

Management Alert

Employers Cannot Get a Break From the California Supreme Court

On April 16, 2007, the California Supreme Court issued its highly anticipated opinion in *Murphy v. Kenneth Cole Productions* regarding whether the “one hour of pay” liability imposed by Labor Code §226.7 for failing to provide meal periods or rest breaks is a wage or a penalty. Rejecting the considered view of 22 of the 24 California appellate justices who had previously considered the issue, the Supreme Court unanimously held that the one hour of pay remedy is in the nature of a wage. This ruling significantly increases the potential liability California employers face for meal and rest period violations.

Murphy's Wage Claim

John Paul Murphy worked as a retail store manager for Kenneth Cole Productions. He was classified as exempt. Following his resignation from the company, he filed a wage claim in October 2002 with the California Labor Commissioner seeking unpaid overtime pay and waiting time penalties. In July 2003, the Labor Commissioner ruled for Murphy, finding that Kenneth Cole Productions had failed to establish that he was an exempt employee, and awarding him unpaid overtime, waiting time penalties, and interest. Kenneth Cole Productions appealed the decision to the San Francisco County Superior Court for *de novo* review. Hastings College of Law Civil Justice Clinic agreed to represent Murphy in the appeal and the Superior Court allowed Murphy to add claims for meal and rest period violations and inaccurate wage statements.

In May 2004, the trial court ruled in Murphy's favor on all claims, and it held that the additional hour of pay imposed by Labor Code §226.7 was compensation, not a penalty. Therefore, it applied a three-year statute of limitations to Murphy's meal and rest period claims, not the one-year statute of limitations that applies to a penalty.

Court of Appeal Decision

Kenneth Cole Productions appealed the trial court's ruling to the California Court of Appeal. The Court of Appeal affirmed in part and reversed in part, ruling that the one hour of pay for violations of Labor Code §226.7 is a penalty subject to a one year statute of limitations and not a wage. This holding helped California employers for a number of reasons, including the following: (1) it limited their liability for violations of Labor Code §226.7 to one year instead of three years; (2) it meant that they were not liable to pay additional penalties that apply to the failure to pay “compensation”, but not to the failure to pay penalties; and (3) it meant that they did not have to pay attorneys' fees and interest that are available for a failure to pay compensation, but not for failure to pay a penalty. The Court of Appeal's ruling was consistent with an earlier decision by the Labor Commissioner that a failure to provide meal and rest periods entitled an employee to a penalty, not a wage.

The Court of Appeal also reversed the trial court's ruling that an employee can raise new claims during a *de novo* review of a Labor Commissioner determination. All other parts of the ruling were upheld.

Supreme Court Penalizes Employers By Holding That The One Hour of Pay Liability Is A "Wage"

The Supreme Court, in an opinion by Justice Moreno, unanimously reversed the Court of Appeal decision, concluding that meal and rest period violations entitle an employee to a one hour wage payment under Section 226.7. The court emphasized that the statutory language ("the employer shall pay the employee one additional hour of pay at the employee's regular rate of compensation") suggests that the additional hour of pay owed for meal period and rest break violations is a wage, as opposed to a penalty, and that Section 226.7 provides compensation for these injuries. The court found the Legislature's decision not to label Section 226.7 a penalty particularly persuasive because the Legislature had established penalties explicitly labeled as such in other Labor Code provisions. The court reasoned that if the Legislature had intended Section 226.7 to be governed by a one year statute of limitations, then it could have so indicated by unambiguously labeling it a "penalty."

The Supreme Court also concluded that the legislative history demonstrates that Section 226.7 was intended to compensate employees for being deprived of meal or rest periods, rather than to punish employers. The court noted that meal periods and rest breaks "have long been viewed as part of the remedial worker protection framework" and that "due to a lack of employer compliance, the [Industrial Welfare Commission] added a pay remedy to the wage orders" for such violations. The court also found it significant that the Legislature eliminated the requirement that an employee file an enforcement action, and instead created an affirmative obligation on the employer to pay the employee one hour of pay. In that way, "a payment owed pursuant to Section 226.7 is akin to an employee's immediate entitlement to payment of wages or for overtime."

The Supreme Court ignored arguments made by Kenneth Cole Productions and employer groups that under established precedents the payment is a penalty. For example, the Court completely ignored that, unlike requiring overtime, the failure to allow meal and rest periods can subject employers to misdemeanor liability under Labor Code §§553 and 1199. The court also glossed over the fact that the amount of pay imposed on an employer for a meal or rest period violation bears no relationship to the amount of break time denied. Finally, the court did not find it persuasive that the Labor Commissioner determined that the Section 226.7 remedy is a penalty. Instead, the court noted that the Labor Commissioner's most recent decision "flatly contradicts" its prior interpretation that the remedy was in fact a wage. The court thus overlooked the fact that the Labor Commissioner's original position was that the Section 226.7 remedy is a penalty.

