regulation be not less than 30 days from the date of publication unless there is ''good cause'' shown for an earlier date. This rule does not require affected persons to take any actions to prepare for its implementation. Furthermore, a delay in the effective date could cause confusion among the affected public as to whether the previously suspended rule is in effect in the meantime. Therefore the Department finds good cause to have this rule effective immediately.

VI. Executive Order 12866; § 202 of the Unfunded Mandates Reform Act of 1995

As stated in the notice of proposed rulemaking, the Department is treating this rule as a ''significant regulatory action'' within the meaning of sec. 3(f)(2) of Executive Order 12866 because the alternative to the proposed rule—lifting of the suspension and implementing the helper regulations while rulemaking is ongoing—could possibly interfere with actions planned or taken by other government agencies.

The AGC contends that the proposal for further rulemaking is inconsistent with Executive Order No. 12866, Section 202 of the Unfunded Mandates Reform Act of 1995, the Small Business Regulatory Enforcement Fairness Act and the Regulatory Flexibility Act. The AGC claims that the concerns expressed by the Department in the proposed rule regarding implementation of the helper regulations are ''vague'' and not ''supported by reliable data.'' Relying upon the Department's own previous cost analysis conducted in 1987 and published along with the final rule at 54 FR 4242 (1989), the AGC claims that ''the Department's contention that no cost would be incurred by continuing the suspension of the helper regulations is simply not true,'' and that failure to implement the helper regulations will ''cost the federal government, taxpayers and the construction industry hundreds of millions of dollars.'' Finally, the AGC asserts that ''the Department's proposal is a 'major rule' and requires both an economic and regulatory flexibility analysis in full compliance with Executive Order No. 12866 and the Small Business Regulatory Enforcement Fairness Act.''

The AGC's comments address potential savings of implementation of the helper regulations, rather than the impact of continuing the suspension. As noted above, the Department is preparing a preliminary regulatory impact analysis which will discuss the Department's estimate of the costs and benefits of the proposed rule in preparation, including any savings that might be realized from implementation of the helper regulations as they now stand. This analysis will be published for notice and comment concomitant with the Department's regulatory proposals concerning the employment of helpers on Davis-Bacon projects.

As discussed above, the Congressional action of lifting the prohibition against implementing the regulation did not itself reinstate the suspended regulation, and a notice or other rulemaking action by the Department was necessary to lift the suspension on the helper regulation. It is the Department's view, therefore, that the suspension has continued in effect since October 1993, and that the suspension continues in effect today. This rule, which continues the previously existing suspension, merely preserves the status quo. Therefore the Department concludes that there will be no cost savings from the continuation of the suspension of the helper regulations that has been in effect since November 1993 during the substantive rulemaking proceedings.

Moreover, as discussed above, a substantial period of time is required before the regulations would be implemented by their incorporation into contracts, and the Department's experience in the period in 1992 and 1993 when the suspended regulation was in effect was that relatively few surveys were completed in which helpers were found to prevail. Thus, any potential savings that would be lost from a failure to implement the helper regulations during the rulemaking period would be minimal.

Accordingly, the Department has concluded that this rule, which continues the suspension of the helper rule and therefore is a continuation of the status quo, will not have an annual effect on the economy of $100 million or more, or adversely affect in a material way the economy or a sector of the economy.

Because this rule will not have a significant economic impact, no economic analysis is required. For the same reason, this rule does not constitute a ''major rule'' within the meaning of § 804(2) of the Small Business Regulatory Enforcement Fairness Act.

VII. Regulatory Flexibility Act

The AGC contends that the Department's conclusion that the proposed continuation of the suspension ''will have no significant impact on small entities is also contradicted by its 1987 estimate. * * *''

Again, the AGC's comments address the potential savings of implementation of the helper regulations, rather than the costs or savings of continuing the suspension. This regulation is merely a continuation of the status quo. Therefore the Department has determined that the rule does not have a significant economic impact on a substantial number of small entities.

Furthermore, the Department has determined that if the current suspension were lifted and the helper regulation implemented, there would not be a significant economic impact on a substantial number of small entities during the interim period prior to completion of rulemaking action on the helper regulations—expected to be completed within a year. Because of the lag times in agency procedures to amend their regulations and incorporate the contract clauses, and the relatively small number of helper classifications which the Department found prevailing in its surveys in 1992 and 1993, it is unlikely that a substantial number of small entities would have the opportunity to use helper classifications during the period before the rulemaking is completed. Accordingly, the rule is not expected to have a ''significant economic impact on a substantial number of small entities'' within the meaning of the Regulatory Flexibility Act, and the Department has certified to this effect to the Chief Counsel for Advocacy of the Small Business Administration. Thus, a regulatory flexibility analysis is not required.

VIII. Document Preparation

This document was prepared under the direction and control of Maria Echaveste, Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor.

Signed at Washington, D.C., this 23rd day of December 1996.

Gene Karp,

Deputy Assistant Secretary for Employment Standards.

[FR Doc. 96–33054 Filed 12–27–96; 8:45 am]

BILLING CODE 4510–27–M

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29 CFR Part 4

RIN 1215–AA78

Service Contract Act; Labor Standards for Federal Service Contracts

AGENCY: Wage and Hour Division, Employment Standards Administration, Labor.

ACTION: Final rule.

SUMMARY: This document adopts as a final rule a new methodology for establishing minimum health and

welfare benefits requirements under the McNamara-O'Hara Service Contract Act (SCA). In this document, the Department of Labor (DOL or the Department) also issues a variance, pursuant to Section 4(b) of the Act, to reflect the Department's practice of issuing prevailing fringe benefit determinations on a nationwide basis, rather than separately for classes of employees and localities. This document also contains other minor, clarifying modifications that conform the regulations to a 1985 court decision, a 1983 treaty, a 1996 intergovernmental compact, and more recent amendments to the Fair Labor Standards Act (FLSA) minimum wage provisions.

EFFECTIVE DATE: June 1, 1997.

FOR FURTHER INFORMATION CONTACT: William Gross, Director, Division of Wage Determinations, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, Room S–3506, 200 Constitution Avenue, NW, Washington, DC 20210; telephone (202) 219–8353. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:

I. Paperwork Reduction Act

This rule does not contain any new or added reporting or recordkeeping requirements subject to the Paperwork Reduction Act of 1980 (Pub. L. 96–511). The existing information collection requirements contained in Regulations, 29 CFR Part 4, were previously approved by the Office of Management and Budget under OMB control number 1215–0150. The general Fair Labor Standards Act (FLSA) recordkeeping requirements which are restated in Part 4 were approved by the Office of Management and Budget under OMB control number 1215–0017.

II. Background

The McNamara-O'Hara Service Contract Act of 1965 (SCA) requires that the Department determine locally-prevailing wages and fringe benefits for the various classes of service employees performing contract work subject to the SCA. Federal service contracts over $2,500 (if the predecessor contract was not subject to a collective bargaining agreement) are required to contain wage determinations issued by DOL that specify the minimum monetary wages and fringe benefits that must be paid to the various classes of workers who perform work on the service contract, based upon rates determined by DOL to be prevailing in the locality where the work is to be performed. However, because fringe benefit data are not generally available on an occupation-specific or on a locality basis, DOL has issued fringe benefit determinations for health and welfare based on nationwide data ever since SCA was enacted.[1]

The Service Employees International Union (SEIU) sued DOL in March 1991 in the United States District Court for the District of Columbia over the longstanding administrative practice, since 1976, of issuing two nationwide rates for health and welfare fringe benefits, and for failure to periodically update SCA health and welfare fringe benefit levels which, at that time, had not been updated since 1986 (*SEIU* v. *Martin*, CA No. 91–0605 (JFP) (D.D.C. April 1, 1992)). Following a remand to the Department for exhaustion of administrative remedies, the DOL's Board of Service Contract Appeals remanded the matter to the Wage and Hour Division to consider alternative methodologies for implementing the statutory objectives. Accordingly, the Administrator of the Wage and Hour Division, by Notice of Proposed Rulemaking (NPRM) published in the Federal Register on May 2, 1996 (61 FR 19770), proposed for public comment various alternative methodologies based on data from the U.S. Bureau of Labor Statistics, Employment Cost Index (ECI). Due to the time constraints, it was not feasible to publish the required regulatory impact analysis for comment with the proposed rule.

The Department thereafter developed information on the occupational mix of service employees engaged in the performance of SCA-covered contracts. Based on data collected by the Federal Procurement Data System for Fiscal Year 1994, the Department conducted a survey which provided specific information on service contract employment by occupation within SIC industry classifications. By Notice published in the Federal Register on October 25, 1996 (61 FR 55239), the Department published its preliminary regulatory impact analysis containing estimates of the economic impact of the various proposed alternatives.

In an action filed by the SEIU in the U.S. District Court for the District of Columbia, the court set a deadline for publication of this final rule of December 24, 1996. *SEIU* v. *Reich*, CA No. 91–-0605 (August 27, 1996).

In response to the proposed rulemaking, the Department received 80 comments. This included comments from seven Federal agencies: Department of the Army, Department of the Navy, Department of the Air Force, Defense Commissary Agency, U.S. Postal Service, Environmental Protection Agency (EPA), and National Aeronautics and Space Administration (NASA). Comments were received from six union organizations: Service Employees International Union (SEIU), the American Federation of Labor-Congress of Industrial Organizations (AFL–CIO), the International Union of Operating Engineers, the Laborers' International Union of North America (LIUNA), District No. 5—ITPE, NMU/MEBA (AFL–CIO), and the International Association of Bridge, Structural and Ornamental Iron Workers. The Contract Services Association of America (CSA), which according to its comment represents more than 240 companies that provide technical and support services to 37 Federal agencies, provided detailed comments, and thirty-three of its member contractors separately submitted comments concurring with CSA's position. Several major government service contractors, including Johnson Controls, Lockheed Martin, Raytheon Aerospace, Aspen Systems Corporation, and Kay and Associates, Inc., also provided comments. In addition, the law firm of Hogg, Allen, Norton & Blue, which stated that it represents a large number of service contractors throughout the country, commented on the Department's proposal.

Thirteen firms which employ or provide employment services to disabled workers under the NISH program and the Javitz-Wagner-O'Day Act (JWOD) submitted comments. The National Star Route Mail Contractor's Association and six mail hauling firms also filed comments. Fringe Insurance Benefits, Inc., which markets and provides services to the Contractors and Employees Retirement Trust Fund and several health plans designed specifically for prevailing wage employees, provided its comments. ACIL, which represents firms performing scientific testing and engineering services, also commented on the Department's proposal.

III. Comments and Analysis of Alternatives

Summary of Comments

A majority of the commenters favored Alternative I, which would provide for a single fringe benefit rate based on ECI all-industry data. The CSA supported the Alternative I methodology, and thirty-three of its member contractors concurred separately with CSA's position. Both the Department of the Army and the Department of the Navy

[1] For a complete description of the history and content of the current methodology, see the *Background* section of the Notice of proposed rulemaking published at 61 FR 19770 (May 2, 1996).

preferred Alternative I. Alternative I was also supported by Lockheed Martin and Kay and Associates, Inc. (KAI).

Little support was offered by the commenters for Alternatives II, III or IV, including the variations of these alternatives. The Defense Commissary Agency and four firms which employ disabled workers supported Alternative II–A, which would provide separate benefit levels for six major occupational groupings, primarily because it would be the least costly in their particular circumstances. None of the commenters favored Alternative II–B, which would provide a single fringe benefit rate based on the occupational mix of service employees engaged in the performance of SCA-covered contracts, or Alternative II–C, which would provide for two benefit levels based on combining occupational groupings into two categories. Alternative III, under which separate rates would apply to each of four geographic regions, was supported by only three commenters. Alternative IV, which would provide for a fringe benefit rate based on a percentage of wages paid was endorsed by Aspen Systems Corporation, which desired a high benefit package for its employees, and three firms which wanted a low benefit package.

The Air Force strongly supported Alternative V–A, which would continue the current methodology of applying two benefit levels based on ECI size-of-establishment data. NASA, EPA, and the U.S. Postal Service, and 3 other organizations also supported this alternative. Three commenters supported Alternative V–B, a variation of the current methodology in that it would be applied by the size, rather than nature, of the contract and the lower benefit level would be based on ''total benefit'' rather than ''insurance only'' ECI data.

