A Littler Mendelson Report

InSight

An Analysis of Recent Developments & Trends

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August 2010

July was a very active month in Congress, for regulators, and at the Department of Labor, as they addressed several significant issues related to the affirmative action obligations of federal government contractors and subcontractors. This Insight discusses several of the most important developments.

Recent Developments Relevant to Federal Government Contractors: August 2010

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OFCCP Initiates Regulatory Revisions for Affirmative Action Obligations Toward Individuals with Disabilities and Covered Veterans

Advanced Notice of Proposed Rulemaking ("ANPRM") Regarding Section 503 of the Rehabilitation Act Relating to Meaningful Outreach for Individuals with Disabilities

In anticipation of strengthening the regulations requiring government contractors to engage in meaningful outreach for qualified individuals with disabilities and before issuing actual proposed regulations, the Office of Federal Contractor Compliance Programs (OFCCP) is asking government contractors to respond by September 21, 2010, to 18 questions.

The questions can be categorized into several categories: (1) how can affirmative action requirements for individuals with disabilities be made more effective; (2) what affirmative action efforts for individuals with disabilities have proved effective for federal contractors; (3) whether the establishment of placement goals for individuals with disabilities would be feasible and effective and how placement goals for individuals with disabilities could be established; (4) whether soliciting self-identification of disability status of all applicants would be effective in opening more opportunities to individuals with disabilities; and (5) what special considerations should OFCCP account for in revising its affirmative action obligations for individuals with disabilities with regard to small entities and businesses.

Below are the specific questions from OFCCP's July 23, 2010 ANPRM:

1. How can the affirmative action requirements of Section 503 be strengthened to measurably increase employment opportunities of covered contractors for individuals with disabilities? If available, include examples or information illustrating the effectiveness of the suggested new requirements.

2. What measures have contractors and subcontractors taken to fulfill the current affirmative action requirements of Section 503? How much did these measures cost?
3. What barriers currently impede Federal contractors from hiring people with disabilities?
4. Are there changes that could be made to the existing language on permissible qualifications standards that would better ensure equal employment opportunities for individuals with disabilities?
5. If OFCCP were to require Federal contractors to conduct utilization analyses and to establish hiring goals for individuals with disabilities, comparable to the analyses and establishment of goals required under the regulations implementing Executive Order 11246, what data should be examined in order to identify the appropriate availability pool of such individuals for employment?
6. Would the establishment of placement goals for individuals with disabilities measurably increase their employment opportunities in the Federal contractor sector? Explain why or why not.
7. What experience have Federal contractors had with respect to disability employment goals programs voluntarily undertaken or required by state, local or foreign governments?
8. What specific employment practices have been verifiably effective in recruiting, hiring, advancing, and retaining individuals with disabilities?
9. To what extent does workplace flexibility, including flexibility in work schedules, as well as job-protected leave, impact recruitment and retention of individuals with disabilities?
10. Has training of employees and/or managers been effective in increasing advancement and/or retention of individuals with disabilities? If so, how?
11. Federal contractors are required to invite all job applicants to voluntarily and confidentially identify their race and gender pre-offer. The collection of this information allows contractors to monitor the impact of their employment practices by race and gender and to assess progress in meeting their affirmative action goals. Existing Section 503 regulations require contractors to invite applicants to voluntarily and confidentially self-identify as a person with a disability after making an offer of employment but before the applicant begins employment. (See 41 CFR § 60-741.42(a).) Would amending the Section 503 regulations to require contractors to invite all applicants to voluntarily and confidentially self-identify if they have a disability prior to an offer of employment enhance a federal contractor's ability to more effectively monitor their hiring practices with respect to applicants with disabilities? Note that a Section 503 regulation requiring contractors to invite voluntary and confidential self-identification as an applicant with a disability pre-offer for affirmative action purposes would not violate the Americans with Disabilities Act. 29 CFR § 1630.15(e); Enforcement Guidance: Preemployment Disability-Related Questions and Medical Examinations (EEOC Notice Number 915.002, October 10, 1995).
12. How can linkage agreements between Federal contractors and organizations that focus on the employment of individuals with disabilities be strengthened to increase effectiveness? Do linkage agreements have better outcomes when higher level company officials are responsible for their implementation/execution? Include examples of cooperative agreements between employers and disability or community recruitment organizations that have been helpful in hiring persons with disabilities.
13. What impact would result from requiring that Federal contractors and subcontractors make information and communication technology used by job applicants in the job application process, and by employees in connection with their employment fully accessible and usable by individuals with disabilities? What are the specific costs and/or benefits that might result from this requirement?
14. What other specific changes to the Section 503 regulations might improve the recruitment, hiring, retention, and advancement of individuals with disabilities by Federal contractors?
15. Regulatory Flexibility Act–Consistent with the Regulatory Flexibility Act, the Department must consider the impacts of any proposed

