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More Overtime Headaches for Employers

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June 8, 2016

The Ninth Circuit has ruled that employer payments of cash in lieu of benefits will be included in an employee's "regular rate of pay" for purposes of overtime calculations. The California City of San Gabriel has been held in violation of the Fair Labor Standards Act by excluding cash payments made to employees in lieu of benefits from their "regular rate of pay" used to calculate overtime compensation, the U.S. Court of Appeals for the Ninth Circuit ruled (Flores v. City of San Gabriel, 2016 BL 175160, Ninth Cir., No. 14-56421, 6/2/16).

Deciding a matter of first impression, the court said cash in lieu of benefits payments aren't covered by an FLSA exclusion codified at 29 U.S.C. § 207(e)(2). While defending an FLSA overtime pay action, the City of San Gabriel argued that the payments fall under the FLSA exclusion because they "are not made as compensation for [an employee's] hours of employment." But agreeing with the Labor Department's interpretation of Section 207(e)(2), the Court said a payment may not be excluded from the regular rate of pay if it is "generally understood as compensation for work," even if it is "not directly tied to specific hours worked by an employee."

The decision is significant because it addresses a relatively common arrangement under flexible benefit plans offered both by public sector and private sector employers. If employees don't use all or part of a benefits allowance, perhaps because they are covered under a spouse's plan, the employer then pays cash in lieu of benefits to the employee. The legal issue is whether such payments must be included in the FLSA's "regular rate of pay," which is used in overtime pay calculations.

The FLSA defines the "regular rate" of pay as "all remuneration for employment paid to, or on behalf of, the employee," subject to a number of statutory exclusions. The City argued that the payments should be excluded from the "regular rate" of pay based on either of two exceptions:

1. Section 207(e)(2) exempts from "regular rate of pay" items such as vacation pay, reimbursable travel expenses and "other similar payments to an employee which are not made as compensation for his hours of employment"; and

2. Section 207(e)(4) excludes from the regular rate of pay "contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees."

Under the 207(e)(2) exception, the City of San Gabriel argued its payments of cash in lieu of benefits are properly excluded because they aren't compensation for hours worked by the employees. The City contended that final phrase permits exclusion of "any payments that do not depend on when or how much work the employee performs." The City argued that because its payments of the unused benefits aren't tied to hours worked or amount of services provided, they are properly excluded from the regular rate of pay. In its ruling, the Ninth Circuit noted that the City's interpretation of Section 207(e)(2) is "directly contrary" to the position articulated by the U.S. Department of Labor (DOL). Under relevant DOL regulations, a payment may not be excluded from the regular rate of pay if it is "generally understood as compensation for work, even though the payment is not directly tied to specific hours" that the employee worked. The DOL's non-exhaustive list of payments that are not intended to be excluded includes bonuses and room and board, which are "commonly considered to be compensation" even though such payments don't fluctuate based on particular hours worked by an employee, the court said. The payments in this case are "properly considered compensation for work" and there is no necessity they must be tied to hours worked to fall outside the Section 207(e)(2) exclusion, the Court decided.

In its alternative argument, San Gabriel posited that payments fall under Section 207(e)(4), as the payments are made under a benefit plan. However, the Court rejected this argument by noting that the cash in lieu of benefits payments are not made to a third party and that the City's flexible benefits plan. Further, the Court rejected the argument that the cash payments were merely "incidental" as they represent more than 40 percent of the City's contributions to the plan.

This Ninth Circuit decision that cash-in-lieu of benefits payments will be included in the "regular rate of pay" for overtime purposes may have a significant effect because a few dollars an hour increase in an employee's pay rate in turn increases overtime pay if the employee works extra hours. Accordingly, the court's ruling could be a deterrent to employers' willingness to offer flexible plans that include cash payments in lieu of benefits.