

**PENNSYLVANIA WAGE PAYMENT AND COLLECTION
LAW UPDATE**

May 2000

www.morganlewis.com

*Brussels ■ Frankfurt ■ Harrisburg ■ London ■ Los Angeles ■ Miami ■ New York
Philadelphia ■ Northern Virginia ■ Pittsburgh ■ Princeton ■ Tokyo ■ Washington*

Pennsylvania Wage Payment and Collection Law Update

May 2000

In one of the few judicial decisions interpreting the Pennsylvania Wage Payment and Collection Law ("WPCL"), the Pennsylvania Superior Court recently held that an employee's equity interest in a corporation constituted "wages" for which the employee was required to be compensated upon his resignation. *Hartman v. Baker*, No. 2230 Pittsburgh 1998, 2000 WL 527891 (Pa. Super. Ct. May 3, 2000). The court also held that, in a case under the WPCL, the employer has the burden of proving by "clear and convincing evidence" that it acted in "good faith" in refusing to make a payment under the WPCL in order to avoid the payment of liquidated damages on claims for unpaid wages.

The plaintiff in *Hartman* worked for Baker as a cable installer from June 1980 until his resignation in June 1989. During the course of his employment, he and Baker exchanged memoranda that outlined a new compensation structure. The new structure reduced plaintiff's salary, but provided him with an equity stake in the business. Despite the failure of the parties to sign the agreement, the court found that a binding contract existed because the subsequent actions of the parties indicated acceptance of the terms outlined in the memoranda. When the plaintiff later sought to exercise his equity position as outlined in the memoranda, Baker refused to comply and disputed plaintiff's right to payment based on the absence of a valid contractual arrangement. Plaintiff sued under the WPCL to recover the amount of the equity payment.

Under the WPCL, an employee who is separated from the employer's payroll is entitled to collect "the wages or compensation earned . . . not later than the next regular payday." 43 Pa. C.S.A. § 260.5. Although the WPCL does not create an employee's substantive right to compensation, it does establish an employee's right to enforce the payment of wages and other compensation to which the employee is otherwise entitled by the terms of an agreement with the employer. Thus, the initial question faced by the *Hartman* court was whether the plaintiff's equity position constituted "wages" that were due to him upon termination. The court held that because the equity position was offered to the plaintiff *as an employee*, it constituted "wages" under the WPCL, the value of which Hartman was entitled to collect from Baker.

The court then addressed several issues relating to the statute's "good faith" defense provided to employers to avoid payment of liquidated damages. The WPCL provides that if wages remain unpaid for 30 days beyond the regular payday or for 60 days beyond the filing of a proper claim or issuance of an award, the employee is entitled to an award of liquidated damages equal to 25% of the past due wages or \$500.00, whichever is greater, in addition to the unpaid wages, interest, and attorneys' fees. An employer can avoid liability for liquidated damages if there exists a "good faith contest or dispute of any wage claim including the good faith assertion of a right of set-off or counter-claim." The appellate court held that it was the employer's burden to prove by "clear and convincing evidence" that it had acted in "good faith." The court noted that "mere negligence or bad judgment is not bad faith," which requires a showing that the employer lacked a reasonable basis for not making the payments or recklessly disregarded its lack of a reasonable basis for doing so. Specifically, the court stated that bad faith does not exist where a party litigates a non-frivolous issue and presents authority to support its theory. In *Hartman*, the court found that because Baker acted in reliance upon an incorrect legal opinion about the binding nature of the memoranda and their ramifications under the WPCL, it acted in good faith, despite the court's conclusion that it owed Hartman the value of his equity interest in the company.

It is important to understand that the WPCL does not create any substantive rights, but is solely a mechanism for enforcing obligations created by the employer. Thus, a properly drafted stock option or restricted stock purchase agreement that provides for the employee to lose all rights to unvested options or shares upon a termination of employment (with or without "cause") will be respected by the courts in Pennsylvania. A lessor of the *Hartmann* decision, however, it to make sure that equity arrangements are indeed properly drafted, because Pennsylvania employees can use the WPCL to enforce their rights under such agreements.

In addition to the wage payment provisions of the WPCL, Pennsylvania employers should be aware that the statute also limits an employer's ability to take deductions from an employee's wages. Any such deductions must either be authorized by law or under Pennsylvania Department of Labor and Industry regulations, and must be for the convenience of the employee only. To pass muster under the WPCL, wage deductions generally require that the

This White Paper is published to inform clients and friends of Morgan Lewis and should not be construed as providing legal advice on any particular matter.

affected employee execute a written authorization for the deduction.

Hartman serves as a reminder to Pennsylvania employers about the broad scope of the WPCL and the need to be careful when fashioning alternative means of employee compensation. The broad definition of “wages” applied in this case will make compliance with the WPCL’s requirements more difficult, especially for employers that frequently compensate employees with non-traditional forms of compensation, such as stock options. The Pennsylvania courts have already held that such fringe benefits as severance and vacation pay are also encompassed within the statutory definition of “wages” which must be paid upon termination, if the employer has agreed to make such payments. As most states have laws similar to Pennsylvania’s WPCL, it is necessary for employers who do business in multiple states to keep abreast of wage payment laws in all such jurisdictions, including the provisions applicable to wage deductions.

The Labor and Employment Law Practice Group at Morgan, Lewis & Bockius LLP has substantial experience in advising employers about the requirements of the WPCL and similar statutes, and in drafting policies, including authorization forms for payroll deductions, to avoid problems under such laws in Pennsylvania and other states. If you have any questions about the *Hartman* case, the WPCL, or other state wage payment laws, please do not hesitate to contact me directly or any of the following:

Michael J. Ossip
Philadelphia
(215) 963-5761
mjossip@mlb.com

Vincent Candiello
Harrisburg
(717) 237-4014
vcandiello@mlb.com

Christopher K. Ramsey
Pittsburgh
(412) 560-3323
ckramsey@mlb.com