Rethinking Pay Equity

A Roadmap For Companies Looking To Mitigate Pay Equity Litigation Risk Exposures

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Pay equity continues to be a hot topic in the news. As the debate over the pay gap between men and women rages, high profile stories such as the U.S. Women's Soccer team filing a gender discrimination lawsuit, walkouts at large technology companies over pay discrepancies, and activist investors challenging corporate boards on pay practices have dominated recent headlines.

These events and others have spurred legislative action at the state and local level and created a complex web of employment law for corporations to navigate. Forty-eight states now have separate laws addressing pay equity in the workplace. In almost every instance, these laws provide much greater protections for employees than the Federal Equal Pay Act.

Key provisions in these recently enacted state laws include restrictions on employers' ability to ask about prior salary history and expansion of the scope of pay equity to include disparities based on race and gender.

This white paper provides an overview of the rapidly changing pay equity landscape and the steps companies can take to identify pay gaps and mitigate pay equity litigation risk.

Overcoming the Impact of Prior Salary Information

Setting starting pay rate based on prior salary may perpetuate pay discrimination, specifically surrounding the gender pay gap. According to the Bureau of Labor Statistics, the average woman made 80 percent of the average man's earnings in the fourth quarter of 2018. At the current pace, the gender pay gap will not be eliminated until approximately 2060. For this reason many advocates have sought prohibitions on requesting or relying on prior salary information during the hiring process. State and local governments are following suit, taking action to address the perceived causes of the pay gap. For employers, this means a need to revisit long-standing practices around pay-setting decisions.

A Patchwork of State and City Prohibitions

Currently, California, Delaware, Hawaii, Massachusetts, New Jersey, Oregon, Puerto Rico, Vermont, New York City, Philadelphia, and San Francisco have passed laws restricting prior salary information, and the list continues to grow.

Many of these laws have unique or different requirements than others. For instance, in some jurisdictions, employers cannot ask applicants for prior salary information, but they can use information that is provided voluntarily. In other jurisdictions, employers can ask (such as for screening purposes) but cannot rely on the information when setting pay rates.

The result is a complicated patchwork of different regulations for multistate employers to navigate.

Federal Law is Evolving

Federal circuit courts are split on whether prior salary information may be a permissible "factor other than sex" under the Equal Pay Act. Pay differentials are permitted when they are based on seniority, merit, quantity or quality of production, or a factor other than sex. These are known as "affirmative defenses," and it is the employer's burden to prove that they apply.

In 2018, the Equal Employment Opportunity Commission (EEOC) successfully argued in a U.S. Court of Appeals that using prior pay alone to determine compensation violates the Equal Pay Act by perpetuating existing gender based gaps in pay. However, this issue will likely end up before the Supreme Court for a substantive ruling.

Who is 'Comparable' for Pay Equity Purposes?

The persistent gender "pay gap" has led many state and local governments to enact new fair pay laws that are broader in certain respects than federal pay discrimination laws. While these state and local fair pay laws vary, they all generally expand the pool of employees who can be compared to determine if pay is equitable.

Under the federal Equal Pay Act of 1963, an employer must pay men and women the same when they are performing equal or "substantially equal" work. To bring a claim, an employee would have to demonstrate that he or she performs virtually the same work as a comparator of the opposite sex and receives less pay. Protections under [Title VII of the Civil Rights Act] are likewise restricted to those who are "similarly situated."

Before 2016, nearly all states had their own "equal pay acts" that mirrored the equal pay for equal work language of the Equal Pay Act. Since 2016, however, states have sought to broaden the pool of comparators to those performing "substantially similar work" or "comparable" work. Additionally, while the Equal Pay Act also restricts comparison to those in the "same establishment," many of the state laws do not restrict comparison to the same establishment or geographic location. For example, California's fair pay law allows comparison to employees in other locations or establishments.

A comprehensive compensation audit that considers the state and local laws that apply to your workforce is the only way to illuminate your litigation exposure.

What's an Employer to Do?

Many employers have decided to end the practice of requesting prior salary information from applicants or using the information in setting starting pay. However, that is not a complete solution. Employers also should consider exploring whether there are any existing pay disparities that were created by the historical use of applicant prior salary information in setting starting pay rates.

