California Fair Pay Act: What Employers Should Know

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Widely lauded as the strongest equal pay legislation in the nation, California's Fair Pay Act (Senate Bill 358) is now law. Effective January 1, 2016, the new law modifies California's existing wage discrimination measures by lowering the bar for gender-based wage claims (whether they be made by women or men) and by offering additional protections to these claimants.

While the actual revisions to existing law are slight, and in some instances only serve to re-state the manner in which the current laws were being interpreted, the changes have the potential to wreak havoc by requiring employers to entirely restructure (and be able to defend) their compensation systems. These rigid systems may affect an employer's ability to offer competitive salaries to high value employees without impacting overall salaries within the company. Further, the heightened focus on pay equality may re-invigorate plaintiffs' lawyers and California's Department of Labor Standards Enforcement ("DLSE") who will be looking to test the boundaries of the mandates. In any event, employers must be aware of the changes and be prepared to address anticipated claims regarding pay disparity.

What Was The Old Law?

California Labor Code §1197.5 ("Section 1197.5") has prohibited discrimination in pay based on an individual's gender since 1949. Largely unmodified since 1976 and similar to federal law, Section 1197.5 required equal payment for "equal work" in the same establishment, except when payments were made pursuant to: (1) a seniority system; (2) a merit system; (3) a system which measures earnings by quantity or quality of production; or (4) a differential based on any bona fide factor other than sex.

The prior version of Section 1197.5 penalized a non-complying employer with liability in the amount of the wage differential plus interest and an equal amount as liquidated damages. California's DLSE administered and enforced the law, and both individual claimants and the DLSE could commence and prosecute civil actions on behalf of aggrieved employees.

What Does The New Law Do?

According to the legislative findings, despite the long-standing law, in 2014, the gender wage gap in California stood at 16 cents on the dollar. Collectively, this amounted to a loss of over $33 billion each year for women working full time in California.

Aiming to eliminate these persistent salary disparities, the new law modifies Section 1197.5 in several ways:

- Claimants no longer must show that they were engaged in "equal work" with someone of the opposite sex. Now, they need only prove that their work was "substantially similar work when viewed as a composite of skill, effort, and responsibility." This lower standard allows for comparisons between employees who perform similar tasks regardless of job title.

- A claimant is no longer limited to making pay comparisons within "the same establishment." Employees may now freely examine pay practices at any the location the employer maintains.

- Perhaps most notably, the new law expressly clarifies that the employer bears the burden of demonstrating that any wage differential falls into one of four specified exceptions. Per the revisions, if there is any differential in pay, the employer must affirmatively demonstrate that the entire wage differential is based on one or more of the following factors, which must now be "applied reasonably":

    - A seniority system
    - A merit system
    - A system that measures earnings by quantity or quality of production
    - A bona fide factor other than sex, such as education, training, or experience.

These exceptions remain the same as in the prior version of Section 1197.5, except that new language clarifies that the "bona fide factor" exception will apply only if the employer demonstrates that the factor is not based on or derived from a sex-based differential in compensation, is job related with respect to the position in question, and is consistent with a business necessity [defined as "an overriding legitimate business purpose such that the factor relied upon effectively fulfills the business purpose it is supposed to serve"].

Further, Section 1197.5 explicitly states that the employer's bona fide factor defense will not apply if the employee demonstrates that an alternative business practice exists that would serve the same business purpose without producing the wage differential.

Enforcement of Section 1197.5 remains with the DLSE and individual claimants as under the prior version, and penalties for violation remain the same.

Section 1197.5 imposes an additional requirement that an employer may not discriminate or retaliate against any employee who wishes to enforce Section 1197.5. It also makes unlawful an employer's prohibition on: (1) an employee's disclosure of his/her own wages; (2) open discussion of wages between employees; (3) inquiries about other employees' wages; or (4) aiding or abetting employees from exercising their rights under this section. Throwing a small bone to employers, Section 1197.5 states that nothing creates an obligation to disclose wages.

Significantly, Section 1197.5 expressly authorizes a new civil cause of action if the employee has been discharged, discriminated against, or retaliated against if he/she discloses or inquires about wages.

Finally, Section 1197.5 increases employer record retention requirements from two years to three years.

How Will the Recent Provisions Affect Pay Practices In California?

