

Broker Exemptions

Compensation Arrangements, the FLSA and Overtime Pay

By Vivian M. Barrios, Steven M. Gutierrez and Michael R. MacPhail

Claims asserting overtime violations under the Fair Labor Standards Act (29 U.S.C. §201 *et seq.*) (“FLSA”) have been on the rise in recent years. Joseph E. Tilson, Jeremy J. Glenn, *The FLSA: Emerging Trends in Wage and Hour Litigation*, PLI Order No. 8878, October 2006, at 573. Of particular concern to many employers throughout the country has been the rise

of collective actions under the FLSA. While individual FLSA claims for unpaid wages are typically small, defense of a collective action under the FLSA can involve numerous plaintiffs, present the potential for high exposure and be costly for an employer to defend. *Id.*

Under the FLSA, a claim may be maintained against any employer by any one or more employees, for and in behalf of him- or herself, or collectively with other employees similarly situated. Section 216(b) of Title 29. Importantly, no employee shall be a party plaintiff to any such action unless he or she gives his or her consent in writing to become such a party and such consent is filed with the court in which such action is brought. Collective actions under §216(b) differ significantly from a class action under Fed. R. Civ. P. 23. In a case that proceeds under §216(b), a party needs to

opt-in to a collective action as opposed to the need to opt-out of a class action brought under Fed. R. Civ. P. 23.

Most circuit courts employ a two-tiered approach to determine whether to certify a FLSA collective action. See *Thiessen v. General Electric Capital Corp.*, 267 F.3d 1095, 1102–05 (10th Cir. 2001). The first determination is made at the “notice stage” where the district court makes a decision whether to certify a representative class conditionally. A conditionally certified class allows the putative class members the opportunity to opt-in. The second step is generally preceded by a motion for de-certification—generally a motion filed after discovery is essentially complete and the matter is ready for trial. It is during this stage that a court will make a factual determination on the similarly situated question. Trial of the merits will follow any finding that a representative class exists. If findings to the contrary are made, the opt-in plaintiffs are dismissed without prejudice and the original claim-

ants proceed to trial on the merits of their individual claims.

Collective actions brought by employees in the financial service industry in the past 18 months have revealed the high stakes involved and are examples of the complexity of the issues that an employer will face if its employees claim they have been wrongly classified as exempt from the FLSA’s overtime pay provisions. Generally, most companies in the financial services industry have assumed their brokers are sufficiently well compensated to enable them to qualify under the administrative exemption provided for under 29 C.F.R. §541.200. However, given the fluctuating, commission-based nature of compensation received by more senior brokers, reliance on compensation as indicia of such qualification may be misplaced. Indeed, the recent collective actions have created doubt as to whether brokers and other financial service employees are in fact exempt from statutory overtime pay requirements.

Brokers and the Financial Services Industry

Notwithstanding the virtual disappearance of the job title “stockbroker,” traditional “wire house” brokerage firms continue to employ investment professionals who help customers buy and sell securities, whom we will call “brokers” in this article (brokers are also known as “registered representatives”). Although this article will not



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discuss the many brokers who are hired by firms on an independent contractor basis, it is worth noting that firms may perceive the independent contractor model to be advantageous, not just because they can expect to realize cost savings, but to ensure avoidance of overtime pay disputes. The trend towards contracting with brokers occurs notwithstanding the legal obligation of all firms to supervise their brokers closely, as well as the inherent difficulties that firms confront when attempting to supervise independent contractors who may be located in numerous geographically dispersed offices that are neither leased nor owned by the firms. Accordingly, the independent contractor model may expose firms to increased liability if they are unable to reasonably detect and prevent the misconduct of their brokers.

Because brokers need a thorough knowledge of economic conditions and trends, employers prefer to hire individuals with a college degree, ideally including courses in business administration, economics and finance. This preference is due to brokers increasingly assuming the role of providing comprehensive financial planning services and moving away from the old model of merely selling stocks. Michael Hayes, *The Salaried Stockbroker*, Registered Rep (2001), available at http://registeredrep.com/mag/finance_salaried_stockbroker/. Brokerage firms also hire individuals who have worked in other industries or were previously successful in other commissioned sales jobs.

