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ABSTRACT

This paper examines how a merit-pay award may lead to employer liability under the following types of laws: constitutional (federal and state); federal and state statutory law; and the common or case law handed down by the federal and state court judges. First, several court decisions are presented to indicate the status of the law as it is likely to apply to merit-pay situations. They involve applications of the federal Equal Pay Act, the federal Civil Rights Act of 1964, the federal Age Discrimination in Employment Act, and the common law. Second, new trends in the law are discussed, including comments on the Civil Rights Act of 1991 and the treatment of subjective criteria in evaluations of employees. Finally, suggestions are made with regard to designing a legally sound merit-pay system, which should entail specific, communicated, and job-related criteria for merit pay; an equitable, monitored, and timely process; and definition of subjective criteria. (LMI)

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LEGAL CONSIDERATIONS REGARDING MERIT PAY SYSTEMS

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Presentation for Symposium

PERFORMANCE APPRAISAL:  
MORE MEANINGFUL MEASUREMENTS FOR MERIT PAY

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## LEGAL CONSIDERATIONS REGARDING MERIT PAY SYSTEMS

There is no question that determination of merit pay awards can be the subject of a legal dispute. Brito v. Zia, 478 F.2d 1200 (10th Cir. 1973) established the precedent that performance appraisals used for promotion decisions come under the EEOC Selection Guidelines, although the courts may apply the guidelines less stringently to such cases than they do to recruitment and hiring decision situations. Merit pay, while not the same as a promotion decision, is closely related, and analogies can, therefore, be drawn to determine the direction of the law as it pertains to merit pay situations.

The Brito case involved application of the federal Civil Rights Act of 1964, Title VII. There are other laws which could bring a merit pay action within the purview of the courts--namely, other federal statutes (i.e., Age Discrimination in Employment and others), state statutes (i.e., New Jersey's Law Against Discrimination), and the case or common law of the states (i.e., tort negligence and contract cases).

In brief, the manner in which merit pay determinations are made can expose employers to legal liability under the following types of laws: constitutional (U.S. and state), state and federal statutory law (including the regulatory laws of state and federal agencies created by those statutes), and the common or case law handed down by the federal and state court judges. With regard to constitutional law, only government employers need be concerned about constitutional restrictions on employment decisions (i.e., the constitutional right of employees to due process--which translates into the right to notice and an opportunity to be heard before negative employment decisions are rendered against them).

Private employers are restricted by the various statutory laws which regulate them, by the contract promises they make to their employees, by basic duties the law historically imposes on employers (tort law), and by public policy considerations.

Cases involving merit pay disputes are few, and therefore it cannot be categorically stated that a legal action grounded in a merit pay decision will be decided one way or another by a court of law. However, as noted above, the trends of the law can be observed as they relate to similar employment decisions (such as promotion cases), and an analogy can be drawn. The reader is cautioned, however, that since the situation is different, the courts can distinguish the facts and apply the law differently. A decision in a promotion case does not create precedent for a case involving a merit pay determination.

This paper will focus on how a merit pay award may lead to employer liability under the above laws. Several court decisions are presented first to indicate the status of the law as it is likely to apply to merit pay situations. They involve applications of the federal Equal Pay Act, the federal Civil Rights Act of 1964, the federal Age Discrimination in Employment Act, and the common law. Secondly, new trends in the law are discussed, including comments on the Civil Rights Act of 1991 and the treatment of subjective criteria in evaluations of employees. Finally, suggestions are made with regard to designing a legally sound merit pay system.

COURT DECISIONS WHICH REFLECT THE STATUS OF THE LAW AS IT MAY AFFECT  
THE LEGALITY OF MERIT PAY SYSTEMS AND DETERMINATIONS

Chamberlain v. Bissell, Inc., 547 F.Supp. 1067 (WD Mich. 1982).

The law involved in this leading wrongful dismissal/performance appraisal case was common law of tort. A 23-year employee was informed in his annual performance review that he was being denied a wage increase. He was not told, however, that there was a real possibility that he would be discharged due to decreased performance. In fact, he was discharged a few months later. The court held that the employer was liable for negligent breach of its ordinary duty toward this employee. Among the considerations that influenced the court's decision was the fact that the company had a written policy of annual reviews which created the expectation in employees that they would be comprehensively informed of where they stood. Had the employer given notice of the impending discharge, the employee could have made the changes which were necessary to improve his performance. (Note: Since the plaintiff was found to be 83% negligent, his award was accordingly reduced.) Although this case concerned performance appraisals as they affect wrongful discharge, the reasoning applied here could be used in a merit pay situation, i.e., when an employee is not fully informed of the criteria which would lead to a merit pay award, there is an argument that this constitutes negligence if the employee is later denied merit pay.

