Comments of the Independent Regulatory Review Commission

Department of Labor and Industry Regulation #12-106 (IRRC #3202)

Minimum Wage

September 21, 2018

We submit for your consideration the following comments on the proposed rulemaking published in the June 23, 2018 *Pennsylvania Bulletin*. Our comments are based on criteria in Section 5.2 of the Regulatory Review Act (71 P.S. § 745.5b). Section 5.1(a) of the Regulatory Review Act (71 P.S. § 745.5a(a)) (RRA) directs the Department of Labor and Industry (Department) to respond to all comments received from us or any other source.

1. RRA Section 2 – Reaching of consensus.

The Department states that between September 29, 2017 and November 20, 2017, the Governor's Middle Class Task Force held six meetings which included workers and students along with representatives of businesses, labor unions, workforce development programs, institutions of higher education and other post-secondary training. During these forums, workers expressed concern about low or stagnant wages, according to the Department.

In addition, the Department sought the expertise of legal counsel, economists, and a policy analyst on the issue of overtime regulations in the development of this proposal and solicited input on a draft regulation from the Minimum Wage Advisory Board (Board). The Board is comprised of representatives of labor organizations, an established recognized association of employers and members of the general public. (RAF #14)

The regulation has generated a great deal of interest from legislators, local governments, nonprofit organizations, human resource management associations and professionals, educational institutions, businesses (including small businesses), labor organizations, economic development councils, representatives of the recreational and tourism industry, and private citizens.

We commend the Department for extending the public comment review period from 30 days to 60 days to allow many individuals, associations, and businesses to participate in the rulemaking process. As a result of the efforts of the Department, a large number of written comments have been received and substantial testimony has been submitted on the rulemaking. While there is support for the Department's proposal, there are also hundreds of comments highlighting numerous and significant outstanding concerns.

Section 2 of the RRA sets forth why the General Assembly established a regulatory review process. Given the interest this proposal has generated, we believe it is appropriate to highlight the following provision of Section 2(a) of the RRA. The provision states, "To the greatest extent possible, this act is intended to encourage the resolution of objections to a regulation and the reaching of a consensus among the commission, the standing committees, interested parties and the agency." 71 P.S. § 745.2(a).

Based on the range of commentators and volume of comments, it appears that the Department's regulatory language has not yet achieved consensus on many issues. We believe the issues raised deserve careful contemplation because the Department's responses will affect approximately 460,000 salaried Pennsylvanians (by 2022), 230,000 businesses (of which 225,400 are small businesses) and 108,491 nonprofit organizations.

The Department stated that its intent is to use the regulatory review process to gain additional input from the public, including businesses and any other interested parties. We encourage the Department to continue its work with the Board, but also engage in dialogue with those individuals and representatives of those programs and employment sectors that were part of the initial Governors Middle Class Task Force meeting as it moves forward with this rulemaking.

2. RRA Section 5.2 (a) – Legislative comments.

Some state lawmakers suggest that the alignment issue should be addressed through legislation rather than regulation. One proposed legislative solution would align federal and state law so that employers would follow just one set of rules, while continuing to allow the state legislature to determine if and when a different approach should apply. Several members of the House and Senate have urged the Department to withdraw its proposal and wait for the federal government to issue its overtime rule first.

Other legislators have expressed their ardent support for the Department's proposal. They view it as a much needed restoration of the overtime pay requirement that has eroded over the past few decades. They assert the Department's rulemaking is long overdue and is needed to protect salaried employees. We encourage the Department to work with the standing committees and state lawmakers to address their issues as the final rulemaking is developed. We will review the Department's responses to legislative concerns to determine if the final-form regulation is in the public interest and consistent with the criteria in the RRA.

3. RRA Section 5.2 (a) – Whether the regulation is in the public interest.

Section 5.2 of the RRA directs the Independent Regulatory Review Commission (IRRC) to determine whether a regulation is in the public interest. 71 P.S. § 745.5b. When making this determination, IRRC considers criteria such as economic or fiscal impact and reasonableness. To make that determination, IRRC must analyze the text of the Preamble and proposed regulation and the reasons for the new or amended language. IRRC also considers the information a promulgating agency is required to provide under Section 5 of the RRA in the Regulatory Analysis Form (RAF). *See* 71 P.S. § 745.5 (a). The explanation of the regulation in

the Preamble to the proposed rulemaking is not sufficient to allow IRRC to determine if the regulation is in the public interest.

