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A Brave New World For Federal Contractors Are You Prepared For The OFCCP's New Proposed Guidelines for Evaluating Compensation Discrimination?

The Office of Federal Contract Compliance Programs (OFCCP), the Agency that enforces the federal affirmative action laws, is committed to increasing its enforcement efforts, including efforts in the area of systemic compensation discrimination. Late last year, OFCCP published two proposals in the Federal Register describing: (1) new standards for evaluating systemic compensation discrimination; and (2) guidelines for employer self-evaluation of compensation practices. Since then, the agency has hired five new statisticians and plans to hire several more — one for each of its regions. It also has hired experienced Equal Employment Opportunity Commission (EEOC) trial attorneys, and has engaged in an awareness campaign announcing the agency's new approach toward auditing, analyzing, and litigating systemic compensation discrimination. OFCCP is committing significant resources to ferreting out and remedying systemic discrimination. In short — it's a brave new world — and government contractors need to be prepared.

New Contractor Selection Plan, Advance Review Notice

In June 2004, OFCCP began piloting a new selection procedure to identify contractor establishments for audit. With the aid of Westat, an outside consultant, OFCCP developed a new statistical model called the Federal Contractor Selection System (FCSS). The new targeting model analyzes both EEO-1 and 2000 Census data to identify establishments that appear likely to have systemic discrimination. Specifically, the FCSS compares contractor establishments' workforce profiles to others in the same industry — and to the profile of the local labor market supply according to the 2000 Census data. Applying its new formula, the agency determines a "probability of discrimination" score. To aid in the new formula's validation process, and to get the process underway, the agency initially plans to conduct targeted compliance reviews of over 600 establishments ranked by the formula as having the "worst" profile.

Of benefit to targeted contractors, the new OFCCP procedure incorporates an advance review notice that advises the targeted federal contractor that "one or more of your establishments has been selected for potential scheduling of a compliance review." The notice explains that OFCCP "will give serious consideration to any remedial action voluntarily undertaken by that particular establishment prior to the conduct of an OFCCP review. Such remedial action may mitigate any relief sought by OFCCP, to the extent the remedial action completely corrects the problem(s) at issue." Using the new system, OFCCP already has selected 3,560 establishments for possible compliance reviews.

New Standards for Evaluating Systemic Compensation Discrimination

Improving on its prior methodology (the so-called "Pay Grade Theory" or "DuBray Method"), OFCCP's newly proposed standards for systemic compensation discrimination analysis has two essential characteristics. First, OFCCP's new method calls for the determination of employees who are "similarly situated." Under this method, employees are similarly situated with respect to pay decisions where they perform similar work, have similar responsibility levels, and occupy positions involving similar qualifications and skills. An employer's preexisting groupings developed and maintained for other purposes — such as job families or affirmative action program job groups — may provide some indication of similarity in work, responsibility level, and skills and qualifications. However, such preexisting groupings are not dispositive and OFCCP anticipates using on-site interviews to assess whether employees included in such groupings are, in fact, similarly situated.

Under its proposed Guidance, OFCCP will use a statistical analysis known as "multiple regression" to account for the influence of legitimate factors on compensation. Multiple regression analysis is a statistical tool for understanding the relationship between two or more variables. Multiple

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regression typically uses a single dependent variable and several explanatory variables to assess the statistical data relevant to the analysis of pay discrepancies. In a case alleging sex discrimination in salaries, for example, a multiple regression analysis would examine not only sex, but also other explanatory variables of interest, such as employees' education, work experience with previous employers, seniority in the job, time in a particular salary grade, and performance ratings. The employer might use multiple regression to argue that salary is a function of the employee's education and experience, while the OFCCP or plaintiff employees might argue that salary also is a function of the individual's gender. OFCCP generally will attempt to build the regression model in such a way that controls for the factors that the investigation reveals are important to the employer's pay decisions, but also allows the agency to assess whether the employer's criteria are affected by illegitimate factors such as gender.

Under the new method, systemic compensation discrimination must be based on disparities that are "statistically significant," *i.e.*, those that could not be expected to have occurred by chance. Thus, to ensure uniformity and predictability, OFCCP only will conclude that a compensation disparity is statistically significant if it is significant at a level of two or more standard deviations. OFCCP will seldom make a finding of systemic discrimination based on statistical analysis alone, but will obtain anecdotal evidence to support the statistical evidence. The Division of Statistical Analysis, staffed by expert level statisticians, will conduct the statistical analysis necessary for evaluating whether there is systemic compensation discrimination.

Guidelines for Employer Self-Evaluation of Compensation Practices

OFCCP will continue to permit contractors to choose their own form of compensation self-evaluation techniques. However, as an incentive for contractors to implement a compensation self-evaluation system that conforms to OFCCP's new method, the agency will deem a contractor in compliance if the contractor's compensation self-evaluation system meets general standards mimicking OFCCP's new method. Thus, in order to meet these general standards, contractors must annually perform a statistical analysis that evaluates groupings of employees that are similarly situated, known as "Similarly Situated Employee Groupings" or "SSEGs." Employees may be placed into the same SSEG if they are "similarly situated," as described above, regardless of any employer-created designation, such as job title, job classification, pay grade or range, etc.

