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Are Registered Representatives Subject to the Fair Labor Standards Act?

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Labor and Employment in the Securities Industry: Are Registered Securities Representatives Subject to the Fair Labor Standards Act?

Barry R. Temkin and Robert S. Goodman[*]

Are registered securities representatives entitled to time and a half pay for working overtime? The concept seems foreign to white-collar workers in the financial services industry, most of whom are professionals or paid on the basis of commissions, or both. Yet a spate of recent federal collective actions has roiled the securities industry, challenging traditional assumptions about the applicability of minimum wage and hour laws to what had traditionally been thought of as a white-collar industry. As explained below, recent cases applying the Fair Labor Standards Act may have simultaneously run afoul of the Congressional intent, as well as financial advisors' contractual and regulatory obligations to arbitrate employment disputes with their associated firms.

The Fair Labor Standards Act (FLSA) was enacted in 1938 to ensure minimum wages for U.S. workers.[1] Section 6(a) of the FLSA mandates that "[e]very employer shall pay to each of his employees who is engaged in commerce or in the production of goods for commerce no less than [the federal minimum wage]." Section 7(a) of the Act further requires that "no employer shall . . . employ any of his employees who is engaged in commerce or in the production of goods for commerce for a workweek longer than [the federal maximum hours] unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed." Certain types of employees are exempt from these provisions, and independent contractors are excluded altogether.

Although the original legislative intent was to provide protection for factory, warehouse and construction laborers,[2] some courts have applied the FLSA in recent years to more traditional white-collar

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professions. A number of recent lawsuits have purported to apply the FLSA to financial advisors registered with the Financial Industry Regulatory Authority (FINRA), the self-regulatory organization of the securities industry. As explained in detail below, these claims have met with mixed results, sometimes within the same case, as individual financial advisors have been subject to fact-specific determinations.

Many financial advisors are independent contractors who are compensated on the basis of commissions generated by their independent sales work. Typically financial advisors receive a percentage payout on the gross commissions and fees generated by their customers. In some firms, particularly those which follow the independent contractor model, financial advisors are parties to independent contractor contracts which subject them to binding arbitration. Large national brokerage firms with multiple branches (i.e., the "wire house" model) are more likely to directly designate their registered representatives as employees.[3] Under either model, FINRA rules provide that industry disputes, between registered securities representatives and their firms, are subject to mandatory binding arbitration.[4]

Claims under the Fair Labor Standards Act may be certified as a collective action, a cousin of the familiar class action provided for by Federal Rule of Civil Procedure 23. A collective action under the FLSA provides for an opt-in procedure; a would-be class member must affirmatively file a written consent to join the class. Any prospective collective action member who does not file a written consent is not a member of the class and is not bound by the court proceedings.[5] A traditional class action, on the other hand, features an opt-out procedure: you are automatically in the class and bound by the court's determination unless you affirmatively opt out in writing.

Recent Collective Actions

The financial services industry has been beset by numerous collective action cases brought by financial advisors under the FLSA. For example, a recent collective action filed by former Merrill Lynch registered representatives alleged that the broker-dealer failed to pay overtime wages to a nationwide class of individual brokers.[6] In order to settle nationwide claims of overtime violations, Merrill paid a settlement of $36.8 million, including $9 million in attorneys' fees.[7] Edward Jones & Co. also paid a large settlement on behalf of a national class.[8]

In a recent FLSA collective action against RBC Dain Rauscher, the court undertook a fact specific analysis of ten individual registered representatives on RBC's motion for summary judgment.[9] All ten of the registered representatives received a guaranteed minimum compensation of $455 a week.[10] The court ruled that five were exempt from the FLSA under one of the statutory exemptions for executive,

administrative or professional capacities. The other five plaintiffs may or may not have been exempt, but fact disputes precluded summary judgment. The court undertook a detailed individualized analysis of the job duties of each registered representative to determine if the employee was covered by the FLSA or came within one of the exemptions. Half of the claims were dismissed on a summary judgment motion, while the remainder proceeded toward trial.

