

# CLIENT ALERTS

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## **OFCCP PUBLISHES FINAL INTERPRETIVE STANDARDS FOR INVESTIGATING SYSTEMIC COMPENSATION DISCRIMINATION AND GUIDELINES FOR VOLUNTARY SELF-EVALUATION OF COMPENSATION PRACTICES BY CONTRACTORS**

On June 16, 2006, the Department of Labor's Office of Federal Contract Compliance Programs ("OFCCP") published its final Interpretive Standards for Systemic Compensation Discrimination under Executive Order 11246 ("Standards") and its final Voluntary Guidelines for Self-Evaluation of Compensation Practices for Compliance with Executive Order 11246 ("Guidelines").<sup>1</sup> The Standards and Guidelines are effective for covered federal contractors and subcontractors ("Contractors") immediately.

Generally, the just released Standards and Guidelines are very similar to the proposed standards and guidelines issued in November 2004 but do contain some significant modifications and clarifications based on public comments. In many instances the Standards and Guidelines provide contractors valuable insight regarding the manner in which OFCCP investigates pay practices and may assist Contractors in identifying potential problems with their current compensation systems. Contractors are advised to review the Standards and Guidelines carefully, and where necessary, seek legal advice in connection with any self-analysis of their compensation systems.

Below is a summary of some of the significant areas of the Standards and Guidelines:

### **1. Final Interpretive Standards for Systemic Compensation Discrimination**

The Standards are intended to govern OFCCP's analysis of Contractors' compensation practices and specifically whether a Contractor

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<sup>1</sup> The OFCCP enforces Executive Order 11246, which prohibits covered federal contractors and subcontractors from making employment decisions on the basis of race, color, national origin, religion, or sex. OFCCP conducts compliance reviews to determine whether covered Contractors have been engaging in workplace discrimination prohibited by Executive Order 11246. As part of the compliance review process, OFCCP investigates whether Contractors' compensation practices are discriminatory.

has engaged in systemic compensation discrimination. Systemic compensation discrimination is defined as discrimination under a pattern or practice theory of disparate treatment. The compensation analysis set forth in the Standards contains two major concepts.

First is the determination of employees who are “similarly situated” for comparison of Contractor pay decisions. Employees are similarly situated if, based on actual facts regarding employees’ work activities, responsibility, skills and qualifications, they perform similar work and occupy positions involving similar responsibility levels, skills and qualifications. Other factors may have a significant bearing on whether employees are similarly situated, such as an employee’s department or other functional unit of the employer, employment status (e.g., full-time or part-time), or compensation status (e.g., union or nonunion; hourly, salaried, or commissioned). Note that OFCCP intends to gather the information to determine similarly situated employees by review of job descriptions and interviews of employees, managers, and HR and compensation personnel. Preexisting groupings, such as pay grades or Affirmative Action Program (“AAP”) job groups, may be relevant only to the extent they group employees together by similar work and their occupation of positions involving similar responsibility levels, skills and qualifications.<sup>2</sup>

The second major concept in the Standards is the reliance on a statistical tool called “multiple regression” to analyze compensation decisions for similarly situated employees by accounting for the relationship among legitimate factors important to how the Contractor makes pay decisions (such as education, experience, performance, productivity, etc.). The determination of whether there are statistically significant compensation disparities between similarly situated employees must be based on a multiple regression analysis. A compensation disparity is statistically significant at a level of two or more standard deviations.

OFCCP will use the multiple regression analysis along with other aspects of the Standards to perform its compensation investigation and to enforce its Standards after using a tiered approach to investigate compensation in compliance reviews. Under the three-part process, OFCCP will first use the pay grade or aggregated compensation data submitted by Contractors in response to Item 11 of OFCCP’s compliance review scheduling letter and then will conduct a simple comparison of group average compensation by pay grade or other aggregated unit submitted by the employer. If a significant disparity is indicated, OFCCP will ask for employee-specific compensation and personnel information and use it to conduct a “cluster regression” following the desk audit. If the cluster regression reveals significant pay disparities, OFCCP will then conduct a comprehensive investigation into the compensation practices, ultimately using the multiple regression analysis and the Standards to govern its investigation and determinations. Critically, according to the Standards, OFCCP, *not* the Contractor, has the burden of not only conducting the multiple regression analysis, but also of gathering the data for it. If the data is already in electronic format, OFCCP will use it, but if it is not, OFCCP must convert the raw data into electronic format.

