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California Meal and Rest Premium Payments Ruling: Retroactive Implications for Employers

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Since the California Supreme Court issued its ruling in the Ferra v. Loews Hollywood Hotel, LCC matter, many articles have alerted California employers that the meal and rest premium payments for non-compliant meal and rest periods must be paid at the regular rate instead of the employee's base hourly rate. This news has certainly prompted employers to work with counsel, their internal payroll departments, and external payroll vendors to adjust the rate at which those premiums are paid going forward. However, while many of those articles note that the rule applies retroactively, it is less clear whether employers should make any adjustments to past payments, and if so, how to do that. This article addresses these points.

Does it matter?
Employers who are currently involved in litigation where meal/rest premium payments are at issue should work with counsel to assess the impact on a potential settlement.

However, even employers not currently in litigation over meal/rest premiums have potential exposure for past underpayment of such premiums. Employers who regularly pay meal/rest premiums will have relatively more exposure because the volume of under-paid penalties will be larger. Potential exposure is also larger for employers who award more incentive payments such as shift differentials and non-discretionary bonuses because the dollar difference between hourly rates and regular rates will be greater. Although the incremental amount owed for a single meal premium is likely small, when combined across all employees over the four-year lookback period in California, the potential exposure can be material, particularly if PAGA penalties are also applied over the one-year period.

A standard, full-time employee working five days per week, eight hours per day, works about 250 shifts per year. If the employee was awarded a meal or rest exception in 25 percent of those shifts, that's over 60 meal premiums per year. Over a four-year period, that is 250 premium payments. If the regular rate is, on average, $1 more than the hourly rate, then the additional amount owed per full-time employee would be $250. That works out to $100,000 in additional amounts owed for just 400 employees. If employers don't make those payments now and end up getting sued, the potential exposure and attorneys' fees will be even higher.

What should you do?
It can be difficult to perform retroactive payroll calculations, particularly if you have changed payroll systems over the relevant period. Typically, there are three main steps to take:

1. **Identify work weeks with meal premium payments.**
   The first step is to collect the payroll data for all non-exempt employees over the period. For employees who are paid weekly, the specific employee work weeks with meal premiums can be identified directly from the payroll data. For employees paid less frequently, meal premium payments may not be assigned to a specific work week. In that case, it may be necessary to incorporate time records to properly allocate meal premium payments to the week in which they were awarded.

2. **Calculate the difference between the regular rate and hourly rate in those weeks.**
   If overtime was paid in the weeks with meal premium payments, the regular rate has already been calculated by payroll, so the difference between that rate and the rate at which the meal premium was paid can be determined. If the week did not have any overtime, the payroll system likely did not calculate the regular rate, and that calculation will need to be performed. The formula for calculating the regular rate is already in the payroll system, but when calculating the regular rate for past pay periods, it is important to account for differences in pay codes that may have taken place over time. For example, if the code "SD" was used previously for shift differential pay, but the current system uses the code "Shift Diff" for such payments, simply applying the current rules to prior data could result in exclusion of relevant payments from that calculation. Review of the pay codes in use over the full lookback period is required to ensure the calculation is performed correctly.

3. **Calculate additional true-ups.**
   In addition to capturing the difference between the hourly and regular rates in the weeks in which meal premium payments were made, it is also necessary to apply a true-up for any payments that spanned multiple pay periods, such as bonuses or commissions. For example, if non-discretionary bonuses were paid annually, a true-up payment for meal premiums now needs to be calculated just as it was for overtime premiums. This additional amount has already been calculated by payroll if the employee also received overtime during the bonus period. In such instances, the incremental amount per hour is available and can be applied to the number of meal premium payments made. If the employee did not work overtime during the bonus period, that calculation will need to be performed. When calculating the additional amount owed for the true-up, it is important to ensure that the appropriate hours worked are included. For example, if it is a quarterly bonus, the bonus amount would be divided over the hours worked over the quarter[1], not just the hours worked in the pay period in which the bonus was paid.

Conclusion

As California employers work with employment counsel and payroll to adjust meal premium payments to be paid at the regular rate going forward, they should be mindful of the retroactive implications of the ruling and ensure any retroactive payments are calculated correctly.

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1 In the matter of Hector Alvarado v. Dart Container Corporation of California, the Court ruled that when calculating a bonuses per-hour value (i.e. the portion of the regular rate due to the bonus), only non-overtime hours should be considered for flat-sum bonuses. For other bonuses, such as production and piece rate bonuses, all hours are used.