

## OUTSIDE COUNSEL

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### *Overtime: Determining an Employee's Regular Rate*

It is common knowledge that the Fair Labor Standards Act (FLSA) requires employers to pay one and one-half times an employee's "regular rate" for all work performed in excess of 40 hours per week. What is too often overlooked, however, is the proper method for determining the regular rate. To avoid extensive liability from noncompliance with the overtime mandates, including liquidated damages and attorneys' fees, employers must understand all the components of the "regular rate."

The regular rate includes "all remuneration for employment paid to, or on behalf of, the employee." (29 U.S.C. §207(e).) It is the "hourly rate actually paid for the normal, non-overtime workweek." (*Walling v. Helmerich & Payne*, 323 U.S. 37, 40 (1944).) Regardless of the basis on which the employee is actually paid (e.g., hourly, salary, commission), the regular rate is always an hourly rate. (29 C.F.R. §778.109.) Additionally, the regular rate must be determined for each particular workweek, even if the employee is paid less frequently than weekly.<sup>1</sup>

The starting point for determining an employee's regular rate for a particular week is to divide total earnings by the total hours for which payment is made.<sup>2</sup> For single-rate hourly employees, the regular rate is



the hourly rate.<sup>3</sup> This, however, is only the beginning; other forms of compensation raise additional considerations. Specifically, employers must consider 1) non-exempt salaried employees, 2) commission payments, and 3) the statutory exclusions from the regular rate.

Simply because a person receives a fixed salary does not automatically exempt him from the overtime requirements. A non-exempt employee paid on a salary basis must still receive one and one-half times his regular rate for all hours over 40. (See generally 29 U.S.C. §207.)

Where an employee receives a weekly salary, divide the salary by the number of hours the salary is intended to cover to determine the regular rate. For example, an employee paid \$500 for a stated 35-hour workweek has a regular rate of \$14.29. If he works a 44-hour week, he must receive \$657.17 (\$500 (for the first 35 hours) + \$71.45 (\$14.29 per hour for hours 36-40) + \$85.72 (\$21.43

per hour for hours 40-44)).

Even if the employer and employee have a clear understanding that the salary is fixed compensation for whatever hours are worked, be it less or more than 40 (i.e., the "fluctuating workweek"), the employee must still receive an additional one-half his regular rate for all hours over 40. With a fluctuating workweek the regular rate varies from week to week, so you must divide the salary by the amount of hours actually worked to determine the regular rate. The regulations give the example of an:

employee whose hours of work do not customarily follow a regular schedule but vary from week to week, whose overtime work is never in excess of 50 hours in a workweek, and whose salary of \$250 a week is paid with the understanding that it constitutes his compensation, except for overtime premiums, for whatever hours are worked in the workweek. If during the course of 4 weeks this employee works 40, 44, 50, and 48 hours, his regular hourly rate of pay in each of these weeks is approximately \$6.25, \$5.68, \$5, and \$5.21, respectively. Since [he] has already received straight-time compensation on a salary basis for all hours worked, only additional half-time pay is due. For the first week [he] is entitled to be paid \$250; for the second week \$261.36 (\$250 plus 4

hours at \$2.84, or 40 hours at \$5.68 plus 4 hours at \$8.52); for the third week \$275 (\$250 plus 10 hours at \$2.50, or 40 hours at \$5 plus 10 hours at \$7.50); for the fourth week approximately \$270.88 (\$250 plus 8 hours at \$2.61 or 40 hours at \$5.21 plus 8 hours at \$7.82). (29 C.F.R. §778.114(b).)<sup>4</sup>

There are two prerequisites to using the fluctuating workweek:

- The salary must be large enough so that the employee's average hourly earnings never fall below minimum wage; and

- "The employee clearly understands that the salary covers whatever hours the job may demand in a particular workweek" and the employer must pay the salary even if the workweek is, in fact, less than 40 hours. (29 C.F.R. §778.114.)<sup>5</sup>

