DOL's Wage and Hour Division Proposes Clarifications to FLSA "Regular Rate of Pay" Exclusions with Potential Implications for Employee Benefits

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On March 29, 2019, the Department of Labor ("DOL" or "Department") Wage and Hour Division ("WHD") submitted a notice of proposed rulemaking ("NPRM" or "proposed rule") and request for comments to the Federal Register regarding exclusions from the "regular rate of pay" (including, notably, where such exclusions impact calculation of overtime) under the Fair Labor Standards Act ("FLSA"). The DOL will be accepting comments until May 28, 2019.

The DOL promulgated the current regulations governing "regular rate of pay" calculations and exclusions in 1968, and, although the DOL has made periodic updates since then, the regulations remain substantively unchanged. In its NPRM, the DOL states that it is seeking to provide "clarity" and regulations that "better reflect the 21st-century workplace." Key portions of the NPRM focus on various employee benefits and whether (or how) those benefits will impact "regular rate" determinations and overtime calculations.

This benefits brief outlines the portions of the NPRM proposals that may be particularly relevant to employee benefits.

Key takeaways for employers are:

- The recently issued proposed rules fail to clearly exempt certain common employer-sponsored benefit arrangements from having to be taken into account for purposes of the FLSA's overtime rules, including, most notably (1) self-funded health and welfare plans that do not utilize a

qualifying trust (such as self-funded plans that utilize a "claims account" with their claims administrator, as well as most Health Reimbursement Arrangements or "HRAs"), (2) discretionary profit sharing contributions to qualified retirement plans where the contribution amount is at the election of the plan sponsor, (3) phantom stock arrangements, and (4) student loan/debt assistance programs.

- There is increasing litigation activity with respect to the FLSA's overtime requirements and many employers had been hopeful that the current rulemaking project would be an opportunity for the DOL to clearly state that the overtime rules do not apply to the above arrangements (as well as all ERISA plans more generally). As discussed below, DOL unfortunately did not take the opportunity to provide such clarifying guidance.
- Employers with the above arrangements should review their arrangements in light of the recent litigation and proposed rulemaking.
- For employers and other stakeholders interested in submitting written comments on the proposed rule, comments are due by May 28, 2019.

Background

Section 7(a)(1) of the FLSA mandates that employers pay non-exempt employees one and one-half times their "regular rate" of pay for time worked in excess of 40 hours a week. Section 7(e) defines "regular rate" to include "all remuneration for employment paid to, or on behalf of, the employee[.]" The provision excludes, however, eight specified categories of payment:

1. Gifts and payments on special occasions;
2. Payments made for occasional periods when no work is performed such as vacation or sick pay, reimbursements for work-related expenses, and other similar payments that are not compensation for hours of employment;
3. Discretionary bonuses, payments to profit-sharing, thrift, or savings plans that meet certain requirements, and certain talent fees;
4. Contributions to a bona fide plan for retirement, or life, accident, or health insurance, or similar;
5. Extra compensation provided by a premium rate for certain hours worked in excess of eight in a day, 40 hours in a workweek, or the employee's normal working hours;
6. Extra compensation provided by a premium rate for work on Saturdays, Sundays, regular days of rest, or the sixth or seventh days of the workweek;
7. Extra compensation provided by a premium rate pursuant to an employment contract or collective bargaining agreement for work outside of the hours established therein as the normal workday (not exceeding eight hours) or workweek (not exceeding 40 hours); and
8. Income derived from a stock option, stock appreciation right, or employee stock purchase plan.

