A Timely Analysis of Legal Developments

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In a development that may have significant implications for mortgage lenders and other financial services employers, the Department of Labor has issued a new Administrator's Interpretation finding that mortgage loan officers do not qualify as exempt administrative employees under the FLSA, reversing its prior position and withdrawing previous opinion letters concluding to the contrary.

Department of Labor Reverses Course: Mortgage Loan Officers Do Not Meet the Administrative Exemption's Requirements

By Robert W. Pritchard, R. Brian Dixon and Andrew J. Voss

On March 24, 2010, the Department of Labor (DOL) abandoned its position on the exempt status of mortgage loan officers as "administrative" employees, vacating an Opinion Letter issued by the Wage and Hour Administrator less than four years ago on September 8, 2006.[1] In its earlier September 2006 Opinion, the DOL found that mortgage loan officers generally meet the requirements of the administrative exemption to the federal Fair Labor Standards Act's overtime requirements if they are responsible for acquiring an understanding of a potential borrower's credit history and financial goals in order to advise the borrower regarding loan options; working with the borrower to create a loan package that best meets those goals while complying with lender requirements; and supervising the processing of the transaction to closing. In a new "Administrator's Interpretation,"[2] the DOL has now concluded that the September 2006 Opinion was based upon a "misleading assumption" regarding the administrative exemption's scope, and a "selective and narrow analysis" of the administrative exemption's requirements. Relying upon facts found during DOL investigations and described in court cases that have focused on the exempt status of this job over the past decade, the DOL now rejects the proposition that mortgage loan officers perform work that is directly related to their employer's general business operations. In the DOL's current view, mortgage loan officers are primarily responsible for the sale of mortgage loans, and therefore, they fall on the "production" side of the "production vs. staff" dichotomy. As production workers, loan officers do not qualify for the administrative exemption.

The Department's abrupt change in position on this issue may well have a significant impact on mortgage lenders and other employers in the financial services sector that had previously relied upon the DOL's September 2006 Opinion (issued in the wake of extensive litigation over this job's proper classification) in determining whether loan officers are eligible for overtime compensation.

The FLSA and the Administrative Exemption

The FLSA requires covered employers to pay certain employees overtime at a rate of

one and one-half times the employee's regular rate of pay for hours worked in excess of forty per week.[3] This requirement is subject to a number of exceptions, including the so-called "white collar" executive, administrative, and professional exemptions that were the subject of regulatory revision to the FLSA in 2004.[4] Under the current rules, in order to qualify for the administrative exemption:

1. An employee must be 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. The employee's primary duty must be 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. The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.[5]

The DOL's September 2006 Opinion assumed that the salary basis test had been met with respect to the mortgage loan officers at issue.[6] In the new March 2010 Interpretation, the DOL focuses exclusively on the second prong of the test: whether loan officers perform office or non-manual work directly related to the management or general business operations of their employer or their employer's customers. Because the DOL has now concluded that the second prong of the test cannot be satisfied, the final question, whether such employees exercise independent judgment and discretion when performing their jobs, was not addressed.

The Primary Duty and the Meaning of "Work Directly Related to Management or General Business Operations"

The DOL introduced its discussion of the second prong of the administrative exemption by highlighting the regulatory distinction between administrative "work related to the management or general business operations" of an employer – running and servicing the business – and "working on a manufacturing production line or selling a product in a retail or service establishment."[7] As examples of administrative work, the regulations identify functional areas such as accounting, budgeting, quality control, purchasing, advertising, research, human resources, and labor relations.[8] According to the DOL, employees responsible for such responsibilities are "staff rather than line employees." Like an employee on a traditional manufacturing line, "production employees" on the other hand, are responsible for work related to the goods and services which constitute the "business' marketplace offerings."[9]

The Interpretation focused on the language in the Preamble to the revised FLSA regulations issued in 2004 (the "Final Rule") describing the dichotomy as "a relevant and useful tool," but ignored the other statements in the Preamble emphasizing that the dichotomy has "always been illustrative—but not dispositive—of exempt status."[10] The Preamble further states that the dichotomy should be used, if at all, as only "one piece of the larger inquiry" and provide an answer to the question of exempt status "only when work 'falls squarely on the production side of the line.'"[11]

The DOL supported its conclusion that loan officers should be considered production workers by characterizing their primary duty as selling mortgage loans. To the extent loan officers are engaged in other activities, such as collecting financial information from customers, running credit reports, assessing different loan products, and discussing products with customers, these activities, in the Department's view, are ultimately intended to support the sale of loans, and accordingly, are properly considered "production work." According to the DOL these activities do not relate to the internal management or general business operations of the loan officers' employer, nor do they involve the servicing of the business itself by providing advice regarding internal operations, such as would be provided by employees in human resources or accounting.

