Pennsylvania Senate Appropriations Committee
The Honorable Patrick M. Browne (R-16), Majority Chair
The Honorable Vincent J. Hughes (D-7), Minority Chair

— and —

Pennsylvania Senate Labor & Industry Committee
The Honorable Lisa Baker (R-20), Majority Chair
The Honorable Christine Tartaglione (D-2), Minority Chair

Public Hearing to Examine the Impact of Recent Changes in Federal Wage, Hour and Overtime Regulations on Businesses, Non-profits and the State Budget

June 21, 2016

Testimony by:
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Good morning Chairman Browne, Chairman Hughes, Chairman Baker, Chairman Tartaglione, and members of the Senate Appropriations Committee and Senate Labor & Industry Committee.

On May 18, 2016, the U.S. Department of Labor (DOL) published its final rule revising the regulations defining the so-called "white collar" exemptions to the overtime provisions of the Fair Labor Standards Act (FLSA)—specifically, those applying to executive, administrative and certain professional employees. The final rule will go into effect on December 1, 2016.

Thank you for the opportunity to speak to you today about the final rule and the impact it will have on the budget of the Commonwealth of Pennsylvania (both as an employer and as an entity that contracts with vendors and service providers who are also employers), and the thousands of businesses, healthcare and educational institutions, and non-profit organizations operating in Pennsylvania, and on the approximately 185,000 individuals who work in Pennsylvania who will be directly affected by the final rule.

My name is Robert Pritchard and I am a shareholder in the Pittsburgh office of Littler Mendelson, P.C., the largest employment and labor law firm in the United States, with over 1000 attorneys devoted exclusively to the representation of employers in employment and labor law matters, including over 50 employment and labor law attorneys in the Commonwealth of Pennsylvania. We represent employers of all shapes and sizes, ranging from large multi-national corporations to small businesses, government entities to healthcare and educational institutions, and non-profit organizations of every size. My practice is devoted exclusively to the representation of employers in matters pertaining to wage and hour compliance, and I have been helping employers evaluate their compliance options and prepare for the anticipated changes to the FLSA's white collar overtime exemptions ever since March 2014, when President Obama directed Secretary of Labor Perez to update the FLSA's exemption regulations.

Since 2004, the minimum salary level for application of the FLSA's white collar overtime exemptions has been $455 per week, or $23,660 per year. The new rule more than doubles this

amount, setting the minimum salary at $913 per week, or $47,476 per year (the 40th percentile of earnings of full-time salaried workers in the lowest-wage census region in the United States). This increase will place the federal minimum salary level higher than the corresponding salary levels in states like California ($41,600 per year) and New York ($35,100 per year). After December 1, 2016, most individuals who earn less than $47,476 per year will not qualify for the white collar exemptions to the overtime provisions of the FLSA.

The rule permits employers to use certain other forms of nondiscretionary bonuses, incentive payments and commissions to satisfy up to 10% of the new minimum salary requirements, but this authorization is of limited utility. The rule still requires employers to pay exempt employees at least 90% of the minimum salary level per week ($821.70 per week). If, at the end of each quarter, the salary plus the additional compensation does not equal at least $913 per week, the rule permits a one-time shortfall payment to be made, by the first pay period following the end of the quarter. We predict that most employers will elect not to take advantage of this provision in the rule. The 10% allowance would be administratively difficult to implement, requiring employers to monitor compensation and ensure that the minimum salary requirements are met each quarter, including for employees separated from employment during the quarter, or those whose incentive earnings cannot be readily calculated by the end of each quarter. Instead, we expect that most employers will conclude that it is much easier to simply pay at least $913 per week as a salary, possibly at the expense of other forms of incentive compensation (*e.g.*, by eliminating a bonus plan and using those funds to support the increase in salary, or by incorporating a guaranteed draw into a commission plan).

The rule also increases the salary needed to qualify as a "highly compensated" employee, which provides a streamlined test for exempt status, from $100,000 per year to $134,004 per year (the 90th percentile of full-time salaried workers in the United States). To satisfy the highly compensated employee test, employees must be paid a minimum of $913 per week in guaranteed salary, and bonuses and other incentive payments can be used to bring the employee to the $134,004 per year required amount. The Pennsylvania Minimum Wage Act (PMWA) does not recognize the streamlined test for highly compensated employees, so this revision is not particularly relevant for Pennsylvania employers.

Notably, the final rule includes a mechanism to automatically increase the foregoing salary levels every three years. The first update will take effect January 1, 2020, with future increases set to take effect on January 1 every three years. The minimum salary for exempt white collar workers will be set to the 40th percentile of weekly earnings of full-time salaried workers in the lowest wage census region in the United States. The highly compensated employee salary threshold will be reset every three years at the 90th percentile of earnings of full-time salaried workers nationwide. The DOL will publish the new rates in the Federal Register at least 150 days before the updated salary levels go into effect.

During the rulemaking's comment period, many employers raised concern that tying increases to the 40th percentile of full-time salaried workers would cause dramatic increases to the minimum salary each time an automatic adjustment is made. Specifically, in the immediate aftermath of the effective date of the final rule, it is anticipated that potentially millions of salaried full-time workers will be reclassified from salaried exempt to hourly non-exempt, thus removing them from the data set used to determine the 40th percentile and the new salary minimum. The DOL

estimates that the final rule will affect 4.2 million white collar workers, including 185,000 in Pennsylvania. If just one-half of those employees are reclassified to hourly status, over 2 million salaried workers at the lower end of the salary scale will be removed from the data set from which the 40th percentile is ascertained, thus ratcheting up the 40th percentile far beyond current projections. In response to this concern, the DOL predicted that only a "small fraction" of newly overtime-eligible employees will be converted to hourly workers, and assumed that the new regulations will have a "negligible" impact on the 40th percentile data used to calculate automatic increases. Respectfully, we disagree. Employers throughout the United States are preparing to convert many employees from salaried exempt to hourly non-exempt. We predict this will have a material impact on the adjusted salary minimum in 2020. If the Commonwealth of Pennsylvania (or any other employer) may be considering providing a salary increase to employees who earn below $47,476 per year to preserve the exemption, we encourage them to consider whether they will want to (or be able to afford to) continue to provide material salary increases every three years.

