

# THE IMPORTANCE OF GETTING THE CALIFORNIA “REGULAR RATE” RIGHT

Publication  
Oct 4, 2021

While most California employers are familiar with the “regular rate” from calculating non-exempt employees’ overtime payments, changes in the law make clear that employers will now need to perform the same regular rate calculation when paying premiums for failing to provide their employees with meal and rest breaks. In the recent decision of [\*Ferra v. Loews Hollywood Hotel, LLC\*](#), the California Supreme Court rejected the view that employers could pay meal and rest break premiums at the employee’s base hourly rate and instead required that employers perform the highly technical regular rate calculation including incentive pay attributable to the pay period when calculating meal, rest, or recovery period premiums.

The stakes for miscalculating the regular rate are now even greater. Employers that incorrectly calculate the regular rate may face class actions lawsuits and lawsuits under the Private Attorneys General Act (PAGA) for the underpayment of overtime wages and meal, rest, and recovery period premium payments. In light of this, California employers should invest time and resources in reviewing their policies and pay practices to ensure they are getting the regular rate calculation right.

## **Brief Summary of *Ferra v. Loews Hollywood Hotel, LLC***

As most California employers know, section 226.7 of the Labor Code requires employers to pay an additional one hour of pay *at the employee’s “regular rate of compensation”* for each workday that the meal or rest or recovery period is not provided (known as a “premium” payment). This premium payment must be made by the

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employer concurrently with the other wages due within the pay period when the break violation occurred.

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In *Ferra*, the Lowes Hollywood Hotel employed Jessica Ferra as a bartender and paid her hourly wages as well as a quarterly non-discretionary incentive payment that was attributable to the pay period when meal-period violations may have occurred. Lowes' practice, however, was to pay employees who were not provided a compliant meal or rest break one hour of premium pay at the employee's base hourly rate without calculating in the quarterly incentive payment attributable to that pay period. Ferra filed a class-action lawsuit arguing that non-discretionary incentive payments should have been factored into the calculation of meal and rest break premiums. The employer understood that "regular rate of compensation" meant only the base hourly rate of pay without considering the quarterly compensation.

The California Supreme Court determined, however, that the term "regular rate of compensation" for the required meal or rest or recovery period premiums was synonymous with the term the "regular rate of pay" for the purposes of calculating overtime. Accordingly, employers must now pay meal, rest, or recovery period premiums at the regular rate used for overtime calculations. The Court went one step further and determined that the decision would apply retroactively.

### **"Regular Rate" Refresh**

Given that employers will need to apply the regular rate used for overtime calculations (whether or not overtime is due in the work week when the violation occurs), employers should review the law including the below roadmap as a reminder on how to calculate the regular rate of pay. California generally follows, with few exceptions, the federal Fair Labor Standards Act (FLSA) when calculating the regular rate of pay. In most cases, the regular rate is calculated by adding all "remuneration" for employment (i.e., all compensation and earnings), except statutory exclusions, in any workweek divided by the total hours worked by that employee in the workweek.

While this may seem simple at first glance, employers should not underestimate the complexities that arise when combining different pay schemes and incentives in calculating the regular rate. Moreover, as noted below, there

are unique public policies in California that modify the calculation only in specific instances.

### **“Statutory” Exclusions from the Regular Rate**

The following is a list of the most commonly used statutory exclusions to the regular rate calculations. This list is not intended to be all-inclusive. Because statutory exceptions can be a legal minefield, you should consult with your California Fisher Phillips attorney before relying on any of them.

- *Gifts* – Gifts made occasionally, and which are not dependent on an employee’s hours worked, production, or efficiency, are not included when calculating an employee’s regular rate.
- *Payments Not for Hours Worked*– Payments to employees that are not compensation for hours worked generally are not included when calculating an employee’s regular rate. Payments for all vacation, holiday, paid sick leave, and paid time off for days not worked, as well as payments for unused vacation, are excluded. Additionally, payments for meal and rest period premiums are similarly excluded.
- *Reimbursements*– Generally, reimbursements for expenses incurred by employees on the employer’s behalf in furtherance of the employer’s interests, such as cellphone plans and credentialing exam fees, are not included when calculating the regular rate. However, if employees are provided with increased compensation that is earmarked specifically as reimbursement for routine expenses, there may be cause to allocate the prearranged increased wages to the regular rate calculation.
- *Excludable Benefits*– Employer contributions to certain benefit plans – such as retirement, life, accident, or health insurance – are not considered compensation when calculating the regular rate so long as the plan meets specific requirements.
- *Certain Premium Payments*– Overtime premiums paid for hours in excess of the daily or weekly overtime requirements need not be included in the employee’s regular rate. However, premiums paid for most differentials and hazardous or dirty work are required to be included in the regular rate.

