

# CALIFORNIA

## EMPLOYMENT LAW LETTER

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### WAGE AND HOUR LAW

## California Supreme Court breaks with federal law, sides with employees

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*A class of food service employees alleged their employer underpaid overtime compensation. The California Supreme Court agreed, ruling that when calculating the hourly value of a flat-sum bonus during a single pay period, the employer must divide the bonus amount earned in the pay period by the non-overtime hours worked by the employee.*

### **Employees challenge overtime calculation**

Dart Container Corporation of California manufactures food service products. In addition to an hourly wage, Dart employees are eligible to earn a flat-sum \$15 per day “attendance bonus” upon completion of a full shift on Saturday or Sunday, regardless of whether they worked overtime that day. Dart calculated overtime pay for employees earning attendance bonuses by dividing each employee’s total earnings, including bonus compensation, by the total hours worked, including overtime hours.

Dart warehouse associate Hector Alvarado sued the company on behalf of himself and other employees, arguing it committed various wage and hour violations, including the underpayment of overtime for the weeks in which he had earned an attendance bonus. Dart

asked the court to dismiss his claims without a trial, arguing that in the absence of applicable California law, its method of calculation complied with federal law and therefore was proper. Alvarado offered a competing method of calculation that was endorsed by California’s Division of Labor Standards Enforcement (DLSE) in its Enforcement Policies and Interpretations Manual. The trial court and the California Court of Appeal sided with Dart. The California Supreme Court granted review and reversed the lower courts’ rulings.

### **California law is unclear**

Under California law, employees are entitled to 1½ times their “regular rate of pay” for work in excess of eight hours per day or 40 hours per week and for any work performed on a seventh consecutive workday. Importantly, an employee’s “regular rate of pay” is not the same as the employee’s normal hourly wage rate. The regular rate of pay can change from pay period to pay period, including adjustments based on other components such as shift differentials and the per-hour value of any nonhourly earned compensation (e.g., piecework, commissions, and bonuses).

The dispute in this case arose over how to factor Dart’s “attendance bonus” into the calculation of the employees’ regular rate of pay, which is critical for

determining their overtime pay rate. Recognizing that California law has been unclear on this issue, the California Supreme Court waded into the debate.

Specifically, the supreme court asked whether the divisor for purposes of calculating the per-hour value of the bonus should be:

- (1) The number of hours the employee actually worked during the pay period, including overtime hours (the federal formula and the one used by Dart);
- (2) The number of nonovertime hours the employee worked during the pay period (the formula endorsed by the DLSE and Alvarado); or
- (3) The number of nonovertime hours that exist in the pay period, regardless of the number of hours the employee actually worked.

Ultimately, the key distinction between the competing formulas was whether to allocate the bonus to all hours worked during a pay period or only the nonovertime hours.

### ***Only nonovertime hours worked should be considered***

California labor laws are liberally construed to protect workers and reflect a long-standing policy of discouraging overtime work. Dart's employees could earn a flat-sum bonus without working any overtime hours. Hence, the supreme court reasoned that only nonovertime hours should be considered when calculating the hourly value of the bonus.

The court next considered whether the divisor for purposes of calculating the per-hour value of a weekly salary should be the number of nonovertime hours *actually* worked by the employee in the workweek in question, which could be less than 40, or whether it should be the number of nonovertime hours that exist in a workweek.

The court could not discern a basis for the latter option, which would dramatically reduce overtime pay rates for part-time employees. Thus, consistent with the DLSE and Alvarado's interpretation, the court held that the divisor should be the number of nonovertime hours *actually* worked in the relevant pay period, not the total nonovertime hours *existing* in the pay period. That leads to a higher regular rate of pay and a higher overtime rate, thus advancing worker protection.

Dart argued that the DLSE's regulations on this issue constituted a "void underground" enforcement policy not entitled to deference. Therefore, it acted correctly by using the method of calculation authorized by federal law. The California Supreme Court disagreed. It acknowledged that the DLSE manual is void and not a formal regulation, but it deemed it to be "persuasive" authority containing a correct interpretation of California law on this issue.

At oral argument, Dart urged the court to apply its holding prospectively only, pointing out that the company had reasonably followed a federal regulation after interpreting the DLSE's guidance as void. Although several justices expressed dismay at the uncertainty created by the DLSE's failure to issue its manual in accordance with California's Administrative Procedure Act, the court nevertheless held that its decision should apply retroactively. *Alvarado v. Dart Container Corporation of California* (Supreme Court of California), 3/5/18.

## ***Bottom line***

Employers that pay flat-sum bonuses should have their pay policies reviewed to ensure they are calculating overtime in compliance with the formula endorsed by the California Supreme Court. Because the court's ruling applies retroactively, noncompliant pay practices could result in significant financial exposure to claims for unpaid wages, penalties, interest, and attorneys' fees. Furthermore, although the court expressly limited its decision to flat-sum bonuses, best practices would encourage you to assess whether *Alvarado's* calculation method could apply to other forms of nonhourly compensation.

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