For many employers, the ramifications of resetting salaries for some employees, and the wave of related issues, including wage compression against other employees, labor cost and budgeting, and changes to business models, require careful planning and consideration, and time is already short as the final rule is set to take effect in less than six months. Employers are struggling to determine how to bear the increased costs of raising salaries to meet the new threshold, or the costs associated with reclassifying employees and paying overtime. To be sure, non-profit organizations cannot simply raise prices to cover these additional costs.[1] State and local governments that rely on tax revenue cannot easily increase revenue to meet these new expenses. Even for-profit employers cannot be expected to readily obtain the revenue needed to absorb the costs of a doubling of the salary level. The most realistic option for non-profit, government and private employers will be to implement a "wage neutral" reclassification initiative, whereby work hours are restricted and controlled (reducing productivity and services, not to mention employee flexibility and morale) and hourly rates are set to levels designed to ensure that, even with overtime pay, a reclassified employee's total compensation (regular plus overtime) does not exceed his or her existing salary. Then, when such employees (who are no longer paid a guaranteed fixed salary regardless of hours worked) work fewer hours than anticipated, their take-home pay will be reduced below their existing salary level. When they work more hours than predicted, their employers will incur overtime costs not anticipated or budgeted.

To plan for and execute the reclassification of positions from exempt to non-exempt to comply with the final rule, the Commonwealth of Pennsylvania (like all employers subject to the FLSA) will need to consider several issues, including:

[1] Non-profits organizations are covered enterprises under the FLSA if they engage in ordinary commercial activities that result in sales made or business of $500,000 or more per year. Even if a non-profit organization is not a covered enterprise, however, the FLSA's overtime requirements apply to any employee of a non-profit organization who makes out-of-state phone calls, mails information or conducts business via the U.S. mail, orders or receives goods from an out-of-state supplier, handles credit card transactions, or performs the accounting or bookkeeping for any of these activities.

- Which employees will be reclassified? Which employees currently classified as exempt earn less than $913 per week? Will the Commonwealth increase their salaries to meet the new salary requirement (and at what cost), or will it reclassify those employees to non-exempt? If some employees in a job classification earn more than $913 per week, while others earn less, will the employer reclassify all employees to non-exempt to promote consistency, or will it create a bifurcated classification in which some are exempt and some are non-exempt?

- How will the reclassified employees be paid? Will they remain salaried or will they be converted to an hourly rate? What will be their new salary or hourly rate? Notably, an employer does not have to retain the employee's existing salary or convert to an hourly rate by dividing the existing weekly salary by 40 in connection with a reclassification. Like other employers, will the Commonwealth attempt to pursue a cost-neutral reclassification (*e.g.*, by establishing a new salary or hourly rate that, when considering anticipated hours worked, the total compensation—including overtime—will approximate the individual's current salary)?

- How will the hours of non-exempt employees be controlled following reclassification to avoid unanticipated overtime costs? Will they be restricted to 40 hours per week or some other maximum number of hours (and if so, what impact will that have on productivity)?

- What changes need to be made to the timekeeping and payroll systems to ensure compliant tracking of hours worked and calculation of overtime pay?

- Are there any wage-hour policies that must be adopted or revised? Will the newly reclassified employees be restricted in their ability to travel for work or to work remotely? Will laptops and mobile devices need to be restricted to prevent "off duty" access to those individuals who will now need to report all hours worked?

- Will managers and/or affected employees need to be trained on any policies or timekeeping practices to help them manage a group of newly-reclassified non-exempt employees not used to having their hours monitored or restricted?

Besides the Commonwealth's need to address these and other challenges regarding its own status as an employer, it should expect that its vendors and service providers will also struggle with the same issues. We therefore recommend that the Commonwealth should seek information and assurances from its vendors and service providers (particularly those with a large contingent of exempt employees earning less than $913 per week) about how they are preparing for the final rule, including whether they can maintain existing levels of productivity and service without imposing additional costs.

As Pennsylvania employers are struggling to plan and prepare for the effective date of the final rule, they face another unnecessary challenge and complication—the many unnecessary inconsistencies between state and federal wage and hour law. The Pennsylvania General Assembly has a unique opportunity to provide much needed relief to Pennsylvania employers by modernizing the Pennsylvania Minimum Wage Act to eliminate unnecessary conflicts in the law.

To be clear, I do not suggest that the Pennsylvania General Assembly should simply abdicate its role in regulating wage and hour issues in Pennsylvania, or merely defer to the standards established under the FLSA.[2] However, where Pennsylvania law deviates from the FLSA, the difference should reflect a deliberate and considered public policy decision about what is appropriate for employers and employees in the Commonwealth, not an inadvertent oversight.

A recent example of an inadvertent deviation between Pennsylvania and federal law involved the payment of overtime to employees working in hospitals, nursing homes, and other healthcare facilities. While the default overtime rules under both the FLSA and PMWA are based upon hours worked over 40 per week, the FLSA has long permitted certain healthcare employers to adopt an "8/80" overtime plan, whereby employees receive overtime compensation if they work over eight hours in a single day or over 80 hours in a two-week period. Such 8/80 plans are favored by these institutions and their employees for providing daily overtime and scheduling flexibility within a 2-week period. While the Pennsylvania Department of Labor & Industry accepted the use of 8/80 plans under the PMWA, the PMWA did not include an express provision authorizing 8/80 plans. Thus, in *Turner v. Mercy Health System*, No. 03670, 2010 Phila Ct. Com. Pl. LEXIS 146 (Mar. 10, 2010), the court held that using an 8/80 plan violated the PMWA. This ruling caught many Pennsylvania healthcare employers by surprise. This non-deliberate inconsistency with federal law led to compliance challenges for healthcare employers who believed in good faith that their 8/80 plans were lawful, and exposed healthcare employers to a barrage of class-action lawsuits. In *LeClair v. Diakon Lutheran Social Ministries*, No. 2010-C-5793, 2013 Pa. Dist. & Cnty. Dec. LEXIS 1 (Jan. 14, 2013), the court awarded $670,532.11 plus prejudgment interest, costs and attorney's fees, against an employer that utilized the 8/80 approach. The absence of an express 8/80 authorization in the PMWA reflected no public policy against 8/80 plans, but a state law that simply failed to "keep up" with innovations at the federal level. The Pennsylvania General Assembly acted quickly in response to these lawsuits, and on July 5, 2012, Governor Corbett signed into law H.B. 1820, which amended the PMWA to permit healthcare employers to use an 8/80 plan. Unfortunately, the amendment came too late for Pennsylvania healthcare employers subject to litigation challenging their 8/80 plans.

