Dear Acting Director DeBisschop:

Introduction

I write on behalf of the International Municipal Lawyers Association; the California Special Districts Association; the California State Association of Counties; the League of California Cities; the International Public Management Association for Human Resources; and the Rural County Representatives of California. These organizations advocate on behalf of cities, counties, special districts, and other municipalities in the state of California and nationally.

Our constituent agencies serve the public and are ultimately funded by the taxpayers. We have strong interest in the Department of Labor’s (“DOL”) proposed regulations regarding the Fair Labor Standards Act (“FLSA”) “regular rate of pay” – and specifically, the regulations implementing 29 U.S.C. section 207(e)(2). We wish to ensure that the DOL understands the various vexing problems and ambiguities facing public agencies under the current state of the law. The DOL’s proposed rulemaking acknowledges several of these ambiguities and problems and we appreciate the DOL’s attention to these matters. We write to offer suggestions on how to ensure that the FLSA is not used to improperly subject government agencies to unexpected and unfair expenses.

In its notice of proposed rulemaking, the Department aptly notes that, “[t]he Department promulgated the majority of part 778 more than 60 years ago” and that, “[s]ince that time, the workplace and the law have changed.” This is particularly true in the public sector. The FLSA did not apply to public agencies 60 years ago. See National League of Cities v. Usery, 426 U.S. 833 (1976) (holding that the Tenth Amendment precluded the FLSA from applying to public agencies). It was not until after Usery was overturned by Garcia v. San Antonio Metropolitan Transit Authority, 469 U.S. 528 (1985) when the FLSA became applicable to public agencies.

The outdated regulations at issue in this rulemaking have posed numerous challenges to public employers, who often provide their employees unique and complex compensation programs, often with multiple types of specialty and incentive pay. These compensation programs are typically a product of collective bargaining between municipalities and the unions representing their employees and the compensation is a matter of public record.

1 These organizations are described more fully in Attachment A.
Despite these cooperative and transparent approaches to setting compensation, public employers can still face considerable liability for inadvertently excluding an item of compensation from the regular rate which is later determined to be includable, even in situations where the regulation is ambiguous when applied to public sector compensation programs. Such expenses can be particularly costly for public employers, particularly in the areas of public safety and other 24-hour operations such as water treatment plants, jails and detention facilities, and hospitals. For example, firefighters work 24-hour shifts and typically have over 100 hours per year of overtime built into their regular work schedules. And it is common for firefighters to work 500 or more overtime hours in a year. Consequently, inadvertent regular rate violations can create enormous unanticipated expenses for public agencies, which are ultimately borne by the taxpayer.

Issues to Consider

The signatories hope the DOL will address the following points and issues in connection with its new proposed regulations.

1. *Flores v. City of San Gabriel*, 824 F.3d 890 (9th Cir. 2016).

In *Flores*, the Ninth Circuit held that cash payments made “in lieu” of receiving health insurance must be included in the regular rate. Medical cash in-lieu benefits are common among California public agencies. Typically, they are provided through a medical Cafeteria plan and are provided to employees when they select a medical plan that costs less than the plan maximum or when an employee can show proof of alternative health insurance coverage through another family member, such as a partner or spouse. As a measure of fairness, rather than effectively paying more to an employee simply because the employee is single and does not have alternative health insurance, this program ensures that employees are able to receive a benefit of an equivalent value.

For years, public employers believed that medical cash-in-lieu benefits were properly excluded from the regular rate of pay. Under the FLSA, all remuneration counts toward the regular rate, *except* for certain pay categories that “shall not be deemed” to be included in the regular rate. 29 U.S.C. § 207(e) (emphasis added). Section 207(e)(2) excludes “payments made for occasional periods when no work is performed due to vacation, holiday, illness...and other similar payments to an employee which are not made as compensation for his hours of employment.” Additionally, 29 U.S.C. § 207(e)(4) permits exclusion of contributions irrevocably made by an employer to a third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits to employees.” Id. § 207(e)(4) (emphasis added).