When a non-exempt salaried employee is paid other than weekly, you must translate the salary to its weekly equivalent. For example, a semi-monthly salary is multiplied by 24 (the number of pay periods in a year) and then divided by 52. The weekly salary is then divided by the number of hours intended to be covered by the salary to determine the regular rate.<sup>6</sup>

There is one situation in which an employer may pay a fixed salary to a non-exempt employee without additional compensation for overtime. Such an arrangement is permitted only where the employee's duties necessitate irregular hours of work and the employee is employed pursuant to an individual or collective agreement that provides: 1) a weekly guarantee of pay for not more than 60 hours based on the specified rate; and 2) a regular rate equal to or greater than the minimum wage and provides for compensation at one and one-half the rate for hours worked in excess of the stated weekly maximum. (29 U.S.C. §207(f).) Any

work over the maximum weekly hours specified in the contract (which cannot be greater than 60) must be paid at time and one-half.<sup>7</sup>

### Commission Payments

In the eyes of the FLSA, "commissions ... are payments for hours worked and must be included in the regular rate." (29 C.F.R. §778.117.) This rule applies whether the commission is the sole form of compensation or an addition to some other form of compensation. Commission earned or paid weekly is included in (or constitutes) the total weekly compensation.

If commission is earned or paid other than weekly:

the employer may disregard the commission in computing the regular hourly rate until the amount of commission can be ascertained. Until that is done he may pay compensation for overtime at a rate not less than one and one-half times the hourly rate ... exclusive of the commission. (29 C.F.R. §778.119.)

Once the commission can be computed, the total commission is apportioned over the number of weeks in the commission period, and that amount is then divided by the number of hours worked in each week to determine the increase in the regular rate. The employee must receive at least one-half that amount for each hour worked over 40 in any of those weeks.<sup>8</sup>

If the regular rate includes wages, commissions and salaries, what, if anything, is excluded?

### Regular Rate Exclusions

The FLSA specifically excludes eight categories of compensation from an employee's regular rate. Understanding the exclusions is critical because any remuneration

that does not fall squarely within one of these exceptions must be included in the total compensation when determining the regular rate.

Section 7(e) (29 U.S.C. §207(e)) specifically excludes:

1. gifts "the amounts of which are not measured by or dependant on hours worked, production or efficiency";

2. "payments made for occasional periods when no work is performed" (e.g., vacation, holiday, sick pay) and reimbursement of expenses incurred in furtherance of the employer's business;

3. "sums paid in recognition of services" if: 1) both the fact and amount of such payments are at the employer's sole discretion, and not pursuant to any prior contract, agreement or promise causing the employee to expect such payments regularly; or 2) the payments are made pursuant to a bonafide profit-sharing or other similar plan;

4. irrevocable contributions for health, retirement, death or similar benefits;

5. premium compensation because the employee works beyond eight hours in a day or 40 in a week (or in excess of the normal hours);

6. premium compensation for work on weekends, holidays, regular days of rest, or sixth or seventh consecutive work day; *but only* if such premium is at least one and one-half times the normal rate for such work;

7. premium compensation provided by an applicable employment or collective bargaining contract for work outside the hours of the normal work day or workweek, *but only* if such premium is at least one and one-half times the normal rate for such work; and

8. income derived from employer-provided grants or rights provided pursuant to a stock option, stock appreciation right, or bona fide employee stock purchase program

which is not otherwise excludable under any of paragraphs (1) through (7).

## Prizes and Awards

Whether prizes awarded for activities outside the employee's normal working hours and duties are included in the regular rate depends on the facts, including:

the amount of time, if any, spent by the employee in competing, the relationship between the contest activities and the usual work of the employee, whether the competition involves work usually performed by other employees for employers, whether an employee is specifically urged to participate or led to believe that they will not merit promotion or advancement unless he participates. (29 C.F.R. §778.332(a).)

