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Labor and Employment Alert

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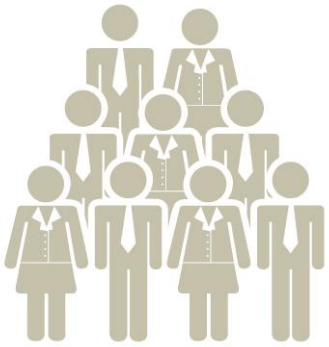
Key Points

- In *Alvarado v. Dart Container Corp. of California*, the California Supreme Court held that California law—unlike federal law—requires employers to calculate overtime by treating flat-sum bonuses as if they were earned during only **nonovertime** hours.
- Employers who previously used the FLSA method for calculating overtime on such bonuses can limit their liability by making one-time payments to current employees to make up the difference on bonuses already paid.
- The court's holding does not apply to bonuses based on productivity, such as production bonuses, piecework bonuses or commissions.



California Supreme Court Breaks With FLSA on Overtime Due for Flat-Sum Bonuses

On March 5, 2018, in *Alvarado v. Dart Container Corp. of California*, the California Supreme Court broke with federal law on the question of "how an employee's overtime pay rate should be calculated when the employee has earned a flat sum bonus during a single pay period." Slip op. at 1.

Federal regulations implementing the Fair Labor Standards Act (FLSA) require employers to account for nondiscretionary bonuses when calculating overtime by treating the bonus as if it were earned during each hour of work in the pay period. Thus, the employer calculates the per-hour value of the bonus by dividing the total bonus amount by the total hours worked. Because overtime hours must be compensated at 1.5 times the regular rate of pay, the employee is then due an overtime premium equal to 0.5 times the per-hour value of the bonus, multiplied by the number of hours worked in the pay period.

Conversely, *Alvarado* held that, under California law, the employer must treat the bonus as if it were earned during only the **nonovertime** hours in the pay period. In practice, this approach differs from the FLSA approach in two ways. First, when calculating the per-hour value of the bonus, the employer must divide the bonus amount by the nonovertime hours, rather than the total hours worked. Second, the employer must calculate the overtime premium due on the bonus by multiplying its per-hour value by 1.5, rather than 0.5.

The approach adopted in *Alvarado* is not novel, and, in fact, it tracks the enforcement position taken by the Division of Labor Standards Enforcement (DLSE) since at least 2002. However, California case law regarding the regular rate of pay has traditionally deferred to the federal regulations, so *Alvarado* represents a notable departure and another potential pitfall for California employers, particularly those with employees both within and outside of the state.

The California and federal methods of calculating overtime on such bonuses are unlikely to yield widely divergent results in practice. Nevertheless, the potential liability for California employers who have, until

now, taken the FLSA approach may be significant, given the potential for penalties on derivative claims, like waiting-time penalties under Labor Code Section 203 or civil penalties under the Private Attorneys General Act (PAGA). Employers can reduce some of this risk by making one-time payments to current employees to make up the difference on flat-sum bonuses already paid. In many cases, these payments would be relatively small (particularly if the employees do not work substantial amounts of overtime) and would likely eliminate the potential for much larger waiting-time penalties if litigation were to arise. Such corrective action may also support a reduction in any penalty award if the employer were found liable in a PAGA action.

Finally, employers should be aware that the *Alvarado* methodology does not appear to apply to all types of nondiscretionary bonuses. *Alvarado* concerned a flat-sum attendance bonus of $15, which employees earned each time they worked a Saturday shift of any length. The court carefully distinguished between that type of bonus—which is wholly independent of the hours worked—and bonuses based on productivity, like "production or piecework bonus[es]" or "commission[s]," which "increase[s] in rough proportion to the number of hours worked." Slip op. at 29.

Without deciding the issue, the court indicated that a different method would likely be appropriate for productivity-based bonuses. Notably, the DLSE makes the same distinction between productivity-based and flat-sum bonuses, and it tracks the FLSA regulations for calculating overtime on productivity-based bonuses.

Contact Information

If you have any questions regarding this alert, please contact:

Gregory W. Knopp
gknopp@akingump.com
310.552.6436
Los Angeles

Jonathan P. Slowik
jpslowik@akingump.com
310.728.3327
Los Angeles