Brokers are governed by securities laws and regulations, as well as the rules of self-regulatory organizations such as the National Association of Securities Dealers (NASD). All brokers must register with the NASD and must first pass the NASD's General Securities Registered Representative Exam, commonly known as the "Series 7" exam. A broker can take the exam after working at a registered brokerage firm for at least four months. Most firms use that time to prepare new brokers for the exam. After two years, brokers can take more exams in order to sell insurance and commodities.

The day-to-day duties and responsibilities of brokers, which vary from firm to firm, are not regulated or defined by law. A survey of job descriptions posted on the Internet indicates that brokers' duties and

responsibilities typically include: (1) establishing and maintaining new accounts through business development/client acquisition activities; (2) providing investment advice to customers in light of their financial needs, risk sensitivity and investment horizon; (3) executing trades for customers; (4) servicing existing accounts by, among other things, providing stock quotes

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A job title alone is insufficient to establish the exempt status of an employee.

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and news to customers; and (5) creating and implementing a plan designed to help customers achieve their financial goals.

Brokers traditionally are paid a commission based on the amount of stocks, bonds, mutual funds and other securities products they sell. Most firms pay a "draw against commission," or a minimum salary based on commissions that they can be expected to earn. Trainee brokers usually are paid a salary until they develop a client base. The salary gradually decreases in favor of commissions as the broker gains clients. U.S. Dept. of Labor, Bureau of Labor Statistics, *Occupational Outlook Handbook* (2007), available at <http://www.bls.gov/oco/ocos122.htm>. Further, brokers who work for discount brokerage firms that promote online trading services, and about 30 percent of brokers who work for banks, are paid a salary, sometimes accompanied by bonuses dependent upon profitability of the office. See *The Salaried Stockbroker, supra*. A small but increasing number of full-service brokers are paid a percentage of the assets they oversee.

FLSA Overtime Exemptions

In order for an employee to be exempt from the overtime requirements of 29 U.S.C. §207(a), he or she must be employed in a "bona fide" executive, administrative or professional capacity. 29 U.S.C. §213. The employer bears the burden of establishing that an employee is employed in a bona fide exempt position. While the FLSA does

not define the terms bona fide executive, administrative or professional employee, the Department of Labor ("DOL") has developed regulations clarifying the term.

According to 29 C.F.R. §541.100, the term "employee employed in an executive capacity" shall mean any employee:

- (1) Compensated on a salary basis at a rate of not less than \$455 per week;
- (2) Whose primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;
- (3) Who customarily and regularly directs the work of two or more other employees; and
- (4) Who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees are given particular weight.

To qualify as an employee employed in a professional capacity under 29 C.F.R. §541.300, an employee must:

- (1) Be paid at least \$455 per week on a salary basis; and
- (2) Have the primary duty of performing work that requires knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction.

Whether an employee's primary duty is the performing work that requires advanced knowledge in a field of science or learning is based on whether:

- (1) The employee performs work requiring advanced knowledge;
- (2) The advanced knowledge is in a field of science or learning; and
- (3) The advanced knowledge is customarily acquired by prolonged course of specialized intellectual instruction.

29 C.F.R. §541.301.

In the financial services industry, most companies have operated under the assumption that their employees are exempt because they qualify as "bona fide" administrative employees. Under 29 C.F.R. §541.200(a), "[t]he term 'employee employed in a bona fide administrative capacity' in section 13(a)(1) of the Act" means "any employee" who is:

- (1) Compensated on a salary or fee basis at a rate of not less than \$455 per week... exclusive of board, lodging or other facilities;
- (2) Whose primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
- (3) Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

This regulation sets forth a "salary basis test." As described above, an employee must be guaranteed at least \$455 per week (or \$23,660 annually) to qualify for the administrative exemption. Salary basis means: (1) the employee regularly receives a predetermined amount each pay period; (2) the amount the employee receives is not subject to reduction because of the quality or quantity of work performed; and (3) the employee receives the full salary for any week in which the employee performs *any* work. 29 C.F.R. §541.602.