The unions commenting favored none of the proposed alternatives, choosing instead to propose another alternative, which would preserve the two-tier benefit system, but would use a different methodology for calculating the lower ''insurance'' benefit rate. The unions proposed that this lower rate be based on all-industry insurance only data, rather than ''size-of-establishment'' insurance data, and that those firms not providing health insurance be eliminated from the data (*i.e.*, eliminating the ''zeros''). The unions also proposed including data on fringe benefits paid to public employees in the low level fringe benefit calculation.

Another alternative was also proposed by Fringe Insurance Benefits, Inc., under which the Department would issue a single level for health insurance which would be the same for all employees, and an additional amount for pension which would vary based upon wages or job classification.

More detailed discussion of the comments on each of the alternatives proposed follows:

Alternative I: Issue a single benefit level based upon ECI data for workers in private industry. The commenters who supported the Alternative I methodology did so generally for three basic reasons. First, they preferred its simplicity in establishing a uniform benefit rate for all employees and the consequent ease with which contractors could administer this rate and the government could verify SCA compliance. Commenters also believed that this methodology would eliminate the possibility of contractors manipulating employee classifications in order to obtain a competitive advantage, which might happen under some of the other proposed methodologies, thus ensuring a ''level playing field for bidders.''

Secondly, many commenters preferred Alternative I because it does not discriminate between classes of employees based on the kind of job they have or the location of their employment, and because it is easy for employees to understand and would result in fewer morale problems. KAI complained that because on some military installations the $2.56 ''total benefit'' package applies to some contracts while the $.90 ''insurance'' applies to others, it has lost highly qualified employees to a different company working at the same base location which paid the same wage but with the higher $2.56 benefit rate. According to KAI, its employees ''never understand or accept why someone else on the same base receives $2.56 per hour in benefits in comparison to the $.90 they receive.'' Vinnell Corporation echoed this concern, stating as follows:

> We have long believed that the two tier fringe benefit rate methodology used for service contracts is discriminatory and creates a disparate impact on those individuals working on projects where the lower rate is applicable. One of Vinnell's current service contracts is at a location where the higher fringe rate is applicable because the project was derived from an A–76 procurement action approximately 15 years ago. At that same location we have a second project where the lower fringe rate is applicable. We find it inconceivable that two carpenters, both working for Vinnell on different service contracts but at the same military installation and receiving the same wage rate should not also receive the same fringe benefit rate.

KAI was also concerned that a two-tiered system ''results in added administrative costs and negates the cost savings associated with economies of scale.''

Finally, many commenters preferred the Alternative I methodology because, as CSA stated in its comments, it produces a benefit rate which is ''sufficient to allow all service contractors to purchase a good benefit package for employees that would cover a range of health and welfare benefits for all contract workers.'' Many commenters expressed their belief that due to the continually rising cost of benefit packages, the current ''insurance only'' benefit rate of $.90 per hour is simply insufficient to purchase any meaningful benefit package, especially one that would include adequate health insurance. KAI offered the following concrete example:

> In 1993, $.89 per hour of benefits allowed the contractor to provide a benefit package with 3 personal days, $10,000.00 of life insurance, profit sharing contribution, dental insurance, and medical insurance with a $250.00 deductible and supplemental accident insurance. The $.90 per hour of benefits in 1996 allows the contractor to provide a benefit package with 4 personal days, zero life insurance, profit sharing contribution, zero dental insurance, and a medical plan with a $350.00 deductible and no supplemental accident insurance.

Contractors favoring Alternative I also believe that the resulting increase in the benefit level for many of their employees would aid them in attracting and retaining qualified employees to work on service contracts with the Federal government.

Both the Department of the Army and the Department of the Navy supported the establishment of a single health and welfare benefit rate to be issued on all SCA wage determinations. The Army stated that it supports one flat rate ''in the interests of simplicity and acquisition streamlining.'' The Army preferred a ''single rate'' methodology because it believes that the standards currently used by DOL to apply the high benefit rate have no rational basis. The Army cited as an example the Department's policy of applying the high rate to ''OMB Circular A–76'' contracts.[2] The Army stated that if DOL is to continue with a two-rate methodology, it must ''publish clear understandable and fair guidance to explain when each rate is applied.''

The Army appears to regard the $1.89 rate as acceptable since it ''splits the

[2] OMB Circular A–76 actions are solicitations with potential for displacement of Federal civilian workers. The rationale behind applying the high benefit level to such contracts is that Federal workers whose jobs are being converted to the private sector should not suffer an abrupt decrease in their benefits.

difference between the 'low' and the 'high' fringe rate.'' However, the Army believes that ''it is important that the contracting agencies have the ability to challenge that one rate by industry. If rates are significantly lower for a particular industry, then DOL should deviate from the one rate and set a lower rate for that industry.''

The Navy similarly concludes that ''[t]he single rate is far more justifiable in terms of both contracting for services and compliance within established employer wage and benefit programs.'' The Navy also expressed belief that DOL has applied the current ''high'' health and welfare benefit level in an artificial manner. Like the Army, the Navy specifically mentioned the OMB Circular A–76 contracts involving displacement of Federal employees as an example of improper application of the high benefit rate. The Navy stated that once the high rate is applied to such a contract, it continues to apply indefinitely to follow-on contracts, and consequently, ''many service contracts contain the artificially high benefit level while the prevailing rates for those contracts are considerably lower.''

The Navy also stated that ''information available within the Federal Employees Health Benefits Program'' would provide a sound basis for establishing a single benefit rate. The Navy is concerned that implementation of the $1.89 rate would create a significant cost increase that might result in ''the federal contracting agencies' inability to continue funding certain services, or existing service levels, or [cause agencies] to reconsider decisions to contract out such services to the private sector,'' thus causing a reduction in the service contract workforces. The CSA also was concerned that ''[i]ncreased cost to government agencies could result in downsizing of contracts and layoffs of employees.''

On the other hand, the Department of the Air Force opposed the Alternative I methodology on the bases that the $1.89 ECI-based rate is too costly and not appropriate for any contractor, being ''too low for employees of large companies or with high-skilled workers and too high for employees of small companies or low-skilled employees.'' The Air Force, however, agreed with the Army and the Navy that ''[t]he current problems with the two rate system stem from the inconsistent application of the two fringe benefit levels resulting in confusion and frustration by Federal contracting agencies, contractors, and service contractors.'' The Air Force further stated that ''[t]he inflexibility, for example, in applying the 'high' fringe benefit rate to A–76 [Federal employee displacement] solicitations and then maintaining the high benefit level regardless of the type of continued circumstances of the contract has created the climate for complaints and attacks on the two level system.''

The Defense Commissary Agency believed that Alternative I would be cost-prohibitive for its contracting purposes since that agency normally uses ''service occupations'' that would be paid the ''low'' health and welfare benefit rate under the current methodology.

Another disadvantage to the Alternative I methodology, specifically mentioned by CSA, is that the all-industry ECI data upon which the Alternative I benefit rate would be based includes ''zeros''—that is data from companies that do not provide the benefit surveyed, thus resulting in a lower rate that does not accurately reflect the actual cost of such benefits. This concern was also reflected in the unions' alternative proposal for determining health and welfare benefit rates, which is separately discussed below.

Many commenters expressed concern that lowering the current high ''total benefit'' rate to the Alternative I single benefit rate would result in serious employee morale problems and disruption in benefits. Accordingly, as will be more fully discussed below, many commenters favored some type of ''grandfathering'' or ''phase-in'' mechanism to ameliorate the disruptive effects resulting from a change in the health and welfare benefit rate methodology.

The unions unanimously opposed the single rate methodology provided in Alternative I primarily because it would reduce existing benefits currently received by those service contract workers to which the higher level ''total benefits'' rate applies. They believed that Alternative I met their primary criterion of establishing a rate high enough to purchase health insurance coverage, but nonetheless found this alternative unacceptable because it would eliminate the existing ''total benefits'' rate. SEIU also opposed Alternative I for the specific reasons that it excludes public employee data and fails to give ''due consideration'' to Federal employee rates.

Alternative II–A: Issue a single benefit level for each of six major occupational groupings based on ECI data for all workers in each of these groupings in private industry. This alternative was favored by the Defense Commissary Agency and four firms which employ workers with disabilities pursuant to programs sponsored under the Javitz-Wagner-O'Day Act (JWOD), based primarily on their view that this alternative would be the least costly in their individual circumstances. The Defense Commissary Agency recommended use of Alternative II–A because the ''service occupations'' it normally uses ''really would justify only a rate of $.62 per hour.'' Eastern Carolina Vocational Center (ECVC), which operates a work center for disabled individuals, explained that Alternative II would be the best alternative for its operations based on cost reasons. While ECVC acknowledged that Alternative II–A may be the most expensive to the government as a whole, it would be the least costly where ECVC was concerned since its workers fall within the second lowest paid occupational group (handlers, equipment cleaners, helpers and laborers, which would receive fringe benefits of $1.24 per hour [based on 1995 ECI data] under this alternative).

Most of the commenters who opposed adoption of Alternative II–A believed that it would be too difficult to administer and enforce, and would result in ''additional costs to the contractor, and ultimately to the contracting agency, for personnel and systems to administer the program.'' The Air Force was concerned that the increase in the complexity of accounting resulting from this alternative would pose ''additional compliance difficulties for contractors and [Wage-Hour] investigators.''

Commenters also expressed concern that too much subjectivity would be inherent in the administration of this alternative. Both CSA and Aspen Systems Corporation specifically stated that utilization of this alternative could lead to gamesmanship involving manipulation of classifications by contractors during the competitive bidding process.

Many commenters expressed their belief that minimum fringe benefit rates differentiating among various groups of employees under Alternative II–A would not reflect the prevailing practice in the service contracting industry and would be unfair to employees in lower-paid occupations. CSA stated that a ''vast majority'' of its member companies ''provide the same level of benefits to all workers, except those workers who are covered under a Collective Bargaining Agreement or a prevailing wage law.'' The AFL–CIO also stated that employers generally provide the same rate of fringe benefits, particularly health insurance, to all employees working on the same

contract. The AFL–CIO further stated that ''a system based on occupational groupings that would provide different employees working for the same employer under the same contract with widely different fringe benefits simply could not be considered to be prevailing since such a system is rarely found among employers.''

Several contractors stated that, especially on those contracts with a mix of labor categories, there could be a high potential for discrimination problems arising under the Internal Revenue Code in view of the large disparity between the various benefit rates. Several commenters were also concerned that having the various benefit levels under Alternative II–A would create serious labor and morale problems. In addressing this point, the AFL–CIO stated as follows:

> [Q]uality health insurance is needed by all service workers regardless of their occupational groupings. The cost of insurance is the same for the custodian as for the computer technician. Establishing different minimum fringe benefit levels based on occupational titles or groupings probably would lead to different levels of health care among service workers, creating basic problems in the workplace.

Finally, several commenters, including Fringe Insurance Benefits, Inc., opposed this alternative because the $.62 rate for ''service occupation'' employees would not be sufficient for such employees to obtain any meaningful health insurance.

Alternative II–B: Issue a single benefit rate adjusted to reflect the difference between the BLS ECI occupational universe and the actual mix of comparable occupations on SCA contracts. No commenters favored this alternative; Lockheed Martin was the only commenter to provide any favorable comments concerning this alternative.[3] Lockheed Martin believes that the benefit rate produced under this methodology would be less than the $1.89 rate produced under Alternative I and that it ''would be more reflective of prevailing benefit levels of SCA type contracts.'' Lockheed Martin also believed this alternative to be easy to administer.

Most commenters opposed Alternative II–B simply because they believed it to be too complicated. CSA believed that ''the data required to effectively accomplish this may be too difficult to obtain and may have too much error to be effective.'' Aspen Systems expressed concern that this alternative would be difficult for the government to implement, thus creating delay, and that it was unclear as to which agency would have the authority to set the single benefit rate. Several commenters, including the AFL–CIO and the Air Force, questioned the accuracy of the Department's calculation of the occupational mix of service employees contained in the regulatory impact analysis, which formed the basis of the cost estimate for this alternative. The Air Force also believes this alternative to be the most inflationary of all those proposed.

Alternative II–C: Issue two benefit levels based on combining the occupational groupings. This alternative likewise garnered no support from any commenters. Many commenters had the same objections to this alternative that they had to Alternative II–A. The commenters generally complained that this alternative would be too complex administratively, and would be discriminatory against workers in certain types of occupations leading to employee morale problems. Aspen Systems believed that there would be too much subjectivity in determining under which of the two broad occupational groupings certain classifications would fall.

