position is not supportable under the language of 29 U.S.C. § 207(e)(5),

1975) (finding the key question to be whether “the agreements providing for higher hourly pay for afterhours work were primarily in the nature of overtime pay agreements rather than production incentive arrangements or night shift differentials”); *Laboy v. Alex Displays, Inc.*, No. 02-c-8721, 2003 WL 21209854 at *4 (N.D. Ill. May 21, 2003) (stating that Section 207(e)(5) is applicable “so long as the overtime compensation is contingent upon the employee having worked in excess of eight hours in a day or a specified number of hours in the workweek”); *Parisi v. Town of Salem*, No. 95-67-JD, 1997 WL 228509 at *2 (D.N.H. Feb. 20, 1997) (“[W]here an employer pays compensation at a premium rate for hours worked in excess of the employee's regular schedule, the premium portion of such pay . . . is not properly considered in computing the employee's regular rate. . . .”).⁵ On the other hand, courts have tended to find that where the employer pays a premium based on criteria other than work beyond regularly scheduled hours – even if the employee typically must work overtime to receive the payment – Section 207(e)(5) does not apply. *See, e.g., Brock*, 789 F.2d at 1179 (finding Section 207(e)(5) inapplicable where employer's premium payment was conditioned not only upon overtime hours worked, but also upon factors such as reporting to work on time, arriving in property physical and mental condition, assembling personal attire properly, and remaining on

(continued...)

which contains no such requirement. *Compare* 29 U.S.C. § 207(e)(6) & (e)(7). Moreover, the *Acton* position appears to have been rejected by every other court considering the matter. *See, e.g., Kolheim v. Glynn County, GA.*, 915 F.2d 1473, 1481 (11th Cir. 1990) (noting Section 207(e)(5) applies to all premiums falling within its definitions, “not just those equal to or greater than 1 ½ times the regular rate”); *Bell v. Iowa Turkey Growers Coop.*, 407 F. Supp. 2d 1051, 1059 (S.D. Iowa. 2006) (noting that Section 207(e)(5) contains no requirement that the premium rate be at least one and one-half times the rate established for nonovertime hours); *Laboy v. Alex Displays, Inc.*, No. 02-c-8721, 2003 WL 21209854 at *4 (N.D. Ill. May 21, 2003) (similar statement to *Kolheim*).

⁵ In *Alexander v. U.S.*, the plaintiffs, border patrol agents, occasionally performed immigration inspection duties “in addition to their border patrol duties.” 32 F.3d 1571, 1572 (Fed. Cir. 1994). These additional activities mostly took place during weekday evening hours, Sundays, and holidays. *Id.* A federal statute provided that border agents “who may be required to remain on duty” to perform inspection duties during weekday evening hours, Sundays, or holidays would receive extra compensation at varying levels. *Id.* at 1574 & n.3. For the extra weekday work, this premium compensation varied depending upon the number of hours worked; for the Sunday and holiday work, employees received double time. *Id.* With relatively little discussion, the court concluded that these premiums “constitute[d] ‘extra compensation provided by a premium rate’” and that they fell “within the statutory exception[] under 29 U.S.C. § 207(e)(5).” *Id.* at 1577.

property between shifts); *Bell v. Iowa Turkey Growers Co-op.*, 407 F. Supp. 2d 1051, 1057-58 (S.D. Iowa 2006) (finding Section 207(e)(5) inapplicable where sixth day premium payments were made regardless of the number of hours previously worked).⁶

One recurring issue regarding this particular form of premium payment arises with employers who typically pay their employees for vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar causes. As a general matter, pay for these non-work hours are to be excluded from the regular rate under Section 207(e)(2). But the hours themselves may be counted as hours worked when attempting to determine whether the premium pay for hours worked in excess of 8 in a day or 40 in a week should be provided. 29 C.F.R. § 778.202(a).