For example, the changes to Section 231.83(2) add language to clarify that administrative personnel must regularly exercise discretion and independent judgment in matters of significance. The description of the amendment does not explain why it is needed. The Department specifies that certain sections are being deleted to comply with federal rules, but does not state if the proposed new language is an alignment with federal requirements or is a new state requirement. In the Preamble to the final-form regulation, the Department should provide more detailed information for each section of the regulation and explain why the amendments are required.

4. RRA Section 5.2 (b)(1) and (2) – Economic or fiscal impacts of the regulation; Protection of the public health, safety and welfare.

The Department estimates the increase in payroll costs for business to be "**well under one-tenth of one-percent of total U.S. payroll costs** . . . ." The Department explains that it used the estimated impact of the enjoined 2016 U.S. federal rule which used a 40th percentile threshold as a milepost for determining costs for Pennsylvania. (RAF #19, #23)

However, the estimated costs of compliance that were provided by nonprofit and higher education employment sectors appear to contradict the Department's estimates. For instance, the following higher education institutions provided these estimates:

- Holy Family University ($134,000);
- Susquehanna University (over $550,000);
- Lackawanna College (2nd year: $16,172 and 3rd year: $24,232); and
- University of Sciences (over $200,000 per year).

The following estimated costs for compliance were provided by nonprofit organizations:

- Pennsylvania Association of Community Health Centers (Health Center 1: $276,179; Health Center 2: $52,000)
- Carson Valley Children's Aid ($230,566 cumulative cost through 2022; $152,732 per year after 2022)
- Bair Foundation (Fiscal Year (FY) 2019-20: $403,560; FY2020-21: $741,504; and FY2021-22: $1,140,024)

Commentators from the nonprofit sector and local governments also challenge the Department's assertion that the impact of the rulemaking can be mitigated by their own decision making and that implementation of it should not have a disruptive effect on Pennsylvania's economy. (RAF#23) Many commentators point out that unlike businesses that can make adjustments, such as raising prices, to offset the costs of higher minimum wage or paying additional overtime, nonprofit organizations rely mostly on private donations and government grants as their primary sources of revenue. Similarly, local governments also rely on limited funding sources, namely state and local tax dollars. Nonprofit organizations, human service advocates and local

governments are concerned that this 'unfunded mandate" will result in the disruption or elimination of critical services for our most fragile populations. We ask the Department to consult with the regulated community to gain a thorough understanding of the fiscal impacts of this proposal and address those findings in the RAF and Preamble submitted with the final-form regulation.

While many commentators applaud the Department's effort to modernize the minimum wage regulations, the general consensus among most employers that commented on the proposal is that the salary levels are "unprecedented," "extreme," and "unsustainable." One commentator provided the following chart to illustrate the "domino effect" of the proposed phase in:

- Year one: $23,660/yr. to $31,720/yr. represents 34.1% increase;
- Year two: $31,720/yr. to $39,832/yr. represents a 25.6% increase; and
- Year three: $39,832/yr. to $47,892/yr. represents a 20.2% increase.

It has been noted that the national average for salary increases has been about 3 percent for the past five years. The difference between the national average for salary increases and the Department's proposed salary increase is significant, even with a three-year phase-in. Employers question the feasibility of absorbing such drastic increases. The Department should explain the reasonableness of the proposed salary thresholds.

Many employers shared it is unlikely that they will be able to increase salaries to the proposed levels. Instead, they may have to convert currently-exempt salaried employees to hourly workers, reduce employee hours and/or benefits, restructure bonus/incentive programs or lay off employees. These options may negatively impact employee morale and workplace flexibility.

The Department projects that by 2022, approximately 460,000 Pennsylvanians will "benefit from increased income and/or improved quality of life" as a result of the implementation of this rulemaking. However, the Department does not address in its RAF response the potential negative consequences that have been reported by employers. The Department should revise its response to RAF #15 to account for these potential impacts on individuals. It should also address the commentator concerns noted above in the Preamble to the final-form regulation.

5. RRA Section 5.2(b)(3) – Clarity, feasibility and reasonableness; Possible conflict with or duplication of statutes or existing regulations.

Alignment with federal regulations/Provide clarity to employers and employees --

The Department explains that this rulemaking is necessary to align the duties tests for the Executive, Administrative and Professional (EAP) exemptions in Pennsylvania minimum wage regulations with the duties test found in the United States Department of Labor (USDOL) regulations interpreting the EAP exemptions found in the Fair Labor Standards Act (FLSA).