Alternative III: Issue a single rate for each of four geographic regions based on ECI data for all workers in private industry. This alternative was endorsed by Goodwill Industries, Inc. of Eastern Nebraska and Southwest Iowa, which stated that this alternative ''would provide the least financial burden to the Federal Government and provide a significant increase in benefits to [its] employees,'' and by the EPA, which believed this alternative to be ''among the most prudent cost effective alternatives.''[4]

Commenters which opposed this alternative stated that regional data is not an adequate substitute for locality data, especially since this methodology would not take into consideration fringe benefit differences within a particular region. One commenter noted that the District of Columbia and Mississippi would be located in the same region, yet the labor costs in these two regions are significantly different. Similarly, the AFL–CIO points out that prevailing rates in San Francisco, which is located in the Western region, are much more likely to be similar to the prevailing rates in Boston than to the prevailing rates in Boise, Idaho, which is also in the Western region. Commenters therefore questioned the usefulness of the geographic breakdown embodied in Alternative III.

Several commenters also pointed out that fringe benefits are provided to employees within a company on a similar basis without reference to geographic location and that benefit plans to which employers subscribe are not structured to take into account geographical differences. CSA and its member companies disliked Alternative III, finding it too difficult to administer because it would possibly require four separate benefit plans. They were also concerned that implementation of this alternative would necessitate major payroll, accounting and administrative changes, and would be especially problematic with regard to employees who work in more than one region. CSA was also concerned as to how contract bids would be evaluated in situations where place of performance of the service contract would be determined by the location of the successful bidder. Finally, CSA believed that this alternative ''could cause non-compliance with IRS discrimination rules on pension plans.'' Hogg, Allen, Norton & Blue was concerned that the establishment of a higher benefit for one geographic region than another might give rise to ''control group issues under ERISA.''

Alternative IV: Issue a single fringe benefit rate (as a percent of wages) based on the relationship between the ECI all-private industry ''total benefit'' rate and the ECI all-private industry average wage rate. This alternative was endorsed by Aspen Systems Corporation and three firms which employ workers with disabilities pursuant to programs sponsored under the JWOD. Aspen Systems believed that this alternative would provide positive incentive to employees ''in the sense that the higher an employee's hourly wage, the higher the employee's fringe benefit rates.'' Aspen Systems also stated that implementation of this methodology would aid firms in attracting and retaining employees in high level classifications, such as specialty and technical personnel. Aspen Systems did not view this alternative as being too burdensome from an administrative standpoint and recommended that the methodology be applied as a percentage of each individual employee's wages rather than of an average based on all wages paid under a contract. The JWOD firms which favored this alternative appeared to do so because the percentage methodology when applied to the wage rates typically paid to their low-wage employees would serve to decrease their labor costs and enhance their competitiveness.

Many commenters believed that this alternative would not be

[3] Lockheed Martin supported Alternative I.

[4] EPA equally supported Alternative V–A.

administratively feasible. For example, Johnson Controls stated that many of its contracts are not staffed with administrative personnel who could adequately perform the requirements associated with this alternative. The Air Force was also specifically concerned that applying multiple fringe benefit rates on a contract would impose an excessive administrative burden on contractors, particularly small contractors such as those operating under the Small Business Administration's ''8a'' program and the ''NISH'' programs. The Air Force also believes that the complexity of accounting inherent in this alternative would pose added compliance difficulties for contractors and Wage-Hour investigators alike. Fringe Insurance Benefits, Inc. was concerned that use of this alternative would provide incentives for employers to intentionally misclassify employees.

Several commenters stated that a methodology providing for multiple fringe benefit rates would naturally lead to problems of inequity and morale in the workforce. CSA and the AFL–CIO both expressed concern that lower paid workers might not be able to obtain adequate health insurance under this alternative. Finally, Fringe Insurance Benefits, Inc., while pointing out that ''the cost of health has no relationship to wages,'' stated that this methodology is ''inconsistent with the traditional approach of providing all non-exempt employees with the same health benefit level.''

Alternative V–A: Issue two fringe benefit levels based on BLS ECI size-of-establishment data for all workers in private industry (Current methodology—applied based on nature of contract). The Air Force, NASA, EPA and the United States Postal Service specifically recommended this alternative. Moreover, several commenters, including Johnson Controls and Hogg, Allen, Norton & Blue, even though they did not choose this alternative, believe this to be the least disruptive alternative since it most closely approximates the present two-level methodology.

The Air Force believes this to be the least costly of all the alternatives proposed and that experience over the past twenty years shows that a methodology providing a two-tier system would best ''meet the needs of large or high-skill contractors and provide a representative rate for the small and low-skill contractors.'' The Air Force further believes that ''[t]he current problems with the two rate system stem from the inconsistent application of the two fringe benefit levels resulting in confusion and frustration by Federal contracting agencies, contractors, and service employees.'' The Air Force favored establishment of regulations that would ''place a high fringe benefit level only on large dollar contracts and contracts that require the use of a highly skilled workforce.''

The United States Postal Service preferred this alternative so that ''the current methods of calculating wages and benefits for highway transportation contract employees would be continued.'' The Postal Service's preference stems from its desire to preserve the status quo with respect to the Department's current policy of special treatment of the mail transportation industry.

The primary objections to this alternative are that the two levels are inconsistently and subjectively applied to contracts and that the insurance level is too low to provide adequate benefits and/or attract and retain qualified employees. SEIU points out that ''size-of-establishment'' data has no direct correlation to the population of establishments performing SCA contracts and the types of contracts to which the two benefit levels apply, *i.e.*, the size of the business has no relationship to the nature of the service contract or to the level of benefit applied under the current methodology. SEIU and the AFL–CIO both stated that the ''size-of-establishment'' approach for the lower ''insurance'' rate has been rejected by the Department's Board of Service Contract Appeals.

Alternative V–B: Issue two fringe benefit levels based on BLS ECI size-of-establishment data for all workers in private industry (variation of current methodology—applied by size/number of employees on contract; lower fringe benefit rate based on ''total benefit'' level). This alternative was favored only by CCAR Services, Inc., an employer of persons with disabilities, whose primary concern was that an increase in the cost of benefit packages would result in a reduction in the number of employees on government service contracts.

The Air Force opposed this alternative because of the problems attendant to its application. The Air Force notes that ECI fringe benefit data is based on the number of employees in the firm, whereas the suggested application would be based on the number of employees on the contract. The Air Force believes this illogical given that many large firms that would normally pay high fringe benefit rates have contracts that utilize only a small number of employees. CSA states that employees would be penalized for working on smaller contracts and that it would be difficult to attract and retain highly skilled workers on small contracts. Finally, Job Options, Inc. states this alternative would lead to a perception by employees of arbitrariness and unfairness since ''there is really no difference from the workers point of view whether or not he or she works for a large or small employer, the workers' needs are the same. Therefore, to either penalize or reward them based on the size of the employer seems unfair to employees.''

Other Alternatives

Unions' Proposal

The union commenters suggested an alternative methodology that would maintain the existing ''two-tier'' system, including the ''total benefits'' rate (currently at $2.56) utilizing the current methodology, but would provide a different methodology for determining only the lower ''insurance'' rate.[5] SEIU and the AFL–CIO both stated that the Department should continue to set the lower fringe benefit rate based on the cost that employers pay for insurance because BLS data shows that insurance is the only benefit which a majority of service workers receive. However, rather than using the ECI size-of-establishment data currently used to determine the ''insurance'' rate, the unions recommended using ECI all-industry data, but only after those establishments that reported no health insurance costs are factored out of the survey data, *i.e.*, after eliminating the ''zeros.'' The unions argued that inclusion of ''zeros'' as amounts paid for health insurance distorts the cost of health insurance paid by employers which actually provide health insurance, and therefore artificially deflates the prevailing fringe benefit rate. The AFL–CIO believes that its proposal would bring the ''insurance level'' cost within the range of $2.00.[6] As discussed below, the unions'' proposal also would include State, local and Federal data in the computation. They argue that inclusion of State and local data is appropriate because nothing in the Act suggests that prevailing rates are based only on private industry. They further suggest

[5] SEIU recommends that the ''Total Benefits'' rate should be ''frozen at $2.56 until such time as the ECI data for all benefits for establishments of 100 or more employees rises above the $2.56'' because the ECI data for 1995 and 1996 fell below this rate.

[6] Fringe benefit data with ''zeros'' excluded is not currently available from BLS. SEIU claims in its comments that BLS has informed them that ''establishments with zero health care benefits can be eliminated from the ECI data by some programming changes * * *''

that inclusion of Federal rates is appropriate because of the statutory provision for the Department to give ''due consideration'' to the rates paid Federal employees.

As an alternative, SEIU suggested that the ''insurance'' rate could be based on data derived from the Federal Employee Health Benefits Program (FEHBP). According to SEIU, the family coverage contribution rate under the FEHBP program was $1.65 in 1996, whereas a blend of single and family coverage rates as reflected in the actual cost per employee to the Federal government would amount to approximately $1.30 per hour. Apparently, SEIU would support either of these two rates as the basis for the ''insurance'' rate.

The Army believes that the unions' proposal to change the ''low'' rate methodology, but retain the methodology for computing the ''high'' rate as it now stands is a ''protectionist stance * * * that cannot be defended.'' The Army states that if DOL decides to continue with a two-rate methodology, the rationale for each rate must be the same. In other words, it would be illogical and inconsistent to determine the lower ''insurance'' rate based on all-industry data, while continuing to determine the higher ''total benefits'' rate based only on ''size-of-establishment'' data.

Insurance Plus Variable Rate

Fringe Insurance Benefits, Inc. (FIBI) recommended implementation of ''a prevailing rate for health insurance that is level and consistent for all employees on the contract and a pension rate that is based on either wages or job classification.'' Under this method, health care costs for each class of employee would be consistent, but other fringe benefits such as pension amount would vary by occupation or wage rate. FIBI suggested that this method would better conform to actual market place practices. Furthermore, FIBI suggested that the Department closely review the National Association of Insurance Commissioners' Small Employer Health Insurance Availability Model Act.

''Due Consideration'' and Inclusion of State and Local Data

Five organizations commented concerning the appropriate procedure for the Department to give due consideration to the wage and fringe benefits paid Federal employees, as required by the Act. Three unions and one contractor stated that due consideration should be given to the wage and fringe benefit rates being paid Federal employees in making SCA wage determinations. SEIU stated that due consideration was intended to narrow the disparity between the compensation received by Federal employees and service contract workers. SEIU's view is that Wage and Hour has made no attempt to determine the cost of Federal employees' fringe benefit in order to close the gap. The AFL–CIO contends that the Department cannot rationally maintain that it gives ''due consideration'' to Federal wage and fringe benefit rates, as required by the statute, when Federal workers are excluded from the data on which the SCA fringe benefit rates are based. LIUNA and Lockheed Martin concurred that in computing the insurance level, ECI insurance benefit costs from all civilian sectors, including government employees, should be used.

The unions strongly supported the inclusion of fringe benefits paid to all public employees, including State and local as well as Federal employees, in SCA fringe benefit rate determinations. According to SEIU, data on fringe benefits paid State and local government employees is readily available in that the ECI now publishes data on fringe benefits paid to ''civilian workers'' including both private and State and local workers combined. SEIU and the AFL–CIO also maintain that data on fringe benefits paid to Federal workers, which SEIU states is ''readily available'' from the Office of Personnel Management, should also be factored into the fringe benefit rates. SEIU states that fringe benefits received by State, local, and Federal workers ''tend to be higher than the fringe benefits paid in private industry'' and their exclusion artificially suppresses the rates currently published by the Department. The unions pointed out that neither the Act nor the regulations make a distinction between private and public service employees, and therefore, there is no basis for excluding public sector fringe benefit data.

In contrast, the Air Force states that if ECI fringe benefit data is to be used, State and local government fringe benefit data should be excluded. The Air Force states that not only are fringe benefits paid by these entities ordinarily above the levels provided by local private industry, but that a disproportionate number of these employees are represented by unions. These factors would tend to skew the data and results, just as would the inclusion of Federal government data. Furthermore, the CSA states that the benefit rate should be based on private industry data and does not believe that the Department should explore the cost and feasibility of expanding ECI to include fringe benefits of State and local workers.