The Ninth Circuit examined whether medical cash-in-lieu payments were properly excluded from the regular rate under sections 207(e)(2) or 207(e)(4). The Court opined that it was a “close question,” but held that these payments must be included in the regular rate, noting that it was bound by the Supreme Court’s narrow construction doctrine. Since *Flores*, the United States Supreme Court reversed the narrow construction doctrine in favor of a “fair” interpretation. *See Encino Motorcars v. Navarro*, 138 S. Ct. 1134, 1142 (2018). *Navarro* thus calls into question the continuing validity of *Flores*. 
The Department's proposed rulemaking also calls into question the reasoning of *Flores*, noting that it incorrectly equates "compensation for work" with "remuneration for employment." *See* XX Fed Reg XX n. 91. We agree with the DOL's skepticism of the Ninth Circuit's reading and encourage the DOL to include specific language in the regulations clarifying that medical cash-in-lieu payments may properly be excluded from the regular rate under 29 U.S.C. § 207(e)(2) or 29 U.S.C. § 207(e)(4).

The Department's proposed amendments to 29 C.F.R. section 778.224 include additional examples of types of compensation that constitute "other similar payments" properly excluded from the regular rate under 29 U.S.C. § 207(e)(2). The Department could add to this list:

- Cash payments made to employees pursuant to a bona fide medical cafeteria plan.

Alternatively, the Department could amend 29 C.F.R. section 778.215 to clarify that medical cash-in-lieu payments constitute "other similar payments" under 207(e)(4).

Since *Flores*, we understand that many agencies have simply eliminated or greatly reduced the benefit of providing cash in lieu of medical coverage. Nobody wins under this scenario and surely the FLSA did not intend this negative outcome. We encourage the DOL to adopt clarifying language to permit agencies to provide these benefits without the additional overtime liability.

2. **Holiday-In-Lieu Pay**

Many public agencies provide pay "in lieu" of having the fringe benefit of a paid holiday schedule. This "HIL" Pay is often calculated to match the value of a given paid holiday. In the fire service, for example, for any given year a firefighter will be assigned a schedule, where they are scheduled to work some days designated as holidays by their employer but will have other days off, depending on their particular shift schedule. When the firefighter works the holiday, she will receive regular pay, plus the HIL Pay. When the firefighter does not work the holiday, she will receive HIL Pay. The pay is sometimes made at the time the holiday occurs, sometimes paid in a lump sum annually, and sometimes paid pro-rata with each paycheck.

We believe the current regulations permit HIL Pay to be excluded from the regular rate. *See* 29 C.F.R. § 778.219 (providing that if an employee who is entitled to "a certain sum as holiday or vacation pay, whether he works or not," receives additional pay for each hour worked on a holiday or vacation day, the sum allocable as the holiday or vacation pay is excluded from the regular rate). In fact, the DOL has itself opined that such pay may be excluded. *See* July 24, 2006 Opinion Letter, attached as Exhibit A. The Field Operations Handbook also supports the conclusion that HIL Pay may be excluded. *See* Section 32d03, attached as Exhibit B. The Department's commentary in its proposed rules also support this reading and state, "when an employee works instead of taking a holiday or using vacation leave, and receives pay for the holiday or vacation leave that he or she did not take in addition to receiving pay for the hours of work performed, the amount paid for the forgone holiday or vacation leave may be excluded.
from the regular rate.” The Department states that it intends to “clarify that payments for forgoing the use of leave are excludable from the regular rate regardless of whether they are paid during the same pay period in which the previously scheduled leave is forgone or during a subsequent pay period as a lump sum.”

Clarification of these regulations is essential. Despite the language in the regulation and prior DOL guidance, many courts have opined that the regulations are unclear and “muddled,” and have ruled against public agencies. See, e.g., Hart v. City of Alameda, 2009 WL 1705612 (N.D. Cal. June 17, 2009) (citing to a 1999 Letter Opinion (attached as Exhibit C) and apparently not considering the more recent 2006 opinion); see also Lewis v. County of Colusa, No. 2:16-cv-01745-VC, 2018 WL 1605754 (E.D. Cal. Apr. 3, 2018); McKinnon v. City of Merced, No. 118CV01124LJOSAB, 2018 WL 6601900 (E.D. Cal. Dec. 17, 2018).