rule on small entities, including small businesses, small nonprofit organizations and small governmental jurisdictions with populations under 50,000. In response to this ANPRM, the Department encourages small entities to provide data on how additional requirements under Section 503 may impact them.

16. OFCCP seeks public comment on the types of small entities and any estimates of the numbers of small entities that may be impacted by this rule.
17. OFCCP seeks public comment on the potential costs of additional 503 requirements on small entities.
18. OFCCP seeks public comment on any possible alternatives to the proposed measures that would allow the agency to achieve their regulatory objectives while minimizing any adverse impact to small businesses.

In our opinion, it seems that the two greatest obstacles to meaningful change in the regulations are: (1) the concern that if contractors that solicit this information at the pre-offer stage, they will be exposed to a greater proportion of failure to hire claims based on disability; and (2) there already are substantial record keeping obligations for federal contractors that place extraordinary burdens on strained human resource and recruiting departments, and adding yet another layer of bureaucracy will dissuade companies from agreeing to contract with the government.

Littler's OFCCP Practice Group intends to submit comments to the Agency and would welcome client and contractor input. Please contact Alissa Horvitz, ahorvitz@littler.com, or Joshua Roffman, jroffman@littler.com, if you would like us to relay your anonymous answers to the OFCCP.

Proposed Regulations for Improved Outreach and Reporting Regarding Affirmative Action Obligations for Covered Veterans Submitted to the White House by OFCCP

On July 2, 2010, OFCCP sent to the Office of Management and Budget ("OMB") its proposed rule relating to "Affirmative Action and Nondiscrimination Obligations of Contractors, Subcontractors, Evaluation of Recruitment and Placement Results under the VEVRAA of 1974, As Amended."

OFCCP has previously announced that it wants to strengthen the extent to which government contractors are engaging in meaningful outreach for covered veterans, and this was a topic that Director Patricia Shiu covered extensively in her town hall meetings last year and this year.

Once OMB approves the proposed regulation, OFCCP will submit it for publication in *The Federal Register*, and will afford contractors an opportunity to submit comments.

The White House's National Equal Pay Enforcement Task Force Calls for Re-Establishment of the Equal Opportunity Survey and for Rescission of OFCCP's Compensation Standards Among Other Recommendations

On July 20, 2010, the White House's National Equal Pay Enforcement Task Force issued recommendations to address pay inequities in the work place, especially those negatively impacting women. The National Equal Pay Enforcement Task Force is comprised of officials from the Equal Employment Opportunity Commission, the Department of Justice, the Department of Labor (including officials from the Office of Federal Contract Compliance Programs), and the Office of Personnel Management. Several of the Task Force's recommendations are of interest to federal contractor community:

- *Reinstate the Equal Opportunity Survey or Establish a Similar Survey*

  The Task Force calls for OFCCP to issue an Advanced Notice of Proposed Rulemaking to seek input from stakeholders on what data should be collected and ways to diminish the burdens of the survey in reestablishing the EO Survey or a similar survey of federal government contractors. The pending Paycheck Fairness Act, which has passed the U.S. House of Representatives

but not the Senate, would require the reinstatement of the EO Survey. It now seems likely that OFCCP will develop a new EO Survey, whether or not Congress passes the Paycheck Fairness Act.