To support its analysis, the DOL pointed to federal cases where courts used the administrative/production dichotomy and evaluated any work involving or collateral to sales as production work, as opposed to work related to the general operations of the business. For example, the DOL pointed out that in *Martin v. Cooper Electric Supply Co*., the Third Circuit rejected the argument that an inside salesperson who represented its employer in negotiations with customers was engaged in administrative work.[12] Such negotiations,

the court concluded, were "part and parcel" of the activity of producing sales of electrical products, which was the employer's primary business purpose. The DOL also cited a number of federal district court decisions that had come to the same conclusion with respect to the primary duty of mortgage loan officers.[13]

The DOL also noted the factors used to determine whether an employee qualifies for the "outside sales" exemption. These are described in the regulations implementing section 13(a)(1) of the FLSA, and include the employee's job description; the employer's qualifications for hire; sales training; method of compensation; and the proportion of earnings directly attributable to sales.[14] The DOL applied these factors to the description of loan officers' duties in several cases and concluded that loan officers are primarily responsible for making sales. Loan officers, the DOL opined, may "compile and analyze potential customers' financial data," but they do so to evaluate a customer's qualifications for a loan, "*i.e.*, to make a sale." Citing numerous cases, the DOL noted that loan officers are also historically compensated almost entirely by commission, even if they also receive a base wage, salary, or draw against commissions. The DOL also cited a number of cases that found employers train loan officers in sale In conclusion, the DOL stated that because a financial services firm is engaged in the business of offering mortgage loans in the marketplace, and loan officers' primary duty is selling those loans, mortgage loan officers therefore perform the "production work" of the business.

The DOL also rejected the argument that a loan officer's primary duty is directly related to the management or general business operations of the employer's customers. The regulations specifically provide that "financial consultants" may be exempt if they act "as advisers or consultants to their employer's clients or customers."[15] As explained in the Preamble to the Final Rule published in 2004, the regulations were not intended to preclude the exemption from applying to an employee who provides expert advice regarding management and general business operations to clients (as opposed to the employer itself).[16] In its Interpretation, however, the DOL focused on the identity of the "customer" and the purpose of the advice. According to the DOL, the exemption does not apply to employees who provide advice to individuals regarding their personal needs, such as people seeking mortgages for their homes.

What this Means for Employers: The Resurgence of the Production vs. Staff Dichotomy

As we expressed in a Littler Insight shortly after the September 2006 Opinion was issued, banks and mortgage lenders had reason to be encouraged by the DOL's interpretation of the "financial services" provisions of the 2004 Final Rule relating to the administrative exemption. Certainly, mortgage lenders had been targeted for wage and hour collective and class actions throughout the last decade, and the Opinion brought clarity to the ambiguous line that separated duties associated with the sale of financial products, from the "administrative" work performed by employees in the financial services industry, which the Final Rule itself describes with such terms as "collecting and analyzing information 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."[17]

Indeed, the Interpretation describes the duties of mortgage loan officers in terms remarkably similar to the language used in the Final Rule to describe an exempt employee in the financial services industry. According to the Interpretation, loan officers "collect required financial information from customer . . . including information about income, employment history, assets, investments, home ownership, debts, credit history, prior bankruptcies, judgments and liens[,]" they "assess the loan products identified [by a computer] and discuss with the customers the terms and conditions of particular loans[,]" and they "try[] to match the customers' needs with one of the company's loan products." It is also clear in the Interpretation that the DOL believes that loan officers "promot[e] the employer's financial products." In the Preamble to the 2004 Final Rules the DOL noted that the regulations "reject[] the view that selling financial products directly to a consumer automatically precludes a finding of exempt administrative status."[18] In the Interpretation, the DOL avoids using such terms as "analyze" and "advise" when describing a loan officer's primary duty, but there seems little more than a semantic distinction between these terms and "assess" and "discuss." To the extent the DOL has attempted to revise the 2004 Final Rule in Section 541.203(b) by "interpreting" it out of effect, it has engaged in rulemaking beyond its delegated authority.