- *Reporting and Call-Back Pay*– Payments made on infrequent and sporadic occasions for failure to give the employee sufficient notice to report to work or not providing employees with less than half of their usual or scheduled workday are excluded from the regular rate.
- *“Predictability Pay”*– Certain localities, including San Francisco and Emeryville, require employers to pay “predictability pay” for employees who do not receive the requisite notice of a schedule change. These payments are excludable so long as they are not so regular that they are “essentially prearranged.”

### **Discretionary vs. Non-Discretionary Bonuses**

Discretionary bonuses can be excluded from the regular rate. While it sounds simple, “discretionary” has a very specific meaning under the law of overtime, and if not carefully evaluated, can lead to an erroneous designation as “discretionary” and significant underpayment of overtime.

To be considered a discretionary bonus, the employer must retain sole discretion to the fact that the payment is to be made and the amount of the payment. The payment must be determined at or near the end of the period for which the bonus is paid and without any prior promise or agreement. Thus, if an employer announces in January that it intends to pay a bonus in June, the employer has abandoned its discretion with regard to the payment of the bonus (even if the bonus plan also has language that the employer may elect not to pay the bonus later for various reasons). Other considerations also may apply in designating a bonus as discretionary or non-discretionary for purposes of the regular-rate calculation for overtime purposes.

In short, don’t fall victim to the common pitfall of merely labeling the bonus as “discretionary” without careful evaluation by legal counsel. A discretionary label is not sufficient alone to guarantee that the payment is truly optional in nature or sufficiently divested from the performance metrics underlying the bonus that otherwise would require inclusion in the regular rate. Complex fact disputes may arise regarding the discretionary designation.

On the other hand, non-discretionary bonuses are designed to incentivize employees, which may occur in a variety of contexts. Bonuses that are paid under a contract, agreement, or promise are considered non-discretionary.

Examples include bonuses to increase productivity, quality of work, or attendance. Employers should audit their policies and practices with legal counsel to determine if the bonus is appropriately categorized as non-discretionary or discretionary.

## **Hiring / Signing Bonuses**

Many employers may be wondering whether hiring or signing bonuses should be included in the regular rate of pay. Generally, bonuses that are paid out at the time that an employee is hired and are not tethered to the employee's performance, hours, or length of service are arguably excluded from the regular rate calculation.

That being said, if any portion of the bonus is deferred or contingent upon performance or the employee's continued employment, the bonus is considered non-discretionary and must be included in the regular rate. The label of the bonus will not be determinative as to its impact on the regular rate or the performance periods that apply in determining the regular rate.

When considering a signing bonus should be coupled with a retention requirement, employers will need to weigh the importance of attracting and retaining qualified employees against the administrative burden of recalculating all premiums payments and the additional overtime due upon the conclusion of the retention period.

## **Flat-Sum Bonuses**

To add yet another complexity to bonus payments, the California Supreme Court's decision in [\*Alvarado v. Dart Container Corporation of California\*](#) held that employers must pay overtime for flat-sum bonuses using a different formula that does not credit the bonus as being earned over all hours worked including overtime hours, resulting in significantly increased overtime. Flat-sum bonuses are those that do not increase or have the potential to increase roughly in proportion to hours worked.

At issue in *Alvarado* was the employer's written policy providing an attendance bonus to any employee who was scheduled to work a weekend shift, and who in fact, completed the full shift. The bonus was paid, however, regardless of the number of hours the employee worked on that day. The Court adopted a new test for calculating

overtime due on a flat-sum bonus which divides the flat-sum bonus by the total *non-overtime* hours (as opposed to all hours in the general regular rate calculation).

Because the regular rate is determined by dividing the bonus only by non-overtime hours, the regular rate itself will be commensurately higher than if the bonus were divided by all hours worked (e.g., a production bonus). Once the flat-sum bonus regular rate is calculated, overtime is then paid at one-and-one-half times this rate rather than one-half (50% times) this rate. In essence, because the bonus did not pay anything for overtime hours worked, this overtime calculation at the full 1.5 times (as opposed to 0.5 times) the regular rate results in an increased amount paid for the overtime hours.

### **Piece-Rate Employees – Rest and Recovery Period Time**

Time spent on rest and recovery periods is “hours worked” and must be compensated and paid as part of total hours worked. This includes employees compensated on a piece-rate basis who are paid in accordance with California Labor Code 226.2. This compensation must be added into all remuneration for employment when calculating the regular rate.

