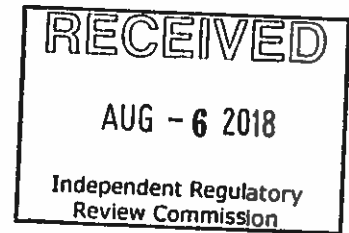




3202



Mr. Bryan Smolock
Director, Bureau of Labor Law Compliance
Department of Labor and Industry
651 Boas Street
Room 1301
Harrisburg, PA 17121

RE: Department of Labor and Industry's Proposed Rulemaking #12-106 (IRRC# 3202): Overtime Pay

Dear Mr. Smolock:

These comments are submitted on behalf of the National Federation of Independent Business Pennsylvania (NFIB PA) in response to the notice of proposed rulemaking #12-106 for Title 34, PA Code Chapter 231, Part XII: Overtime Pay. NFIB is the nation's leading small business advocacy association, representing 14,000 members in Pennsylvania and 300,000 throughout the United States. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses.

NFIB believes that the Department of Labor and Industry's (L&I) proposed regulation will have a substantial negative impact on small businesses and their employees. Accordingly, NFIB urges L&I to withdraw the proposed rulemaking for the following reasons. First, the proposed rulemaking will not result in increased pay for employees of small businesses, but instead will result in limiting employee hours and diminishing career opportunities. Second, the proposed rule should be withdrawn or modified because it does not align with the duties test under the Fair Labor Standards Act (FLSA) and will cause confusion for many employers. Third, the proposed regulation suffers the same fatal defect as a similar federal overtime proposal, which was permanently enjoined by a federal district court for requiring inordinate focus on heightened salary requirements when classifying employees as exempt or non-exempt. And finally, NFIB urges L&I to postpone rulemaking until after the U.S. Department of Labor (DOL) releases its final revised overtime rule.

Summary of proposed rule

The Fair Labor Standards Act generally requires covered employers to pay their employees overtime premium pay of one-and-one-half times the employee's regular pay for all hours worked over 40 in a workweek. However, there are a number of exemptions from the FLSA's minimum wage and overtime requirements. Section 13(a)(1) of the FLSA, codified at 29 U.S.C. 213(a)(1), exempts from both minimum wage and overtime protection "any employee employed in a bona fide executive, administrative, or professional capacity... or in the capacity of outside salesman." The FLSA does not define the terms "executive," "administrative," or "outside salesman."

DOL has consistently used its rulemaking authority to define and clarify the section 13(a)(1) exemptions. Since 1940, the implementing regulations have generally required each of three tests to be met for the

exemption to apply. First, the employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (the “salary basis test”). Second, the amount of the salary paid must meet a minimum specified amount (the “salary level test”). Third, the employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”).

Currently, to qualify for the exemption, the minimum salary that a worker must receive under the FLSA’s salary level test is \$455 per week (\$23,660 annually). L&I’s proposed rulemaking seeks to more than double this amount to \$921 per week (\$47,892 annually) over three years. Up to 10% of the proposed salary threshold may be satisfied through the payment of nondiscretionary bonuses. After full phase-in of the initial increase, L&I seeks – for the first time – to automatically increase the salary threshold at the 30th percentile of all salaried wage earners in the Northeast U.S. region every three years.

Meanwhile, L&I proposes several changes to the duties test, including dispensing with Pennsylvania’s “long test” and “short test” in favor of a standard duties test, which L&I asserts is more consistent with FLSA’s regulations. But the proposal still contains several problematic discrepancies related to exemptions and “primary duty” requirements, which will make compliance significantly more difficult for small businesses.

1. Proposed regulation will not result in increased pay for employees

L&I has marketed the proposed rule by promising “considerable economic benefits for the Commonwealth as well as a healthier, happier population.” Unfortunately, the true consequences of the proposal will be greater costs and burdens on small businesses. As a result, employees will enjoy less flexibility, fewer benefits, and will suffer possible pay cuts. The proposed changes will also negatively impact workplace morale, as employees will feel like they are demoted when converted from salaried positions to hourly employees. This will in turn hurt a small business’s quality, customer service, and reputation.