In a 1998 letter (copy attached), Deputy Chief Counsel Richard C. Lengler acknowledged the challenges facing employers subject to the FLSA and PMWA, and the desire to avoid unnecessary inconsistencies between the two laws:

> Because many employers are subject to dual coverage under the FLSA and the MWA, we wish to avoid, to the largest extent possible, the burdening of employers and the employees with two different sets of standards.

[2] Many states do not have any overtime provisions, so FLSA-covered employers in those states are subject to a singular federal standard. These states include Alabama, Arizona, Delaware, Georgia, Idaho, Iowa, Louisiana, Mississippi, Nebraska, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, and Virginia. Other states provide that their overtime rules do not apply to employers that are covered by the FLSA, including Indiana, Kansas, and New Hampshire.

Unfortunately, there are numerous examples of the PMWA burdening employers and their employees with regulations that are not consistent with the FLSA—not because of a deliberate policy decision to take a different path—but because of a failure to "keep up" with an ever-changing landscape. Mr. Lengler acknowledged this reality in his letter:

> [I]t is obvious that this agency has not attempted rulemaking under the MWA on the same magnitude as the federal Wage and Hour Division has under the FLSA. To do so, seemingly, would require the filling of possibly two volumes of the Pennsylvania Code. By the same token, Pennsylvania has not been nearly as vigilant in updating its regulation; rather, it appears that the last substantial changes to the regulations occurred in 1979.

We predict this failure to align the PMWA with the FLSA on various issues as to which there is no sound policy justification for a different approach will create serious challenges for employers as they prepare for the impact of the final rule. Here are just four examples:

1. The Fluctuating Workweek

As employers prepare to reclassify employees from exempt to non-exempt, many hope to retain the "salaried" status of such individuals. Allowing a non-exempt employee to remain salaried (as opposed to hourly) may improve morale (as employees perceive reclassification to hourly status may be perceived as a demotion) and preserve benefit eligibility (as some benefit plans depend on one's status as salaried versus hourly), and provide the employee with a guaranteed weekly compensation regardless of hours worked. Under the FLSA, a salaried employee can be paid overtime using the so-called "fluctuating workweek" method, under which their fixed weekly salary is deemed compensation for all hours worked (with an additional overtime premium paid for hours worked over 40 per week). It is anticipated that employers planning to reclassify their employees from exempt to nonexempt in response to the final rule will want to consider implementing a fluctuating workweek compensation plan.

Over seventy years ago, the U.S. Supreme Court ruled that the FLSA permitted employers to calculate overtime compensation using the fluctuating workweek method, under which an employee's regular rate is determined by dividing his or her fixed weekly salary by all hours worked each week. *Overnight Motor Transportation Co. v. Missel*, 316 U.S. 572 (1942). In 1968, the U.S. Department of Labor incorporated the concept of the fluctuating workweek into its interpretive bulletin as an authorized method of calculating overtime. 29 C.F.R. § 778.114; *see also* 29 C.F.R. § 778.109 ("[T]he regular hourly rate of pay of an employee is determined by dividing his total remuneration for employment (except statutory exclusions) in any workweek by the total number of hours actually worked by him in that workweek for which such compensation was paid.").

One example of an employer that utilized the fluctuating workweek method to calculate overtime compensation for its salaried nonexempt employees was GNC Holdings, Inc., a Pittsburgh-based employer with over 15,000 employees nationwide. Earlier this year, the U.S. Court of Appeals for the First Circuit upheld GNC's use of the fluctuating workweek as lawful under the FLSA. *Lalli v. General Nutrition Centers, Inc.*, 814 F.3d 1 (1st Cir. Feb. 12, 2016).

Yet in *Chevalier v. General Nutrition Centers, Inc.*, the Court of Common Pleas of Allegheny County held that the very same fluctuating workweek plan was unlawful under the PMWA. No. GD-13-017194, 2014 Pa. Dist. & Cnty. Dec. LEXIS 145 (Oct. 20, 2014). Why the different outcome? Like the FLSA, the PMWA provides that overtime shall be compensated at one and one-half times the employee's "regular rate." *See* 43 P.S. § 333.104(c). However, unlike the FLSA, the PMWA delegates to the Secretary of Labor and Industry the authority to promulgate regulations to prescribe how the overtime rule will be interpreted under Pennsylvania law. *Id.* The *Chevalier* court observed that the Secretary promulgated no regulation regarding whether the fluctuating workweek would be permitted under the PMWA. The court concluded that because the Secretary failed to address whether the fluctuating workweek method was lawful under the PMWA, it was for the court to do so, and the court decided that the fluctuating workweek did not advance the policy of the PMWA.

In his letter, Mr. Lengler predicted a different outcome, writing that the Department of Labor and Industry "had assumed that a fluctuating workweek was permitted under Pennsylvania law." He explained:

> [W]e would be inclined to interpret our law on the same plane as federal law—as opposed to advocating higher standards than those imposed by federal law. . . .
>
> I am reticent to infer a conscious intention to reject the idea of a fluctuating workweek, simply based on the absence of regulatory language on the state level similar to 29 C.F.R. § 778.114. . . .
>
> I believe that L&I will embrace the fluctuating workweek, since the MWA and existing regulations support such an interpretation, and because Pennsylvania employers will not be subjected to greater burdens than those imposed by federal law through, at best, a latent discrepancy between state and federal regulations.

