

California Supreme Court Invalidates Long-Standing Employer Practices and Creates Retroactive Liability in Ruling that Meal and Rest Break Premiums Must Be Paid at the “Regular Rate”

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On July 15, 2021, the California Supreme Court ruled in *Ferra v. Loews Hollywood Hotel, LLC* that employers must pay meal and rest period premiums at the “regular rate” of pay. The regular rate of pay, which is used to calculate overtime, includes all forms of nondiscretionary compensation paid to nonexempt employees. The Court held that paying meal and rest period premiums at a base hourly or “straight time” rate is not consistent with the law.

Previously, California appellate courts had determined that employers could legally pay meal and rest period premiums at an employee’s base hourly rate of pay. Given the significance of this decision, employers should immediately review their meal and rest break premium pay practices and audit all forms of compensation paid to nonexempt employees to ensure proper calculation of the “regular rate” of pay for purposes of overtime, California paid sick leave, and meal and rest period premiums.

Meal and Rest Period Requirements

Under California law, employers covered by the Industrial Welfare Commission wage orders must provide nonexempt employees with a 30-minute meal period that begins before the end of the fifth hour of work, and a second 30-minute meal period that begins before the end of the tenth hour of work. In addition, employers are required to furnish nonexempt employees with a paid 10-minute rest period for every four hours of work (or major fraction thereof). Missed, late, or interrupted meal periods can constitute a violation of law.¹ Similarly, missed rest periods can also constitute a violation of law. Under Labor Code section 226.7, meal and rest period violations trigger an obligation to compensate an employee for 1 hour of pay (break premiums).

The “Regular Rate” of Pay

When a nonexempt employee is entitled to overtime pay, the law requires the employer to compensate that employee at a factor of the regular rate of pay (i.e., 1.5 times the regular rate of pay for overtime; 2 times the regular rate of pay for double-time).

¹ Records reflecting noncompliant meal periods raise a rebuttable presumption of liability for a premium payment. See our prior alert from March 9, 2021 for additional information about that rebuttable presumption.

This “regular rate of pay” is a legal term that is not necessarily equivalent to the employee’s base hourly pay. Depending upon the compensation paid to an employee in a particular workweek, it means the higher of:

- (i) the employee’s base hourly rate of pay if the employee earns only one rate of pay in the workweek and receives no other nondiscretionary compensation;
- (ii) the weighted average of the employee’s hourly rates of pay where more than one hourly pay rate is in effect during the workweek; or
- (iii) the weighted average of the employee’s base hourly rate(s) of pay and any additional nondiscretionary compensation an employee earns in the workweek (e.g., commissions, bonuses, pay-in-lieu of benefits).

As a result, an employee who is paid nondiscretionary compensation in addition to an hourly base rate will have a higher regular rate of pay in a workweek in which the employee earns that additional compensation.

Employers Must Pay Break Premiums at the “Regular Rate” of Pay

In *Ferra*, the plaintiff filed a wage and hour class action alleging that Loews underpaid employees who received premium wages for noncompliant meal and rest breaks because Loews paid those premiums using an employee’s base hourly rate instead of the regular rate of pay.

In addition to paying an hourly wage, Loews paid the plaintiff nondiscretionary quarterly bonuses. Like the vast majority of California employers, Loews did not include any nondiscretionary compensation in calculating premium wages for noncompliant meal and rest breaks. Loews’ rationale, and its argument in the case, was that Labor Code section 226.7 provides that premium wages are payable at an employee’s “regular rate of compensation.” That differs slightly from the term “regular rate of pay” that appears in Labor Code section 510(a), governing overtime. Therefore, Loews asserted that using “compensation” instead of “pay” in section 226.7 indicated that the Legislature did not intend premium wages to be paid using the overtime calculation method, which does factor in additional nondiscretionary pay. Both the trial court and the Court of Appeal agreed with Loews.

However, the California Supreme Court reversed. It held that “regular rate of pay” and “regular rate of compensation” are interchangeable. The Court examined the history of the term, which is derived from the federal Fair Labor Standards Act, noting that “regular rate” was the “operative term.” The Court also reviewed the legislative histories of Labor Code section 510(a) and section 226.7. It determined that the Legislature enacted section 226.7 with the understanding that “regular rate” was the operative phrase, so it intended that premium wages be calculated in the same manner in which overtime is calculated.

***Ferra* Applies Retroactively**

Significantly, the Court expressly denied Loews' request for its decision to apply only going forward. As a rule, judicial decisions apply retroactively, and the Court was unsympathetic to Loews' arguments, which included that the decision will expose employers to significant liability for underpaid premiums. Although the Court stated there is no evidence that employers will be exposed to such liability, it essentially invited these claims to go forward by suggesting that a prospective decision would enable employers "in avoiding 'millions' in liability" owed to employees.

Takeaways

- ❖ Immediately review and update any policies and practices to pay meal and rest break premiums at the regular rate of pay
- ❖ Consider proactively auditing meal and rest period premiums paid over the last four (4) years and retroactively paying the difference to employees who earned nondiscretionary compensation and received break premiums at a base hourly rate
- ❖ Review all types of compensation paid to nonexempt employees to ensure appropriate adjustments to the overtime, sick, and meal and rest period premium rates of pay for all forms of nondiscretionary compensation, including payments made on a periodic basis (e.g., nondiscretionary quarterly or annual bonuses, commissions, standby stipends, etc.)
- ❖ Implement other wage and hour best practices to minimize exposure to class and collective actions, including using arbitration agreements with class and collective action waivers and conducting wage and hour audits under consultation with an attorney

If you have questions, please contact an attorney in our Employment Law group by phone at (916) 321-4444 or via email.

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