29 U.S.C. § 207(e)(1)-(8).

Key Employee Benefits-Related Proposals

- **Exclusion of Payments for unused leave:** The FLSA excludes "payments made for occasional periods where no work is performed" from the regular rate. The proposed rule would clarify that, for payments made to an employee for *foregoing* leave *(e.g.*, cash-out of unused annual leave), payment may be excluded from the regular rate regardless of the *type* of leave at issue.
- **Clarification that wellness programs, tuition benefits and similar benefits offerings may be excluded:** Currently, the FLSA regulation providing a list of examples of "other similar payments that are not compensation for hours of employment" dates from 1950. The DOL proposes adding a more modern list of examples, including wellness programs and tuition benefits.
- **For bona fide plans, clarification of the types of benefits that may be excludable:** The DOL proposes adding new examples to the existing list of "bona fide plan" examples. Currently, the list of examples includes only benefits generally related to health and retirement: additional examples would relate to unemployment, accidents, and legal services.
- **Clarification regarding discretionary bonuses:** The NPRM would clarify that a bonus' label is not determinative: instead, whether a bonus is discretionary depends on the specific facts surrounding the bonus.
- **Examples are not exclusive:** The NPRM would add a new introductory statement to 29 C.F.R. section 778, providing that, while the *categories* of payment in FLSA section (7)(e) are exhaustive, the *types* of payment listed in the rules are not: employers are free to be creative within the categories listed in the statute.[1]

GROOM INSIGHT | The NPRM is somewhat helpful in that it updates examples of plan types that may qualify for various exclusions and modernizes some of the language in the regulations. Nonetheless, the rule does ***not*** *address several of the most significant areas of concern regarding employee benefits, including the steps plans must take to ensure that any particular plan qualifies as a bona fide plan (for example, what it means that an "employer's contributions must be paid irrevocably to a trustee or third person"), under what circumstances a profit-sharing plan may qualify for the exclusion for a "bona fide profit-sharing plan or trust," whether student debt assistance can be excluded along with tuition assistance, or the status of phantom stock and restricted stock units.*

[1] The NPRM also includes proposals regarding: (1) the exclusion for time that would not otherwise qualify as hours worked; (2) the exclusion for expenses that are per se reasonable and excludable; (3) the requirement that "call back" pay be "infrequent and sporadic;" (4) the exclusion for overtime premiums; and (5) the basic rate computation (for situations where employers calculate overtime based on a basic rate, as opposed to the regular rate of pay). Although important, these exclusions are not as clearly relevant to employee benefits, and hence this brief will not discuss those proposed exclusions.

The Department first issued regulatory guidance interpreting the FLSA in 1948, and the regulations are found at 29 C.F.R. Parts 548 and 778.[2] The Department has updated these regulations repeatedly to account for changes in the law, but the pace of updates fell off dramatically after 1967, the last year the DOL updated *any* of the regulations at Part 548. While Part 778 has been updated more often – most recently in 2011 – the last comprehensive revision occurred in 1968. The current regulations therefore use antiquated language and examples, and often do not reflect current employment trends. Moreover, the interpretative guidance predates major changes in the laws governing employee benefits, including the Employee Retirement Income Security Act of 1974 ("ERISA"), enacted in 1974, and Internal Revenue Code section 401(k), enacted in 1978.

Benefits Implications of the New Proposals

Of particular interest to benefits managers is that the NPRM would clarify the categories of remuneration that may be excluded from the regular rate. Most importantly, the NPRM makes clear that the DOL is taking a relatively broad view of those categories and is seeking to update its examples for the 21st century. The following proposals may be of particular interest with regard to employee benefits:

A. Clarifications Regarding Payments for Unused Leave and Reimbursements

FLSA section 7(e)(2) exempts payments made for occasional periods when no work is performed such as vacation or sick pay, and the DOL's regulations make clear that this exemption applies to payments made to employees who forgo leave as well. The relevant regulation, 29 C.F.R. section 778.219, is currently entitled "Pay for foregoing holidays and vacations" and the regulation refers specifically to holidays and vacations in describing these situations.

In the NPRM, the DOL notes that, often, "employers no longer provide separate categories of leave" and that the specific references to holidays and vacations may therefore be misleadingly narrow. The NPRM would update this provision to make clear that pay for unused time off may be excluded regardless of the type of leave, which is consistent with actual Departmental practice. The provision would be retitled "Pay for forgoing holidays and *unused leave*" and would make clear that leave generally, including undifferentiated paid time off, may qualify for the exclusion.

