Government and Legal Issues in Compensation
Government: Part of the Employment Relationship

Government is a key stakeholder in compensation decision making

- Governments’ usual interests are whether…
  - Procedures for determining pay are fair (e.g., pay discrimination)
  - Safety nets for the unemployed and disadvantaged are sufficient (e.g., minimum wage, unemployment insurance)
  - Employees are protected from exploitation (e.g., overtime pay, child labor)

(Milkovich & Newman, 2008)
Effect of Government Decisions on the Labor Market

- **Demand**
  - Government a big employer (@ 17% of the U.S. labor force)
  - Indirectly affects labor demand through its purchases and financial policy decisions (e.g., interest rates charged to banks)

- **Supply**
  - Affects labor supply through legislation
  - Immigration policy and how rigorously it is enforced is important factor in labor supply (e.g., see new White House immigration site and opposition to new policy)

(Milkovich, Newman, & Gerhart, 2014)
<table>
<thead>
<tr>
<th>Year</th>
<th>Act Title</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1931</td>
<td>Davis-Bacon Act</td>
<td>Requires that mechanics and laborers on public construction projects be paid the “prevailing wage” in an area.</td>
</tr>
<tr>
<td>1934</td>
<td>Securities Exchange Act</td>
<td>Created the Securities and Exchange Commission (SEC). Currently, the SEC requires companies that have more than $10 million in assets and whose securities are publicly traded and held by more than 500 owners to periodically report information, which is available to the public. This includes disclosure of compensation received by the CEO, CFO, and three other highest paid executives.</td>
</tr>
<tr>
<td>1936</td>
<td>Walsh-Health Public Contracts Act</td>
<td>Extends prevailing-wage concept to manufacturers or suppliers of goods for government contracts.</td>
</tr>
<tr>
<td>1938</td>
<td>Fair Labor Standards Act</td>
<td>Sets minimum wage, hours of work, overtime premiums; prohibits child labor.</td>
</tr>
<tr>
<td>1963</td>
<td>Equal Pay Act</td>
<td>Equal pay required for men and women doing “substantially similar” work in terms of skill, effort, responsibility, and working conditions.</td>
</tr>
<tr>
<td>1964</td>
<td>Title VII of Civil Rights Act of 1964</td>
<td>Prohibits discrimination in all employment practices on basis of race, sex, color, religion, or national origin.</td>
</tr>
<tr>
<td>1965</td>
<td>Executive Order 11246</td>
<td>Prohibits discrimination by federal contractors and subcontractors in all employment practices on basis of race, sex, color, religion, or national origin.</td>
</tr>
<tr>
<td>1967</td>
<td>Age Discrimination in Employment Act (ADEA)</td>
<td>Protects employees age 40 and over against age discrimination.</td>
</tr>
<tr>
<td>1978</td>
<td>Pregnancy Discrimination Act</td>
<td>Pregnancy must be covered to same extent that other medical conditions are covered.</td>
</tr>
</tbody>
</table>

(Milkovich, Newman, & Gerhart, 2014, pp. 594-596)
### Exhibit 17.1: U.S. Federal Pay Regulations (cont.)

<table>
<thead>
<tr>
<th>Year</th>
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</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>Americans with Disabilities Act</td>
<td>Requires that “essential elements” of a job be called out. If a person with a disability can perform these essential elements, reasonable accommodation must be provided.</td>
</tr>
<tr>
<td>1991</td>
<td>Civil Rights Act of 1991</td>
<td>Increases border of proof on employers to rebut some discrimination claims. Stronger remedies available in cases of international discrimination.</td>
</tr>
<tr>
<td>1993</td>
<td>Family and Medical Leave Act</td>
<td>Requires employers to provide up to 12 weeks’ unpaid leave for family and medical emergencies.</td>
</tr>
<tr>
<td>1997</td>
<td>Mental Health Act</td>
<td>Mental illness must be covered to same extent that other medical conditions are covered.</td>
</tr>
<tr>
<td>2000</td>
<td>Worker Economic Opportunity Act</td>
<td>Income from most stock plans need not be included in calculating overtime pay.</td>
</tr>
<tr>
<td>2002</td>
<td>Sarbanes-Oxley Act</td>
<td>Executives cannot retain bonuses or profits from selling company stock if they mislead the public about the financial health of the company.</td>
</tr>
</tbody>
</table>

