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VIA E-MAIL BSMOLOCK@PA.GOV

Bryan M. Smolock, Director
Department of Labor & Industry
Bureau of Labor Law Compliance
651 Boas Street
Harrisburg, Pennsylvania 17121

Re: Proposed Regulation #12-114: Minimum Wage

Dear Mr. Smolock:

I write on behalf of the Workplace Policy Institute (WPI) of the law firm Littler Mendelson, P.C. with respect to Proposed Regulation #12-114, which would update the regulations regarding tipped employees and the regular rate under the Pennsylvania Minimum Wage Act of 1968 (PMWA). WPI facilitates the employer community's engagement in legislative and regulatory developments that affect their workplaces and business strategies. With more than 1,500 lawyers, Littler is the largest law firm in the world with a practice devoted exclusively to the representation of employers in employment and labor law matters. More than fifty of our employment attorneys practice in the Commonwealth of Pennsylvania. On a regular basis, we advise Pennsylvania employers with respect to their compliance with the PMWA and represent Pennsylvania employers in disputes arising under the PMWA. We thank the Pennsylvania Department of Labor & Industry (DLI) for considering these comments.

A. DLI Should Defer Rulemaking on the 80/20 Rule Pending Resolution of Litigation on the Federal 80/20 Rule.

DLI claims that its "proposed regulation mirrors USDOL's proposed regulation" with respect to the so-called "80/20 rule." (Regulatory Analysis Form § 10 at p.5; *id.* at § 11 at p.9 (claiming that proposed regulation "would mirror USDOL's final regulation on the 80/20 rule published on October 29, 2021"); *see also* Notice of Proposed Rulemaking at p.7). DLI should be aware that the Restaurant Law Center and the Texas Restaurant Association filed a lawsuit in the United States District Court for the Western District of Texas challenging the federal rule. *Restaurant Law Center, et al. v. United States Department of Labor, et al.*, Case 1:21-cv-01106 (W.D. Tex.). The lawsuit seeks to have the federal regulation enjoined and then vacated by the Court because it is arbitrary, capricious, and contrary to the Fair Labor Standards Act. DLI's proposed regulation is susceptible to the identical legal challenges presented in the federal litigation,

which is currently pending. DLI should defer its rulemaking on the 80/20 rule until the federal litigation is resolved. Then, DLI can account for the results of that litigation and make any needed adjustments.

B. The Proposed Tip Credit Rule Does Not "Mirror" the Federal Rule.

While DLI claims that its proposed regulation "mirrors" the federal 80/20 rule, that is not entirely true. The proposed regulation is significantly more abbreviated than the federal rule. For example, unlike its federal counterpart, the proposed regulation does not provide a definition (or examples) of "duties that directly generate tips" or "duties that do not directly generate tips [but] support the duties that generate tips." Unlike its federal counterpart, the proposed regulation does not address the concept of "work that is not part of the tipped occupation." Unlike its federal counterpart, the proposed regulation does not specify that the 20% limitation only applies to hours for which the employer has taken a tip credit.

It is possible that these omissions do not reflect DLI's deliberate intent to reject the omitted provisions. However, a court may conclude otherwise. In *Chevalier v. General Nutrition Centers, Inc.*, for example, the Pennsylvania Supreme Court held that DLI's failure to incorporate the "fluctuating workweek" method of calculating overtime into its "regular rate" regulations should be interpreted as a deliberate "intent to reject" the corresponding federal regulation.[1] If DLI truly intends to "mirror" the federal 80/20 rule, it should say so expressly. On the other hand, if DLI intends that the omitted provisions should not inform interpretation of state law, it should say so expressly. Instead, DLI's silence on the matter will lead to another "latent discrepancy" between state and federal law – a discrepancy that accomplishes nothing but confusion for the regulated community. If DLI intends that its regulation "mirror" its federal counterpart, there is a solution that does not require DLI to copy word-for-word the entire federal regulation on the subject. Rather, DLI could simply adopt a "catch-all" incorporation by reference provision that clarifies that the FLSA standards will apply.

C. The Proposed Regulation on Credit Card Transaction Fees Requires an Amendment to the PMWA.

The proposed regulation would prohibit employers from deducting a percentage of credit card surcharges from employees' tips when a customer pays a bill and gives a tip using a credit card. (Regulatory Analysis Form § 11 at p.10). DLI contends that this provision "is compelled by the express language of the Act."

[1] This is true even though in 1998, Deputy Chief Counsel Richard C. Lengler wrote that DLI "had assumed that a fluctuating workweek was permitted under Pennsylvania law" and explained: "[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.... 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."

