The Changing Compensation Landscape for Government Contractors

New Executive Order Mandates Paid Sick Leave for Employees of Government Contractors, and Department of Labor Issues Final Rule on Contractor Pay Transparency.

By Julia E. Judish and Rebecca C. Rizzo

Two recent developments have added to the list of the Obama Administration's compensation-related initiatives. On Labor Day, September 7, 2015, President Obama issued an Executive Order that will require federal contractors and subcontractors to provide their employees working on covered government contracts with up to seven days of paid sick leave per year, effective for federal contracts entered into on or after January 1, 2017. On September 11, 2015, the Department of Labor (DOL) issued its Final Rule on Executive Order 13665, which amended Executive Order 11246 to prohibit "pay secrecy policies and actions" for government contractors and subcontractors. The Final Rule prohibits federal contractors and subcontractors from discriminating against their employees or applicants for inquiring about, discussing, or disclosing compensation information, carves out an affirmative defense to alleged violations with regard to certain categories of employees, and requires covered contractors to include a mandatory notice in their existing employee handbooks and to inform employees and applicants of the nondiscrimination prohibition. The Final Rule becomes effective January 11, 2016.

The Obama Administration's agenda to increase the economic stability of the middle class and to prevent compensation discrimination has taken many forms, beginning with President Obama's signing the 2009 Lily Ledbetter Fair Pay Act shortly after taking office. Many of the Administration's compensation-related

initiatives affect almost all U.S. employers, such as the recent Notice of Proposed Rulemaking to raise the minimum salary level for white-collar exemptions under the Fair Labor Standards Act (FLSA) (described in our Client Alert of July 7, 2015). Others have been limited to the government contractor community, as the President's executive authority enables him to mandate changes there without recourse to Congress. Pillsbury has described many of these government contractor-focused initiatives in prior client alerts and external publications on June 23, 2015, May 2015, April 2015, April 15, 2014 and March 20, 2014.

Paid Sick Leave for Employees of Federal Contractors and Subcontractors

President Obama's paid sick leave Executive Order will require federal contractors and subcontractors to provide all employees working on covered contracts with one hour of paid sick leave for every 30 hours worked. Both exempt and non-exempt employees are entitled to accrue paid sick leave. Contractors may cap the annual accrual of paid sick leave at a minimum of 56 hours. Employees must be permitted to carry over their accrued paid sick leave from one year to the next and, if an employee is rehired by a covered contractor within 12 months after a job separation, the contractor must reinstate the employee's accrued paid sick leave. Contractors, however, are not required to pay out any accrued but unused paid sick leave upon termination of employment. These requirements will apply to government contractors and subcontractors working on covered federal contracts entered into on or after January 1, 2017. According to a White House Fact Sheet, this Executive Order will give approximately 300,000 people working on federal contracts the ability to earn paid sick leave.

Covered contracts will include:

- a procurement contract for services or construction;
- a contract or contract-like instrument for services covered by the Service Contract Act (SCA);
- a contract or contract-like instrument for concessions, including any concessions contract excluded by DOL regulations at 29 CFR 4.133(b); and
- a contract or contract-like instrument entered into with the Federal Government in connection with Federal property or lands and related to offering services for Federal employees, their dependents, or the general public.

In addition, for a contract to be subject to the Executive Order, the wages of employees under such contract or contract-like instrument must be governed by the Davis-Bacon Act, the SCA, or the FLSA (with respect to either exempt or nonexempt employees). The paid leave requirement applies to all employees performing services in support of the covered contract or of any lower-tier subcontract that supports the covered prime contract.

Contractors must allow eligible employees to use the paid sick leave for an absence resulting from: (1) their own physical or mental illness, injury, or medical condition; (2) obtaining diagnosis, care, or preventative care from a health care provider for themselves; (3) caring for a child, a parent, a spouse, a domestic partner, or any other individual related by blood or affinity whose close association with the employee is the equivalent of a family relationship who has a physical or mental illness, injury, or medical condition or who has a need for diagnosis, care, or preventative care; or (4) domestic violence, sexual assault, or stalking of the employee, a member of the employee's family, or a person with whom the employee has a familial relationship.

To use the paid sick leave, employees must request the leave, orally or in writing, and provide the expected duration of the leave. When the need for leave is foreseeable, such requests must be made at least seven calendar days in advance. When the need for leave is not foreseeable, employees must request leave as soon as practicable. Contractors cannot condition the use of paid leave on the requesting employee finding a replacement to cover any work time he or she will miss.

Contractors may require a certification issued by a health care provider for paid sick leave used for the purposes set forth in (1) – (3) above only for absences of three or more consecutive workdays. If requested, employees must provide such certification within 30 days from the first day of the leave. For leave for three or more consecutive work days that is related to domestic violence, sexual assault, or stalking, contractors may require employees to provide documentation from an appropriate individual or organization with the minimum necessary information establishing a need for the employee to be absent from work.

