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CALIFORNIA EMPLOYERS MUST RECALCULATE MEAL AND REST BREAK PREMIUMS

Article

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In a unanimous and long-awaited decision in *Ferra v. Loews Hollywood Hotel, LLC*, the California Supreme Court on July 15th, ruled that employers must pay premium payments to employees for missed meal, rest and recovery breaks at the “**regular rate of compensation**,” which includes not only the based hourly rate, but also any nondiscretionary or performance-based incentive payments like bonuses or commissions received by the employee; much like the rate used to calculate the overtime rate of pay. This holding has huge implications for California employers in that it applies retroactively over the last four years, which means employers need to act quickly to avoid class action or PAGA claims.

FACTS

Jessica Ferra, a bartender who worked for Loews Hotel in Los Angeles, filed a claim alleging that Loews incorrectly calculated her premium pay when it refused to include nondiscretionary incentive payments. Loews’ meal and break policy stated that employees who were not provided with a compliant meal or rest period are entitled to an additional hour of pay based on their **base hourly wage** at the time the meal or rest period was missed. Ferra alleged that her quarterly incentive payments were wrongfully omitted from the calculation of the pay owed her in addition to hourly wages. In a surprise reversal of the California Court of Appeals, the California Supreme Court agreed with Ferra.

CASE PROGRESSION THROUGH THE LOWER COURTS

Ferra filed this suit as a class action against Loews in 2015. Her central claim was that Loews' omission of the nondiscretionary payments from its calculation of premium pay did not adequately compensate her for noncompliant meal or rest breaks in accordance with her "regular rate of compensation" required by Labor Code section 226.7(c). Labor Code section 226.7(c) states: "If an employer fails to provide an employee a meal or rest recovery period in accordance with a state

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law... 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." Similarly, the IWC Wage order No.5-2001, which applies to bartenders, hotel staff and similar types of employees says, "the employer shall pay the employee one hour of pay at the employee's regular rate of compensation for each work day that the meal or rest period is not provided." Like most California employers, Loews interpreted "regular rate of compensation" as the base hourly rate.

The trial court granted summary adjudication in favor of Loews, disagreeing with Ferra's claim that Loews was required to consider nondiscretionary compensation in its calculation of premium pay. Instead, the trial court found that the "regular rate of compensation in section 226.7(c) is not interchangeable with the term regular rate of pay under section 510(a), which is the section of the statute that governs overtime pay." The Court of Appeal affirmed the trial court's decision ruling that the premium for non-complaint rest and meal periods is in fact the employee's base hourly wage. The Supreme Court of California reversed this decision and held in favor of Ferra, not only prospectively but also retroactively for the four-year period in which such premiums are recoverable.

WHY THIS CASE IS IMPORTANT: UNDERSTANDING THE NEW STANDARD FOR EMPLOYERS WHEN CALCULATING THE HOURLY PREMIUM RATE FOR EMPLOYEES WHO ARE NOT PROVIDED COMPLIANT MEAL, REST OR RECOVERY PERIODS

Employers have long understood the requirement for calculation of the "regular rate" of pay for overtime purposes, which includes all nondiscretionary payments as well as the base hourly rate. Most businesses currently do not treat overtime pay requirements the same as penalties imposed for noncompliant breaks. The reading of the law before the current case and standard business operating procedure was to compensate the employee an additional hour of their base hourly pay for any missed meal, rest, or recovery breaks.

In this new holding from the California Supreme Court, the court examined the wording used in the overtime provisions as well as the non-compliant break provisions and found that in accordance with the spirit of the law and underlying public policy concerns, the terms "regular rate of pay" and "regular rate of compensation" were essentially intended to have the same meaning and application. The court reflected that the legislative intent was to protect the average worker as well as to ensure that the health, safety and preservation of family life be honored.

Under California law governing overtime, an employee is entitled to one and a half times their regular rate of pay for any time over eight hours in a single workday. In addition, an employee is entitled to double time for any hours worked in excess of twelve in one day. In addition to special provisions for overtime pay, California law also lays out specific provisions for noncompliant or missed meal or rest breaks for employees. The daily penalty is assessed for each category of noncompliant break (short, late, or missed) in the amount of an additional hour of pay at the employee's regular rate of compensation.