Many employers have employees whose normal working hours are greater or less than normal (*e.g.*, 7 hours per day or 35 hours per week). An employer may still provide premium payments that are excludable from the regular rate with respect to such employment arrangements. 29 U.S.C. § 207(e)(5) (“[E]xtra compensation provided by a premium rate paid for certain hours worked . . . in excess of the employee’s normal working hours or regular working hours”); 29 C.F.R. § 778.202(b) (accord). These types of payments are true overtime premium payments and are excludable from the regular rate. 29 C.F.R. § 778.202(b). They are also creditable toward overtime compensation. *Id.*

However, such employment arrangements provide fertile ground for abuse. The regulations attempt to address this with provisions clarifying that employers may not creatively evade overtime requirements by dividing a normal workday into a “straight time” period – to which one hourly rate is assigned – followed by a so-called “overtime” period – to which a higher “rate” is specified. 29 C.F.R. § 778.202(c). The DOL considers this arrangement to be a device that undermines the FLSA’s purposes, and thus, the premiums will be considered part of the regular rate. *Id.* § 778.202(c), 778.501. In

⁶ In *Dunn v. County of Muskegon*, No. 1:97-cv-01003, 1998 WL 34302060 at *4 (W.D. Mich. Nov. 5, 1998), the court rejected the plaintiffs’ contention that Section 207(e)(5) was inapplicable where premium payments were made in connection with a CBA.

other words, an employer cannot artificially break up an eight-hour day into four hours of “straight time” and four hours of “overtime” in order to lower the regular rate.

B. Premium Pay for Work on Saturdays, Sundays, and Other “Special Days.”

Section 207(e)(6) of the FLSA provides that the following form of extra compensation may be excluded from the regular rate:

Extra compensation provided by a premium rate paid for work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in nonovertime hours on other days.

29 U.S.C. § 207(e)(6). Unlike the premium pay exclusion in Section 207(e)(5), this particular “extra compensation” exclusion (as well as the Section 207(e)(7) exclusion discussed below) is that the premium rate must be at least one and one-half times the rate established in good faith for similar work performed in nonovertime hours. *See* 29 C.F.R. § 778.203(a); *see, e.g., Bell*, 407 F. Supp. 2d at 1059-60 (holding that employer was entitled to exclude “sixth-day” premiums that were one and one-half times the employees’ hourly rate of pay because the purpose of such premiums was to compensate employees for their scheduled day off). As the Seventh Circuit explained in *Interstate Brands*:

[I]f [an employee's] regular weekday rate were \$10 and the rate for Sunday work were \$15, the Sunday premium would not be figured back into the “regular rate,” and time-and-a-half pay for overtime during the week would remain at \$15. But if the Sunday rate were \$14, the extra pay would be included in the “regular rate,” raising the overtime rate for both weekdays and Sundays.

Interstate Brands, 57 F.3d at 578.

The unique requirement leads to potential problems with respect to pieceworkers or employees who have two or more different rates of pay. In such situations, the premium must be one and one-half times either (1) the “bona fide” rate applicable to the type of job the employee performs on the Saturday, Sunday, holiday, or “special day,” or (2) the average hourly earnings in the week in question. 29 C.F.R. § 778.203(b) (noting

that the rate has to be established in good faith in order to avoid “fictitious schemes and artificial or evasive devices discussed in Subpart F.”)

The term “holiday” means those days customarily observed in the community in celebration of some historical or religious occasion. *Id.* § 778.203(c). Giving someone an “arbitrary day of rest” – as opposed to a “regular” one – will not bring the payment under the purview of this exception. *Id.* Moreover, asking someone to report to work less than 24 hours in advance and then paying a premium does not satisfy the standard. *Id.* § 778.203(d). Such a premium must be included in the regular rate, as it amounts to a penalty to the employer for not giving enough notice. *Id.*

C. “Clock Pattern” Premium Pay.

Section 207(e)(7) of the FLSA provides that the following form of extra compensation may be excluded from the regular rate:

Extra compensation provided by a premium rate paid to the employee, in pursuance of an applicable employment contract or collective-bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not exceeding eight hours) or workweek (not exceeding the maximum workweek applicable to such employee under subsection (a) of this section, where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek.

