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EMPLOYMENT

Evaluating Pay Equality: Steps Investment Managers Should Consider to Avoid Running Afoul of Equal Pay Laws

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While harassment allegations against an ever-growing number of male power figures dominate the news, another equal employment opportunity issue simmers steadily below the surface: the pursuit of pay equity for women and minorities. In the past few years, several states have passed pay equity laws affording employees greater protections than those historically provided by federal law, and equal pay has become a focal point in politics and board rooms. Investment managers can expect increasing scrutiny of these issues in the months and years ahead.

As firms turn their attention toward the year-end compensation cycle, they should consider taking the initiative to identify and correct any unwarranted pay disparities. This article outlines key federal and state equal pay laws, as well as steps investment managers should take in planning and conducting an internal pay analysis.

Key Federal Laws Requiring Equal Pay

Most claims alleging unlawful pay disparity under federal law are brought pursuant to Title VII of the Civil Rights Act of 1964 ("Title VII") or the Equal Pay Act ("EPA").[1]

Title VII

Title VII broadly prohibits discrimination in compensation based on an individual's race, color, religion, sex or national origin.[2] In a typical Title VII pay discrimination case, a plaintiff claims that he or she received lower wages than "similarly situated" comparators outside of the plaintiff's protected class.[3]

Plaintiffs often use statistics that compare the average pay of similarly situated employees inside and outside of the protected class to prove their cases. Whether comparators are "similarly situated," however, is often a hotly contested issue. Job titles are not determinative;[4] rather, similarity depends on whether "the jobs generally involve similar tasks, require similar skill, effort, and responsibility, [have similar] working conditions, and are similarly complex or difficult."[5]

Even where two employees perform similar work, pay differences can be lawful where they are supported by neutral factors, such as the employees' respective education, experience, tenure and job performance. If a statistically significant pay difference exists even after accounting for potential neutral explanations, a jury may infer that the difference is due to intentional discrimination.

In addition to asserting claims of intentional discrimination, employees can assert that a firm's compensation practices have a "disparate impact" on a protected class. Disparate impact claims do not require a showing of discriminatory intent; rather, such discrimination occurs when (1) a facially neutral compensation policy significantly disadvantages a protected group; and (2) the employer cannot demonstrate that the policy is "job related and consistent with business necessity."[6]

Equal Pay Act

Unlike Title VII, which broadly prohibits compensation discrimination against all protected categories, the EPA only bars discrimination based on gender. Under the EPA, firms are prohibited from paying employees of one sex a lesser rate for "equal work" in positions requiring "equal skill, effort, and responsibility, and which are performed under similar working conditions."[7]

A plaintiff pursuing a claim under the EPA can challenge disparities within the same "establishment" – generally, a distinct physical location – rather than disparities across an employer's entire business.[8] A plaintiff need not show that the employer acted with discriminatory intent; rather, a showing that the employer paid workers of one gender more than workers of the other gender for equal work will result in liability.[9] In addition, unlike Title VII, which requires pay differences to be "statistically significant" to raise an inference of discrimination, the EPA can be violated by any pay difference, no matter how small.

Affirmative Defense Available to Firms

Under both Title VII and the EPA, a firm can establish an affirmative defense by showing that a particular pay difference resulted from: (1) a seniority system; (2) a merit system; (3)

a system that measures earnings by quantity or quality of production; or (4) a differential based on "any factor other than sex."[10] The burden is on the defendant firm to demonstrate that the proffered reasons did, in fact, cause the disparity.[11]

Key State Equal Pay Laws

In addition to the above federal laws, many states have passed laws prohibiting discrimination in compensation. Laws in various jurisdictions – including New York, Connecticut, California, Maryland and (as of July 1, 2018) Massachusetts – provide greater protections than their federal counterparts.