The regulations provide the following example:

[a] prize paid for work performed in obtaining new business for an employer would be regarded as remuneration for employment. [This type of work is] normally performed by salesmen . . . the time spent by the employee in competing for such a prize (whether successfully or not) is working time . . . . On the other hand, a prize or bonus paid to an employee when a sale is made by the company's sales representative to a person whom he recommended as a good sales prospect . . . [is not] compensation for services if in fact the prize-winner performed no work in securing the name of the sales prospect and spent no time on the matter for the company in any way. (29 C.F.R. §778.332(b).) Prizes related to the "quality, quantity or efficiency of work done by the employee during his

customary working hours at his normal assigned task . . . [are] obviously paid as additional remuneration for employment" and must be included in the regular rate. (29 C.F.R. §778.331.) Such payments include, but are not limited to, prizes for best attendance, efficiency, and/or productivity. The prize value must be allocated over the covered period (if the prize is merchandise, the cost to the employer is used). That amount is then divided by the number of hours worked in each week to determine the increase in the regular rate. The employee must receive at least one-half that amount for each hour worked over 40 in any of those weeks.

## Idle Time

Payments for idle time, including vacation, holiday, illness, jury duty, failure of the employer to provide sufficient work, or other "absences of the non-routine character which are infrequent or sporadic or unpredictable" may be excluded from the regular rate. (29 C.F.R. §778.218.) Payments for idle time must be distinguished from payments for non-productive time (e.g., waiting for work or traveling on employer business). To the extent non-productive time is considered working time, payments for such time must be included in the regular rate. (29 C.F.R. §778.223.)

Show-up, callback, or other similar payments are also excluded to the extent they exceed the regular or overtime compensation due for the number of hours actually worked. (Id.) When an employee is on-call, but not confined to any particular place and may come and go as he pleases provided he leaves word where he can be reached, the hours spent are not considered hours

worked and need not be paid (except for any time actually worked). Nevertheless, if he receives pay for such time the compensation must be included in the regular rate. (29 C.F.R. §§220; 222.)

Reimbursement of expenses incurred by the employee on the employer's behalf is not considered compensation. As the saying goes, however, "there's no such thing as a free lunch." If an employee is reimbursed for, or provided, personal necessities (e.g., transportation to/from work, meals or lodging), it is considered compensation. The amount paid to the employee or the fair value of the facilities furnished must be included when calculating the regular rate. (29 C.F.R. §778.217.)

## Bonuses

Bonuses paid as gifts are excludable only if they are truly in the nature of a gift (e.g., a holiday bonus). To exclude a bonus payment:

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. [The] bonus is determined by the employer without prior promise or agreement. 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. (29 C.F.R. §778.211(b).)

Such bonuses may not be measured by hours worked, production, or efficiency; nor may they be "so substantial that it can be assumed that employees consider it a part of the wages for which they work . . ." Notwithstanding, such gift bonuses are excludable even if they are regularly paid, the employees expect

it, and the bonus amount varies according to the employee's regular rate of pay or seniority; as long as the amount is not directly measured by productivity, efficiency or hours worked. (29 C.F.R. §778.212.)<sup>10</sup>

Bonuses that do not meet these criteria, such as those based on productivity, quality of work, longevity or attendance are all included in the regular rate. (29 C.F.R. §778.211(c).) Where the bonus is paid weekly, it is simply included in the weekly earnings. Bonuses determined over a period of time are treated like commissions similarly earned; they must be apportioned over the total period covered by the bonus. (29 C.F.R. §778.209.)

