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Benefits Alert

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Ninth Circuit Rules: Waiver Payments Must Be Included in Employee Overtime Calculation Under FLSA

On June 2, 2016, in *Flores v. City of San Gabriel*, the Ninth Circuit Court of Appeals held that waiver payments made to an employee in lieu of benefits **must be included in his/her regular rate of pay when calculating overtime** under the Fair Labor Standards Act (FLSA). Also of major significance is the Ninth Circuit's finding that if a benefits plan is not a "bona fide" plan, then **even the contribution amounts paid by an employer to trustees or third parties (e.g., insurance carriers) must be included** in the calculation of an employee's regular rate of pay.

Although employers throughout the country should be aware of this ruling (because the other circuit courts will likely soon weigh in), it is binding law only in the Western states and US territories that fall within the Ninth Circuit's jurisdiction: 1) Alaska; 2) Arizona; 3) California; 4) Guam; 5) Hawaii; 6) Idaho; 7) Montana; 8) Nevada; 9) Oregon; 10) Washington; and 11) the Northern Mariana Islands.

Background

In general, "rate of pay" under the FLSA means *all forms of compensation* except for certain items that are specifically excluded under Section 207(e) of the FLSA (such as Christmas gifts, stock options or employer contributions paid to a third party for a health benefits plan, etc.).

The City (of San Gabriel) offers a Flexible Benefits Plan (Plan) to its eligible employees which provides employees with a certain benefits allowance amount that they can use to purchase medical, vision, and dental benefits. If employees showed proof of other medical coverage, they could waive the City's medical benefits and then receive the unused portion of the benefits allowance as a separate line-item cash payment on their paychecks (i.e., cash in lieu of benefits). From 2009 through 2011, such employees received approximately $1,000 – $1,300 per month for waiving the City's coverage. In total, the cash payments constituted a whopping 42% to 47% of the total contributions the City made to the Plan during those 3 years.

A group of the City's police officers sued the City for violations of the FLSA's overtime rules, claiming that the City failed to include payments for the unused benefits allowance when calculating the officers' regular rate of pay, which

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then resulted in lower overtime compensation. The City made two distinct arguments as to why the cash in lieu of benefits payments should be excluded:

- The payments were not compensation for hours worked by the officers (i.e., not tied to hours worked) and should be excluded under Section 207(e)(2) of the FLSA; and
- The payments are contributions pursuant to a bona fide plan providing health insurance or similar benefits for employees and should be excluded under Section 207(e)(4).

Ninth Circuit's Ruling

The Ninth Circuit rejected both of the City's arguments and upheld the district court's decision in favor of the officers.

Cash in lieu of benefits is not excludable compensation under §207(e)(2)

In addressing the first part of the City's argument, the Court referenced the Department of Labor's (DOL's) interpretation of Section 207(e)(2) in which the DOL explained that bonuses or board/lodging would be included in the calculation of regular rate of pay even though such amounts are not directly attributable to any particular hours of work. The Court found this to be persuasive and highlighted that the key question is *whether the payment is a form of compensation for performing work* rather than whether a particular payment is tied to hours worked. The Ninth Circuit concluded that waiver cash is compensation for work and is not excludable in the calculation of the employee's regular rate of pay.

Cash in lieu of benefits is not excludable compensation under §207(e)(4)

As to the second part of the City's argument, the Court reviewed whether the cash in lieu of benefits payments could be excluded as contributions to a bona fide (benefits) plan under Section 207(e)(4). The Ninth Circuit pointed out that the exemption exists for "contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan" but in this case, the cash in lieu payments went directly to employees instead of going to a trustee or third party. Therefore, the cash payments could not be excluded from the calculation of regular rate of pay.

Bona fide plan status

During the Court's review of the City's second argument, the Court also looked closely at whether the City's Plan was even a bona fide plan in the first place. The Ninth Circuit reviewed whether the totality of the cash payments from the Plan was an incidental part of the Plan (as set forth at 29 CFR §778.215(a)(5), which explains that if a bona fide plan provides cash payments to employees instead of benefits, such amounts must be an incidental part of the plan).

In a 2003 Opinion Letter, the DOL explained that it has historically used a 20% threshold for determining if cash payments are incidental to a bona fide plan. If a bona fide plan provides cash payments to employees instead of benefits, such amounts must be an incidental part of the plan. The Ninth Circuit found the DOL's 2003 Opinion Letter to be unpersuasive because the DOL never provided any rationale or basis for why 20% was chosen as the appropriate percentage to determine whether cash payments are an incidental part of a plan.

Although the Court found that 20% is not the appropriate threshold, it did not provide any further guidance as to what would be an appropriate bright line percentage for a determination of whether cash payments are "incidental." Instead, the Court stated that the 42% to 47% that the City paid as cash in lieu of benefits was not incidental and therefore the Plan was not a bona fide plan under the FLSA. Therefore, **even the City's payments to third parties under the Plan could not be excluded from the employees' regular rate of pay**. This part of the Court's holding is arguably the most devastating part of the case because it means that all amounts that the City paid into the Plan for employees must be included in employees' regular rate of pay (not just the cash in lieu of payments made to employees that waived coverage).

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Employer Takeaways

Employers with offices that fall within the Ninth Circuit's jurisdiction should review their current health coverage opt-out policy and carefully evaluate the impact that this case will have on their overtime liability under FLSA. It is clear from Flores that such cash payments must be included in the calculation of an employee's rate of pay for FLSA overtime purposes. For specific advice about whether to apply retroactive adjustments and/or how far back to look, employers should consult with their legal counsel.

It's important that employers also review whether the percentage of the waiver payments (when compared to the total amount of employer contributions to the plan) could potentially fall outside of what would be considered an "incidental" part of a bona fide plan. If so, the financial impact could be significant.

During the review of the opt-out policy, employers should also keep in mind that certain cash in lieu of benefits payments may also impact the Affordable Care Act's calculation of affordability under Section 4980H.