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Management Alert

Paid Sick Leave for Federal Contractors Final Rule—Prognosis and Practical Challenges

By Joshua D. Seidman, Tracy M. Billows, Alexander J. Passantino, Ann Marie Zaletel, and Dana Howells

Seyfarth Synopsis: *The United States Department of Labor's Final Rule on paid sick leave requirements for many federal contractors, which was published on September 30, 2016, will apply to covered contracts beginning on January 1, 2017. The obligations facing employers, which range from multiple accrual thresholds and unlimited usage of earned sick leave to broad recordkeeping obligations and protected family members, are complex and require careful planning to avoid potential pitfalls.*

As we previously reported, on September 30, 2016 the United States Department of Labor ("DOL") published its Final Rule on federal contractor paid sick leave. The Final Rule, which implements Executive Order 13706 (the "Order"), will provide paid sick leave benefits to many employees of certain federal contractors beginning in less than three months.[1]

Satisfying the Final Rule and Order will be no easy feat for covered employers. This is particularly true for employers that are already subject to one or more of the existing state and local paid sick leave laws.[2] The Final Rule deviates from these laws in several significant ways and expressly requires such employers to "comply with the requirement that is more generous to employees." Given the intricacies of the Final Rule, below are summaries of many of its key provisions, as well compliance options for employers.

Which Employers Are Covered?

The Final Rule explains that both federal contractors and subcontractors are covered businesses if they have a covered contract, as defined below. The requirements specifically will apply to "new contracts," which the Final Rule defines as covering both new **and** replacement contracts entered into, whether or not through solicitations, **on or after January 1, 2017**. Importantly, a contract that is entered into before January 1, 2017 will be considered a "new contract," and thus subject to the Final Rule, if, on or after January 1, the contract is (a) renewed, (b) extended, or (c) amended due to a change that is outside the contract's scope. The obligation would not apply, however, to the unilateral exercise of a pre-negotiated option to renew an existing contract by the Federal Government.

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1 The DOL released a Proposed Rule for public review and comment prior to publishing the Final Rule. Seyfarth Shaw submitted comments on certain important aspects of the Proposed Rule. A number of the comments resulted in updates in the Final Rule that benefit covered employers.

2 The five states with paid sick leave laws are Connecticut, California, Massachusetts, Oregon, and Vermont. The Vermont law becomes effective on January 1, 2017 for most employers. The current municipal paid sick leave laws include: (1) San Francisco, CA; (2) Washington, D.C.; (3) Seattle, WA; (4) Long Beach, CA; (5) SeaTac, WA; (6) New York City, NY; (7) Jersey City, NJ; (8) Newark, NJ; (9) Passaic, NJ; (10) East Orange, NJ; (11) Paterson, NJ; (12) Irvington, NJ; (13) Los Angeles, CA; (14) Oakland, CA; (15) Montclair, NJ; (16) Trenton, NJ; (17) Bloomfield, NJ; (18) Philadelphia, PA; (19) Tacoma, WA; (20) Emeryville, CA; (21) Montgomery County, MD; (22) Pittsburgh, PA; (23) Elizabeth, NJ; (24) New Brunswick, NJ; (25) Spokane, WA; (26) Santa Monica, CA; (27) Plainfield, NJ; (28) Minneapolis, MN; (29) San Diego, CA; (30) Chicago, IL; (31) Berkeley, CA; (32) Saint Paul, MN; (33) Morristown, NJ, and (34) Cook County, IL. A number of these laws, including Santa Monica, Spokane, Minneapolis, Chicago, Saint Paul, Berkeley, Cook County, and Pittsburgh, are not yet in effect. The Los Angeles law for private employers became effective on July 1, 2016. There is also a separate Los Angeles paid sick leave law that has been in effect since late-2014 and applies to certain hotel employers. Similarly, the Long Beach and SeaTac ordinances only apply to hospitality or transportation employers.