The bad news for employers did not end there. The Supreme Court upheld Murphy's right to add additional claims on appeal, as a means "to discourage frivolous and unmeritorious appeals" from Labor Commissioner awards.

Murphy Leaves A Number of Unanswered Questions

Two issues that will arise in future cases were not presented to the Supreme Court. First, and most important, is whether an employer is liable for missed meal periods that result from an employee's own choice. Section 226.7 makes the employer liable only when it fails to "provide" a meal period. What does "provide" mean? The common understanding is "to make available." That is what nearly all employers already do now, routinely. Yet plaintiffs' attorneys and unions have argued that "provide" really means that an employer must compel its employees to take meal breaks. While many California employers will continue to require employees to take meal periods, both as a matter of efficiency and safety and as a conservative approach toward legal compliance, employers still have an argument, left untouched by the *Murphy* decision, that the employer complies with the meal period law so long as its policies and practices leave the employee free to

decide whether to take the meal or not. This especially may be true where the employees have discretion to set their own schedule for breaks and meals, as may be the case for employees, such as drivers, who work at locations apart from direct supervision.

Second, *Murphy* did not address whether an employer can be liable for one additional hour of pay per day for failing to provide a meal period and one additional hour of pay per day for failing to allow a rest period – or merely one additional hour of pay per day in total.

Third, it remains unknown if meal period plaintiffs can claim not only the three year statute of limitations applying to Labor Code claims, but also the four year statute of limitations available for claims under the Unfair Competition Law (“UCL”). The California Supreme Court has permitted UCL claims for wages, including overtime premium pay, on the theory that the UCL permits recovery of claims for restitution and that “earned wages” are the “property” of the employee who has given labor in exchange for that property. *Cortez v. Purolator Air Filtration Products Co.*, 23 Cal. 4th 163, 178 (2000). The *Murphy* court arguably already has decided this issue in the employee’s favor by characterizing meal period pay as “premium pay.” The point remains, however, that meal period pay is not “earned” in the sense that overtime premium pay is. Employers do have a colorable argument that the statute of limitations for meal period pay should be three years, not four.

What Murphy Means for California Employers

The *Murphy* decision is a huge victory for wage and hour plaintiff attorneys who can now recover attorneys’ fees and costs for bringing meal and rest period claims on behalf of California employees. In addition, California employers will face further detrimental consequences for meal and rest period violations, such as these:

1. A three year statute of limitations for violation of a statutory obligation to pay wages, instead of the one year statute applicable to a claim for a penalty.
2. Tax withholding and employer taxes for the meal and

rest period wage payments.

3. Attorneys’ fees for the prevailing plaintiff’s attorneys. Labor Code §218.5.
4. Prejudgment interest on a wage claim. Labor Code §218.6.
5. Possible penalties for failing to pay wages on termination of employment. Labor Code §203.
6. Possible additional civil penalties under the Labor Code for failing to pay wages, including under the California Private Attorney General Act of 2004 (the bounty-hunter statute). Labor Code §§2698-2699.
7. Possible liability for additional claims if an employer seeks review of a Labor Commissioner ruling.

The unanimity of the decision also indicates a continued willingness by the California Supreme Court to interpret the Labor Code in the manner most favorable to employees and the plaintiffs’ bar. Beyond the issue of meal and rest periods, this decision will embolden the plaintiffs’ bar to continue pursuing claims that expand the scope of employer liability.

The Supreme Court’s decision, though clearly not a positive development for employers, underscores the importance of proactively developing systems to achieve and document California Labor Code compliance. Most if not all employers can effectively manage their exposure with a carefully developed and coordinated plan.

If you have any questions concerning this Management Alert, please contact the Seyfarth Shaw LLP attorney with whom you work or any labor & employment attorney on our website at www.seyfarth.com.

ATLANTA

One Peachtree Pointe
1545 Peachtree Street, N.E.
Suite 700
Atlanta, GA 30309-2401
404-885-1500
404-892-7056 fax

BOSTON

World Trade Center East
Two Seaport Lane
Suite 300
Boston, MA 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO

131 South Dearborn Street
Suite 2400
Chicago, IL 60603-5577
312-460-5000
312-460-7000 fax

HOUSTON

700 Louisiana Street
Suite 3700
Houston, TX 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES

One Century Plaza, Suite 3300
2029 Century Park East
Los Angeles, CA 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK

1270 Avenue of the Americas
Suite 2500
New York, NY 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO

400 Capitol Mall
Suite 2350
Sacramento, CA 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO

560 Mission Street
Suite 3100
San Francisco, CA 94105-2930
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.

815 Connecticut Avenue, N.W.
Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS

Boulevard du Souverain 280
1160 Brussels, Belgium
(32) (2) 647 60 25
(32) (2) 640 70 71 fax



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