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Paid Sick Leave

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Contractors Face Choices, Challenges With New Paid Sick Leave Rules

BY JENNIFER PLITSCH AND JEFF BOZMAN

The Labor Department recently released final regulations implementing Executive Order 13706, which established mandatory paid sick leave for employees working on federal service, construction and concessions contracts. The broad coverage of the new rules — which are essentially coextensive with the coverage of the Service Contract Labor Standards (commonly known as the Service Contract Act, or SCA) and Davis-Bacon Act (DBA) — prompted extensive critiques during the public comment period on the proposed rules.[1] Fortunately, the Labor Department incorporated some changes to the proposed regulations, narrowing the proposals in some important respects.[2] Nevertheless, the final rule still imposes significant obligations on federal contractors and subcontractors.

Many of the associated compliance challenges are not obvious from the text of the rule. In addition to increased compliance obligations, there will likely be additional costs imposed on contractors as a result of the final rule. The costs are likely to come both from the paid sick leave itself (a maximum of seven days per year) and from the layers of complexity on top of contractors' existing compliance obligations with respect to these types of contracts. The new rules will influence the calculations for contractors that already offer paid sick leave, either through a dedicated sick leave policy or a broader paid time-off policy. More importantly, contractors that offer those benefits as part of an SCA fringe benefit package must take quick action to recalculate the value of those fringe benefit packages after ''backing out'' the value of the 56 hours of paid sick

[1] Establishing Paid Sick Leave for Federal Contractors, 81 Fed. Reg. 67,598 (Sept. 30, 2016).

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[2] *See, e.g.*, 81 Fed. Reg. at 67,614 (discussing solicitation of comments on whether to apply the rule to contracts performed exclusively by exempt employees).

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leave required by the executive order. Managing SCA benefits is already a complicated compliance undertaking for employers, and these new rules increase the challenges. In this article, we review the highlights of the final regulations and discuss choices for contractors to make before the regulations take effect in January 2017.

Some Improvements to the Proposed Regulations

A few features of the final regulations will ease some of the compliance burden. First, the Labor Department removed a provision that would have required successor contractors to reinstate unused leave: ''After careful consideration of these comments, the Department is promulgating the Final Rule without requiring that successor contractors reinstate paid sick leave to employees who worked on the predecessor contract.''[3] The final language streamlines the process associated with transitioning federal service contracts, although the preamble suggests that the Department might revisit the issue of inter-contractor reinstatement if it is able to ''identif[y] a logistically viable mechanism to address the concerns expressed about costs, including to the government.''[4]

Second, the final regulations explicitly state that the regulations do ***not*** include contracts that fall outside the scope of the SCA. When the department published the proposed regulations, it requested comments on whether to extend coverage to certain service contracts that are excluded from SCA coverage. These contracts include those involving services performed ''exclusively by bona fide executive, professional, or administrative employees,'' often known as ''white-collar'' employees. In the final regulations, the department agreed that the contracting community's familiarity with the SCA, its implementing regulations, and the related Minimum Wage Executive Order counseled in favor of consistency with those rules, and declined to extend the coverage requirements for paid sick leave to service contracts performed exclusively by bona fide executive, administrative or professional personnel, which are not covered by the SCA.

Contractors should bear in mind, however, that this change only affects contracts that are performed exclusively by exempt employees. When a contract is covered by the SCA, the provisions of the paid sick leave regulations will apply to all personnel working on or in connection with that contract, including the bona fide executive, administrative and professional employees.

Potentially Helpful Options for Contractors

In several contexts, the regulations use a ''trade-off'' mechanism whereby contractors can avoid some compliance burdens in exchange for maximizing the amounts of paid sick leave they offer covered workers. A trade-off applies, for instance, with respect to white-collar employees for whom contractors have no current obligation to track hours. Under the final rule, ''the contractor may, as to that employee, calculate paid sick leave accrual by tracking the employee's actual hours worked or by using the assumption that the employee works 40 hours on or in connection with a covered contract in each workweek.''[5] In effect, contractors may either track hours of exempt employees as they do for non-exempt employees, or they may avoid the tracking burden by assuming the exempt employee is working a full-time schedule of 40 hours per week and giving exempt employees the full amount of paid sick leave on that basis.

Trade-offs also apply to the contractor's choice for tracking the amount of paid sick leave employees earn. The regulations specify an accrual rate of one hour of paid sick leave for each 30 hours worked on or in connection with a covered contract. Instead of awarding paid sick leave on this accrual basis, however, contractors may elect to front-load the full amount of paid sick leave (*i.e.*, 56 hours) at the beginning of each year. Doing so, however, changes the rules with respect to the total amount of paid sick leave an employee may have available for use at a given time. Contractors that award paid sick leave using the accrual method may cap the amount of paid sick leave available for use at 56 hours. Contractors that use the front-loading method may not do so. In exchange for the convenience of front-loading, contractors must allow employees to accumulate a larger pool of available hours.