The Legislative History

The literal language of the FLSA applies broadly to all employees, and courts interpreting the statute have imposed no limitations on its reach, aside from specific exemptions enumerated in the law. However, the legislative history of the FLSA suggests that it was not originally intended to apply to traditional white-collar, professional jobs, like financial advisor. The original intent of the FLSA was to raise the living standards and improve the working conditions of the working class. The FLSA was passed during the Great Depression in light of the "striking" social contrast "between well-paid skilled labourers and executives and professional workers and *the substandard labourer* paid just a fraction of what his labour is economically worth."[11] The day the original bill was introduced to Congress — May 24, 1937 — President Roosevelt asserted that because one-third of the U.S. population was ill-nourished, ill-clad, and ill-housed, "the time has come to take further action to extend the frontiers of social progress."[12] At least one economist at the time noted that the implications of the FLSA lay in "federal statutory recognition of the fact that the living conditions of those in the lowest income group should not be determined solely by the anonymous forces of the market mechanism."[13] "When enacted in 1938, the FLSA included interlocking definitions that Congress designed to bring within their sweep an incomparably broader spectrum of working people and employment settings than the common law or even many labor-protective statues had ever covered."[14]

The courts have recognized the statutory intent to protect working class factory laborers. "The legislative debates indicate that the prime purpose of the legislation was to aid the unprotected, unorganized and lowest paid of the nation's working population; that is, those employees who lacked sufficient bargaining power to secure for themselves a minimum subsistence wage."[15] Thus, the legislative history of the FLSA supports its application to the working poor. There is little historical data showing that the statute was intended to apply to the commission-based white-collar sales force.

Overtime for Entertaining Clients?

Application of the FLSA to commission-based financial advisors

raises difficult analytical questions. Many financial advisors are independent contractors, who set their own hours and who market their expertise to prospective customers. Even in the case of an employee of a traditional wire house, a substantial part of the financial advisor's time is spent entertaining and soliciting customers. If, for example, a financial advisor takes a prospective customer out to drinks or dinner, is that work? And if so, is it the type of work that the FLSA was intended to compensate? Other activities of financial advisors come to mind as well: participating in golf tournaments, attending Rotary Club or other community events. Many financial advisors derive their customer base from community involvement in activities such as coaching little league or soccer, or from contacts they make attending their local church or synagogue. Does the law require broker-dealers to compensate their registered representatives for the time they spend in such personal activities, on the theory that community activities may ultimately result in paying business? The problems inherent in drawing such lines complicate the applicability of FLSA standards to commission-based sales personnel in the securities industry.

Employees or Independent Contractors

The FLSA covers "employees" and requires that they be paid time and a half for overtime work (over 40 hours per week). The statute indicates that the FLSA only applies to employees, and the Supreme Court has held that the term "employ" excludes independent contractors.[16] The first question in analyzing an FLSA claim is whether the financial advisor is an employee or an independent contractor who would not be covered by the FLSA. In making such determination, the following factors are taken into account in an analysis known as the economic reality test:

- the degree of control the broker-dealer exercises over the financial advisor;
- whether the financial advisor has any opportunity for profit or loss in the broker-dealer's business;
- what is the degree of skill and independent initiative required to perform the work;
- the permanence or duration of the relationship with the broker-dealer;
- whether the work of the financial advisor is an integral part of the broker-dealer's business;
- whether the financial advisors depend on the brokerage for the opportunity to render service or are they in business for themselves.[17]

Under this test, a financial advisor earning income from working for only one broker-dealer is more likely to be determined to be an em-

ployee than an independent contractor.

Exemptions from Overtime Requirements of FLSA

If a financial advisor is determined to be an employee, the next question is whether he or she is exempt from the overtime requirements of the FLSA. There are several exemptions in the statute and regulations, particularly the "administrative employee" exemption and the "highly compensated" exemption, under which a financial advisor may qualify.

In 2006, the United States Department of Labor issued an opinion letter furnishing guidance on whether or not registered representatives in the securities industry are exempt from the overtime pay requirements of the FLSA under the so-called "administrative employee" exemption.[18] This exemption applies to certain highly-compensated employees who exercise substantial discretion in their job duties.

