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The Public Sector

DOL issues new guidance on overtime rules, reducing, but not eliminating, exposure to liability

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The question of when and whether employees are entitled to overtime pay under federal law has often vexed private- and public-sector employers. Parts of the Fair Labor Standards Act (FLSA) are opaque and antiquated, and the interpretive guidance provided by U.S. Department of Labor (DOL) regulations has often left even experienced employment law practitioners in doubt about how to handle complex overtime issues.

The significant risks associated with FLSA violations, including liquidated damages for "willful" violations, a loose "willfulness" standard, attorneys' fees, and a two- or three-year statute of limitations depending on an employer's "good faith," have provided a strong initiative for employers to settle questionable cases. The fact that DOL regulations are not a safe harbor protecting compliant employers from judicial scrutiny presents an additional risk.

DOL updates regs covering regular rate of pay

In December 2019, the DOL issued a final rule addressing which types of payments employers must include and exclude when calculating employees' regular rate of pay to determine overtime rates. The FLSA requires employers to pay nonexempt employees overtime at 1½ times their regular rate when they work more than 40 hours in a workweek. The regular rate isn't just an employee's hourly rate of pay but includes "all remuneration for employment" unless it's specifically excluded by Section 7(e) of the FLSA. "Remuneration" is a very broad term that implicates a broad range of payments. The DOL's new rule is intended to provide clarity by defining which perks and benefits are includable as "remuneration."

The final rule is the first significant update to the regulations governing regular rate in more than 50 years. According to the DOL, the rule will allow employers to more easily offer perks and benefits to their employees. Under the new regulations, an employer may exclude the following payments from its regular rate of pay calculations:

- Parking benefits, wellness programs, on-site specialist treatment, gym access and fitness classes, employee discounts on retail goods and services, certain tuition benefits (whether they're paid to an employee, an education provider, or a student loan program), and adoption assistance;
- Unused paid leave, including paid sick leave or paid time off;
- Certain penalties required under state and local scheduling laws;
- Reimbursed expenses, including cell phone plans, credentialing exam fees, organization membership dues, and travel, even if they aren't incurred "solely" for the employer's benefit (the rule also clarifies that reimbursements that don't exceed the maximum travel reimbursement under the Federal Travel Regulation system or the optional IRS substantiation amounts for travel expenses are per se "reasonable payments");
- Certain sign-on and longevity bonuses;
- The cost of office coffee and snacks for employees as gifts;
- Discretionary bonuses (the DOL clarifies that the label given to a bonus doesn't determine whether it is discretionary and provides additional examples); and
- Contributions to benefits plans for accidents, unemployment, legal services, or other events that could cause future financial hardship or expense.

Importantly, the new regulations don't carry the same force of law as the FLSA, and compliance will not fully insulate employers from legal challenges under the Act. For instance, the history underlying the new DOL regulations on holiday in-lieu pay shows that compliance with DOL regs doesn't immunize employers from federal lawsuits.

Holiday in-lieu pay

The work schedules of employees in 24/7 operations (e.g., police and fire departments) are different from those of employees who routinely work five days a week and get holidays off. Employees in 24/7 employment typically work on the holidays that occur on scheduled workdays, and they are paid for time worked on those holidays.

Holiday in-lieu pay is a common feature in public-sector sworn employment. Under a holiday in-lieu arrangement, all 24/7 employees in the work unit receive a uniform amount of pay conferred on a periodic basis—most defensibly, within the same pay period. Also, when employees work on a holiday, they are still paid for their work time, typically at straight-time rates.

The previous DOL regulations (29 CFR § 778.219) and a 2006 interpretive bulletin specifically approved that practice. Relying on the DOL's viewpoint, many employers haven't included the value of holiday in-lieu pay when calculating employees' regular rates for FLSA purposes. However, attentive union lawyers realized that an attack on the DOL's approach could bear fruit.

Successful challenges to previous DOL regulations

Employees who filed relatively recent federal district court cases involving the city of Merced and Colusa County claimed that their holiday in-lieu arrangements violated the FLSA. The employers invoked the old DOL regulations and the interpretive bulletin as a defense. But the courts hearing the cases declined to accept the DOL's stance, finding that the FLSA requires employers to include holiday in-lieu payments in regular rate of pay calculations if employees don't have a choice about whether to work on a holiday.

Word of those victories spread to unions representing employees who receive holiday in-lieu pay, leading to threats of litigation by union lawyers against various public employers. While federal courts' decisions aren't precedential or binding on other federal courts, the prospect of expensive federal litigation with potential losses that would include substantial back pay and attorneys' fees loomed large, particularly since the federal decision in *McKinnon v. City of Merced* came out in late 2018.

Thankfully, the new DOL regulations specifically and firmly state that holiday in-lieu pay need not be included in the calculation of regular pay rates. The DOL emphasized that the regulation does not "[make] the excludability of such payments dependent on the employee having the option to work or not work on the holiday." Instead, all that's required is that an employee receive some amount of holiday pay in addition to being paid for his actual hours worked on the holiday. Notably, the DOL directly criticized the court's analysis in the *Merced* case.

Union lawyers capitalize on FLSA uncertainties

For decades, union lawyers have been able to capitalize on the litigation risks employers face when administering overtime policies and practices. A good example is the 2016 decision in *Flores v. City of San Gabriel* from the 9th U.S. Circuit Court of Appeal (whose rulings apply to all California employers). The case involved "in-lieu" payments for employees who opt out of their employer's health benefits programs. Few, if any, employers—including San Gabriel—include those payments in their regular rate calculations.

The city successfully defended its practice at the trial court level, but the 9th Circuit reversed, holding that in-lieu payments must be included in regular rate calculations. That prompted many union lawyers to threaten federal litigation unless employers changed their practices and paid employees two to three years of back pay plus attorneys' fees. Such cases are expensive because the FLSA requires that any settlement agreement be approved by a court or the DOL.

After *Merced*, union lawyers, following the *Flores* template, approached employers that hadn't included the value of holiday in-lieu pay in their regular rate calculations. Given the new regulations and the DOL's critique of the *Merced* reasoning, we can expect those efforts by union lawyers to recede. But the fact that the courts don't necessarily defer to the DOL remains a wild card. Employers that have been threatened with lawsuits over in-lieu pay are wisely considering their options.

Bottom line

The new DOL regulations provide welcome clarity and relief with regard to the excludability of many types of compensation that modern employers want to provide. The regs also reduce the prospect of legal challenges against employers that don't include certain payments in their regular rate calculations. However, federal courts aren't required to accept the DOL's interpretation of the FLSA. Here are some things to keep in mind:

- Some employers already include holiday in-lieu pay in their regular rate calculations. They now have a basis for reconsidering that practice, but they must be sure to comply with any legal collective bargaining requirements.
- When faced with an employee's attorney's demand for back pay and its prospective inclusion in the rate of pay calculations, employers need to carefully evaluate the risks and benefits of settlement. The DOL's stance provides a good deal of leverage.
- Employers calculating their potential exposure should remember to get credit for overtime payments that go beyond FLSA requirements.

It's a good time for agencies that haven't recently audited their pay policies and practices for FLSA compliance to do so.

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