Increased labor and regulatory compliance costs for small businesses

According to the Regulatory Analysis Form, the costs of the proposed rulemaking to Pennsylvania’s estimated 225,400 small businesses will be “de minimis” and can be mitigated by their own decision-making. The rule is “not expected to have a disruptive effect” on the state’s economy. Unfortunately, this assertion seriously underestimates the compliance costs to small businesses and overestimates the benefit to employees.

First, L&I underestimates compliance costs because it does not consider business size when estimating the time it takes to read, comprehend, and implement the proposed changes. L&I’s assumptions erroneously disregard a basic reality of regulatory compliance – the smaller the business, the more difficult and time consuming it is to ensure compliance. Numerous studies have identified that regulatory compliance disproportionately affects small businesses. A 2014 study for the National Association of Manufacturers found that businesses with fewer than 50 employees spent 30 percent more on regulatory compliance per employee, each year, than their larger counterparts.¹

¹ <http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Executive-Summary.pdf>

Common sense also dictates that small businesses are impacted disproportionately. Primarily, this is because small companies lack specialized compliance personnel. Typically, small businesses operate without human resource professionals on staff, much less in-house legal counsel. Therefore, the duty of compliance falls to the business owner or the primary manager—requiring them to divert their limited time and energy away from more productive business. These individuals are not regulatory experts and generally lack experience wading through cumbersome regulatory text. It simply takes longer for them to synthesize regulatory requirements. Alternatively, a small business could hire an outside expert to devise a compliance plan, but this is usually cost-prohibitive for smaller companies.

Though L&I asserts that “nearly all employers already have systems and policies in place” to comply with the proposed rule, this is not the case for many small businesses that may have a few employees. These businesses will not only have to take the time to understand the new requirements, as well as the differences between state and federal law, but will also need to put into place new time tracking and possibly accounting systems to comply, all of which increase costs.

Employees Will Not Benefit Under the New Rules

Complying with the proposed rule is not as simple as looking at a salaried employee’s weekly pay. This is just one piece of the puzzle. Most small businesses operate on a small profit margin and would need to make careful choices about how to manage the new requirements while keeping costs down. In most cases this will mean converting previously exempt employees to hourly employees; however, this does not mean that the employees will take home more pay. On the contrary, they may be hurt as employers are forced to cut their hours or their base pay to ensure compliance and meet budgetary projections.

If an employee is currently salaried and makes greater than the current threshold of \$455 per week, but less than the proposed \$921 per week, the owner must now spend a considerable amount of time calculating out varying options to manage the new regulation – none of which is beneficial for anyone involved. As an example, suppose the employee in question is Mario, a manager at a small business who works an average of 50 hours per week at a weekly salary of \$865 (\$45,000 annually). L&I seems to presume that the proposed rule will result in a pay increase for Mario’s to \$921 per week (\$47,892 annually). However, this is not a realistic projection.

In a small business operating on tight margins, the company may not be able to afford to pay Mario more than he is already making. The owner, Linda, has three options to remain viable. Mario is converted to an hourly employee in each, and Linda must carefully manage Mario’s hours.

1. The first option is to pay Mario an hourly rate of \$21.63, while prohibiting him from working more than 40 hours in a week. This would ensure that he is still paid \$865 per week; however, Linda will have to take on the ten hours of lost productivity herself.
2. The second option is to pay Mario a significantly lower hourly rate so that he still brings home \$865 per week when factoring in 10 hours of overtime.
3. The third option is to bring in a new employee to fill the lost productivity, but to do so in a way that Linda is only paying \$865 per week for both Mario and the new employee.

Mario would be best off under the first option; however, it is probably not a realistic option. The typical small business owner is already stretched thin. Linda will most likely rule out this option because she is

already spending all her available time operating the business, generating sales, monitoring inventory, and other necessary duties. In addition, now she must track Mario's hours.