For example, an employer using the front-loading method may provide 56 hours of paid sick leave at the start of Year 1. The employer must then permit the employee to carry over into Year 2 any unused portion of that paid sick leave. If the employee uses no paid sick leave in Year 1, she would begin Year 2 with 112 hours of paid sick leave (56 hours for Year 2, plus the carry-over balance of 56 from Year 1), which is a larger pool of hours than she would accumulate under the accrual method.

The preamble explains that contractors using the front-loading method may cap the carry-over to 56 hours, thereby effectively limiting employees to 112 hours.[6] For contractors that already have paid sick leave policies offering more than 56 hours per year, however, that limitation stands in some tension with the regulatory text, which prohibits usage caps. The preamble appears to contemplate a maximum of 112 hours that are subject to the new requirements, but the regulatory text still has clear language prohibiting a usage cap by contractors using the front-loading method. In other words, contractors that have been generous with their policies could find themselves constrained by carrying over 56 hours while also offering their existing (voluntary) allotment of more than 56 hours, leading to a leave balance in excess of the 112-hour maximum suggested in the preamble. As a result, contractors that currently front-load employees with more than 56 hours should carefully examine their existing policies to ensure that revisions comply with the new regulations, without inadvertently committing themselves to a more expansive benefit scheme not required by the new regulations.

[3] 81 Fed. Reg. at 67,631.
[4] *Id.*
[5] 29 C.F.R. § 13.5(a)(1)(iii) (2016).
[6] *See* 81 Fed. Reg. at 67,647.

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Compliance Obligations (The Bad News)

Even with the narrowing of the compliance obligations and options for trade-off mechanisms, there is no question that significant new compliance obligations remain, in terms of both costs and recordkeeping. Contractors must update their recordkeeping systems to track (among other items) paid sick leave balances, employees' requests, and documentation of ''certifications,'' which employers may require if an employee uses three or more consecutive full workdays of paid sick leave. Contractors must also provide written notices of paid sick leave balances at the end of each pay period or each month, whichever interval is more frequent.

The regulations also present challenges for contractors that include paid sick leave as part of a fringe benefit package for SCA-covered employees. The final rule reiterates the principle that paid sick leave benefits cannot be used to meet SCA fringe benefit obligations. The SCA prohibits contractors from claiming credit for benefits that are required by law, as these paid sick leave hours are.[7] As a result, contractors that currently offer similar benefits must back them out of their SCA fringe benefit calculations. For instance, if a contractor currently includes paid sick leave as one of the benefits in a health and welfare fringe benefit package, that contractor must subtract the value of those benefits from the health and welfare package, at least to the extent that the benefits are coterminous with the 56 hours required by the executive order and the new rule. After doing so, the contractor will have to replenish the health and welfare fringe benefits package with other equally valuable benefits, or offer an equivalent cash payment in lieu of those benefits.

Recognizing the complexity of that process, and the fact that the new benefits have substantial value, the Labor Department published a series of frequently asked questions in which it announced a plan to publish new health and welfare benefit rates for SCA contractors who receive paid sick leave under this new rule. That rate is expected to be lower than the current rate, but it has not yet been published. It is not clear how extensive these rate changes will be, and they may not change enough to offset the new costs associated with the final regulations.

Other challenges remain. Contractors have the option of keeping existing paid sick leave benefits, but they must ensure that the benefits are at least as generous as those required by the regulations, and they must comply with the regulations' provisions on allowable use and recordkeeping. Calculating the carry-over of paid sick leave from year to year is also a complex process, even with the front-loading option. Contractors have exposure to risk through the rule's sanctions regime for noncompliance, which states that ''miscalculating'' an employee's leave balance can constitute prohibited interference with the employee's right to paid sick leave. Contractors should take advantage of the short window before implementation begins to analyze the costs and benefits of each option, and to determine which method makes the most sense for their business.

Conclusion

In the final analysis, these regulations present new and, in some cases, non-obvious burdens for federal contractors. Thoughtful analysis now can help business leaders organize efforts to minimize the cost of compliance and reduce the risk of potentially painful sanctions for noncompliance.

[7] 29 C.F.R. § 4.171(c) (''No benefit required by any other Federal law or by any State or local law . . . is a fringe benefit for purposes of the Act.'').