(Milkovich, Newman, & Gerhart, 2011, pp. 594-596)
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<thead>
<tr>
<th>Year</th>
<th>Act or Regulation</th>
<th>Description</th>
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<tbody>
<tr>
<td>2004</td>
<td>Financial Accounting Standards Board Statement 123 R</td>
<td>Value of all employee stock options must be expensed at estimates of fair value on financial statements.</td>
</tr>
<tr>
<td>2006</td>
<td>Securities and Exchange Commission (SEC) rule change on executive compensation disclosure</td>
<td>Adopts enhanced executive compensation disclosure requirements. For example, the Compensation Discussion and Analysis in the proxy statement must address the objectives and implementation of executive compensation programs.</td>
</tr>
<tr>
<td>2009</td>
<td>Lilly Ledbetter Fair Pay Act</td>
<td>Employers can be liable for current pay differences that are a result of discrimination (as defined under existing laws such as Title VII of the Civil Rights Act) that occurred many years earlier.</td>
</tr>
<tr>
<td>2009</td>
<td>Troubled Asset Relief Program (TARP), American Recovery and Reinvestment Act of 2009 (ARRA)</td>
<td>Financial institutions receiving funds from TARP have restrictions on compensation. Prohibits use of several compensation programs, including, but not limited to bonuses, retention awards, and incentive pay, except where part of a preexisting employment contract, during the period TARP funds are received. Restricted stock is permitted if one-third or less of annual compensation. In firms receiving the largest TARP assistance, restrictions cover senior executives and next 20 highest paid employees.</td>
</tr>
</tbody>
</table>
Acts of Congress & Compensation

For simplicity, Henderson (1989) put legislation into the categories, which you may find helpful (see the “Legal Issues” handout @ class web site):

- Wage and hour legislation
- Employer pension and benefits legislation (previously covered)
- Tax treatment legislation
- Antidiscrimination legislation
- Wage and price control legislation
- Disclosure & Accounting legislation (considerable recent activity here – see Exhibit 17.1 in book)
Fair Labor Standards Act (1938)

- The Fair Labor Standards Act (FLSA) regulates:
  - employee status
  - minimum wage
  - overtime pay
  - child labor
  - record keeping
  - other administrative requirements

See FLSA Site; under the “E Tools” section (scroll down page) you can download the Dept. of Labor’s “Comprehensive FLSA Presentation.” Also see this e-law guide for minimum wage and overtime.

(Milkovich & Newman, 2008)
Employee Status Under FLSA

When classified as an employee, an organization must:

- Withhold federal/state/local income taxes
- Match Social Security/Medicare withholding
- Include person in company benefit programs
- Pay for unemployment insurance and workers’ compensation
- Allow up to 12 weeks of unpaid leave for family emergencies
- Provide any other state or federally mandated benefits

(Milkovich & Newman, 2008)
Contractor Status Under FLSA

To be classified as a contractor, a person must

- Have ability to set own hours and determine sequence of work
- Work off-site
- Work by the project rather than have a continuous relationship with the employer
- Be paid by the job
- Have an opportunity for profit and loss
- Furnish own tools and training
- Be self-employed or work with a leasing company

(Milkovich & Newman, 2008)
Exempt & Non-Exempt Status Under FLSA

- Non-exempt employees are included in FLSA regulations and have full protection of the law.

- Exempt employees are excluded from FLSA minimum wage or overtime provisions.