President Obama unveiled this Executive Order at a speech in Boston, Massachusetts, as part of a renewed call for legislation expanding paid sick and family leave for all employees. Massachusetts voters had previously approved a new paid sick leave law that went into effect statewide on July 1, 2015.

Mandatory paid sick leave is on the rise, with at least four states and at least 20 cities[1] across the United States requiring paid sick leave, as of the date of this Alert. In addition, the Montgomery County, Maryland Council recently passed an amendment to the County Code requiring employers in the County to provide up to 56 hours of paid sick and safe leave to covered employees, beginning October 16, 2015.

Final Rule on Non-Retaliation for Disclosure of Compensation Information

The Final Rule implementing Executive Order 13665 applies to all federal contractors and subcontractors with contracts entered into or modified on or after January 11, 2016, that exceed $10,000 in value. It includes four main components:

- It amends the Equal Opportunity Clause in 41 C.F.R. § 60-1.4(a) by adding a new subsection prohibiting pay secrecy policies and actions. The new nondiscrimination provision states:

  The contractor will not discharge or in any other manner discriminate against any employee or applicant for employment because such employee or applicant has inquired about, discussed, or disclosed the compensation of the employee or applicant or another employee or applicant. This provision shall not apply to instances in which an employee who has access to the compensation information of other employees or applicants as a part of such employee's essential job functions discloses the compensation of such other employees or applicants to individuals who do not otherwise have access to such information, unless such disclosure is in response to a formal complaint or charge, in furtherance of an investigation, proceeding, hearing, or action, including an investigation conducted by the employer, or is consistent with the contractor's legal duty to furnish information.

  As with the rest of the Equal Opportunity Clause, contractors must include this nondiscrimination provision in every covered subcontract or purchase order, although 41 C.F.R. § 60-1.4(e) permits the Equal Opportunity Clause to be "included by reference," rather than written in full.

[1] Connecticut, California, Massachusetts, Oregon, Washington, DC, San Francisco, CA, Emeryville, CA, Oakland, CA, Jersey City, NJ, Newark, NJ, Passaic, NJ, East Orange, NJ, Paterson, NJ, Irvington, NJ, Trenton, NJ, Montclair, NJ, Bloomfield, NJ, New York City, NY, Eugene, OR, Portland, OR, Philadelphia, PA, Pittsburgh, PA, Seattle, WA, and Tacoma, WA.

- It establishes an affirmative defense to violations of the nondiscrimination requirement with respect to employees who improperly disclose compensation information to which the employee has access as part of the employee's essential job functions.

- It mandates incorporation of the full nondiscrimination provision into existing employee handbooks and manuals and dissemination of the nondiscrimination provision to both employees and applicants by electronic means or by posting in a conspicuous location. Contactors must use the precise language prescribed in the Final Rule. In the preamble to the Final Rule, the DOL explained that it rejected suggestions that contractors be allowed to develop the language with which they describe the nondiscrimination provisions because "uniformity of such language is necessary to ensure consistency and clarity in the information provided to applicants and employees."

- It defines the terms "Compensation," "Compensation information," and "Essential job functions."

Pay Secrecy Defined

The Final Rule is entitled "Prohibitions Against Pay Secrecy Policies and Actions." The meaning of those terms is clarified by the addition of new definitions in 41 C.F.R. § 60-1.3 and the explication of general defenses available to employers.

Under the Final Rule, "*Compensation*" means "any payments made to, or on behalf of, an employee or offered to an applicant as remuneration for employment." This includes salary, wages, overtime pay, shift differentials, bonuses, commissions, vacation and holiday pay, allowances, insurance and other benefits, stock options and awards, profit sharing and retirement, but it can also include other forms of compensation.

"*Compensation information*" is defined very broadly. That term means:

The amount and type of compensation provided to employees or offered to applicants, including, but not limited to, the desire of the contractor to attract and retain a particular employee for the value the employee is perceived to add to the contractor's profit or productivity; the availability of employees with like skills in the marketplace; market research about the worth of similar jobs in the relevant marketplace; job analysis, descriptions, and evaluations; salary and pay structures; salary surveys; labor union agreements; and contractor decisions, statements and policies related to setting or altering employee compensation.

In combination with the nondiscrimination provision, therefore, the new definitions section makes clear that a contractor cannot take adverse action against or prohibit employees or applicants from discussing their own compensation or a wide range of compensation-related matters. There is considerable overlap between the Final Rule and the protections in the National Labor Relations Act (NLRA) for covered employees to engage in concerted activity relating to the terms and conditions of their employment, including compensation terms. The Preamble to the Final Rule explains that "there is a close relationship in the type of activity each law protects," because the NLRA has been interpreted as bestowing the right of employees "to ascertain what wages are paid by their employer, as wages are . . . probably the most critical element in employment." Nonetheless, "one specific purpose of the Order is to expand protections against pay secrecy policies to individuals and types of activities beyond that protected by the NLRA," such as by protecting supervisory employees who discuss compensation matters and by protecting inquiries made on an individual basis, rather than, as protected by Section 7 of the NLRA, for the purpose of "mutual aid or protection."

