



Avoiding Lawsuits under the Federal Labor Standards Act (FLSA): Overtime Pay & Rise of Class Action Lawsuits

This update applies to businesses with a large number of *hourly* employees who receive *bonuses*.

There has been a rise nationally and specifically in Wisconsin in plaintiff's attorneys filing class action suits against employers based on specific nuanced areas of federal law. One area of concern is violations under the FLSA. The incentive in these suits is that the plaintiff's law firm can recover attorneys fees as part of the suit from the employer. The attorney's fees often overshadow the damage to employees from underlying violations. For example, a class action suit could arise from underpaying overtime by \$50-\$100 per employee, but the plaintiff's legal fees may be tens of thousands of dollars.

Accordingly, it is important to review your employment practices, specifically in the areas of bonuses and overtime pay, to avoid costly litigation.

Short Summary of Issue

Under the FLSA, if hourly employees receive any kind of bonuses that are considered non-discretionary, those bonuses must be included in calculations of overtime pay.

The definition of "non-discretionary" bonuses is surprisingly broad. For example, bonuses that are likely to be considered "non-discretionary" include:

- Bonuses announced to employees to induce them to work more steadily or more rapidly or more efficiently
- Bonuses announced to employees to induce them to remain with the firm are regarded as part of the regular rate of pay
- Attendance bonuses
- Individual or group production bonuses
- Bonuses for quality and accuracy of work
- Bonuses contingent upon the employee's continuing in employment until the time the payment

FLSA exemptions are narrowly construed against employers. Cases within the Seventh Circuit have trended to finding bonuses non-discretionary as long as the employees had some expectation that they would receive the bonus if they met certain conditions.

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Applicable Laws: The FLSA

The Fair Labor Standards Act (FLSA) establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in Federal, State, and local governments.

Most businesses are subject to the FLSA, as the FLSA applies to an employer engaged in interstate commerce or with annual gross sales volumes of \$500,000 or more.

The FLSA requires that an employee be compensated with overtime pay at a rate not less than one and one-half times the employee's "regular rate" for hours worked in excess of forty in a week. An employee's "regular rate" includes all remuneration for employment paid to the employee, subject to eight statutory exemptions. "Discretionary" bonuses are one of the exemptions; "non-discretionary" bonuses are not.

FLSA exemptions are narrowly construed against employers.

Applicable Laws: Wisconsin Wage and Hours Laws

Wisconsin law mirrors federal law. Where either federal or state law is more favorable to the employee or is more restrictive upon the employer, that law must be followed.

The Wisconsin wage and hour laws apply to all employers who employ full or part-time employees in private employment.

The wage and hour laws deal with minimum wages, maximum hours, overtime pay, child labor and recordkeeping. The Wisconsin wage and hour laws are enforced by the Equal Rights Division – Labor Standards Bureau of the Department of Workforce Development.

Generally, Wisconsin Wage and Hours Laws require that Employees be paid for all hours worked.

Each employer subject to Wisconsin's overtime regulations must pay to each covered employee 1 1/2 times the employee's "regular rate" of pay for all hours worked in excess of 40 hours per week.

"Regular rate" includes all remunerations paid to or on behalf of the employee such as commissions, nondiscretionary bonus, premium pay, and piecework incentives.

Discretionary Bonuses

Generally speaking discretionary bonuses do not need to be included in the calculation of overt

The relevant exemption for bonuses (29 USC § 207(e)(3)) provides:

(e) "Regular rate" defined. As used in this section the "regular rate" at which an employee is employed shall be deemed to include all remuneration for employment paid to, or on behalf of, the employee, but shall not be deemed to include—

....

(3) Sums [sums] paid in recognition of services performed during a given period if either, (a) both the fact that payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly; . . .

“Non-discretionary” bonuses do not qualify for exclusion from the regular rate, and they must be totaled in with other earnings to determine the regular rate on which overtime pay must be based.

Federal regulations provide further guidance. In order for a bonus to qualify for exclusion as a discretionary bonus **the employer must retain discretion both as to the fact of payment and as to the amount until a time quite close to the end of the period for which the bonus is paid. The sum, if any, to be paid as a bonus is determined by the employer without prior promise or agreement.** The employee has no contract right, express or implied, to any amount.