### **Commissioned Employees**

Employers that pay commissions to employees less frequently than the regular pay period will need to calculate the additional overtime and meal-rest-recovery period premium payments owed for the pay period when violations occurred, also known as “true-up” payments. In California, the frequency of commission payments is regulated by law. In most situations, the commission payment must be apportioned back over the workweeks during which the commission was earned. In the situation where an employee’s hours are vastly different from one week to the next, or when it is not possible or practicable to allocate commissions among workweeks differently, in calculating the regular rate, the commission payment may be divided by the total hours worked for the entire period over multiple work weeks which the commissions were earned.

It follows that any *increase* in the regular hourly rate for any workweek in which a meal-rest-recovery period violation occurred will require a supplemental premium payment for such workweek. The additional overtime owed generally is

calculated by multiplying the increase in the hourly rate by one-half and then multiplying by the number of overtime hours worked in that workweek. Any additional double time is calculated by multiplying the increased hourly rate by all double time hours worked in the workweek. As noted, the overtime calculation will be different for flat-sum bonuses.

As a practical matter, payments will occur in stages when commissions are paid at different intervals than other wages. For meal-rest-recovery premium payments, employers will need to pay the premium at the employee's base hourly rate (or the known regular rate from other bonuses or hourly payments received concurrently with the base rate) until commissions can be calculated and are paid. Once commissions are calculated, employers will need to provide a "true-up" payment resulting from the increased regular rate, similar to bonuses.

Employers should add (or allocate) the commissions to total remuneration over the pay period, then divide the total remuneration by the total hours worked over the applicable pay period to get the ultimate regular rate of pay resulting from all sources of compensation. Because the meal and rest premium was (or should have been) already paid at the employee's base rate (or known regular rate at the time), the employer need only pay the increased amount of the regular rate or simply subtract the base rate (or known regular rate at the time) from the ultimate regular rate to get the "true-up" payment owed.

One thing to consider – if an employee's compensation consists mostly of commissions, the regular rate will likely be significantly higher than the employee's base hourly rate. For employers that were previously paying premiums at the employee's base rate, employers would do well to ensure proper budgeting for the increased premium payments.

### **Employees Paid at Multiple Rates**

When an employee works at two or more hourly rates in the same workweek, the regular rate for that week is the weighted average of such rates or the "blended" regular rate. For example, suppose an employee works a total of 42 hours for the workweek: 32 hours at \$18.00 per hour plus 10 hours at \$16.00 per hour. In this case, the weighted average (or "regular rate") is \$17.52. This rate is calculated by adding the \$736 straight time pay for the workweek [(32 hours x

$\$18.00/\text{hour}) + (10 \text{ hours} \times \$16.00/\text{hour}) = \$736]$  then dividing this amount by the 42 hours worked for the week.

Overtime is paid at one-half times the regular rate of \$17.52 x 2 overtime hours = \$17.52. If an employee did not receive two compliant meal periods over two different days during this workweek, this employee would be owed an additional \$35.04 [the regular rate (\$17.52) x 2 hours of premium payments].

### **Non-Exempt Salaried Employees**

Non-exempt employees paid on a salary basis must still be paid overtime at the regular rate of pay. In this scenario, the regular rate of pay is calculated based on a maximum 40-hour workweek rather than using all hours worked. Overtime is then calculated by multiplying the regular rate by one and one-half as opposed to the one-half premium used in the general calculation.

For example, if an employee is compensated a weekly salary of \$2,000 and works 42 hours in a workweek, the regular rate of pay is \$50.00 [ $\$2,000 / 40 \text{ hours}$ ]. Overtime is paid at \$75.00 per hour [ $1.5 \times \$50.00$ ]. Accordingly, this employee is owed \$150.00 for overtime compensation [ $\$75.00 \times 2 \text{ hours of overtime}$ ]. If this employee were not provided with three meal periods for each of three separate days in this workweek, the employee would be entitled to an additional \$150.00 [ $\$50 \times 3$ ].

### **Recommendations for Employers**

First and foremost, employers should review the formulas they are using to calculate the regular rate of pay and ensure that the regular rate is correctly calculated. Employers should also evaluate any bonuses to make sure they are correctly categorized. Finally, employers should evaluate their current practices for paying meal and rest period premiums.

Given the complexities of the regular rate calculations, employers should consult with their Fisher Phillips attorney regarding these important issues. As new developments occur in California, we will continue to assess and provide necessary updates. Please ensure you are [subscribed to Fisher Phillips' Insight system](#) to gather the most up-to-date information. If you have questions, please contact your Fisher Phillips attorney or the authors of this Insight.