29 U.S.C. § 207(e)(7). To qualify for this exception, the premium pay must be for work performed outside of the hours established as the basic workday or workweek and not for some other reason. 29 C.F.R. § 778.204(a). If the basic workday is established in good faith as 8 a.m. to 5 p.m., a premium for time worked between 5 p.m. and 8 a.m. is a true overtime premium. *Id.* § 778.204(b). However, where the contract does not provide for the payment of a premium except for work between midnight and 6 a.m., the premium would not qualify under this section since it is not a premium paid for work outside the established workday but only for certain special hours outside the established workday. *Id.* Similarly, where payments for work after 5 p.m. are made only if the employee had a meal or rest period, such payments are not true overtime premiums. *Id.*

The statute requires the premium to be paid “in pursuance of an applicable employment contract or collective bargaining agreement.” 29 U.S.C. § 207(e)(7). The agreement may be written or oral. 29 C.F.R. § 778.204(c); *see, e.g., Brock v. Wilamowsky*, 833 F.2d 11, 16 (2d Cir. 1987) (noting that it was “questionable” whether there was a contract to pay evening and night premiums, but in all events, the premium did not meet exception because it was not one and one-half times the employees’ hourly rate). If the agreement is written and the practices of the parties differ from such agreement, however, the regulations provide that it must be determined whether the practices of the parties have modified the contract. *Id.*

Collective bargaining agreements between longshoreman and their employers provide a good example of the type of an agreement to pay this type of premium. *See, e.g.,* 29 C.F.R. § 778.206. One typical CBA may provide that a normal workday and workweek is Monday through Friday 8 a.m. to 12 noon and then 1 p.m. to 5 p.m. *Id.* Work outside such workday and workweek is paid for at premium rates not less than one and one-half times the bona fide straight-time rates. *Id.* For example, if an employee is paid \$5 per hour under such an agreement for handling cargo during the basic, normal, or regular workday and \$7.50 per hour for like work outside such workday, the extra \$2.50 will be excluded from the regular rate and may be credited to overtime pay due under the Act. *Id.*

VI. Conclusion and Tips for Compliance.

In the coming years, federal courts may see a surge in lawsuits alleging miscalculations of the regular rate of pay. These sorts of FLSA claims are fundamentally and philosophically different than off-the-clock and misclassification claims, which involve alleged FLSA violations that, when corrected, generally result in better pay for employees. That may not be so in the regular rate arena. Congress created exceptions to inclusions within the regular rate to encourage employers to provide extra forms of compensation, such as gifts, discretionary bonuses, stock options, pay for non-work hours, premium payments, and the like. By tagging employers with liability for making these payments because they do not technically comply with one or more myriad regulations,

courts run the risk of contravening Section 207's purpose and actually harming employees in the long run.

Until the current scheme is overhauled, however, employers should consider the following strategies for compliance with respect to some of the more common forms of compensation in addition to an hourly wage:

- With respect to discretionary bonuses, include multiple representations in employee handbooks, policies, and, to the extent possible, collective bargaining agreements that the bonuses are discretionary both as to whether they are to be paid and the amount of any payment. Such provisions do not guarantee compliance, but they do not hurt. In addition, if possible, tie any bonus provided to employees to a percentage of both straight-time and overtime earnings. Such bonuses comply with the FLSA's overtime provisions and need not be included in the regular rate.
- With respect to bonuses or commissions that are deferred for longer than two years, refrain from allocating such compensation to a period that exceeds 104 workweeks. The Department of Labor may take the position that such a scheme violates the FLSA.
- Carefully consider the requirements for "extra compensation" and premium payments from Sections 207(e)(5)-(7), and understand that a mere shift differential must be included in the regular rate.
- For employers who want to provide incentives to employees to work certain shifts, consider implementing a system like the one found in 29 C.F.R. § 778.202(b). That is, genuinely make the standard workweek less than 40 hours and/or the standard workday less than 8 hours, and provide premiums to those who work more than that.
- If an employer meets the FLSA's requirements for a retail or service establishment, the employer should consider compensating its employees by commission. If the commissions make up more than half of the employee's compensation and the regular rate of pay is 150% of the minimum wage, the commissions may be excluded from the regular rate.