(*Id.*). That is not correct. In fact, the proposed regulation would require an amendment to the PMWA. The Act currently provides:

> In determining the hourly wage an employer is required to pay a tipped employe, the amount paid such employe by his or her employer shall be an amount equal to: (i) the cash wage paid the employe which for the purposes of the determination shall be not less than the cash wage required to be paid the employe on the date immediately prior to the effective date of this subparagraph; and (ii) an additional amount on account of the tips received by the employe which is equal to the difference between the wage specified in subparagraph (i) and the wage in effect under section 4 of this act. The additional amount on account of tips may not exceed the value of tips actually received by the employe. The previous sentence shall not apply with respect to any tipped employe unless:
>
> (1) Such employe has been informed by the employer of the provisions of this subsection;
>
> (2) All tips received by such employe have been retained by the employe and shall not be surrendered to the employer to be used as wages to satisfy the requirement to pay the current hourly minimum rate in effect; where the gratuity is added to the charge made by the establishment, either by the management, or by the customer, **the gratuity shall become the property of the employe**; except that this subsection shall not be construed to prohibit the pooling of tips among employes who customarily and regularly receive tips.

43 P.S. § 333.103 (emphasis added). DLI relies on the phrase "the gratuity shall become the property of the employe" to justify its proposed regulation. However, that phrase only applies as a condition precedent to whether the "previous sentence" shall apply with respect to the tipped employee. If an employer is not taking the tip credit, then this language does not apply.

43 P.S. § 333.109 grants to the Secretary the authority to make and revise regulations "which shall be deemed appropriate to carry out the purposes of this act and to safeguard the minimum wage rates thereby established." Where an employer complies with the minimum wage rates established by the PMWA *without relying on the tip credit*, the Secretary does not have authority to regulate an employer's decision to pay the credit card transaction fee from the amount charged by the patron, before distributing the balance to the employee (or allocating the balance according to a valid tip pool arrangement). At minimum, DLI should amend the proposed regulation to make clear that it does not apply where an employer is not claiming the tip credit.

D. DLI Does Not Have Authority to Prohibit Tip-Pooling Arrangements Where No Tip Credit Is Taken.

Subject to certain conditions, federal law allows employers to require that tipped employees share tips with non-tipped employees in a tip pooling arrangement so long as the employees generating the tips are paid the non-tip minimum wage rather than the tipped minimum wage. (Regulatory Analysis Form § 11 at p.9). In contrast, the proposed regulation would prohibit tip pooling arrangements that include workers

who are not traditionally tipped – even if the employer does not claim the tip credit. That proposed regulation is invalid for the same reason the proposed regulation regarding credit card transaction fees is invalid. Specifically, if an employer complies with the minimum wage rates established by the PMWA *without relying on the tip credit*, the Secretary does not have authority to regulate an employer's decision to include back-of-house employees (or other workers who are not traditionally tipped) in a tip pool.

Quite simply, an employer satisfies its obligations under the minimum wage provisions of the PMWA by paying employees (even those who customarily receive tips) a cash wage of at least the minimum wage set forth in 43 P.S. § 333.104(a). If the employer pays a tipped employee a cash wage of at least $7.25 per hour (the current minimum wage established by § 333.104(a)), then the "additional amount on account of the tips" contemplated by the PMWA (in the definition of "wage" found in § 333.103(d)) is $0. In that scenario, the employer is not claiming any tip credit, and the subsequent requirements of § 333.103(d) that might justify regulatory action (*e.g.*, requiring the employer to provide information about the tip credit and requiring the employee to retain tips except to the extent part of a tip pool) do not apply. At minimum, DLI should amend the proposed regulation to make clear that its restrictions on tip pooling do not apply where an employer is not claiming the tip credit.

E. The Proposed "Regular Rate" Regulation Generates Confusion.

The proposed regulation purports to clarify that the regular rate "in all cases ... should be calculated based on a regular, 40-hour work week and not the total hours worked including overtime, which may be irregular and inconsistent from week to week." (Regulatory Analysis Form § 10 at p.7-8; *id.* at § 11 at p.12; Notice of Proposed Rulemaking at p.7). DLI claims that its proposed regulation is like the laws in California, Connecticut, New Jersey, and New Mexico. (Regulatory Analysis Form § 12 at p.16). That is incorrect.

The proposed regulation adds new subsection "g" to 34 Pa. Code § 231.43, and states:

> The regular rate for salaried employees who are not exempt from overtime is determined by totaling all remuneration for employment to or on behalf of the employee received in a workweek except sums, payments, contributions, and compensation enumerated in subsection (a) divided by 40 hours.[2]

First, the proposed regulation only applies to "salaried employees" and not (as described in the Regulatory Analysis and Notice of Proposed Rulemaking) "in all cases." Many employees who are not "salaried" also receive "remuneration for employment" that must be included in the regular rate – e.g., hourly employees who receive commissions and bonuses – and the existing and proposed regulations do not provide any guidance regarding how such remuneration should be incorporated into the overtime calculation for such employees. It appears that the proposed regulation's limitation to "salaried employees" (and "silence" as to hourly employees) reflects a deliberate intent that the regulation does not apply to hourly employees.

[2] On page 7 of its Notice of Proposed Rulemaking, DLI states that new subsection "g" would provide that the regular rate of pay would exclude remuneration "enumerated in § 403.43(a)." (Notice of Proposed Rulemaking at p.7.) The reference to "§ 403.43(a)" appears to be a typographical error.

But that leaves the regulated community unsure how to calculate overtime on commissions or other incentive compensation paid to non-salaried employees.