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To those contractors familiar with DOL's rules implementing Executive Order 13658, Establishing a Minimum Wage for Contractors (the "Minimum Wage EO"), the definitions will be quite familiar. The Final Rule contains a lengthy definition of "contracts or contract-like instruments" and notably states that "[t]he term contract shall be interpreted broadly."

To be covered, the contract must be one of the following:[3]

- A procurement contract for construction covered by the DBA;
- A contract for services covered by the SCA;[4]
- A contract for concessions, including any concessions contract excluded from coverage under the SCA by DOL regulations at 29 CFR 4.133(b),[5] or
- A contract in connection with Federal property or lands and related to offering services for Federal employees, their dependents, or the general public.[6]

With respect to subcontracts, the Final Rule explains that only covered subcontracts (i.e., those that meet the above standards) of covered prime contracts are subject to the Order's and Final Rule's sick leave requirements. As with prime contracts, the sick leave requirements do not apply to subcontracts for the manufacturing or furnishing of materials, supplies, articles, or equipment between a manufacturer or other supplier and a contractor for use on a covered contract. Here is a helpful example to illustrate this point—A subcontract to supply napkins and utensils to a covered prime contractor operating a fast food restaurant on a military base is **not** a covered subcontract.

The Final Rule also contains certain exclusions from coverage, which include (a) grants, (b) contracts and agreements with and grants to Indian Tribes, (c) procurement contracts for construction that are not covered by the DBA, and (d) contracts for services that are not covered by the SCA. Also, and as discussed below, the Final Rule does not apply to certain groups of employees. Despite these exclusions, in the preamble to the Final Rule (the "Preamble") the DOL advises contracting agencies to be aggressive in their application of coverage and try to extend coverage to contracts even where the Final Rule may not strictly apply. Thus, employers should be vigilant during the contracting process to ensure that the Order and Final Rule will not apply to their contracts.

Which Employees Are Covered?

The Final Rule potentially covers a wide range of employees. To determine employee eligibility,[7] covered employers must assess whether the individual performs "work on or in connection with" a covered contract. It does not matter if the employee is full-time, part-time, etc. The Final Rule explains that performing work "on" a covered contract means that the employee is directly performing the specific services called for by the contract. By comparison, an employee performs work "in connection with" a covered contract if his or her work is necessary to the performance of the contract but is not the specific services set forth in the contract.

As is the case with the Minimum Wage EO regulations, the Final Rule contains a narrow exemption for employees who perform work "in connection with" a covered contract (as set forth above) and who spend less than 20 percent of their hours worked in a particular workweek performing work in connection with covered contracts. The exemption does **not** apply to work "on" a covered contract.

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3 An **additional coverage requirement** is that the wages of employees under such agreements must be governed by the Davis-Bacon Act ("DBA"), Service Contract Act ("SCA"), or Fair Labor Standards Act ("FLSA").
4 The SCA does not define or limit the type of services which may be contracted for and subject to the law's requirements. Among the examples cited by the SCA are contracts for (a) laundry and dry cleaning, (b) transportation of the mail, (c) custodial, janitorial, or guard service, (d) packing and crating, (e) food service, and (f) miscellaneous housekeeping services. The SCA, specifically 29 C.F.R. § 4.130, provides a long, illustrative list of covered service contracts that can be used by companies seeking to determine if they are covered by the Final Rule.
5 The Final Rule defines a "concessions contract" to mean "a contract under which the Federal Government grants a right to use Federal property, including land or facilities, for furnishing services." Importantly, such contracts include, but are not limited to, "a contract the principal purpose of which is to furnish food, lodging, automobile fuel, souvenirs, newspaper stands, and/or recreational equipment, regardless of whether the services are of direct benefit to the Government, its personnel, or the general public."
6 For SCA- and DBA-covered contracts, coverage applies to prime contracts at the thresholds specified under those Acts (currently, $2,500 and $2,000, respectively). For other procurement contracts, coverage applies when the prime contract exceeds the micro-purchase threshold (currently $3,500). For all other contracts, coverage applies regardless of contract value.
7 In addition, to be eligible for sick leave benefits, employees' wages must be governed by the SCA, DBA, or FLSA.

