Insight

IN-DEPTH DISCUSSION

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California Governor Signs AB 1513, Severely Limiting Piece-Rate Compensation but Throwing a Liability Life Raft to Employers

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On October 10, 2015, Governor Edmund Gerald Brown, Jr. signed into law legislation that re-writes the definition and rules governing the payment of piece-rate compensation in California. Assembly Bill (AB) 1513 creates new California Labor Code section 226.2 and sets forth requirements for the payment of a separate hourly wage for "nonproductive" time worked by piece-rate employees, and separate payment for rest and recovery periods to those employees.

The legislation builds on California appellate court decisions in *Gonzales v. Downtown LA Motors*, 215 Cal. App. 4th 36 (2d App. Dist. Mar. 6, 2013) and *Bluford v. Safeway, Inc.*, 216 Cal. App. 4th 864 (3d App. Dist. May 8, 2013). The law has profound implications for employers, including agricultural and transportation companies, which historically compensate employees based on piece-rate and activity-based formulas. Many such employers have been battling minimum wage and other class-action claims in recent years based on the *Gonzales and Bluford*, cases and a number of federal district court cases following and expanding on those holdings.

There is, however, good news for some employers subject to the legislation who have not yet been, or have only recently been, the subject of class action litigation based on a failure to pay wages in accordance with these recent cases. New Labor Code section 226.2 provides a limited safe harbor for employers that 1) have not been sued regarding these issues prior to April 2014, 2) come into compliance with all of the obligations now described in section 226.2 before the end of 2015, and 3) pay actual or liquidated damages by the end of 2016. All employers that have paid piece rate or activity based pay must seriously consider the options provided by this legislation.

Gonzalez, Bluford, and the Redefining of Piece-Rate Compensation in California

Many industries in California, and throughout the country, have traditionally and overwhelmingly utilized piece-rate plans to compensate employees and incentivize productivity. Over the last several years, employers using piece-rate compensation have found themselves increasingly

battling claims by class-action plaintiffs that such piece-rate pay plans violate California's minimum wage law. This litigation directly challenged the application in California of the long standing interpretation of the federal wage and hour law that only compared the total compensation for a workweek to the total hours worked in that week, regardless of how the total compensation was calculated or the activities for which that compensation was paid.

Under this standard provided by federal minimum wage law, an employer is compliant with its minimum wage obligation if the total compensation for a workweek, when divided by the total number of hours worked in the workweek yielded an "average" hourly wage equal to or above minimum wage. However, in *Armenta v. Osmose, Inc.*, 135 Cal. App. 4th 314 (2d App. Dist. Dec. 29, 2005), a California appellate court held that the "averaging" permitted by federal law violates California law. Osmose paid its employees by the hour at a rate that was well in excess of the minimum wage, but did not pay the employees for every fractional hour that they worked. California law was construed to require the payment of the minimum wage *for each hour or fractional hour worked* regardless of how well paid the employees were for their productive hours. California law does not permit the "averaging" of wages over any period to determine whether an employee has been paid minimum wage.

In 2011, a federal district court in the Central District of California in *Cardenas v. McLane Foodservices, Inc.*, held the no-averaging principle in California extended to piece-rate compensation. Just as a high hourly rate of pay for productive hours cannot be averaged to determine minimum wage compensation, piece-rate pay cannot be "averaged" over non-productive activities to provide compensation for such activities. In other words, a piece rate or production based pay plan does not provide compensation for any activities that do not directly increase the amount of piece rate compensation earned. If non-productive duties are not separately compensated, then they are not compensated at all, which results in claims for minimum wages. "[I]t is irrelevant whether the pay formula was intended to compensate pre- and post-trip duties, or even if employees believed it covered those duties, if its formula did not actually directly compensate those pre- and post-trip duties." *Cardenas,* 796 F.Supp.2d at 1253.

Several other federal court decisions followed Cardenas and have concluded that various trip-pay and similar piece-rate systems violate California's minimum wage requirement because the trip-pay or similar piece-rate pay plan cannot provide compensation for activities that are not directly included in the piece-rate calculation. *See e.g., Quezada v. Con-Way Freight, Inc.*, 2012 U.S. Dist. LEXIS 98639 (July 11, 2012).

