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California's Meal and Rest Period Rules: The Debate Rages On

by Jennifer Brown Shaw

As many employers have learned recently, California Labor Code section 226.7(b) requires non-exempt employees to be paid one hour's pay at their regular rate for each workday they are not provided a meal or rest period that complies with the requirements of the applicable Industrial Welfare Commission ("IWC") wage order.

A debate has raged since the Legislature enacted section 226.7(b) in 2001 as to whether these payments for missed or otherwise non-compliant meal and rest periods constitute "wages" or "penalties." The legal significance of this issue for employers is that claims for unpaid wages are covered by a three-year statute of limitations (and permit restitution under a four-year statute of limitations), while claims for penalties are covered by a one-year statute of limitations.

Within the past few months, three California courts of appeal found the payments constituted a penalty, while another court of appeal ruled the payments were both a wage to employees and a penalty to employers. The California Supreme Court will be resolving this question within the next several months.

Background

The California Division of Labor Standards Enforcement (DLSE) initially interpreted and enforced the meal/rest period payment as a wage, which resulted in the application of the three-year statute of limitations. Attorneys promptly capitalized on this position by filing class actions against

California employers for alleged meal and rest period violations, which often resulted in substantial settlements.

In late 2004, the DLSE changed its position and issued an emergency regulation, in part, to clarify the payment was in fact a penalty and not a wage. While employers initially celebrated this development, it was relatively short-lived; the DLSE subsequently withdrew the emergency regulation and is pursue the formal regulatory process, which left employers back at the beginning.

In June 2005, the Labor Commissioner issued an order in *Hartwig vs. Orchard Commercial, Inc.* finding that the meal/rest period payment was a penalty and not a wage. The DLSE then designated the order as a precedential decision, a positive development for employers.

During November 2005, California's Second District Court of Appeal commented on the wage/penalty issue in *Caliber Bodyworks, Inc. vs. Superior Court of Los Angeles*. In a footnote, the court explained that while section 226.7(b) does not expressly label the payment a "penalty," it is in the nature of a statutory penalty because it requires the employer to pay more than the value of the missed or non-compliant meal or rest period. The court also noted that because the payment does not compensate the employees for any extra time worked, but rather punishes the employer for its failure to provide required meal and/or rest periods, it should be considered a penalty.

Of course, that was not the end of the story. Three courts of appeal have since directly addressed the issue in *Murphy v. Kenneth Cole Productions, Inc.*; *National Steel and Shipbuilding Company vs. Superior Court of San Diego*; and *Mills vs. Superior Court of Los Angeles*. In addition, the DLSE elected not to file the meal/rest period regulation after all, but rather to begin the process of drafting a new regulation. These developments have left the law in this area in quite a state of flux.

The Kenneth Cole Decision

In December 2005, California's First District Court of Appeal directly confronted the wage/penalty debate in *Murphy vs. Kenneth Cole Productions, Inc.*

Plaintiff John Murphy worked for Kenneth Cole as a store manager in San Francisco. During October 2002, Murphy filed an administrative complaint with the DLSE alleging he was misclassified as an exempt employee and thereby denied overtime, interest, and waiting-time penalties. After a hearing in July 2003, the Labor Commissioner issued a decision finding Kenneth Cole failed to prove Murphy qualified as an exempt employee, and awarded him \$29,531.21. Murphy was not represented by counsel at the hearing, and did not allege he had missed any required meal or rest periods.

Kenneth Cole appealed the order de novo to the California Superior Court in San Francisco. The Hastings College of Law Civil Justice Clinic represented Murphy before the trial court. In May 2004, the trial court awarded Murphy unpaid overtime, missed

meal and rest period payments, penalties for failing to furnish itemized pay statements, waiting-time penalties, and prejudgment interest, for a total judgment of \$64,206.85. The trial court also awarded attorneys' fees to Murphy of \$62,171.40. Kenneth Cole again appealed.

The court affirmed the judgment in all respects, except with respect to the missed meal and rest periods, which were not raised before the DLSE. The Court also directed the trial court to reconsider the appropriate amount of attorneys' fees because of the partial reversal.

The good news for employers is that the Court ruled the meal/rest period payment is a penalty subject to the one-year statute of limitations. Also, the court's decision was based on an independent analysis of the wording, history and intent of the Legislature when enacting section 226.7(b), and the intent of the IWC when it promulgated the wage order. Unfortunately, the court's analysis of the class members' exempt status will make it more difficult for employers to prevail in such cases.

