Blogs
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Wage & Hour Developments

Giving a Nondiscretionary Bonus? Check the Regular Rate Calculation

Determining an employee's overtime rate of pay can be tricky. The U.S. Department of Labor (DOL) recently found an employer owed over $1 million in back wages to employees in California and Kentucky for violations that included miscomputation of overtime pay rates. The employer failed to account for certain bonuses earned by nonexempt workers, and therefore paid overtime rates that were too low.

It is commonly understood that nonexempt employees are entitled to "time and a half" for weekly overtime hours worked under federal law (while some states, notably California, have additional rules regarding the payment of overtime). What is less well understood is that the very term "time and a half" can be misleading, and it is not always accurate—it wrongly implies that overtime is just a simple formula: the non-overtime hourly rate plus one-half of that rate. But when employers award nondiscretionary bonuses and other compensation to their nonexempt employees yet only pay overtime based on the "time and a half" of the employee's normal hourly pay rate, a violation is likely to occur.

To the surprise of many, the colloquial term "time and a half" does not appear in the Fair Labor Standards Act (FLSA). Rather, the statute requires employers to pay employees one and one-half times their "regular rate of pay" after an employee works more than 40 hours in a workweek. Importantly, the "regular rate of pay" must include all money paid to an employee for hours worked, services rendered, or performance except for the specific categories of payment the FLSA permits an employer to exclude. In short, the "regular rate" and "hourly rate" can be very different.

The complexity of calculating regular rates can be especially challenging when paying nondiscretionary bonuses to nonexempt employees. The DOL explains that bonuses are nondiscretionary when "employees know about and expect" them. Examples of nondiscretionary bonuses the DOL provides include bonuses based on a "predetermined formula," such as group or individual production bonuses, bonuses for the accuracy of work, and safety bonuses. Unless a statutory exception applies, employers must include nondiscretionary bonuses in an employee's regular rate of pay when calculating and paying a nonexempt employee overtime.

Failure to use the accurate regular rate when paying overtime can lead to costly consequences for employers, as in the example recently found by the DOL. Inquiries by the DOL or state administrative agencies are not the only risk—regular rate problems are prime targets for expensive class or collective actions. An employer wrongly paying employees overtime at lower rates than the FLSA requires, on a systematic basis, can be relatively easy to prove using business records and can multiply quickly when the errant scheme affects many employees.

When compensation for nonexempt employees includes regular bonuses, there is ample margin for errors to be made on a broad scale. It is not always easily determined whether bonuses are "discretionary" or should be excluded or part of the regular rate. Also, the mechanics of the computation itself can be complex and vary based on the period over which the compensation was earned and the date paid. Consultation with your legal and other professional advisors can help avoid potentially large wage-and-hour traps related to multifactored compensation.

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