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How You Might Be Overpaying Your Employees

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Over the last 10 years or more, there have been numerous wage and hour class and collective actions where one of the complaints is underpayment of overtime. More specifically, many plaintiffs have been alleging that their overtime pay was less than what should have been paid due to incorrect calculations of regular rate of pay. In such cases, the issues are which earning types should be included in the regular rate of pay calculation. In the cases where I was involved, I found that the actual calculation of regular rate varies significantly by employer. Some variations on the regular rate of pay calculations that I have seen are as follows:

1. Employers do not include certain earnings in calculation of regular rate of pay that should be included.

2. Employers include all earnings that should be included in regular rate of pay in their actual calculation of regular rate of pay and their calculation is correct. Their pay stubs are very straightforward and contain all the key (and required) information so that employees can easily replicate their pay amounts.

3. Employers include all earnings that should be included in regular rate of pay in their actual calculation of regular rate of pay and their calculation is correct. Their pay stubs are hard to understand and oftentimes miss key information, and therefore it is very difficult (if not impossible) to figure out why employees receive what they are paid.

4. Employers include all earnings that should be included in in their actual calculation of regular rate of pay but their formula for regular rate is incorrect in such a way that employees are paid more than what they should be paid.

5. Employers include some earnings that are not required to be included in regular rate of pay in their actual calculation of regular rate of pay.

In the first example, employees are underpaid for their overtime. In the second and third examples, employees receive exactly what should be paid; however, in the third, employers (especially in California) may be required to pay penalties due to incomplete wage statements.

Examples four and five are cases where employees are overpaid for their overtime work, though there are various mechanisms through which overpayment may occur. Below I show some examples.

Retroactive Increase in Hourly Rate

John Doe works for Company A and his hourly rate increases from $20 to $23 on Sept. 19, 2016, which is a pay period (weekly) starting date. The new rate is retroactively applied to the preceding pay period which is from Sept. 12, 2016, to Sept. 18, 2016. In the pay period ending Sept. 18, 2016, Doe worked 60 hours in which 20 hours are overtime, and he received a check with a gross pay of $1,400 ($20/hour x 40 regular hours + 1.5 x $20/hour x 20 overtime hours).

Method 1 – Overpayment

Company A calculates $210 of retroactive pay as a sum of the following two components and pays it to Doe in the next paycheck with a description "retroactive pay."

- Retro pay for regular hours: $120 = ($23/hour - $20/hour) x 40 hours
- Retro pay for overtime hours: $90 = 1.5 x ($23/hour - $20/hour) x 20 hours

Now Company A thinks that this $210 of retroactive pay should be included in Doe's regular rate of pay in the pay period ending Sept. 18, 2016, and that Doe should receive a retroactive overtime premium. Company A calculates that the $210 of retro pay should increase Doe's regular rate of pay by $3.50 ($210 divided by 60 total hours worked in the pay period ending Sept. 18, 2016) and that Doe should receive an additional overtime premium of $35 (0.5 x $3.50/hour x 20 hours). Company A pays Doe $35 in the next paycheck with a description "retroactive overtime premium." As a result, Doe's total gross pay is $1,645 in the pay period ending Sept. 18, 2016.

- Regular Hours: $800 ($20/hour x 40 regular hours)
- Overtime Hours: $600 (1.5 x $20/hour x 20 overtime hours)
- Retroactive Pay: $210 ($3/hour x (40 regular hours + 1.5 x 20 overtime hours)
- Retroactive Overtime Premium: $35 (0.5 x $3.50/hour x 20 overtime hours)

This $35 of "retroactive overtime premium" is totally unnecessary because the "retro pay" of $210 already includes 50 percent premium of 20 hours of overtime worked. To see what went wrong, let's calculate the amount that Doe would have received if the new rate of $23.00 had been applied starting Sept. 12, 2016. His gross pay would have been $1,610 ($23/hour x 40 regular hours + 1.5 x $23/hour x 20 overtime hours). The difference between what he actually received ($1,645.00) and what he should have received ($1,610.00) is $35.00, which is exactly the amount of "retro overtime premium."

Method 2 – Correct Payment

Company A calculates "retroactive pay" in a different way. This time "retroactive pay" is calculated by a rate increase times all hours worked which is $180 [($23/hour - $20/hour) x 60 hours]. Company A includes this additional $180 in the regular rate calculation and calculates the increased rate of regular rate as $3.00 ($180 divided by 60 total hours worked). The "retroactive overtime premium" is calculated as $30 (0.5 x $3.00/hour x 20 hours). As a result, Doe’s total gross pay would be $1,610, exactly what he is supposed to be paid.