The previous EO Survey was established late in the Clinton administration and then abandoned by the Bush administration based on its finding that the survey did not effectively serve OFCCP's mission. When the EO Survey was used, it was sent each year to almost 50,000 federal government contractor locations. It sought information on the location's affirmative action plan, job listings, as well as summary data of the location's employment activity and compensation by EEO-1 category, broken out by both gender and race/ethnicity.

- *Rescind OFCCP's 2006 Compensation Standards*

In a move that has been expected, the Task Force calls for OFCCP to publish a Notice of Proposed Rescission of the Agency's 2006 Compensation Standards. The Standards established that OFCCP would focus its investigative resources vis-à-vis compensation exclusively on systemic cases. Under the Standards, OFCCP established a three-step approach to evaluate contractors' compensation practices. The final step of analysis, which OFCCP imposed on itself before it would issue a Notice of Violations asserting systemic compensation discrimination, involved the development of similarly situated employee groups ("SSEGs") and an analysis using multiple regression analysis to assess whether any pay disparities by gender or race/ethnicity were unexplained.

The Standards had a troubled history. First among many was the fact that the development of SSEGs of sufficient size to allow the development of meaningful statistical models proved incredibly difficult in the context of a typical single establishment affirmative action plan, which more times than not did not have enough employees or too diverse a workforce to allow the development of statistically sound groupings and models. Another problem was the fact that U.S. Supreme Court seemed to reject the very legal principle upon which the Standards were based in its *Ledbetter v. Goodyear Tire* decision, which held that pay discrimination claims under Title VII must be based on decisions, not disparities. As OFCCP's Standards focused only on pay disparities, the *Ledbetter* decision proved problematic, despite OFCCP's assertion that the decision did not apply to the Agency. Even after passage of the Lilly Ledbetter Fair Pay Act in 2009, OFCCP's Standards remained out of step with Title VII law on compensation discrimination, as the new law still required that a claimant point to a discriminatory decision., while OFCCP continued to focus on disparities.

It is unclear whether OFCCP will abandon its Compensation Guidelines, which accompanied the Standards and provided contractors with an approach that they could follow if they wanted to develop SSEGs and multiple regression analyses of their compensation practices. It seems likely that the Guidelines will be rescinded along with the Standards, creating even greater reason for contractors to refrain from developing regression models for the purpose of evaluating their compensation within the context of its affirmative action plans—something that Littler has advised clients against doing for some time now.

Even without the formal rescission of the Standards, we have seen OFCCP move away from statistical analyses of compensation, allowing its compliance officers to analyze compensation using cohort analyses by job title or within a job group. It seemed to be only a question of time before OFCCP formally abandoned its Standards.

It is unknown what approaches to evaluating compensation OFCCP will develop as it replaces the Standards. At a minimum, we would expect the Agency to give itself more flexibility in how it evaluates contractors' compensation practices. At the same time, we are fearful that OFCCP may return to some previously-used and much maligned pay grade-based methodologies to evaluate compensation, such as the infamous DuBray method.

- *Rescind OFCCP's Active Case Management Directive*

The Task Force called for rescission of OFCCP's Active Case Administration ("ACM") directive. Established under the Bush administration, ACM called for the Agency to focus its investigatory resources almost exclusively on cases with indicators of

systemic discrimination. Under ACM, OFCCP did no more than a cursory review of a contractor's desk audit submission if the data did not show any indicators of systemic discrimination in hiring, promotion, termination, or compensation. ACM also called for "focused" reviews in those instances and areas where indicators were found. Very few OFCCP compliance reviews were subject to a full desk audit and even fewer to an on-site compliance evaluation if the desk audit submission did not show statistical evidence of systemic discrimination.

This approach seemed to enable OFCCP to conduct more compliance reviews and recover larger financial remedies in those that it pursued. At the same time, OFCCP all but ignored other aspects of contractors' affirmative action plans, such as the contractor's action-oriented programs and good faith efforts to address placement goals. Over the last year, there has been a decided movement away from focusing almost exclusively on systemic cases, and OFCCP has begun to emphasize "full compliance." The rescission of ACM would simply formalize this change. Indeed, OFCCP had given us a preview of this development when it called for compliance reviews conducted under its September 2009 American Recovery and Reinvestment Act ("ARRA") directive to not follow ACM.