For contractors with 250 or more employees, OFCCP deferral to the employer's analysis only will occur if the employer performs multiple regression analysis. The contractor must ensure that any factor within the contractor's control that is included in the analysis is not itself subject to discrimination. The contractor must make a reasonable attempt to produce SSEGs that are large enough for meaningful statistical analysis, *i.e.*, usually containing at least 30 employees overall, with five or more incumbents

who are either male/female or minority/non-minority. In certain cases, small numbers of employees will not be sufficiently similarly situated to other employees to permit such groupings. In that case, employees may be eliminated from the statistical evaluation process; however, the contractor is expected to conduct a self-evaluation of pay decisions related to such employees using non-statistical methods. The contractor must investigate any statistically significant compensation disparities produced by the self-evaluation analyses that it has developed, and determine whether such statistical disparities are explained by legitimate factors. If the statistical disparities cannot be explained, the contractor must provide appropriate remedies (such as back pay for adversely affected employees and appropriate compensation adjustments), which will depend on the time period in which the disparities emerged.

OFCCP's guidelines contemplate that some contractors may take the position that their compensation self-evaluation is subject to the attorney client privilege or attorney work product doctrine. In such cases, OFCCP will permit the contractor to certify its compliance in lieu of producing the methodology and results of its compensation self-evaluation analyses. The certification must be in writing, signed by a duly authorized officer of the contractor under penalty of perjury, and must state that the contractor has performed a compensation self-evaluation with respect to the affirmative action program or workplace at issue, at the direction of counsel, and that counsel has advised the contractor that the compensation self-evaluation analyses and results are subject to the attorney-client privilege and/or the attorney work product doctrine. As OFCCP will not be able to evaluate the contractor's compliance with its new method, a contractor that opts for this compliance certification alternative will not be entitled to OFCCP deferral as described above. As a result, OFCCP will evaluate those contractors' compensation practices without regard to the analysis or results of their compensation self-evaluation systems.

Pattern and Practice Litigation Likely to Increase

OFCCP plans to use its proposed guidelines to bolster its commitment to enhanced enforcement efforts. Notably, the day after issuing its proposed guidance in the Federal Register, the Department of Labor announced that OFCCP's enforcement efforts in fiscal year 2004 yielded \$34,567,070 in financial remedies to address discrimination claims — a 31% increase over fiscal year 2003. In that same announcement, OFCCP chief Charles James commented that OFCCP continues to focus on "rooting out and remedying systemic discrimination." As indicated above, OFCCP has hired high profile litigators and statistical experts to assist with these enforcement goals.

Companies can expect resulting litigation over systemic compensation discrimination to be complex and expensive. Systemic discrimination cases brought by OFCCP usually allege a pattern and practice theory of discrimination. In such cases, OFCCP attempts to establish a *prima facie* case by showing that discrimination because of race, sex or other protected status was the company's standard

operating procedure — the regular rather than the unusual practice. OFCCP uses statistical data as well as anecdotal evidence to establish that such an unlawful practice existed. In cases where OFCCP provides sufficient evidence that discrimination is the company's standard operating procedure, the burden shifts to the company to defeat OFCCP's evidence by showing that OFCCP's proof is either inaccurate or insignificant. If the company's rebuttal evidence does not warrant outright dismissal of the case, a factfinder must then decide whether OFCCP has demonstrated a pattern and practice of discrimination. Litigation of these pattern and practice cases can be lengthy, costly, involve media publicity and risk disclosure of highly proprietary compensation information and other employment information.

Companies viewed as "repeat offenders" are the most likely targets of OFCCP pattern and practice litigation, particularly in hiring cases. OFCCP has confirmed that it is developing a strategy of pursuing cases where there is evidence of a pattern and practice revealed through the audit of three or more facilities of the same company involving essentially the same issues. OFCCP is working with top plaintiffs' counsels from across the nation to advise the agency on how best to pursue cases against these "three time offenders" for the greatest impact. OFCCP is in the process of identifying companies for potential pilot testing of this new strategy. It is anticipated that the OFCCP may use a similar strategy to target federal contractors' other employment practices (e.g., relating to promotion and/or termination).

Action Items

These proposed guidelines and trends demonstrate that OFCCP is toughening its enforcement efforts and planning to put more "teeth" into their enforcement remedies. Federal contractors should review OFCCP's proposed guidelines and consider ways to lessen the possibility of being issued an OFCCP notice of violation. At a minimum, contractors should work with counsel to:

- ♦ Audit their existing affirmative action programs to ensure compliance with OFCCP's requirements;
- ♦ Determine how the new Guidance applies to their business;
- ♦ Assess whether modifications to existing HRIS systems are necessary to capture the information and factors needed for proper statistical analysis;
- ♦ Form appropriate SSEGs;
- ♦ Conduct appropriate statistical analyses of compensation, applicant versus hire, promotion and termination data.
- ♦ Ensure to the maximum extent practicable that the company's statistical self-evaluation, at least any initial self-evaluation, is protected by privilege and not subject to discovery in litigation brought by the government *or* private litigants;
- ♦ Determine whether ongoing self-audits and other analyses can/should be protected by privilege; and
- ♦ Analyze information obtained from any self-evaluation to assess whether any remedial actions are warranted.

If you have questions about these proposed guidelines, please contact: Valerie Hoffman, vhoffman@seyfarth.com; Bob Nobile, rnobile@seyfarth.com; Bill Perkins, wperkins@seyfarth.com; Leigh Jeter, ljeter@seyfarth.com; or Greg Davis, gmdavis@seyfarth.com.

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