In addition to the salary test, there is, consistent with elements two and three, a duties test. To qualify for the administrative exemption, the employee must be performing work "directly related to the management or general business operations of the employer or the employer's customers." 29 C.F.R. §541.201. An employee meets this obligation if he or she assists with the running or servicing of the business. *Id.* The primary duty test also requires the employee to exercise discretion and independent judgment "with respect to matters of significance." 29 C.F.R. §541.202. The regulations define the phrase "discretion and independent judgment" as judgment involving the comparison and the evaluation of possible courses of conduct, after the various possibilities have been considered. "Matters of significance" requires evaluation of the level of importance or consequences of the work being performed. *Id.*

Under 29 C.F.R. §541.203, brokers and other financial industry employees generally meet the duties requirements for the administrative exemption. Typically, such employees met the requirement by doing such work as "collecting and analyzing in-

formation regarding the customer's income, assets, investments or debts; determining which financial products best meet the customer's needs and financial circumstances; advising the customer regarding the advantages and disadvantages of different financial products; and marketing, servicing or promoting the employer's financial products." An employee whose primary duty

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Brokers can qualify under the bona fide administrative employee exemption.

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is selling financial products, however, will not qualify for the administrative exemption. *Id.* Accordingly, brokers employed by "discount" brokerage firms, which focus primarily on taking unsolicited customer orders, may be ineligible for the administrative exemption. To ensure this does not happen, brokerage firms should consider creating written job descriptions that include providing investment advice, as discussed below. Moreover, a job title alone is insufficient to establish the exempt status of an employee. 29 C.F.R. §541.2. The exempt status is determined by examining whether the employee's salary and job responsibilities meet the tests enumerated above.

The new DOL regulations, which became effective on August 23, 2004, created a completely new exemption that allows employers to avoid paying overtime for employees who make more than \$100,000 annually. The exemption for "highly compensated employees" requires that the employee:

- (1) Perform office or non-manual work;
- (2) Customarily and regularly perform any one or more the exempt duties or responsibilities of an executive, administrative, or professional employee;
- (3) Be paid a minimum salary of at least \$455 per week on a salary or fee basis; and
- (4) Be guaranteed a total annual compensation of at least \$100,000.

29 C.F.R. §541.601. This new exemption

could be applied to brokers as long as the requirements for eligibility were met. For companies to guarantee that their brokers qualify for the exemption, they would need to ensure that their compensation arrangements guaranteed both an annual salary of at least \$100,000 a year and a weekly salary of \$455. If those salary requirements were met, employers would need only to ensure that the employee did not perform manual work and that the employee "customarily and regularly" performed at least one of the exempt duties listed in the other exemptions.

Stockbrokers and Other Registered Representatives Can Qualify for the Administrative Exemption

Of particular note, a 1994 Department of Labor opinion letter specifically stated brokers and customer brokers could qualify as exempt under the FLSA. Dept. of Labor, FLSA, 1994 WL 1004755, (March 7, 1994) (The term "customer broker" used in the DOL opinion letter is not a term commonly used in the industry. The DOL does not define this ambiguous term). The letter explained stockbrokers can qualify under the bona fide administrative employee exemption, provided that the duties, responsibilities and salary tests were met. *Id.* However, brokers who are undergoing extended on-the-job training do not qualify for the administrative exemption, since they are "not actually performing the duties of an administrative employee," and are not exercising the requisite level of discretion and independent judgment. *Id.*