Rather than posit broad categories of exemption from the Act, the Labor Department devised a complicated, fact-specific analysis, depending upon the salary paid to the individual registered representative at issue and the specific duties of each individual broker. For example, the Labor Department formula considers whether the work involves collecting and analyzing information regarding the customer's income, assets, investments or debts, whether an individual employee's work involves determining which financial products best meet the customer's needs and financial circumstances, whether the work involves advising the customer regarding the advantages and disadvantages of different financial products and whether the work involves marketing, servicing or promoting the employer's financial products, all of which support the administrative exemption. On the other hand, if an individual broker merely has a sales-oriented job in response to customer orders or cold-calls customers, this undercuts the administrative exemption.

The compensation structure analyzed by the Labor Department in its 2006 opinion letter assumed that the registered representative would be paid a guaranteed minimum salary or draw of $455 or more a week which the firm would guarantee, without offset, deduction or adjustment. According to the Labor Department, "at no point in the registered representative's employment is he or she asked to repay the guaranteed minimum salary/draw payments if he or she does not earn enough credits in excess commissions or fees above the minimum salary/draw amount. Rather, the registered representative at all times is guaranteed and receives not less than a predetermined amount that equals or exceeds the $455 minimum weekly salary requirement for the administrative exemption."[19] Thus, in order to meet the

administrative exemption to the FLSA, an employer must show that the individual registered representative is guaranteed a minimum salary/draw of $455 a week and satisfies the above-described factors showing that the employee's primary duty is the performance of work directly related to the management or general operations of the employer or the employer's customers. Moreover, the broker-dealer must show that the registered representative's work involves the exercise of discretion and independent judgment with respect to matters of significance.

The analysis under the "highly compensated" exemption, on the other hand, is more straightforward. Under 29 C.F.R. § 541.601(a), an employee with a total annual compensation of at least $100,000 is held exempt under FLSA Section 13(a)(1) if the employee "customarily and regularly performs one or more of the exempt duties of an executive, administrative or professional employee."[20] The high level of compensation eliminates the need for a detailed analysis of job duties, but the regulations do specify that the "highly compensated" exemption is limited to employees whose primary duties include the performance of office or non-manual work.[21] Thus, carpenters, construction workers and longshoremen, etc. would not qualify for the exemption, while a registered securities representative earning at least $100,000 most likely would.[22]

Are FLSA Claims By Registered Securities Representatives Arbitrable?

Although many courts have exercised jurisdiction over FLSA claims in the securities industry, there is substantial authority that FLSA claims against registered broker-dealers are arbitrable. All registered representatives and registered associated persons in the securities industry sign a Form U-4, Uniform Application for Registration in the Securities Industry. These forms, as well as FINRA rules, obligate industry registrants to submit their intra-industry disputes to binding arbitration. Form U-4 expressly calls for the arbitration of all intra-industry disputes, and provides in relevant part as follows:

> I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of [FINRA] as may be amended from time to time and that any arbitration award rendered against me may be entered as a judgment in any court of competent jurisdiction.[23]

Most courts to address the issue have compelled arbitration of FLSA claims by financial advisors.[24] Numerous courts throughout the country have likewise granted motions to compel arbitration of FLSA claims, whether brought individually or as a collective action.

The FINRA staff has taken a contrary view, through a 1999 opinion letter posted on FINRA's website, arguing that collective actions are not arbitrable due to an exclusion in the FINRA rules for class actions.[25] The FINRA interpretive letter simply expresses the opinion of the staff however, and it has not been adopted by the FINRA board. Judicial deference has not been afforded to this view, as no court has applied the 1999 opinion letter to a case involving the arbitrability of a FLSA collective action.[26] Rather, courts have and continue to compel arbitration of collective actions in the face of FINRA's non-binding position. As recently as August 2010, for example, the U.S. District Court for the Southern District of New York granted a motion to compel arbitration of FLSA collective action claims.[27]

Conclusion

As discussed, some courts have applied the overtime and minimum wage requirements of the Fair Labor Standards Act to financial advisors. However, while the statute itself makes no limitations, the application of such rules to commission-only sales professionals appears to be inconsistent with the legislative intent of the FLSA. Moreover, most financial advisors sign pre-dispute arbitration agreements with their employing firm mandating arbitration of employment disputes. Many courts have enforced such agreements by compelling arbitration of securities industry employment disputes.

NOTES:

[1]29 U.S.C.A. § 201 (1938).