## Benefit Plans

The regulations set forth five conditions, all of which must be met for benefit plan contributions to be excludable from the regular rate:

1. Contributions are made pursuant to a specific plan or program adopted by the employer and communicated to the employees;
2. The primary purpose of the plan is to provide for payments to employees on account of age, death, disability, illness, etc.
3. (a) the benefits are specified or definitely determinable on an actuarial basis; or (b) There are definite formulas for determining both employer contributions and employee benefits; or (c) There is a definite formula for determining employer contributions and a provision for determining individual benefits that is consistent with the purposes of the plan;
4. Employer contributions must be irrevocable (this does not prevent return of excess contributions); and

5. Employees cannot have the right to assign benefits under the plan, nor the option to receive any part of the employer's contribution in cash. (This does not prevent payment to the employee of the amount in the plan upon severance of employment or termination of the plan.) (29 C.F.R. §778.215(a).)<sup>11</sup>

If the plan does not meet all these requirements the amount of the contribution is treated like a bonus, and must be apportioned over the appropriate period. (29 C.F.R. §778.214(c).)

Three types of premium compensation are excluded from the regular rate:

1. premium compensation because the employee works beyond eight (8) hours in a day or forty (40) in a week (or in excess of the normal workday or workweek);
2. premium compensation for work on weekends, holidays, regular days of rest, or sixth or seventh consecutive work day; *but only* if such premium is at least one and one-half times the normal rate for such work; and
3. premium compensation provided by an applicable employment or collective bargaining contract for work outside the hours of the normal workday or workweek, *but only* if such premium is at least one and one-half times the normal rate for such work.

Premium compensation that falls into any of these categories is not only excluded from the regular rate, it can also be credited towards any overtime compensation due. (29 U.S.C. §207(h).) To qualify as excludable and creditable premium compensation, the premium must actually be contingent on working specific days or hours, and must be based on hours worked. Premium

payments for work performed during overtime hours without regard to the number of overtime hours actually worked do not qualify even if the payment is greater than what would be owed on a per hour basis. (29 C.F.R. §778.310.)

It is important to note the distinction between paragraph 1 on one hand, and paragraphs 2 and 3 on the other. Paragraphs 2 and 3 require that for such premium pay to be excludable from the regular rate (and simultaneously creditable towards overtime), the premium rate must be "not less than one and one-half the rate established in good faith for like work performed" in non-premium pay situations. Premium pay for weekends, regular days of rest, holidays, sixth or seventh consecutive workdays, or for work outside of the normal hours of work that is less than this threshold must be included in the regular rate and is not creditable towards overtime (unless it qualifies as an overtime premium pursuant to paragraph 1). (29 C.F.R. §778.203.)

To qualify under paragraph 2, the premium must be due because the work is performed on the day specified. For example:

a premium rate paid to an employee only when he received less than 24 hours' notice that he is required to report to work on his regular day of rest is not a premium paid for work on one of the specified days; it is a premium imposed as a penalty upon the employer for failure to give adequate notice to compensate the employee for the inconvenience of disarranging his private life. The extra compensation is not an overtime premium. It is part of his regular rate of pay .... (29 C.F.R. §778.203(d).)

Paragraph 3 applies only to premium pay for work outside the "normal" workday or workweek, and

must be distinguished from premium pay required only during certain hours (e.g., between midnight and 6 a.m.) or under certain conditions (e.g., if the employee did not have a lunch period), which cannot be excluded from regular rate nor credited towards overtime.

Premium payments that do not fall into one of these categories are included in the regular rate.

## Stock Options

In May of 2000, Congress amended the FLSA to exclude the value of certain stock options. Under the Worker Economic Opportunity Act, the value of options is excluded from the regular rate if:

(a) grants are made pursuant to a program, the terms and conditions of which are communicated to participating employees either at the beginning of the employee's participation in the program or at the time of the grant;

(b) in the case of stock options and stock appreciation rights, the grant or right cannot be exercisable for a period of at least 6 months after the time of grant ... and the exercise price is at least 85 percent of the fair market value of the stock at the time of grant;

(c) exercise of any grant or right is voluntary; and

(d) any determinations regarding the award of, and the amount of, employer-provided grants or rights that are based on performance are

(i) made based upon meeting previously established performance criteria (which may include hours of work, efficiency, or productivity) of any business unit consisting of at least 10 employees or of a facility, except that, any determinations may be based on length of service or minimum schedule of hours or days of work; or

(ii) made based upon the past performance (which may include any criteria) of one or more employees in a given period so long as the determination is in the sole discretion of the employer and not pursuant to any prior contract.<sup>12</sup>

The value of stock options that do not meet these criteria must be included when calculating the regular rate.

