

Equal Pay Laws Shine Light on Difficulty of Defining “Equal”

A strict interpretation of the California Fair Pay Act would have a huge impact on employee pay as we know it— and it reveals a gap in the way most firms operate when it comes to pay equity.

The principles around gender pay equity sound basic: men and women should receive the same amount of pay for equal or similar work. However, when examining the California Fair Pay Act— one of many pieces of equal pay legislation that has swept the globe— it turns out that the implementation of this idea is anything but simple.

When you dig below the surface, there is an often-overlooked statement in the California Fair Pay Act that could have huge implications. Within AB 2282: Section 1. 1197.5(a)(3), it says, “The one or more factors relied upon [should] account for the entire wage differential.” Or, in other words, if you take into account all business relevant measurable factors, the pay gap between men in your organization and women in your organization should be exactly zero. Most compensation experts can probably confirm that this is not easy. So how is this handled in the real world? There are, in fact, four different interpretations of equal used when discussing pay equity.

- **Conventional Legal Equal:** This interpretation of equal is derived mostly from legacy lawsuits; it states that you would have to adjust the pay of individuals who receive significantly less than they should up to the level where the difference is not statistically significant anymore.
- **Statistical Equal:** This is what certain government agencies would consider to be equal. It implies the need to make sure that there are no statistically significant differences on the group level (e.g., women as a group and men as a group).
- **Mathematical Equal:** What we believe the California law implies, this definition of equal suggests that there should be absolutely no pay gap at the group level without any reference to statistical uncertainty.
- **Pay Equation/Utopian Equal:** Every individuals’ pay can be fully explained by clearly defined and measured business-relevant rules.

Next, let’s dive into each application of equal and the impact it has on addressing fair pay within organizations.

Conventional Legal Equal

This definition grew out of lawsuits over several decades. Most of the time a lawsuit originates from one individual employee comparing his or her pay level to a relevant colleague in a similar position. Courts acknowledged that

not every pay differential down to a cent is a concern and then borrowed a convention from statistical research as a standard to flag issues. That convention is typically referred to as “statistical significance” or “two standard deviations.” For math aficionados this is represented as $p < .05$. You can read textbooks and philosophy of science articles about this fascinating concept— but, the bottom line is, under conventional legal definitions of equal, employers are given a benefit of the doubt. Only if the pay difference is so large that you can be 95% confident that there is more at play than random noise does it raise a red flag that there could be a problem.

Until recently, preventative pay equity analyses usually only identified the few individuals in your organization with the largest discrepancy— regardless of gender or ethnicity— because, frankly, those are the people who are most likely to sue you. However, experience tells us that addressing discrepancies at the fringes does little to address the organizational-wide gender or ethnicity pay gap. These issues do not stem from a few extreme cases but rather from smaller pay deviations that systematically affect the larger population.

Statistical Equal

This interpretation of equal requires aggressive pay adjustments to address more systemic group-level pay gaps. The Office of Federal Contract Compliance Programs (OFCCP) and state and federal agencies that look for systematic pay gaps use this standard. Once all relevant business factors are considered, this standard does not require employers to manage to a 0% gender pay gap, for example. Instead, it requires that the pay gap must not be statistically significant. In smaller organizations or business divisions, that could still mean that a 5% to 10% pay gap is permissible. Conversely, at companies with greater headcount even 1% can be considered problematic. The difference here is that small absolute differences may raise red flags only in larger populations as it is a lot easier to spot patterns when you have a lot of data available.

Mathematical Equal

This interpretation is more aggressive than the first two definitions. This definition simply drives organizations, regardless of size, to bring group level pay gaps down to zero without considering statistical significance. In fact, we believe that courts in California— where the Fair Pay Act alludes to this interpretation of equal— may take a more hardline stance in this regard in deciding whether a company is in violation of the law. As a result, we generally recommend that organizations with employees in California and organizations that declare to the world that they closed the gender pay gap should consider working with this definition of equal when computing employee pay adjustments.

Utopian Equal

The fourth definition of equal is truly problematic. A proper reading of the California law suggests that any employee who receives less than any other employee of a different gender for the same or similar work— after accounting for business-relevant discrepancies in pay— can successfully sue for pay discrimination. This would mean that organizations have to either stop differentiating pay beyond job family and grade-level classification or they must devise a precise pay equation, such as:

$$\text{Base Pay} = \text{Level} * \$10,000 + \text{Job Family} * \$5,000 + \text{Years of Experience} * \$300 + \text{MBA Premium} (\$2,000) + \text{Average of last three performance rating} * \$500 \text{ (Note: Illustrative Equation only)}$$

We are not recommending that companies should design and use such an equation at this point in time. We are waiting for case law to provide further detail into how the courts will interpret the language in the California Fair Pay Act. With that said, quite a few of our clients are developing a loose pay equation to guide supervisory decision making. Some companies have even started to limit pay differentiation beyond grade, job family and geography.

Next Steps

Each company needs to undertake a cost/benefit assessment to decide at which level of “equal” they want to operate. We help clients with that decision and design and implement tools to get them on the path to more pay transparency with firm compensation rules in preparation for what might come in the future.

As companies become more transparent about how pay is determined (whether they are driven to do so by law, technical advancements or cultural shifts), they will have to elevate the importance of compensation professionals and the skills they bring to design fair and business-related rewards practices. In the end, it’s still all about internal and external pay fairness. The laws and technology, however, are putting a magnifying glass on all aspects of rewards and it’s essential that companies are prepared to operate in this era of transparency.

If you have any questions about addressing equal pay or pay transparency in your organization and want to speak with one of our experts, please write to consulting@radford.com.

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