A more recent Department of Labor opinion letter reconfirmed brokers can qualify under the bona fide administrative employee exemption provided under the FLSA. Dept. of Labor, FLSA 2006-43 (November 27, 2006). The letter confirmed the typical duties of a broker, described above, generally meet the test set forth in section 29 C.F.R. §541.200(a). The letter stated brokers who collect and analyze client information, compare and evaluate possible investment options, and identify investment strategies and potential investments based on their knowledge of the market conditions and the clients' particular circumstances would meet the duties test of 29 C.F.R. §541.200(a). Moreover, the letter stated such brokers also would meet the "exercise of discretion and independent

judgment” test. However, the letter again cautioned: brokers whose primary duty was sales would not meet the duties test. *Id.* The meaning of this letter is unclear since some “sales” of securities by brokers are solicited, based on the broker’s analysis of the client’s investment objectives and the security being recommended. The letter appears to refer to brokers who function primarily as “order-takers” for customers who place trade in securities on an unsolicited basis. Since industry trends encourage brokers to play an active role in advising clients, and taking client orders can be done online with no need for a broker, it can be expected that over time fewer brokers will have unsolicited sales execution as their primary duty. Again, any written job descriptions for brokers referring to “sales” activity should be accompanied by language emphasizing the broker’s role in actively analyzing and managing the client’s financial affairs.

Companies With Employee Registered Representatives Should Be Careful to Ensure Their Employees Meet Both the Duties and Salary Tests

While the 1994 and 2006 Department of Labor letters provide firms with some comfort regarding whether their brokers are exempt under 29 C.F.R. §541.200(a), prudent employers should ensure their employees, regardless of title, actually meet the exemption’s requirements. Recent suits by brokers have rested on claims that the employees do not meet either the salary or duties tests of 29 C.F.R. §541.200(a). Under these recent claims, even the 2006 Opinion Letter would be irrelevant, since the employees claim their primary duties are not those contemplated by the regulations.


In a recent case, *Burns v. Merrill Lynch, Pierce, Fenner and Smith Inc.*, N.D. Cal. C-04-4135, a former broker filed a collective action seeking overtime pay. The broker claimed he worked in excess of 40 hours per week, but was never paid overtime wages. The broker claimed he did not qualify for any exemption under the FLSA. He claimed that while his company may have assumed he met the administrative exemption, his job duties and salary did not meet the requirements of 29 C.F.R. §541.200(a). The broker claimed he and others similarly situated did not receive a guaranteed salary, but rather were paid on a commission-only

basis and that, based on that compensation arrangement, he was “non-exempt” and Merrill Lynch owed him overtime compensation at a rate of one-and-one-half times his regular rate of pay for all hours worked in excess of 40 hours per week. The broker also argued the plaintiffs did not perform administratively exempt duties and did not exercise the kind of independent judgment and discretion required by the regulations. The parties in *Burns v. Merrill Lynch, Pierce, Fenner and Smith Inc.*, eventually went to mediation, which resulted in a total possible payout to the current and former brokers of \$27.575 million and an additional \$9.25 million in attorneys’ fees.

In another recent case, *Thill v. Edward D. Jones & Co., L.P.*, N.D. Cal. 05-0238186, another set of securities brokers sued for overtime wages under the FLSA. The brokers, much like the ones in *Burns*, contended they regularly worked more than 40 hours per week, but were not paid overtime. Thus, the employees claimed Edward Jones

owed them 1.5 times their regular rate of pay for all hours worked in excess of 40 per week. The brokers claimed their actual duties did not qualify them for any exemption under the FLSA, including the administrative exemption.

Advice to Employers

To ensure broker employees meet the exemption requirements set forth in 29 C.F.R. §541.200(a), firms should guarantee their employees a salary of at least \$455 per week. Brokers can still receive commissions, as long as they are guaranteed at least that amount. Further, firms should ensure brokers’ duties involve more than merely executing customer orders and include the substantive providing of financial advice based on their knowledge of the industry and the customer’s individual needs and investment objectives. If firms follow this advice, they can avoid costly class action lawsuits by brokers seeking millions of dollars in overtime pay and attorneys’ fees. 

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