''Grandfathering'' or ''Phase-In''

Nine organizations provided comments concerning the possibility of ''grandfathering'' and/or ''phasing-in'' any of the proposed alternative health and welfare benefit rate(s). CSA and its member contractors specifically recommend that the current ''total benefit'' level of $2.56 be ''grandfathered'' throughout the life of all existing contracts, including all options and extensions, and that all new contracts and recompetitions convert to the new health and welfare rate at the time of award. The Navy concurs that ''the revised benefit rate should be implemented only at the resolicitation of a contract, or the new solicitation of contract services.'' The Navy also states that ''[a]ny existing contract would continue with the same present benefit level through the end of that contract, regardless of options or extensions.'' The Navy did not specifically indicate whether its ''grandfathering'' scheme would apply only to the ''total benefit'' level or would also apply to the current ''insurance'' level of $.90 as well. The Army also agrees that ''implementation should occur when a contract is being resolicited or a new requirement is being awarded.'' The Army anticipates that this would allow implementation ''to occur over a period of one to four years, given the fact that most contracts are for a five year term.''

KIA, on the other hand, suggested that contracts subject to the $2.56 level be ''grandfathered to protect the current level until such time as the lower single level of $1.89 can catch up to it.'' Hogg, Allen, Norton & Blue also offered this suggestion. These commenters generally believe that this approach would protect incumbent employees against a reduction in their fringe benefits upon recompetition and would protect incumbent contractors against predatory pricing practices by non-incumbents at the time of recompetition. They believe that grandfathering the high benefit level until the new rate catches up, provided it is not cost-prohibitive for the agencies involved, would cause the least disruption for contractors and employees alike.

SEIU states that equity dictates that no employee's benefits should be cut back. In addition, LIUNA believes it appropriate for the Secretary of Labor to issue an exemption or variance for purposes of preserving the current high benefit rate. Another organization concurred, stating that because of the inevitable employee dissatisfaction resulting from a reduction in benefits,

contracts should be grandfathered to protect the current level ''until any lower level H & W rate can catch up because failure to do so would negatively impact employee morale and retention.''

The AFL–CIO proposes a two-year phase-in approach for implementation of its recommended new ''insurance'' rate. The AFL–CIO recommended that implementation of the new ''insurance'' rate start with all contract anniversary dates after September 30, 1997, and that only one-half of the difference between the current rate and the new rates which would otherwise apply for fiscal year 1998 be implemented at that time. On the next anniversary date of the contract, the second half of the increase would be implemented.

The Air Force strongly opposes grandfathering the high fringe benefit level should a final rule be adopted to change to a methodology other than Alternative V–A. The Air Force objects to the Department artificially retaining higher fringe benefit rates, which they do not believe to be supported by the surveys. The Air Force recommends a ''phase-in'' period whereby the rate[s] would ''take effect only upon recompetition of each contract.'' The Air Force believes that, while a phase-in period would not reduce the eventual cost of the benefit increase, it would at least serve to ''reduce the immediate negative impact on employees facing layoffs.''

The Defense Commissary Agency recommends against a permanent grandfathering at the current rate because that agency believes that the current rates are already too high for the type of work for which it contracts. Instead, the Defense Commissary Agency recommends a phase-in period of two years, with half the reduction occurring the first year, and movement to the then-current rate the second year.

Analysis

Based on a careful review of the comments and further analysis of the various alternatives, the Department has concluded that Alternative I best accords with the Department's dual responsibilities to determine fringe benefits which prevail, and to select a methodology which is administrable and not unduly disruptive for employees, contractors, contracting agencies, and the Department. Currently there are no occupation-specific or locality-based fringe benefit data available. Furthermore, virtually all commenters opposed any alternative which would result in their having to pay different fringe benefits to different classes of workers or in different parts of the country. While recognizing that no methodology will satisfy all parties interested in the service contracting process, the Department believes that Alternative I represents a reasonable application of the statutory requirement to establish prevailing fringe benefit rates and best meets the concerns expressed by the commenters to the Department's proposal. (See also the discussion below concerning the Department's issuance of a variance under Section 4(b) of the Act.)

Pursuant to the Alternative I methodology, the applicable fringe benefit level would be based on employer costs per hour worked for all benefits—excluding holidays and vacations, which are separately determined, and excluding benefits otherwise required by law, such as social security, unemployment insurance, and workers' compensation payments—as reported annually by the BLS Employment Cost Index (ECI) study of employer costs for employee compensation in the private sector (i.e., all workers, all industries, all establishment sizes, and all occupations). Under this ''total benefits'' approach, the Department will issue a single nationwide health and welfare fringe benefit level applicable to all employees engaged in the performance of SCA-covered contracts, based on the average cost[7] for the following compensation components:

(1) sick and other leave (excluding vacation and holiday leave);

(2) insurance, consisting of life, health, and sickness and accident insurance plans;

(3) retirement and savings, consisting of pension and savings and thrift plans; and

(4) other benefits not otherwise required by law.

The Department chooses Alternative I because, as noted by many commenters, this determination method is simple to understand and to comply with, and relatively simple to administer and enforce. The Department also chooses Alternative I because it is consistent with the Department's general practice of using cross-industry data which is not differentiated by size-of-firm in determining prevailing wage rates. The Department has concluded that use of size-of-firm data should not be continued because the Department's application of the two benefit levels did not in fact correspond to the size of the employer, and because review of the survey conducted in preparation of the Department's impact analysis (61 FR 55239, October 25, 1996) led the Department to conclude that the low ''insurance'' level which was applied to most contracts was particularly inappropriate for the large numbers of white collar and skilled blue collar workers employed on Federal service contracts.

Furthermore, the Department prefers Alternative I over the current methodology (Alternative V–A) because it addresses concerns expressed by commenters that the current two-tier system has been inconsistently and subjectively applied. This approach is also preferable because it applies the same minimum hourly benefit level for all service employees and does not require any subjective judgments as to which benefit level to apply based on the type of contract or employee. Accordingly, adoption of Alternative I will largely avoid the potential for employee morale problems and perceptions of unfairness and inequity that are inherent in the current system and in those alternatives that would establish different rates for different occupations (Alternatives II–A, II–C, and IV).

The Department also notes that Alternative I provides a benefit level that is sufficient for service contract employees to obtain meaningful health insurance coverage and will allow service contractors to obtain and retain qualified employees. This is consistent with the Department's goals of encouraging employers to provide a high quality and high performance work place. In contrast, the current low insurance fringe benefit level, because it is based on only ''small'' employers and averages in those employers which provide no fringe benefits, has resulted in a fringe benefit level significantly lower than the level actually paid by employers in private industry.

Alternative I also is consistent with the desire of almost all commenters that health and welfare fringe benefit rates be based upon nationwide data. The Department agrees with those commenters which opposed the alternative (III) which would base rates on the four regional breakdowns because it does not take into account the potentially wider prevailing rate disparities *within* regions and because employers commented that they generally provide similar benefits to their employees regardless of location.

The Department has decided not to mix State and local government fringe benefit data with ECI private industry data in determining the fringe benefit

[7] The cost of the benefit components in the BLS ECI study is an average based on data from all employers in the survey, including those employers that do not provide the particular benefit. Averaging in these ''zeros'' gives consideration to the degree to which a benefit in fact is paid by employers.

level applicable under this methodology. The Department has concluded that the determination of the prevailing fringe benefit level should be based only on private industry data since this is the sector that competes for government contracts. Public employee benefit rates are not representative of the benefit levels paid by the universe of private firms that comprises SCA contractors. Rather, fringe benefit levels paid by State and local governments are substantially different than private industry, and consequently, inclusion of such data would inappropriately skew the fringe benefit determination.

The Department has also concluded that inclusion of Federal fringe benefit data is not feasible.[8] The Department has not been able to obtain usable cost data for Federal benefits other than health and life insurance. The pension system provides a defined benefit package for one group of employees[9] and a defined contribution system for others, with contributions which vary according to the level of contributions by employees. Pension and sick leave both vary with the pay of employees. Thus, it is apparent that data on fringe benefits paid to Federal employees would not readily mix with ECI private industry data. However, the Department has taken ''due consideration'' of the Federal benefit system in its selection of Alternative I, which utilizes ''total benefits'' data and will bring SCA fringe benefit levels more into line with Federal benefits.

The Department shares the view of many commenters that any change in the methodology should avoid the serious adverse effect of a substantial reduction in fringe benefits for those service employees currently employed on contracts subject to the ''total benefit'' level. We anticipate that employers paying the higher benefits in accordance with past determinations of the Department will face the Hobson's choice of cutting fringe benefits for their workers (possibly losing them to employers who are not Federal service contractors which pay higher fringe benefit packages) or becoming uncompetitive. Similarly, Federal agencies may lose the continuity of services provided by major contractors which may become uncompetitive, or by valuable employees who leave because of the reduction in their fringe benefits.

Accordingly, the Department has concluded that the current ''total benefit'' level should be grandfathered at the present rate ($2.56 per hour) until the single benefit provided by Alternative I (all-industry, all-occupation average) reaches or exceeds $2.56. This grandfathered rate will apply to all contracts which currently contain the high, ''total benefit'' level, and future solicitations for those contracts. The grandfathered rate will not apply to contracts for new services.

The Department also believes it is necessary to allow contracting agencies (which may have budgeted based upon existing fringe benefit levels) and contractors (which will likely need to develop new fringe benefit plans) a period of time in which to prepare for the change in minimum fringe benefit levels. Accordingly, the new methodology established by this final rule will apply only to wage determinations issued on or after June 1, 1997. This date was selected so that the new rate will apply to contracts solicited and options exercised for the fiscal year beginning October 1, 1997. For the same budgetary and planning reasons, the Department has also concluded that a four-year phase-in of the rate set by the new methodology would be appropriate. The Department believes that this approach is preferable to the alternative suggestion of applying the new rate only to new solicitations, and not to extensions and options on existing contracts, because it is more equitable. Furthermore, the Department is concerned about potentially serious problems in applying the proper fringe benefit determination because of difficulties in ascertaining whether the wage determination is needed for a new contract or exercise of an option.

As discussed above, most of the alternative methodologies proposed did not garner significant support from commenters, though they were fully considered by the Department in light of the rulemaking record.

The Department did not select Alternative II–A, which would set different rates for each of six occupational groups, because it would be much more difficult for contractors to administer and for Wage-Hour to enforce. The Department considered it significant that commenters stated that providing different levels of benefits according to occupation is contrary to the common practice of employers providing the same benefit program to most employees, and that it would be difficult for insurance carriers to accommodate. Commenters also agreed generally that having different benefit levels based upon occupation would create serious labor-management and morale problems. The Department also shares the concern expressed by several commenters about subjectivity inherent in this alternative and the possibility that some contractors might attempt to manipulate the classifications in order to obtain a competitive advantage.

Alternative II–B is similar to Alternative I in that it would provide a single benefit level for all employees and all contracts. However, no commenters responded favorably to this new concept for computing health and welfare fringe benefits, which would set the fringe benefit level based upon available information regarding the mix of occupations used on Federal service contracts. Under this alternative, fringe benefit rates would be determined based upon the survey the Department conducted last year which formed the basis for its impact analysis. Commenters generally expressed little confidence in the Department's efforts to determine the occupational mix on SCA-covered contracts.

The Department did not select Alternative II–C for many of the same reasons it declined to adopt Alternative II–A. Reducing the occupational groupings from six to two would decrease the frequency of having different levels paid to groups of employees on the same contract. However, where that situation arose, there still would be a distinct possibility of perceptions of discrimination and consequent employee morale problems. Moreover, determining the appropriate mixing and weighting of the various occupational group rates would be difficult.

The Department rejected Alternative III because the Department agrees with the many commenters expressing the belief that establishing benefit rates on a regional basis offers no significant advantage over using a nationwide rate. To the contrary, regional data does not reflect variations in labor costs and fringe benefit rates *within* a region, which, as the commenters pointed out, are often more substantial than variations among regions. Moreover, this option would be inconsistent with the reportedly common practice among employers, including service contractors, of providing similar fringe benefits to most employees nationwide, without regard to either occupation or geographic location. This alternative would be particularly problematic to those government service contractors which perform contracts for similar services at various facilities and installations throughout the country. It

[8] Inclusion of Federal benefits would likely have little impact in any event. For example, Federal health insurance would affect the insurance level by no more than a few cents per hour.

[9] The level of the defined benefit plan presumably is also affected by the fact that participating employees do not receive credit towards Social Security benefits for their period of Government service.

could also create serious administrative problems for service contractors whose contracts require performance in multiple locations that fall within different regions.