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Importantly, the Final Rule extends its paid sick leave benefits to employees who are exempt from the FLSA's overtime and minimum wage provisions. This obligation may be foreign to certain covered federal contractors as it does not independently exist under the SCA and DBA.

The Final Rule also adds an exclusion for certain employees covered by collective bargaining agreements ("CBA"). More specifically, if a CBA ratified before September 30, 2016 applies to an employee's work performed on or in connection with a covered contract, and the CBA provides the employee with **at least** 56 hours (or 7 days, if the CBA refers to days rather than hours) of paid sick time (or paid time off that may be used for reasons related to sickness or health care) each year, the Final Rule does not apply to the employee until the date the agreement terminates or January 1, 2020, whichever is first.

If such a CBA provides the employee with paid sick time (or paid time off that may be used for reasons related to sickness or health care) each year, but the amount provided under the CBA is **less than** 56 hours (or 7 days), the contractor must provide covered employees with the difference between 56 hours (or 7 days) and the amount provided under the existing CBA in a manner consistent with either the Order and Final Rule or the terms and conditions of the CBA. In practice, and to avoid a potential unfair labor practice charge under the National Labor Relations Act, employers seeking to rely on this aspect of the CBA exemption would need to negotiate with the union over providing the additional paid sick leave **before** making any changes to union employees' sick leave allotment.

How Much Paid Sick Leave Can Employees Accrue, Use, and Carryover?

Accrual Rate and Annual Accrual Cap

Under the Final Rule, employers must allow employees to accrue paid sick leave at a rate of one hour of sick leave for every 30 hours of work on or in connection with a covered contract,[8] up to at least 56 hours per year.[9] Practically, to prevent an employee from accruing paid sick leave for hours worked "on" non-covered contracts, employers must maintain records that accurately reflect work on covered versus non-covered contracts. By the same token, to prevent an employee from accruing paid sick leave for hours worked "in connection with" non-covered contracts, employers can estimate the portion of an employee's hours worked on such contracts, as long as the estimate is reasonable and verifiable.

Employers can determine paid sick leave accrual for exempt employees by assuming they work 40 hours per week on or in connection with a covered contract. Alternatively, if exempt employees work fewer than 40 hours on or in connection with covered contracts during a given week, employers can base sick leave accrual on those hours as long as the employers have (a) probative evidence to support the hours worked "on" a covered contract, and (b) reasonable and verifiable information about the hours worked "in connection with" a covered contract.

The Final Rule allows employers to calculate employees' sick leave accrual each pay period or month (whichever is shorter). However, employers generally should not deny an employee's paid sick leave request mid-pay period or mid-month without first factoring in how much sick leave the employee has accrued since his or her balance was last updated.

Under an accrual system, unused paid sick leave must rollover from one year to the next. Any carried over paid sick leave will not count toward the employee's annual 56-hour accrual limit, meaning that even if the employee carries over 56 hours of paid sick leave from the prior year, the employee can still accrue up to 56 hours in the current year, subject to the below limitations.

Frontloading Option

The Final Rule does not limit employers to using an accrual system for providing sick leave benefits. Employers are expressly allowed to avoid the accrual rate requirement by frontloading employees at least 56 hours of paid sick leave at the start of each accrual year. In addition, for employees hired or assigned to work on or in connection with a covered contract mid-year,

8 Importantly, unlike the DOL's Proposed Rule, employees do **not** accrue paid sick leave when they are in paid time off status.
9 "An accrual year is a 12-month period beginning on the date an employee's work on or in connection with a covered contract began or any other fixed date chosen by the contractor, such as the date a covered contract began, the date the contractor's fiscal year begins, a date relevant under State law, or the date a contractor uses for determining employees' leave entitlements under the [Family and Medical Leave Act]" ("FMLA").