If the employer promises in advance to pay a bonus, he has abandoned his discretion with regard to it. Thus, if an employer announces to his employees in January that he intends to pay them a bonus in June, he has thereby abandoned his discretion regarding the fact of payment by promising a bonus to his employees. . . . **Similarly, an employer who promises to sales employees that they will receive a monthly bonus computed on the basis of allocating 1 cent for each item sold whenever, is his discretion, the financial condition of the firm warrants such payments, has abandoned discretion with regard to the amount of the bonus though not with regard to the fact of payment.** Such a bonus would not be excluded from the regular rate. On the other hand, if a bonus such as the one just described were paid without prior contract, promise or announcement and the decision as to the fact and amount of payment lay in the employer's sole discretion, the bonus would be properly excluded from the regular rate.

To be an excluded bonus, the bonus must not be paid “pursuant to any prior contract, agreement, or promise.” For example, any bonus which is promised to employees upon hiring or which is the result of collective bargaining would not be excluded from the regular rate under this provision of the Act. **Bonuses which are announced to employees to induce them to work more steadily or more rapidly or more efficiently or to remain with the firm are regarded as part of the regular rate of pay.** Attendance bonuses, individual or group production bonuses, bonuses for quality and accuracy of work, bonuses contingent upon the employee's continuing in employment until the time the payment is to be made and the like are in this category. They must be included in the regular rate of pay.

Cases within the Seventh Circuit have trended to finding bonuses non-discretionary as long as the employees had some expectation that they would receive the bonus if they met certain conditions.

- *Weninger v. Gen. Mills Operations LLC*, 344 F. Supp. 3d 1005, 1007-08 (E.D. Wis. 2018): The court held that a wage incentive bonus determined annually and calculated according to a formula was a non-discretionary bonus. The bonus was calculated according to a

formula established by the employer in order to encourage or reward their rapid, safe, consistent, and efficient work performance, and the bonus was known to employees. If an employee is an active, full-time employee at the time the bonus is made, he or she is entitled to receive it. The formula takes into account the employee's work performance, the production facility's performance, the safety and reliability of the facility, and other performance metrics.

- *Gilbertson v. City of Sheboygan*, 165 F. Supp. 3d 742, 749-50 (E.D. Wis. 2016): The court held that lump sum bonus payments given to employees at the top of their position's wage scale were non-discretionary. While the compensation program provided that increases were not automatic and it was up to each supervisor and/or department head to approve the amount granted to the employee, criteria were included in the evaluations, and the bonuses fell into the category of those "which are announced to employees to induce them to work more steadily or more rapidly or more efficiently or to remain with the firm are regarded as part of the regular rate of pay."
- *Caraballo v. City of Chi.*, 969 F. Supp. 2d 1008, 1017 (N.D. Ill. 2013): The court held that certain bonuses were non-discretionary because they were included under the Collective Bargaining Agreement. The employer had no discretion whether to pay the bonuses if the employees fulfilled the conditions required for the payment.

In sum, it appears that to be exempt, the bonus must be truly discretionary, and the employees can have no prior expectation that they will receive the bonus; the bonus must be entirely dependent on the employer.

Recommendations

Employers should review all bonus policies.

Unless a bonus plan is set up as "entirely discretionary" with no references to other factors in any written materials or in the presentation of the bonus plan to employees, an employer should err on the side of counting the bonuses in calculations of the employee's overtime payrate.

Practically, there are questions of how to implement such a policy. If you utilize a payroll service, ensure that they are complying with the FLSA and the bonus and overtime calculation provisions.

If you handle payroll in-house, make sure you understand how the calculations apply to different employees. Guidance from the Department of Labor is attached for your reference.

If you have any questions, please contact our office to discuss further.

EXERPT FROM DEPARTMENT OF LABOR GUIDANCE

Example #1 – Bonus paid and earned during the pay period

Bonuses For purposes of calculating overtime pay, section 7(e) of the FLSA provides that non-discretionary bonuses must be included in the regular rate of pay. Non-discretionary bonuses include those that are announced to employees to encourage them to work more steadily, rapidly or efficiently, and bonuses designed to encourage employees to remain with a facility. Few bonuses are discretionary under the FLSA, allowing exclusion from the regular rate (see [29 CFR 778.200](#) and [778.208](#)). Referral bonuses paid for recruitment of new employees are not included in the regular rate of pay *if all of the following conditions are met*: (1) participation is strictly voluntary; (2) recruitment efforts do not involve significant time; and (3) the activity is limited to after-hours solicitation done only among friends, relatives, neighbors and acquaintances as part of the employees’ social affairs.