Alternative IV (benefits based on a fixed percentage of each employee's wages) was not chosen by the Department primarily because of the extreme difficulty that would be posed by its administrative requirements. Several commenters expressed serious concern that the additional administrative and recordkeeping requirements that would be associated with this alternative would simply be too burdensome, especially for smaller contractors. Although the Department is of the view that there is a correlation between wage levels and fringe benefits paid when viewed across the entire workforce, the Department recognizes that individual employers reportedly provide the same or similar benefit packages to most employees (especially insurance benefits), without regard to wage levels. Moreover, the Department agrees with the commenters that this alternative has the greatest potential for creating problems of inequity and morale in the workf orce. The Department also notes that under this alternative many lower paid workers simply would not receive adequate health insurance.

As discussed above, the Department decided against continuing the methodology proposed under Alternative V-A or the variation proposed under Alternative V-B primarily because of the lack of evidence justifying continued use of ECI ''size-of-establishment'' data, which has been difficult to defend before the Board of Service Contract Appeals, and commenter concerns regarding the manner in which the two rates have been applied and the resulting effects on the morale of the work force.

The Department also seriously considered the union proposal. The Department was concerned about the lack of opportunity for comment on this specific alternative. Furthermore, the Department believes that the union proposal, which would maintain the existing ''two-tier'' system, including the current method for determining the high ''total benefits'' rate, while providing a revised methodology for determining the lower ''insurance'' rate, would be difficult to support given that the two rates would be based on inconsistent methodologies. Under the union proposal, the high ''total benefit'' rate would continue to be set based on ECI ''size-of-establishment'' data for large firms (establishments with 100 or more employees). However, the Department's use of ''size-of-establishment'' data was successfully challenged in proceedings before the BSCA. Though the specific challenge was to the use of ECI ''size-of-establishment'' data as a basis for the low ''insurance'' rate, the Department believes that any legal shortcomings identified in that action would likely apply as well to the use of such data in establishing the ''total benefit'' level. Neither the comments nor the Department's own survey provided evidence to refute the Department's statement in its Notice of Proposed Rulemaking (61 FR 19773) that the major problem with the continued use of ''size-of-establishment'' data is that there is little evidence to show that the average benefit level for small firms corresponds best to benefits paid by private employers on contracts similar to most SCA contracts, or that the benefit level paid by large firms corresponds to the rates paid by employers on contracts to which the ''total benefit'' package has been applied under SCA. Thus, just as there is questionable justification for relying upon ''size-of-establishment'' data as the basis for the ''insurance'' rate, there is equally questionable basis for relying upon such data in setting the ''total benefit'' rate. Finally, the union proposal would continue to raise concerns about the potential for inconsistent and subjective application of the two levels.

The Department also rejected the alternative suggested by the FIBI. Like the union alternative, this alternative had not been offered for public comment. It has the distinct advantage of being consistent with many employers' reported practice of providing one insurance benefit package to their employees, while providing pension or other benefits at a level varying with wages. However, the Department is concerned that this proposal would be difficult and burdensome to administer, requiring detailed recordkeeping.

IV. Comments and Analysis of Other Fringe Benefit Issues

Variance Under Section 4(b) of the Act

Approximately ten organizations commented regarding the Department's proposal to issue a variance under Section 4(b) of the Act from the statutory requirement that the Secretary determine prevailing fringe benefits for the various classes of service employees in the locality.

Johnson Controls stated that using a single nationwide rate ''does not reflect the economic factors of the local geographic areas for the prevailing benefits from a competitive and comparability standpoint. Nationwide average data is skewed and does not reflect a valid depiction of benefits when compared with local geographic prevailing benefit data.'' However, Johnson Controls did not identify any source of locality-based fringe benefit data nor did it support the use of regional data as proposed in Alternative III. Rather, Johnson Controls opposed use of such regional data because it would not take into consideration ''the economic fringe benefit differences within the region.''

SEIU stated that the absence of available data that could be used to set the fringe benefit rates on a locality basis is universally recognized. SEIU therefore supported the Department's proposal that ''a variance be permitted to establish national fringe benefit rates on the grounds that there is no reliable locality data available which would permit the department to establish fringe benefit rates on a locality basis.'' The AFL-CIO believed that ''only a national 'insurance level' rate is practical and consistent with the SCA.'' The AFL-CIO favored nationwide rates not only because of the absence of reliable locality-based data, but also because many insurance plans operate on a national basis and Federal service contractors often operate in multiple locations.

District No. 5—ITPE, NMU/MEBA (AFL–CIO) stated that they strongly support the position of the AFL–CIO that the fringe benefit rates should be uniform throughout the nation. In addition, the CSA recommended that the Department continue to issue health and welfare benefits on a national level stating that employers typically provide similar benefits regardless of location. Most of CSA's member companies felt that the utilization of locality-based fringe benefit data for selected metropolitan areas is not a desirable practice. Further, they felt that the benefits derived from collecting the data on a locality basis would not be worth the considerable survey costs.

The Air Force also did not favor using locality-based fringe benefit data for certain metropolitan areas. In their opinion, the resulting disparity in fringe benefit rates for large metropolitan areas versus the remainder of the nation would be inequitable and discriminatory to those workers outside the metropolitan areas.

Pony Express stated that any plan should take into account the differences in pay and fringes by region or locality.

After review of the comments, the Department has concluded that it is

appropriate to issue a variance from the statutory requirement in Section 2(a)(2) of the Act that the Secretary determine the fringe benefits to be prevailing for the ''various classes of service employees'' ''in the locality.'' Fringe benefit data simply are not available for specific classes of employees or localities. Furthermore, it is evident from the comments that there would be significant administrative burdens to employers in providing fringe benefit plans which vary by locality or by class of employee. Such a system would be contrary to the reportedly common practice by employers, as evidenced by the comments, of providing one fringe benefit package to most employees. Any other system would likely also result in significant morale problems among employees.

Therefore, the Department has determined that a variance is necessary and proper in the public interest. Furthermore, the Department has determined that in light of the reportedly common practice of employers providing the same fringe benefit plan to most employees, a variance to provide a uniform nationwide level of benefits would be in accord with the remedial purposes of the Act to protect prevailing labor standards.

Different Benefit Levels for Certain Industries

The National Star Route Mail Contractors' Association and their member organizations support the current method used by the Department for setting wage and fringe benefit rates for the mail hauling industry. The Department sets wage and fringe benefit rates for the mail hauling industry for four geographic regions based on a special survey by the U.S. Postal Service. Wage determinations applicable to this industry contain monetary amounts due for health and welfare and pension benefits.

In addition, both the Department of the Army and the Department of the Navy supported having variation in fringe benefit rates under certain circumstances. Specifically, the Army stated that if a national rate were the standard, it would be important that the contracting agencies have the ability to challenge that one rate by industry. Moreover, if rates are found to be significantly lower for a particular industry, then the DOL should deviate from that one rate and set a lower rate for that industry. The Department of the Navy supported having a single health and welfare benefit rate for all SCA wage determinations. At the same time, however, it suggested use of the Section 4(b) variance procedure to prevent impairment of the Government's business where the agency can show that the fringe benefit rate determined under these regulations ''would prevent adequate contract competition.''

After review of the comments, and in consideration of the limited circumstances where special wage rates and fringe benefit rates are currently issued for certain industries, the Department has determined that it is appropriate to allow variances to permit industry-specific fringe benefits in certain limited circumstances upon application of the contracting agency. Such variations from the single nationwide rate will be allowed only on a showing that the variation is necessary and proper in the public interest or to avoid the serious impairment of government business. This might be satisfied, for example, where an agency is unable to obtain contractors willing to bid on the services because the service will be performed at the contractor's facility by employees performing work for the Government and other customers, and as a result, paying the required SCA fringe benefits would cause undue disruption to the contractor's own work force and pay practices. In all cases, in order to obtain a variance, it will also be necessary for the contracting agency to provide comprehensive data from a valid survey demonstrating the prevailing fringe benefits for the specific industry (not broad ECI data), in order to demonstrate that the variance is in accordance with the remedial purpose of the Act to protect prevailing labor standards.

This variance procedure does not constitute an opportunity to request a separate fringe benefit package for every class of employee or industry, but rather will require a showing of special circumstances. As discussed, it is evident from the ECI that practices do in fact vary widely among industries and occupations. Such an industry-by-industry or occupation-by-occupation approach has already been rejected through the consideration of the various alternatives and the decision to issue fringe benefit determinations without regard to occupation and based on cross-industry data.

If the criteria for granting a variance are met, and industry-specific data are found to be adequate for establishing an alternative prevailing fringe benefit determination, the party presenting such data will be responsible for updating the data on a regular basis. If the data are not regularly updated, then future procurements will be subject to the standard cross-industry determination.

Significant support was received for continuing the special fringe benefit determination for the mail transportation industry. The regulation acknowledges the appropriateness of industry determinations under certain conditions; the specific merits of such an approach for the mail industry is not appropriately an issue for this rulemaking proceeding, but will receive the Department's prompt attention.

Average Cost

Approximately 15 organizations commented regarding the average cost issue. Under the Department's regulations at § 4.175, fringe benefit contributions (or cash payments in lieu thereof) must ordinarily be made with respect to each service employee in the amount specified on the wage determination for all hours worked on the contract up to 40 hours per week. However, the regulations at § 4.175(b) prescribe a different compliance rule where the wage determination specifically identifies the benefit as an ''average cost.'' Under the ''average cost'' fringe benefit determination, a contractor's contributions to a ''bona fide'' fringe benefit plan may vary among employees so long as total contributions for all hours worked (not just hours up to 40 in a workweek) by service employees on a particular contract average at least the specified amount per hour per service employee. In practice this average cost methodology is used only for the high ''total benefits'' fringe benefit rate.

CSA (and its 35 or so member organizations which filed comments in general support of CSA's comments) supported the average cost concept because of the flexibility it permits employers in the establishment of fringe benefit plans. Specifically, the CSA (and CSA member organizations which concurred with CSA's comments) stated that average cost is the preferred method because it allows companies to offer benefits in a comprehensive package that provides a variety of options. It allows for flexible benefit design for employees and helps service contractors to remain competitive. CSA stated that the average cost concept is the basis for the development of group insurance premiums, and that it allows for more efficiency in auditing. CSA believed that eliminating average cost would cause such an administrative burden on larger employers with self-insured medical plans that such an option would no longer be feasible. CSA also believed that the average cost concept allows small companies to obtain relief from administrative burdens by ''outsourcing benefits administration and/or

purchasing 'packaged service contract benefit plans.' ''

National Star Route Mail Contractors' Association and seven member organizations strongly oppose the use of an average cost concept. While acknowledging that some type of average cost concept ''may be advisable,'' National Star Route believes that any advantages would be outweighed by the significant administrative and bookkeeping difficulties inherent in such a system, especially in circumstances where ''an employee works on several contracts covered by different wage determinations.'' National Star Route was also concerned that use of average cost would result in substantial decreases in benefits for large numbers of service employees, would not guarantee equal benefits to all employees, and would create the possibility that some employees would not be provided with any benefits (*e.g.,* employees not working enough hours to become eligible for medical coverage). In short, National Star Route believes that ''[i]nstead of averaging, employees should be benefitted on their individual basis.''

National Star Route also believes that an averaging system would necessitate delay in some fringe benefit payments, since that averaging process would have to await the closing of the pay period. Finally, National Star Route expressed strong opposition to any methodology that would require its members to make fringe benefit payment for hours worked over 40. It stated that this would create such an increase in their overall labor costs that they might be rendered non-competitive against railroads, airlines and ''various transportation groups within the U.S. Postal Service itself,'' thus causing the trucking industry to lose its market share of mail transportation.

Other commenters opposed to the average cost concept stated that the unequal division of benefits would unfairly disadvantage single versus married employees and short-term versus long-term employees. Some commenters foresaw the possibility that ''a handful of very compensated employees could tilt the average high enough to meet the minimum average benefit with little or no contributions to the 'average' employee.''

The Air Force also opposed the average cost concept in conjunction with any of the proposed fringe benefit methodologies. The Air Force believes that average cost allows some workers to receive preferential compensation based on personal circumstances, and that some companies use average cost to ''exclude specific workers or to cause portions of their work force to suffer at the expense of more favored groups.'' The Air Force is of the opinion that it is more appropriate ''for workers with higher risks or with more costly health care plans to pay these costs individually and not cause other workers to pay disproportionate shares of earnings or benefits to subsidize others.'' The Air Force also recommends that regulations be adopted to limit the hourly fringe benefit contributions to the standard 40 hour work week since ''this is routinely done for both the private sector and government sector benefit plans.''

