Compensation Strategies in the Era of the Lilly Ledbetter Fair Pay Act

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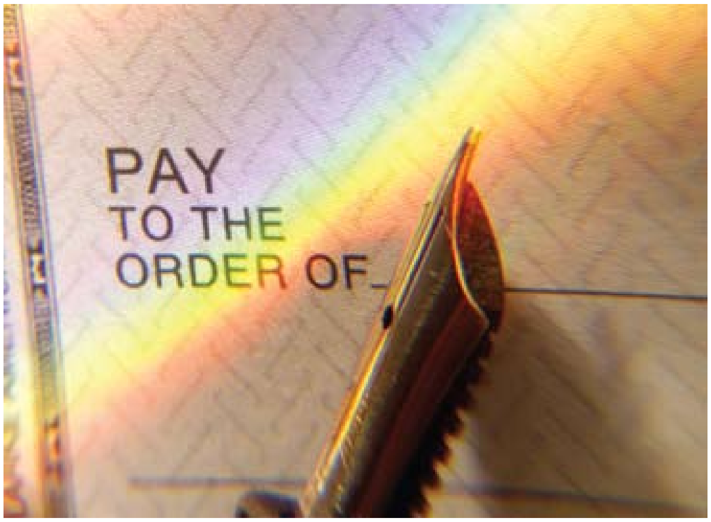

Since President Barack Obama signed the Lilly Ledbetter Fair Pay Act on January 29, 2009, there has been ample commentary from the legal community suggesting that employers may benefit from undertaking a *privileged* review of compensation decisions in order to mitigate ongoing risks created by historical employment decisions. As employers consider undertaking such reviews, there are a number of considerations that will impact the review's effectiveness, as well as any remediation strategies, if appropriate, and ongoing management of future risks.

Conducting Analyses of Current Compensation Relationships

While some companies may want to make knee-jerk adjustments to employee compensation, employers should hold off on any out-of-cycle compensation changes until a thorough review has been completed. Undertaking a comprehensive compensation review before making remedial compensation adjustments can likely prevent poor business decisions that do not mitigate ongoing legal risks. Any remedial compensation adjustments should be based on a comparison of employees that the employer reasonably expects to have similar compensation.

In determining who an employer expects to have similar compensation, the employer should consider (1) the relevant compensation measure for a group of employees, and (2) what affects this group of employees' compensation level.

First, how are employees compensated? Some forms of compensation include base salary or hourly wages, commission payments, bonus or other incentive payments, and shift differentials. It is important to note that some compensation decisions with respect to bonuses, incentive payments, and commissions may be specific to discrete periods and may not have recurring impacts on pay checks. Others, such as shift differentials and less-than-full-time work schedules, should be properly adjusted when making compensation comparisons. Hence, efforts to mitigate ongoing risks created by historical employment decisions may be served best by focusing on those components of compensation that are impacted by past employment decisions. Within a given company, there may be groups of employees whose studied compensation measure should be different from other employees and who should be studied separately from other employees (e.g., commissioned versus salaried employees). When determining reasonable groups of employees, employers should identify employees doing similar types of work. Employers should consider their company's organizational structure (e.g., business units, lines of business, affirmative action plans), the market structure (e.g., occupation, function, job families), the skill requirements of particular positions, and the level at which salary decisions are made when determining comparator groups. The groups should be structured such that the populations are sufficiently large to provide meaningful statistical analyses, but not so large as to group together dissimilar employees whose characteristics are likely to be valued differently within the market or the company.

Once appropriate employee comparators and compensation measures have been identified, employers need to identify the different characteristics—both employee- and employer-related—that impact compensation decisions. For most employers, employees are compensated differently for a variety of reasons. As such, it is important that any analysis of relative employee compensation include the job and employee characteristics that impact employee compensation. A non-exhaustive list of some of the job- and employee-related characteristics that typically affect compensation include:

- Level of responsibility
- Market for particular type of work
- Work experience
- Local labor market conditions
- Level and type of education
- Organizational specific business processes

Counsel should consider the legal defensibility of particular characteristics included in a compensation audit in light of the Ledbetter Act (and, prospectively, the Paycheck Fairness Act). In determining the compensation-related characteristics that should be included in the review, it may be necessary to examine other employment outcomes, such as promotion decisions and performance evaluations, and to evaluate the defensibility of these characteristics.