Although the distinctions between these terms may not be clear, it is apparent that the tide has shifted at the DOL, perhaps dramatically. Employers are advised to note the Department's aggressive use of the production vs. staff dichotomy tool in its analysis, as applied to a modern services industry that does not fit comfortably within this analytical framework. In the Preamble to the 2004 Final Rules, the DOL clearly recognized that this tool was only useful to the extent "it clarifie[d] the analysis."[19] The application of the test should not be viewed "as an end in itself."[20]

As the scope of wage and hour litigation has expanded significantly in recent years, courts have frequently been asked to apply the administrative exemption to modern, service and information industry jobs, and many have declined to consider or even mention the dichotomy, considering it out-dated. For example, in *McLaughlin v. Nationwide Mutual Insurance Co*., the court cited with approval other district court decisions, both within and outside the Ninth Circuit, that refused to apply the dichotomy, finding it inapplicable to "service providers."[21] Noting the Department's 2004 Final Rules had moved away from the dichotomy in the service industry context, the court declined to analyze the duties of insurance claims adjusters under what it called "an outdated line of reasoning."[22]

Likewise, in *Roe-Midgett v. CC Services, Inc*., the Seventh Circuit emphasized the industrial-age genesis of the term "production" and its limited applicability in the modern service industry context.[23] Although *Roe-Midgett* did not apply the 2004 regulations, which took effect after the plaintiffs in the case had filed suit, the court nevertheless found the new regulations "informative on the issues before us."[24] The Seventh Circuit found the new regulations suggested a more traditional definition of "production," such as working on a manufacturing production line, and concluded that the production vs. staff dichotomy was not particularly useful when applied by analogy to the modern service industry context.[25]

The DOL's broader view of the dichotomy has been applied by at least one recent circuit court decision, however. In *Davis v. J.P. Morgan Chase & Co*.,[26] a case cited by the DOL in the Interpretation, the Second Circuit Court of Appeals applied the dichotomy in a contrasting and unexpected way – perhaps consistent with the DOL's new perspective. *Davis* addressed the question of whether a financial underwriter qualifies for the administrative exemption to the FLSA. The underwriters at issue were responsible for reviewing loan applications in consideration of the employer's underwriting standards and guidelines to determine whether loans should be approved and funded. Ironically, the *Davis* court relied in part upon the DOL's effort "to clarify the classification of jobs within the financial industry through regulations and opinion letters," pointing to Section 541.203(b), discussed above, and the opinion letters issued by the Department that found loan officers to be engaged in administrative work, based upon their "advisory duties" with customers. The work of underwriters, by contrast, did not relate to "setting 'management policies' nor to 'general business operations' such as human relations or advertising."[27] Rather, according to the Second Circuit, their work involved "the 'production' of loans – the fundamental service provided by the bank."[28]

The DOL's reversal of course in the Interpretation presents an immediate challenge to those employers in the financial services industry that have relied in good faith on the September 2006 Opinion that mortgage loan officers qualify for the administrative exemption. That Opinion has now been vacated and provides no legal basis for a *continuing* good faith determination that loan officers are not eligible for overtime pay. Such employers are advised to review their compensation policies and practices with respect to any employee who "perform[s] the typical job duties" of a mortgage loan officer, regardless of job title. The determination of the proper classification of employees with respect to their entitlement to overtime pay under the FLSA must be made on a case-by-case basis, by reference to the relevant duties and responsibilities of the position at issue and the relevant regulations.

More broadly, the March 2010 Interpretation highlights a distinct change of direction at the DOL and a departure from its previous view regarding the limited utility of the production vs. staff dichotomy and how it should be considered within the context of the modern workplace. It certainly can be argued that this Interpretation conflicts with both the Preamble and the 2004 Final Rules and, as such, is an improper attempt by the DOL to change its regulations without complying with its rulemaking obligations. In a complex service or information industry setting, it is often difficult to identify and describe an employer's "product" in a way that easily permits the identification of employees engaged in "production" work. In such cases, many courts have concluded that the test simply has no useful role. The DOL may decide otherwise and broaden the application of this Interpretation to other service industries.

Robert W. Pritchard is a Shareholder in Littler Mendelson's Pittsburgh office, R. Brian Dixon is a Shareholder in Littler Mendelson's San Francisco office, and Andrew J. Voss is a Shareholder in Littler Mendelson's Minneapolis office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Mr. Pritchard at rpritchard@littler.com, Mr. Dixon at bdixon@littler.com, or Mr. Voss at avoss@littler.com.