These adverse opinions appear to stem from courts’ confusion regarding what it means for a payment to be “due to” a holiday under 29 U.S.C. section 207(e)(2). E.g., Hart, 2009 WL 1705612 at *2-3; Lewis, 2018 WL 1605754 (E.D. Cal. Apr. 3, 2018). Hart determined—contrary to the DOL’s position—that a payment cannot be due to a holiday unless it is made in the same period in which the holiday falls. Courts also struggle with what it means to “forego” a holiday under 207(e)(2). E.g., McKinnon v. City of Merced, 2018 WL 6601900, at *6 (E.D. Cal. Dec. 17, 2018); Lewis 2018 WL 1605754, at *3 (E.D. Cal. Apr. 3, 2018).

29 C.F.R. section 7789.219(a) provides examples of HIL pay properly excluded from the regular rate. However, the examples still leave ambiguity in situations such as those at issue in Hart and its progeny. We request that the DOL provide an additional example involving set schedules of firefighters and other public employees who, due to the nature of their work, work a set schedule without regard to holidays. For example, the DOL could include the following at 29 C.F.R. § 778.219(a)(4):

A firefighter is scheduled to work a set schedule of two 24-hour shifts on duty, followed by four 24-hours shifts off duty. This cycle repeats every six days. The firefighters’ employer recognizes ten holidays per year and provides firefighters with holiday pay for these holidays, similar to the holiday pay provided to other employees. Due to the cycle of the schedule, the firefighters may be entitled to holidays off, but may be required to forego the holiday if their schedule requires them to work that day or if an emergency arises. In recognition of this fact, the firefighters’ employer provides the employees holiday pay regardless of whether the firefighter takes the holiday off or foregoes the holiday and works it. If the firefighter works on the holiday, she will receive her regular salary plus the holiday pay. If the firefighter does not work on the holiday, she will receive her holiday pay. In such instances, the employer’s holiday pay may be excluded from the regular rate of pay. This is so regardless of whether the holiday pay is paid in the pay period in which the holiday falls, as a lump sum, or on a pro rata basis throughout the year.
We appreciate the DOL including this or similar language in its final rules.

3. Sick Leave Incentive Pay

Public agencies often agree to contractual provisions that incentivize employees not to abuse accrued sick leave. These incentive programs are formulated in varying ways. For example, some agencies provide for the annual “buyback” of accumulated paid leave assuming certain criteria are met—such as maintaining a minimum amount of paid leave in the employee’s account. This sort of “buyback” pay has been held to be excludable from the regular rate. See Balestrieri v. Menlo Park Fire Prot. Dist., 800 F.3d 1094 (9th Cir. 2015). Another example is when an employee pays a cash incentive for conserving sick leave. Under this form of sick leave incentive program, employees receive a cash payment if a minimum amount of sick leave is maintained in the sick leave account. This program incentivizes employees not to abuse their sick leave because they will be motivated not to allow their leave balance to drop below a targeted threshold. There appears to be no meaningful distinction between these programs, as they both provide for cash payments based on minimum leave balances. Yet, the latter program has been argued by employees to constitute an “attendance bonus” and therefore includable in the regular rate. The decisions in this area are all over the map because the regulations do not provide precise guidance as to what qualifies as excludable. See, e.g., Featsent v. City of Youngstown, 70 F.3d 900, 905 (6th Cir. 1995) (awards for nonuse of sick leave are similar to payments made when no work is performed due to illness, and are thus excludable); Chavez v. City of Albuquerque, 630 F.3d 1300, 1310 (10th Cir. 2011) (sick leave buy backs are compensation for additional service and should be included in the regular rate).

Our constituent public agencies would welcome regulations that clarify and confirm the criteria for excluding leave related cash-outs from the regular rate.

4. Negotiability of Rates

The DOL has a longstanding rule that the regular rate is a product of arithmetic and cannot be negotiated. See 29 C.F.R. § 778.108. We understand the basis for this rule— to prevent employers from manipulating the overtime rate. In the context of highly compensated employees in a unionized environment, however, this rule should be relaxed. For example, when employees are earning in excess of $100,000 total compensation annually, with numerous perks and premiums—all in excess of FLSA minimums—there should be little federal interest in parsing the pay packages to ensure increased overtime pay.

We suggest that the DOL issue regulations permitting the negotiation of the actual overtime rate to be paid. This could occur in instances of highly compensated employees, and in instances when FLSA minimums are clearly exceeded.

Conclusion
We look forward to DOL’s rulemaking, and hope that our concerns can be meaningfully addressed.

Very truly yours,

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Executive Director and General Counsel
International Municipal Lawyers Association