The legislation, which was passed with almost no opposition, demonstrates the California Legislature's uniform goal of seeking to eradicate discrepancies in pay. Yet many of the changes only codify current practices. For example, pursuant to the DLSE's Enforcement Manual, under the prior version of Section 1197.5, the employer already bore the burden of establishing that its pay systems objectively fit within the exceptions to equal pay, all of which remain essentially the same. Further, employers were already prohibited from retaliating against or discharging employees who openly discussed wages under California Labor Code §232.

Because these provisions were already in effect, it may be that the revised Section 1197.5 results in little or no increase in wage claims and has no practical effect.

On the other hand, claimants and the DLSE could begin to actively test what tasks are considered "substantially similar" and what categories could properly qualify as a "bona fide factor other than sex." The language appears to require employers to establish bona fide factors that are specifically crafted for each "position in question" and to analyze how those factors are consistent with a business necessity. Moreover, the provisions suggest that if an employee can come up with any alternative business practice that "would serve the same business purpose," the employer's defense will not apply.

In recent years, many employers have moved away from job evaluation systems that compare internal job criteria, instead using predominantly market-based job classification methodologies. It appears that job evaluation tools may again become useful as a key means of legal compliance with respect to what constitutes "substantially similar work." Job levels established through the application of internal evaluation systems, in conjunction with labor market data, then become the framework within which non-discriminatory pay decisions can be made.

Employees may also examine whether removing the "in the same establishment" language exposes employers with locations outside of California to standardize pay throughout all of its locations or just within California.

The overall impact is unclear. However, because employers will be held accountable to prove that they have objective criteria to account for the entire differential in wages between any and all employees who are performing substantially similar work, employers may lose flexibility and discretion to offer an extraordinary candidate or a highly valued employee an aberrant wage (whether male or female). Employees may be forced into rigid pay scales as employers may find

this to be the easiest solution. This could greatly impact an employer's ability to compete for talented employees.

What This Means For Employers Now

In order to prepare for potential claims in January, 2016 by employees under Section 1197.5, employers should do the following:

- Perform a compensation audit to identify any potentially material and/or gender-based pay differences within the work force. Employers should review each type of work performed rather than the specific job title and analyze/understand what factors justify pay disparities.

- Ensure policies that specifically prohibit pay discrimination

- Emphasize that the employer does not prohibit discussions of salaries while ensuring employees understand that they can't be forced into disclosing their personal compensation to another employee

- Provide training to supervisors regarding employees' freedom to discuss wages

- Provide training to those making compensation decisions to understand what factors are permissible in setting wages and salaries, and what system the employer has in place for each position

- Lengthen records retention times from 2 to 3 years

Ongoing Salary Administration Decisions for Employers

As employers review different approaches to annual salary administration in order to ensure ongoing compliance with the law, there are several key areas for both short-term and longer-term consideration:

- Employers must review and update all documentation (job descriptions) to clearly identify, along with specific required knowledge, skills and abilities, minimum educational qualifications (as applicable), required experience (if any), and any licensure or certification that applies to each job in the organization. Current and accurate documentation is a primary tool for supporting job-specific pay differences.

- Employers should use a valid, quantitative job evaluation methodology to establish relative levels of job-specific skills and responsibilities as a means of measuring and leveling jobs across the organization. This will facilitate clearly defined job equivalencies that define "substantially similar work" within grades and salary ranges.

- Employers should also consider implementing specific salary range guidelines that apply to all pay decisions, including new hire salaries and pay increases for existing employees in connection with annual reviews, promotions, transfers, and other personnel actions. For example, internal guidelines might focus on actual salaries, not just on the percentages of the increases, which can often perpetuate inequities. Differentiating criteria may include such objective, gender-neutral factors as legitimate performance metrics, experience and/or education. Utilizing equivalent guidelines for the hiring process will then prevent a carefully achieved internal equity from being disturbed through employee turnover and non-compliant salary offers.

- Employers may also want to consider updating human resources communication materials relating to compensation plan administration in order to more clearly illustrate how pay equity is evaluated and maintained. This will equip managers/supervisors with accurate and factual information to ensure clear employee understanding of what the law means to them.

In summary, employers will bear significant burdens to ensure that basic pay decisions do not create unintended consequences across the organization. Utilizing transparent and effective salary administration policies will ensure compliance with Section 1197.5 and facilitate communication with employees on how the employer is maintaining an equitable pay program.

Cozen O'Connor's Labor & Employment attorneys are available to provide counsel and guidance on the issues discussed in this Alert.

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