California Supreme Court Adds to Employers' Pain By Requiring Higher Rate of Pay for Missed Meals and Breaks: A 3-Step Plan of Action

Insights
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The California Supreme Court ruled yesterday that if an employer fails to provide a legally compliant meal period or rest break, the wage premium they must pay out must be paid at the "regular rate of compensation" – which includes not just hourly wages but all nondiscretionary payments for work performed by the employee. Going one step further, the Court also determined that its ruling applies retroactively and will apply to any past practices that took place before yesterday's decision (subject to applicable statutes of limitation). As a result of the *Ferra v. Loews Hollywood Hotel, LLC* decision, California employers would do well to review their current wage-and-hour practices with regards to meal, rest, and recovery periods, including determining whether violations occur and how premiums should be calculated for such violations. What more do you need to know about this decision? This Insight provides you with a three-step plan to take as a result of yesterday's decision.

Meal and Break Violations Require Employers to Pay a 1-Hour Premium: *But at What Rate?*

As most Californians know, there are requirements pertaining to meal and rest periods which can be highly technical. Indeed, California law dictates the times by which breaks should be commence, the conditions during such breaks, and generally, how long they should last. However, not everyone in the Golden State is readily aware that when an employer fails to provide a legally compliant meal period or rest break, Labor Code section 226.7(c) states "the employer shall pay the employee one additional hour of pay *at the employee's regular rate of compensation* for each workday that the meal or rest or recovery period is not provided." This payment must be made concurrently with the other wages due within the pay period when the break violations occurred.

Similar language is used in California regulations and statutes for purposes of overtime. Specifically, California generally requires overtime pay at one-and-a-half times an employee's "regular rate of pay" or twice that rate for double time. For purposes of overtime, if the employee is paid only a single hourly rate with no additional incentives or supplements, it's simple because that rate is the regular rate of pay. However, if an employee receives hourly pay plus incentives (such as non-discretionary bonuses), then the regular rate factors in the incentive pay to come up with an average hourly rate of pay which is higher than the base hourly rate. Similarly, if an employee receives multiple different hourly rates of pay with no additional incentives, the regular rate for overtime purposes will be the weighted hourly rate derived from all of the different hourly rates for particular work weeks within the pay period.

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A central issue in yesterday's decision was simply whether the phrase "regular rate of compensation" had the same meaning as "regular rate of pay." Although the answer ultimately was "yes," the analytical path getting there was detailed and informative.

Facts of the Case

The facts of the case are relatively straightforward. Loews Hollywood Hotel employed Jessica Ferra as a bartender and paid her hourly wages as well as quarterly nondiscretionary incentive payments. If an hourly employee was not provided a compliant meal or rest break, Loews circumspectly paid the employee an hour of pay at only the employee's base hourly rate without factoring any remotely calculated quarterly incentive payments into that hourly rate. Loews believed this was the "regular rate of compensation" mandated by Labor Code section 226.7(c).

In 2015, Ferra filed a class action lawsuit challenging this practice. She argued that nondiscretionary incentive payments should be factored into the regular rate of compensation for purposes of meal and rest break premiums. The trial court and Court of Appeal agreed with Loews that the "regular rate of compensation" used in section 226.7(c) was not synonymous with the "regular rate of pay" used in Labor Code section 510(a) governing overtime. Ferra appealed to the state's highest court, which issued its long-awaited ruling yesterday.

The Holding: The "Regular Rate of Compensation" Has the Same Meaning as "Regular Rate of Pay"

The Court first acknowledged that neither the Labor Code nor the applicable Wage Order defined "regular rate of compensation" and that the words themselves could reasonably be construed to mean either hourly wages (Loews' interpretation) or hourly wages plus nondiscretionary payments (Ms. Ferra's interpretation). Given the parties' comparison of the term "regular rate of compensation" regarding meal, rest, and recovery periods and "regular rate of pay" for purposes of overtime, the Court analyzed whether the two terms are synonymous. The Court addressed various "canons of interpretation" used by the courts and invoked by the parties in interpreting the language used by the Industrial Welfare Commission and California legislature with regard to the nature of the hourly premium mandated by law. Although Loews contended that the drafters of the law must have intended something different for "regular rate of compensation" and "regular rate of pay," both used in the same statute, the Court strongly disagreed, noting that canons of interpretation "are not immutable rules."