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<sup>2</sup> Such analysis is a departure from the pay grade or pay range theory whereby it was assumed employees were similarly situated with respect to evaluating pay decisions if the Contractor placed employees’ jobs in the same pay grade. Under one version of the pay grade theory, after identifying employees in the same pay grade, there would be a comparison of the median compensation of male versus female and minorities versus nonminorities in each pay grade. If there was a significant difference in median compensation between men and women or between nonminorities and minorities within a given pay grade, then the next step was to determine whether the disparity was explained by median or average differences in other factors, such as time in the pay grade, prior experience, education, or performance. If a pattern of unexplainable pay disparities emerged, OFCCP would allege that the Contractor violated the nondiscrimination requirements of Executive Order 11246.

If, after investigation and under the Standards, OFCCP determines there are discriminatory compensation practices, it will issue a Notice of Violations alleging systemic discrimination with respect to compensation practices. Except in unusual cases, OFCCP will not issue a finding of systemic compensation discrimination without providing anecdotal evidence to support OFCCP's statistical analysis, and OFCCP will not exclude factors that influenced employees' compensation unless there is proof that the factor was tainted by the employer's discrimination. OFCCP will attach the regression analyses and results and summarize the anecdotal evidence in the Notice of Violations.

Additionally, the Standards also raise the possibility that OFCCP may also assert a compensation discrimination violation if the Contractor establishes compensation rates for jobs that are occupied predominantly by women or minorities that are significantly lower than rates established for jobs occupied predominantly by men or non-minorities, where there is evidence that the Contractor made the job-wage rate decision based on the sex, race, or ethnicity of the incumbent employees who predominate 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 the market survey specified for that job, while establishing for the predominantly male or nonminority job the full market rate specified under the same market survey.

Finally, OFCCP attempts to address confidentiality of compensation and other personnel data provided by the Contractor to OFCCP during a compensation investigation by stating that it will treat such materials as confidential to the maximum extent the information is exempt from public disclosure under the Freedom of Information Act.

## **1. Final Voluntary Guidelines for Self-Evaluation of Compensation Practices**

OFCCP's Guidelines are *voluntary* and intended to provide suggested techniques to comply with the compensation self-evaluation requirement of 41 C.F.R. 60-2.17(b)(3). OFCCP has included an incentive for Contractors to adopt voluntarily the methods outlined in the Guidelines. If a Contractor in good faith reasonably implements the general standards outlined, OFCCP will coordinate its compliance monitoring with the Contractor's self-evaluation approach and will deem the Contractor in compliance with 41 C.F.R. 60-2.17(b)(3). OFCCP does permit other methods of self-evaluation. Some type of self-evaluation of compensation practices by Contractors is required, but it does not need to conform to the Guidelines. Unlike a failure to adopt any self-evaluation method, a Contractor's decision to implement a self-evaluation that does not follow the Guidelines will, according to OFCCP, not be a basis for a finding of noncompliance with 41 C.F.R. 60-2.17(b)(3). The following is a summary of the self-evaluation standards set out in the Guidelines:

A. The self-evaluation must be performed by grouping employees who are similarly situated, referenced by OFCCP as "Similarly Situated Employee Groupings," or "SSEGs." Such groupings are based on performance of similar work and occupancy of positions that are similar in responsibility levels, skills and qualifications involved in the positions. Other factors may include the employee's department or other functional unit of the employer, employment status (e.g., full-time or part-time), or compensation status (e.g., union or nonunion; hourly, salaried, or commissioned). SSEGs should contain at least thirty employees and contain five or more employees from either of the following pairs: male/female or minority/nonminority. Employees who are not included in SSEGs do not have to be included in statistical evaluations, but nonstatistical evaluations must be used to evaluate pay decisions concerning them. If more than 30 percent of the employees are not subject to statistical analysis, OFCCP will carefully scrutinize the statistical analyses and nonstatistical evaluations. Self-evaluation programs are not limited to groupings from one AAP or establishment.