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employers are allowed to prorate the amount of frontloaded paid sick leave. The proration should be based on the amount of pay periods remaining in the benefit year.

While the frontloading option may seem attractive, it comes with a particularly burdensome component—the obligation to permit employees to carryover up to 56 hours of earned, unused paid sick leave at year end. First, this requirement veers far afield from most existing state and local paid sick leave laws, which for the most part do not require carryover where the employer frontloads employees' annual paid sick leave entitlement at the very beginning of the year.[10] Second, mandating carryover under a frontloading system likely will result in increased costs for covered employers due to (a) the added administrative burden of implementing year-end sick leave carryover, and (b) the substantial windfall likely garnered by eligible employees as a result of the combined new year lump grant and carried over unused time from the prior year. As discussed in greater detail below, employees who carryover unused paid sick leave at year end **and** receive a lump grant of additional sick leave at the start of the benefit year could wind up with a sick leave bank ranging from seven to 14 days. Because employees can use all of this paid sick leave in a single year (see below), the potential expense to employers that use the frontloading alternative is considerable.

This potential increased expense largely comes from guidance in the Preamble addressing frontloaded lump grants and carried over sick time. Interestingly, the Final Rule itself does not address exactly how much paid sick leave employers must grant to employees at the start of a new benefit year where the employees carry over to the new year some amount of unused sick leave from the prior year. However, the Preamble, specifically 81 FR 67598, 67628, resolves this ambiguity.

Consider the following example—an employee works for a contractor that uses a frontloading system for sick leave compliance. At the end of Year 1 the employee carries over 16 hours of unused paid sick leave into Year 2. According to the Preamble, the contractor must permit the employee to have 72 hours (16 hours plus 56 hours) of paid sick leave available for use as of the beginning of Year 2. An employee in the same situation (i.e., with 16 hours of unused sick leave at the end of Year 1), but covered by an accrual system, would only start Year 2 with 16 hours of sick time available for use. In addition, the employee would have to use the carried over 16 hours and work enough time in Year 2 to accrue 56 additional sick leave hours before he/she could potentially use 72 hours.

No Usage Cap and "Point in Time" Accrual

Significantly, and consistent with the Proposed Rule, the Final Rule expressly states than employers **cannot** set an annual or per event cap on paid sick leave **usage**. Depending on carryover, employees **could potentially use 112 hours of paid sick leave in a single year**.

With *accrual policies*, the compromise according to the DOL is to allow a "point in time" accrual cap, which means employers can cap accruals at 56 hours. As a result, an employer with an accrual policy can freeze employees' paid sick leave accrual if the combination of accrued and carried over sick leave in the employee's bank is 56 hours, even if the employee has accrued less than 56 hours of paid sick leave since the start of the accrual year. Accruals would stay frozen at 56 hours until the employee uses some sick leave and drops below the cap. Once below the cap, the employee would begin to accrue again until his/her bank reaches 56 hours (i.e., triggers the "point in time" accrual cap) or his/her accrual for that year reaches 56 hours (i.e., reaches the annual accrual cap).

Under What Circumstances May Employees Use Sick Leave?

Employees can use accrued paid sick leave for (a) the employee's or the employee's covered family member's mental or physical illness, injury or medical condition, or need to obtain diagnosis, care or preventive care from a health care provider, or (b) certain reasons relating to domestic violence, sexual assault, or stalking of the employee or the employee's covered family member. Covered family members include the employee's child, parent, spouse, domestic partner, or **any other individual related by blood or affinity** whose close association with the employee is the equivalent of a family relationship, the latter of which is broadly defined as "any person with whom the employee has a significant personal bond that is or is like a family relationship, regardless of biological or legal relationship."