- *Increased Coordination Between the Department of Labor, the Department of Justice, and the Equal Employment Opportunity Commission*
- *Abolish Limits on the Number of Full Compliance Reviews that OFCCP Can Conduct at One Time*

Executive Agencies Issue Interim Final Rule Requiring Contractors to Identify Their Subcontractors and to Disclose Executive Compensation Information

As of July 8, 2010, a new interim rule has been added to the Federal Acquisition Regulations increasing the reporting burden on federal contractors. The rule requires that, by the end of the month following the month a contract is awarded, and annually thereafter, the contractor must report all first-tier subcontract awards expected to amount to $25,000 or more, as well as the names and total compensation of the contractor's five highest paid executives for the contractor's preceding completed fiscal year. The same data must be provided for each qualifying subcontractor. The contractor is responsible for reporting each qualifying subcontractor's data, and notifying such subcontractors that the required information will be made public. This reporting requirement will be inserted as a clause in most solicitations and contracts with a value of $25,000 or more, including commercially available off-the-shelf (COTS) item contracts, as well as actions under the simplified acquisition threshold (currently $100,000) but meeting the $25,000 threshold. Existing indefinite-delivery indefinite-quantity contracts are to be amended accordingly. Federal contractors now have to answer three questions:

1. Do I have to report our executive compensation?
2. Do I have to report this particular subcontract?
3. Do I have to report the executive compensation of this particular subcontractor?

A "yes" to any of those questions imposes a reporting burden, but the answers will depend on several provisions and exemptions sprinkled throughout the new rule.

Exemptions and Exclusions from the New Interim Rule

- Classified solicitations and contracts, and contracts with individuals are exempt from the new reporting requirements.
- The definition of first-tier subcontract specifically excludes "supplier agreements with vendors, such as long-term arrangements for materials or supplies that would normally be applied to a contractor's general and administrative expenses or indirect cost."
- Any contractors whose gross income in the previous tax year is less than $300,000 are exempted entirely from the requirement to report subcontractor awards (but not necessarily the requirement to report the contractor's own executive compensation).

- Similarly, if a subcontractor's gross income in the previous tax year is less than $300,000, the contractor does not need to report awards to that subcontractor.
- Finally, a contractor (prime or sub) is only required to report executive compensation data if, in the previous fiscal year such contractor received 80 percent or more of its annual gross revenues from Federal contracts, loans, grants and cooperative agreements, and $25,000,000 or more in annual gross revenues from the same, and the public does not already have access to the executive compensation information through public filings as required under the Securities and Exchange Act of 1934 or section 6104 of the Internal Revenue Code of 1986. It is presumed that 80-85 percent of contractors and subcontractors will fall into at least one exemption.

Phase-in Schedule for 2010 and 2011

Even if a contractor and subcontractor are not exempted, whether a particular subcontract must be reported is subject to the following phase-in schedule. Until September 30, 2010, the new rule applies only to newly awarded subcontracts if the prime contract award amount is $20,000,000 or more. Beginning October 1, 2010, subcontractor reporting applies if the prime contract is for $550,000 or more. Finally, beginning March 1, 2011, the rule will apply to all prime contracts of $25,000 or more.

Comments on this interim rule need to be submitted by September 7, 2010, and may be submitted on-line, by fax, or mail. The agencies are particularly interested in comments as to whether this collection of information is necessary and ways in which the burden of collecting the information can be minimized.

Wall Street Financial and Regulatory Reform Act Creates New Internal Diversity Obligations for Companies Wishing to Contract with Federal Financial Agencies

The Wall Street Financial and Regulatory Reform Act contains provisions requiring the following federal agencies to develop new Offices of Minority and Women Inclusion and standards for ensuring that companies that wish to contract with these agencies themselves have a sufficiently diverse workforce:[1]

- The Departmental Offices of the Department of the Treasury
- The Federal Deposit Insurance Corporation
- The Federal Housing Finance Agency
- Each of the Federal Reserve Banks
- The Board of Governors of the Federal Reserve System
- The National Credit Union Administration
- The Office of the Comptroller of the Currency
- The Securities and Exchange Commission
- The (new) Bureau of Consumer Financial Protection

Each agency's Office of Minority and Women Inclusion will be required to develop standards for:

- Equal employment opportunity, and the racial, ethnic, and gender diversity of the workforce and senior management of the agency;
- Increased participation of minority-owned and women-owned businesses in the programs and contracts of the agency, including standards for coordinating technical assistance to such businesses; and

- Assessing the diversity policies and practices of entities regulated by the federal agencies listed above.