(Milkovich, Newman, & Gerhart, 2014)
Exempt Status Categories Under FLSA

There are multiple classifications of exempt employees under FLSA:

- Executives
- Administrative Employees
- Professionals
- Computer Employees
- Outside Salespeople
- Highly compensated Employees

See Exhibit 17.4 on pp. 600-601 for examples

(Milkovich, Newman, & Gerhart, 2011)
Minimum Wage

- Legislation is intended to provide an income floor for workers in society’s “lesser” jobs
  - Federal minimum wage is currently $7.25 per hour as of July 24, 2009. The **minimum wage for federal construction and service contractors** was raised to $10.10 per hour by Executive Order 13658 signed on 2/12/14
  - Almost all states have their own minimum wage to cover jobs omitted from federal legislation; PA minimum wage is currently **$7.25 per hour**; NY minimum wage is currently **$8.00 per hour** and will increase to $8.75 per hour on 12/31/14 and $9.00 per hour on 12/31/15.

- If state and federal legislation cover same job, the higher rate prevails; check state minimum wages [here](#)
Effects of Minimum Wage Rate Increases on Wage Structure

- **Direct effect** – refers to increase in wages for jobs at bottom of wage curve that have been below minimum wage

- **Indirect effect** – refers to changes in remainder of the wage curve to maintain appropriate differentials for jobs that deserve higher pay

Indirect effect often greater than direct effect because companies spend more money on increasing pay of high-level jobs (to maintain differentials) than they spend on raising pay of low-level jobs to new minimum

(Milkovich & Newman, 2008)
“Living Wage”

- At local levels it provides a minimum wage tailored to living costs in an area.

- Because they are so narrowly tailored, it is speculated that their real intention is to reduce any cost savings a municipality might receive from outsourcing from public to private employees.

(Milkovich, Newman, & Gerhart, 2014)
Overtime and Hours of Work

- Overtime provision of the FLSA requires payment at one-and-a-half times the standard for working more than 40 hours per week.

- The conditions that inspired the legislation have changed since the law was passed. Current employers face:
  - An increasingly skilled workforce with higher training costs per employee
  - Higher benefits costs, the bulk of which are fixed per employee

(Milkovich, Newman, & Gerhart, 2014)
Overtime and Hours of Work (cont.)

■ What time is covered?
  - OSHA (Occupational Safety and Health Administration) legislation specifies the number of breaks that must be provided in an eight-hour workday
  - Portal-to-Portal Act provides that time spent on activities before beginning the “principal activity” is generally not compensable

■ What income is covered?
  - The Worker Economic Opportunity Act, a 2000 amendment to FLSA, allows stock options and bonuses to be exempt from inclusion in overtime pay calculations

■ Compensatory time off
  - Federal legislation has been proposed (but still has not passed; original phrasing was in 2011 edition of text) that would give employees and employers the option of trading overtime pay for time off

(Milkovich, Newman, & Gerhart, 2014)
## FLSA Basic Overtime Provisions

- **Non-exempt workers** must be paid 1.5 times their *regular rate of pay* for hours worked in excess of 40 in any workweek.

- **Regular rate of pay** includes *base pay plus*:
  - Non-discretionary bonuses
  - Shift premiums
  - Production bonuses
  - Commissions

- Overtime is paid on *time worked*, not time compensated.

- A *workweek* is any fixed, recurring period of 168 consecutive hours (7 x 24 hours).

(Milkovich, Newman, & Gerhart, 2011)
Child Labor Provisions

- FLSA restricts hours and conditions of employment for minors
  - Persons under 18 cannot work in hazardous jobs
  - Persons under 16 cannot be employed in jobs involving interstate commerce except for nonhazardous work for a parent or guardian

(Milkovich, Newman, & Gerhart, 2014)
Compliance Enforcement

- **Wage and Hour Division of U.S. Department of Labor** enforces FLSA minimum wage and overtime provisions

- **Equal Employment Opportunity Commission (EEOC)** enforces equal pay provisions

(Milkovich & Newman, 2008)
Prevailing Wage Laws

- A government-defined prevailing wage is minimum wage that must be paid for work done on covered government projects or purchases.