The second option is more realistic since Linda needs an employee who can put in 50 hours per week. But because she can only afford to pay \$865 per week, she must set Mario's base hourly wage at \$17.30.

While Mario's take-home pay remains unchanged, Linda is now dealing with greater administrative burdens and Mario feels like he has been demoted with the new requirement to record his hours. What is more, Mario is worse off because he must work exactly 50 hours each week to earn \$865; whereas, in the past, he earned his full salary even in slower weeks when there was less to do, or when taking time to address his family's needs during the workweek. Not only does Mario lose the flexibility to handle family emergencies and to pick up his children from school, but he may also lose benefits that he previously enjoyed as an exempt employee—such as guaranteed annual paid time off.

Mario may suffer even further if Linda responds to these regulatory changes by cutting his hours. She might divide Mario's current 50-hour workweek between two employees, perhaps shifting some of Mario's responsibilities to another existing employee or hiring someone new. This split could be 40 hours for Mario and 10 for the other employee; it could be even at 25 hours each; or any combination in between. Regardless of what Linda decides, the hourly rate for the position will be \$17.30. If she lets Mario work 40 hours, his pay is now \$692 per week (\$35,984 annually). If she cuts him to 25 hours, his take home pay will be \$432.5 per week (\$22,490 annually). Under either of these scenarios, Mario will not only feel slighted, but will likely have to find a side job to make up the difference from what he was making previously. It's possible that he will have to work more than 50 hours per week to make the same pay between two jobs and will spend additional time commuting. His family will most likely see him less under this scenario. And meanwhile, Linda may find it difficult to retain capable and motivated part-time employees.

A fourth option would be for Linda to close her doors. If Linda cannot find a way to comply with the new requirements and manage the costs within a tight margin, she may go out of business. She may initially try to increase prices to offset the costs of paying a higher salary; however, this may result in lost sales as her business becomes less competitive. And, in the end, if forced to close, everyone loses under the proposed rule.

We know with certainty that businesses will be forced to restructure, and without real benefit to employees. This is true for larger companies as well. In fact, IBM cut pay for 8,000 employees in response to a lawsuit alleging that the company had improperly classified technical employees as exempt. The company settled and reclassified these employees as non-exempt hourly workers so that they would be eligible for overtime; however, those employees received a 15% pay cut in their base salary so that the company could pay the overtime required of their positions under the new scheme. Not surprisingly, many employees were upset by this change and believe that they may end up working more hours for less money.²

² <https://www.informationweek.com/ibm-responds-to-overtime-lawsuits-with-15--salary-cuts/d/d-id/1063638>

As these examples illustrate, L&I's assumptions about the supposed benefits of this rule are deeply flawed. The result is greater compliance costs for small businesses that must now track hours. But employees are no better off.

The appeal of small business flexibility

Since small businesses cannot usually compete with larger firms in salary, they often seek to attract and retain talented workers by providing innovative benefits like flexible leave policies, designed specifically to fit the needs of their employees and their businesses. Indeed, small businesses are leaders in flexible working arrangements, a key benefit for many of their employees.

Studies have shown that small businesses are more likely to allow employees to: change starting and quitting times, work some regular paid hours at home, have control over when to take breaks, return to work gradually after childbirth or adoption, and take time off during the workday to attend to caregiving or other family or personal needs without loss of pay.³ These flexible work arrangements increase employee satisfaction; however, employers may not be able to continue providing this sort of flexibility for managers if the proposed rule is finalized.

For example, many businesses allow their salaried employees to telework, providing flexibility to work from home when they have a sick child or need to avoid a time-consuming commute on occasion. This benefit is almost impossible to manage with an hourly employee. Therefore if companies are forced to convert employees from exempt to non-exempt, this benefit will no longer be available to many workers.

The vast majority of small business owners value their employees and treat them like extended family. They often offer other non-compensation benefits that are highly valued, including training opportunities, paid meals, and travel. Many of these benefits will be discontinued in order for businesses to comply with and pay for the increased costs of the proposed regulation.