The Department has concerns as to whether it is appropriate to expand the average cost concept to the basic fringe benefit level to be established under Alterative I. The Department is concerned that this concept, which would involve a radical change for most contractors, did not receive sufficient attention in the comments to warrant further action at this time. The Department is also concerned about the inequities of averaging, which allows contractors to make arbitrary determinations to deny fringe benefits altogether to some workers or classes of workers. Currently this system, which may be difficult to understand and administer for small contractors, is utilized primarily by sophisticated major contractors. Furthermore, the average cost concept requires payments or contributions at the prescribed fringe benefit level with respect to all hours worked, including hours over 40. Therefore this method could increase the costs of some contracts where the employees work a significant amount of overtime.

On the other hand, the Department recognizes the advantages of allowing averaging across a workforce where a contractor has an elaborate fringe benefit system with variable costs based on factors such as choice of health benefit plans, and pension and sick leave contributions, and payments which vary based on wages. The Department is considering further rulemaking on this issue and would welcome additional comments, including comments on any revisions to the current averaging method which may be appropriate. If there is significant support, the Department will consider further rulemaking. In the meantime, the Department is making no change in the regulation at § 4.175(b).

V. Comments and Analysis of Other Issues

Time-Frame for Section 4(c) Substantial Variance Hearings

The SCA and the regulations provide a procedure to request a determination that collectively bargained wages and fringe benefit rates required to be paid pursuant to Section 4(c) of the Act are ''substantially at variance'' from prevailing local wages or fringe benefits. The Department requested comments on a proposal suggested by the National Performance Review (NPR) that the regulations be tightened to provide a 60-day time-frame for completion of substantial variance hearings.

Seven organizations commented concerning the Section 4(c) variance issue. SEIU, AFL–CIO, CSA, District No. 5—ITPE, NMU/MEBA (AFL–CIO), and the LIUNA strongly opposed the proposal to reduce the 60-day time limit to conduct the entire Section 4(c) hearing process. They believed that the proposed restricted time frame for the completion of substantial variance hearings is totally impractical and should, therefore, be rejected. In fact, they believe the current time-frame of 60 days from the issuance of an Order of Reference until the opening of the hearing to be too short; they recommended that if any changes in the time-frames were to be made, the deadline should be extended.

The unions stated that this ''fast track'' approach, suggested by the National Performance Review without input from workers and unions, ignores the practical difficulties of litigation. They point out that in most instances where the contracting agency requests a substantial variance hearing, ''the agency has enjoyed the benefit of months spent assembling the data that it will use to challenge the wage rates negotiated between the service contractor and the unions. The new time frame suggested essentially forces the service contractor or union to proceed to the substantial variance hearing without the time necessary to assemble the supportive evidence.''

The Army suggested that the time frame be expanded to within 90 to 120 days. They stated that the current system can take years and affords no relief to the agencies.

In contrast, the Air Force strongly supported any effort to reduce the amount of time in the substantial variance process. The Air Force stated that reducing the time-frames will force the parties to address the issues in a prompt manner, while simplifying the process, and stated that an unbiased third party should be able to look at the

facts and determine if the data supports the existence of a substantial variance. They assert that the fact that the contractor must continue to pay the rates being challenged in the hearing makes it imperative that a timely and final decision be made. Finally, the Air Force recommended that regulations be implemented to stay the payment of rates that are being challenged until the final decision is made. In this regard, the Air Force stated as follows:

> The current structure forces the contracting agency into paying the cost of the increased rate or rates until a decision is made. This leaves the contracting agency no way to recover funds paid on rates that are ultimately determined to be substantially at variance. If rates are deemed to be at variance, this results in legal victory without proper cost recovery. If the rates were temporarily frozen this would not result in a loss if the final determination was made that rates did not substantially vary. It would simply delay the payment long enough for that decision to be made and applied.

The regulations currently provide a period of only 85 days from the date of the Order of Reference to the Chief Administrative Law Judge to appoint an administrative law judge (ALJ) to conduct a hearing, to the date of the ALJ decision. It is believed that this time-frame, if followed, provides a sufficiently fast track for proceedings. In addition, the Department has initiated a procedure to alert affected parties (union, contractor and agency, as appropriate) when a request for a substantial variance proceeding is received, in order to allow additional preparation time.

Other Proposals

The Department also proposed certain minor, technical modifications necessitated by amendments to the FLSA, a 1985 court decision, a 1983 treaty, and a 1986 intergovernmental compact. The Department received no comments on these minor proposals and has decided to proceed with these proposed minor changes.

In order to conform to more recent amendments to the FLSA establishing a new minimum wage, § 4.2 is revised to delete the reference to now out-of-date minimum wage rates; likewise, the tip credit example in Section 4.6(q) is modified to delete the language in the proviso that is based on the minimum wage rates provided by the 1978 amendments to the FLSA.

The text of § 4.112, which was invalidated by the 1985 court decision in *AFL-CIO* v. *Donovan*, 757 F.2d 330 (D.C. Cir. 1985), is modified to reinstate the language of the previous regulations as they appeared in the July 1, 1983, edition of the CFR. Final regulations published on October 27, 1983 (48 FR 49736), among other things, established a new provision in 29 CFR 4.112 that would have excluded from the Act's coverage contracts under which only a minor or incidental portion of the services would be performed within the geographical limits of the United States as defined in the Act. The D.C. Circuit held that this new provision had been adopted in violation of the notice-and-comment requirements of the Administrative Procedure Act. Under the restored language, which conforms to the Department's practice in the administration of this provision since the 1985 decision, if a service contract is performed in part within and in part outside the United States, any portion performed in the United States is covered.

In addition, the restored regulatory language includes changes that were necessary to conform to more recent enactments pertaining to the geographic scope of the SCA. As indicated in § 4.112, the SCA covers contract services furnished ''in the United States,'' as that phrase is defined in Section 8(d) of the Act. The geographical area included within this definition was changed in the invalidated 1983 regulation to conform to the Treaty of Friendship Between the United States and the Republic of Kiribati, T.I.A.S. No. 10777, ratified June 21, 1983, by excluding Canton Island. The regulations are further amended to take into consideration changes necessitated by the 1986 Compact of Free Association between the United States and the Governments of Marshall Islands and the Federated States of Micronesia, set forth at 48 U.S.C. 1901 note, to exclude the Eniwetok Atoll, and the Kwajalein Atoll. In addition, pursuant to the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, set forth at 48 U.S.C. 1801 note, all laws not explicitly dealt with elsewhere in the Covenant which are applicable to Guam and are of general application to the States, are applicable to the Commonwealth of the Northern Mariana Islands (CNMI). Because the SCA is applicable to Guam, the regulation is amended to add the CNMI.

VI. Conclusion

For the foregoing reasons and after consideration of all of the comments submitted in response to the proposed rule published on May 2, 1996, in the Federal Register (61 FR 19770) and the preliminary regulatory impact analysis published in the Federal Register on October 25, 1996 (61 FR 55239), the Department is making the following changes in the regulations:

The Department has decided to issue a new § 4.52 [10] to set forth the methodology for determining future prevailing fringe benefit determinations. The Department is adopting the methodology provided in Alternative I as the appropriate methodology for establishing minimum health and welfare benefit rates under the SCA. Pursuant to this methodology, the fringe benefit rate will be based on nationwide ECI data for all employees in private industry, and will include all benefits (excluding holidays and vacation, ''benefits otherwise required by law'', and supplemental pay such as shift differentials, considered to be wages under SCA).

This methodology replaces the current methodology of issuing two benefit rates, ''insurance'' and ''total benefit,'' based on ECI size-of-establishment data, which have applied to SCA contracts on the basis of the nature of the contract. However, the Department has decided to ''grandfather'' the current ''total benefit'' rate at its present level ($2.56) until the rate determined in accordance with Alternative I equals or exceeds $2.56. This grandfathered rate will apply to those contracts which currently are subject to the ''total benefit'' level, and to future solicitations for such contracts; the grandfathered rate will not apply to solicitations for new services.

The regulations will also allow for a four-year ''phase-in'' period under which only one-quarter of the difference between the current ''insurance'' rate and the new all-industry rate will be implemented for wage determinations issued on or after June 1, 1997. One-third of the remainder of the increase would be implemented the following year, and one-half of the remainder the following year. Beginning June 1, 2000, the new methodology will be fully implemented.

The Department has also decided that it is necessary and proper in the public interest and in accordance with the remedial purposes of the Act to protect prevailing labor standards to issue a variance pursuant to Section 4(b) of the Act and § 4.123 of the regulations from the Act's provisions that require fringe benefit determinations be made for various classes of workers in the locality. Pursuant to this variance, the Department will issue a nationwide level of benefits applicable to all classes of employees. The Department has also

[10] Existing 4.52 and subsequent sections are renumbered accordingly.

provided a procedure to permit contracting agencies to request a variance to allow industry-specific fringe benefits in certain limited circumstances. Finally, the regulation will continue to recognize as prevailing those situations (ordinarily where the provisions of a collective bargaining agreement are found to prevail) where a single fringe benefit rate is paid with respect to a majority of the workers in an occupation in a locality.

VII. Executive Order 12866/Small Business Regulatory Enforcement Fairness Act

On the assumption that the change in methodology for determining prevailing fringe benefits would have an annual impact on the economy of $100 million or more, the Department prepared and sought comments on its preliminary regulatory impact analysis (61 FR 55239 (October 25, 1996)). As discussed below, the Department has now completed its final regulatory impact analysis and has concluded that this rule, after full implementation, will have an annual effect on the economy of $100 million or more. Therefore the Department has concluded that the rule is economically significant within the meaning of Executive Order 12866, and that the rule is a major rule within the meaning of Section 804(2) of the Small Business Regulatory Enforcement Fairness Act. However, the rule does not require an economic impact analysis under Section 202 of the Unfunded Mandates Reform Act of 1995 because it will not require State, local, or tribal government, or private sector expenditures, in excess of $100 million in any one year; rather, the costs of the increases in fringe benefits will be borne by the Federal government.

Discussion of Comments

Five commenters provided specific comments regarding the Wage and Hour Division's SCA Occupational Employment Survey and Impact Analysis: the AFL-CIO, the Contract Services Association, the Navy, the Air Force, and the Army. Their comments concerned six areas:

Survey Purpose: The Army and Navy were critical of the survey for being directed exclusively toward Federal contractors whose wages and benefits are already established by DOL's own wage determinations, not by the labor market of the locality where the services are performed. At the same time, the Navy contended that ''prevailing benefits are unattainable by any reasonable or affordable survey effort.'' The Air Force criticized the survey because it did not survey ''prevailing rates'' in the locality labor market.

These comments reflect a misunderstanding of the purpose of the survey. The survey only sought information on occupational employment under the SCA, along with the relevant wage determination issued for each contract. As stated in several communications with each Federal agency asked to participate in the survey, its purpose was to ''estimate the distribution of employment by occupation on contracts covered by the McNamara-O'Hara Service Contract Act.'' As noted in the preliminary impact analysis, wage data utilized in the analysis were from the Bureau of Labor Statistics, Employment Cost Index, not from the fringe benefits paid by these contractors or from the wage determinations used for these contracts.

Survey Procedures: The Army, Navy and Air Force were critical of the survey procedures. Specifically, the Navy contended that receipt of the survey material was the first notification contracting agencies received from DOL that such a survey was being conducted. The Navy also contended that the survey methodology had not been discussed or coordinated ahead of time with the contracting agencies. The Air Force claimed that the survey was developed without agency Labor Advisor input. The Army stated that there was not meaningful coordination and communication between DOL and the Army.

As summarized in the preliminary impact analysis, the then U.S. Army Labor Advisor fully participated in the work group that helped design the survey procedures and materials. Staff of the Office of Federal Procurement Policy also participated in this process, which was initiated in April 1995. In June 1995, the U.S. Air Force and General Services Administration Labor Advisors participated in pilot testing the survey process and materials, and were specifically requested to provide ideas for improvement. The initial survey mailing was to each Federal Procurement Agency's Federal Procurement Executive, in September 1995. In that transmittal from the Wage and Hour Administrator, top agency procurement officers were asked to ''designate a data collection coordinator to assume overall responsibility for your agency's role in this special study.'' Several of these designees were the agency Labor Advisor, or comparable agency staff. These coordinators were asked to ''contact each of the offices responsible for contracts selected for this survey * * * and ensure that data collection instructions are properly followed).'' Throughout the course of the survey, written and telephone contacts were maintained between the Wage and Hour Division and participating survey coordinators.

