A Timely Analysis of Legal Developments

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California Supreme Court Applies Administrative Exemption to Claims Adjusters

By Alison Hightower

In the waning days of 2011, a unanimous California Supreme Court gave California employers a holiday present in its long-awaited opinion that diminishes the importance of the outmoded analytical tool known as "the administrative/production worker dichotomy" for determining whether employees are properly classified as exempt "administrative" employees for the purposes of wage and hour law. In its decision in *Harris v. Superior Court* (*Liberty Mutual*), the court re-establishes the necessity of analyzing all aspects of the administrative exemption and emphasizes the relevance of federal law in interpreting the exemption. As a result, the decision could help California employers relying upon the administrative exemption.

At issue in *Harris v. Superior Court* was the exempt status of a certified class of Liberty Mutual insurance claims adjusters, who the lower appellate court found were not exempt as a matter of law under the administrative exemption. If employees fall within the "administrative exemption" under California law, they are exempt from California laws requiring payment of overtime, minimum wage, and from meal/rest break obligations.[1]

As explained by the California Supreme Court, the administrative exemption applies to employees who: (1) are paid at least twice the minimum wage; (2) perform administrative work, defined as office or non-manual work "directly related to management policies or general business operations of his/her employer or his/her employer's customers;" (3) have primary duties that involve that administrative work; and (4) discharge those primary duties by "customarily and regularly exercising discretion and independent judgment."[2] Wage Order 4-2001 directs that whether work is considered exempt "shall be construed in the same manner as such terms are construed in [certain] regulations under the Fair Labor Standards Act . . . ." Since Wage Order 4-2001 incorporates certain federal regulations, at issue was whether those regulations affected the interpretation of California's exemption.

The "Administrative/Production Worker Dichotomy:" Dispositive Or Outmoded Analytical Tool?

The scope of California's administrative exemption has been one of the most hotly-contested and litigated of California's overtime exemptions, particularly since the exemption is not defined identically to the federal administrative exemption. Employers were hoping that this decision

would provide more clarity on California's exemption, particularly regarding whether the "administrative/production worker dichotomy" analytical tool should be used, and, if so, how.

In *Harris*, the appellate court used the "administrative/production worker dichotomy" and did not consider whether the claims adjusters met any other aspect of the administrative exemption—particularly whether they spent more than half their time performing exempt tasks. The appellate court concluded that the claims adjusters were mere "production" workers because their obligation was to investigate, adjust and settle claims—arguably the mere "production work" of an insurance company.

The California Supreme Court Reversed the Employees' Victory, Distinguishing the "Administrative/Production Worker Dichotomy"

The California Supreme Court rejected this analysis, sending the case back to the lower court for further proceedings, including a possible trial and a re-examination of whether the class was properly certified. In so doing, the court's analysis and its rulings could help employers in subsequent litigation regarding the scope of the administrative exemption.

First, the court diminished the importance of the "administrative/production worker dichotomy" analytical tool that the plaintiff class advocated and the lower court adopted. The appellate court below had, in the words of the California Supreme Court, "felt bound" by the *Bell* cases—two appellate decisions interpreting the administrative exemption with respect to insurance claims adjusters employed by Farmers Insurance Exchange.[3] These *Bell v. Farmers Insurance Exchange* opinions were the linchpin to the plaintiffs' analysis because the "production dichotomy" rendered irrelevant how much discretion and judgment the claims adjusters utilized. All that mattered in those cases was whether the adjusters were deemed to have the "primary duty" of "producing the . . . goods or services that the enterprise exists to produce and market."[4] Using the administrative/production worker dichotomy as an analytical tool to determine whether the employees served in an administrative capacity, the *Bell II* court found that the insurance adjusters' work was not administrative.

At oral argument, Justice Chin asked counsel for Liberty Mutual whether the *Bell* opinion could be distinguished or had to be overruled. Appellate courts generally shy away from overruling opinions if possible, and Liberty's counsel responded that Farmers' insurance adjusters in the *Bell II* decision were readily distinguishable from Liberty's adjusters because their duties were different. In *Bell*, Farmers had conceded that its adjusters performed "routine and unimportant" work given their rather low settlement authority, and Liberty made no such concession. The court agreed that Liberty offered substantial evidence that its adjusters' work was neither routine nor unimportant. The majority below erred in ignoring this evidence and relying on *Bell*, the court held.

Important Rulings that Clarify the Test for Determining the Administrative Exemption

More importantly for other California employers, the court emphasized that the *Bell II* decision was interpreting an out-dated Wage Order from 1998,[5] which failed to provide a sufficient explanation of the extent of the administrative exemption. The California Supreme Court noted that the 2001 Wage Order,[6] along with the incorporated federal regulations, "set out detailed guidance." The appellate court thus erred when it relied on this "distinguishable authority" and "create[d] a rigid rule" without considering the appropriate federal regulations, and by failing to recognize that "the [administrative/production worker] dichotomy is a judicially created creature of the common law which has been effectively superseded in this context by the more specific and detailed statutory and regulatory enactments."[7]

Further, the court clarified that under the relevant federal regulations incorporated into the Wage Order, whether an employee's work is "directly related to management policies or general business operations" depends, in part, on "whether it involves advising management, planning, negotiating, and representing the company." The court admonished the lower appellate court for taking too narrow an approach in its interpretation of this prong of the administrative exemption. In other words, an employee's work ***may*** be directly related to management policies or general business operations even if it is not performed at the corporate policy level. By so noting, the court agreed with employers that the administrative exemption is not necessarily limited in its application to those residing in the corporate suite, or other high level management. This is probably the most important holding of the court's opinion since it makes clear that the administrative exemption can apply to a large number of employees within an organization.