# CLIENT ALERTS

B. On an annual basis, Contractors must conduct some generally accepted statistical analysis of SSEGs and account for legitimate factors affecting compensation. Multiple regression analysis must be used for any establishment with more than 500 employees.

C. Contractors must investigate any statistically significant compensation disparities (two or more standard deviations) to determine if they are explained by legitimate factors. If disparities cannot be explained, appropriate remedies, such as back pay or pay adjustments, must be provided.

D. Contractors must contemporaneously create and retain documents relating to any statistical and non-statistical self-evaluation of compensation practices, so as to be able to explain and justify its decisions and conclusions, follow-up investigation, and pay adjustments. Such documents and data must be made available to OFCCP. OFCCP may also review personnel records and interview employees to determine the accuracy of representations.

As with the Standards, discussed above, OFCCP attempts to address confidentiality concerns by stating that it will treat compensation and other personnel information provided to OFCCP as confidential to the maximum extent the information is exempt from public disclosure under the Freedom of Information Act.

Finally, if the Contractor takes the position, based on advice of counsel, that its compensation self-evaluation is subject to disclosure protection under the attorney-client privilege or attorney work product doctrine, to avoid “legal disputes” over the applicability of such protections, OFCCP will permit the Contractor to certify in writing that it has followed the self-compliance Guidelines in lieu of producing the methodology of its results during a compliance review. The certification by an authorized officer of the Contractor under penalty of perjury must state that the self-evaluation of compensation practices has been performed at the direction of counsel and that counsel advised the Contractor that the results are subject to the asserted privileges.

## **2. CAUTION: Self-Evaluation of Compensation Practices Is Costly and Could Be Discoverable**

OFCCP’s Guidelines will no doubt create significant expense not only in collecting, tracking and maintaining the data necessary to do the analysis, but also in the cost of engaging statisticians for the regression analyses. While the new Guidelines attempt to address some of the concerns voiced by Contractors regarding the potential for disclosure of the compensation practices self-evaluation in litigation, even if the self-evaluation is conducted pursuant to counsel’s request and contains counsel’s analysis, there is no guarantee that it will remain protected from disclosure by privilege. In fact, OFCCP specifically states that “it is apparent that many employers perceive the possibility of disclosure of compensation self-evaluations in litigation as a compelling disincentive to conducting such analysis. However, OFCCP has no authority to establish privileges applicable in litigation in federal or state court.” Further, OFCCP recognizes that an employer risks liability when making corrective compensation adjustments under the self-evaluation process, such as claims of minority or female employees that the employer’s own analysis shows that compensation adjustments were not sufficiently made to remedy any discrimination. Thus, Contractors considering implementing any form of compensation analysis should seek appropriate counsel.

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Epstein Becker & Green, P.C. attorneys are experienced in the representation and counsel of employers large and small in virtually every industry in the United States and in all aspects of equal employment and affirmative action matters. For more information about these new Standards and Guidelines or other equal employment or affirmative action matters, please feel free to contact **Peter Stein** at (203) 326-7420, **Jonathan Plissner** at (203) 326-7416, or **Dean Singewald** at (203) 326-7410. Mr. Stein's e-mail address is [pstein@ebglaw.com](mailto:pstein@ebglaw.com), Mr. Plissner's e-mail address is [jplissner@ebglaw.com](mailto:jplissner@ebglaw.com), and Mr. Singewald's e-mail address is [dsingewald@ebglaw.com](mailto:dsingewald@ebglaw.com).

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