A new provision added by the Final Rule, at 41 C.F.R. § 60–1.35(a), explains that employers do not violate the nondiscrimination provision if they discipline an employee "for violation of a consistently and uniformly applied company policy, *[provided] that this policy does not prohibit, or tend to prohibit, employees or applicants from discussing or disclosing their compensation or the compensation of other employees or applicants.*" Thus, just as under the NLRA, contractors cannot adopt confidentiality policies that prohibit disclosure of salary or compensation information, unless those policies provide a specific safe haven for employees to discuss compensation information with each other, with management, or with job applicants. A contractor must also show that it did not discipline an employee more severely for a rule violation because the employee discussed or disclosed compensation. This analysis, in which an affected employee could claim that discipline for a rule violation was pretext for prohibited pay secrecy discrimination, is similar to the familiar analysis in Title VII discrimination cases. The Preamble to the Final Rule makes clear that the DOL will use Title VII's "motivating factor framework for analyzing causation" in pay secrecy discrimination claims, rather than the "but for" causation standard applicable to Title VII retaliation claims.

Affirmative Defense for Violations by Certain Employees

The Final Rule also establishes an "essential job functions" affirmative defense to an alleged violation. As stated in the new nondiscrimination provision of the Equal Opportunity Clause, adverse actions taken by a contractor against an employee for disclosure of compensation information will not be deemed discriminatory if the employee has access to the compensation information of other employees or applicants as part of the employee's essential job functions (defined as the employee's "fundamental job duties") and disclosed the compensation of such other employees or applicants to others who do not otherwise have access to such information.

A job function may be considered essential if: (1) the access to compensation information is necessary in order to perform that function or another routinely assigned business task; or (2) the function or duties of the position include protecting and maintaining the privacy of employee personnel records, including compensation information.

The source of the information gained by an employee with compensation-related essential job functions is critical to examining whether the disclosure of compensation information can warrant disciplinary action. In an agency-sponsored webinar, DOL officials explained that if, for example, a payroll administrator discloses to an employee that he or she is being paid less than another worker based on information the payroll administrator learned in performing the essential functions of her position, the contractor may take adverse action against the administrator. By contrast, if employees were to tell the administrator about their pay over lunch, and the administrator tells the employees that they are being paid more or less than other workers based on this information, the administrator would be protected, and the contractor would be prohibited from taking action against the administrator. Similarly, if a janitor empties a trash can and sees a document revealing that a female engineer is being paid less than her male counterpart, the janitor is protected from adverse action if he reveals this pay disparity to the female engineer. Although emptying the contents of the trash can was part of the janitor's fundamental job duties, the scope of those duties do not ordinarily involve access to compensation information, so the contractor would not be able to invoke the "essential job functions" affirmative defense to discipline the janitor.

The essential job functions defense is a complete defense, meaning that the protections of the Executive Order shall not apply and a contractor is allowed to take adverse action on those grounds. However, this defense does not apply to covered employees who disclose compensation information in response to a formal complaint or charge in furtherance of an investigation, proceeding, hearing or action.

Next Steps for Federal Contractors and Subcontractors

Federal contractors and subcontractors should take steps now to ensure that they are prepared to comply with these new laws and regulations once they become effective.

As a first step, contractors should review their paid leave policies to determine whether or not they need to revise those policies to come into compliance with the new Executive Order requiring the provision of paid sick leave. If the contractor's existing policies are sufficiently flexible to cover all purposes covered by the Executive Order and provide for accrual and carryover of paid leave in amounts sufficient to meet the Executive Order's requirements, no additional changes may be needed. On the other hand, contractors will need to expand their paid sick leave policies if they limit paid leave benefits to full-time employees, require a waiting period before paid leave is accrued, exclude temporary employees from paid leave benefits, or do not extend paid sick leave to absences related to domestic violence or sexual assault. In addition, government contractors must update their employee handbooks to add the required pay secrecy nondiscrimination provision and should update their employee intranet and "careers" webpages to post the nondiscrimination provision there, as well as displaying it in conspicuous locations—including interview waiting areas—if electronic dissemination to employees and/or applicants is not feasible., Employee confidentiality agreements and other personnel policies should be reviewed and revised as necessary to ensure that they do not prohibit employees and applicants from disclosing their compensation to other employees and applicants.

Lessons for All Employers

Employers should monitor the paid leave requirements in the jurisdictions in which they have employees. Further, employment practices that are mandatory only in the government contract sector frequently become viewed as the new normal by employees, who come to expect all employers to have policies that match the standards of government contractor employers. On the state level, legislatures frequently model employment legislation applicable to all employers after federal standards for government contractors. The Executive Order's pay secrecy protections, to the extent they do not already overlap with NLRA protections, can be viewed as a potential harbinger of requirements that may become applicable to all employers in the future.

If you have any questions about the content of this alert please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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