

Management Alert

OFCCP Releases Final Rules on Guidelines for Evaluating Systemic Compensation Discrimination and Contractor Self-Evaluation Pay Practices

Last Friday, June 16, 2006, the U.S. Department of Labor's Office of Federal Contract Compliance Programs (OFCCP) released its finalized Interpretive Standards for Systemic Compensation Discrimination Under Executive Order 11246 and Voluntary Guidelines for Self-Evaluation of Compensation Practices for Compliance with Executive Order 11246.

To a large extent, the final interpretive standards and voluntary guidelines closely follow the language contained in the proposed text of both rules that were issued in November 2004. In response to public comment, however, the OFCCP has made minor revisions to both rules. The interpretive standards and voluntary guidelines go into effect immediately. The OFCCP rejected calls for a grace or "pilot period," saying that it is not "requiring" contractors to implement the self evaluation standards as they are entirely voluntary and also that it has been using the Interpretive Standards for several years. A more detailed discussion of the proposed rules can be found in our [March 28, 2005 client alert](#).

Interpretive Standards for Systemic Compensation Discrimination

In issuing the new interpretive standards, the OFCCP has finally provided formal guidance regarding how it will evaluate systemic compensation discrimination under Executive Order 11246. Importantly, the OFCCP stated that it will not use its new standards in every compliance review. Rather, the agency will continue to use its "tiered-review approach" which first looks at pay grade or aggregated compensation information for indicators of potential discrimination. If the OFCCP spots indications of potential discrimination, it will then conduct further analysis using its new interpretive standards. Any Notice of Violation containing findings of systemic compensation discrimination will be based upon its new standards.

As in the proposed rule, the final interpretive standards contain three principal components:

- Compensation comparisons of "similarly situated" persons, based on work performed, responsibility level, skills and qualifications involved based on actual facts regarding employees' work activities, responsibility, skills and qualifications;
- Application of multiple regression analysis, a statistical technique to account for the influence of multiple, legitimate factors influencing contractor compensation decisions; and
- Except in unusual cases, anecdotal evidence of discrimination, along with supporting statistical data, will be required before a Notice of Violation alleging systemic compensation discrimination will be issued.

With respect to the statistical analysis component, the OFCCP expressly confirmed that contractors are not required to conduct their own multiple regression analysis or even enhance their human resources information systems to include data such as experience, education or performance ratings (although those factors are often important in these analyses). The agency states that it will obtain this information through interviews and review of personnel files and other documents. Accordingly, contractors should be on the alert for such requests for documentation and interviews during the course of a compliance evaluation as they may signal the OFCCP's budding theory of compensation discrimination for a particular group of employees. Significantly, when the OFCCP articulates a finding of compensation discrimination in a Notice of Violation, if requested, the OFCCP will provide the contractor with the regression model used by the

agency, the results from the regression analysis, and a summary of the anecdotal evidence. Contractors should be sure to request this information.

In the Final Rule, the OFCCP offers other details about the standards it is adopting, including:

- Defining "systemic compensation discrimination" as discrimination under a pattern or practice theory of disparate treatment;
- Stating that systemic compensation discrimination will be found when there are statistically significant compensation disparities between similarly situated employees after factoring in legitimate factors influencing compensation;
- Defining "statistical significance" as a level of two or more standard deviations;
- Advising that pooled regression models must be accompanied by statistical tests generally accepted in the statistics profession to determine which interaction terms should be included in the model; and
- In response to concerns about the confidentiality of compensation and personnel information provided to the OFCCP during a systemic compensation investigation, assuring that such information will be kept confidential to the "maximum extent the information is exempt from public disclosure under the Freedom of Information Act."

Voluntary Self-Evaluation Guidelines

The OFCCP's self-evaluation guidelines apply only to those contractors who want to take advantage of the agency's representation that it will not independently

evaluate compensation practices if the contractor follows the OFCCP's guidance. The agency calls this a "Compliance Coordination Incentive." The OFCCP says, however, that if a contractor does not choose to conduct such a self-evaluation, it will not suffer any adverse consequences from the OFCCP. Contractors must, nevertheless, conduct some type of compensation analysis each year to remain in compliance.