For example, a key affirmative defense to equal pay law claims – i.e., that the pay disparity at issue was caused by a factor other than sex – is much narrower (or even non-existent)[12] under various state laws. To establish this defense in New York, Connecticut, California and Maryland, for example, a firm must demonstrate that the disparity was caused by a "bona fide" factor other than sex, and that such factor (1) is job-related; (2) was not "derived from a sex-based differential" in compensation; and (3) is consistent with "business necessity."[13] Further, even if a firm satisfies this heightened showing, an employee can override the defense in New York, Connecticut or California by demonstrating that there is an alternative employment practice that would serve the same business purpose without creating the compensation differential.[14]

These foregoing state laws also expand equal pay law protections in other ways. In Maryland, for example, the applicable statute prohibits discrimination against an employee based not only on sex, but on the employee's gender identity.[15] In California, a pay equity claim can be based not only on comparators in the plaintiff's work establishment, but on company employees in other locations as well.[16] In New York, a successful plaintiff can recover liquidated damages of up to 300 percent of the pay disparity, among other available remedies.[17]

In addition to these substantive protections, state laws also contain procedural protections designed to help redress existing pay disparities. For example, each of the above-noted states now bars employer policies that would prohibit employees from sharing or communicating about their respective compensation, so that employees can learn if they are being underpaid compared to their colleagues.[18]

Several states have also enacted laws prohibiting firms from inquiring about or using a candidate's pay history as part of the hiring or onboarding process. A New York City law with such a prohibition went into effect on October 31, 2017,[19] and similar laws will take hold in California and Massachusetts in 2018.[20] See "Four Steps NYC-Based Fund Managers Should Take in Light of Newly Enacted Law Prohibiting Compensation History Queries When Interviewing Prospective Employees" (May 11, 2017).

These new measures are likely to have an inflationary impact on employee compensation. Candidates will be free to seek whatever compensation they choose, and a hiring firm will be limited in its ability to peg compensation to a candidate's current level of pay.

What Now?

In the coming months, investment managers should anticipate increased focus on pay equity issues from employees, governmental agencies and the plaintiffs' bar. Firms should consider taking proactive steps to minimize risk, including utilizing the year-end compensation cycle to conduct an internal pay analysis to identify and address any latent inequalities. Firms should use extreme care in planning and conducting these reviews, however.

Role of Legal Counsel

First and foremost, any internal pay analysis should be led by a firm's legal counsel in a manner that preserves the attorney-client privilege. Firm counsel will want to create a paper trail clearly framing the purpose of the review – i.e., to allow counsel to evaluate legal risk and provide advice to his or her client based on applicable law. A failure to properly characterize the review in this fashion may impair the firm's ability to protect its results from disclosure later on.

See our three-part series on preserving the attorney-client privilege when conducting internal investigations: "Establishing Privilege and Work Product" (Mar. 23, 2017); "Minimizing Cooperation Risks" (Mar. 30, 2017); and "Implications for Collateral Litigation" (Apr. 6, 2017).

To the extent a firm engages an outside consultant to assist with the review – as is often the case when statistical analyses are conducted at larger workforces – the consulting relationship should be structured so as to maximize the likelihood that the privilege will apply. See our three-part series on the use of Kovel arrangements: "Utilizing, Invoking and Waiving the Kovel Privilege for Consultants" (Oct. 20, 2016); "Preparing an Engagement Letter for, and Implementing, a Compliant Kovel Arrangement" (Oct. 27, 2016); and "Where Fund Managers May – and May Not – Be Able to Use Kovel Arrangements" (Nov. 3, 2016).

Employee Identification

Second, firms should identify the employees to be included in the review and the positions to be grouped together for purposes of the analysis. In general, firms should look at pay disparities between employees who are similarly situated with respect to the skills required for the position, the tasks performed on a day-to-day basis and the employees' levels of responsibility.

Data-Gathering

Third, firms must gather all of the necessary data to conduct the review. Compensation data (including base salaries, bonuses, carried interest, benefits and any other form of remuneration) is essential, but the review should also consider information that may provide non-discriminatory explanations for any identified pay differences, such as employees' relative prior experience, tenure, education, employment agreements, performance metrics and reviews.

For firms that base compensation decisions on a mixture of objective and subjective criteria, or purely on subjective factors, gathering the relevant data points can be difficult. Even written performance reviews have come under attack from the plaintiffs' bar in recent years, including by resort to studies regarding "inherent biases" and their potential impact on performance evaluations.[21] A firm trying to insulate its pay practices from legal challenge should look not only at the relevant metrics, but must be able to articulate, and should consider documenting, legitimate business justifications to support each metric.

Decisions About Potential Adjustments

Fourth, if review of a firm's pay practices reveals compensation disparities that cannot be explained by neutral, non-discriminatory factors, the firm will face a number of strategic decisions regarding potential pay adjustments.

