# CLIENT NEWS BRIEF

## Ninth Circuit Ruling Regarding Overtime Payments and the Fair Labor Standards Act May Have a Significant Impact on Employers

July 2016
Number 47

Striking a major blow to the practice of providing employees with cash payments in lieu of benefits (or "opt-out payments"), the Ninth Circuit Court of Appeals issued a ruling on June 2, 2016, holding that employers, including public agency employers, must include these cash payments in the regular rate of pay when calculating the overtime rate for employees under the Fair Labor Standards Act (FLSA). (*Flores v. City of San Gabriel* (9th Cir., June 2, 2016, No. 14-56421) __ F.3d __ [2016 U.S. App. LEXIS 10008].)

This ruling, coupled with the Internal Revenue Service's (IRS) recent treatment of these same arrangements in the context of the Affordable Care Act (ACA), shows a trend discouraging the use of cash-in-lieu payments related to health care coverage.

In *Flores*, the city provided a flexible benefits plan to its employees under which each employee was furnished a designated monetary amount for the purchase of medical, vision and dental benefits. All employees were required to use a portion of the amount to purchase vision and dental benefits, but could opt out of purchasing medical benefits with proof of alternate coverage. If an employee opted out of medical benefits, the city paid the employee the unused portion of the benefits allotment as a cash payment added to the employee's regular paycheck. For payroll purposes, the city has historically designated these cash-in-lieu payments as "benefits" and excluded them from its calculation of employees' regular rate of pay. Non-exempt police officers sued the City of San Gabriel for underpayment of overtime compensation, challenging the city's treatment of cash-in-lieu payments.

Under the FLSA, employers must pay their employees premium overtime compensation of one and one half times the regular rate of pay. The "regular rate" of pay includes "all remuneration for employment paid to, or on behalf of, the employee," subject to a number of exclusions set forth in § 207(e) of the FLSA.

In *Flores*, the city argued that it properly excluded cash-in-lieu payments from employees' regular rate of pay because the payments were not compensation for hours worked or otherwise tied to the amount of service provided by employees, citing statutory language that excludes payments made for such purposes as vacation, holidays, travel expenses and "other similar payments to an employee which are not made as compensation for his hours of employment." The court rejected this argument, explaining that the question of whether a particular payment falls within the "other similar payments" clause turns on whether the payment is a form of compensation for performing work – not on whether the payment is tied to an hourly wage.

The city also attempted to argue that the cash-in-lieu payments were properly excluded because the FLSA excludes contributions made by an employer to a trustee or third person pursuant to a "bona fide" benefits plan from the regular rate of pay. The court also rejected this argument, explaining that the city's

Dulcinea A. Grantham
Partner and Labor & Employment
Practice Group Co-Chair
Walnut Creek Office
dgrantham@lozanosmith.com

Niki Nabavi Nouri
Associate
Walnut Creek Office
nnabavinouri@lozanosmith.com

Lozano Smith
ATTORNEYS AT LAW

payments are not made to a trustee or third party and therefore do not meet the requirements of the benefits exclusion.

Taking it one step further, the court also found that the city's flexible benefits plan as a whole failed to meet the requirements of a "bona fide plan" because the city's cash payments to its employees constituted more than 40% of the total plan contributions and thus were not incidental. As a result, even the city's payments to trustees or third parties under its plan were not properly excluded under the benefits exclusion.

An employer who violates the FLSA's overtime provisions is liable for the amount of unpaid overtime compensation and an equal amount of liquidated damages which results in an employer having to pay double the amount of the underpayment. Employers that can show that they acted in good faith and had reasonable grounds to believe their actions did not violate the FLSA may avoid the otherwise mandatory award of liquidated damages.

In an attempt to show the city's good faith, an employee in the payroll department testified that the payroll and human resources departments work together to determine whether to include a particular type of payment in the regular rate of pay when the payment is first provided, conducting further review of the designation if new authority surfaces. The city also included other types of payments in the regular rate of pay and provided overtime payments that were more generous than what the FLSA requires.

The court described the city's evidence of its good faith as "paltry," explaining that employers need to be able to show they have taken concrete steps to ensure compliance with the FLSA. Further, the city's generosity in some areas failed to mitigate its inability to show how it properly determined to exclude the payment at issue. For similar reasons, the court also found that the city's violation was "willful," and therefore extended the statute of limitations from two years to three years, an action permitted under the FLSA for willful violations.

This is the first time that the Ninth Circuit has considered the treatment of cash-in-lieu payments in the context of FLSA overtime. The Court of Appeals preceded its analysis with the requirement that the FLSA be construed liberally in favor of employees, explaining that it would not find an exemption applicable except in contexts "plainly and unmistakably" within the given exemption's "terms and spirit." While this case involved treatment of a very specific type of payment to employees, it serves as an important message to all employers that determinations related to the regular rate of pay for employees must be made carefully and with an understanding that, if ever challenged, the employer must show the concrete steps it took to confirm that its designation was in compliance with the FLSA.

In light of this ruling, employers would be wise to immediately review their regular rate of pay for non-exempt employees and work with counsel to consider whether there are any issues with current designations and exclusions of compensation. Immediate action to add cash-in-lieu payments to the regular rate of pay for purposes of overtime may be necessary to mitigate damages in case of future challenge.

We will update you if this case is appealed. For further information regarding calculation of the regular rate of pay for non-exempt employees or regarding the treatment of specific type of payments for purposes of the FLSA, please contact the authors of this Client News Brief or an attorney at one of our nine offices located statewide. You can also visit our website, follow us on Facebook or Twitter, or download our Client News Brief App.