The NPRM would also update 29 C.F.R. section 778.217 to make clear that, where an employee incurs expenses on an employer's behalf and is reimbursed, that reimbursement may be excluded under

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[2] Note that the NPRM essentially treats 29 C.F.R. section 778 *et seq.* as a set of binding regulations, but courts have tended to treat this section as interpretive guidance because the DOL did not originally proceed through notice and comment. *See, e.g.*, *Flores v. City of San Gabriel*, 824 F.3d 890, 898 n.1 (9th Cir. 2016) ("Section 778.224 is an interpretive bulletin . . . which lack[s] the force of law."); *Madison v. Resources for Human Development, Inc.*, 233 F.3d 175,186 (3d Cir. 2000) ("To grant *Chevron* deference to informal agency interpretations would unduly validate the results of an informal process."). For convenience, this brief follows the NPRM's style in referring to these materials as regulations.

section 7(e)(2) even if the employee did not incur the expense "solely" on the employer's behalf, bringing the text of the regulation into conformity with DOL guidance and subsequent court decisions.

B. Clarifications Regarding Wellness Programs and Similar Benefits

In addition to payments made for occasional periods when no work is performed and reimbursements for work-related expenses, FLSA section 7(e)(2) provides an exclusion for "other similar payments to an employee which are not made as compensation for his hours of employment." The DOL interprets this exemption to provide for "benefits unconnected to the quality or quantity of work[,]" and believes that this standard should clarify "that there is space for a variety of creative benefits offerings[.]"

29 C.F.R. section 778.224, however, currently provides a brief (though non-exhaustive) list of examples dating to 1950, including "[s]ums paid to an employee for the rental of his truck or car" and the cost to the employer of furnishing to employees parking, restrooms, lockers, on-the-job medical care and recreational facilities. Given the age of these examples (and their questionable relevance to most of today's workplaces), the NPRM proposes the addition of the following contemporary examples:

- Onsite specialist treatment;
- Gym access, gym memberships, and fitness classes;
- Wellness programs;
- Employee discounts on retail goods and services; and
- Tuition and other benefits.

Of these new examples, wellness programs and tuition benefits may be of particular interest: the DOL is now specifically proposing that wellness programs – including risk assessments, biometric screenings, vaccination clinics, nutrition classes, weight loss programs, smoking cessation programs, stress reduction programs, exercise programs, and other forms of health coaching – may be excluded from the regular rate. Furthermore, the DOL also proposes specifying that tuition discount programs may count as excluded "similar benefits."

The NPRM further suggests that tuition discount programs in particular may be excluded as "sums paid as gifts" under FLSA section 7(e)(1) or as part of a bona fide plan under section 7(e)(4). Moreover, the Department is requesting comment on the potential ramifications of its proposal regarding tuition reimbursement programs in particular.

GROOM INSIGHT | Although the NPRM addresses tuition assistance programs, it does not specifically address student debt assistance programs – even though some of the Department's public supporting material (e.g., its press release) suggests it is considering these benefits as well. Interested employers may want to consider commenting on the proposed rule and suggesting that the Department specifically add student debt assistance programs to the list of examples.

C. Clarifications Regarding Similar Benefits under Section (e)(4)

FLSA section (e)(4) excludes "contributions irrevocably made . . . to a trustee or third person pursuant to a bona fide plan providing old-age, retirement, life, accident, or health insurance or similar benefits for employees." 29 C.F.R. section 778.215(a)(2) lists as examples benefits provided "on account of death, disability, advanced age, retirement, illness, medical expenses, hospitalization, and the like." This list dates from 1968. Recognizing that the universe of potential benefits is far wider now, the NPRM proposes adding "accident, unemployment, and legal services" specifically to this list. The DOL also requests comment on additional examples.

Notably, however, the DOL does not propose reforming the standards applicable to bona fide plans under section 778.215(a)(3)-(5), which lays out a multi-part test governing when a benefit plan (regardless of benefit type) may qualify as a bona fide plan. This regulation has engendered a significant amount of recent litigation. *See, e.g., Russell v. Gov't Employees Ins. Co*, No. 17-cv-672-JLS, 2018 WL 1210763 (S.D. Cal. Mar. 8, 2018). The NPRM proposes no changes to this portion of the rule.