Referring to its 2018 decision in *Alvarado v. Dart Container Corporation of California*, the Court reasoned that an employee's regular rate of pay for purposes of overtime *is not* the same as an employee's straight time rate. Rather, the regular rate of pay as used by the California Industrial Welfare Commission (IWC) and the Labor Code is consistent with the meaning of regular rate in the federal Fair Labor Standards Act (FLSA). There, incentive pay is part of an employee's overall compensation package that must be factored into the regular rate of pay for purposes of calculating overtime. Accordingly, the Court determined the legislative history and prior precedent showed that

overtime. Accordingly, the Court determined the legislative history and prior precedent showed that the term "regular rate of pay" used in the Wage Orders refers to all compensation for work performed, i.e., not only hourly wages but also nondiscretionary earnings as the "regular rate" is used under the FLSA.

The Court did not find persuasive Loews' arguments that, because the IWC and Legislature used different terms ("of pay" versus "of compensation"), they intended a different definition. Rather, the Court reasoned the operative term is "regular rate" which has a particular meaning when calculating overtime. Similarly, the Court found no history or support for a contradictory interpretation of regular rate of compensation and instead found the terms were used interchangeably in legislative sessions, court decisions, and by the IWC.

The Court used an example proffered by Ferra to demonstrate why it sided with her arguments. If an hourly employee ($25 per hour), a piece rate employee ($50 per piece), and an hourly plus piece rate employee ($20 per hour plus $10 per piece) all earned $1,000 in a given week, the hourly and piece rate employees would receive $25 for a break premium under Loews' interpretation whereas the hourly plus piece rate employee would only receive $20. The Court did not believe there should be a disparity between workers receiving purely hourly rates and workers receiving a combination of hourly rates and incentives. Ruling otherwise, it said, may incentivize employers to lower hourly base rates for workers to reduce the impact of premium required for the violations.

Retroactive Application Ruling Adds to the Pain

The Court went one step further and determined that the decision will apply retroactively. Such a result was expected since California judicial decisions ordinarily interpret existing law and do not make new law, whereas new laws made by the legislators and commissions acting with regulatory authority typically are prospective only.

The Court determined no considerations of fairness or public policy warranted applying the decision only prospectively. This means that the decision will apply to past practices that have already taken place. Of course, the retroactive reach of the decision will not operate to revive claims already barred by the applicable statutes of limitation.

What Should You Do?

The Supreme Court's decision requires California employers' careful attention. What should you do as a result of yesterday's ruling? Here are the three steps you should take to ensure compliance with the new standard.

1. ***Vigilantly Comply with Meal and Break Rules***
   First and foremost, this decision again highlights the importance of forming and maintaining compliant meal, rest, and recovery period policies. Equally important: you need to demonstrate constant vigilance in complying with the relevant laws and regulations, including the calculation of the one-hour premium required when violations occur.

But as everyone knows, even the best policies and strong practices are subject to the occasional deviation due to conditions sometimes beyond your control. Indeed, the California Supreme Court's groundbreaking 2012 *Brinker* decision made it clear that you need not police whether meal periods are taken (although you may wisely choose to do so). That case says you satisfy your duty to provide meal periods if you relieve your employees of all duty, relinquish control over their activities, permit them a reasonable opportunity to take an uninterrupted 30-minute meal break, and do not impede or discourage them from doing so. A similar standard now applies to the mandated rest period, therefore demonstrating that you need not conclude that every category of missed meal or rest period translates into a mandate to pay the required premium.

2. ***Use the Correct Formula – But Take Steps to Prevent Repeat Problems***
   Second, this decision gives you the precise formula for satisfying one key aspect of what the law requires: how to properly compensate an employee on the occasional (and hopefully rare) instance of a noncompliant break. But lest you forget, the best practice is to investigate and correct the situations giving rise to payment of these premiums, including maintaining work environments that provide the necessary breaks.

   Of course, it is absolutely vital to give careful attention regarding what constitutes a violation of Section 226.7 when making the premium payments. You may have a payroll system in place for automatically paying the premiums without any investigation, such as when a time record displays a short or missing meal period (which may have occurred *without your fault*). In such a case, the answer is not calculating the premium correctly, but not paying the premium *at all if there is no violation.*

3. ***Determine What to Do About Problems in Your Past***
   Finally, yesterday's decision was ruled to be retroactive in scope, meaning that you may now realize that you failed to satisfy the strict terms laid out by the California Supreme Court in the past. Those actions may come back to haunt you unless you take action. But before running off to make additional premium payments in an attempt to fix things, you should coordinate with your California wage and hour attorney to determine the best approach in your specific situation. You will want to take into account any unique circumstances involved at your workplace before developing a plan of action.

We will continue to monitor developments in this area and provide updates as appropriate. Make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information. For more information, contact your Fisher Phillips attorney, the authors of this Insight, or any of the attorneys in our California offices.

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