Mr. Lengler was correct. Nothing in the legislative history of the PMWA indicated a deliberate policy decision to reject the fluctuating workweek. Despite this, the "latent discrepancy" between the PMWA and the FLSA resulted in a finding that a Pennsylvania corporation violated the PMWA by utilizing a pay practice that is perfectly lawful under the FLSA. As Pennsylvania employers weigh their options in reclassifying employees to nonexempt in response to the final rule, the Pennsylvania General Assembly could eliminate the "latent discrepancy" between the PMWA and FLSA by stating that (except as otherwise provided because of a deliberate policy decision) the PMWA's overtime provisions should be interpreted in a manner consistent with the FLSA (including the fluctuating workweek method and the other approaches to calculating overtime authorized in the DOL's interpretive bulletin at 29 C.F.R. Part 778).

2. Hours Worked

As Pennsylvania employers prepare to reclassify up to 185,000 individuals from exempt to nonexempt, one of the most critical issues will be to ascertain how to manage and record all hours worked by those employees, who were not used to having their work hours monitored or

controlled. This will be especially challenging in Pennsylvania where the question of what constitutes "hours worked" remains highly controversial due to another "latent discrepancy" between the PMWA and the FLSA.

The definition of "hours worked" has had a robust history in federal law. The Supreme Court's expansive interpretation of the term in the 1940's (culminating in *Anderson v. Mt. Clemens Pottery Co.*, 328 U.S. 680 (1946)), led to passage of the 1947 Portal-to-Portal Act, which amended the FLSA to clarify that certain "preliminary" and "postliminary" activities did not constitute compensable hours worked. The contours of that law continue to receive attention. In *Integrity Staffing Solutions, Inc. v. Busk*, 135 S. Ct. 513 (2014), the U.S. Supreme Court held that time spent going through security screening after clocking out was not compensable because it was a "postliminary" activity that was not integral and indispensable to the employees' principal work activities.

Amazingly, controversy continues to fester about whether the PMWA's definition of "hours worked" incorporates (or should even be influenced by) the 1947 Portal-to-Portal Act. Indeed, after the Supreme Court decided *Integrity Staffing*, related state law cases throughout the United States were voluntarily dismissed based on an acknowledgement that the "hours worked" determination would be the same under the state law as it was under the FLSA. Not so in Pennsylvania. The employees in the Pennsylvania case argued that the PMWA never adopted the Portal-to-Portal Act amendments to the FLSA, and that the definition of compensable work that predated the 1947 Portal-to-Portal Act should govern. This alleged "latent discrepancy" between the PMWA and FLSA about what constitutes "hours worked" is likely to create severe complications for employers as they convert up to 185,000 Pennsylvania employees to nonexempt.

Another example of the "latent discrepancy" between the PMWA and FLSA on the question of "hours worked" arose in the case of *Caiarelli v. Sears, Roebuck & Co.*, 616 Pa. 38 (2012). There, the trial court held that the employees' travel time amounted to non-compensable commuting time, and held that certain work activities performed at home were "de minimis" (that is, so minor as not to warrant legal relief). The trial court relied on what it viewed as comparable law under the FLSA. Specifically, under the FLSA, as amended by the Portal-to-Portal Act and the Employee Commuting Flexibility Act, time spent traveling to and from the actual place of performance of the employee's "principal activity" is not counted as compensable work time. The Superior Court affirmed, but the Pennsylvania Supreme Court granted review. That appeal was dismissed (as having been granted improvidently), but a dissenting opinion from the dismissal order revealed a potential serious disconnect between federal and state law. The dissenting opinion noted that the Pennsylvania General Assembly has not adopted the Portal-to-Portal Act or the Employee Commuting Flexibility Act, or even expressly recognize a "de minimis" rule. So the question remains whether the PMWA should be interpreted in a manner consistent with the FLSA regarding the question of "hours worked" where the PMWA did not explicitly adopt the Portal-to-Portal Act or Employee Commuting Flexibility Act amendments to the FLSA. That these issues remain controversial due solely to a "latent discrepancy" between the PMWA and FLSA causes grave concern and uncertainty for employers as they prepare for the changes that will be necessitated by the final rule.

3. Employees Working at Two or More Rates

Another scenario in which the PMWA differs from the FLSA for no apparent policy reason involves the calculation of overtime for employees who work at two or more hourly rates. The DOL's interpretive bulletin provides that under the FLSA, when an employee works at two or more different rates of pay in a single week, the employee's regular rate for that week is the "weighted average" of such rates (*i.e.*, the total earnings at all rates, divided by the total number of hours worked). The overtime premium is then calculated as a function of that "weighted average" regular rate. 29 C.F.R. § 778.115.

Under the PMWA, however, the default rule is the "rate in effect" method. That is, the employer must pay the employee 1.5 times the non-overtime hourly rate established for the work being performed during the overtime hours. 34 Pa. Code § 231.43(d)(2).

To our knowledge, Pennsylvania is the only state that adopts the "rate in effect" method as the default, placing it in conflict not only with the FLSA but with the approaches taken in every other state (which either require "weighted average" or permit either approach). There is no policy justification for deviating from the federal approach. Indeed, the federal approach eliminates the potential "mischief" of an employer scheduling the employee for the lower-rate work during overtime hours, and the unnecessary recordkeeping burden of trying to determine what work was being performed the moment the employee crossed over into an overtime scenario.

As employers prepare to reclassify employees before the effective date of the final rule, any compensation plan that contemplates more than one pay rate will inevitably generate conflict between these incompatible approaches to calculating overtime.

4. Ongoing Classification Inconsistencies

As employers ascertain their obligations under the FLSA, one consideration will be whether to continue to classify certain employees as exempt following the effective date of the final rule. For employees who already earn at least $913 per week, the final rule will have no necessary impact, although employers must continue to ascertain whether such individuals satisfy the "duties" tests of the exemptions under federal law (and some such employees who exceed the salary amount may nonetheless be reclassified to align them with similar employees who earn less than $913 per week). For employees who earn less than $913 per week, employers must consider whether to reclassify them to nonexempt or to increase their salary to meet the new minimum. But even after that assessment is complete, Pennsylvania employers must still contend with the impact of the PMWA and the reality that the state law includes unnecessary (and unintended) traps for the unwary regarding the exemption tests.

