Next Steps For Employers After Calif. Break Premium Ruling

By **Penny Chen** (July 23, 2021)

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Many California employers know that nonexempt employees are entitled to 30-minute meal breaks and 10-minute rest breaks. They also know that when a break is not provided, the employee is entitled to a penalty equal to one hour of pay.

Until recently, most employers simply added an hour of pay at their base rate. It was easy for payroll to process and easy to explain to employees, so that was that.

Not so fast, said the California Supreme Court. On July 15, the court issued the landmark decision of Jessica Ferra v. Loews Hollywood Hotel LLC, holding that meal, rest and recovery periods must be paid not at an employee's base hourly rate, but at their "regular rate of pay."

Historically, regular rate of pay was primarily used for calculating overtime, which is defined as time and a half or two times the regular rate of pay.

An employee's regular rate of pay is often higher than their base hourly rate because the regular rate includes additional compensation, such as nondiscretionary bonuses, shift differentials, commissions and piece rate pay.

Under this decision, not only must premiums now be paid at the regular rate of pay, the ruling applies retroactively, meaning that liability for noncompliance could reach back four years.

Background of Ferra v. Loews Hollywood Hotel

According to court documents, Jessica Ferra was a bartender employed by Loews Hollywood Hotel. Her compensation included both hourly wages and quarterly nondiscretionary incentive payments, including incentive bonuses.

Pursuant to California Labor Code Section 226.7 and the Industrial Welfare Commission wage orders, which entitle employees to an additional hour of pay at the "regular rate of compensation" when breaks are not provided, Loews paid a one-hour premium for noncompliant breaks.

However, it did so at employees' base hourly rate.

Ferra brought a class action on behalf of Loews' nonexempt employees, alleging that "regular rate of compensation" means "regular rate of pay," and that break premiums should have incorporated all nondiscretionary incentive payments in addition to the base hourly rate.

Ferra argued that in enacting Section 226.7 and the wage orders, the Legislature and Industrial Welfare Commission intended "regular rate of compensation" to be synonymous with "regular rate of pay," and the difference in word choice did not signify an intent to apply a different meaning.

Loews countered that the phrase "regular rate of pay" is a term of art. Therefore, in requiring break premiums to be paid at the regular rate of compensation while defining overtime in terms of regular rate of pay, the Legislature intended for these phrases to carry different meanings.

The California Court of Appeal, Second Appellate District, agreed with Loews in a 2-1 decision, relying on the principle articulated in the California Supreme Court's 1999 decision in Briggs v. Eden Council for Hope & Opportunity that "[w]here different words or phrases are used in the same connection in different parts of a statute, it is presumed the Legislature intended a different meaning."[1]

Ferra appealed.

The California Supreme Court's Decision

In a unanimous decision penned by Justice Goodwin Liu, the court found, quoting from the appeals court's dissenting opinion, that "[w]hen the Legislature enacted Section 226.7 in 2000, it did so against the backdrop of long-standing federal law that defined overtime pay in terms of an employee's 'regular rate.'"

The court noted that subsequent jurisprudence appeared to identify "regular rate" as the operative term.

Legislative history and the Industrial Welfare Commission's statement as to the basis[2] also indicated that the commission and Legislature may have used "regular rate of pay" and "regular rate of compensation" interchangeably.

Thus, the court reasoned, the term of art at issue was actually "regular rate," and "regular rate of pay" and "regular rate of compensation" did, in fact, mean the same thing.

Ultimately, the court fell back on the purpose behind the Labor Code and wage orders, which is to protect employees and to address concerns about their "working conditions, wages, and hours."

Under this framework and mindset, the court concluded that break premiums must be paid at the regular rate of pay.

Ferra Applies Retroactively

Generally, judicial decisions are applied retroactively, whereas laws passed by legislation apply prospectively.[3] Narrow exceptions to retroactivity exist for judicial decisions that change a settled rule.

In commentary that may be unsurprising following the California Supreme Court's January decision in Vasquez v. Jan-Pro Franchising International Inc.[4] — which examined the retroactivity of another landmark ruling from 2018, Dynamex Operations West Inc. v. Superior Court[5] — the court declined to apply Ferra prospectively only.

The court reasoned that because the appeals court decision was divided, and federal district courts were conflicted, there was no settled law regarding the proper rate of break premium pay.

Therefore, no exception to retroactivity applied.

The statute of limitations for meal and rest break violations is up to four years, meaning that employees may bring claims with liability extending as far back as four years.

Who Might This New Development Impact?

Ferra impacts any employee who is legally entitled to meal and rest breaks and who receives any form of nondiscretionary compensation in addition to hourly wages, or base salary in the case of a salaried nonexempt employee. This is most often seen in:

- Nonexempt employees who receive nondiscretionary bonuses, such as safety bonuses, attendance bonuses, meet-target bonuses, profit-based bonuses, retention bonuses and many performance-based bonuses;
- Nonexempt employees who receive piece-rate pay, commissions or other production-based compensation, often seen in manufacturing, sales and recruiting roles;
- Employees who receive shift differential pay, commonly seen in health care and manufacturing settings;
- Commissioned sales employees who may be exempt from overtime, but who are still subject to meal and rest break laws (sometimes referred to as inside sales employees); and
- Transportation workers who do not fall within the ambit of the Federal Motor Carrier Safety Act, and therefore are subject to California's meal and rest break laws.

