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JUNE 2006

The Department of Labor's Office of Federal Contract Compliance Programs (OFCCP) has released its final compensation guidelines for the investigation of systemic compensation discrimination and contractor self-evaluation of compensation practices.

OFCCP Issues Final Guidance on Standards for Investigating Systemic Compensation Discrimination and Conducting Self Audits of Contractor Compensation Systems

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On November 16, 2004, OFCCP published two notices pertaining to systemic compensation discrimination. The first notice set forth the proposed standards that OFCCP would be using to investigate alleged systemic compensation discrimination during compliance reviews. The second notice set forth proposed self-evaluation standards that companies could use if they wished to conduct an investigation into their own compensation practices but then have OFCCP defer to that self-evaluation in an audit.

On June 16, 2006, OFCCP published final notices in the Federal Register (Systemic Compensation Discrimination Notice and Guidelines for Self-Evaluation of Compensation Practices). Highlights of the final notices are as follows:

I. Interpreting Nondiscrimination Requirements of Executive Order 11246 With Respect to Systemic Compensation Discrimination

By and large, the OFCCP's notice regarding the standards by which it will pursue systemic compensation discrimination remained the same from the proposed notice to the final notice. OFCCP intends to use multiple regression analyses to evaluate contractor compensation. Where it finds statistically significant evidence (greater than two standard deviations) of disparities against females and minorities, along with (in most

cases) anecdotal evidence of discrimination, it will issue a Notice of Violations and consider enforcement options to obtain remedial relief for the affected class.

We think that employers will find the following points noteworthy:

- *The OFCCP intends to continue using a "tiered" approach to investigating compensation in compliance reviews.*
- Under the tiered-review approach (also commonly known as the three-part trigger test), OFCCP uses pay grade (or other aggregated compensation) information submitted in response to Item 11 of OFCCP's compliance review scheduling letter to conduct a simple comparison of group average compensation data.
- If this comparison indicates a significant disparity, OFCCP will ask the contractor for employee-specific compensation and personnel information. OFCCP will take this employee-specific compensation information and conduct a cluster regression analysis.
- If the cluster regression indicates significant disparities, OFCCP will conduct a com-

prehensive evaluation of the contractor's compensation practices, at which point the final interpretative standards released today govern OFCCP's investigative activity and enforcement determination.

- *OFCCP onsite compensation investigations are likely to be lengthy and burdensome for employers in terms of the amount of resources that HR and compensation staff are going to have to devote to the audit if the contractor cannot appropriately group its employees at the desk audit stage to pass the first or even second steps of the tiered approach.*
- In order to determine whether employees are similarly situated, OFCCP intends to gather information on employees' job duties, responsibility levels, and skills and qualifications, and other pertinent factors through review of job descriptions and interviews of employees, managers, and HR and compensation personnel.
- Although some of this information can be given to OFCCP via copies shipped to the Agency for review in its offices, it is clear that OFCCP envisions having a much larger on-site presence if it gets to this stage of its investigation.
- *OFCCP acknowledges that there is a tension between developing an accurate analysis and the complexity and burden associated with doing so but is blind to the reality of the costs this guidance will impose on employers.*
- OFCCP states in its guidance that it, not the contractor, has the burden of gathering data and conducting the multiple regression analysis. "Contractors need not convert their data to

electronic format for purposes of a compliance evaluation. If the data is already in electronic format, OFCCP will use it, but if not, OFCCP has the responsibility of taking the raw data and converting it into an electronic format which can be used in the regression analysis. Similarly, contractors are not required to hire experts to conduct the multiple regression analyses; OFCCP will conduct them."

- That guidance ignores the reality of a proactive employer defense. If a government contractor knows it is being audited by the OFCCP, and that systemic compensation discrimination is going to be a major focus of the government's investigation, it is going to take proactive steps to determine its potential exposure before any data is disclosed to the OFCCP. Employers are going to end up spending substantial sums of money to audit and update their HRIS databases, populate their databases with information previously not quantified in an HRIS system, such as prior relevant experience, education, performance, and hire their own experts to run these analyses.
- Employers should be reminded that running their own in-house regression analysis models or engaging non-lawyer consultants outside the parameters of the attorney-client privilege is going to substantially raise the employer's risk of having to disclose its entire process in private litigation.
- *OFCCP has agreed to disclose the actual regression model, not just the results of the regression model, in support of any Notice of Violation (NOV)*

containing an allegation of systemic compensation discrimination.

