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Regular Rate Under The FLSA: The Time Bomb Waiting To Explode?

The Editor interviews Stanley Weiner, Partner, Jones Day.

Editor: Please describe for our readers why calculating overtime for non-exempt employees in determining their regular rate of pay is such a complex issue.

Weiner: While the Fair Labor Standards Act has not been significantly changed in over 50 years, there has been an explosion of wage-hour litigation over the last five to seven years. The issue of the “regular rate” has not been part of this litigation explosion – at least until now. When the FLSA was passed, compensation systems were simpler. And, you did not have the large white-collar work force we have today nor large labor shortages in industries such as healthcare where employers have to figure out creative compensation programs to recruit and retain employees. The regulations and the statute have not kept pace with the changes in the workplace. The workplace has changed dramatically, but the statute has remained static.

Today a company may have hundreds of different pay codes, and offer all sorts of incentives, bonuses and commission-type payments to make the workforce more productive, or to induce workers to take on certain hours and types of work, or be flexible about their schedules.

When speaking with clients about this issue, they are surprised when they find that often their payroll people are including a lot of payments to employees in the regular rate of pay calculation that they do not have to include, that they may not be including items which they are required to include and that there are many questionable items which are not being reviewed. Employers are spending a lot of time worrying about complying with exemption



Stanley Weiner

and off the clock issues which have been the focus of the recent wave of litigation. They have not focused on regular rate issues.

Editor: Is there pending legislation in Congress to reflect the changes in the workplace?

Weiner: Nothing can be expected. The last effort by the Department of Labor to modernize the white-collar exemptions created a political firestorm, even before the shift in power in Congress. Now that the Democrats are in control, if there is any legislation in this area, it would be to require employers to include more types of pay in the regular rate, not less.

Editor: Why is the Department of Labor’s \$34 million settlement with Wal-Mart so significant?

Weiner: The settlement raised the visibil-

ity of the long-dormant regular rate issues. The DOL has called the settlement, a substantial part of which dealt with regular rate issues, the “gold standard” for future settlements. We can expect the DOL and plaintiffs’ counsel to attempt to use this as a means of requiring other employers to settle on a similar basis.

Editor: What was the primary issue in that case?

Weiner: As reflected in public sources, it arose from Wal-Mart’s internal discovery that it was not properly calculating and paying certain types of compensation. This included how and whether certain payments, such as bonuses, were included in calculating the regular rate of pay. It concerned both the calculation itself, as well as the timing and payment of certain compensation.

Editor: What about class certification issues which come about where large groups of employees are involved?

Weiner: That is where the battle is often won or lost in wage-hour litigation. Many settlements occur before a case is certified as a collective or class action; avoidance of certification is a primary goal of defendants in these cases. If the issue is simply that of regular rate, there is little debate in many cases. It is hard to argue that individual decisions predominate in a regular rate case – when all employees are affected the same way by the same uniform practice. Moreover, under the FLSA, the bar for certification is much lower than in a traditional class action. This makes it more difficult for an employer in a regular rate case to avoid certification as compared to other types of wage-hour cases.

Please email the interviewee at sweiner@jonesday.com with questions about this interview.

Editor: Has the plaintiffs' bar become interested in these cases?

Weiner: More and more, often as part of other wage-hour litigation. One prominent plaintiff's lawyer refers to regular rate claims as "low hanging fruit."

Editor: What is included in the term "regular rate"?

Weiner: The statute says that you have to include all remuneration paid to an employee and then it has a series of exceptions, the major ones being occasional gifts, Christmas bonuses of up to two weeks, holiday pay, payments for illness and other time off, travel expenses and "other similar payments paid to an employee which are not made as compensation for his hours of work." Much of the litigation is over whether the payment is compensation for hours of work or not. Some courts have taken a narrow view looking only at the enumerated list of exclusions and others have said that as long as it is not compensation for services rendered it is excluded.

Editor: What is the driving force behind the suits filed by employees?

