

California Supreme Court Sets Retroactive Standard for Calculating Meal and Rest Break Premiums

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On July 15, 2021, the California Supreme Court in *Ferra v. Loews Hollywood Hotel, LLC* clarified that the “regular rate of compensation” for meal and rest break premiums is synonymous with the “regular rate of pay” used to calculate overtime payments. This means employers must account for an employee’s base hourly rate, as well as other forms of nondiscretionary compensation (e.g., commissions, nondiscretionary bonuses) when calculating meal and rest break premiums. Significantly, the Court held that its decision applies retroactively.

The California Supreme Court’s ruling represents a departure from the reasoning of a prior California Court of Appeal decision and numerous federal court cases. Given this sudden shift, employers should review their formulas for calculating meal and rest break premiums to ensure compliance.

Background

In 2000, California adopted Labor Code section 226.7, which requires employers to provide an additional hour of pay to employees who are not provided the opportunity to take a meal or rest break in accordance with the governing wage order. Section 226.7 specifies that the extra hour of pay is “at the employee’s regular rate of compensation for each work day that the meal or rest period is not provided.”

Since the enactment of section 226.7, courts have grappled over the term “regular rate of compensation.” This term is undefined by the Labor Code, which, until *Ferra*, left its meaning open to interpretation. This resulted in a series of conflicting federal court decisions, many of which concluded that the term encompasses only an employee’s base hourly rate.

Given the lack of binding legal authority, California employers were without a definitive answer regarding how to calculate meal and rest break premiums. That changed with *Ferra v. Loews Hollywood Hotel, LLC*.

Ferra v. Loews Hollywood Hotel, LLC

The plaintiff in *Ferra* worked as a bartender for Loews Hollywood Hotel, LLC (Loews). Her compensation included hourly wages and nondiscretionary quarterly incentive payments. If an hourly employee missed a meal or rest break, Loews paid that employee a one-hour premium equal to the employee’s hourly wage. Loews did not include nondiscretionary incentive payments when calculating the premiums.

In 2015, the plaintiff brought a class action against Loews, asserting, among other things, that it failed to pay meal and rest break premiums in accordance with Labor Code section 226.7. The plaintiff argued that the term “regular rate of compensation” in section 226.7 has the same meaning as the term “regular rate of pay” used to calculate overtime in accordance with Labor Code section 510. Because an employee’s “regular rate of pay” should include nondiscretionary bonuses and incentives, the plaintiff argued that Loews miscalculated meal and rest break premiums by failing to include incentive payments in its premium calculations.

The trial court granted summary adjudication in favor of Loews, finding that the “regular rate of compensation” is limited to an employee’s base hourly rate. The Court of Appeal affirmed, observing that the California Legislature’s use of different terms in Labor Code sections 226.7 and 510 supported the conclusion that the terms have different meanings. The Court of Appeal also cited numerous federal decisions reaching the same conclusion.

The California Supreme Court reversed, finding that the terms “regular rate of compensation” and “regular rate of pay” are synonymous. The Court observed that the term “regular rate” has been historically interpreted to mean “regular rate of pay.” Although Loews stressed the Legislature’s use of the different terms “compensation” and “pay,” the Court noted that both terms are used interchangeably in other portions of Labor Code sections 226.7 and 510. Because “regular rate of pay” and “regular rate of compensation” have the same meaning, the Court concluded that both include “not only hourly wages but all nondiscretionary payments for work performed by the employee.” The Court also reiterated its “general guidance that the ‘state’s labor laws are to be liberally construed in favor of worker protection.’”

Regular Rate of Pay Calculation

The Court in *Ferra* did not address how to correctly calculate the premium for missed meal and rest breaks, other than indicating that it must include all forms of relevant compensation, as is required in determining the regular rate of pay for purposes of calculating overtime premiums. Determining an employee’s regular rate of pay under California law depends on the compensation type and structure. For example, commissions, shift differentials, and nondiscretionary bonuses (those intended to compensate for services performed, hours worked, production or proficiency, or as an incentive to remain employed) must be included in the regular rate of pay. Common exclusions from the regular rate are gifts for special occasions, expense reimbursements, tips, and discretionary bonuses.

After determining the appropriate forms of compensation to include in the regular rate of pay, employers then must calculate the hourly value of all such compensation, so the one-hour premium can be paid for any missed meal periods or rest breaks. The general rule for computing the regular rate of pay is to use the legal maximum regular hours (not including overtime hours), which is usually eight hours per day and 40 hours per week. As an example, assume an employee earns \$20 an hour, works 40 regular hours and two hours of overtime, and earns an additional \$200 flat-sum bonus for the week. Because the employee’s regular rate of pay must include the flat-sum bonus, the employee’s regular rate of pay for that week would be \$25 [$\5 per hour on flat-sum bonus ($\$200$ divided by 40 regular hours) + $\$20$ base hourly rate]. As a result, the one-hour premium for missed breaks during the week in this example would be \$25.

California law recognizes an exception to the general rule for calculating the regular rate of pay for purposes of

paying overtime premiums on commissions and other production-based bonus compensation. The Court in *Ferra*, however, did not specifically address this issue. Applying this exception to the above example, assume that instead of a flat-sum bonus, the employee earned \$200 in commissions for the week. The regular rate of pay would be \$24.76 [\$200 divided by 42 total hours worked (including overtime hours) + \$20 base hourly rate], which yields a smaller hourly premium than the flat-sum calculation.

As a result, the regular rate of pay calculation is more complex than it appears based on the variety of issues and factors at play, ranging from the type of the compensation or bonus to the time period in which it was earned. Further complexity may arise when the employee earns a combination of these different types of compensation or when the employee earns a bonus or commission over an extended period of time, such as monthly or quarterly. In the latter case, employers may need to supplement previously paid premiums to account for additional bonuses or commissions earned at a later time if they are allocable to an earlier period in which the employer had paid a meal or rest break premium. Employers should expect that these and other issues will be litigated and addressed in future cases.

Retroactive Application

Significantly, the Court in *Ferra* held that its decision applies retroactively. This holding means that employers may be liable for past violations of Labor Code section 226.7 — stretching back three to four years, depending on the applicable statute of limitations — if they failed to incorporate all nondiscretionary payments for work performed by the employee when calculating the regular rate of pay for purposes of paying meal or rest break premiums. The California Supreme Court's other recent decision in *Donohue v. AMN Services, LLC* (which we addressed [here](#)) adds to the importance of strict compliance with meal and rest break requirements. Employers should carefully consider and assess the impact of these Supreme Court decisions on their past and current practices for providing compliant breaks and paying meal and rest break premiums when due.

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