An intermediate care facility for the disabled pays its employees on a bi-weekly basis. If employees work all the hours that they are scheduled to work in a pay period, they are given a \$100 bonus. If an employee works overtime, must this bonus be included in their regular rate of pay for overtime purposes?

Yes. In computing an employee’s regular rate under the 40 hour overtime standard, the employer must add half of the bi-weekly bonus (\$50) to the employee’s earnings (hourly rate times the total hours worked) for that week. The resulting total compensation would be divided by the total hours the employee worked during that week to determine the regular rate.

An employee paid biweekly at a rate of \$12 per hour plus a \$100 attendance bonus, working a schedule of 56 hours per week as shown in the chart below, would be due overtime pay as follows:

WEEK 1	Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
Hours Worked	8	8	8	8	8	8	8

WEEK 2	Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
Hours Worked	8	8	8	8	8	8	8

\$100 (bi-weekly attendance bonus) ÷ 2 =	\$50 (weekly bonus equivalent)
56 hours worked x \$12/hour + \$50 (weekly bonus equivalent) =	\$722 (total ST compensation)
\$722 (total ST compensation) ÷ 56 hours worked =	\$12.89 (regular rate)
\$12.89 (regular rate) x ½ =	\$6.45 (half-time premium)
\$12.89 (regular rate) + \$6.45 (half-time premium) =	\$19.34 (overtime rate)
40 (straight time hours) x \$12.89 (regular rate) =	\$515.60 (straight time earnings)
16 (overtime hours) x \$19.34 (overtime rate) =	\$309.44 (overtime earnings)
Total earnings for week one	\$825.04
Total earnings for week two	\$825.04

Total earnings for bi-weekly period

\$1,650.08

Example #2 – Bonus earned over a series of pay periods

Bonuses For purposes of calculating overtime pay, section 7(e) of the FLSA provides that non-discretionary bonuses must be included in the regular rate of pay. Non-discretionary bonuses include those that are announced to employees to encourage them to work more steadily, rapidly or efficiently, and bonuses designed to encourage employees to remain with a facility. Few bonuses are discretionary under the FLSA, allowing exclusion from the regular rate (see [29 CFR 778.200](#) and [778.208](#)). Referral bonuses paid for recruitment of new employees are not included in the regular rate of pay *if all of the following conditions are met*: (1) participation is strictly voluntary; (2) recruitment efforts do not involve significant time; and (3) the activity is limited to after-hours solicitation done only among friends, relatives, neighbors and acquaintances as part of the employees' social affairs.

In an effort to attract more nursing personnel, a skilled nursing facility's nursing department gives hourly paid LPNs and RNs a \$2,000 bonus after being employed six months. Does this bonus have to be included in the regular rate? If so, how does it need to be calculated?

Yes. The retention bonus must be included in the regular rate calculation in overtime weeks covered by the bonus period. The retention bonus described above was earned over six months or 26 weeks. The weekly equivalent is \$76.92 ($\$2,000 \div 26$ weeks). If an employee works overtime during the 26 week period, the increase in the regular rate is calculated by dividing \$76.92 by the total hours worked during the overtime week.

In the following calculation, the \$2,000 retention bonus was earned over six months or 26 weeks, for a weekly equivalent of \$76.92 ($\$2000 \div 26$ weeks). If the employee worked ten hours of overtime in their 9th week of employment, the employee would be due an additional \$7.70 in overtime earning as follows:

$$\begin{aligned} \$76.92 \div 50 \text{ hours} &= && \$1.54 \text{ (increase in the regular rate)} \\ \$1.54 \times \frac{1}{2} &= && \$.77 \text{ (increase in the additional half-time premium)} \\ \$.77 \times 10 \text{ hours of overtime worked} &= && \$7.70 \text{ (increase in overtime earnings due to the bonus)} \end{aligned}$$

Example #3 – Shift Differentials

Employers also must include shift differential pay when determining an employee's regular rate of pay (see [29 CFR 778.207\(b\)](#)). The following example provides guidance on how to calculate overtime for employees who receive shift differential pay.

