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Court Upholds Labor Department Interpretation That Mortgage Loan Officers Are Not Exempt From Overtime

By Thomas H. Petrides, John L. Longstreth

A federal district judge in Washington, D.C. has upheld an “Administrator’s Interpretation” issued in 2010 by the U.S. Department of Labor (“DOL”) that loan officers in the mortgage banking industry typically do not qualify as exempt employees under the administrative exemption of the federal Fair Labor Standards Act (“FLSA”). The Mortgage Bankers Association (“MBA”) had challenged the March 24, 2010 Administrator’s Interpretation (“Interpretation”) issued by the Acting Administrator of DOL’s Wage and Hour Division because the Interpretation had reversed and rescinded a contrary DOL Opinion Letter issued in 2006 that had concluded mortgage loan officers were generally exempt under the administrative exemption. However, Judge Reggie B. Walton ruled on June 6, 2012 that the 2010 Interpretation was not inconsistent with the FLSA regulations and was not arbitrary, capricious, or otherwise unlawful.¹ The court thus let stand the DOL’s Interpretation that employees performing the typical duties of a mortgage loan officer do not qualify for the administrative exemption and are therefore entitled to receive minimum wages and overtime compensation under the protections of the FLSA.² The MBA has the right to appeal this decision to the D.C. Circuit.

Procedural History and Background

The 2004 Amendments to the FLSA Regulations

The FLSA generally requires that covered employers must pay minimum wages to their employees as well as overtime compensation to employees who work more than 40 hours per week.³ However, the FLSA exempts “any employee employed in a bona fide executive, administrative, or professional capacity[,] ... or in the capacity of outside salesman ...” and authorizes DOL to define and delimit these terms by regulation.⁴ In August 2004, the DOL issued revised regulations stating that the administrative exemption applies to an employee:

- (1) Compensated on a salary or fee basis at a rate of not less than \$455 per week . . . ;
- (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.⁵

The 2004 regulations included an example illustrating application of the exemption to the financial services industry:

Employees in the financial services industry generally meet the requirements for the administrative exemption if their duties include work such as collecting and analyzing information regarding the customer’s income, assets, investments or debts; determining which

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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. However, an employee whose primary duty is selling financial products does not qualify for the administrative exemption.⁶

A preamble to the 2004 regulations also stated that "many financial services employees qualify as exempt administrative employees, even if they are involved in some selling to consumers."⁷

The 2006 DOL Opinion Letter

For more than 30 years, the DOL announced its FLSA interpretations by issuing written "Opinion Letters" in response to inquiries from private parties seeking guidance. A September 2006 opinion letter, issued at the MBA's request, addressed application of the administrative exemption to loan officers in the mortgage banking industry (the "2006 Opinion Letter").⁸ The request had set forth various duties typically performed by loan officers, and asked DOL to assume that these officers spent less than fifty percent of their working time on "customer-specific persuasive sales activity."⁹ Applying the three components of the administrative exemption set forth in the 2004 regulations, the 2006 Opinion Letter noted that, although employees whose primary duty involves sales cannot qualify for the administrative exemption, many financial services employees could, and had been found to, fall under the exemption. Accordingly, the DOL concluded that the loan officers described in the MBA's request "ha[d] a primary duty other than sales, as their work include[d] collecting and analyzing a customer's financial information, advising the customer about the risks and benefits of various mortgage loan alternatives in light of their individual financial circumstances, and advising the customer about avenues to obtain a more advantageous loan program."¹⁰ These loan officers, if paid on a "salary basis," therefore qualified for the administrative exemption.