The Director of these new offices will be promulgating regulations at some point in the future in an effort to develop and implement standards and procedures to ensure "the fair inclusion and utilization of minorities, women, and minority-owned and women-owned businesses in all business and activities of the agency at all levels, *including in procurement*, insurance, and *all types of contracts*."

The types of contracts that will be affected by these new standards include:

> all contracts of an agency for services of any kind, including the services of financial institutions, investment banking firms, mortgage banking firms, asset management firms, brokers, dealers, financial services entities, underwriters, accountants, investment consultants, and providers of legal services.

Moreover, these contracts include "all contracts for all business and activities of an agency, at all levels, including contracts for the issuance or guarantee of any debt, equity, or security, the sale of assets, the management of the assets of the agency, the making of equity investments by the agency, and the implementation by the agency of programs to address economic recovery."

The agencies identified above will be required to report annually to Congress the following five information points:

- A statement of the total amount paid by the agency to contractors since the previous report;
- The percentage of amounts described above that were paid to minority-owned and women-owned businesses;
- The successes achieved and challenges faced by the agency in operating minority and women outreach programs;
- The challenges the agency may face in hiring qualified minority and women employees and contracting with qualified minority-owned and women-owned businesses; and
- Any other information, findings, conclusions, and recommendations for legislative or agency action, as the Director (of each Office) determines appropriate.

Finally, the Director of each Office of Minority and Women Inclusion will include a procedure for the Director to make a determination whether a contractor, and, as applicable, a subcontractor, has failed to make a good faith effort to include minorities and women in its workforce. Upon receipt of a recommendation from the Director, the agency's administrator may (1) terminate the contract or (2) make a referral to the Office of Federal Contract Compliance Programs, or take other appropriate action.

In short, companies that want to do business with any of these federal agencies in the future can expect a significant increase in the extent to which these agencies probe the racial and gender composition of the contractor's workforce as part of the contract award process.

Department of Labor Administrative Law Judge Rejects OFCCP's Assertion that It Can Extend the Period of Review for a Compliance Review Forward After the Date that the Compliance Review Was Initiated by OFCCP

On July 23, 2010, a Department of Labor Administrative Law Judge ("ALJ") found that OFCCP impermissibly sought to extend the desk audit phase of a compliance review to cover employment activity that occurred after the date that the compliance review was initiated by OFCCP. The case involved a compliance evaluation that OFCCP initiated in July 2007 of a Frito-Lay facility in Dallas, TX. Frito-Lay's desk audit submission covered the period from January 1, 2006 through June 30, 2007. In response to subsequent information requests, Frito-Lay provided hire and applicant data going back to July 2005—two years before the date that OFCCP initiated the compliance review—and forward to December 31, 2007, which was the end of Frito-Lay's current affirmative action plan year at the time the compliance review was initiated.

In November 2009, as the compliance review remained at the desk audit phase, OFCCP requested applicant and hire data for one job

group where OFCCP's initial analysis of the 2005-2007 data showed a disparity in hiring between female and male applicants. Frito-Lay declined to provide the data, asserting that hire and applicant data for 2008 and 2009 was not relevant to a compliance review that was initiated in 2007.

On April 28, 2010, OFCCP filed an Administrative Complaint asserting that Frito-Lay had refused to provide data it was required to submit to OFCCP. OFCCP's based its position on the notion that agencies have broad authority to gain access to records and documents and that, by implication, there was no temporal limit to the relevancy of documents to a compliance review. In support of its position, OFCCP relied heavily on administrative case law that allowed broad discovery to OFCCP in the enforcement context, sometimes covering several years.