The opinions of the federal courts were adopted in 2013 by the California state appellate courts. In *Gonzales v. Downtown LA Motors*, the Second Appellate District concluded that piece-rate compensation cannot be "averaged" over all hours worked to provide compensation for non-productive time. The appellate court concluded that mechanics who were guaranteed two times the minimum wage in compensation for their total hours worked were not paid anything for their non-productive time. In other words, the employees must be separately paid an hourly wage for any time they spent waiting between repair jobs.

"Averaging piece-rate wages over total hours worked results in underpayment of employee wages required "by contract" under Labor Code section 223, as well as an improper collection of wages paid to an employee under Labor Code section 221, as illustrated by the following example: a technician who works four piece-rate hours in a day at a rate of $20 per hour and who leaves the jobsite when that work is finished has earned $80 for four hours of work. A second technician who works the same piece-rate hours at the same rate but who remains at the jobsite for an additional four hours waiting for customers also earns $80 for the day; however, averaging his piece-rate wages over the eight-hour workday results in an average pay rate of $10 per hour, a 50 percent discount from his promised $20 per hour piece rate. The second technician forfeits to the employer the pay promised "by statute" under Labor Code section 223 because if his piece-rate pay is allocated only to piece-rate hours, he is not paid at all for his nonproductive hours."

Gonzalez, 215 Cal. App. 4th at 50.

Gonzalez created a number of legal and practical issues for employers who used a piece-rate pay plan to provide compensation for non-productive duties. Employers found themselves facing potentially enormous back-pay and penalty liability for piece-rate pay practices that were common and long-standing.

Two months after the *Downtown LA Motors* decision, the onerous interpretation of California law was reinforced by the Third Appellate District in *Bluford v. Safeway, Inc.* In *Bluford*, the court considered (among other things) the obligation to pay for the 10-minute rest breaks required by

the Wage Orders of California's Industrial Welfare Commission. The court concluded that such rest breaks were non-productive time for which compensation must be ***separately provided apart from any piece rate pay plan:***

"[R]est periods must be separately compensated in a piece-rate system. . . . Under the California minimum wage law, employees must be compensated for each hour worked at either the legal minimum wage or the contractual hourly rate, and compliance cannot be determined by averaging hourly compensation. Thus, contrary to Safeway's argument, a piece-rate compensation formula that does not compensate separately for rest periods does not comply with California minimum wage law."

Bluford, 216 Cal. App. 4th at 870.

The California Supreme Court declined to review either the *Gonzalez* or the *Bluford* decisions, and it has not otherwise addressed the application of California's minimum wage laws to piece-rate compensation. However, the conclusions reached in the *Gonzalez* and *Bluford* decisions have been incorporated by the California legislature into AB 1513.

New Labor Code Section 226.2 Requires Separate Hourly Pay for Rest and Recovery Periods and "Nonproductive" Time Worked by Piece-Rate Employees

AB 1513 creates new section 226.2 of the California Labor Code, which applies to all employees compensated on a piece-rate basis.[1] The new section, which will become effective January 1, 2016, codifies three, basic statutory requirements for the payment of employees on a piece-rate basis:

- Employees must be separately compensated for the time to take rest and recovery breaks. These breaks must be paid at an hourly rate no less than the greater of either the applicable minimum wage or the employee's average hourly wage for all time worked (exclusive of break time) during the work week.
- Employees must be separately compensated for "other nonproductive time," which is defined as "time under the employer's control, exclusive of rest and recovery periods, that is not directly related to the activity being compensated on a piece-rate basis." Notably, the statute does not define "activity," and thus does not resolve the practical difficulty created by *Cardenas, Gonzalez,* and related cases holding a piece rate must separately compensate each duty performed. Employers will still face challenges defining what "activity" is compensated by a piece-rate and what closely related activities are not compensated by the piece rate. Employers will have the additional complication of determining what work time is spent in activities that are not "directly related" to the piece rate compensation plan.
- Section 226.2 provides that this "other nonproduction time" time must be compensated at an hourly rate no less than the applicable minimum wage. The statute provides that the amount of "other nonproductive time" to be paid may be determined either by actual records or by the employer's "reasonable estimate," but the statute provides no further direction on what differences may exist between the "actual records" or the employer's "reasonable estimate."
- Employee wage statements will be required to include the following information, besides that which is already required under existing Labor Code section 226(a):
  - The total hours of compensable rest and recovery periods, the rate of compensation for those periods, and the gross wages paid for those periods during the pay period.
  - The total hours of other nonproductive time, the rate of compensation for that time, and the gross wages paid for that time during the pay period.

