

Labor Law Release

August 2007

Flat Rate & Flagged Hours

It is common in businesses providing installation or repair services to pay employees using a flat rate or flagged method of compensation. Under this system, each project is allocated a certain number of hours. This is what is called “flagged hours.” An employee is paid a set amount of money for each flagged hour completed.

For example, if a muffler installation is three flagged hours, and if the employee is paid \$20 per flagged hour, when (s)he completes the job, she will earn \$60. (S)he will earn \$60 whether she completes the job early, on time or late. If (s)he finishes early, the worker can complete more projects.

Business owners believe that by offering this type of compensation, which is in essence a “piece rate” employees will work more quickly and generate more revenue. It also helps weed out employees who work more slowly and thus earn less money. The flagged hour method of compensation may indeed accomplish these goals.

Business owners also believe that they might escape paying overtime rates to employees under the flat rate of compensation. Unfortunately, while this may be true in other states, it is not true in California. The use of the flat rate or flagged hour method of compensation may result in substantial liability if the employer does not pay overtime or minimum wage.

Federal Law

California employers must comply with state and federal wage and hour laws. The basic federal law governing wages is the Fair Labor Standards Act (“FLSA”). Under the FLSA, an employee is entitled

to overtime compensation if (s)he works more than 40 hours in a workweek.¹

The FLSA contains numerous exemptions from the overtime rule. One of the overtime exemptions is for an employee: (1) who works in a retail or service establishment; (2) receives at least one and one-half more than the minimum wage as his/her regular rate of pay; and (3) receives more than one-half of his/her compensation in commissions on goods or services.²

Many businesses which use the flagged hour method of compensation are in the retail or service industries. In fact, a Circuit Court in Florida has opined that a flagged hour system used by an auto repair facility constituted a commission as contemplated in section 207(i).³ Other legal authorities support that position. Dept. of Labor Op. Letter, FLSA 2006-15NA (June 29, 2006); Dept. of Labor Field Operations Handbook, § 21h04(d).

Under federal law, the regular rate of pay is calculated by dividing the employee’s total compensation for the workweek by the number of hours actually worked.⁴ If a company pays an employee at least \$8.78 (\$5.85 [federal minimum wage] x 1.5), then all elements for the exemption will be met. However, to make this showing, a company will be required to show the employee’s weekly hours worked and weekly compensation for each workweek.

In sum, a company’s installers, mechanics or technicians may qualify for the exemption from

¹ 29 U.S.C. § 207(a)

² 29 U.S.C. § 207(i)

³ *Klinedinst v. Swift Investments, Inc.*, 260, 1251, 1256 (11th Cir. 2001)

⁴ 29 C.F.R. § 779.419(b)

overtime under section 207(i) if all elements of the exemption have been met. It is the employer's burden to make this showing.

State Law

Unfortunately, California employers must also comply with state law, which does not always parallel federal law. In this case, state law probably precludes companies from using the flagged hour method of compensation with installers, mechanics or technicians to avoid overtime obligations.

California governs wages primarily through a series of 17 wage orders. The wage orders are substantially similar. Nevertheless, they do differ slightly resulting in very serious consequences. Under California law, businesses are precluded from using the flagged hour method of compensation for installers, mechanics or technicians to avoid overtime obligations.

There are two reasons why installers, mechanics and technicians will still be entitled to overtime compensation. To understand the first reason, the business owner must understand how California wage orders work.

California businesses must determine which wage order or orders apply to their workforce. Most California wage orders are "industry" wage orders. If an industry wage order applies to a business, then all employees in the business are covered by that wage order. If there is not an applicable industry wage order, then the business must examine the California "occupation" wage orders to see if one of them applies to any of the employees working for the business. In some cases, it is possible for multiple occupation wage orders to apply to various employees in a business.

In the repair and installation industries, there are three possible wage orders that could apply. Wage Order #7 governs the mercantile industry. This order covers business "operated for the purpose of purchasing, selling, or distributing goods or commodities at wholesale or retail."⁵ This wage order covers auto dealers for example.