The 2006 Opinion Letter further concluded that "[b]ecause the criteria in the duties test for the administrative exemption in the 2004 revised final regulations are substantially the same as under the prior rule, the outcome of this opinion would be essentially identical under either version of the regulations."¹¹

The 2010 Administrator's Interpretation

On March 24, 2010, the DOL announced in a sweeping change that it would no longer issue Opinion Letters based on specific requested facts, but instead will periodically issue "Administrator's Interpretations" setting forth a general interpretation of the law, applicable across-the-board to all those affected by the provision at issue, to provide guidance as it relates to an entire industry or category of employees. That same day, DOL issued its first "Administrator's Interpretation" expressly withdrawing the 2006 Opinion Letter and instead concluding that employees who perform the typical job duties of a mortgage loan officer do not qualify for the "administrative employee" exemption.¹²

The 2010 Interpretation determined that a loan officer's primary duty is not "administrative" work "directly related to the management or general business operations of the employer" under the test set forth in the 2004 regulations, and instead concluded that "a mortgage loan officer's primary duty is making sales."¹³ The Interpretation also concluded that because individual homeowners do not have management or general business operations, "work for an employer's customers does not qualify for the administrative exemption where the customers are individuals seeking advice for their personal needs, such as people seeking mortgages for their homes."¹⁴

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Prior to issuing the 2010 Interpretation, the DOL did not use the “notice and comment” process generally required by the Administrative Procedure Act (“APA”)¹⁵ when a federal administrative agency issues or amends a regulation.

The District Court Proceedings

In January 2011, the MBA sought judicial review of the 2010 Administrator’s Interpretation in the United States District Court for the District of Columbia, asserting that the DOL violated the APA because the Interpretation conflicts with a prior position taken by the DOL, and was issued without providing prior notice of the change and an opportunity to comment on it. MBA also contended the Interpretation was arbitrary, capricious, and inconsistent with the regulation. MBA asked that the Interpretation be vacated and DOL enjoined from enforcing it.

The District Court, however, upheld the Interpretation. Judge Walton recognized the general rule that if an agency’s interpretation of a statute or rule “itself carries the force and effect of law” as an “authoritative departmental interpretation” then it cannot be changed without notice and comment. However, he also recognized an exception to that rule if the challenging party did not “substantially and justifiably” rely upon a “well-established agency interpretation.” Judge Walton found this exception applicable here because DOL’s prior interpretation was only in effect for a period of four years, from 2006 to 2010, and he concluded that MBA’s members had not substantially and justifiably relied on it to their detriment.¹⁶ He also noted that under the Portal to Portal Act employers would not be liable for any damages resulting from their good faith reliance on the 2006 Opinion Letter, thus further establishing DOL’s ability to reverse that interpretation without prior notice and comment.

The District Court spent very little time discussing the MBA’s claim that the 2010 Interpretation was arbitrary and capricious, noting that this is a “narrow” standard of review that does not allow a court to “substitute its judgment for that of the agency.” The court held that the financial services illustration in the 2004 regulation on which MBA relied was “intended to provide examples, not an alternative test for the applicability of the administrative exception,” and that even under that illustration the exemption was not available if a loan officer’s “primary duty is selling financial products,” as the 2010 Interpretation had found.

Likely Issues on Appeal

The immediate implication of the decision is that the 2010 Interpretation will remain in place unless and until it is vacated by an appellate court. MBA may appeal as of right to the D.C. Circuit, and an appeal will raise substantial issues. The D.C. Circuit tends to be uncomfortable with agency actions that upset settled expectations, as its rule requiring notice and comment for changes in authoritative agency interpretations reflects.

The appeal may also raise issues regarding whether the procedural rule on which MBA has primarily relied, requiring notice and comment when an authoritative interpretation is altered, is itself inconsistent with precedent of the U.S. Supreme Court. For example, the government argued in the district court that the recent decision in *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502 (2009), precludes courts from distinguishing for these purposes between initial agency action and subsequent agency action undoing or revising that action. Longstanding precedent also holds that courts cannot add to the APA’s required rulemaking procedures.¹⁷ Judge Walton was bound by Circuit precedent and did not address this issue, but should the Court of Appeals adopt the government’s argument a significant avenue for challenging agency changes in position may be foreclosed. The appeal may

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also address the often difficult distinction between legislative rules, which generally require notice and comment to adopt or revise, and interpretive rules, which generally do not.

Finally, whatever the ultimate result of the MBA's challenge to the 2010 Interpretation, a key issue is highlighted by Judge Walton's observation that employers who reasonably relied on the 2006 Opinion Letter may not be liable for any resulting damages for failure to pay overtime during the relevant time period between 2006-10. Judge Walton did not consider it necessary to rule on the issue definitively, but certainly suggested strongly that employers have a legitimate defense to claims for overtime pay for the period in which they acted in compliance with the 2006 Opinion Letter.

