

RECENT COURT RULING REGARDING CASH-IN-LIEU OF BENEFITS MAY AFFECT MANY PUBLIC AGENCIES AND OTHER EMPLOYERS

On June 2, 2016, the U.S. Court of Appeals for the Ninth Circuit issued an opinion that may lead many public agencies to change the way they provide benefits to their employees. The case, *Flores v. City of San Gabriel*, arises from a lawsuit brought under the federal Fair Labor Standards Act (FLSA). The plaintiffs, a group of police officers employed by the City, claim that they were underpaid for their overtime hours, because their rate of overtime pay did not take into account the compensation they received through the City's cash-in-lieu of benefits program. The court's ruling last month in the plaintiffs' favor will cause many public agencies and other employers that offer cash-in-lieu of benefits programs to take a second look at those programs.

SPECIFICS OF THE CASE

The City of San Gabriel offered a Flexible Benefits Plan in which it furnished a designated amount of money to each employee for the purchase of medical, dental and vision coverage. Each employee was required to select dental and vision coverage. Employees were also required to select medical coverage, unless they provided proof of other coverage (e.g., through a spouse's coverage). Employees who elected to forgo employer-paid coverage would get the amount left in the allotment in cash. The amount of the cash payment varied each year, but was as high as \$1300 a month in 2012. The additional funds were included in those employees' paychecks and were subject to federal and state withholding and Medicare taxes. These payments to employees for unused benefits accounted for more than 40% of the total benefits paid under the Flexible Benefits Plan annually. These payments were designated as "benefits" in the City's payroll system and, therefore, not used to calculate the employees' regular rate of pay for the purpose of paying overtime.

THE NINTH CIRCUIT'S HOLDING

The court held:

1. Under the FLSA, the City's payment of cash-in-lieu was compensation for work and, therefore, not exempt from inclusion in the regular rate of pay. The payments, therefore, were wrongly excluded from the regular rate of pay for the purpose of calculating the overtime rate for those officers who chose cash-in-lieu.
2. Under the FLSA, cash payments made to employees as part of a "bona fide plan" can be exempt from inclusion in the regular rate of pay as long as the payments are "incidental" to the plan. The City's Flexible Benefits Plan paid out more than 40% of its benefits as cash. Noting that prior Department of Labor Guidance had indicated that no bona fide plan could pay more than 20% of plan assets in cash, the court found that the City's cash payments were not an "incidental" part of the plan. Moreover, because the plan was not a "bona fide plan" under the FLSA, even payments to trustees or third parties under the plan would be included in the rate of pay for the officers.
3. The City's violation of the FLSA was not in good faith and the City did not have reasonable grounds to believe its actions complied with the law. The court found that the City failed to take active steps to

ensure that its actions complied with the FLSA. Therefore, in addition to back wages, the plaintiffs were entitled to “liquidated damages” under the FLSA, doubling the amount of wages owed the plaintiffs.

4. The City’s violation of the FLSA was “willful” because it took no affirmative steps to ensure that its designation of benefit payments complied with the law. Therefore, the plaintiffs would be entitled to a three-year statute of limitations, thereby increasing the potential monetary award for back wages for the plaintiffs.
5. The City did demonstrate that it qualified for a partial overtime exemption under §207(k) of the FLSA, somewhat limiting the amount of work hours that would count toward overtime for the officers.

COMPLIANCE IMPLICATIONS

While this ruling is likely to be appealed, it is one that must be taken into account in reviewing an employee benefit plan, especially for employers whose employees work a large number of overtime hours. Plan sponsors with a cash-in-lieu of benefits option should take a close look at how those plans comply with this ruling, with the written plan requirements of Internal Revenue Code § 125, and with recent guidance regarding opt-out payments under the Affordable Care Act. A Keenan *Briefing* on the opt-out guidance can be found at:

http://www.keenan.com/news/brief/2016/BRF_20160719_HCRProposedRegulationsOpt-OutPayments_KA.pdf

Plan sponsors with cash-in-lieu plans should take regular, affirmative steps to review their plans for compliance with the FLSA. Some plan sponsors may wish to explore alternative options for their flexible benefit plans, including the use of tax-exempt alternatives. Employers may wish to consult with counsel, as well as their health plan consultants, on these issues.

For questions regarding this *Briefing*, please contact your Keenan Account Manager.

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