- *In adding new investigative standard paragraph 7, the OFCCP is opening up the door to comparable worth claims.*
- "OFCCP will also assert a compensation discrimination violation if the contractor establishes compensation rates **for jobs** (not for particular employees) that are occupied predominantly by women or minorities that are significantly lower than rates established for jobs occupied predominantly by men or nonminorities, where the evidence establishes that the contractor made the job wage-rate decisions based on the sex, race or ethnicity of the incumbent employees that predominate in each job. Such evidence of discriminatory intent may consist of the fact that the contractor adopted a market survey to determine the wage rate for the jobs, but established the wage rate for the predominantly female or minority job lower than what that market survey specified for that job, while establishing for the predominantly male or non-minority job the full market rate specified under the same market survey." (emphasis in original)

II. Guidelines for Self-Evaluation of Compensation Practices with Nondiscrimination Requirements of Executive Order 11246 with respect to Systemic Compensation Discrimination

The idea behind a contractor self-evaluation process was that employers would develop their own compensation analyses and, in exchange for doing

OFCCP's work for it, OFCCP would afford the contractor a significant amount of deference in a compliance review. The employer would be given this deference if its self-evaluation process met the OFCCP's standards, including:

- grouping employees into Similarly Situated Employee Groups (SSEGs);
- using multiple regression analysis for populations above 500 employees;
- including at least 70% of the population in the compensation study;
- performing the analysis annually; and
- investigating (and resolving) any statistically significant compensation disparities.

The parameters contained in the second and third bullets are new in the final guidance. OFCCP previously had indicated that multiple regression analysis would be the preferred methodology for establishments with 250 employees, but in light of public comment, it expanded that threshold to 500 employees. In addition, whereas the proposed notice advised contractors that at least 80% of the employee population had to be included in an SSEG, the final notice lowered that percentage to 70%.

In our view, there remain major legal flaws with such a process, and we caution those clients that are thinking of availing themselves of OFCCP's offer of "coordination" in an audit.

- *There is no safe, privileged protection for self-evaluation in litigation.* The OFCCP admits that employers are unlikely to be able to protect such self-evaluative studies in litigation. "Based on the comments OFCCP received, it is apparent that many

employers perceive the possibility of disclosure of compensation self-evaluations in litigation as compelling disincentive to conducting such analyses. However, OFCCP has no authority to establish privileges applicable in litigation in federal or state court."

Employers that conduct less than statistically meaningful and reliable regression analyses face exposure from both protected and nonprotected groups.

- OFCCP further acknowledged the risk of liability that employers face should they choose to make corrective compensation adjustments under a self-evaluation process.
- Employers that commission a nonprivileged, less than fully-developed compensation analysis for the purposes of evaluating pay disparities, and then take action based on such a flawed compensation analysis model face substantial exposure. "For example, female or minority employees may bring claims based on the theory that the employer's own self-evaluation study established that the employer engaged in discrimination or that the employer did not make sufficient compensation adjustments to remedy the discrimination.... Similarly, male or non-minority employees may sue the employer alleging violation of Title VII because the employer gave salary adjustments to female or minority employees under [a flawed] compensation self-evaluation."
- *Given the OFCCP's admission about the extent to which its investigative processes produce "false positive" and*

"false negative" results, it makes no strategic sense that employers would want to proactively disclose to OFCCP their confidential and proprietary compensation data, their strategies and thought processes in developing their SSEGs and regression models, documents evidencing pay disparities for women and minorities, and the amount of any remedies awarded.

- To avail itself of the OFCCP's deferential standards, a contractor must be prepared to produce all of the following information to OFCCP in an audit:
 - documents necessary to explain and justify its SSEG formulations;
 - the data used in the statistical analyses and the results of the analyses for 2 years from the date that the analyses are performed;
 - the data and documents explaining the results of any non-statistical methods that the contractor used; and
 - documentation as to any follow-up investigation into statistically significant disparities, the conclusions of such investigation, and the pay adjustments made to remedy such disparities.

Instead, it seems worth the risk to submit data in response to Item 11 of the Scheduling letter in groupings that pass the tiered administrative approach, and adopt a wait-and-see approach from OFCCP.

Littler Mendelson will be conducting several complimentary web seminars in July to inform clients about these new guidelines, and we will be at the National Industry Liaison Group Annual Conference in Phoenix August 6-8. Please check our website at www.littler.com for

future announcements about these web seminars and visit our booth at the conference. Please also advise us if you wish to be added to our OFCCP mailing list to receive updates specifically on OFCCP-related topics.

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