



## THE PUBLIC SECTOR

### 9th Circuit: 'In lieu' benefits cash-outs must be included in 'regular rate' calculations

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Calculating an employee's "regular rate of pay" is important for many reasons, among them determining the employee's overtime pay rate. That calculation may not be so easy, however. On June 2, 2016, the 9th Circuit issued a decision in *Flores v. City of San Gabriel* in which it found that cash-outs of unused portions of health insurance premiums must be included in the calculation of an employee's regular rate of pay under the Fair Labor Standards Act (FLSA), for both public- and private-sector workers.

#### ***City's cash-in-lieu-of-benefits policy violates FLSA***

Under the FLSA, employees who work overtime must be compensated "at a rate not less than one and one-half times the regular rate" at which they are employed. With limited exceptions, the FLSA requires that employers include all "remuneration for employment" when calculating the regular rate of pay.

The city of San Gabriel maintained a "Flexible Benefits Plan" in which it provided a fixed contribution to each employee for the purchase of medical, vision, or dental benefits—benefit amounts that are not usually calculated as part of an employee's regular pay rate. With proof of alternative coverage, employees could forgo medical benefits and receive the unused portion in cash with their paycheck. The city did not include the value of the "cash-out" when it calculated employees' regular rate of pay for overtime purposes.

In 2012, current and former police officers sued the city in federal court, claiming that the cash-in-lieu-of-benefits program violated the FLSA. The officers alleged that by not including the cash-out payments in its pay calculations, the city failed to fully compensate them for the overtime they worked. The city denied their claim.

The district court ultimately agreed with the officers that the city should have included the cash-in-lieu-of-benefits payments in its regular rate calculations. On appeal, a panel of the 9th Circuit affirmed the trial court's finding.

#### ***9th Circuit's ruling***

The 9th Circuit began by examining 29 U.S.C. § 207(e)(2), which excludes from the regular pay rate "payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause; . . . and other similar payments to an employee which are not made as compensation for his hours of employment." The city contended that this section permits the exclusion of payments like its cash-out that don't depend on when or how much work the employee performs. The court disagreed.

The 9th Circuit held that the sole question was whether the payments at issue were generally understood as compensation to employees, and it didn't matter whether the payments were tied to specific hours worked by employees. While calling it a "close question," the court concluded that the city's payments constituted "compensation for work" and they therefore weren't properly excluded under § 207(e)(2).

The 9th Circuit next considered whether the cash-out payments could be excluded under 29 U.S.C. § 207(e)(4) as "contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees." The court had "no trouble" finding that the payments weren't excluded under this provision because "the City pays the unused benefits directly to its employees and not 'to a trustee or third person.'"

Critically, the court also held that because the city paid out more than 40 percent of its benefits payments as cash, the payments were not "incidental" to the plan. Therefore, all plan payments (i.e., both the in-lieu payments as well as the city's health insurance contributions) were includable in the regular rate.

Adding insult to injury, the 9th Circuit penalized San Gabriel with a liquidated damages award and an extra year of liability because its breach of the FLSA was "willful," suggesting that the city would have known it was violating FLSA if it had exercised due diligence. *Flores v. City of San Gabriel*, Nos. 14-56421 & 14-56514 (9th Cir., June 2, 2016).

## Bottom line

If this decision is not overruled, it could have a serious material impact in workplaces where employees work substantial amounts of overtime and the employer provides cash-outs for unused health insurance benefits above an “incidental” amount. Overtime obligations may increase significantly in those workplaces as a result of the 9th Circuit’s decision. The decision may also lead to a new wave of litigation against the many employers—public- and private-sector alike—that offer “opt outs” without including their value when calculating base rates of pay.

Further, this case can be read to result in different overtime rates for employees who perform identical work, depending on whether or not they “cash out” their health benefits. Cash in lieu of benefits is one of many benefits—such as free lunches—that employers must keep in mind when calculating the regular rate of pay. The court’s issuance of liquidated damages and finding of a “willful” violation are also of concern. The *Flores* decision will take many employers by surprise,

despite their efforts to keep in step with the complexities of the FLSA.

One partial solution, of course, is to eliminate cash-in-lieu payments, but that isn’t as simple as it sounds. Unionized workplaces (which make up the vast majority of the California public sector) cannot unilaterally eliminate cash-out programs but instead must negotiate the issue with their employees’ unions. And most collective bargaining agreements or memoranda of understanding contain “zipper” clauses that prevent changes to contract terms for the duration of the agreement.

**Editor’s note:** The authors are involved in filing a friend-of-the court brief for the likely appeal in this case on behalf of the California League of Cities.



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