Increasing the overtime threshold and forcing employees back on the clock cuts off an avenue through which small business owners can shine through unique programs that benefit their businesses, their customers, and their employees. In this increasingly tight labor market, the proposed rule would in fact take away some primary advantages small businesses have to attract great employees.

Proposed salary threshold is too high and does not consider geographic differences

The proposed rule, like the federal rule proposed before it, represents an unprecedented effort by L&I to vastly expand non-exempt status to workers. It is unprecedented because of its ambition to automatically make non-exempt anyone who makes less than 30% of salaried earners in the Northeast U.S. region. By comparison, the current federal threshold – promulgated in 2004 – was set at roughly the 20th percentile of salaried employees in the South region of the U.S. and in the retail industry. The 2004 rule recognized that the cost of living varies in different parts of the country and adjusted accordingly. This proposal makes no such effort, even though various regions of Pennsylvania have differing average salaries. In 2017, 60 of Pennsylvania's 67 counties had average weekly wages below the national average of \$1,111, with seven reporting wages below \$700. Six of the seven counties with wages above the national average were concentrated in the Philadelphia and Pittsburgh regions. In fact,

³ <http://familiesandwork.org/downloads/2014NationalStudyOfEmployers.pdf>

if applied against 2017 weekly salaries, the average worker in 51 Pennsylvania counties would not qualify for exemption under L&I's proposed rule.⁴

Lower salaries go further in some areas than others. As an example, a manager working in Altoona currently making \$33,000 annually has the same purchasing power as a manager in Carlisle earning \$38,229.⁵ Differences are even more extreme in some rural areas, especially when compared to some areas of the Northeast region of the U.S., on which automatic increases will be based. Small businesses in less expensive areas should not be forced to pay rates currently paid in areas with much higher costs of living.

Making the cost of business unjustifiably higher for businesses in some areas will inevitably drive employers to areas where they can build their businesses at a lower cost – including other states – and employees will follow. This would exacerbate an already troublesome trend of out-migration in many areas of Pennsylvania. Since 2007, a significant majority of counties, mostly in rural areas of the commonwealth, saw more taxpayers move out than move in. The proposed rule would raise the overtime salary threshold to unrealistic levels in these areas, which will only increase the cost of doing business and exacerbate the exodus. For these reasons, L&I should either follow U.S. DOL's 2004 example in setting salary thresholds or should consider only Pennsylvania statistics in so far as the salary threshold is to be based on regional considerations—*i.e.*, excluding New York, Massachusetts, Connecticut, etc.

Concerns with automatically updating the threshold

The proposed rule would – for the first time – establish a mechanism to automatically increase the salary threshold at specified intervals. Indexing the minimum salary threshold would likely result in instability in labor and administrative costs for small businesses in perpetuity. Every three years, small businesses would be forced to reconsider classifications given to their employees and reassess potential raises, bonuses, or promotions for employees.

Small businesses will need to constantly review the impact that automatic increases will have on salary compression, merit increases, and budgets. This reconsideration of positions costs time and money and, if it occurred during a downturn in the economy, the increased costs would exacerbate problems for small businesses and force tough decisions at inopportune times. Accordingly, NFIB believes that L&I should abandon its proposal to automatically increase the salary threshold. Any subsequent updating must occur through formal rulemaking.

2. Duties test should mirror federal rule

L&I has proposed changing the state's duties test in several areas. While the current test is not perfect, small businesses have had 14 years of experience working with it and generally understand its application. NFIB appreciates L&I's intention to simplify the duties test. But, if this is the goal, a better option would be to adopt the text of the duties test in the federal rule or to simply incorporate the federal standard through citation. Instead, the proposed rule requires small businesses to familiarize themselves with new rules – which differ materially from the federal standards. Dealing with the

⁴ https://www.bls.gov/regions/mid-atlantic/news-release/countyemploymentandwages_pennsylvania.htm

⁵ https://www.philadelphiafed.org/-/media/research-and-data/publications/economic-insights/2017/q4/rs_purchasing-power.pdf?la=en

changes and the interaction of the new requirements on both the state and federal level will increase compliance costs for small businesses.