Wage Order #9 covers the transportation industry. This wage order includes "the repairing, parking, rental, maintenance, or cleaning of vehicles."⁶ This wage order will cover most repair facilities. One California court case states that this wage order

applies "in an auto repair shop not connected to auto dealerships."⁷

If neither Wage Order #7 or #9 applies to a particular business, Wage Order #4 probably applies to a company's mechanics and installers.⁸

Wage Orders #7 (mercantile) and #4 (mechanics) include an exemption from overtime very similar to the federal exemption. It reads: "The [overtime] provisions ... shall not apply to any employee whose earnings exceed one and one-half (1½) times the minimum wage if more than half of that employee's compensation represents commissions."⁹

However, this exemption is not found in Wage Order #9 (transportation). This means that if Wage Order #9 applies to a business, none of its employees can be considered exempt from overtime compensation, even if the company pays them by the flagged hour method.

Even companies whose workers are subject to Wage Orders #7 or #4 probably cannot use the overtime exemption. Under California law, a payment is a commission if: (1) the employee is principally involved in selling a product or service; and (2) the amount of compensation is a percent of the price of the product or service.¹⁰ Since the principal activity of a mechanic is not in selling a service, (s)he is not earning a commission.¹¹

The definition of "commission" is derived, in part, from Labor Code section 204.1 which makes commissioned employees employed by an employer licensed as a vehicle dealer by the DMV exempt from overtime. However, this exemption from overtime, found in the Labor Code, does not apply to mechanics that are not in the principal business of selling vehicles.

Payment of Overtime Compensation

Because the flagged hour method of payment will not provide an exemption from overtime compensation, the employer will be required to pay the employee at least one and one-half times (and sometimes double) the regular rate of pay for all overtime hours worked. Because the employee is

⁷ *Keyes Motors, Inc. v. DLSE*, 197 Cal.App.3d 557, 562 n.2

⁸ 8 C.C.R. § 11040(2)(O)

⁹ 8 C.C.R. § 11040(3)(D); 11070(3)(D)

¹⁰ *Ramirez v. Yosemite Water Co., Inc.*, 20 Cal.4th 789, 803 (1999)

¹¹ *Ibid.*; DLSE Enforcement Policies and Interpretations Manual, § 5.4.1; DLSE Op. Letter 1983-11-25.

⁵ 8 C.C.R. § 11070(2)(H)

⁶ 8 C.C.R. § 11090(2)(N)

earning a “piece rate” the employer will need to determine the regular rate of pay each workweek.

The regular rate of pay for a flagged hour employee is determined by dividing all compensation earned (including compensation earned during overtime) by all hours worked. This is the “regular rate of pay” for the week.

The employer will need to then pay at least one-half this regular rate of pay for each hour of overtime worked. Overtime is anything over eight hours in a workday or 40 hours in a workweek.

Liability for Failure to Pay Overtime

An employer who fails to pay overtime compensation incurs a liability for the amount of unpaid wages. In addition, the employer can incur a waiting period penalty calculated at the employee’s daily wage for up to 30 days if that employee leaves the job (quit or fired) without receiving all wages paid to him.

Employees can seek back wages for the past four years. Employees are also entitled to attorneys’ fees if they hire a lawyer to pursue their case.

Conclusion

Federal law under the FLSA provides an overtime exemption for person working in a retail or service establishment who receives at least one and one-half more than the minimum wage as his/her regular rate of pay and receives more than one-half of his/her compensation in commissions on goods or services. However, even if this exemption could apply to your operation, state law does not provide businesses with an exemption from overtime for installers, mechanics and technicians.

We encourage all employers to examine their pay practices. It is important to understand which wage order applies to the business so that employers pay employees correctly. It is also important to understand how to calculate the regular rate of pay and the overtime rate of pay for employees who do work overtime. And it is imperative that employers who use the flagged hour method of payment pay their mechanics, installers and technicians overtime compensation.

For more information, contact Doug Larsen at 256-5000.

This is not intended as a complete analysis of the subject matter, or legal advice on any specific matter. Contact us if you have specific questions or need further assistance.