One Minute Memo® 60s

Federal Formula for "Flat Sum" Bonus Overtime Calculation Rejected

By Christopher J. Truxler and Joshua A. Rodine

Seyfarth Synopsis*: California employers must use the formula prescribed by the Division of Labor Standards Enforcement Manual to calculate overtime on flat sum bonuses, not the bonus overtime formula used under federal law.*

California law generally follows federal law as to how employers should calculate overtime pay on nondiscretionary bonuses for non-exempt employees. But California law on calculating bonus overtime has been somewhat unclear in relation to "flat sum" bonuses. On March 5, 2018, in *Alvarado v. Dart Container Corp.*, the California Supreme Court decided that a formula invented by the Division of Labor Standards Enforcement—without engaging in any administrative rulemaking—is the proper method for calculating bonus overtime pay, and that the DLSE's formula applies retroactively.

The Facts

Hector Alvarado worked as an hourly employee for Dart Container, which makes cups, plates, and other food service products. Alvarado earned an attendance bonus of $15 for each full weekend shift he worked. Dart, in calculating overtime pay generated by the bonus, followed the method established by the federal Wage Hour Division in 29 C.F.R. § 778.110. Under the federal formula, the regular rate for a weekly bonus would be the amount of the bonus divided by all weekly hours worked (both straight hours and overtime hours), and the regular rate would divided by two before multiplying it by the number of weekly overtime hours worked to calculate the amount of overtime pay generated by the bonus.

Alvarado sued Dart for unpaid bonus overtime. Alvarado argued that, for "flat sum" bonuses, California employers must determine the regular rate by dividing the bonus by only the straight time hours worked, as specified in the DLSE Manual, and not by the total hours worked.

The trial court granted Dart summary judgment, holding that Dart properly used the federal method. The Court of Appeal affirmed, opining that while the DLSE Manual's formula represented a reasonable effort to prevent dilution of the regular rate by overtime hours, the Manual is not binding legal authority. Because no California law required otherwise, the Court of Appeal affirmed Dart's use of the federal method.

The Supreme Court Decision

The Supreme Court, reversing the lower courts, adopted the formula proposed in the DLSE Manual, on a theory that the DLSE's formula was necessary to discourage employers from requiring employees to work overtime hours. The Supreme

Court announced that an employer, in determining the regular rate on a flat sum bonus, must divide the bonus by only the straight-time hours worked during the period, not by all hours. Moreover, the Supreme Court announced that the regular rate must be multiplied by 1.5, not 0.5, when applied to the number of overtime hours worked during the week. Adding insult to injury, the Supreme Court rejected Dart's request that this judicially unprecedented holding apply prospectively only.

The Supreme Court justified its decision by emphasizing California's longstanding policy of discouraging employers from imposing overtime work. To effectuate this policy, the Supreme Court reasoned, a flat sum bonus must be treated as if it were earned on an hourly basis throughout the relevant pay period. The Supreme Court rejected the Court of Appeal's reasoning that no state law governed the issue, because the DLSE's Manual, though not binding legal authority, was interpreting the underlying statutory law, and because courts interpreting that law are free to adopt the DLSE's view if courts find that view persuasive.

In a remarkable concurring opinion, four of the Supreme Court's seven justices acknowledged that the "spare language" of statutory law could have left employers "somewhat uncertain about how to proceed," and that the DLSE Manual was not an "authoritative construction by a state agency." The four concurring justices further acknowledged that employers who "fully intended to comply with state overtime laws" "may now be faced with substantial penalties"—an "unfortunate" state of affairs that "conceivably could have been avoided had an interpretative regulation of this subject been promulgated through formal APA rulemaking." The concurring justices nonetheless agreed that the Supreme Court's new interpretation should apply retroactively, even if, "[r]egrettably," "more was not done to help employers meet their statutory responsibilities."

What Alvarado Means For Employers

Alvarado is an unwelcome decision that takes a poorly reasoned DLSE provision in a nonbinding manual and declares it to be the law, applied retroactively. This development arguably might visit "substantial penalties" on employers who were not using the DLSE's flat sum bonus formula, as four justices sadly acknowledge. Now would be a good time to revisit nondiscretionary bonuses for non-exempt employees with the lessons of *Alvarado* in mind.

If you would like further information, please contact Christopher J. Truxler at ctruxler@seyfarth.com, or Joshua A. Rodine at jrodine@seyfarth.com.

www.seyfarth.com