Best practices include the following:
• Remove salary history inquiries from applications;
• Train recruiters and talent acquisition team not to ask about salary history;
• Implement written guidelines for establishing starting pay;
• Train those involved in pay-setting decisions to set pay without reliance on prior pay;Conduct an internal review of pay of others in similar positions for equity;
• Document the reasons for pay differences, particularly in starting pay rates; and
• Under attorney-client privilege, consider conducting a broader pay equity analysis to determine if reliance on prior salary history has perpetuated wage gaps in the organization and, if so, take remedial steps to address any issues.

Going Beyond Compensation Data with a Pay Equity Audit

Pulling together compensation data to meet EEOC requirements for EEO-1 Component 2 compensation data can be challenging for companies and their Human Resource professionals. Despite the painstaking collection process, the aggregate data itself provides no information to assess whether an organization has potential pay equity issues based on gender or race/ethnicity. However, it could be used by the EEOC or a private litigator to identify potential organizations or individuals to investigate.

To gain true insight into pay equity, the data collection process must be accompanied by an in-depth look at compensation policies and practices. A comprehensive compensation audit that considers the state and local laws that apply to your workforce is the only way to illuminate your litigation exposure.

In addition to helping organizations better understand potential risk to a government investigation or a private lawsuit, compensation audits (or pay equity reviews) can provide additional benefits, such as improving employee retention and morale. A compensation audit may also enhance a company's reputation among current and prospective employees, positioning the company as a caring, progressive employer. Perhaps most importantly, insights into current compensation policies and practices may help company leadership avoid potential pitfalls and limit risk exposure going forward.

Audit Best Practices

A detailed understanding of how compensation is determined within the organization is critical. Factors such as who is responsible for setting compensation, what employee related factors influence how much an employee is paid, and the outside market for a particular skill, etc. dictate what data needs to be collected. This process is the only way to properly analyze compensation and determine if there are potential differences among similarly situated employee groups.

When employee groups are sufficiently large, compensation analyses are typically conducted using a statistical method known as a regression analysis. This method allows the researcher to estimate potential differences between employee groups after accounting for pay-related characteristics (e.g., job seniority) to identify areas requiring further examination.

For smaller populations where a regression is not possible, the analysis would focus on cohorts to identify any potential areas of concern. With either of these approaches, it is critical to identify employee groups for whom you expect compensation to be similar; and it's essential for the data on which your analyses are based to be complete and accurate. Deficiencies in either of these areas could lead to poor decisions based on the outcomes of the analyses.

Additional tips for employers when considering a pay audit include:

- Expand the pay groupings beyond job title and compare jobs that share similar functions. New state laws are breaking away from the idea that relatively minor job-related distinctions should command different pay. Employers will need to broaden their ideas of comparable tasks and roles.
- Evaluate the pay groupings multiple ways to see where potential issues may exist, and then focus on ensuring that those issues are defensible in the relevant jurisdiction.
- Audit job descriptions and the actual job duties of employees - skills, efforts, and responsibilities - to ensure that pay analyses will compare the "right" employees and identify actual legal risk for the jurisdiction.

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Acting On Your Results

If the compensation audit shows areas of concern that need to be addressed, there are several things to consider before making any compensation adjustments.

- First, develop a plan to determine target employee groups and how aggressive you will be in your adjustments.
- Second, set a budget for the adjustments. Note that salary adjustments will have an on-going cost.
- Third, determine who within the targeted groups should be adjusted by considering performance, equity, and legal concerns associated with these adjustments.
- Fourth, get "buy-in" from direct managers and decision makers to support the adjustments.
- Last, plan follow-up monitoring.

Compensation today is a product of multiple employment decisions, including starting pay, promotional increases, and merit increases. In addition, hiring, promotion and termination decisions have the potential to impact pay differences among employee groups. Thus, it is necessary to monitor these activities to ensure pay equity in the future.

Common Explanations for Pay Differences

There are a number of reasons a pay equity audit may reveal pay gaps in your workforce.

Job Related

In a pay discrimination claim, the employer bears the burden of demonstrating that pay differences between comparable employees are based on lawful factors. Although the Equal Pay Act references "equal" pay, comparable employees may be paid at different rates if the pay difference is based on "any factor other than sex."

