EMPLOYMENT LAW360

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An Unexpected Employer-Friendly Decision In Calif.

Thursday, Sep 06, 2007 --- In Prachasaisoradej v. Ralphs Grocery Company Inc., No. S128576, the California Supreme Court granted an unexpected victory to employers who do business in the state and who wish to incentivize and reward their employees through bonuses based on net profits.

In a lawsuit brought by a former employee of Ralphs supermarkets, the state supreme court, in a 4-3 decision, reversed a court of appeals ruling and held that Ralphs' bonus plan, which was based on store profits and included a calculation for workers' compensation costs, did not violate a California law that prevents employers from shifting workers' compensation costs to employees.

The court determined that the bonus plan was lawful because it was in addition to the employees' ordinary wages and the employees understood the terms of the plan. The decision has surprised many in the legal community and suggests that more employers in California will now implement bonus plans based on net profits.

* Case Overview *

In Prachasaisoradej, the California Supreme Court reviewed Ralphs' incentive compensation plan, under which certain employees of each store were eligible to receive, over and above their regular wages, supplementary sums based upon their store's profits. Under the plan, profits were determined by subtracting store operating expenses from store revenues.

Significantly, one feature of the plan was that workers' compensation costs were deducted as part of store operating expenses.

Previously, in Ralphs Grocery Co. v. Superior Court, 112 Cal.App.4th 1090 (2003), a court of appeal reviewed this same plan and found it unlawful.

In that prior case, the court of appeal found that the deduction of workers' compensation costs was contrary to California Labor Code Section 3751 (a), which prohibits an employer from, among other things, "tak[ing] any deduction from [employee] earnings ... either directly or indirectly, to cover the whole or any part the cost of [workers'] compensation."

The court of appeal in the previous case opined that the plan effectively charged back a portion of such costs to employees through deductions from their wages.

Disapproving both this prior court of appeal decision and the lower courts' rulings in the case at issue, a closely divided California Supreme Court in Prachasaisoradej found that the plan did not violate California wage-protection laws because Ralphs was simply providing "supplementary compensation designed to reward employees, over and above their regular wages, if and when their collective efforts produced a positive financial result for the store where they worked."

The court found that, among the most significant aspects of the plan, it did not "create an expectation or entitlement in a specified wage, then take deductions or contributions from that wage to reimburse Ralphs for its business costs."

As the court summarized, "[a]t the outset, all Plan participants received, regardless of the store's performance, their guaranteed normal rate of pay—the dollar wage they were promised and expected as compensation for carrying out their individual jobs."

Plan payments were "over and above this regular wage" and plan participants "understood that their payments, and the amounts thereof, arose only under a formula that compared the store's actual Plan-defined profit, if any, for a specified period, with target figures previously set by the company."

Finally, once the amount of an employee's plan compensation was calculated under this formula, Ralphs did not thereafter reduce it by taking unauthorized deductions, contributions, or charges.

The court did not find the deduction of workers’ compensation costs as part of the plan particularly troubling. It deemed workers compensation costs "ordinary business expenses" that could be figured in along with such other store expenses as "the electric bill and the cost of goods sold" to determine the store's profits, upon which supplementary plan payments were calculated.

In reaching its decision, the court emphasized that "each employee was offered, promised, and paid full compensation for his or her individual work, an agreed and guaranteed dollar wage, which did not vary with the store's financial fortunes, and from which no unauthorized amounts were deducted, withheld, set off, or otherwise received or collected back by the employer."

It further emphasized that the plan encouraged employees' cooperative and collective contributions to the profitable performance of their stores "by sharing with these employees, in addition to their regular wages, a portion of the profits, if any, their efforts had produced, and which Ralphs would otherwise be entitled to retain for itself."

Central to the lawfulness of the plan was the fact that "it was only after the store had completed the relevant period of operation, and the resulting profit or loss figure was then derived, that it was possible to determine, by a further comparison to the preset targets, whether Plan participants were entitled to a supplementary incentive compensation payment, and if so, how much."

* Implications for Employers *

In a summer during which the California Supreme Court unanimously held in Murphy v. Kenneth Cole that premiums for missed meal and rest breaks are to be considered "wages" rather than "penalties," subjecting employers to a longer limitations period and additional penalties for alleged violations, the employer-friendly decision in Prachasaisoradej is an unexpectedly favorable ruling for employers.

However, it is important that employers not misread the court's decision. The court concluded that Ralphs' well-drafted bonus plan did not violate the law.

It did not hold that employers may take workers' compensation into account in setting an employee's regular compensation, nor did it hold that all bonus plans that include a calculation for workers' compensation costs would necessarily be lawful. To the extent that employers wish to implement bonus plans that include such calculations, they must be careful to do so in a manner that complies with Prachasaisoradej.

At least two critical considerations should be kept in mind in light of Prachasaisoradej. First, if an employer decides to create an employee incentive payment plan that includes a calculation for workers' compensation costs, Prachasaisoradej suggests that it should be carefully and clearly structured to provide "supplemental" payments over and above the employees' ordinary wages.

Second, if an incentive plan will include the deduction of employer operational costs as part of the ongoing calculations of payments, Prachasaisoradej suggests those calculations are best made on a collective basis, rather than an individualized basis.

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