Survey Universe: The Contract Services Association, Navy, and Air Force had concerns regarding the reliability of the survey universe. The Contract Services Association and the Air Force stated that the universe under represents the actual population of covered FTEs, especially contracts under $25,000. At the same time, the Navy claimed that the universe overstated the number of contracts, by including procurements that actually were not covered by SCA.

The preliminary impact analysis acknowledges that the FPDS excludes certain segments of the contract universe. ''For example, it does not contain data from the U.S. Postal Service, Air Force/Army Exchange Service, and most contracts under $25,000. Therefore, since the impact analysis is based upon a sample drawn from the FPDS population, estimates made only represent the covered contracts included in the FPDS, and should not be considered as representing the universe of all covered contracts. For this reason, the focus of the Impact Analysis was on the relative differences among costs likely to be generated by each alternative listed.'' (61 FR 55246) As with many large surveys, it should be expected that some sampled units may be wrongly included because they should not have been included in the population. Therefore, the questionnaires returned with notation by the contracting offices indicating that the contract was not covered by SCA were excluded from the survey and were used to correct the population of SCA-covered contract obligations by SIC. These corrections were based upon an assumption by the Wage and Hour Division that those closest to contract administration are best informed regarding SCA coverage.

Survey Findings: Both the Air Force and the Navy contended that the survey overestimates the number of contracts assigned the current high ($2.56) health and welfare benefit level and underestimates the number assigned the low ($0.90) level. The Navy stated: ''If one were to accept the contention made in DOL's survey impact report, that the ''high'' health and welfare benefit level is paid on a large percentage of all service contracts, that conclusion would be due in part to DOL's own historical practice of applying that benefit level artificially.'' The Navy further stated that the majority of contract workers are paid at or near the low health and

welfare benefit level, while an Air Force internal study concluded that 64 percent of FTEs are at the low level and 19 percent at the high.

In fact, the survey did *not* find a large number of *contracts* at the high health and welfare benefit level. Table 4 of the preliminary impact analysis clearly shows 80.7 percent of contracts at the low level, 14.3 percent at the high level, and 5.0 percent set by collective bargaining agreement pursuant to Section 4(c) of the Act. The survey did find 42.5 percent of FTEs at the high level, 34.1 percent at the low, and 23.4 percent under Section 4(c). Of course, there is no reason to believe that such ratios are necessarily the same for all agencies.

Survey Reliability: Four of the five commenting parties questioned survey reliability. The Contract Services Association, Air Force, and AFL–CIO expressed concern over the survey's ''7 percent'' response rate. In addition, the Contract Services Association and the Air Force questioned the size and representativeness of the sample. The AFL–CIO claimed that nonresponse to the survey was a source of systematic bias and error, resulting in population estimates not reflective of the SCA population.

As explained in the preliminary impact analysis, the survey usable response rate was 20.2 percent of the sample (not 7 percent). The sample, which was selected by contract value within industry group, represented 35 percent of the number of contracts in the population, and 63 percent of population contract value. Usable responses to the survey represented 7.2 percent of *population* contracts and 19 percent of contract value. At the same time, the apparent similarity to the FPDS data in the universe by industry appears to limit the potential for bias of the estimates obtained from the sample data. The process whereby FTE/contract value ratios (by occupational group within industry group), once established, were applied to the population (not the sample) to estimate FTE totals would also tend to limit the potential for bias caused by the low response rate.

Impact Analysis: The Air Force claimed that the survey underestimates the number of FTEs at the low health and welfare benefit level, and therefore that the impact analysis underestimates cost increases associated with the various alternatives. Based on its survey of Air Force contracts, the agency developed its own estimate of the cost of the current size-of-firm methodology ($612,202,240) and of the cost of Alternative I, based on increasing the low benefit to $1.89 ($970,503,040). The Air Force then compared its estimate of the cost of Alternative I to its calculation of the DOL estimates [11] ($720,462,080 and $961,800,320, respectively, according to the Air Force). Therefore, the Air Force concludes that a total annual cost increase of $358,300,800 would be incurred by accepting ''DOL's proposed single fringe benefit alternative of $1.89 per hour,'' and not the ''DOL estimate'' of $241,338,240.

Even assuming that the results of Air Force's survey of the number of contracts/employees subject to the two current fringe benefit rates could be generalized to other agencies, the Air Force analysis appears to be incorrect in four respects: (1) In doing its calculations of the DOL estimate, the Air Force seems to have mistakenly multiplied the low benefit health and welfare amount ($0.90) times the high benefit FTE total (117,200), and the high benefit amount ($2.56) times the low benefit FTE total (94,100). Therefore the Air Force underestimated the DOL current cost estimate by $79,741,585. (2) By underestimating current costs by almost $80 million, alternative cost increases were overestimated by a like amount. (3) The Air Force cost computations for Alternative I assumed the Department would continue to issue the high rate for contracts currently receiving that rate. Although comments were solicited on the issue of grandfathering the high rate, the Department's estimate was not based on this assumption. (4) The Air Force computations for combining the $2.56 with a $1.89 level appear to have understated costs by over $5 million.

Final Regulatory Impact Analysis

After review of the comments, the Department has concluded that there is no reason to change its estimates of the relative costs of the various alternatives projected, as set forth in the preliminary regulatory impact analysis.

The Department has now obtained 1996 ECI data, which shows that the all-private-industry, all-employee rate under Alternative I would increase from $1.89 (1995 data) to $1.91 (1996 data) per hour. The Department therefore has computed the cost of the alternative selected utilizing 1996 data, and based on the survey projection that 44.5 percent of covered employees (94,048 FTE) are employed on contracts currently subject to the low ($.90) benefit, and 55.5 percent (117,215 FTE) are employed on contracts currently subject to the high ($2.56) benefit:

1. The cost of prevailing fringe benefits determined in accordance with the current methodology:

Cost for employees receiving benefits of $.90 per hour: $.90 × 94,048 FTE × 2080 hrs. = $176,057,856

Cost for employees receiving benefits of $2.56 per hour: $2.56 × 117,215 FTE × 2080 hrs. = $624,146,432

Cost of current methodology: $176,057,856 + $624,146,432 = $800,204,288 ($3788 per FTE)

2. The first-year increase in the cost of the new methodology, i.e., the cost of increasing the fringe benefits for employees currently receiving $.90 per hour by $.25 per hour (one-fourth of the increase to $1.91): $.25 × 94,048 FTE × 2080 hrs. = $48,904,960 ($231 per FTE)

Thus the first-year increase in costs caused by the new methodology would be less than $50 million per year. In succeeding years it can be anticipated that the increase in fringe benefits costs for employees receiving the low rate may be somewhat higher than $.25 per hour as the cost of fringe benefits varies from year to year. However, it is anticipated that this increase will be more than offset by savings where contracts currently requiring fringe benefits of $2.56 are not succeeded by new contracts for substantially the same services; contracts for new services which would have received the $2.56 rate under the former procedures will receive the new ''all-industry, all-employee'' rate at the rate it is being phased in.

By the fourth year, if the $1.91 rate were to hold, the increased annual cost would be approximately: $1.01 × 94,048 FTE × 2080 hrs. = $197,576,038 ($935 per FTE)

The administrative burden, if any, of the various alternatives proposed is discussed in some detail in the preamble above. From the comments, it is evident that the alternative chosen is among the least burdensome of the various alternatives, since it does not involve paying different benefits to different workers on the same contract or in different regions of the country. However, during the period where both rates are issued, those contractors which have contracts subject to both rates (as is sometimes currently the case) will continue to have the burden of administering two benefit programs. In addition, the change in the fringe benefit rate will involve the administrative burden of contractors making changes in their fringe benefit plans to accommodate changed fringe

[11] The Department's proposed impact analysis as published in the Federal Register did not set forth a total cost for the various methodologies, but rather advised the public of the cost per FTE. Therefore the Air Force did its own calculations of the Department's estimated cost.

benefit rates, both during the transition period and as prevailing benefits change over time.

The Department has not been able to obtain data which would allow it to quantify the benefits to the affected workers and to society of providing workers prevailing fringe benefits, or to quantify any indirect effects on jobs, productivity, or the Federal deficit, and no such data was provided by commenters. A significant issue raised in the comments, as discussed above, is the concern that the current low ''insurance'' rate is not high enough to provide meaningful health insurance to employees. The Department believes, as stated by many commenters, that the rate established through the selected methodology will allow employers to provide meaningful health benefits, with the concomitant direct benefit to the employees and indirect benefit to society from a healthier work force, including reduced pressure on public health resources.

IX. Regulatory Flexibility Act

Under the Regulatory Flexibility Act, Public Law 96–354 (94 Stat. 1164; 5 U.S.C. 601 *et seq.*), Federal agencies are required to prepare a final regulatory flexibility analysis that describes the anticipated impact of a rule on small entities. After review of the comments received and consideration of the various alternatives, the Department has prepared the following regulatory flexibility analysis regarding this rule:

(1) *The need for and objectives of the rule.*

SCA requires that the Department of Labor (DOL) determine locally-prevailing wages and fringe benefits for the various classes of service employees performing contract work subject to the SCA. Contracts over $2,500 (if the predecessor contract was not subject to a collective bargaining agreement) are required to contain wage determinations issued by DOL that specify the minimum monetary wages and fringe benefits that must be paid to the various classes of workers who perform work on the service contract, based upon rates determined by DOL to be prevailing in the locality where the work is to be performed. As discussed previously, fringe benefit data are not generally available on an occupation-specific or on a locality basis, which prompted DOL to issue fringe benefit determinations for health and welfare based on nationwide data ever since SCA was enacted.

The Service Employees International Union (SEIU) sued DOL in March 1991 in the United States District Court for the District of Columbia over the longstanding administrative practice, since 1976, of issuing two nationwide rates for health and welfare fringe benefits, and for failure to periodically update SCA health and welfare fringe benefit levels which, at that time, had not been updated since 1986 (SEIU v. Martin, CA No. 91–0605 (JFP) (D.D.C. April 1, 1992)). In this court challenge, the district court remanded the case to DOL for exhaustion of administrative remedies and final agency action, which led to the decisions of DOL's Board of Service Contract Appeals that remanded the matter to the Wage and Hour Division to consider alternative methodologies for implementing the statutory objectives (BSCA Case No. 92–01 (August 28, 1992) and Case No. 93–08 (September 23, 1993)). Based on the Board's decisions, the Department decided that the best process for developing a methodology to establish prevailing SCA fringe benefits consistent with statutory requirements would be to propose various alternatives through rulemaking. In the meantime, SEIU moved the district court to reopen its case against the Department. The district court dismissed the case without prejudice to SEIU's right to reopen for reconsideration upon a showing that DOL has not adopted a final rule in this matter by July 31, 1996 (*SEIU* v. *Reich*, CA No. 91–0605 (CRR) (D.D.C. January 19, 1996)).

On May 2, 1996, the Administrator of the Wage and Hour Division published a Notice in the Federal Register (61 FR 19770) proposing for public comment various alternative fringe benefit determination methodologies. As explained in the proposed rule, however, it was not feasible to publish a regulatory impact analysis for comment with the proposed rule. At the time the Department was completing the development of data on the occupational mix of service contract employees in order to provide a basis for the impact analysis. That analysis was completed and published for comment on October 25, 1996 (61 FR 55239). In the meantime, the Court set a deadline for publication of the final rule of December 24, 1996. *SEIU* v. *Reich*, CA No. 91–0605 (August 27, 1996).

(2) *Summary of significant issues raised by the public comments in response to the initial regulatory flexibility analysis.*

The Department received a number of comments regarding the economic impact analysis and the survey that was conducted to determine the occupational mix on Federal service contracts. Those comments are specifically addressed in the economic impact analysis section above. No comments were received on the initial regulatory flexibility analysis.

(3) *Number of small entities covered under the rule.*

The definition of ''small business'' varies considerably depending upon the policy issues and circumstances under review, the industry being studied, and the measures used. The Small Business Administration's Office of Advocacy generally uses employment data as a basis for size comparisons, with firms having fewer than 100 employees or fewer than 500 employees defined as small.[12]

Statistics published by the Internal Revenue Service indicate that in 1990, an estimated 20.4 million business tax returns were filed for 4.4 million corporations, 1.8 million partnerships, and 14.2 million sole proprietorships, most of which are ''small''—fewer than 7,000 would qualify as large businesses if an employment measure of 500 employees or less is used to define small and medium-sized businesses.[13]

Federal procurement data are compiled and reported by the Federal Procurement Data Center (FPDC) in the *Federal Procurement Data System Federal Procurement Report* (Washington, D.C.: U.S. Government Printing Office). The value of Federal contracts and volume of contract ''actions'' are currently reported individually to the FPDC for contract actions exceeding $25,000; actions of less than $25,000 are reported only in the aggregate. A contract ''action'' differs from an initial contract ''award'' because a single contract may involve more than one action—for example, a modification to an initial contract award is reported to the FPDC as a separate action and may involve the obligation or de-obligation of funds.