10 Currently, only two existing paid sick leave laws -- Los Angeles, CA and Tacoma, WA -- require employers with a frontloading system to permit year-end carryover.

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Importantly, when an employee requests to use paid sick leave for the above close association by blood or affinity standard, employers cannot require that the employee provide "extensive or detailed information about" the "family-like relationship" between the employee and the individual. In fact, the Preamble explains that an employee "need only assert that a family or family-like relationship exists, such as by stating that the employee needs to care for her ill grandmother or needs to accompany a man who is like a brother to him to a doctor's appointment." As a result, employers have few, if any, options to regulate an employee seeking to use the close association by blood or affinity standard, and any effort to do so could result in unlawful interference or discrimination as described below.

Do Employers Need to Notify Employees of Their Available Sick Leave Balance?

The Final Rule requires that employers inform their employees, in writing, of the employee's available sick leave in three circumstances: (a) no less than each pay period or month (whichever is shorter); (b) upon separation of employment; and (c) when an employee is rehired by the employer within 12 months of separation of employment. Employers can satisfy some or all of this requirement by providing the notification on employee paychecks or through an online system.

What Notice Must Employees Provide When Using a Sick Day?

Employers must allow employees to use accrued paid sick leave upon the employee's oral or written request, assuming the request is sufficient to inform the employer (a) that the absence is for a permitted purpose, and (b) if possible, the expected length of the absence. If the need to use sick leave is foreseeable, the request must be made at least seven calendar days before the date the leave is to begin. If the employee cannot provide seven days' notice, the request must be made as soon as is practicable, which in most cases means the day the employee learns of the need for leave or the next business day.[11]

Employers must respond to requests to use paid sick leave as soon as is practicable, which the Final Rule states can usually be accomplished immediately or within a few hours of the request. Like the Proposed Rule, the Final Rule allows employers to deny an employee's paid sick leave request if the employer provides a written explanation for the denial to the employee. Denial is appropriate if, for example, (a) the employee did not provide sufficient information about the need for paid sick leave,[12] (b) the reason given is not consistent with the permitted uses of paid sick leave, (c) the employee did not indicate when the need would arise, (d) the employee has not accrued, and will not have accrued by the date of leave anticipated in the request, a sufficient amount of paid sick leave to cover the request, or (e) the request is to use paid sick leave during time the employee is scheduled to be performing non-covered work. Employers will want to develop appropriate communications to ensure this written explanation requirement is met.

Can Employers Require Certification or Documentation of Proper Use?

Employers generally can require an employee to provide documentation or certification of the need for sick leave only if the employee has been absent for three or more consecutively scheduled **full** workdays. Employers can only require such documentation if employees are informed about the requirement before the employee returns to work. In practice, this likely only requires employers to provide notice of the documentation requirement in a written policy that is distributed to employees because doing so is a "reasonably calculated" way "to provide actual notice of the requirement."

Employers can require that the documentation be provided within 30 days of the first day of the employee's absence. The Final Rule lists many examples of what is considered appropriate documentation or certification. In addition, under certain circumstances, an employer can retroactively deny an employee's sick leave request based on a failure to comply with the employer's certification/documentation requirement.

11 "As soon as is practicable" means as soon as both possible and practical, taking into account all of the facts and circumstances of the individual case.
12 If the denial is based on insufficient information, the employer must allow the employee to submit a new, corrected request.

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Employers also are explicitly allowed to authenticate the documentation by contacting the healthcare provider or other person who created or signed the documentation or certification. Importantly, the employer cannot request additional details about, seek a second opinion on, or otherwise question the documentation's content. Moreover, a human resources employee, leave administrator, or management official should make this contact, as opposed to an employee's direct supervisor.

Are There Notice or Posting Requirements that Employers Must Follow?

Covered employers must post a notice provided by the DOL in a "prominent and accessible place" at the workplace. Electronic notice is permitted.

What Records Must Employers Maintain?