Several commentators have remarked that the proposal does not fully align with the federal regulations because significant provisions are not included in the Department's proposal. Specifically, they identify the following exemptions that are not part of the Department's proposal, but are part of the federal overtime rule:

- Highly compensated employee;
- Outside sales;
- Certain computer employees;
- Business owners under the executive exemption; and
- Employees of educational establishments under the administrative exemption.

A concern among commentators is that the omission of these significant provisions will only add to the inconsistencies between the state and federal regulations thereby making compliance more complicated and increasing the likelihood of litigation. For instance, several commentators from the health care industry have remarked that the Department's proposal does not include the 8/80 method of overtime calculation. (Act 109 of 2012) They want to avoid what they refer to as "non-deliberate inconsistencies" with federal law that can lead to compliance challenges. Other commentators note the absence of a "concurrent duties test" as applied to executive employees and key terms such as "primary duty" and "salary basis" in the Definitions section.

Many of these same commentators, including state legislators, have noted that the USDOL is in the process of seeking public input on the federal overtime rule. (29 CFR Part 541) They are concerned that the state regulations and the federal regulations will once again be misaligned if the state's final rulemaking is adopted in advance of the federal changes. The Department should explain in the Preamble and RAF why it is in the public interest to proceed with this rulemaking in advance of the federal changes. If the Department continues with promulgation of the regulation, it should address how it will handle future misalignment with revised federal regulations. It should also explain its plans to review the state's regulations once the federal overtime rule is adopted and how it will communicate with the regulated community regarding any changes.

Applicability

There appears to be some confusion as to whether this proposal applies to public employers. We have received many comments from counties that included their estimated costs for compliance with the proposed rulemaking. For example:

- Franklin County ($61,826 by 2022);
- Berks County (2nd year: $58,972; 3rd year: $194,964);
- Blair County (1st year: $14,647; 2nd year: $85,875; 3rd year: $1,136527);
- Forest County (1st year: $19,178; 2nd year: $52,032); and
- Lycoming County ($261,032 by 2022).

A representative of local governments notes that a clear exemption for public employers, based on their coverage under the FLSA, that was once in the state's Minimum Wage Act (Act) has been amended out of the law. The commentator explains that a 1970s interpretation of the Act indicated that the definition of "employer" should not be construed to include the Commonwealth and its political subdivisions. The commentator asks the Department to clearly carve out the exemptions so that there is no confusion about the applicability of the regulations.

The Department's responses to RAF #15, #19, and #20 do not include information pertaining to local government. Are the proposed changes applicable to the Commonwealth and its political subdivisions? If so, the Department should provide the number of employers and explain how they will be affected by the regulation or state why these public employers are exempt from the requirements. The Department's response to RAF #20 should be revised to include specific costs and or savings to local governments, if this rulemaking applies. If this rulemaking does not apply, the Department should explicitly identify the types of employers which are exempt from the requirements of the rulemaking.

6. RRA Section 5.2 (b)(3)(iv) – Reasonableness of requirements, implementation procedures and timetables for compliance by the public and private sectors.

Another concern that has been expressed is the amount of time that employers will need to familiarize themselves with the new rules, analyze their workforce and determine how to comply. This may require employers to evaluate employee salaries, consider reclassifying some employees, draft new compensation plans, and modify bonus and benefit plans.

The Department identifies the three-year phase-in as a special provision that will assist businesses to adapt to the changes. (RAF#25) The Department also believes that this timeframe will give nonprofit organizations the ability to adjust operationally and strategically with their funding requests. (RAF #15)

As proposed, the first threshold increase would immediately become effective upon publication in the *Pennsylvania Bulletin*, with subsequent increases phased-in over the following two years. The Department anticipates that the expected date of delivery of the final regulation is 2019. (RAF #29)

One state lawmaker requests that the Department consider delaying the initial implementation for a period of time that would allow for notification to employers about their responsibilities. The Department should explain how the implementation schedule provides sufficient time for compliance and is reasonable for employers to make necessary adjustments to their business practices. It should also describe the process the Department will undertake to communicate with the regulated community about the new requirements and implementation schedule.

SPECIAL DEFINITIONS

7. Section 231.82. Executive.
Section 231.83. Administrative.
Section 231.84. Professional. – Whether regulation is supported by acceptable data; Reasonableness of requirements, implementation procedures and timetables for compliance; Statutory authority; Whether the regulation represents a policy decision of such a substantial nature that it requires legislative review.

Salary Threshold Phase-In and Automatic Reset

The Department is proposing to raise the current salary thresholds for EAPs from $250 per week under the "short test" or $155-$170 per week under the "long test" to $610 per week ($31,720 annually) effective upon the date of publication of the final regulation in the *Pennsylvania Bulletin*; $766 per week ($39,832) effective one year later; and $921 per week ($47,892) effective one year later.