As an initial matter, the Pennsylvania Code persists in maintaining outdated "long" tests for the "executive" and "administrative" exemptions, requiring employees to be paid on a salary basis at not less than $155 per week, exclusive of board, lodging or other facilities. 34 Pa. Code §§ 231.82 - .83. For an employee who works 40 hours per week, $155 equates to less than $4 per hour. The Pennsylvania Code's "long test" for the "professional" exemption requires a salary of not less than $170 per week ($4.25 per hour for a 40-hour week). 34 Pa. Code §§ 231.84. That

these outdated tests remain in the Pennsylvania Code is sufficient proof that the regulations implementing the PMWA simply do not "keep up" with the times.

The Pennsylvania Code's "short tests" for the white collar exemptions are generally aligned with the "duties" tests under the corresponding FLSA regulations as they existed prior to 2004. However, differences remain between the Pennsylvania exemptions and the federal exemptions. For example:

- The Pennsylvania Code requires a salary of not less than $250 per week ($6.25 per hour for a 40-hour week), exclusive of board, lodging or other facilities, whereas the FLSA regulations require a salary of $455 per week ($913 per week as of December 1, 2016);
- The executive exemption under the Pennsylvania Code does not require that the employee possess the authority to hire or fire other employees (or to make suggestions and recommendations on the hiring, firing, advancement, promotion or any other change of status of other employees that are given particular weight). *Compare* 34 Pa. Code § 231.82 with 29 C.F.R. § 541.100.
- The administrative exemption under the Pennsylvania Code does not expressly require that the employee exercise discretion and independent judgment "with respect to matters of significance." *Compare* 34 Pa. Code § 231.83 with 29 C.F.R. § 541.200.
- The professional exemption under the FLSA exempts certain teaching, legal and medical professionals from the salary requirement, whereas the Pennsylvania Code does not expressly exclude such individuals from the salary requirement for the professional exemption. *Compare* 34 Pa. Code § 231.84 with 29 C.F.R. § 541.303 - .304.
- The Pennsylvania Code defines "outside salesman" as an employee who is "employed for the purpose of and who is customarily and regularly engaged more than 80% of work time away from the employer's place or places of business" making sales or obtaining orders. The employee may not spend over 20% of the hours worked in any week in work of a nature not directly related to and in conjunction with the making of sales (provided that work performed incidental and in conjunction with the employee's own outside sales or solicitations, including incidental deliveries and collections, will be not regarded as nonexempt work). 34 Pa. Code § 231.85. The FLSA regulations eliminated the 20% rule in 2004, as the DOL concluded that it was "complicated and confusing." 69 Fed. Reg. 22160 (Apr. 23, 2004). As amended in 2004, the FLSA requires only that an "outside salesman" be "customarily and regularly engaged away from the employer's place or places of business" when making sales or obtaining orders. 29 C.F.R. § 541.500. Yet the 20% rule persists in the Pennsylvania Code.
- The FLSA was amended to provide an exemption for certain computer employees compensated on an hourly basis at a rate not less than $27.63 an hour. 29 U.S.C. § 213(a)(17). The Pennsylvania Code includes no option for paying an hourly rate to an exempt computer professional.
- The FLSA provides an abbreviated test for "highly compensated" executive, administrative and professional employees who earn at least $100,000 per year ($134,004 per year effective December 1, 2016). 29 C.F.R. § 541.601. The Pennsylvania Code does not include a streamlined "highly compensated" standard.
- The FLSA provides robust guidance on how to comply with the "salary basis" requirements of the white collar exemptions. 29 C.F.R. § 541.600 - .606. The

> Pennsylvania Code provides no guidance, leaving employers to wonder if the authorized deductions under the FLSA (*e.g.*, for unpaid FMLA leave, or for a disciplinary suspension) would be held to eviscerate the exemption under the PMWA.

It may be that there are sound policy justifications for Pennsylvania to deviate from the FLSA's standards for determining exempt status. However, such deviations should be deliberate and should reflect a purposeful decision to adopt a standard that differs from the FLSA standard that governs the overwhelming majority of employers and employees in Pennsylvania, rather than the "latent discrepancy" between laws that results due to neglect and/or inattention over decades.

Several states have accomplished this objective in a straightforward manner, by incorporating by reference the FLSA standards into their laws (while reserving the ability to deviate from the FLSA where justified as a matter of public policy). Ohio R.C. 4111.03 incorporates the FLSA overtime rules in a straightforward manner:

> An employer shall pay an employee for overtime at a wage rate of one and one-half times the employee's wage rate for hours worked in excess of forty hours in one workweek, in the manner and methods provided in and subject to the exemptions of section 7 and section 13 of the "Fair Labor Standards Act of 1938," 52 Stat. 1060, 29 U.S.C.A. 207, 213, as amended.

Missouri adopted a similar approach. Missouri Revised Statutes Section 290.505 provides:

> 1. No employer shall employ any of his employees for a workweek longer than forty hours unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed.
>
> ...
>
> 3. ... [T]he overtime requirements of subsection (1) shall not apply to employees who are exempt from federal minimum wage or overtime requirements including, but not limited to, the exemptions or hour calculation formulas specified in 29 U.S.C. Sections 207 and 213, and any regulations promulgated thereunder.

Alaska offers a useful model of a slightly different approach—adopting the FLSA provisions by reference, but specifically adopting a different salary requirement. Alaska Statutes 23.10.055 provides that the state's overtime requirement does not apply to individuals employed "in a bona fide executive, administrative, or professional capacity" and that such terms will have "the meaning and shall be interpreted in accordance with 29 U.S.C. 201 - 219 (Fair Labor Standards Act of 1938), as amended, or the regulations adopted under those sections," except that the minimum salary will equal two times the state minimum wage for a 40-hour week.

Other jurisdictions take a similar approach either within the overtime statute itself or in the regulations, adopting the FLSA standards by reference except to the extent a specific exception

is made as the result of a policy determination that a deviation is warranted. These jurisdictions include Maryland, Massachusetts, Montana, New Jersey, North Carolina, Rhode Island, and the District of Columbia.

