

MANAGEMENT ALERT

Employer Services Practice Group

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Wal-Mart and Its Aftershock

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What Do the Wal-Mart Punitive Damage Award, the Withdrawal of Meal and Rest Period Regulations and Conflicting Meal Period Court Decisions Mean for California Employers?

On December 22, 2005, a Northern California jury awarded \$115 million dollars in punitive damages to employees of Wal-Mart for alleged violations of California's meal and rest period requirements. The verdict in Savaglio v. Wal-Mart Stores also included \$57 million in general damages. In a post-verdict interview, the jury foreman was blunt - the large award was intended to send a "very clear message" to California businesses that they should explicitly follow California's employment law.

Barely two weeks later, on Friday, January 13, 2006, the California Division of Labor Standards Enforcement formally withdrew its proposed flexibility regulations. While the decision to withdraw affirmed the Division's continued view that meal and rest period payments are a statutory "penalty," it also announced that new regulations would be drafted and new public hearings scheduled in 2006. For all practical purposes, the flexibility guidelines represented by the regulations were withdrawn. For California employers, it was not a great way to start out the year.

At the same time, during December 2005 and January 2006, several conflicting court decisions were issued on the issue of whether meal and rest period payments required by California Labor Code § 226.7 are "penalties" subject to a one-year statute of limitations, or "wages" subject to a three or four year statute of limitations. In Murphy v. Kenneth Cole, Caliber Bodyworks, Inc. v. Superior Court, and Mills v. Superior Court, California appellate courts decided that such payments represent penalties. However, in National Steel and Shipbuilding Co. (NASSCO) v. Superior Court, another appellate court decided that the payments were better characterized as "wages." This issue will eventually need to be decided by the California Supreme Court.

Meal and Rest Breaks - The Enforcement Challenge

Effective monitoring of employee meal and rest periods poses one of the greatest day-to-day challenges employers face. Employees expect flexibility as to when, and sometimes if, they take breaks. Day-to-day work pressures can affect those decisions. These competing factors not only complicate enforcement by the employer - they affect uniform and fair enforcement by the Labor Commissioner. The stakes were raised and the need for clear enforcement guidance heightened on these issues when the Legislature, during the Davis administration, imposed an additional cost on employers for



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missed meal and rest periods in the form of an additional one hour of payment, measured by the employee's hourly pay.

During 2005, the California Division of Labor Standards Enforcement began a rule-making process with the intent of publishing regulations that would assist employers and employees alike in determining when and how meal and rest period requirements would be enforced. The final proposed regulations made it clear, consistent with California law, that employers must make meal and rest periods available and cannot discourage employees from taking them. Workers would also have had the option to waive meal periods if they work fewer than six hours in one day. The proposed regulations also clarified that meal and rest period payments are "penalties" subject to the one-year statute of limitations, not "wages," which can be subject to longer limitations periods, up to four years.

The Wal-Mart Verdict

As most employers realize, California law requires that employees receive "off-duty" meal periods of at least 30 minutes for every five hours worked. Wal-Mart acknowledged that it "had compliance issues" with California's meal period requirements when suit was filed against it in 2001. At trial, Wal-Mart stated that there was no basis for punitive damages, and that prior problems had since been corrected through the use of new monitoring technology. Still, employees testified that they frequently went without meal and rest periods because they felt Wal-Mart would penalize them. Employees also testified that they were pulled from their meal and rest periods to make up for staff shortages. Additionally, evidence was presented that Wal-Mart allegedly pressured managers to lower store labor costs, resulting in under-staffed stores, "off-the-clock" work, as well as missed meal and rest periods.

Wal-Mart - Issues on Appeal

Although the Ninth Circuit previously upheld a punitive damage award in a meal period case against a Red Lobster restaurant in Bender v. Darden Restaurants, Inc., the better view under California law is that Wal-Mart should not be subject to a "double penalty" through the issuance of a punitive damage award. In Murphy v. Kenneth Cole, Murphy, a retail clothing store manager, filed a DLSE complaint alleging that he was misclassified as overtime exempt. The DLSE found in Murphy's favor, but Kenneth Cole filed a *de novo* appeal. On appeal, the trial court found that Kenneth Cole failed to prove that Murphy was exempt. Murphy also raised new claims for meal and rest period payments, which were awarded by the trial court. The Court of Appeals affirmed the trial court with respect to the overtime exemption issue. The court stated that substantial evidence supported the trial court's finding that Murphy did not have the requisite input in hiring and firing decisions, or utilize independent discretion or judgment, because almost all aspects of the store and Murphy's work were controlled by the district manager or by Kenneth Cole's procedural manual. The Court also noted that Murphy spent 90% of his time engaged in nonexempt tasks.