The proposed state standards, while perhaps slightly simpler, still have flaws. For one, the duties test under the proposed regulation omits a number of exemptions that are included in the federal rule, such as the exemption for computer-related employees and employees in sales. The federal rules also recognize other miscellaneous exemptions:

- Salesmen, partsmen and mechanics employed by automobile dealerships
- Commissioned sales employees of retail or service establishments
- Drivers, driver's helpers, loaders and mechanics under certain circumstances
- Local delivery drivers and driver's helpers
- Newspaper deliverers and other employees
- Lumber operations employees of businesses with less than nine employees
- Farm workers
- Seasonal and recreational establishment employees

Pennsylvania businesses are already at a competitive disadvantage to those in other states because of differences between state and federal overtime provisions that make compliance more complicated and expensive. These differences also create avenues for expensive litigation for small businesses who do their best to comply, but are overwhelmed by the complexity of the overlapping requirements.

If L&I truly wants to create a simple and streamlined duties test that would be easier for employers to understand and manage, it should adopt the federal duties test word-for-word.

3. The Proposed Rule is Subject to Legal Challenge

By proposing to raise the salary threshold by more than 100%, the rulemaking suffers the same problem as a similar rule proposed by the U.S. Department of Labor, which was enjoined by a federal court in 2017. The court found that the federal rule exceeded the agency's authority "by making overtime status depend predominantly on a minimum salary level."

As with the FLSA, Pennsylvania's statute, at section 333.105.105, contains specific exemptions to the minimum wage and overtime provisions of the act. These exemptions were debated by the General Assembly and signed by the Governor into law; however, they would have little impact should the department's proposed rulemaking go into place. The minimum salary threshold for overtime would make many of the exemptions obsolete because the proposed salary requirement far exceeds the salary that many employees are paid within these categories. A change as impactful as this should not come from L&I, but from the legislature. Only that august body, accountable to the People, can adequately consider the pros and cons through public debate.

4. Federal Rulemaking is Forthcoming

Now is an inopportune time to consider the real impact of proposed state overtime regulations on employers, who are also awaiting proposed changes from the federal government on the same issue.

The U.S. Department of Labor is expected to propose a new overtime rule in the coming months. That rulemaking will cover Pennsylvania employers. Therefore, it would only be proper for L&I to postpone

this rulemaking. If L&I is intent upon moving forward, it should at the least provide an opportunity for public comment once the federal rule is settled, so that affected businesses may have opportunity to speak to the combined effect of the federal requirements and L&I's contemplated changes.

Many individuals who have commented on the L&I regulatory package may wish to make observations about how the state proposal interacts with a new federal rule. This is because the overlap and interaction of the two layers of wage regulations affect businesses' daily operations differently than the state's alone. The comments L&I is gathering now on the proposed regulation may well be irrelevant by the time the agency promulgates final regulations. The regulated community should have the ability to comment fully on the impact of the proposed state rule as that rule will interplay with the new federal rule. To do otherwise creates an incomplete picture as L&I proceeds to final rulemaking.

Conclusion

NFIB strongly believes that L&I should withdraw the proposed rule because it will not achieve L&I's intended goals. Instead of increasing pay for employees, the proposed rule will force small-business owners to take more control of employee hours in order to keep costs in check. This control will come at a cost for small business owners and their employees. Not only will employers face higher costs and more regulatory hurdles, but employees are likely to see reduced benefits and less flexibility. Further, employees will see diminished opportunities for career growth, while employers will face a crisis of morale. For all of these reasons, the burdens imposed by the proposed rule outweigh the supposed societal benefits.

We appreciate the opportunity to comment on the proposed rule. Please do not hesitate to contact me should you need further information on the impact of the proposed rule on Pennsylvania small businesses.

Sincerely,



Rebecca K. Oyler
Pennsylvania Legislative Director