On January 11, 2006, Murphy petitioned the California Supreme Court to review the decision. The Supreme Court subsequently granted the petition.

The DLSE's Election Not to File the Regulation

On January 13, 2006, the Acting Director of the California Department of Industrial Relations announced the DLSE had elected not to proceed with the proposed meal/rest period regulation in light of the Kenneth Cole decision; instead, the DLSE intends to issue a new package of proposed regulations at a later date, beginning a completely new rulemaking process.

In making this announcement, the Director explained the Kenneth Cole decision is in full agreement with the DLSE's enforcement position and, when viewed in combination with the Hartwig precedential decision, one of the main purposes for the DLSE to

implement the regulation (that is, to establish the payment under section 226.7(b) is a penalty and not a wage) no longer existed.

Unfortunately, the DLSE apparently did not to anticipate a conflict was about to develop among California's courts of appeal.

The NASSCO Decision

In a bit of employment law drama, one week after the DLSE announced its decision not to proceed with the meal/rest period regulation, California's Fourth District Court of Appeal reached an entirely different result in *National Steel and Shipbuilding Company vs. Superior Court of San Diego (NASSCO)*. The decision was filed on January 20, 2006.

Plaintiffs Robert Godinez, Indalecio Parra and John Petersen sued NASSCO in San Diego Superior Court in a class action alleging missed meal and rest periods during the past four years. Plaintiffs sought: (1) "compensation" of one additional hour of pay for each day meal and rest period violations occurred; (2) restitution under California's Unfair Competition Law; (3) injunctive relief enjoining further meal and rest period violations; and (4) attorneys' fees and costs.

NASSCO moved to strike any reference in the complaint to a time period more than one year before the filing of the complaint on the ground that the one additional hour of pay was a penalty, and not a wage, thereby subjecting plaintiffs to the one-year statute of limitations. The trial court denied NASSCO's motion and ruled that Labor Code section 228.7(b) created a wage and not a penalty.

On appeal, California's Fourth District Court of Appeal disagreed, and ruled that the payment was both a wage to employees and a penalty to employers. In adopting this conclusion, the court "harmonized the statutory scheme" and reasoned that employment law statutes must construed in favor of the employee. Accordingly, in the

court's view, the payment should be subjected to the longer three-year statute of limitations for claims based upon a statute rather than the one-year statute generally applicable to penalties. The court expressly rejected the Kenneth Cole decision in its analysis.

The NASSCO Court also held that the meal/rest period payments are restitutionary, and recoverable under California's Unfair Competition Law, which includes a four-year statute of limitations. As a result, the court effectively expanded the statute of limitations for such claims to four years.

The court's parting words invited the Legislature to amend the meal and rest period statute if the decision did not reflect the Legislature's intent.

The Mills Decision

Plaintiff Deborah Mills sued Bed, Bath and Beyond, Inc. (BBB) in Los Angeles Superior Court in a class action alleging missed meal and rest periods, and unfair business practices under California's Unfair Competition Law.

BBB demurred to Mills' complaint on the grounds that payments for missed meal and rest periods are penalties and not wages, and therefore not recoverable under California's Unfair Competition Law. The trial court agreed with BBB's arguments and sustained the demurrer. Mills then filed a writ petition asking the appellate court to vacate the trial court's order concluding section 226.7(b) payments are not wages.

On January 27, 2006, the Second District Court of Appeal denied Mills' writ petition and ordered Mills to pay BBB's costs on the petition. The court first determined that section 226.7(b) is ambiguous as to whether the required payment constitutes an additional wage or a penalty. The court then examined the legislative history of section 226.7(b) and concluded based on that review that the payments were intended to be penalties.

The court's opinion also addressed the issue of whether the payment under section 226.7(b) can be aggregated, i.e., whether a missed meal break and a missed rest break in a single day count as two penalties or only as one penalty. In this regard, the court instructed that "[i]f all of the break periods in an eight-hour shift are missed, an entire hour's pay is due." This conclusion is certain to cause additional concern to attorneys who regularly seek two hours' pay per workday against employers, i.e., one hour's pay per day for a meal period violation and one additional hour's pay per day for one or more rest period violations.

Conclusion

Time will tell whether missed meal and rest period payments are properly characterized as penalties, wages, or both. In the meantime, employers should continue taking appropriate steps to strictly comply with the rest and meal period requirements, and stay tuned for new developments.

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