A personal care assistant at an assisted living facility is paid \$8 an hour and overtime on the basis of the 40 hour workweek standard. She works three eight-hour day shifts at \$8 an hour and three eight-hour evening shifts. The assistant is paid \$1 shift differential for each hour worked on the evening shift. How much should she be paid for her eight hours of overtime?

The additional half-time must be computed based on the regular rate of pay. The regular rate is defined as the total remuneration divided by the total hours worked. The assistant earned a total of \$408 for the 48 hours that she worked (\$8 an hour times 24 hours plus \$9 an hour times 24 hours). Her regular rate equaled \$8.50 and her half-time premium is \$4.25. Her total earnings for the 8 hours of overtime are \$102.

Straight-time computation

3 days x 8 hours/day x \$8/hour	\$192
3 evenings x 8 hours/evening x \$8/hour	\$192
3 evenings x 8 hours/evening x \$1/hour (shift differential)	\$ 24
Total ST earnings	\$408

Regular rate and half-time premium computation

\$408 (total ST compensation) ÷ 48 (total hours worked) =	\$ 8.50 (regular rate)
\$ 8.50 (regular rate) x ½ =	\$ 4.25 (half-time premium)
\$ 8.50 (regular rate) + \$ 4.25 (half-time premium) =	\$12.75 (overtime rate)

Total compensation calculation

40 hours x \$ 8.50 (regular rate) =	\$340 (straight time earnings)
8 overtime hours x \$12.75 (overtime rate) =	\$102 (overtime earnings)
Total earnings	\$442

Example #4 – Multiple rates of pay

An employee works as a nurses’ aide on a full time basis at \$11 an hour. On weekends, the employee fills in as a receptionist and is paid \$7 an hour. She is paid on a 40-hour workweek overtime basis. How is her overtime computed?

Overtime may be computed on the regular rate of pay, determined by the weighted average of the two rates. For example, if the employee worked 40 hours at \$11 and 16 hours at \$7, the following is the regular rate calculation:

40 hours x \$11/hour + 16 hours x \$7/hour =	\$552 (total ST compensation)
\$552 (total ST compensation) ÷ 56 hours worked =	\$9.86 (regular rate)
\$9.86 (regular rate) x ½ =	\$4.93 (additional half time premium)
\$9.86 (regular rate) + \$4.93 =	\$14.79 (overtime rate)
\$9.86 (regular rate) x 40 hours =	\$394.40 (total straight time earnings)
\$14.79 (overtime rate) x 16 (overtime hours)	\$236.64 (total overtime earnings)
Total compensation	\$631.04

If an employee works at two or more different jobs in a single workweek, for which different non-overtime rates of pay have been established, his or her employer may use a weighted average to compute the employee’s regular rate (as shown in the above example). However, an employee

who performs two or more different kinds of work, for which different straight time hourly rates are established, may agree with his or her employer in advance of the performance of the work that he or she will be paid during overtime hours at a rate not less than one and one-half time the hourly rate established for the type of work he or she is performing during the overtime hours (see [29 CFR 778.419](#)).

Example #5 – Salary paid to a non-exempt employee

If under the employment agreement, a salary sufficient to meet the minimum wage requirement in every workweek is paid as straight time for whatever number of hours are worked in a workweek, the regular rate is obtained by dividing the salary by the number of hours worked each week (see [29 CFR 778.114](#)).

To illustrate, suppose an employee's hours of work vary each week and the agreement with the employer is that the employee will be paid \$420 a week for whatever number of hours are required. Under this agreement, the regular rate will vary in overtime weeks. If the employee works 50 hours, the regular rate is \$8.40 (\$420 divided by 50 hours). In addition to the salary, half the regular rate, or \$4.20, is due for each of the 10 overtime hours, for a total of \$462 per week. If the employee works 60 hours, the regular rate is \$7.00 (\$420 divided by 60 hours). In that case, an additional \$3.50 is due for each of the 20 overtime hours for a total of \$490 for the week.

In no case may the regular rate be less than the minimum wage required by the FLSA.

If a salary is paid on other than a weekly basis, the weekly pay must be determined in order to compute the regular rate and overtime pay. If the salary is for a half month, it must be multiplied by 24 and the product divided by 52 weeks to get the weekly equivalent. A monthly salary should be multiplied by 12 and the product divided by 52.