The Pennsylvania General Assembly has adopted FLSA standards by incorporation in certain limited aspects of the PMWA. Section 4 of the PMWA provides a minimum wage of $7.15 per hour beginning July 1, 2007. However, the PMWA states that "[i]if the minimum wage set forth in the Fair Labor Standards Act of 1938 . . . is increased above the minimum wage required under this section, the minimum wage required under this section shall be increased by the same amounts and effective the same date as the increases under the Fair Labor Standards Act, and the provisions of subsection (a) are suspended to the extent they differ from those set forth under the Fair Labor Standards Act." The minimum wage under the FLSA has been $7.25 per hour since July 24, 2009. By virtue of its reference to the FLSA, the PMWA minimum wage since July 24, 2009 has been $7.25. Similarly, when the Pennsylvania General Assembly authorized the use of 8/80 plans for healthcare employers, it did so by referencing the FLSA: "An employer shall not be in violation of this subsection if the employer is entitled to utilize, and acts consistently with, section 7(j) of the Fair Labor Standards Act of 1938 (52 Stat. 1060, 29 U.S.C. § 207(j)) and regulations promulgated under that provision."

The Pennsylvania General Assembly is uniquely positioned to act now, before the December 1, 2016 effective date of the final rule, to amend the PMWA to clarify that its minimum wage and overtime requirements adhere to the corresponding provisions of the FLSA and its implementing regulations and interpretations, as they may be amended from time to time, except as specifically determined (either in the PMWA itself or by the Secretary in the Pennsylvania Code) based upon a policy determination to take a different approach (*e.g.*, to adopt a higher minimum wage or a lower salary for application of the white collar exemptions, or to exempt certain small employers, charitable or educational institutions, or nonprofit organizations from the state overtime law).

By aligning the PMWA with the FLSA unless it is determined that public policy requires a different approach, the General Assembly would eliminate the "latent discrepancies" that have arisen between the PMWA and FLSA that create hardships and unnecessary compliance challenges for Pennsylvania employers, and would enable employers to more effectively plan and prepare for the impact of the final rule.

Thank you once again for the opportunity to testify about the final rule and its impact on the Commonwealth of Pennsylvania and those who do business here and those who work here. I would be happy to answer any questions at this time.

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November 12, 1998

Judith E. Harris, Esquire
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Re: [redacted]

Dear Ms. Harris:

This letter is intended to represent this agency's views of the issues discussed in your September 3, 1998, letter.

I.

The first issue that should be examined is the possible exemption of the employees under 34 Pa. Code § 231.43(f), which applies to certain employees of retail or service establishments. This is because the remaining issues are seemingly moot if the employees are exempt under this regulation.

I located no previous letters or internal opinions discussing this exemption. However, the exemption appears to mirror the federal exemption in the Fair Labor Standards Act ("FLSA"), 29 U.S.C. § 207(i), for retail or service-establishment employees. Accordingly, interpretations of federal law are likely to be persuasive in applying the state-law exemption. *See, e.g., Commonwealth v. PLRB*, 527 A.2d 1097 (Pa. Cmwlth. 1987). Executive Order No. 1996-1 requires a compelling Pennsylvania interest to justify adoption of regulations that exceed federal standards. 4 Pa. Code § 1.374(b)(16). While this directive unquestionably came after this agency's adoption of minimum-wage regulations, it provides an insight into how executive agencies should be construing and applying

their regulations. Consequently, this agency is not inclined to construe regulatory exemptions more narrowly than their federal counterparts, in the absence of a clear intention that is evidenced by significant differences in language between the federal and state exemptions. In the case of the retail- and service-establishment overtime exemptions, we discern no notable differences between federal and state law. Indeed, it seems as if the state regulation was modeled after 29 U.S.C. § 207(i).

In terms of the mechanics of the exemption, they appear to be relatively straightforward, with one possible exception. The regular rate of pay must exceed one and one-half times the statutory minimum wage, which was $4.25/hour prior to September 30, 1996. In this regard, Section 4(a.1) of Pennsylvania's Minimum Wage Act ("MWA"), 43 P.S. § 333.104(a.1), incorporated the federal minimum wage under an escalator clause adopted in 1988. Hence, the regular rate (which includes commissions under 34 Pa. Code § 231.43(a)) must have been at least $6.38/hour ($4.25 x 1.5) during much of the period covered by the litigation against your client. Obviously, commission payments are going to have to be either allocated, or apportioned, to specific weeks to determine the employee's regular rate of pay, since the workweek is the basic unit of measure under both federal and state law.

Next, a determination must be made as to the percentage of the employee's compensation representing commissions over a representative period; if it exceeds 50 percent, then the exemption applies. The regulation also makes clear that all earnings resulting from commissions are to be counted as commissions, without regard to whether they exceed any draw or guarantee. This means that where commissions exceed the draw, the amount of commission includes both the draw and the additional commission earnings. On the other hand, if the commissions fall short of the draw, only the actual commission earnings are counted. Finally, if the employee receives either his draw or actual commission earnings, whichever is greater, federal regulations suggest that the draw cannot be considered as commissions, because the draw is actually a salary. 29 C.F.R. § 779.416.

The state regulation exemption for retail and service establishments further defines a "representative period" to be not less than one month. Regulations supplement the statutory exemption on the federal level by requiring the period to be as follows: (a) as recent to the current workweek as practicable; (b) sufficient in length to reflect seasonal or temporary changes; (c) not more than one year; (d) recomputed as often as necessary to reflect gradual changes in the characteristics of employment; (e) representative with respect to the particular employee and dependent on his individual earning pattern; (f) the same period may be used for each person in a group having substantially similar employment; and (g) it must be established in accordance with a specific formula designated and substantiated in the employer's records. 5 C.B.C., *Employment Coordinator*, ¶C-12,209 (1993), *citing* 29 C.F.R. § 779.417(a)-(d). Although an argument could be made that the federal criteria are not found in state regulations, and, therefore, should not be utilized, we believe that they possess a persuasive value and should be consulted in applying the state-law exemption. Because many employers are subject to dual coverage under the FLSA and the MWA, we wish to avoid, to the largest extent possible, the burdening of employers and the employees with two different sets of standards. Therefore, we most likely would borrow the federal criteria for interpreting our regulations.