It is important to keep in mind that statistical analyses are only the start of the compensation review process. Statistically significant differences indicate that the protected group compensation difference is not likely to have occurred by chance. It may be that protected group members were in fact paid less than their nonprotected counterparts, or it may be the case that the analysis has omitted factors that explain compensation differences. As such, groups showing statistically significant compensation differences should be reviewed carefully to determine whether the analysis has omitted factors related to compensation or whether there are individual employee payments that do not "fit" with other employees in the comparison group (outliers). When feasible, omitted compensation-related characteristics should be collected and included in the comparison, and individual "outliers" should be documented.

Remediation Strategies

When undertaking a compensation review, a company should be prepared to take any follow-up action deemed necessary by legal counsel. When statistically significant differences between protected and non-protected group members are identified, counsel can provide guidance on alternative remediation strategies, including inaction. Each remediation strategy will have consequences in terms of cost, manageability, effectiveness, and risk. The compensation analyses and individual outlier review can assist in evaluating the pros and cons of each alternative action. Each of these consequences should be considered and explored with counsel before engaging in a remediation strategy.

Some remediation strategies—such as across-the-board fixed-dollar-amount adjustments—may reduce the protected group pay difference to acceptable levels of risk, but may result in poor business decisions such as providing poor-performing individuals with pay increases. On the other hand, thorough reviews of individuals can be time consuming. Further, the pay adjustments resulting from an individual review may be insufficient to attain the desired level of risk (i.e., the protected group pay differences may remain statistically significant following remediation).

In other cases, the compensation review may suggest a need to address deficiencies in the job classification structure rather than individual remediation. Deficiencies in the classification system may include overly broad pay bands that fail to sufficiently differentiate the level of employee responsibility; misclassifications of employees who have outgrown their current pay range; overly broad job classifications that do not allow groupings of individuals who are performing similar work; or overly narrow job classifications that isolate large numbers of individuals into unique classifications.

Going Forward Into the Future

Assuming that an employer achieves the desired level of risk through a properly structured compensation review, the question becomes how to manage and minimize the risk going forward. The pay differences that may have been addressed as a part of the review are likely the result of many isolated decisions over an extended period of time. The cost of addressing the cumulative effect of those differences can be significant and, presumably, the employer will not want to outlay such expenditures in the future, if avoidable.

There are three primary employment decisions that routinely impact the relative salary relationships of employees and account for the majority of employee salary adjustments—starting salary, merit increases, and promotional increases. Employers can avoid entering new salary differences into the compensation process by monitoring these processes.

For most employers, the workplace is a dynamic environment in which new employees are hired, promoted, and terminated regularly. With more recent downsizing activities, establishing and maintaining employee compensation relationships, which are determined at a particular point in time, may present particular challenges for employers. Therefore, it is especially important to be vigilant about managing risks by monitoring these other employment activities and their impact on compensation relationships, given the passage of The Lilly Ledbetter Fair Pay Act of 2009.

Labor and Employment Leadership Column

"May you live in interesting times"

This phrase wishing turbulent times could be a good description of the current landscape facing healthcare employers. Congress is focused on employment issues at a pace not seen since the early 1990s. The Labor and Employment Practice Group (L&E PG) has had a productive year covering these issues with more interest and participation among our members than ever before. Thank you for volunteering to write articles for this newsletter, speaking on or attending teleconferences, listening to the audio tutorials on the website, and working on toolkits with other Practice Groups, among other things. Opportunities continue for our members. Please let any of the Vice Chairs know if you are interested in participating in our group's activities in the coming year.

The L&E PG is in the home stretch heading toward the AHLA Annual Meeting in Washington, DC. We hope you can join us in Washington for the Labor and Employment Practice Group Annual Luncheon on Tuesday, June 30, 2009. Our speaker, Alexander Passantino, is the former Acting Administrator of the Department of Labor's Wage and Hour Division. Mr. Passantino brings interesting insight to current wage and hour and audit issues. See page 11 for more detailed information about the Luncheon.

Sincerely,

Labor and Employment Practice Group Leadership