

Factoring Bonuses to Calculated a Non-Exempt Employee's Overtime Pay

A California employer is required to include non-discretionary bonuses in its calculation of a non-exempt employee's regular rate.¹ This requirement affects how an employee's overtime rate is calculated, entitling an employee to additional compensation. However, employers often overlook this statutory requirement or fail to calculate their employees' regular rate appropriately. This article will clarify when a bonus must be considered as part of a non-exempt employee's regular rate for the purpose of calculating overtime and how to calculate a non-exempt employee's regular rate and overtime pay pursuant to the Labor Code and the California Supreme Court's recent ruling in *Alvarado*.

Bonuses Included in an Employee's Regular Rate

Non-discretionary and discretionary bonuses are "wages," which must be timely paid; however, non-discretionary bonuses are included in the calculation of an employee's regular rate, whereas discretionary bonuses are not.² A bonus is considered discretionary if it is at the sole discretion of the employer to award, and the bonus is not pre-announced or expected by the employees.³ Common examples of discretionary bonuses are "sums paid as gifts at a holiday or other special occasions, such as a reward for good service."⁴ As opposed to discretionary bonuses, non-discretionary bonuses are pre-announced so that employees expect to be awarded if they meet predetermined specific criteria. Non-discretionary bonuses are often measured by or depend upon the hours worked, production, or efficiency and can be calculated by a percentage of production or a flat sum. Earned non-discretionary bonuses must be included in an employer's calculation of its employee's regular rate of pay."⁵

Calculating an Employee's Overtime Pay Factoring the Appropriate Bonuses

The DLSE Manual contains provisions on how to calculate overtime on non-discretionary bonuses, distinguishing between formulaic bonuses (including percentage of production) and flat sum bonuses. Production bonuses are "based on a percentage of production or some formula other than a flat amount [which] can be computed and paid with the wages for the pay period to which the bonus is applicable." Production bonuses are earned during straight time as well as overtime hours, so the regular rate for such a bonus is calculated by dividing the bonus by the total hours worked during the period to which the bonus applies.⁶ The overtime premium due on the bonus is then calculated multiplying one-half of the regular rate for the bonus by the number of overtime hours worked during the period in which the bonus was earned.⁷

¹ FLSA 7(e) and Division of Labor Standards Enforcement ("DLSE") Manual 35.7

² *Id.* See also https://www.dir.ca.gov/dlse/faq_overtime.htm.

³ DLSE Manual 35.4.4.

⁴ Payments in recognition of service performed during a given period are excluded if both the payment and amount thereof are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement or promise causing the employee to expect such payments regularly. [29 USC § 207(e)(3)(a); see 29 CFR §§ 778.108, 778.211(a); *Abbey v. United States* (Fed.Cl. 2011) 99 Fed.Cl. 430, 438-439]

⁵ Opinion Letter of the California Department of Industrial Relations, Division of Labor Standards Enforcement (November 2015)

⁶ DLSE Manual 49.2.4

⁷ *Id.*

The issue of how to calculate the rate of overtime pay when an employee receives a flat sum bonus was recently resolved in *Alvarado v. Dart*. The Court of Appeal had granted summary judgment for Dart Container Corp., holding that the employer’s use of the FLSA calculation rather than the formula endorsed by the DLSE was permissible.⁸ Alvarado had alleged that Dart violated California law by not using the DLSE formula to calculate his regular rate.⁹ The Court of Appeal disagreed, finding that the DLSE Manual provisions were not enforceable because the DLSE Manual was prepared “without input from affected employers, employees, or the public generally” and was not adopted in accordance with the Administrative Procedure Act rulemaking procedures, and as such, the provisions in the manual “are void regulations which are not binding on this court.”¹⁰ Without any other state law governing the issue, the court found the company’s formula permissible as it complied with federal law.¹¹

The California Supreme Court granted cert to determine what the proper method is for calculating the rate of overtime pay when an employee receives both an hourly wage and a flat sum bonus.¹² The Court has held ... (ENTER HOLDING DLSE Manual 49.2.4.2)

An employee’s regular rate should always include non-discretionary bonuses. California law specifically dictates the method in which your employer must calculate your overtime rate. Moreover, the Court’s recent decision in *Alvarado* elucidates that the DLSE calculation governs how flat rate non-discretionary bonuses are factored into an employee’s overtime rate. (Other implications – DLSE Manual has the force of law?) As this is a complicated and changing area of law, it is important to consult with an attorney if you think your employer has improperly paid you.

⁸ DLSE Manual sections 49.2.4.2 and 49.2.4.3

⁹ *Alvarado v. Dart Container Corp. of California*, (2016) 197 Cal. Rptr. 3d 304, 306, review granted and opinion superseded, 369 P.3d 553.

¹⁰ *Id.* at 307.

¹¹ *Id.* at 316.

¹² *Alvarado v. Dart Container Corp.* 369 P.3d 553 (May 11, 2016)