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Memorandum

TO: ADAI/IATA

FROM: Jeff Halbert

DATE: June 21, 2016

RE: No Deference for DOL Overtime Rule for Service Advisors

U.S. Supreme Determines DOL Service Advisor Rule Not Entitled to Deference

By: Jeffrey B. Halbert

On June 20, 2016, the U.S. Supreme Court issued its opinion in *Encino Motorcars v. Navarro*, vacating a March 2015 Ninth Circuit Court of Appeals decision which determined that service advisors are not considered "salesman" for purposes of an exemption from overtime under the Fair Labor Standards Act. The Supreme Court's opinion expressly rejected interpretative regulations issued by the U.S. Department of Labor in 2011, which overturned years of precedential authority recognizing the exempt status of service advisors.

The Fair Labor Standards Act (FLSA) requires employers to pay overtime to covered employees who work in excess of forty (40) hours per week. For more than fifty (50) years the FLSA has contained an exemption from the overtime compensation requirement for "any salesman, partsman, or mechanic primarily engaged in selling or servicing automobiles" at a covered dealership. *See* 29 U.S.C. §213(b)(10)(A).[1] The DOL was authorized by Congress to promulgate necessary rules, regulations, or orders with respect to this provision. In 1970, the DOL issued a regulation that defined "salesman" to mean " an employee who is employed for the purpose of and is primarily engaged in making sales or obtaining orders or contracts for sale of the vehicles…which the establishment is primarily engaged in selling." 29 C.F.R. §779.372(c)(1). The regulation excluded service advisors, who sell repair and maintenance services, but not vehicles, from the exemption. However, several courts rejected the DOL's conclusion that service advisors are not covered by the exemption. In 1978, the DOL issued an opinion letter departing from its previous position and stated that service advisors could be exempt. Subsequently, in 1987, the DOL confirmed its new interpretation by amending its Field

[1] **29 C.F.R. §779.372(c)(1), 779.372(d)**: employee qualifies under the salesman exemption if: (i) employee is employed by nonmanufacturing establishment primarily engaged the sale of vehicles to ultimate purchasers and (ii) spends over 50% of his/her time engaged in making sales or obtaining orders or contracts for sales of vehicles.

Operations Handbook to clarify that service advisors should be treated as exempt under the FLSA. In 2011, however, the DOL issued a final rule that reverted back to the original 1970 regulation and interpreted that the statutory term "salesman" included only those who sell vehicles. In doing so, the DOL provided little, if any, explanation for its decision to abandon its decades-old practice of treating service advisors as exempt.

The *Navarro* case involved several individuals employed as service advisors who filed suit in U.S. District Court in California alleging that the dealership had failed to pay them overtime compensation for work in excess of forty (40) hours in a week. The dealership moved to dismiss the case based on the salesman exemption. The District Court granted the motion, but the decision was overturned on appeal to the Ninth Circuit Court of Appeals in March 2015. On appeal, the Court deferred to the DOL's 2011 regulation and held that service advisors were not covered by the exemption, while at the same time recognizing that the decision would conflict with other circuit courts of appeal decisions recognizing the exemption. Specifically, the Court's decision was based on its conclusion that the preamble language found in the 2011 regulation constituted an interpretation of the FLSA entitled to legal deference. The dealership sought review by the U.S. Supreme Court in October 2015 asking the Court to overturn the 9th circuit holding and resolve the apparent split of opinion among the various circuit courts of appeal to decide the issue. The petition was granted January 15, 2016 and oral arguments were conducted on April 20, 2016.

In a 6-2 decision, the Supreme Court determined that the FLSA exemption must be construed without placing any controlling weight on the DOL's 2011 regulation. Importantly, it faulted the DOL for failing to give sufficient consideration to dealerships' reliance interests during the rulemaking process, and for failing to provide a "reasoned explanation" for the abrupt change of policy as to the exempt status of service advisors.

> "The industry had relied since 1978 on the Department's position that service advisors are exempt from the FLSA's overtime pay requirements, and had negotiated and structured compensation plans against this background understanding. In light of this background, the Department needed a more reasoned explanation for its decision to depart from its existing enforcement policy. Instead the Department said almost nothing. It did not analyze or explain why the statute should be interpreted to exempt dealership employees who sell vehicles but not dealership employees who sell services. This lack of reasoned

> explication for a regulation that is inconsistent with the Department's longstanding earlier position results in a rule that cannot carry the force of law, and so the regulation does not receive *Chevron* deference.

The decision effectively requires the Ninth Circuit to reconsider its prior decision consistent with the language of the FLSA without reliance on the DOL's 2011 regulation.

Although the result is arguably favorable to dealers, a thorough review of the decision leaves more questions than answers. The majority opinion was primarily focused on the DOL's failure to provide a reasoned explanation for the change in position after decades of reliance by dealers. However, the Court did not determine definitively that service advisors are exempt under the applicable statutory provision. In fact, it simply sent the case back to the Ninth Circuit to reconsider its decision in light of the statutory text. In his dissent, Justice Clarence Thomas, joined by Justice Alito, agreed that the Court should not afford deference to the 2011 regulation, but he would have gone ahead to interpret the statute, stating "we have an obligation to decide the merits of the question presented." On this basis, Justice Thomas agreed that overtime was not warranted and would have reversed the Ninth Circuit decision.

Unfortunately, dealers are no closer to resolution of this issue. The Court's ruling is limited in that it acknowledged that the DOL is "entitled to change its mind, so long as it explains itself." Once the case is returned to the Ninth Circuit, it is very likely that the Court could still decide that the FLSA does, in fact, require payment of overtime to service advisors. Alternatively, the DOL could just as easily issue a new regulation with a more detailed explanation as to its rationale that would resolve the issue and likely be accorded deference if challenged.

With the foregoing in mind, at least for the foreseeable future, the exempt status of service advisors is secure. However, dealers will need to continue to monitor this decision, as well as any additional announcements from the DOL as to the exempt status of service advisors.

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