Conclusion

While the District Court's decision is unfavorable to employers seeking to use the administrative exemption to classify loan officers, ultimate resolution of the validity of the 2010 Administrator's Interpretation will likely be in the Court of Appeals. The decision also does not address or directly determine whether a loan officer may in fact qualify for the administrative exemption under the FLSA based on the particular duties of that loan officer, since the interpretation is based on generalized assumed facts and not the circumstances of any individual case. The deference due the 2010 Interpretation in individual cases in which overtime payments are at issue also remains uncertain at best, given the DOL's decision not to use notice and comment procedures in adopting it and its designation of the rule as merely interpretive. *See, e.g., Christopher v. SmithKline Beecham Corp.*, No. 11-204, slip op. at 10-12 (U.S. June 18, 2012)(giving no deference to DOL's interpretation of the FLSA's outside sales exemption as advanced in an adjudicatory context, because the interpretation would impose "potentially massive liability on respondent for conduct that occurred well before that interpretation was announced;" agency must give "fair warning" and protect against "unfair surprise"). Of course, any individual employer considering reclassification of its loan officers in response to the decision should seek advice of counsel as to the particular circumstances and the proper methods for doing so.

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¹ *Mortgage Bankers Ass'n v. Solis*, No. 11-cv-73 (D.D.C. June 6, 2012).

² This court decision, however, does not address whether loan officers may qualify as exempt under the “highly compensated” or “outside sales” exemptions.

³ 29 U.S.C. §§ 206(a)(1) and 207(a)(1).

⁴ 29 U.S.C. § 213(a)(1). Other exemptions, such as the “highly compensated” exemption and retail commission sales exemption are also available.

⁵ *Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees*, 69 Fed. Reg. 22122-191 (Apr. 23, 2004) (codified at 29 C.F.R. § 541; 29 C.F.R. § 541.200(a)).

⁶ 29 C.F.R. § 541.203(b) (entitled “Administrative exemption examples”).

⁷ 69 Fed. Reg. at 22146.

⁸ Wage and Hour Opinion Letter FLSA2006-31 (September 8, 2006) (subsequently withdrawn pursuant to U.S. Department of Labor, Administrator’s Interpretation No. 2010-01 dated March 24, 2010).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.* The 2006 Opinion Letter also concluded that “the use of software programs or tools to assess risk and to narrow the scope of products available to the customer does not necessarily disqualify the employees from the administrative exemption for lack of discretion and independent judgment.”

¹² U.S. Department of Labor, Administrator’s Interpretation No. 2010-01 dated March 24, 2010. *See K&L Gates Labor & Employment Alert* dated March 31, 2010.

¹³ *Id.* In reaching this conclusion, the Interpretation relied on the fact that a significant portion of the loan officers’ compensation is composed of commissions from sales, that their job performance is evaluated based on sales volume, and that much of the non-sales work performed by the officers is completed in furtherance of their sales duties.

¹⁴ *Id.*

¹⁵ *See* 5 U.S.C. § 553 (2006).

¹⁶ Judge Walton also believed that the DOL had previously taken the position that loan officers were not exempt based on a 1999 opinion letter. However, the May 16, 1999 opinion letter cited in the decision (1999 WL 1002401 (DOL WAGE-HOUR)), determining that “loan officers are engaged in carrying out the employer’s day-to-day activities rather than in determining the overall course and policies of the business,” was issued to one particular mortgage brokerage company by a DOL staff member (rather than the Administrator) and was itself replaced on reconsideration by a February 17, 2001 opinion letter (2001 WL 1558764 (DOL WAGE-HOUR)) stating that “the primary duty of the loan officer consists of the performance of office or nonmanual work directly related to the management policies or general business operations of the employer or the employer’s customers.” The 2001 letter was subsequently withdrawn by the 2010 Interpretation.

¹⁷ *See Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524 (1978) (holding that “generally speaking” the APA’s notice and comment requirements “established the maximum procedural requirements which Congress was willing to have the courts impose upon agencies in conducting rulemaking procedures”).

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