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However, the Court of Appeals held that the trial court should have dismissed Murphy's meal and rest period claims. These claims were barred, the court stated, because meal and rest period payments are statutory "penalties" subject to the one-year statute of limitations. The court stated that these payments represent penalties because they are based upon an arbitrary amount, paid in addition to salary paid for work performed during the meal or rest period.

The Wal-Mart trial court's decision to allow the Wal-Mart jury to address the issuance of punitive damages came well before the December 2005 issuance of Murphy v. Kenneth Cole, and before any published California appellate court guidance on the penalty issue. Indeed, the trial court's initial decision holding that punitive damages would not represent a "double penalty" under California law, because general damages payments to potential class members are considered "wages" and not a "penalty," is vulnerable on appeal. The court expressly acknowledged that if the "statutory" payments were deemed a penalty, punitive damages would be unavailable because they would represent a double penalty.

Complicating things further, two new cases addressing the issue of whether meal period payments are "penalties" or "wages" were issued in January 2006. In NASSCO v. Superior Court, a California appellate court issued a decision contrary to Murphy v. Kenneth Cole. NASSCO held that meal and rest period payments are "compensatory" and therefore subject to a longer statute of limitations. The court noted that the Legislature had meant to protect employees when it enacted the statute providing meal and rest period payments, and that the statute should be interpreted with that in mind. The court adopted the view that meal and rest period payments are payments for additional work performed during meal and rest periods, notwithstanding that employees are already compensated for their work time if they work through a meal or rest period. Curiously, the NASSCO court failed to distinguish the holding in Murphy v. Kenneth Cole.

In the second case, Mills v. Superior Court, another California appellate court held that meal and rest period payments are statutory "penalties." Mills noted that such payments have nothing to do with the amount of additional time actually worked, but rather represent a fixed sum due regardless of the amount of missed break periods. The Mills Court also noted that the statute mandates that such payments be provided and are not left to an employer's discretion. In sum, the resolution of the "penalty" issue is clearly one that will ultimately be presented to the California Supreme Court to resolve.

Punitive Damages in Wage and Hour Litigation - What's Next

It is especially important for employers and their counsel to understand the differing legal issues and risks raised by the Wal-Mart punitive damages award. It can be argued that there is no legal basis for imposing punitive damages because the California Legislature already imposes a statutory penalty in the form of the meal period payment. This is consistent with the view expressed in Murphy v. Kenneth Cole and by the Division of Labor Standards Enforcement in the proposed regulations.



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However, the Wal-Mart jury also found that Wal-Mart acted "with malice, oppression or fraud in failing to provide meal periods to class members as required by California law." Employee advocates can be expected to suggest that such general findings are based upon the jury's factual assessment of the employer's knowledge of its wage and hour practices and constitute an independent basis for awarding punitive damages. In this context, while the statutory penalty debate is important for many reasons - the risks posed by the possibility that a jury can exercise its discretion to "punish" an employer for their wage and hour practices is far greater.

Conclusion and Action Recommendations

The lesson from Wal-Mart is that if wage and hour violations can expose employers to punitive damages awards for "bad behavior," the risk for employers has been dramatically raised. Unfortunately, when the motivation to litigate arises, yesterday's flexible boss can become today's ogre. If that picture is effectively painted to a jury, the risks to employers are enormous. As a result, no matter what happens as the inevitable appeal progresses, California employers should realize that the stakes for less-than-full compliance with California's meal and rest period requirements just drastically increased.

Employers can take effective proactive steps to minimize risk. An effective compliance policy includes regular wage and hour compliance reviews, audits, ongoing assessment of the exempt and non-exempt status of key personnel in light of the latest cases, clear written policies and an ongoing commitment to training of human resource personnel and managers in understanding and applying the law. Employers are strongly encouraged to contact wage and hour attorneys for assistance and reexamine their written policies and practices. AALRR's wage and hour attorneys are litigators who have assisted numerous clients in compliance plans as well as in defense of such claims and can assist your organization as well.

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