Second, the proposed regulation would impose an unprecedented burden on Pennsylvania employers that is not shared by employers in any other state, forcing multi-state employers to adopt a single-state carve-out to its payroll processes. Even California recognizes a distinction between "flat sum" compensation (including fixed weekly salaries and flat-sum bonuses) and variable incentive pay (including commissions and variable bonuses). At minimum, DLI should do the same.

California Labor Code § 515(d)(1) provides that for the purpose of computing the overtime rate of compensation required to be paid to a nonexempt full-time salaried employee, "the employee's regular hourly rate shall be 1/40th of the employee's weekly salary." In *Alvarado v. Dart Container Corp. of Cal.*, 4 Cal.5th 542 (2018), the California Supreme Court extended this principle to other "flat sum" amounts paid to nonexempt employees, holding that "flat sum" incentive compensation "is properly treated as if it were fully earned by only the *nonovertime* hours in the pay period, and therefore only *nonovertime* hours should be considered when calculating the bonus's per-hour value." *Id.* at 562. Thus, the regular rate associated with "flat sum" incentive compensation is determined by dividing such compensation by the non-overtime hours worked during the pay period. *Id.* at 565-66. Then, because the "flat sum" incentive has not yet provided *any* compensation for the overtime hours worked, the additional overtime compensation owed is equal to one and one-half times (rather than one-half times) that rate times all overtime hours worked. *Id.*

The California Supreme Court recognized that a "different analysis" is warranted when the incentive may increase in size as the employee works more hours, including overtime hours (such as in the case of a production bonus or a commission). *Alvarado*, 4 Cal.5th at 561 n.6. Calling this an "important distinction," the Supreme Court explained that when incentive compensation rewards each hour of work (including overtime hours), the incentive already "constitutes base compensation, including base compensation for overtime work." *Id.* at 568. Logically, the regular rate associated with such a variable incentive is calculated by dividing the amount earned "by the total number of hours worked, including overtime hours." *Id.* at 570. Then, the additional overtime compensation that is payable because of the bonus, is that corresponding rate "multiplied by 0.5 (not 1.5) and by the number of overtime hours." *Id.* That makes sense. When an incentive payment already compensates an employee for all hours worked, including overtime hours, then the regular rate associated with that incentive payment is the amount of the payment divided by all hours worked. Then, because that regular rate has already been paid for all hours worked, the only additional amount needed to bring the employee's compensation for overtime hours to "one and one-half times" the regular rate is an additional one-half that regular rate, for all overtime hours.

No other state (not even California) requires that the regular rate associated with variable incentive compensation is to be determined by dividing that compensation by non-overtime hours. Every other state (even California and the few other states that prohibit the so-called "fluctuating workweek" with respect to fixed weekly salaries) recognize that the regular rate associated with variable incentive pay should be determined by dividing that pay by all hours worked.

We defer to other commenters on the policy question of whether Pennsylvania should allow the "fluctuating workweek" method to be used with respect to the fixed weekly salary (or other "fixed sum" incentive compensation) of a nonexempt employee. However, even if DLI concludes that Pennsylvania should prohibit the "fluctuating workweek" method with respect to salaried nonexempt employees, it should recognize that variable incentive compensation is different. One example of how to recognize this distinction in a regulation (applicable in "all cases" and not just as to salaried workers) is as follows:

> The regular rate associated with a fixed salary or any fixed-sum incentive compensation shall be determined by dividing the fixed amount by all non-overtime hours worked during the relevant period; the corresponding overtime due on that amount shall be determined by multiplying that rate by one and one-half times the number of overtime hours worked during that period. The regular rate associated with variable incentive compensation shall be determined by dividing the variable amount by all hours worked during the relevant period; the corresponding overtime due on that amount shall be determined by multiplying that rate by one-half times the number of overtime hours worked during that period.

F. The Proposed Amendment Changing "Christmas" to "Holiday" Pertains to Gifts that are Excluded from the Regular Rate.

DLI states that it proposes to amend 34 Pa. Code § 231.43(a)(1) to replace "at Christmas time" with "during any holiday" "to reflect that sums paid for any holiday should count towards the calculation of the regular rate." (Notice of Proposed Rulemaking at p.6). We assume this is a typographical error and that DLI's intent is to ensure that holiday gifts (not just Christmas gifts) are "not" included in the regular rate (*i.e.*, that the foregoing sentence should read, "...for any holiday should not count towards..."). Indeed, § 231.43(a) lists the categories of remuneration that are ***excluded*** from the regular rate (*i.e.* those that "shall not be deemed" to be included in the regular rate), so changing "Christmas" to "holiday" merely clarifies that DLI is not favoring Christmas over other holidays in which an employer might choose to give gifts to its employees. While we support the proposed amendment (to replace "at Christmas time" with "during any holiday"), the amendment would clarify that gifts (made at any holiday) that are not measured by or dependent on hours worked, production, or efficiency may be excluded from the regular rate.

Thank you for considering our comments.

Very truly yours,

/s/ Robert W. Pritchard

Robert W. Pritchard