GROOM INSIGHT | Notably, the NPRM does not address 29 C.F.R. section 778.215's additional bona fide benefit plan requirements. A fair amount of recent litigation has focused on under what circumstances a benefit plan may qualify for this exemption, regardless of the type of benefit it offers. See, e.g., id., currently on appeal before the 9th Circuit, Russell v. Gov't Employees Ins. Co., No. 18-55682 (holding that discretionary profit-sharing contributions could be excluded from the regular rate of pay. The court reached this conclusion because the discretionary qualified retirement plan included the required "definite formula[s]" for determining the amount contributed by the employer and the benefits allocated to each employee because the plan's formula "quantifie[d] each variable" and "describe[d] those variables' relations to each other"); Gilberston v. City of Sheboygan, 165 F. Supp. 3d 742, 750 (E.D. Wis. 2016) (holding that a self-funded HRA plan could not be excluded because the company did not make irrevocable payments to the plan). The NPRM does ***not*** *address these issues, meaning that guidance, at least in the immediate term, is likely to come by way of court decisions. Perhaps most strikingly, the Sheboygan decision could be read to significantly narrow the circumstances where employers may exclude self-funded medical benefits from the regular rate of pay, but the NPRM does not address this issue.*

D. Clarification Regarding Discretionary Bonuses

FLSA Section 7(e)(3) provides that bonuses paid to employees at an employer's "sole discretion . . . at or near the end of the period and not pursuant to any prior contract, agreement, or promise" may also be excluded from the regular rate. The NPRM proposes adding additional language and a new subsection to 29 C.F.R. section 778.211 to provide clarity and additional examples. The DOL proposes to clarify that the label given a bonus is not determinative: "Instead, the terms of the statute and the facts specific to the bonus at issue determine whether bonuses are excludable[.]" The NPRM also

provides examples of bonuses that may be discretionary, including merit bonuses not awarded according to pre-established criteria, severance bonuses, and employee-of-the-month bonuses.

*GROOM INSIGHT | Although the NPRM addresses discretionary bonuses, it does **not** address the other exclusions included in section 7(e)(3) of the statute, including payments to bona fide profit-sharing plans or thrifts or savings plans. The regulations governing profit-sharing plans are confusing (particularly because it can be difficult to differentiate the standards governing profit-sharing plans under section 7(e)(3) and bona fide benefits plans under section 7(e)(4)) and somewhat antiquated. At least one court has held that profit-sharing plans need not satisfy requirements governing both the above exceptions, so long as the relevant plan meets the bona fide benefit plan requirements. Russell, 2018 WL 1210763, at *6. The NPRM does **not** address this issue.*

E. Clarification Regarding Multiple Exclusions

The proposed rule would also add language to 29 C.F.R. section 778.1 clarifying that, while FLSA section 7(e) provides an exhaustive list of excludable *categories* of remuneration, it does not include an exclusive list of *practices* or *types* of remuneration. By adding this language, the DOL seeks to clarify that employers may be creative in providing benefits, and that employers should not feel restricted to only the examples the DOL specifically provides.

Conclusion

The NPRM includes several important updates relevant to benefits. First and foremost, while the DOL's proposals are mostly clarifications, not wholesale rule changes, it is helpful to know that the DOL does not believe wellness programs or tuition benefits must be factored into the regular rate of pay, that the DOL does not believe that a practice's type or label is determinative, and that 29 C.F.R. section 778.215(a)(3)-(5)'s list of bona fide plans is not exhaustive. In general, the proposed rule makes clear that the Department is taking a relatively broad view of the FLSA's exclusions, allowing employers flexibility in designing benefits programs.

That said, the impact of the proposed rule is likely to be modest. The changes the DOL proposes in the NPRM are mostly clarifications that broadly track existing practice. Importantly, the DOL has not proposed addressing areas that have created particular difficulty for employers in recent years, including the specific rules governing when any type of benefit plan qualifies as a bona fide plan. The NPRM does not attempt a wholesale revision or restructuring of an antiquated and often confusing FLSA regulatory structure. The DOL's NPRM takes a step towards moving the FLSA regulatory structure into the 21st century, but much more work is needed to fully modernize these rules and help resolve some of the disputes surrounding the FLSA in 2019. Interested parties should take this opportunity to comment on the proposed changes, as well as FLSA regulatory issues that the Department declined to address.