Small businesses were awarded $58.8 billion of the $184.2 billion spent by the Federal government on goods and services in Fiscal Year (FY) 1989, including $31.6 billion awarded directly to small firms and $27.2 billion awarded to small subcontractors by Federal

[12] The State of Small Business: A Report of the President Transmitted to the Congress (1991), together with The Annual Report on Small Business and Competition of the U.S. Small Business Administration (United States Government Printing Office, Washington, D.C., 1991), p. 19. A more detailed breakdown also used is: under 20 employees, very small; 20–99, small; 100–499, medium-sized; and over 500, large. In general, a business bidding on a government contract is regarded as small if it has fewer than 500 employees (see p. 221).

[13] U.S. Department of the Treasury, Internal Revenue Service, SO Bulletin (Spring 1990) Table 19; reprinted by SBA in The State of Small Business (1991), Id., p. 21.

prime contractors.[14] Small firms accounted for more than one-half (51.3 percent) of the value of contracts under $25,000, but only 14.1 percent of those over $25,000 in FY 1989.[15] Since FY 1979 when the FPDC first began reporting procurement data regularly, the share of Federal procurement dollars awarded to small firms has fluctuated between 14 and 16 percent over the entire period—for FY 1989 it was 14.1 percent overall.

Of the major product/service categories under which contract actions are reported to the FPDC, the ''other services'' category (which includes a variety of non-construction activities ranging from technical, sociological, administrative, and other professional services, to installation, maintenance, and repair of equipment) amounted to 28.9 percent of the total Federal prime contract actions reported individually in FY 1989. Small businesses were awarded $6.8 billion or 14.7 percent of the contract dollars awarded for services in FY 1989.[16]

This FPDS data on small business awards does not correlate precisely with the number of contract actions or contract dollars awarded that are subject to the SCA. However, the ''services'' category can be considered a reliable proxy for analyzing the universe of SCA-covered contracts reported to the FPDC that may be awarded to small businesses. Of a total 502,138 contract actions valued at $177.8 billion that were individually reported to the FPDC in FY 1992 (i.e., actions over $25,000 each), 82,957 contract actions, valued at $18.1 billion, were classified as subject to the SCA.[17] Of these awards, we estimate that $2.66 billion (14.7 percent) went to small businesses. These figures, however, do not include any portion of the contract actions not individually reported but reported in summary to the FPDC, which totaled 19.6 million contract actions valued at $22.02 billion.[18] Based upon the percentage of contract actions and contract dollars in the services category that were reported individually to FPDC as being subject to SCA, we estimate that an additional 2,905,696 actions, valued at $2.2 billion, of the actions reported in summary to the FPDC were subject to SCA. Of these awards, we estimate that $1.1 billion (50 percent) went to small businesses.

No current employment data are available by size of business that would relate to Federal contracts awarded subject to SCA. (The SBA measures employment change on a current basis for each small- or large-business-dominated industry using Bureau of Labor Statistics payroll data.[19])

(4) *Reporting, Recordkeeping and Other Compliance Requirements of the Rule.*

All SCA-covered contractors (including small businesses) are required to maintain records specified under 29 CFR Part 4 that demonstrate compliance with the statutory requirements to furnish equivalent fringe benefits or cash equivalents at not less than prevailing rates.

This final rule, which relates to the procedures to be followed by DOL for determining prevailing health and welfare fringe benefits to be paid to service employees working on Federal service contracts covered by SCA, contains no new reporting, recordkeeping, or other compliance requirements applicable to small businesses. Although some of the proposed alternatives likely would have involved additional recordkeeping obligations, the alternative selected does not require any additional recordkeeping. In fact, contractor comments regarding the ease of administration and compliance under this alternative were an important factor in selecting the alternative.

(5) *Description of the steps taken to minimize the significant economic impact on small entities consistent with the objectives of the Service Contract Act.*

As noted in the discussion of the various alternatives, the methodology selected (Alternative I) was clearly the alternative favored by most employers, many of which were small businesses. The factual, policy and legal reasons for selecting Alternative I and the reasons for rejecting the other alternatives are fully addressed in the discussion of the various alternatives. A key factor underlying the support of Alternative I by many employers, including many small entities, was the ease of administration and compliance under this alternative. In addition, this alternative was favored because it produces a benefit rate that is sufficient to allow all service contractors to purchase a reasonable benefit package for all contract workers. Under the current two-tier benefit structure, the low level benefit has been generally considered to be too low for employers to purchase even a minimal health and welfare package for their workers.

Proposed Alternatives II—IV were generally viewed by most commenters as being administratively difficult, especially for small employers. Notwithstanding the greater administrative burden, these alternatives were favored by some because they yielded a lower fringe benefit rate for many workers. For service contractors in general, however, these alternatives would have imposed significant administration and compliance difficulties.

List of Subjects in 29 CFR Part 4

Administrative practice and procedures, Employee benefit plans, Government contracts, Investigations, Labor, Law enforcement, Minimum wages, Penalties, Recordkeeping requirements, Reporting requirements, Wages.

Accordingly, for the reasons set out in the preamble, 29 CFR Part 4 is amended as set forth below:

PART 4—LABOR STANDARDS FOR FEDERAL SERVICE CONTRACTS

1. The authority citation for Part 4 continues to read as follows:

Authority: 41 U.S.C. 351, et seq., 79 Stat. 1034, as amended in 86 Stat. 789, 90 Stat. 2358; 41 U.S.C. 38 and 39; 5 U.S.C. 301; and 108 Stat. 4101(c).

2. Section 4.2 of Subpart A is revised to read as follows:

§ 4.2 Payment of minimum wage specified in section 6(a)(1) of the Fair Labor Standards Act of 1938 under all service contracts.

Section 2(b)(1) of the Service Contract Act of 1965 provides in effect that, regardless of contract amount, no contractor or subcontractor performing work under any Federal contract the principal purpose of which is to furnish services through the use of service employees shall pay any employees engaged in such work less than the minimum wage specified in section 6(a)(1) of the Fair Labor Standards Act of 1938, as amended.

3. The introductory text of § 4.6(q) of Subpart A is revised to read as follows:

§ 4.6 Labor standard clauses for Federal service contracts exceeding $2,500.

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(q) Where an employee engaged in an occupation in which he or she customarily and regularly receives more than $30 a month in tips, the amount of tips received by the employee may be credited by the employer against the minimum wage required by Section 2(a)(1) or 2(b)(1) of the Act to the extent permitted by section 3(m) of the Fair

[14] The State of Small Business, *supra* at 220.

[15] Ibid.

[16] Id., pp. 223, 226 & 235–237.

[17] Federal Procurement Data System Standard Report, Fiscal Year 1992, Fourth Quarter, pp. 74–75.

[18] Id., p. 74.

[19] Id., p. 34.

Labor Standards Act and Regulations, 29 CFR Part 531. To utilize this proviso:

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§§ 4.52 through 4.55 [Redesignated as §§ 4.53 through 4.56]

4. Sections 4.52 through 4.55 of Subpart B are redesignated as §§ 4.53 through 4.56 respectively.

5. A new § 4.52 is added to read as follows:

§ 4.52 Fringe benefit determinations.

(a) Wage determinations issued pursuant to the Service Contract Act ordinarily contain provisions for vacation and holiday benefits prevailing in the locality. In addition, wage determinations contain a prescribed minimum rate for all other benefits, such as insurance, pension, etc., which are not required as a matter of law (i.e., excluding Social Security, unemployment insurance, and workers' compensation payments and similar statutory benefits), based upon the sum of the benefits contained in the U.S. Bureau of Labor Statistics, Employment Cost Index (ECI), for all employees in private industry, nationwide (and excluding ECI components for supplemental pay, such as shift differential, which are considered wages rather than fringe benefits under SCA). Pursuant to Section 4(b) of the Act and § 4.123, the Secretary has determined that it is necessary and proper in the public interest, and in accord with remedial purposes of the Act to protect prevailing labor standards, to issue a variation from the Act's requirement that fringe benefits be determined for various classes of service employees in the locality.

(b) The minimum rate for all benefits (other than holidays and vacation) which are not legally required, as prescribed in paragraph (a) of this section, shall be phased in over a four-year period beginning June 1, 1997. The first year the rate will be $.90 per hour plus one-fourth of the difference between $.90 per hour and the rate prescribed in paragraph (a) of this section; the second year the rate will be increased by one-third of the difference between the rate set the first year and the rate prescribed; the third year the rate will be increased by one-half of the difference between the rate set in the second year and the rate prescribed; and the fourth year and thereafter the rate will be the rate prescribed in paragraph (a) of this section.

(c) Where it is determined pursuant to § 4.51(b) that a single fringe benefit rate is paid with respect to a majority of the workers in a class of service employees engaged in similar work in a locality, that rate will be determined to prevail notwithstanding the rate which would otherwise be prescribed pursuant to this section. Ordinarily, it will be found that a majority of workers receive fringe benefits at a single level where those workers are subject to a collective bargaining agreement whose provisions have been found to prevail in the locality.

(d) A significant number of contracts contain a prevailing fringe benefit rate of $2.56 per hour. Generally, these contracts are large base support contracts, contracts requiring competition from large corporations, contracts requiring highly technical services, and contracts solicited pursuant to A–76 procedures (displacement of Federal employees), as well as successor contracts thereto. The $2.56 benefit rate shall continue to be issued for all contracts containing the $2.56 benefit rate, as well as resolicitations and other successor contracts for substantially the same services, until the fringe benefit rate determined in accordance with paragraphs (a) and (b) of this section equals or exceeds $2.56 per hour.

(e) *Variance procedure.* (1) The Department will consider variations requested by contracting agencies pursuant to Section 4(b) of the Act and § 4.123, from the methodology described in paragraph (a) of this section for determining prevailing fringe benefit rates. This variation procedure will not be utilized to routinely permit separate fringe benefit packages for classes of employees and industries, but rather will be limited to the narrow circumstances set forth herein where special needs of contracting agencies require this procedure. Such variations will be considered where the agency demonstrates that because of the special circumstances of the particular industry, the variation is necessary and proper in the public interest or to avoid the serious impairment of government business. Such a demonstration might be made, for example, where an agency is unable to obtain contractors willing to bid on a contract because the service will be performed at the contractor's facility by employees performing work for the Government and other customers, and as a result, paying the required SCA fringe benefits would cause undue disruption to the contractor's own work force and pay practices.

(2) It will also be necessary for the agency to demonstrate that a variance is in accordance with the remedial purpose of the Act to protect prevailing labor standards, by providing comprehensive data from a valid survey demonstrating the prevailing fringe benefits for the specific industry. If the agency does not continue to provide current data in subsequent years, the variance will be withdrawn and the rate prescribed in paragraph (a) of this section will be issued for the contract.

6. Section 4.112 of Subpart C is revised to read as follows:

§ 4.112 Contracts to furnish services ''in the United States.''

(a) The Act and the provisions of this part apply to contract services furnished ''in the United States,'' including any State of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, Outer Continental Shelf lands as defined in the Outer Continental Shelf Lands Act, American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, Wake Island, and Johnston Island. The definition expressly excludes any other territory under the jurisdiction of the United States and any United States base or possession within a foreign country. Services to be performed exclusively on a vessel operating in international waters outside the geographic areas named in this paragraph would not be services furnished ''in the United States'' within the meaning of the Act.

(b) A service contract to be performed in its entirety outside the geographical limits of the United States as thus defined is not covered and is not subject to the labor standards of the Act. However, if a service contract is to be performed in part within and in part outside these geographic limits, the stipulations required by § 4.6 or § 4.7, as appropriate, must be included in the invitation for bids or negotiation documents and in the contract, and the labor standards must be observed with respect to that part of the contract services that is performed within these geographic limits. In such a case the requirements of the Act and of the contract clauses will not be applicable to the services furnished outside the United States.

Signed at Washington, D.C., on this 24th day of December, 1996.

Gene Karp,

Deputy Assistant Secretary for Employment Standards.

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