Covered employers must maintain records of their compliance with the Final Rule and Order during the course of the covered contract, and for period of at least three years thereafter. The Final Rule lists **15 different types of records** that employers must preserve in order to be in full compliance.

What Can Employers Not Do?

Employers cannot: (a) interfere with an employee's accrual or use of paid sick leave (the Final Rule provides a lengthy, nonexclusive list of interference examples); (b) discharge or discriminate against an employee for exercising his or her rights under the Final Rule;[13] (c) fail to make and maintain appropriate records; (d) fail to maintain the confidentiality of any medical or other personal information received as part of an employee's request and use of sick leave; and (e) require, as a condition of an employee using paid sick leave, that the employee seek or find a replacement worker.

Must Unused Sick Leave Be Paid Upon Employment Separation?

Consistent with the Order, when an employee's employment relationship ends, whether by termination, resignation, retirement, or otherwise, the covered business has no obligation to reimburse the employee for accrued, unused sick leave. However, any accrued sick leave must be restored to an employee who is rehired within 12 months of separation from employment, unless the employer cashes out an employee's accrued, unused sick leave upon separation.

How Does the Final Rule Interact With Other Laws?

The Final Rule contains detailed information about how it and the Order interact with other laws, including the SCA, DBA, FMLA, and state and local paid sick leave laws.[14] The Final Rule expressly allows paid sick leave to run concurrently with unpaid FMLA leave.

The Final Rule notes that an employer's existing paid time off policy will satisfy it and the Order if the policy meets virtually all of the applicable requirements, a process that will be extremely challenging for employers in practice. Employers with paid time off policies that provide more than 56 hours of paid sick leave have two compliance options. First, employers can choose to make all paid time off under the policy compliant with the Order and Final Rule. Second, employers can track and maintain records of when an employee uses paid time off for permitted purposes as set forth above, in which case they would only need to provide 56 hours of paid time off that complies with the Final Rule and Order.

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13 Discrimination includes considering an employee's exercise of his or her rights under the Final Rule as a negative factor in employment actions, such as hiring, promotions, disciplinary actions, or as an occurrence under an employer's attendance policy.
14 The leave required under the Order and Final Rule are **in addition to** any vacation requirements under the DBA and SCA. In addition, sick leave provided under the Order and Final Rule cannot be used to satisfy a contractor's health and welfare fringe benefit obligations.

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What Should Employers Do Now?

Employers should take steps now to ensure that they comply with the Final Rule and the Order before January 1, 2017. These are among the actions to consider:

- Assess whether any existing contracts or subcontracts with the federal government are the types of contracts that may be subject to the Final Rule;
- Assess whether the organization will be entering into any covered contracts in 2017;
- Train the organization's contracting and procurement specialists to identify the types of contracts and contract language that will trigger coverage;[15]
- Review sick leave, vacation, PTO or other paid time off policies and procedures to ensure that they meet at least the minimum requirements of the Order and Final Rule;
- Determine the dates on which existing federal government contracts may become subject to the Order and Final Rule (e.g., renewal dates, re-solicitation dates) and, if necessary, start developing paid sick leave policies that comply with the Order and Final Rule for any employees who are not covered under existing policies;
- Develop templates and communications related to any written notice requirements; and
- Train supervisory and managerial employees, as well as HR, on the Final Rule's requirements.

If you would like further information, please contact your Seyfarth attorney, Joshua D. Seidman at jseidman@seyfarth.com, Tracy M. Billows at tbillows@seyfarth.com, Alexander J. Passantino at apassantino@seyfarth.com, Ann Marie Zaletel at azaletel@seyfarth.com, or Dana Howells at dhowells@seyfarth.com.

15 DOL has stated that the FAR Council will be issuing regulations containing the FAR clause implementing the obligation. In addition, non-FAR-covered contracts will be required to contain the contract provisions identified as Appendix A in the regulations.

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