Lamphear v. Prokop, 31 FEP Cas. 673 (1983). The complainant in this race discrimination case involving a promotion decision, was a white male who was Chief Appeals Officer of the Civil Service Commission. He expected to be made Chief of the Merit Protections Board (when it replaced the Civil Service Commission). He was passed over in favor of a black

male. In deciding against the complainant in this reverse discrimination case, greater weight was given to the written performance appraisal documents than to the conflicting testimony produced at the hearing. The lesson to be learned from Lamphear is the importance of documentation in the performance appraisal process, a lesson equally appropriate in merit pay decisionmaking. To the extent the criteria for merit pay are communicated, and accurate and timely reports of performance are documented, an employer is in a better position to defend its decision.

Nord v. U.S. Steel Corp., 37 FEP (BNA) 1232 (11th Cir. 1985). In this sex discrimination case, all management personnel and supervisors were males, and the principal factor in the promotion decision at issue was the recommendation of a supervisor. There was no system of posting openings, and opportunities for promotion were passed by word of mouth only. There was an absence of established criteria for promotion decisions, and this was influential in the court's finding for the female employee. The rationale of this promotion case is also applicable to a merit pay case. Employers who wish to award merit pay should be sure to establish the qualifications for such an award, and rely as much as possible on objective standards. Subjective evaluations can lead to an inference of discrimination especially in situations such as this one in which the evaluators were not members of the complainant's protected class.

Grove v. Frostburg National Bank, 31 FEP (BNA) 1675 (D.Md. 1982). This case also involved a subjective evaluation. Violation of the federal Equal Pay Act was charged. A female bank loan teller was paid less than a male teller doing the same work. The Vice President of the Bank made the pay decision based on his "gut feeling". The bank's "system was not

organized or structured and was not based on systematic evaluations using predetermined criteria." A violation of the law was found.

Danielson v. Fletcher, 770 F.Supp. 388 (N.D. Ohio 1991). This promotion case was brought under the federal Age Discrimination in Employment Act. A white male over 40 years of age lost a promotion decision to a 36-year-old white male. Subjective evidence was the basis of the promotion decision. The court noted that subjective evidence alone is not a per se violation of the age discrimination law. The case turned on the credibility of the person who made the promotion decision. The lesson from this case for merit pay decisionmakers is that courts recognize the necessity of utilizing subjective criteria in certain situations. However, other factors bearing on the decision will then be considered--in this case the critical factor was the credibility of the evaluator. Therefore, for merit pay systems, those vested with the power to make the decisions should be carefully selected, properly trained, and prepared to convince a court of the appropriateness and legitimacy of their decisions.

The above case, Danielson, contained another legal issue which was not critical to the decision of the court, but which provides insight into the court's thinking on a related matter. There was convincing evidence in the case of a persistent practice of inflated ratings. The court stated, "The mere existence of this system casts a shadow over the credibility of those who put it into effect." Such a finding--without an convincing defense--would help employee-plaintiffs establish that whatever defense the employer has for a discriminatory practice, it is merely a pretext for actual discrimination. (In Danielson, the inference of discrimination was successfully rebutted by the defense, as noted above.)

NEW TRENDS IN THE LAW REGARDING SUBJECTIVE CRITERIA  
IN EVALUATIONS OF EMPLOYEES

The use of subjective criteria in making employment decisions has met with mixed reactions by the courts in deciding whether or not a violation of an antidiscrimination statute has taken place. In the absence of objective criteria, an employer charged with discrimination may have a difficult time defending its position if there is any evidence of discrimination at the workplace. This evidence could consist of discriminatory comments by supervisors or managers, harassment activity, statistical evidence of discriminatory action against a protected class, or any form of discriminatory behavior in the employment setting. Without job-related, objective standards driving the employer's decision, a plaintiff-employee can establish an inference of discrimination and satisfy his or her burden of proving intentional discrimination.

One of the leading cases dealing with subjective criteria was Grano v. Dept. of Development of the City of Columbus, 699 F.2d 836 (6th Cir. 1983). On page 837 of that decision the court stated:

"Courts have frequently noted that subjective evaluation processes intended to recognize merit provide ready mechanisms for discrimination... Moreover, the legitimacy of the articulated reason for the employment decision is subject to particularly close scrutiny where the evaluation is subjective and the evaluators themselves are not members of the protected minority... Obviously the more subjective the qualification and the manner in which it is measured, the more difficult it will be for the defendant to meet the burden imposed by the court... Subjective employment evaluations, however, are not illegal per se. The ultimate issue in each case is whether the subjective criteria were used to disguise discriminatory action."

