California Supreme Court Will Have The Final Word On Exceptions To Activity-Based Pay Systems

Insights
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Over a decade has passed since an appellate court in California ruled that employers could not average pay for productive activity to include unpaid non-productive activity in meeting their minimum wage obligations. That decision engendered additional state and federal decisions over the years holding that, under California law, piece-rate compensation similarly could not be averaged into time spent on non-piece work such as waiting time between jobs or time spent on rest periods.

These decisions ultimately resulted in, or significantly contributed toward, legislation taking effect on January 1, 2016 (AB1513), which provides specific guidelines for paying piece-rate employees for (1) productive activity, (2) non-productive activity, and (3) 10-minute rest periods which must be authorized and permitted for every four hours of work or major fraction thereof. AB1513 was encoded as Section 226.2 of the Labor Code.

Section 226 does not define "piece-rate" compensation, but the Division of Labor Standards Enforcement (DLSE) has attempted in its enforcement guidelines to fill in the gaps by resorting to the American Heritage Dictionary. That source defines the term as: "work paid for according to the number of units turned out."

Consequently, a piece rate must be based upon an ascertainable figure paid for completing "a particular task or making a particular piece of goods." The DLSE then provided examples of piece-rate plans to include the following:

- Automobile mechanics paid on a "book rate" (i.e., brake job, one hour and fifty minutes, tune-up, one hour, etc.), usually based on the Chilton Manual or similar;
- Nurses paid on the basis of the number of procedures performed;
- Carpet layers paid by the yard of carpet laid;
- Technicians paid by the number of telephones installed;
- Factory workers paid by the widget completed;
- Carpenters paid by the linear foot on framing jobs.

The DLSE further noted that a piece-rate plan of compensation "may include a group of employees who share in the wage earned for completing the task or making the product" and that "piece-rate

and commission plans may be in addition to an hourly rate or a salary rate of pay. Such plans may also be in the alternative to a salary or hourly rate. As an example, compensation plans may include salary plus commission or piece-rate; or a base or guaranteed salary or commission or piece-rate whichever is greater." (DLSE Website Frequently Asked Questions regarding AB1513).

However, Section 226.2 simply lays out two principal options for paying employees for piece work (commission and other incentive pay systems are not addressed). The first method pays separately for (1) productive activity, (2) non- productive activity, and (3) 10-minute rest periods at the greater of the applicable minimum wage or the average rate of pay for the work week which does not take into consideration the time and compensation for rest periods or any overtime premiums.

The second method eliminates the need to separately keep track of time spent on productive versus non-productive hours and simply pays (1) a base hourly wage at no less than the applicable minimum wage for all hours worked, plus (2) rest period compensation at the greater of the applicable minimum wage or the average rate of pay for the work week which does not take into consideration the time and compensation for rest periods or any overtime premiums. If the employee's base wage includes rest-period time, then a pay supplement would be added if the average hourly rate is higher than the base hourly rate.

Certified Tire & Service Centers Compensation Plan

Some employers altogether abandoned the piece-rate methods of compensation and developed creative hourly rate programs that took production into consideration. One ingenious method departing from the "activity based" piece-rate model was addressed in *Certified Tire & Service Centers Wage & Hour Cases,* 28 Cal.App.5th 1 (2018).

In that case, the employer paid technicians an hourly wage for all work performed, but the actual hourly rate earned by a technician would vary from pay period to pay period. However, the hourly rate for any pay period also was guaranteed to be at least an agreed-upon minimum hourly rate that the technician was assigned at the time of hire, which always exceeded the legal minimum wage. The hourly rate paid to a technician during any given pay period could wind up being higher than the guaranteed minimum hourly rate based on a formula that rewarded the technician for work that was billed to the customer by Certified Tire as a separate labor charge.

Specifically, Certified Tire would multiply the dollars billed by the technician to the customer by 95%, then multiply that amount by a fixed "tech rate" assigned to the technician depending on experience and qualifications, and then divide that amount by the total hours worked by the technician during the pay period, which produced the "base hourly rate." As described in the opinion, "if the base hourly rate exceeded the technician's guaranteed minimum hourly rate, the technician was paid the base hourly rate for all time worked during the pay period. If the guaranteed minimum hourly rate was higher than the base hourly rate, the technician was paid the guaranteed minimum hourly rate for all time worked during the pay period. Overtime hours are paid at one and a half time the hourly rate that applies during the pay period."