Attorneys for Loews argued that the correct canon of statutory interpretation should be that a lawmaker is presumed to intend a different meaning when it uses different wording in a statutory scheme. Because the legislature used the term regular rate of compensation instead of regular rate of pay, many courts have concluded that the legislature intended premium payments to be paid at the base hourly rate of pay and did not intend nondiscretionary payments to be included in this formula. Defendant also argued that the two provisions should not be interpreted as similar because one is meant as a penalty for noncompliance and the other is not considered a penalty, but as additional compensation for extended work hours.

The Supreme Court of California, however, applied a different statutory construction and found that "where statutes use synonymous words or phrases interchangeably, those words or phrases should be understood to have the same meaning." Thus, the court found that it was the legislature's intent to give those words the same meaning in this context. The Court went

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on to say that compensating employees in this way for noncompliant break periods is in accordance with long-standing public policy efforts to protect employees from becoming overly tired at work and being injured as a result, or suffering increased stress, which is in line with the spirit and underlying purpose of the law.

THE DECISION APPLIES RETROACTIVELY

It is important to note that this case has retroactive application, going back as far as four years, and is likely to expose employers to significant potential liability. Loews made this argument before the court, but the judges bristled at this assertion, finding it more persuasive that employees instead would be inadequately compensated. The Court determined that the potential damage to uncompensated employees outweighed the additional liability and the potential for increased lawsuits against employers.

CALCULATING PREMIUM PAYMENTS AFTER THIS RULING

Calculating the regular rate of compensation can be quite difficult, depending on an employee's compensation structure, commissions earned, incentive plans implemented by the employer to boost productivity, and the manner in which bonuses are awarded. The regular rate of compensation may even change from week to week depending upon such factors as number of hours worked, types of hours worked, incentive or selling programs and many other factors that may come into play. Employers are urged to meet with payroll and accounting teams to ensure that ALL nondiscretionary payments to nonexempt employees are included along with the base hourly rate in calculating the regular rate of compensation for both overtime and noncompliant break premium payments.

IMMEDIATE MEASURES CALIFORNIA EMPLOYERS SHOULD TAKE MOVING FORWARD

- Update company policies and all payroll systems to properly articulate and calculate the noncompliant break premium payment. Ensure that your payroll team calculates noncompliant break premiums in the same manner that the regular rate of pay is calculated for overtime purposes.
- Remedy any past premium payments if future nondiscretionary payments are received in the same year that would change the calculation of the regular rate of compensation.
- Pay restitution for any past premiums paid under an incorrect rate for all nonexempt employees over the past four years.
- Consider minimizing administrative burdens by eliminating nondiscretionary payments, performance based-incentives, or bonuses going forward.
- Ensure that nonexempt time records reflect compliant meal periods of at least 30 minutes in duration before the fifth hour worked.
- Consider having nonexempt employees document compliant rest periods every shift.
- Ensure that you have in place valid meal break waivers or on-duty meal period agreements, where applicable.
- Implement signed acknowledgements every pay period confirming that nonexempt employees were provided opportunities to take compliant meal and rest periods and know of no other time worked for which they have not been paid in that pay period, which helps bolster proof of compliance and minimize exposure in future claims.

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WSHB IS MONITORING FUTURE DEVELOPMENTS IN THIS AREA

We know from the *Naranjo v Spectrum Security Services, Inc.* case that these premium payments for noncompliant breaks are currently considered penalties and not unpaid wages. In practice, this means that the derivative penalties such as inaccurate wage statements, waiting time penalties, and attorneys' fees don't currently apply to claims for unpaid premiums. However, *Naranjo* is also pending before the California Supreme Court, so employers may get another adverse ruling if the Court decides that meal and rest break premiums are "wages" such that failure to pay premiums can give rise to wage statement and waiting time penalties. The *Ferra* Court's extensive analogizing of overtime premium pay and meal and rest break premiums may hint that it views the two in a similar light.

The attorneys at WSHB are here to assist employers as they adapt to evolving legal landscape and are available to advise on the best course of action.