Frito-Lay countered that none of the cases relied upon by OFCCP took place in the context of a compliance review and that the underlying compliance review in each of the cases cited by OFCCP in fact covered a period of between one to two years, implicitly supporting Frito-Lay's contention that a compliance review is limited to the period of time (up to two years in cases where the Agency is investigating potential discrimination) preceding the date that the compliance review was initiated.

Frito-Lay pointed to consistent language in the regulations promulgated in 1997 by the Clinton administration that OFCCP's initial regulatory intent was to have a compliance review assess activity prior to the date that the compliance review began, and potentially going backwards up to two years. Comments to the 1997 regulations stated so much and also stated that OFCCP would define the parameters of a compliance review in its Federal Contract Compliance Manual ("FCCM").

OFCCP argued that the FCCM was not binding on the Agency and conferred no rights on a private party such as Frito-Lay. Frito-Lay countered that OFCCP's 1997 regulations specifically established the Agency's intent to define the timeframe and other relevant parameters of a compliance review in the FCCM.

The ALJ agreed with Frito-Lay, holding that the "EO, regulations, case law and the FCCM contemplate that the temporal scope of the desk audit phase of a compliance review cannot be extended beyond the date that the contractor received its Scheduling Letter."

The ALJ's decision is an important victory for the contractor community, as in the last year or two, both in presentations and in some compliance reviews, OFCCP has asserted that it has the authority to extend an audit going forward as the Agency saw fit. In its presentations on this issue, OFCCP consistently cited cases that addressed the temporal scope of discovery in an enforcement proceeding. None of these cases addressed the issue of the temporal scope of the compliance review itself. Indeed, the actual compliance reviews within those enforcement cases consistently were limited to a period of two years or less.

In advocating for this authority, OFCCP downplayed the legal significance of language within its own regulatory framework and the FCCM, which consistently state that compliance reviews look at activity that occurred prior to the initiation of the audit. Moreover, and paradoxically for the contractor community, at the same time that OFCCP began asserting that it had the authority to extend the timeframe for a compliance review forward, individual OFCCP officials continued to refuse to allow government contractors to introduce information about their employment practices after the date that the compliance review began, arguing, among other things, that the information could be "tainted." In deemphasizing the legal importance of the regulatory framework promulgated by the Clinton administration and the FCCM, it appears that OFCCP may be less concerned with what were likely the primary policy reasons that the compliance review framework was set up the way it was under the Clinton administration—specifically, a desire and intent to conduct compliance reviews quickly and worry that contractors might "taint" data for periods that occurred after they received their scheduling letters.

Despite this important victory for the contractor community, the ALJ's decision revealed the limitations of litigation as a way to establish and clarify existing law and regulations. As the matter at hand was still at the desk audit phase, the ALJ's decision addressed the temporal scope of only the desk audit phase of a compliance review. Nonetheless, the regulatory guidance relied upon by Frito-Lay applies to the entirety of a compliance review; not just the desk audit phase. That being said and importantly, the ALJ did not hold that a different temporal scope applied to other phases of a compliance review. But because the case was still at the desk audit phase, his

decision was narrowly focused on that phase of the audit.

It is expected that OFCCP will file exceptions to the ALJ's decision with the Department of Labor's Administrative Review Board. Frito-Lay was represented in the matter by Littler Mendelson Shareholder Joshua Roffman.

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[1] Although the label "Office of Minority and Women Inclusion" is the same label that legislators gave to the oversight office that the Federal Housing Finance Agency was ordered to create in legislation passed in 2008, (Housing and Economic Recovery Act of 2008, 122 Stat. 2654), these new Offices of Minority and Women Inclusion in the Wall Street Financial Regulatory and Reform act are *substantially* broader. Proposed regulations implementing the Offices of Minority and Women Inclusion for the FHFA, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, were published on January 11, 2010, 75 Fed. Reg. 1289. Proposed regulations specifically dealing with equal opportunity in contracting appear in 12 CFR § 1207.11 (FHFA itself) and 1207.21 (Office of Finance and the regulated entities), but other than requiring contractors to commit to principles of EEO and nondiscrimination, there are no requirements that the agencies themselves assess the diversity of the contractors' workforces or face contract termination.