California's Regular Rate: Getting It Right Can Save Money

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With the increasing focus on wage-and-hour litigation, the issue of an employee's "regular rate" arises in most every case involving alleged unpaid overtime. It also factors into an employer's payroll, each and every pay period. Here's a brief roadmap through this sometimes rocky terrain.

The FLSA Formula For Defining The "Regular Rate"
Under the federal Fair Labor Standards Act (FLSA), the regular rate includes all compensation, earnings, or "remuneration" for work performed except certain kinds of payments specifically excluded, such as reimbursement for expenses incurred by an employee on the employer's behalf, or special situations such as reporting-time premiums, discretionary bonuses, and a few others including vacation, or holiday pay.

To avoid confusion and costly payroll errors, some of the "statutory" exclusions from the regular-rate formula may need to be further defined. For example, a "non-discretionary" bonus is any bonus that is awarded based on performance or service and which employees can expect to be paid based upon the relevant criteria. There are only limited situations that would permit a bonus to be called "discretionary," such as a Christmas bonus paid with no performance or service consideration.

There is a broad array of potential sources for an employee's "earnings," which may consist of payment by a piece-rate, salary, commission, or some other basis, but without regard to the particular method of payment. Unless the employee earns only an hourly rate (in which case that generally will be the regular rate), the regular rate is calculated by dividing all earnings for the pay period (except for the statutory exclusions noted above) by the total number of hours actually worked. The regular rate therefore is the average hourly rate resulting from the following fraction:

All weekly earnings/all hours worked = regular rate

The regular rate can never be less than the applicable statutory minimum wage. If an employee is also paid a base hourly rate plus a bonus, the bonus amount must be added to the total week's compensation, resulting in a regular rate that is greater than the base hourly rate.

Once determined, the regular rate is used to calculate overtime. Under federal law, that generally means 1.5 times all hours worked over 40 in a workweek. Under California law, this premium must be paid for all hours worked in excess of eight hours in any workday and 40 hours in any workweek;

or on the first eight hours worked on the seventh consecutive day of work in any workweek. Additionally, employees are entitled to double their regular rate of pay for all hours worked in excess of 12 hours in any workday; and for all hours worked in excess of eight on the seventh consecutive day of work in a workweek. Special overtime zones exist for employees working under a properly-implemented alternative workweek.

Under both federal and state law, there are "exemptions" or "exceptions" to the general overtime requirements which may apply to various occupations or industries. They are narrowly interpreted, and the law most favorable to the employee generally will apply in any particular situation.

The California "Regular Rate" Formula

California generally follows federal regulations regarding the calculation of the regular rate. If an employee is paid by a piece rate or commission basis, one of two methods may be used to determine the regular rate and overtime: 1) the piece or commission rate may be used as the regular rate and the employee is paid 1.5 times this rate for production for regular overtime hours and double this rate for double-time hours during the week; or 2) the standard regular rate is determined by dividing total earnings for the workweek by the total hours worked during the workweek. Under the second method, for each overtime hour worked, the employee is entitled to an additional ½ of the regular rate for hours requiring payment at 1.5 times the regular rate, and to the full rate for hours requiring double time. This method is by far the most commonly used.

Differences between federal and state law exist for calculating a salaried employee's regular rate and overtime. A nonexempt employee's salary paid for a period in excess of a workweek first must be reduced to its workweek equivalent to reach the regular rate. For example, if the salary is $2,000 per month, you would multiply this amount times 12, then divide the result by 52 weeks to get the equivalent weekly salary ($461.54). In California, the regular rate for a salaried nonexempt employee is deemed to be 1/40th of the employee's weekly salary, which must at least be the minimum wage. Under federal law, if a nonexempt employee is employed solely on a weekly basis, the regular hourly rate is determined by dividing the weekly salary by the fixed number of hours the salary is intended to compensate.

Alternatively, if the employee's hours are expected to fluctuate from week to week, under the "fluctuating workweek" method, the salary may be paid under an agreement that the salary covers however many hours are worked in a workweek, with the regular rate determined by dividing the weekly salary by the total number of hours worked in the workweek. Overtime is then paid at ½ of the regular rate times each overtime hour worked. The difference in overtime owed is significant. If an employee works 50 hours including 10 hours overtime, with a weekly salary of $1000, the employee would earn $100 in overtime under federal law and $375 in overtime under California law.

For employees paid a daily guarantee or "day rate," which is paid regardless of the number of daily hours worked, the California Labor Commissioner takes the position that, ordinarily, the hours to be used in computing the regular rate of pay may not exceed the legal maximum regular hours which, in most cases, is eight hours per workday, 40 hours per workweek. Again, the resulting rate must at least be the applicable minimum wage. Once again, the results under federal and California law are strikingly different. If an employee works 10 hours each day for 5 days, at $200 per day rate, the employee has earned $1,000 for the week, but the employee generally would earn only $100 overtime under federal law and $375 under California law.

Blended Regular Rates

Where an employee in a single workweek works at two or more different types of work for which different straight-time rates have been established, the regular rate for that week is the weighted average of such rates. For example, suppose an employee works a total of 42 hours for the workweek: 32 hours at $11.00 per hour plus 10 hours at $9.00 per hour. In this case, the weighted average (or "regular rate") is $10.52. This rate is calculated by adding the $442 straight time pay for the workweek [(32 hours x $11.00/hour) + (10 hours x $9.00/hour) = $442] then dividing this amount by the 42 hours worked for the week. Overtime is paid at ½ times the regular rate of $10.52 x 2 overtime hours = $10.52.

Employers therefore must be cautious when paying different hourly rates, or hourly rates with separate piece rates for piece work, because the overtime premium will be blended after factoring in all other rates times the hours worked at those rates. Additionally, the "rate-in-effect" method for paying hourly-rate overtime rarely applies in California, except in specified situations such as when an employee is being paid a "prevailing wage" for a public works project.

California also generally recognizes a "group regular rate" methodology for computing the regular rate of pay involving piece-rate, formula, or incentive pay workers. This method generally involves a formula whereby the total group's compensation is divided by the total number of people in the group, with each employee being paid his or her share. The regular rate for each worker is determined by dividing the pay received by the number of hours worked respectively. Of course, the regular rate cannot be less than the minimum wage.

No Manipulation To Avoid Overtime

In California, the regular rate is designed to further a two-fold public policy underlying overtime: 1) to spread employment by encouraging employers to avoid overtime work and thereby employ additional workers on a regular basis; and 2) where the employer prefers overtime work, to compensate the employee for the burden of working longer hours. Any methodology that seeks to undermine the regular rate to avoid payment of an overtime premium may be invalidated by the courts or the California Labor Commissioner as a subterfuge.

For example, an employer cannot first calculate weekly pay at the base piece or incentive rate, then avoid overtime by reducing those base rates so that the employee always receives the same level of compensation without an overtime premium based on the original rates.

Conclusion

Employers should do frequent regular rate tune-ups by consulting with their legal counsel and conducting internal audits on a regular basis. The calculation of the regular rate can be extremely complex when combining different pay schemes and incentive rates, but getting the number right can make thousands of dollars difference in the calculation of overtime. This can make all the difference in the end, both in calculating damages when claims are made, or in getting it right when calculating overtime during payroll.

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