While accurately calculating an employee's regular rate may be time consuming, it is essential. Failure to pay proper overtime can result in liability for unpaid overtime for the previous three years, liquidated damages equal to the amount of unpaid wages, attorneys' fees, and costs. In cases of repeated willful violations, the FLSA also allows the imposition of civil penalties and imprisonment.



(1) Herein "week" will refer to workweek. "An employee's workweek is a fixed and regularly recurring period of 168 hours — seven consecutive 24 hour periods ... [o]nce the beginning time of an employee's workweek is established, it remains fixed regardless of the schedule of hours worked by him." 29 C.F.R. §778.105. The workweek may be changed only if such change is permanent and not intended to evade the FLSA. Such a change, however, necessarily results in a situation where some hours will fall in both the "old" and "new" workweeks. In such case, the employer must pay the greater of the amount due by counting all overlapping hours only in the first week or only in the second week. 29 C.F.R. §778.302.

(2) Where employees are granted a retroactive pay increase it necessarily increases the regular rate. Accordingly, employees must also receive the resulting difference for all overtime hours worked during the period of retroactivity. Deductions for such things as the cost of board or lodging, union dues, tools, or uniforms do not reduce the regular rate. 29 C.F.R. §778.304.

(3) Where an employee works at multiple tasks earning multiple rates, the regular rate is the weighted average of all the rates in proportion to the number of hours worked at each. If the employee agrees before performing the work, the employer may base overtime on the

"rates applicable to the same work when performed during non-overtime hours." 29 U.S.C. §207(g)(2).

(4) Obviously, the regulations have not been amended to reflect the current minimum wage.

(5) If it is unclear whether a fixed salary is intended to cover a fixed or variable workweek, "the practice of making deductions from the salary for hours not worked in short weeks will be considered strong, if not conclusive, evidence that the salary covers a fixed workweek." 29 C.F.R. §778.306.

(6) Alternatively, the parties may agree in advance of performance of work that the regular rate will be determined by dividing the salary by the number of working days in the pay period and then by the amount of hours in a regular work day. 29 C.F.R. §778.113.

(7) Agreements of this type are referred to as "Belo Agreements." (See *Walling v. W.H. Belo Co.*, 316 U.S. 624 (1942)). The exemption is designed for employees whose duties are "such that neither he nor his employer can either control or anticipate with any degree of certainty the number of hours he must work from week to week. [H]is duties must necessitate significant variations in weekly hours of work both below and above the statutory weekly limit on nonovertime hours." 29 C.F.R. §778.405 (emphasis added). All the employee's hours, not only the overtime hours, must vary significantly; the variation must be from week to week, and cannot simply be the result of alternating fixed workweeks. Moreover, the number of hours covered by the guarantee must be reasonably related to the actual number of hours the employee is expected to work. 29 C.F.R. §778.412. Finally, the contract must provide for a regular rate of pay, and cannot consist in whole or in part of commissions or bonuses. 29 C.F.R. §§778.408(c); 778.413. As examples of the types of employees that fit this criteria, the regulations list outside buyers, on-call servicemen, insurance adjusters, newspaper reporters and photographers.

(8) The regulations provide alternative methods when it is impossible or impractical to apportion the commission equally among the workweeks. See 29 C.F.R. §778.120(b).

(9) See 29 U.S.C. §251 et seq.; 29 C.F.R. §§785; 790 (discussing "working time").

(10) Payments made to a bona-fide profit sharing plan are also excluded. 29 C.F.R. §778.213.

(11) Plans approved by the IRS pursuant to Section 401(a) of the Internal Revenue Code meet paragraphs 1, 4 and 5. 29 C.F.R. §778.215(b).

(12) 29 U.S.C. §207(e)(8).