[2]This intent is supported by Section 13(a)(1) of the FLSA, which exempts individuals "employed in an executive, administrative or professional capacity." The exemption was included in the original FLSA of 1938.

[3]A wire house has been defined as: "A relatively large, multi-office brokerage firm that uses electronic communications to transmit customer orders for execution." *See* Wall Street Words: An A to Z Guide to Investment Terms, *located at* http://financial-dictionary.thefreedictionary.com/wire+house (last visited Oct. 20, 2010).

[4]*See* FINRA Rule 13200 (a), http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=5283&element_id=4203&highlight=arbitrated#r5283 (last visited Oct. 20, 2010).

[5]29 U.S.C.A. § 216 (b); Vivian M. Barrios, Steven M. Gutierrez and Michael R. MacPhail, Compensation Arrangements, the FLSA and Overtime Pay, In House Defense Quarterly, Spring 2007, at 16.

[6]Burns v. Merrill Lynch Pierce Fenner and Smith, No. 04-4135 (N.D. Cal. Feb. 17, 2006).

[7]Barrios, Gutierrez and MacPhail, *supra* note 5, at 19.

[8]Barrios, Gutierrez and MacPhail, *supra* note 5, at 19.

[9]*See In Re RBC Dain Rauscher Overtime Litigation*, 703 F.Supp.2d 910 (D.Minn. 2010).

[10]703 F.Supp.2d 910, 925 (D. Minn. 2010).

[11]John W. Tait, *The Fair Labor Standards Act of 1938*, 6 U. TORONTO L.J. 192, 192 (1945).

[12]John W. Tait, *The Fair Labor Standards Act of 1938*, 6 U. TORONTO L.J. 192, 197 (1945) (quoting WAGE AND HOUR MANUAL 747 (BNA 1941)).

[13]Otto Nathan, *Favorable Economic Implications of the Fair Labor Standards Act*, 6 LAW AND CONTEMPORARY PROBLEMS 419, 419 (1939).

[14]Bruce Goldstein et al., *Enforcing Fair Labor Standards in the Modern American Sweatshop: Rediscovering the Statutory Definition of Employment*, 46 UCLA L. Rev. 983, 1004 (1999). The FLSA has a dual purpose. Not only is it meant to help substandard conditions of low-income workers, but it is also designed to address unfair competition among employers. The original bill defined "employee" broadly in order to preclude circumvention of the bill through the use of legal devices like the independent contractor.

[15]*Brooklyn Sav. Bank v. O'Neil*, 324 U.S. 697, 707 n.18, 65 S. Ct. 895, 89 L. Ed. 1296 (1945) (citing 81 Cong. Rec. 7652, 7672, 7885; 82 Cong. Rec. 1386, 1395, 1491, 1505, 1507; 83 Cong. Rec. 7283, 7298, 9260, 9265 (1937–38); *see also* H. Rep. No. 75-1452, at 9 (1937); S. Rep. No. 75-884, at 3 to 4 (1937).

[16]Section 3(e) of the FLSA defines employee as "any individual employed by an employer." The Supreme Court has interpreted the term "employ" as broad, but "not so broad so as to include individuals who, without any express or implied compensation agreement, might work for their own advantage on the premises of another." *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728-729, 67 S. Ct. 1473, 91 L. Ed. 1772 (1947).

[17]*Zheng v. Liberty Apparel Co. Inc.*, 355 F.3d 61, 67, 9 Wage & Hour Cas. 2d (BNA) 336, 149 Lab. Cas. (CCH) ¶ 34799 (2d Cir. 2003); *Brock v. Superior Care, Inc.*, 840 F.2d 1054, 1058–59, 28 Wage & Hour Cas. (BNA) 801, 28 Wage & Hour Cas. (BNA) 940, 28 Wage & Hour Cas. (BNA) 1016, 108 Lab. Cas. (CCH) ¶ 35029, 108 Lab. Cas. (CCH) ¶ 35053 (2d Cir. 1988) ("the ultimate concern is whether, as a matter of economic reality, the workers depend upon someone else's business for the opportunity to render service or are in business for themselves").

[18]U.S. Dept. of Labor, Wage and Hour Division, FLSA 2006-43 (Nov. 27, 2006), http://www.dol.gov/whd/opinion/FLSA/2006/2006_11_27_43_FLSA.pdf.