Grano was a promotion case in which a male was given the promotion over a female employee. The two employees had equal objective qualifications, and the employer, who was familiar with the female's work, did not interview her, but based his decision on his subjective evaluation of her abilities. The court held that as long as a decision results from an observation or investigation of an employee's performance, the subjective decision can stand. If, however, the subjective decision has



no rational basis, but comes only from the decisionmaker's subconscious, it would likely be suspect and a violation may be found. A key determinant in this case was the fact that the employer/evaluator was knowledgeable about the plaintiff-employee's work.

As can be seen from the cases cited, the degree of scrutiny which courts will give to subjective criteria depends on several other factors. Closer scrutiny will apply if the evaluators are not members of the protected group of which the plaintiff is a member (Nord and Grano, supra). When only subjective criteria are used the court will consider such factors as whether or not the evaluator/decision maker had personal knowledge of the plaintiff-employee's qualifications and/or performance. In the absence of such personal knowledge, the unsupported decision is likely to be held discriminatory (Grano, supra, and Tye v. Polaris Joint Voc. Sch. Dist. Bd. of Educ., 811 F.2d 315 (6th Cir. 1987)). In the Tye case a school superintendant decided against the renewal of a female vocational guidance counselor's contract. Due to economic problems, one of two such counselor positions had to be eliminated--the other position was held by a male. A deciding factor in the court's decision favoring the plaintiff-employee was that the superintendant based his decision on his subjective feelings and impressions and not on a personal knowledge of the plaintiff's work performance.

The Tye case contained a dissenting opinion which illustrates the point that different facts and circumstances in cases which are otherwise similar can give rise to opposite conclusions. The dissent argued that since this was a reduction-in-force case it should not be treated the same as other cases involving discrimination charges, and that the majority opinion was incorrect in finding for the employee.

In cases involving higher level employees, less scrutiny is applied by the courts (EEOC v. IBM Corp., 583 F.Supp. 875 (D.Md 1984)). Several cases have been decided in which the plaintiffs were university professors charging discrimination. In Greene v. Board of Regents of Texas Tech Univ., 474 F.2d 594 (5th Cir. 1973) the court decided in favor of the employer-defendant and noted that evaluations for promotion and pay increases are necessarily judgmental. The court further indicated that decisions based on subjective criteria will be upheld if correct procedures are used. The rationale for according such deference to the subjective conclusions concerning university professors and other high level employees is that the courts may be reluctant to substitute their judgment for the judgment of professionals with more expertise and knowledge regarding the positions and persons involved. However, by 1978, the U.S. Supreme Court cautioned against courts abdicating their responsibility in deferring too readily to subjective decisionmaking in hiring, promotion and tenure decisions of universities in Title VII cases (Sweeney v. Bd. of Trustees, 569 F.2d 169 (1st Cir.) vacated and remanded, 439 U.S. 24, 99 S.Ct. 295, 58 L.E.2d 216 (1978)).

Courts have indicated that when subjective criteria form the basis of employment decisions, the court will consider such factors as whether or not the employer followed established procedures, whether the procedures were fair, whether the employee had an opportunity to personally review and inspect evaluations in his or her file, and whether the process allowed the employee to challenge allegedly inaccurate materials in the file. Further, courts will consider whether the employee had adequate notice of his or her rights in the situation. See Stoller v. Marsh, 682 F.2d 1971 (DC Cir. 1982).

Two major developments in the area of subjective criteria in employment decision making which may affect merit pay determinations are (1) the U.S. Supreme Court's decision in Watson v. Fort Worth Bank and Trust Co., 108 S.Ct. 2777 (1988), and (2) the Civil Rights Act of 1991.

In the Watson case, the plaintiff was a black woman who alleged race discrimination against the bank for its failure to promote her to a supervisory position. No formal criteria were in place for the decision, and it was based on subjective judgments of supervisors. Since there were no objective criteria in evidence, the plaintiff's attempt to argue the case as a disparate impact case (in which the plaintiff claims a facially neutral practice resulted in an adverse impact on a protected class) was rejected. The trial court treated it as a disparate treatment case in which it was necessary to prove intent to discriminate. The defendant bank was able to show that there were legitimate, nondiscriminatory reasons for its decision. When the U.S. Supreme Court reviewed the case it established a new rule--that cases involving subjective criteria could be treated as a disparate impact case. The significance of Watson is that employers can no longer insulate themselves from disparate impact claims simply by injecting subjective criteria into their decisionmaking processes.

The Civil Rights Act of 1991 extended the ramifications of Watson by eliminating the need for plaintiffs in disparate impact cases to identify the facially neutral practice which is causing the adverse impact. The statutory language states, "if the complaining party can demonstrate to the court that the elements of a respondent's decisionmaking process are not capable of separation for analysis, the decisionmaking process may be analyzed as one employment practice." In a

merit pay situation, if an employee has been denied merit pay and can infer by statistics that there is discrimination involved in the process, the entire merit pay system will be subject to scrutiny even when the decisions are based largely on subjective criteria and no particular criteria have been singled out by the plaintiff as being discriminatory. The employer must then be prepared to defend all elements of its process of determining merit pay recipients.