- Sets pay for work done to produce goods and services contracted by federal government.

- Prevailing-wage laws prevent contractors from using their size to drive down wages.
  - Contractors must determine the “going rate”.
  - Normally the “union rate” for labor becomes the going rate.
  - That rate then becomes the mandated minimum wage on the government-financed project.

(Milkovich, Newman, & Gerhart, 2014)
Prevailing Wage Laws

- A number of laws contain prevailing-wage provisions
  - Davis-Bacon Act
  - Walsh-Healey Public Contracts Act
  - Service Contract Act
  - National Foundation for the Arts and Humanities Act
  - Nursing Relief for Disadvantaged Areas Act

(Milkovich, Newman, & Gerhart, 2014)
Pay Discrimination: What Is It?

- Law in compensation realm recognizes two types of discrimination:
  - **Access discrimination** – denial of particular jobs, promotions, or training opportunities to qualified women or other protected groups
  
  - **Valuation discrimination** – looks at pay women, protected groups, and men receive for the jobs they perform

☑ It is discriminatory to pay minorities/women less than males when performing equal work - working side-by-side, in same plant, doing same work, producing same results

(Milkovich, Newman, & Gerhart, 2014)
Pay-Related Antidiscrimination Legislation

- Equal Pay Act (1963)
- Civil Rights Act (1964)
- Age Discrimination in Employment Act (1967)
- Wage Garnishment Act (1968)
- Americans with Disabilities Act (1990)
- Lilly Ledbetter Fair Pay Act (2009)

(Milkovich, Newman, & Gerhart, 2011)
Discriminatory Compensation Practices

- Types of compensation practices which may be discriminatory
  - Extra pay plans
  - Leave policies
  - Maternity leave
  - Pension policies

(Milkovich & Newman, 2008)
The Equal Pay Act (1963)

- Prohibits wage discrimination on the basis of gender when employees perform work in the same establishment.

- Differences in pay between men and women doing equal work are legal if based on an **affirmative defense**:
  - Seniority
  - Merit or quality of performance
  - Quality or quantity of production
  - Some factor other than sex

- In legal terms, the equal work standard requires only that jobs be substantially equal, not identical.

(Milkovich, Newman, & Gerhart, 2014)
Equal Pay Act Definitions

- **Skill** - Experience, training, education, and ability as measured by the performance requirements of a particular job
- **Effort** - Mental or physical—the degree of effort (not type of effort) actually expended in the performance of a job
- **Responsibility** - The degree of accountability required in the performance of a job
- **Working conditions** - The physical surroundings and hazards of a job, including dimensions such as inside versus outside work, heat, cold, and poor ventilation

(Milkovich, Newman, & Gerhart, 2011)
Equal Pay Act (cont.)

- For an employer to support a claim of unequal work, the following conditions must be met:
  - The effort/skill/responsibility must be substantially greater in one of the jobs compared
  - The tasks involving the extra effort/skill/responsibility must consume a significant amount of time for all employees whose additional wages are in question
  - The extra effort/skill/responsibility must have a value commensurate with the questioned pay differential

(Milkovich, Newman, & Gerhart, 2014)
Factors other than sex include:

- Shift differentials
- Temporary assignments
- Bona fide training programs
- Differences based on ability, training, or experience
- Other reasons of “business necessity”

(Milkovich, Newman, & Gerhart, 2014)
Not permitted under Equal Pay Act…

- Are defenses such as:
  - union rules, or that
  - the wage is the prevailing pay for the market

- Time of day does not constitute dissimilar working conditions.
  - However, if a differential for working at night is paid, it must be separated from the base wage for the job.

(Milkovich & Newman, 2008)
Exhibit 17.11: Sources of Earnings Gaps

(Milkovich, Newman, & Gerhart, 2014, p. 621)