[19]U.S. Dept. of Labor, Wage and Hour Division, FLSA 2006-43 (Nov. 27, 2006), http://www.dol.gov/whd/opinion/FLSA/2006/2006_11_27_43_FLSA.pdf at 7.

[20]See 29 C.F.R. § 541.601(a). The duties of executive, administrative and professional employees are identified in subparts B, C & D of 29 C.F.R. § 541.

[21]*See* 29 C.F.R. § 541.601(c).

[22]*See* at 29 C.F.R. § 541.601(d).

[23]Form U-4, http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf (last visited Oct. 20, 2010).

[24]*See e.g., Kozma v. Hunter Scott Financial L.L.C.*, 2010 WL 724498 (S.D. Fla. Feb. 25, 2010) (FLSA claim dismissed by the Court and sent to FINRA for arbitration); *Carter v. Countrywide Credit Industries, Inc.*, 362 F.3d 294, 297–98, 9 Wage & Hour Cas. 2d (BNA) 705 (5th Cir. 2004) (FLSA claims are arbitrable); *Bailey v.*

Ameriquest Mortg. Co., 346 F.3d 821, 822–23, 9 Wage & Hour Cas. 2d (BNA) 11, 149 Lab. Cas. (CCH) ¶ 34782 (8th Cir. 2003) (reversing district court decision declining to compel FLSA claims to arbitration under FAA); *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 506, 8 Wage & Hour Cas. 2d (BNA) 7, 146 Lab. Cas. (CCH) ¶ 34589 (4th Cir. 2002); *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456, 1458, 4 Wage & Hour Cas. 2d (BNA) 385, 134 Lab. Cas. (CCH) ¶ 33638 (11th Cir. 1997) (proper to compel an FLSA claim to arbitration); *Kuehner v. Dickinson & Co.*, 84 F.3d 316, 320–21, 3 Wage & Hour Cas. 2d (BNA) 481, 3 Wage & Hour Cas. 2d (BNA) 672, 132 Lab. Cas. (CCH) ¶ 33406 (9th Cir. 1996) (compelling registered representative who signed Form U-4 to arbitrate FLSA claims); *McFadden v. Clarkeson Research Group, Inc.*, 2010 WL 2076001 (E.D.N.Y. May 18, 2010) (compelling registered representative who signed Forum U-4 to arbitrate FLSA claims); *Chapman v. Lehman Bros., Inc.*, 279 F. Supp. 2d 1286, 1290, 8 Wage & Hour Cas. 2d (BNA) 1836 (S.D. Fla. 2003) (dismissing plaintiffs' collective FLSA claims because they were obligated to arbitrate them as they had signed U-4 forms); *Wilks v. Pep Boys*, 241 F. Supp. 2d 860, 867, 8 Wage & Hour Cas. 2d (BNA) 900 (M.D. Tenn. 2003) (compelling plaintiffs to arbitrate FLSA claims); *Bolamos v. Globe Airport Sec. Servs., Inc.*, 2002 WL 1839210 (S.D. Fla. May 21 2002) (staying court proceedings pending arbitration of FLSA claims); *Giordano v. Pep Boys—Manny, Moe & Jack, Inc.*, 2001 WL 484360 (E.D. Pa. Mar. 29, 2001) (compelling arbitration of FLSA claims).

[25]Jean I. Feeney, Interpretive Letter to Cliff Palefsky, Esq., FINRA (Sept. 21, 1999), http://www.finra.org/Industry/Regulation/Guidance/InterpretiveLetters/P002521. The letter was written by Jean I. Feeney as Assistant General Counsel to the National Association of Securities Dealers, Inc. ("NASD") (now FINRA).

[26]*See* Report and Recommendation and Order Adopting Magistrate's Report and Recommendation in Nieto, et. al. v. Goldman Sachs & Co., O.K., No. 04 Civ. 21824 (S.D. Fla. Jan. 28, 2005), expressly rejected the 1999 opinion letter's application to a case involving the arbitrability of a FLSA collective action.

[27]Gomez v. Brill Securities, Inc., 10 Civ. 3503 (S.D.N.Y. August 13, 2010).