The Equal Employment Opportunity Commission (EEOC) and some federal courts have taken the position that the "factor other than sex" affirmative defense is limited to "job-related" factors. Many of the new state equal pay laws, such as those in California and Massachusetts, expressly permit only "job-related" explanations. Other state laws, such as those in New Jersey and Oregon, take this a step further by providing exclusive lists of factors that can be used to justify pay differences, such as merit, experience, or production.

Questions remain about what it means for a pay difference to be "job related," and about the ways in which the evolving social and legal landscape are changing how courts and enforcement agencies view common explanations for pay differences.

Market Factors

Sometimes pay is whatever it takes to recruit the best talent. This may result in long-term employees being paid less than newer hires. Arguing that various market conditions are "job related" can be difficult. Enforcement agencies, such as the EEOC and state counterparts and the Office of Federal Contract Compliance Programs (OFCCP), are skeptical of pay differences that are caused by market factors at the time of each employee's hire. Common audit questions include whether the company will increase employees' pay to help "catch them up" to the current market rates; and if not, why?

New Hire Negotiations

Salary negotiations at the time of hire historically have been used as a factor "other than sex" for paying people differently. However, investigators now question whether negotiation practices are consistent between gender and race groups. Employers will be required to prove both that negotiation was the actual reason for the pay difference and that gender and race/ethnicity groups were not adversely affected by negotiation practices. Keeping a record of the negotiation and pay increases attributable to negotiations will be key in providing burden of proof, as investigators and courts will require that such explanations be supported by documentation.

Performance

Many companies say they "pay for performance." A closer review often reveals that employees receive increases at different rates despite equal evaluation scores. In a pay investigation, the correlation between performance and pay increases is analyzed by lining up years of performance scores against pay increases and looking for inconsistencies. As the pool of potential comparators becomes broader under new state laws, employers may find it more difficult to explain discrepancies by reference to performance.

When performance is used as a justification for paying people differently, employers should be prepared to prove (1) that there is documentation to support the claim that performance is weaker; and (2) that evaluations are based on objective criteria and administered fairly.

Experience

Prior relevant experience is a solid, job-related explanation for differences in pay. However, employers may be required to demonstrate that experience is valued equally between employees of different genders or races/ethnicities. Employers who do not keep data on employees' prior experience in their human resource information system may be required to produce resumes or applications to prove experience levels. Common questions include: How is the experience related to the job duties? How much discretion does the employer have in valuing experience? Is it the number of years or quality of the experience that matters? How does the employer quantify the difference?

The key to using experience in defending an investigation or litigation is a well-developed policy regarding the use of experience in pay-setting decisions and consistency in the application of that policy.

Mergers and Acquisitions

OFCCP and EEOC have been open to accepting recent mergers or acquisitions as an explanation for differences in pay. The thinking here is that if the acquired employer paid its employees at higher rates, the new employer generally would not reduce the pay of the new employees, but it also may not increase the pay of the existing employees. This would create differences in pay for the same jobs. Over time, however, those differences in pay should dissipate as the new organization's pay system is aligned. If the employees are doing essentially the same work and at least three years have passed since the transition, additional explanation likely will be necessary.

Red-Circling

"Red-circling" is when an employee's pay rate is temporarily capped when moving into a new role because the employee was receiving higher pay in a prior position. The key to defending this practice often comes down to the length of time and consistency with which red-circling is used. Common questions include: Is the red-circling temporary? Is everyone red circled in this situation, or is it the rare exception? Do women and minorities have equal opportunity? Has the practice been consistent over the years?

Conclusion

As the pay equity landscape continues to change rapidly, employers must be proactive to stay ahead of the ever-evolving legislation and subsequent enforcement.

It's important not only to be aware of the factors that may contribute to key differences in pay, but also to understand the specific steps that companies can take to identify pay gaps and mitigate pay equity litigation risk. Among these, eliminating prior salary information from compensation-setting decisions and conducting a detailed compensation audit to identify pay gaps and understand acceptable pay differences are key to reducing a company's exposure to pay equity litigation.

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