In the lawsuits that resulted, the plaintiffs argued the compensation plan was flawed because they did not have the opportunity to increase their base hourly rate by participating in activities that did not generate production dollars. In effect, they contended that they were not paid at all for the non-productive work and that minimum wage laws had been violated. A central component of their argument was that, much like the cases in the appellate decisions, they were being paid on an "activity based" method of compensation, which requires separate payment for productive and non-productive activity.

However, the court rejected that argument, reasoning that, although the pay system "has similarities to a piece-rate system or a commission-based system because technicians are able to increase their earnings by increasing their production," this was "not an "activity-based compensation system." The court reasoned that "the technicians are always paid on an hourly basis for all hours worked at a rate above minimum wage regardless of their productivity, and regardless of the type of activity in which they were engaged during those hours." By so ruling, the court rejected plaintiffs' argument that defendants must somehow "make a separate additional payment to the technician to comply with the minimum wage and rest period requirements."

The California Supreme Court granted review of the decision but did not order the appeals court decision depublished while review is pending.

Dark Horse Express **Decision**

In *Jimenez-Sanchez v. Dark Horse Express, Inc.*, 32 Cal.App.5th 224 (2019), truck drivers paid under different piece-rate compensation methods filed a class action and a motion or class certification. The trial court denied plaintiffs' motion, and the plaintiffs appealed, asserting the claims of the proposed class were based on statutory and regulatory requirements and uniform policies of defendant, presenting predominantly common issues of law and fact suitable for determination on a class basis.

In this case, one question which arose was whether compensation for non-productive time and rest breaks could be included in the piece-rate compensation agreement, a practice condemned by other appellate decisions. The appellate court reversed and remanded the case back to the trial court, noting that the issue of whether the tasks plaintiffs characterized as "nonproductive time" and rest breaks were included in, or incidental to, the activities for which the piece work payment was made was a question still to be determined. Further, the resolution to this issue would depend on the terms of each driver's employment agreement with defendant. In its analysis, the court further determined that the trial court had used improper criteria in its analysis. The Supreme Court granted review; unlike the *Certified Tire* case, the court ordered this decision depublished for the time being.

What These Latest Developments Mean

It's quite possible that, in granting review of the above decisions, the California Supreme Court is seeking to clarify the legal standards for adjudicating alleged activity-based compensation systems

seeking to clarify the legal standards for adjudicating alleged activity-based compensation systems in class actions. Whether that means that the court will modify the appellate court's ruling with regard to the creative hourly method of pay addressed in *Certified Tire* is uncertain.

Previous decisions have upheld an employer's development of pay methods that do not violate public policy despite plaintiffs' arguments to the contrary. An essential component in those cases has been that the employers in question actually paid the employee in question a base wage from which there was no deduction then added an incentive component that was expressly drafted so that there was no illegal deduction from an employee's *expected* wage. *See, e.g., Prachasaisoradej v. Ralphs Grocery Co., Inc.*, 42 Cal.4th 217 (2007) (unlawful deduction claim failed where employees received base wages without reduction and incentive element was specifically defined and paid accordingly without violation of public policy); *Steinhebel v. Los Angeles Times Communications, LLC,* 126 Cal.App.4th 696, 704–12 (2005), 24 Cal.Rptr.3d 351 (newspaper could charge back commission advances to subscription telemarketers paid a base hourly wage for all hours worked where commission was deemed earned in addition to base wages only if subscription was retained for 28 days); *see also DeLeon v. Verizon Wireless, LLC,* 207 Cal.App.4th 800 (2012) (no underpayment of contractual or statutory wages occurred where the terms for earning the incentive pay were clearly defined, including chargebacks).

Thus, it remains to be seen whether the California Supreme Court will go down the road and invalidate variable hourly compensation agreements, replacing them with its own preferred version of how wage payments can be structured. It's also quite possible that the court makes only minor changes to the analysis, leaving intact an employer's freedom of contract regarding payment of wages within specified limits the law permits.

In any event, employers with incentive-based compensation systems should contact their legal counsel in developing strategies to address the uncertainty created by recent actions of the Supreme Court in granting review of cases addressing alleged activity-based compensation systems.

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