Weiner: Many of the lawsuits are brought by employees because they do not understand their pay checks, not because they feel cheated. Some hours are paid at certain rates and other hours at other rates. They want to know why they are paid overtime at certain times and not at others. The complexity of the pay system makes the paycheck more complicated. Many companies have outsourced payroll, so there is often no one in-house who can give an adequate explanation. I would wager that half of the suits filed could have been forestalled if employees had gotten timely and understandable responses from their employers to their questions.

Editor: Please enumerate some of the areas in the FLSA where employers can easily fall into a trap, such as the bonus system.

Weiner: Employers need advice in constructing a bonus system that does not have to be included in the regular rate of pay. The basic rule is that a bonus can be excluded if it is discretionary as to whether it is paid and as to the amount of any payment. While the typical bonus plan may have "discretionary" language, the courts will look at actual historical practices in

deciding whether the bonus must be included in the regular rate. For example, if 75 percent of employees get the bonus in most years, many courts will find that the bonus is not really discretionary – even if the employer has been using the right language in the plan. Employers also often use terms such as "target compensation," which includes salary and bonus, when informing both new hires and current employees of their expected compensation. This type of language undercuts the notion that the bonus component of pay is discretionary.

Editor: How are commissions calculated when determining the regular rate?

Weiner: Some employers wrongly believe that payments not paid on an hourly basis should not be included in the regular rate; they will not pay overtime on commissions. This is clearly not the case. But, the main issue on commissions is the timing of the regular rate calculations. The regulations in this area are very clear. Typically, an employer must retroactively allocate the commission payments over the period when it was earned, and then recalculate the regular rate for this period, including the payment of overtime, to take into the commission payments.

Editor: How may an employer avoid including profit-sharing contributions from the calculus of regular rate?

Weiner: My advice is for employers to consult the regulations and statute. Unless it is a qualified profit sharing plan where at the end of the year you determine that a certain percentage of the profits are paid into a trust, it is probably going to be included in the regular rate of pay like any other nondiscretionary bonus.

Editor: How are sick days, vacation and personal time treated?

Weiner: Those payments are excluded from the calculation of the regular rate of pay. However, there is an issue when employers attempt to offer incentives for employees who do not use their time off. If I have a program where I agree to pay you for unused sick days, it could be argued that it is compensation for hours worked. The Court of Appeals for the Eighth Circuit ruled such payments amounted to a disguised attendance bonus and thus constituted compensation for hours worked.

There are some gray areas. For example, there is a significant gray area about

incentive programs to not use health insurance or to select a less costly plan for the employer. Those areas are potential litigation targets.

Editor: What cautionary advice do you offer employers as a way to hedge against being snared by the subtleties of the wage and hour laws?

Weiner: Wal-Mart stated that by their calculations it also overpaid people in excess of \$20 million dollars for which no remuneration was sought. For the most part a company cannot offset overpayments with underpayments. So, step one is to review each pay code to determine whether individual payments should be included in or excluded from the regular rate. Second, there should be a systematic legal review of new or modified forms of pay before they become part of the payroll system. Third, companies should review the timing of delayed regular rate and overtime payments, such as must be done for bonuses, incentives and commissions that are paid for a period of time beyond the work week. Employers have gotten into trouble when they set up policies for payment based on administrative convenience. Both the FLSA and state wage payment laws do not allow you to wait to make a payment when it is convenient; it must be paid when it is reasonably calculable. Fourth, the employer must educate the HR people, business people, and supervisors on this issue so that as they come up with new compensation systems they understand the potential overtime that the company will have to pay on those incentives. Fifth, there needs to be a mechanism where employees, their supervisors and the human resources people understand the pay check and compensation systems so that they can answer employee questions. There needs to be a vehicle for handling issues internally. The company should also analyze whether they need so many pay variations which create the opportunity for error.

Editor: How does an employer come to grips with the various state laws on wages and hours?

Weiner: California is the most difficult state to comply with in that there are a series of rules that establish different standards and in many cases higher standards than the FLSA.

My advice is that you need to look at the wage payment requirements in the states in which you operate.