The more problematic issue (alluded to above) concerns what is a retail or service establishment. Neither the MWA nor its regulations define retail or service establishment. Consequently, we would again refer to federal law for guidance. Here, we encounter two issues: (1) whether a travel agency fits within the exemption's concept of *retail*; and (2) how much of the sales must be retail for the exemption to apply. Addressing the second issue first, we find a federal regulation setting up a 75% test; *i.e.*, 75% of the goods, services, or both must not be predicated on sales for resale. 29 C.F.R. § 779.411. An argument can be made, however, that the "75% standard" is a substantive standard, rather than simply an interpretation of the term *retail or service establishment*. On the other hand, a logical construction of the term would appear to require at least a majority (*i.e.*, greater than 50%) of the sales to be at the retail level. We are not sure how far

beyond 50% Pennsylvania courts may be willing to go in interpreting Section 231.43(f) without crossing the line into legislating.

The first issue enumerated above concerns whether travel agencies fit within the concept of *retail*. Your opponent cites a case, *Wirtz v. Healy*, 227 F.Supp. 123 (D.C. Ill. 1964), which denies the federal exemption to employees of a travel agency. Similarly, federal regulations place travel agencies outside of the retail concept. 29 C.F.R. § 779.317. I am not sure why travel agencies are outside of the exemption, while other service establishments can claim the exemption. Indeed, one commentary points out that "the term *retail* has been held alien to . . . business activities (including some quite similar to some of the . . . businesses which were held entitled to the exemption)." Annot., 7 A.L.R. Fed. 624, 656 (1971). Nonetheless, given our frequent consultation of federal law in applying the MWA, I predict that this agency will accept *Healy* and the federal regulation as authority placing travel agencies outside of the exemption.

II.

The next issue raised by your letter concerns 34 Pa. Code § 231.43(c). This exemption corresponds to the federal government's exemption for "Belo" agreements. A Belo arrangement (named for the Supreme Court's decision in *Walling v. A. H. Belo Corp.*, 316 U.S. 624 (1942)), allows the employee and employer to agree to an artificial "regular rate" to be used in determining overtime for employees who work irregular hours. 5 C.B.C., *Employment Coordinator*, ¶C-16,280 (1997). Without going into the complicated details of Belo agreements, it appears that the arrangement used by [redacted] is not a Belo arrangement. There is nothing in the documentation you provided to suggest fluctuations in overtime and non-overtime hours to justify a Belo agreement. More importantly, a Belo contract cannot provide for commissions in addition to the regular rate, because the regular rate agreed to by the parties does not control the employee's total compensation. *Ibid.* at ¶C-16,290, *citing* 29 C.F.R. § 778.403(c). As the federal regulations explain: "For this reason, it is not possible to enter into a

guaranteed pay agreement . . . ." 29 C.F.R. § 778.403(c). A requirement for a guaranteed pay is likewise found in 34 Pa. Code § 231.43(c)(2).

III.

The third exemption raised by your letter is 34 Pa. Code § 231.43(d). Subsections (1) and (2) of that section speak about piece rates, and are skipped over in this analysis because there is nothing to suggest that the representative worker (whose contract was supplied to us) worked at piece rates. Subsection (3) addresses basic rate agreements, a concept that is better understood by reference to federal law. Under this type of arrangement, the parties agree to use what amounts to an average rate for overtime-pay computation purposes, instead of the "regular rate." 5 C.B.C., *Employment Coordinator*, ¶C-16,325 (1997). I find no opinions in our files addressing this concept.

There appears to be little question that the "basic rate" exemption does not apply to the employee's base earnings under the sample contract you have furnished. This portion of the employee's compensation package consists of a salary, not the substitution of an average wage that is substantially equivalent to the employee's hourly earnings.

Similarly, the commission portion of the [redacted] compensation package does not appear to be a "basic rate." In this regard, past earnings are not utilized to compute an average rate to facilitate on-going, weekly computation of overtime. Rather, commissions are calculated and paid quarterly.

IV.

The major issue which you did not raise, and which I believe could be at the center of this dispute, is whether Pennsylvania recognizes a fluctuating workweek. In this regard, overtime is computed under paragraph "3.2a" of the employment contract using base earnings for the week, and a variable number of hours worked.

This arrangement is permitted under the FLSA. 5 C.B.C., *Employment Coordinator*, ¶C-16,277 (1997). However, a federal court decision suggests that such an arrangement is not permitted under Pennsylvania law. *Friedrich v. U.S. Computer Services*, 833 F.Supp. 470 (E.D. Pa. 1993). The Department of Labor and Industry ("L&I") did not participate in this case, and it has only been within the last year that the ramifications of *Friedrich* have been called to our attention. Previously, we had assumed that a fluctuating workweek was permitted under Pennsylvania law, although the issue never appears to have been the subject of an in-depth analysis. We have yet to issue any pronouncements regarding *Friedrich*, subsequent to being made aware of its ramifications.

A federal court's analysis of state law, of course, is not binding on the state courts. *Lilley v. Johns-Manville Corp.*, 596 A.2d 203 (Pa. Super. 1991). Therefore, *Friedrich* is not precedent in the strictest sense of the term. This brings us to the question of whether we would embrace *Friedrich*. At this point, without having been called upon to prosecute an actual wage claim, I would venture to say that if a plausible construction could be made of the MWA and/or its regulations that would allow a fluctuating workweek on the same terms as the FLSA, this agency would embrace such a construction. This is because we would be inclined to interpret our law on the same plane as federal law—as opposed to advocating higher standards than those imposed by federal law.

