

Are Brokers Entitled to Overtime Pay?

By JAMES J. ECCLESTON

It started with, “Huh — brokers should be paid overtime?” Fast forward, Smith Barney and UBS have settled nationally (for \$98 million and \$89 million, respectively), Merrill Lynch has announced a national settlement (for an as yet undisclosed sum, but having already agreed to pay \$37 million to settle in California), and Morgan Stanley has settled in California (for \$42.5 million).

Moving forward, Smith Barney has announced that it will pay brokers a minimum guaranteed monthly salary, will pay the salaries of their sales assistants, will discontinue payroll deductions for trading errors, and possibly may even extend allowances for travel and entertainment expenses. Although Smith Barney’s *quid pro quo* is reduced broker commission payouts, in a year of record Wall Street profits let’s see whether competition on the street nixes that plan.

Even with this flurry of developments, much more is still to come. That’s because other wirehouses, regional firms and independent firms still are, or soon may be, in litigation. Settlements may occur, and court rulings may change the landscape. Finally, the regulators may weigh in with their opinions. Indeed, recently a court decision and a Department of Labor Opinion Letter have entered the mix.

Preliminarily, one must remember that nearly every state has its own laws governing overtime pay (and expense deductions). These laws are not preempted by federal law, known as the Fair Labor Standards Act, but instead supplement it to create additional employee rights. Moreover, states themselves have regulations, court opinions and attorney-general opinions, all of which must be weighed.

Court Decision

The recent court decision involved A.G. Edwards. Brokers sued that firm for overtime and, in response, A.G. Edwards filed a motion for summary judgment. A.G. Edwards argued that there was no genuine issue as to the fact that commission-based brokers are not entitled to (or are exempt from) overtime payments. The federal district court in California denied the motion for summary judgment in its entirety.

To win its summary judgment motion, A.G. Edwards was required to prove that it had satisfied two tests under FLSA for an exemption from overtime pay requirements: the guaranteed salary test and the duties test. A.G. Edwards argued that it satisfied the guaranteed salary test because the firm paid its brokers a draw against future commissions. Nonetheless, the court rejected the argument that a draw was the equivalent of a guaranteed salary, reasoning that, “Case law and the DOL [Department

of Labor] letters cited by both parties, therefore, appear to support that deduction of [broker's] draw salary from a subsequent paycheck is an impermissible offset."

Turning to the duties test, A.G. Edwards attempted to convince the court that the primary duties of its brokers were "administrative," as distinguished from "sales," such that they fell within one of the duties exemptions to overtime pay requirements. A.G. Edwards claimed, among other things, that its brokers underwent extensive training on management of client portfolios, "only a small portion of which focused on prospecting." Nonetheless, the court relied on testimony and documents suggesting that the primary duty of A.G. Edwards' brokers was to sell. Accordingly, the court found that there was a genuine issue of material fact "regarding whether [brokers] are engaged in work that results from the product that [A. G. Edwards] profits from, in this case sales of securities and other financial offerings, rather than in the administration of [A.G. Edwards'] business or that of its existing customers."

Opinion Letter

The Department of Labor Opinion Letter — the second of the two recent developments — came in response to a hypothetical factual scenario that the Securities Industry Association presented to the Department of Labor in seeking an Opinion Letter. In a nutshell, the chief hurdle the SIA had to overcome was to describe brokers' employment duties such that the DOL would opine that the primary duty of brokers was not sales. FLSA regulations define "primary duty" as "the principal, main, major or most important duty that the employee performs" based on all the facts, with the major emphasis on "the character of the employee's job as a whole."

The SIA represented to the DOL that the primary duty of brokers was not sales but, instead:

- collecting and analyzing a client's financial information;
- advising the client about the risks, the advantages and the disadvantages of various investment opportunities in light of the client's individual financial circumstances; and
- recommending to the client only those securities that are suitable for the client's particular financial status, objectives, risk tolerance, tax exposure and other investment needs.

Based upon the foregoing, the DOL opined that such a broker (as described) would not primarily be engaged in sales. The consequence is that such a broker would come within the administrative exemption, meeting one of the two tests (the other being salary) to be exempt from FLSA's overtime pay requirement.

Certainly, while courts give DOL Opinion Letters substantial weight, they are not statutes and need not be followed. Indeed, one commentator has criticized the Opinion

Letter, likening the opinion to “calling a person who sells clothing at Men’s Wearhouse a fashion textile consultant.”

A footnote in the Opinion Letter may reveal the course that at least some courts may choose to follow in deciding whether brokers fall within the duties test of the administrative exemption. The DOL writes, “The fact that some [brokers] receive a fee based on the total value of assets in an account, even if no orders or trades are executed, provides further support for the assertion that their primary duty is not sales.” Time will tell whether compensation based not upon commissions for sales but fees for assets under management makes a difference in FLSA jurisprudence.

The DOL Opinion Letter also clarified that the salary-basis test can be met if the broker is paid *both* a guaranteed minimum salary or draw of at least \$455 per week, and additional compensation above the guaranteed minimum, even if the calculation of the additional compensation takes into account the minimum guarantee. Critically —and what A.G. Edwards was faulted for not doing in its case — the broker’s guaranteed minimum payment (by salary or draw) is predetermined and cannot be subject to reduction or repayment.

As courts nationwide interpret all of this, weighing equally important state laws, regulations and opinions, brokers may soon witness one of the more significant shifts in wage practices since the advent of fee-based compensation.

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