Employers will be able to satisfy the requirement to pay for other nonproductive time by paying minimum wage for ***all hours worked***, in addition to any piece rate. The employer is not required to specify information regarding the other nonproductive time on its wage statements.

1 Importantly, although the safe harbor affirmative defense would preclude liability for failure to compensate employees for rest and recovery periods that must be paid, it does NOT impact any claims based on the employer's alleged failure to provide such breaks.

Employers who have employees in California paid on any productivity or piece-rate basis should examine the statute carefully and consult counsel to be sure they comply with these requirements by the end of the year.

The Limited Safe Harbor May Provide Some Relief for Employers Who Have Piece Rates and Who Were or Could be Sued for Failing to Pay for "Nonproductive" Time

The *Cardenas, Gonzalez,* and *Bluford* decisions created enormous back-pay and civil- and statutory-penalty liability for employers with longstanding piece-rate compensation practices that were previously considered fully compliant with minimum wage requirements. Class action lawsuits have abounded. AB 1513 provides limited relief for employers facing recently filed litigation on these claims, or who fear they could face liability if such a claim is filed now that the statute has codified these concepts.

Section 226.2 provides that an employer may assert an affirmative defense to all liability for failure to compensate for rest and recovery periods and other non-productive time ***if*** it satisfies ***all of*** the following requirements by ***December 15, 2016***:

- The employer makes payments to each of its current and former employees for the amount of break and other non-productive time not separately compensated as now required by the statute during the period July 1, 2012 through December 31, 2015. These payments may be calculated using either of the following methods (at the employer's election):

  1) The actual amount of wages due for the break and nonproductive time that must be separately compensated, plus interest; or

  2) Four percent (4%) of the employee's gross earnings during that period. If the employer paid additional amounts to cover some of what is now considered other nonproductive time, those amounts (up to 1% of gross earnings) may be deducted from the payments, for a minimum payment of 3% of gross earnings.

- The employer makes a good faith effort to locate and provide these payments to each of its former employees who would qualify.
- The employer provides written notice to the Department of Industrial Relations by ***July 1, 2016*** of its intention to make these payments.

If an employer satisfies these requirements, it can assert this affirmative defense in any claim or action filed ***on or after March 1, 2014***, unless judgment has already been entered and the time for appeal expired by the end of 2015. The affirmative defense precludes any liability, whether asserted as wages, damages, liquidated damages, statutory penalties, or civil penalties, based solely on the employer's failure to timely pay the employee separately for rest and recovery periods and other nonproductive time for time through ***December 31, 2015***.[2]

Depending on the calculation of the payment required under this safe harbor, some employers may be able to take advantage of significant relief from potential liability in current or probable litigation, easing the transition to an alternative compensation plan that complies with the payment requirements of the new statute.

Conclusion

The ability of an employer to use a piece-rate only compensation plan to pay an employee for all of his or her hours of work has greatly diminished in California over the last several years. AB 1513, which will codify much recent federal and state case law in new Labor Code section 226.2, resolves – adversely to the historical use of piece rate pay plans – many questions about how employers must address the use of such compensation plans. The new statute is complex, it can require immediate action by affected employers, and compliance with the new law and its safe harbor provision will not be easy. AB 1513 does not address many questions about proper compliance and creates many new questions that will be left to the courts to resolve. The safe harbor provision, if carefully applied, may offer relief to some employers who face years of potential back-pay and penalty liability.

Employers should contact counsel if they believe they may be subject to AB 1513 or have questions regarding their liability under the new statute, as the timeframes for coming into compliance and taking advantage of the possible safe harbor are limited.

2 The full text of AB 1513, including the full text of the new Labor Code section 226.2, can be found at *https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=20....*