What Does This Mean for Employers?

At its core, Ferra heralds a change in the way employers must calculate break premiums, but does not alter employers' underlying obligation to provide compliant breaks, or their defenses.

As the Ferra court noted, an employer "may defend against" meal and rest break claims "as it has always done."

The case also does not create derivative liability from underpayment of premiums, such as wage statement violations or waiting time penalties — rather, that question is to be addressed by the California Supreme Court in the pending case of Naranjo v. Spectrum Security Services Inc.

Where employers are most likely to feel the impact of Ferra is in the logistical considerations of adjusting premium rates, as well as in litigation.

It goes without saying that adjusting premiums rates requires an understanding of how to navigate California's often confusing regular rate rules.

In its simplest form, the regular rate of pay is the quotient of all compensation for the week (except enumerated categories, such as overtime premiums and discretionary bonuses) divided by hours worked.

Due to these complexities, employers should not assume that their payroll vendor will

automatically know what to include in their regular rate calculations.

If an employee only earns an hourly wage, the regular rate calculation is simple.

Jane Doe works 40 regular hours and five overtime hours in a week. She earns $15 an hour and receives no other nondiscretionary incentive compensation, so her regular rate is $15.

But if Jane earns $15 an hour and a $100 bonus for meeting a production target, her regular rate is increased to $17.22:

[($15 x 45 hours) + $100] / [45].

To further complicate matters, if Jane's $100 bonus is not a production bonus but rather a flat attendance bonus, her regular rate is increased to $17.50 because overtime hours are not considered in calculating the per-hour value of the bonus:

[$15 + ($100 / 40 regular hours worked)].

If a nondiscretionary bonus covers multiple pay periods, such as a quarterly bonus, Jane is entitled to retroactive adjustment of her regular rate.

Previously, employers likely considered regular rate calculations only for weeks in which employees worked overtime, but they now must conduct this analysis for any week in which a meal or rest break is not provided.

For litigation, Ferra means not only an increase in potential damages, but also a heightened risk of class certification and Private Attorneys General Act penalties.

One of the largest hurdles plaintiffs lawyers face in meal and rest break class actions is their burden to prove that there exists enough commonality between absent class members such that their claims can be adjudicated on a representative basis.

Likewise, many courts subject PAGA claims to manageability standards that prevent representative adjudication of what could be potentially thousands of individual claims.

While the commonality inquiry remains unchanged on a claim for failure to provide breaks, that element may be easier to meet for systemic underpayment of break premiums, particularly where the regular rate is already considered for overtime.

Employers and counsel should be prepared to lean on arguments arising from individual inquiry required to determine whether each individual employee, or category of employees, was entitled to any regular rate adjustments, and in what weeks.

What Can Employers Do?

Ferra left a slew of unanswered questions, not the least of which include: When are premiums due?

Overtime can be paid in the pay period following the one in which overtime hours are worked, but most employers pay break premiums in the same pay period they are accrued.

Can employers now change their premium payment schedule so that premiums are paid in the following pay period, without running afoul of unsettled law regarding whether break

premiums should be treated like wages?

While these questions have yet to be answered, employers can take action to mitigate litigation risk.

First and foremost, employers should promptly work with their payroll vendor to pay break premiums at the regular rate. They should also verify correct calculation for the regular rate.

Because the Ferra decision is retroactive, employers should also assess potential retroactive liability and consider adjustments for prior premiums. Courts have broad discretion to decrease PAGA penalties down from the statutory default, and prompt remedial action is a commonly considered factor in that determination.

There is no fix as good as prevention. Employers should audit their policies and practices on provision of meal, rest and recovery periods.

Given the increased stakes of violating break laws and recent developments that have increased the employer's burden in defending against these claims,[6] companies should consider periodic wage and hour training for managers and employees.

Finally, for employers who have been considering employment arbitration agreements, now may be a good time to dust off those discussions. A well-drafted arbitration agreement can be a powerful tool in mitigating class action risk.

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[1] Ferra v. Loews Hollywood Hotel, LLC, 40 Cal. App. 5th 1239, 1247 (2019).

[2] The Statement as to Basis is a document that explains the "how and why" of the IWC.

[3] Vasquez v. Jan-Pro Franchising Int'l Inc., 10 Cal. 5th 944, 951 (2021).

[4] Vasquez v. Jan-Pro Franchising International Inc., 10 Cal. 5th 944, 951 (2021).

[5] Dynamex Operations West, Inc. v. Superior Court, 4 Cal. 5th 903 (2018).

[6] In February 2021, the California Supreme Court invalidated rounding of time for meal breaks and established a presumption of noncompliance where time records do not reflect compliant meal breaks, rather than requiring employees to first prove that the employer failed to provide breaks. Donohue v. AMN Services, LLC, 11 Cal. 5th 58 (2021).