While the goal (i.e., eliminating pay differences between similarly situated employees) is simple in theory, achieving it can be far more difficult in practice. The challenge is to try to obtain mathematical parity while also accounting for relevant business objectives and avoiding an unintentional adverse impact on other protected classes.

Furthermore, one of the simplest solutions – reducing certain employees' pay to achieve parity – is prohibited by governing law.[22]

Implementation of Adjustments

Finally, a firm will need to decide how and when to go about making any appropriate pay adjustments. The goal is to correct any outliers without generating claims for back pay in the process. Under both federal and state law, the statute of limitations for a pay discrimination claim may date back three years or more, meaning that an aggrieved employee could seek several years of back pay. Particularly against this backdrop, firms will want to use care in making, communicating and implementing compensation decisions.

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[1] The Age Discrimination in Employment Act and the Americans With Disabilities Act also prohibit compensation discrimination on the basis of age or disability, respectively. See 29 U.S.C. § 623; 42 U.S.C. § 12112.

[2] See 42 U.S.C. § 2000e-2(a).

[3] See, e.g., Dimino v. Georgia Dep't of Administrative Services, 631 Fed. Appx. 745, 748-749 (11th Cir. 2015).

[4] E.E.O.C. Compliance Manual § 10-III(A)(1)(b) (2000).

[5] Id.

[6] E.E.O.C. Compliance Manual § 10-III(B) (2000).

[7] 29 U.S.C. § 206(d)(1).

[8] See 29 U.S.C. § 206(d)(1); 29 C.F.R. § 1620.9(a).

[9] See Mickelson v. New York Life Ins. Co., 460 F.3d 1304, 1311 (10th Cir. 2006); Ryduchowski v. the Port Authority of N.Y. and N.J., 203 F.3d 135, 142 (2d Cir. 2000), cert. denied, 530 U.S. 1276 (2000).

[10] See 29 U.S.C. § 206(d)(1); Mickelson v. New York Life Ins. Co., 460 F.3d 1304, 1311 (10th Cir. 2006).

[11] See Mickelson v. New York Life Ins. Co., 460 F.3d 1304, 1312 (10th Cir. 2006).

[12] See Mass. Bill. S. 2119 § 2(b) (2016).

[13] See N.Y. Lab. Law § 194(1)(d); Conn. Gen. Stat. Ann. § 31-75(b); Cal. Lab. Code §§ 1197.5(a)(1)(D), (b)(1)(D); Ann. Code Md. § 3-304(c)(7).

[14] See N.Y. Lab. Law § 194(1)(d); Conn. Gen. Stat. Ann. § 31-75(b); Cal. Lab. Code §§ 1197.5(a)(1)(D), (b)(1)(D).

[15] See Ann. Code Md. § 3-304(b).

[16] See Cal. Lab. Code §§ 1197.5(a).

[17] See N.Y. Lab. Law § 198.1-a.

[18] See N.Y. Lab. Law § 194(4)(a); Conn. Public Act No. 15-196(b)(1); Cal. Lab. Code §§ 1197.5(j)(1), (b)(1)(D); Mass. Bill. S. 2119 § 2(c)(1); Ann. Code Md. § 3-304.1.

[19] See, e.g., N.Y.C. Council Int. No. 1253-A (2016).

[20] Mass. Bill. S. 2119 § 2(c) (2016); Cal. A.B. 168 (2017).

[21] See, e.g., Paola Cecchi-Dimeglio, How Gender Bias Corrupts Performance Reviews, and What to Do About It, Harvard Business Review, April 12, 2017, available at https://hbr.org/2017/04/how-gender-bias-corrupts-performance-reviews-and-what-to-do-about-it; Kieran Snyder, The abrasiveness trap: High-achieving men and women are described differently in reviews, Fortune, August 26, 2014, available at http://fortune.com/2014/08/26/performance-review-gender-bias; Ryduchowski v. the Port Authority of N.Y. and N.J., 203 F.3d 135, 143-145 (2d Cir. 2000) (upholding jury verdict that employer failed to establish valid merit system defense under the EPA where the evidence supported a finding that the defendant's "detailed evaluation procedures were not systematically applied to all employees because of the gender prejudice of [plaintiff's] superiors. . . ."), cert. denied 530 U.S. 1276 (2000).

[22] See, e.g., 29 C.F.R. §§ 1620.12; 1620.25.