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[1] U.S. DOL, W&H Div., Op. Letter, FLSA 2006-31, Sept. 8, 2006.

[2] In issuing this "Interpretation," the DOL announced that it will discontinue its practice of issuing "opinion letters" in response to specific industry or employer requests. Rather, the DOL will issue "Administrator Interpretations" when the Department determines that further clarity regarding the proper interpretation of a statutory or regulatory issue is appropriate, in order to provide guidance "across-the-board to all those affected by the provision at issue." Future requests for DOL opinions will receive references to statutes, regulations, and cases that may be relevant, but the DOL will no longer analyze the specific facts presented in the request. It may be presumed that an employer's reasonable reliance upon such "Interpretations" will satisfy a defendant's burden to prove good faith when an act or omission is challenged as a violation of the FLSA. *See* 29 U.S.C. § 259(a) (setting forth limits on liability when an employer establishes that it acted in reliance upon an "interpretation" issued by the Administrator of the Wage and Hour Division).

[3] 29 U.S.C. § 207(a).

[4] 29 U.S.C. § 213(a)(1). Two other exemptions have also received considerable attention in the mortgage industry over the past decade. In Opinion Letter FLSA2006-11 (Mar. 31, 2006), the Department of Labor concluded that loan officers who are customarily and regularly engaged away from their employer's place of business may be considered exempt under the outside sales exemption. *See* 29 U.S.C. § 213(a)(1). Employers in the mortgage industry have also asserted the "retail establishment" exemption on behalf of commissioned loan officers. 29 U.S.C. § 207(i). The DOL pointed to many mortgage lenders' reliance upon section 7(i) and the outside sales exemptions as further evidence in support of the conclusion that these employees have a primary duty of sales, and therefore, the administrative exemption does not apply.

[5] 29 C.F.R. § 541.200(a).

[6] *See* FLSA 2006-31, p. 2.

[7] 29 C.F.R. § 541.201(a).

[8] 29 C.F.R. § 541.201(b).

[9] *See Bothell v. Phase Metrics, Inc*., 299 F.3d 1120, 1127 (9th Cir. 2002) (quoted in the Interpretation).

[10] 69 Fed. Reg. 22,122, 22,141 (Apr. 23, 2004).

[11] *Id*. (citing *Phase Metrics*, 299 F.3d 1120).

[12] 940 F.2d 896 (3d Cir. 1991), *cert. denied*, 503 U.S. 936 (1992).

[13] *See Casas v. Conseco Fin. Corp*., 2002 WL 507059 (D. Minn. 2002); *Wong v. HSBC Mortgage Corp*., 2002 WL 753889 (N.D. Cal. 2008); *Barnett v. Washington Mut. Bank*, 2004 WL 1753400 (N.D. Cal. 2004); *Pontius v. Delta Fin. Corp*., 2007 WL 1496692 (W.D. Pa. 2007); *Chao v. First Nat'l Lending Corp*., 516 F. Supp. 2d 895, 904 (N.D. Ohio 2006). In *Pontius*, the court denied both parties' cross-motions for summary judgment, finding a material issue of fact regarding whether the loan officers were primarily responsible for producing sales or administrative duties.

[14] *See* 29 C.F.R. § 541.504(b).

[15] 29 C.F.R. § 541.201(c).

[16] *See* 69 Fed. Reg. at 22,142.

[17] 29 C.F.R. § 541.203(b).

[18] 69 Fed. Reg. at 22,146.

[19] 69 Fed. Reg. at 22,141 (citing *Phase Metrics*, 299 F.3d 1120).

[20] Id.

[21] 2004 U.S. Dist. LEXIS 21841, at **13-14 (D. Or. Aug. 18, 2004).

[22] Id. at *15. See also *Heffelfinger v. Electronic Data Sys. Corp*., 580 F. Supp. 2d 933, 956 (C.D. Cal. 2008) (administrative/production dichotomy "is often of limited use outside of the manufacturing context in which it was devised").

[23] 512 F.3d 865, 870 (7th Cir. 2008).

[24] *Id*.

[25] *Id*. at 872.

[26] 587 F.3d 529 (2d Cir. 2009).

[27] *Davis*, 587 F.3d at 534.

[28] *Id*.