The Civil Rights Act of 1991 also includes a section relating to "mixed motive" cases--those in which an employer's decision is based on both discriminatory and nondiscriminatory factors. Prior to passage of the Act, an employer could escape liability by demonstrating that, although there is some evidence of discrimination, the decision would have been the same in the absence of such discrimination. The Act clearly states that in a "mixed motive" case, the employer is in violation of the law. Therefore, it is incumbent on employers to insure that no evidence of discrimination exists--because even if the evidence consists only of a comment or action which can be interpreted as discriminatory and there is ample evidence of nondiscriminatory reasons for the employer's decision, liability will attach for the discriminatory element. (It should be noted, however, that the statute limits the damages in such a situation.)

The provisions of the Civil Rights Act of 1991 were a direct reaction to several U.S. Supreme Court cases which Congress believed were watering down the civil rights of employees in protected classes. The mixed motive case at issue was Hopkins v. Price Waterhouse, 109 S.Ct. 1775 (1989). In that case a female candidate for partnership in a large accounting firm was not nominated for partnership, based to a great extent on the subjective evaluations of her by the partners. Although she was

rated extremely highly on objective factors such as generation of business, there were many complaints about her personal characteristics. Comments that she was "macho" and that she needed a "course in charm school" were made. Concerns were expressed that a "lady" should not use profanity, and suggestions were made to her that she "walk more femininely, talk more femininely, wear make up, have her hair styled, and wear jewelry." The trial court found for the plaintiff, indicating that the defendant's evaluation system was infected by impermissible, sexually stereotyped attitudes towards women. The U.S. Supreme Court, however, remanded the case to allow the employer to show that it would have made the same decision in the absence of the discriminatory motives. If the employer was successful in that regard, it would not be liable to the plaintiff, and there would be no violation of Title VII found. Under the new statute a case involving the same facts would not be sent back to the lower court, and the defendant would at the least be liable for plaintiff's attorney's fees and costs. (In the actual case, the employer was not able to demonstrate that it would have made the same decision regarding the plaintiff's candidacy for partnership status in the absence of the discriminatory attitudes evidenced in court. The plaintiff was awarded partnership status, backpay, and other remedies available under Title VII.)

In summary, the use of subjective measurements in merit pay decisions will not be considered a per se violation of the civil rights laws. Systems should be designed, however, to eliminate subjectivity to the extent possible, because the system is less defensible the more it involves subjective criteria. When subjectivity is injected, greater weight is given by the courts to the other factors and circumstances surrounding the merit pay determinations. In fact, factors outside the

merit pay system itself may be considered by the court--such as incidents of sexual or racial harassment, evidence of "stereotyped" attitudes about women, minorities, the handicapped, etc. The ambiguous nature of the subjective criteria makes it possible and probable for courts to look beyond the measurements, and beyond the system, to give meaning to the subjective criteria in any particular employment setting.

In light of the court decisions and laws discussed above, the following suggestions for establishing a legally defensible merit pay system are made.

#### SUGGESTIONS FOR DESIGNING LEGALLY SOUND MERIT PAY SYSTEMS

Criteria for obtaining merit pay should be specific and job-related.

Criteria should be commonly understood and should be communicated to the employees in a timely manner.

Process should be equitable and should allow employees an opportunity to comment, review, and appeal.

Evaluators should be made aware of the necessity of avoiding any discriminatory statements, implications, or inferences both in and out of their decisionmaking sessions.

Process should be monitored, and feedback from affected employees should be obtained. Adjustments should be made as needed.

Evaluators should have personal knowledge of the candidate's performance or qualifications if the merit pay decision is based on subjective criteria.

Documentation of the process should be maintained at all levels.

When subjective criteria is used, care should be taken to define the subjective criteria. For example, "reliability" could be indicated by such objective determinants as whether or not assigned tasks are completed on time; "responsibility" could be demonstrated by performance of the job duties with little or no need for supervision; and "accountability" could be shown by whether the employee keeps accurate and complete records, and whether the files are kept in an orderly and efficient manner.

Openings for "stereotyping" should be avoided when subjective criteria constitute part of the decision. For example, if "leadership" is a major component in the award of merit pay, the trait should be defined. In the absence of a definition, an all-male evaluation team may unconsciously ascribe such attributes as physical stature and a commanding voice as characteristics of leadership. The one diminutive, high performing, female candidate may inadvertently be overlooked as someone with leadership characteristics--simply because she does not fit their "image" of a leader.