- Regular Hours: $800 ($20/hour x 40 regular hours)
- Overtime Hours: $600 (1.5 x $20/hour x 20 overtime hours)
- Retroactive Pay: $180 ($3/hour x 60 hours)
- Retroactive Overtime Premium: $30 (0.5 x $3.00/hour x 20 overtime hours)

The difference between the two methods is how “retroactive pay” is calculated. If method one is used, then the retroactive overtime premium is already included in “retroactive pay” and hence the calculation of “retroactive overtime premium” step is unnecessary. If Method two is used, then one needs to calculate “retroactive overtime premium” and to pay it in the next paycheck.

Time-And-A-Half vs. One-Half

The same John Doe works 50 hours in the pay period ending Sept. 25, 2016, for Company A. Of the 50 hours, 40 hours are regular (nonovertime) hours and 10 hours are overtime hours. Also he works 10 hours in a graveyard shift in which he earns an additional $2 per hour.

Method 1 – Overpayment

Company A understands that Doe’s regular rate of pay to be higher than his normal hourly rate, and calculates that the regular rate of pay is $23.40 per hour — $0.40/hour higher than his normal hourly rate — because of $20 shift differential pay in a week of 50 hours worked ($20 divided by 50 total hours worked). Then Company A calculates that Doe’s overtime pay would be $351 (1.5 x $23.40/hour x 10 hours). Doe receives $920 for his regular hours ($23/hour x 40 hours) and $20 for his graveyard shift work ($2/hour x 10 hours). Therefore, his gross pay for this pay period is $1,291.

- Regular Hours: $920 ($23/hour x 40 regular hours)
- Overtime Hours: $351 (1.5 x $23.40/hour x 10 overtime hours)
- Shift Differential: $20 ($2/hour x 10 hours)

Doe is overpaid.

Method 2 – Correct Payment

One of the correct ways to calculate is as follows. First, for all hours Doe works, Company A calculates total hourly wages of $1,150 ($23/hour x 50 hours). Second, for all graveyard shift hours, Company A calculates total shift premium of $20 ($2/hour x 10 hours). Third, Company A calculates Doe’s regular rate of pay of $23.40 (($1,150 + $20) / 50 hours). Finally, Company A calculates Doe’s overtime premium of $117 (0.5 x $23.40/hour x 10 hours). Then his gross pay would be $1,287.

- All Hours Worked: $1,150 ($23/hour x 50 hours)
- Shift Differential: $20 ($2/hour x 10 hours)
- Overtime Premium: $117 (0.5 x $23.40/hour x 10 hours)

There is an overpayment of $4.00 in the first method. Method one does not incorporate the fact that the additional regular rate of pay beyond Doe's normal hourly rate ($0.40 = $23.40 - $23.00) due to shift premium is considered to be earned from all hours worked (50 hours) and not just from regular hours worked (40 hours). Therefore, in calculating overtime pay, Company A is required to pay Doe's overtime hours by only 1/2 times this $0.40/hour extra regular rate of pay and 1 and 1/2 times the normal hourly rate. Method one has an overpayment of 1 times overtime hours times $0.40 extra regular rate of pay.

California Is Different

In California, if an employer fails to provide a legally required meal period, the employer must pay the employee one additional hour of pay at the employee's regular rate of pay. Sometimes, employers pay such penalties and include them in regular rate of calculations when employers should first calculate the employee's regular rate of pay (which should not include meal/rest break penalties) and second pay the employee one hour of pay at the employee's regular rate of pay. If the employee works overtime in the same week, then the overtime premium amount is going to be overpaid because of the inclusion of the meal/rest break premium in the regular rate of pay.

Also, in California, certain hours are double-time hours for which employees receive a 100 percent of premium pay at their regular rate of pay. However, some employers pay double-time premium at 100 percent of the normal hourly rate and then include those double-time premium amounts in regular rate of pay which is then used to calculate overtime premium resulting in overpayments. Double time is nothing more than overtime with a 100 percent premium. Oftentimes, employers who are new to California make these mistakes.

Conclusion

It is perfectly fine for employers to adopt overtime pay practices that are more employee-friendly than required (Fair Labor Standards Act and state laws) as long as those employers are aware they are providing more compensation than is required under law. For example, some employers count nonwork hours such as vacation and sick time for purposes of overtime calculations. Another example is that some employers pay overtime premium for any hours over 37.5 instead of 40. As a last example, some employers include some discretionary bonuses in regular rate of pay calculations. However, there are employers who have been paying their employees more than what should have been paid without knowing that they have been overpaying their employees.

It is probably a good idea for employers to audit their payroll data and, in particular, overtime calculations. If they find that they have been overpaying their employees, then they may either (1) correct their overtime pay calculations or (2) adopt their unintended employee-friendly overtime pay practice as their official pay practice.

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