The Department is also proposing a triennial automatic reset to adjust the salary level (beyond the initial three-year phase-in period) that is based on the 30th percentile of weekly earnings of full-time nonhourly workers in the Northeast Census region in the second quarter of the prior year as published by the USDOL, Bureau of Labor Statistics exclusive of board, lodging or other facilities. The proposal requires the Department to publish the new salary level figure on its website and in the *Pennsylvania Bulletin*. §§ 231.82(5)(iv), 231.83(3)(iv) and 231.84(4)(iv).

Commentators have asked the following questions regarding this provision:

- Why did the Department use the data based on the 30th percentile of weekly earnings of full-time nonhourly workers in the Northeast regions rather than data from neighboring states?
- With regard to the automatic reset of the salary threshold every third year, what happens in times of economic downturn?
- What opportunities exist for the regulated community to have input or provide feedback to the Department regarding a new salary threshold?
- What is the Department's statutory authority to implement an automatic reset of the salary threshold?

As noted by many commentators, the Department's proposal is similar to an attempt by the USDOL in 2016 to increase the salary threshold. It uses an almost identical methodology for setting the salary threshold that includes an automatic escalator provision. The Department explains that a district court in Texas issued an injunction on the grounds that the salary threshold level, set at 40% of salaried workers in the lowest census region, was so high it rendered the duties test for the EAP exemptions irrelevant. How does the Department's proposal differ from the USDOL attempt to enact a similar regulation two years ago? How does it avoid the same legal challenges in Pennsylvania? Did the Department consider using other data or another methodology? The Department should explain why it is reasonable to pursue this option.

Whether this regulation represents a policy decision of such a substantial nature that it should receive legislative review

While there are some lawmakers that fully support the Department's approach, others question whether this regulation represents a policy decision of such a substantial nature that it should be reviewed by the legislature. In their view, the proposal is not "a mere clarification or adjustment for value lost to inflation." Instead, they contend, the proposal goes beyond any reasonable

inflationary adjustment and is too significant of a consideration to be left to unelected department officials. Has the Department sought input from the legislature? The Department should clarify to what extent it has engaged the legislature in developing this regulatory package. We would encourage the Department to work with legislators and the standing committees as it advances this rulemaking to the final stage of regulatory review.

We will review the Department's response to these questions and commentators' concerns in our determination of whether this rulemaking is the public interest.

Inclusion of bonus pay

Under the proposed regulation, an employer may satisfy up to ten percent of the salary threshold with nondiscretionary bonuses, incentives and commissions that are paid quarterly or more frequently. (§§ 231.82(6); 231.83(4); 231.84(5)) One commentator observes that while this approach recognizes the way that many employees are paid, it doesn't take into account "the burden of making quarterly adjustments." Employers could potentially be adjusting payroll up to four times every year for every exempt employee for which a non-discretionary bonus, incentive or commission is used to satisfy the salary threshold. The Department should explain the reasonableness of and rationale for this provision and how it aligns with federal regulations.

In addition, commentators urge the Department to increase the percentage or remove the percentage cap altogether for nondiscretionary bonuses and incentive payments (such as incentives tied to productivity and profitability) to satisfy the salary level test. They explain that nondiscretionary bonuses and incentive programs are an integral part of employment packages and recruiting efforts in a wide range of industries. They are concerned that companies may raise salaries to meet the threshold, but eliminate bonus and incentive programs altogether. How did the Department determine that 10 percent was an appropriate cap? The Department should explain, in the Preamble to the final rulemaking, its rationale for establishing a percentage cap for nondiscretionary bonuses and incentive payments as part of the salary level test.

8. Section 231.83. Administrative. – Clarity, feasibility and reasonableness; Possible conflict with or duplication of statutes or existing regulations.

In existing Paragraph (2), the phrase "customarily and regularly" is used to describe the discretion and independent judgment that an individual working in an administrative capacity must possess to qualify for an exemption from the overtime rule. Several commentators have remarked that this phrase does not appear in the Administrative section of the federal regulations at 29 CFR §541.200. The Department should delete the phrase in this paragraph or explain why it is needed and how it aligns the state regulations with the federal regulations.

9. Miscellaneous.

We note that in Section 231.1 (relating to Definitions) that the term "Handicapped worker" appears. We encourage the Department to take this opportunity to update this term to reflect "people first" approach and replace it with a term such as "worker with a disability."