In this regard, I am hesitant to place the same weight, as the *Friedrich* court did, on the absence of state rulemaking adopting a regulation equivalent to 29 C.F.R. § 778.114. The federal regulation, according to the source note in the *Code of Federal Regulations*, was adopted January 26, 1968. While it is true, as the *Friedrich* court observed, that the Pennsylvania minimum-wage and overtime regulations were promulgated in 1977, I am unable to assume (as the *Friedrich* court apparently did) that these regulations were adopted from scratch. Rather, the 1977 rulemaking took existing (and presumably pre-Commonwealth Documents Law) regulations and "reviewed" them, "improved" upon them and revised them to eliminate "inconsistencies between the existing regulations and the act, as

amended." 7 Pa.B. 25 (Jan. 1, 1977). While the preambles accompanying both the proposed and the final rulemaking are meager by today's standards, it is important to realize that prior to the enactment of the present-day MWA, there was a statute on the books known as the "Minimum Wage Act of 1961," act of September 15, 1961, P.L. 1313, 43 P.S. §§ 333.1-333.18 (repealed). That statute, in turn, contained authority for the adoption of regulations: 43 P.S. §§ 333.9(a), 333.12 (repealed). Accordingly, there is a possibility that the 1977 regulations passed under the MWA were substantially a re-codification of regulations promulgated under the 1961 act before the federal government's adoption of 29 C.F.R. § 778.114.

Second, it is obvious that this agency has not attempted rulemaking under the MWA on the same magnitude as the federal Wage and Hour Division has under the FLSA. To do so, seemingly, would require the filling of possibly two volumes of the *Pennsylvania Code*. By the same token, Pennsylvania has not been nearly as vigilant in updating its regulations; rather, it appears that the last substantial changes to the regulations occurred in 1979. In short, I am reticent to infer a conscious intention to reject the idea of a fluctuating workweek, simply based on the absence of regulatory language on the state level similar to 29 C.F.R. § 778.114.

The next step is the analysis to determine whether support for a fluctuating workweek can be derived from the MWA or the existing regulations. In *Jay R. Reynolds, Inc. v. Department of Labor and Industry*, 661 A.2d 494, 497 (Pa. Cmwlth. 1995), the court recognized that an agency may render (and rely on) interpretative law as long as the interpretative rule tracks the meaning of the statute that it interprets, and does not expand the plain meaning of that statute. In my view, the concept of a fluctuating workweek can be accommodated under existing law. Not only is there no language forbidding a fluctuating workwork, or defining 40 hours as the standard for determining the employer's regular rate for overtime purposes, but the language of 34 Pa. Code § 231.43(b) seems to support this concept. That regulation requires that an employee's regular rate be calculated by

total hours actually worked in the workweek for employees paid by the day or the job. The logical extension of this methodology, in my view, encompasses the fluctuating workweek by using total hours actually worked to determine the actual rate. Indeed, the fluctuating workweek simply gives recognition to the fact that some employees are paid a fixed salary without regard to hours, and quite logically allows their regular rate to be determined by using the hours actually worked, and not an artificial standard. The mandating of a 40-hour standard for non-exempt employees paid salary, when determining their regular rate, would appear to be the more expansive construction of the statute, and the one requiring the specific adoption of regulations. Consequently, I believe that L&I will embrace the fluctuating workweek, since the MWA and existing regulations support such an interpretation, and because Pennsylvania employers will not be subjected to greater burdens than those imposed by federal law through, at best, a latent discrepancy between state and federal regulations.

V.

The last item of possible concern involves the method used by [redacted] to average commissions. Once again, we would place great stock in federal interpretations. While federal regulations sanction both deferred overtime on commissions, 29 C.F.R. § 778.119, and the subsequent allocation of equal amounts of commissions to each week through averaging methods, 29 C.F.R. § 778.120, the particular method used by [redacted] differs somewhat from the example in the materials I have reviewed. *See*, 5 C.B.C., *Employment Coordinator*, ¶C-16,266 (1997). I simply bring this difference to your attention, but admittedly cannot say that [redacted]'s methodology is necessarily wrong—particularly since I have been unable to produce any substantial numerical disparity, in favor of the employer, between the compensation due under [redacted]'s formula and the amount of overtime calculated by the method prescribed in the materials I consulted.

Specifically, your client's example contains a step "b", whereby the total overtime hours in the quarter are divided by the number of weeks in which overtime was worked, to produce a figure as to average overtime hours per week, and then overtime compensation for the quarter is calculated using the average number of overtime hours per week. In contrast, the illustration in the *Employment Coordinator* recommends the computation of overtime pay on a week-by-week basis using the average weekly commission earnings and the actual number of overtime hours (not an average) worked in each week. Because your client's formula automatically excludes weeks in which overtime was *not* worked in calculating the average overtime hours, I am unable to discern any substantial difference that works against the employee. For instance, page 5 of the employment contract, which you furnished me, sets forth an example whereby the overtime attributable to commissions is $17.84. Using the *Employment Coordinator* methodology, I came up with a slightly less amount ($17.67), as follows:

a. $\frac{\$1,000.00}{13} = \$76.92$ (*Average additional compensation*)

b. *Hypothetical distribution of 20 overtime hours over eight weeks:*

Week #	Actual Overtime Hours
1	1
2	1
3	1
4	1
5	3
6	3
7	5
8	5

VI.

In summary, the existence of authority on the federal level denying the *retail or service* exemption to travel agencies will likely dictate the same approach on the state level, as far as this agency is concerned. Similarly, I do not believe the exemptions set forth in 34 Pa. Code §§ 231.43(c) and (d) are implicated. I also believe that there is an issue involving the recognition of the fluctuating workweek under Pennsylvania law, and, in the process, suggest that the construction of Pennsylvania's MWA regulations by the *Friedrich* court is open to question. Finally, I note a possible discrepancy between the method used by [redacted] to average commission payments, and the illustration used in the *Employment Coordinator*, which appears to track the examples prescribed by 29 C.F.R. § 778.120.

L&I's Bureau of Labor Law Compliance ("BLLC") does not have any special forms for self-audits, and usually accepts what is submitted by employers. If necessary, BLLC can specially devise a form for your client's use in this matter.

I hope that this information is helpful to you.

Very truly yours,

Richard C. Lengler

Richard C. Lengler
Deputy Chief Counsel

c: Robert E. Moore, Director, BLLC
Mark A. Serenl, Esquire
File