The guidelines for self-analysis include:

- Self-evaluation must be based on "similarly-situated groupings" or "SSEG's." The most important factors include: job duties, responsibility level, skills and qualifications. These groups must contain at least 30 employees and at least five employees from each comparison group (e.g., male/female or minority/non-minority). If groups are smaller than 30 employees, non-statistical analysis must be utilized. The OFCCP modified its requirement regarding the percentage of employees who must be included in SSEG's, reducing it from 80% to 70%. The agency also clarified that multiple establishments may be included in a single analysis;
- Self-evaluation must use some form of statistical analysis permitting tests of statistical significance generally accepted in the statistics profession. Contractors with 500 or more employees must use multiple regression analysis. The Final Rule reflects the OFCCP's agreement to increase the size of employers subject to this requirement from employers with 250 or more employees;
- Self-evaluation must be conducted on an annual basis. Contractors must investigate any statistically significant compensation disparities disclosed by the self-evaluation and provide appropriate remedies if disparities cannot be explained by legitimate factors. Appropriate remedies may include back pay and other make whole relief; and
- Contractors must contemporaneously create, retain, and make available to the agency, documents and data relating to its self-evaluation.

For contractors who conduct a self-evaluation but assert the attorney-client privilege or the attorney work product privilege over the results, thereby not releasing their self-evaluation to the OFCCP, the Final Rule offers no better solution than that proposed in the original guidelines. For these contractors, the OFCCP offers an "Alternative Compliance Certification," by which a contractor verifies it has followed the agency's compensation self-evaluation guidelines, along with other representations. However, there is little to be gained by seeking such a certification since the agency will not accept the contractor's representation that its results are non-discriminatory: the OFCCP will simply conduct its own compensation analysis.

It is important that a contractor, before adopting the new optional self-evaluation standards, weighs the pros and cons of doing so. Some of the favorable reasons to implement the new self-evaluation standards are as follows:

- Multiple regression analysis is a very robust tool for compensation analysis and its use will assist a contractor to understand, in a sophisticated way, where there are pay disparities that correlate to race/ethnicity or gender.
- This method is especially useful for a contractor with many employees who may benefit from the efficiency of the analysis and who already has

much of the necessary data in its human resources information system. The necessary data may include employee performance ratings, education level and other information used to determine compensation.

- A contractor who follows the self-evaluation standards and remedies disparities that are revealed, and turns its self-evaluation over to the OFCCP in a compliance evaluation, may also benefit from a more streamlined audit since the OFCCP should defer to the contractor's self-evaluation and should not conduct its own analysis.
- However, a contractor should weigh whether it is better to turn over the self-evaluation or not (if it has conducted the evaluation under privilege and, by releasing it, would waive the privilege). Ideally, any such self-evaluation should be undertaken under privilege, according to specific directions and with analysis by counsel in order to avoid discovery in litigation.
- While, in order to preserve the privilege, the contractor would not turn its self-evaluation over to the OFCCP, it would have the benefit of knowing, in advance, what the OFCCP will find.

There are, however, significant reasons a contractor may not choose to not adopt the new self-evaluation standards, including:

- The expense of conducting an annual multiple regression analysis;
- Another especially troubling concern is that self-critical results of such a self-evaluation, using the same standards articulated by the courts to find discrimination, may be discoverable during

employment discrimination litigation. In other words, well-intentioned contractors could easily find themselves the victim of their own analysis.

At the very least, in order to provide a measure of protection, the analysis should be conducted under privilege;

- Without the protection of a privilege, unless a contractor is prepared to commit the resources to provide back pay for all disparities existing for the prior two years, and other appropriate remedies for every adverse finding, it should seriously consider whether it should adopt this tool for self-evaluation;
- Contractors should also realize that multiple regression analysis has limitations. For example, results taken from a snapshot on an annual basis are a moving target and there may be somewhat differing adverse findings each year.

For more information about these regulations or any other affirmative action related matter, please contact your attorney at Seyfarth Shaw or partners in the Affirmative Action Practice Group, including Valerie Hoffman at vhoffman@seyfarth.com, Bob Nobile at rnobile@seyfarth.com or Bill Perkins at wperkins@seyfarth.com

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