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Labor & Employment Alert

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Lemm v. Ecolab — California Court of Appeal holds that "percentage bonuses" based on regular and overtime hours comply with California laws

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The Court rejected a different interpretation of California law that would have required employers to pay "overtime on overtime" on "percentage bonuses" plans, which would have led to significant exposure for employers utilizing such plans.

What's the Impact?

- Employers utilizing, or considering, "percentage of gross earnings" bonus paradigms should review their policies to ensure they conform with *EcoLab*.
- *EcoLab* sets forth a roadmap for an administratively simple way to comply with California overtime rules for employees with sales-based compensation.

California has "a long-standing policy of discouraging employers from imposing overtime work." (*See Alvarado v. Dart Container Corp.* (2018) 4 Cal. 5th 542.) This is manifested, in part, by requiring employers to pay overtime to non-exempt employees for qualifying hours (e.g., over 12 per day, over 40 per week). This extremely simple in principle is extremely complicated in practice. The core of that complexity is proper calculation of the "regular rate of pay."

This is so because there are several ways to calculate "regular rate of pay", and California has rules for when each calculation should apply. *Lemm v. EcoLab* adds one more rule to set, and it's of an "employer-friendly" variety.

Background and procedural history of *Lemm v. EcoLab*

Lemm worked for EcoLab as a non-exempt sales manager with a specific route, often more than 12 hours a day and 40 hours in a week. It was undisputed that EcoLab's paid Lemm 1.5x and 2.0x of his hourly rate for all qualifying overtime and doubletime hours.

EcoLab's sales-based compensation policy was not commission-based (e.g., percentage of each sale) or a piece rate (e.g., $100 per deal). Rather, under the EcoLab plan, meeting certain metrics would trigger a set multiplier of Lemm's total hourly compensation—e.g:

> [straight time wages + overtime wages + doubletime wages] x [5%].

These kinds of policies are sometimes referred to as "percentage bonuses" plans and are expressly authorized under the regulations to the Fair Labor Standards Act ("FLSA").

> ["[T]he contract or plan . . . made prior to the performance . . . may provide for the simultaneous payment of overtime compensation[.] For example . . . the rate of 10 percent of the employee[']s straight time earnings, and 10 percent of his overtime earnings."]. (*See* 29 CFR 778.210)

EcoLab argued that its percentage bonus plan complied with both federal and California law. Lemm disagreed, arguing that EcoLab should have used a method of calculation applicable to "flat rate" bonuses under California law.

The trial court sided with EcoLab. Lemm appealed.

The Court of Appeal's employer-friendly decision

The Court held that EcoLab's percentage bonus plan complied with California law because:

- The Ninth Circuit (and several California District Courts) had previously held that such "percentage bonuses" were a lawful way to calculate and pay additional overtime wages resulting from contingent compensation in California.
- Paying a federal "percentage bonus" results in the exact same amount of additional overtime as paying overtime "true-ups" according to a formula found in the Department of Labor Standards Enforcement Manual ("DLSE Manual"); though it was careful to note that the DLSE Manual is not binding authority, but rather more like "an 'underground regulation' not entitled to the same level of deference as the IWC's wage orders." (See DLSE Manual, Section 49.2.4.1.)
- The formula Lemm argued should apply is also found in the DLSE Manual, and has been adopted by the California Supreme Court as the proper method for calculating "flat sum

bonuses" (e.g., safety, attendance), requiring EcoLab to apply that formula *on top of* the existing "percentage bonus" and result "overtime on overtime," which "contravenes Labor Code section 510 and [the Wage Orders], which require an employer to pay an overtime premium of 1.5 times the regular rate of pay, not some greater amount."

What employers should do

Provided that *EcoLab* is not overturned or "depublished" by the California Supreme Court, which happens from time to time, it represents a significant win for employers. This is so because calculating overtime true-ups in California can often be complex, or administratively difficult, or both. Whereas the "percentage bonus" calculation is simple and intuitive—i.e., [regular wages + overtime wages + doubletime wages] x [Percentage]. In a state like California, which severely punishes the failure to pay *any amount* of wages, regardless of intent, simple and intuitive pay policies and practices are extremely valuable tools.

Nixon Peabody's lawyers have extensive experience in the preparation, review, and analysis of bonus plans, commission agreements, and other forms of contingent compensation policies. Our lawyers also have extensive experience defending against "regular rate of pay" claims in court. Our dedicated team of California labor and employment attorneys guide our clients through complex legal matters, including being in receipt of PAGA Notices, and other unique California policies and practices.

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