The court also emphasized the difficulty in relying on the particular role of employees in one business to deduce a rule applicable to another

kind of business. The plaintiffs argued that claims adjusters' exempt status was indistinguishable from that of probation officers who were deemed non-exempt employees by the Ninth Circuit.[8] The California Supreme Court held, however, that the plaintiffs could not rely on this decision because claims adjusters' duties were different from probation officers. This judicial observation is a mixed blessing, since it suggests that employers cannot reliably extrapolate from decisions involving one job classification to another, decreasing employers' certainty in their classification decisions for myriad job classifications that have not been scrutinized by any court.

The Future of the Production Dichotomy

Most critically, the court did not eliminate the "administrative/production worker dichotomy" from ever being considered in the administrative exemption analysis. The court instead stated that its ruling was limited to how that dichotomy applied to the insurance adjusters in *Harris*.

Nevertheless, the court admonished that only if the relevant statutes and Wage Orders fail to give adequate guidance should a court "reach out to other sources," such as the "administrative/production worker dichotomy," to determine if particular employees are properly classified as exempt. The court also suggested that this exemption analysis should not include a "strained attempt to fit the operations of modern-day post-industrial service- oriented businesses into the analytical framework formulated in the industrial climate of the late 1940s."

This latter remark certainly implies that the court will scrutinize application of the production dichotomy to many modern service-oriented jobs, and that comment may dissuade lower courts from relying on the dichotomy as a dispositive test for applying the exemption to many job classifications. At a minimum, the court's emphasis on the dichotomy as a tool of last resort may help employers at least avoid losing similar classification cases on summary judgment.

Class Certification Issues Await Another Day

The plaintiffs had succeeded in certifying a class of all "non-management California employees classified as exempt by Liberty Mutual and Golden Eagle who were employed as claims handlers and/or performed claims-handling activities." On Liberty's motion to decertify, the trial court decertified the class for claims arising after October 1, 2000—the effective date of a new Wage Order 4—but left the class certified as to those employed at an earlier time. Both sides were unhappy, and on appeal the appellate court ordered the trial court to deny Liberty's motion to decertify in its entirety. Liberty then asked the California Supreme Court to decertify that class on the basis that the certification was premised upon the assumption that the administrative/production worker dichotomy was dispositive. The court unfortunately declined to rule on this issue, noting that the parties were free to raise that issue on remand.

Consequently, whether Liberty will now be able to decertify the class will be determined by the lower court, which will have to adjudicate the exemption issue anew based on the correct analysis required by the California Supreme Court. Liberty presumably will contend that variations among the duties performed by different claims adjusters create individualized issues that predominate over common issues. We will have to wait for further proceedings and decisions on this issue from the lower courts, including a possible trial and appeals.

Conclusion

While the "administrative/production worker dichotomy" is not dead, its importance appears significantly reduced given the California Supreme Court's unanimous criticism of the dichotomy and its application to a modern economy. The court did not, however, provide much guidance for how to interpret the administrative exemption with respect to other job classifications, electing instead to provide a narrow opinion that pushes off to another day further clarification of that exemption and its application to specific jobs. This is not surprising, given that Liberty Mutual advocated distinguishing rather than overruling *Bell* outright. The court did stress the applicability of federal law, particularly the federal regulations expressly incorporated into the Wage Orders,[9] as well as federal decisions,[10] and thus employers may find guidance in those regulations and the more plentiful federal cases interpreting them.

Nevertheless, since this new decision is limited to one type of employee working for one employer under one set of circumstances, California employers cannot conclude that the administrative exemption applies to other employees working in different jobs with other sets of duties and responsibilities. Indeed, the court made this abundantly clear when it cautioned against extrapolating from probation officers to claims adjusters. Employers thus should review the particular circumstances of their employees classified as exempt under the administrative

exemption to determine if they are properly classified, since litigation in this area is not likely to disappear. But employers can breathe a little bit easier in 2012 knowing that the California Supreme Court unanimously discredited the "administrative/production worker dichotomy" and the rigid, out-dated approach used by the appellate court in *Harris* to resolve a classification dispute. Time, and future opinions, will tell how this court will interpret that exemption as to other job classifications and to other class actions.

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[1] The applicability of California's meal period provisions to exempt employees is uncertain. The meal period statute, California Labor Code section 512, does not expressly exclude exempt employees from coverage, although the Wage Orders do. In published decisions, at least two state appellate courts in California's Second Appellate District concluded that when Wage Order meal period provisions conflict with section 512, the former is invalid. *See Bearden v. U.S. Borax, Inc.*, 138 Cal. App. 4th 429 (2006), and *Lazarin v. Superior Court* (*Total Western, Inc.*), 188 Cal. App. 4th 1560 (2010), *review denied*, 2011 Cal. LEXIS 590 (Jan. 19, 2011). In California, all published Courts of Appeal decisions are binding on trial courts. *Auto Equity Sales v. Superior Court*, 57 Cal. 2d 450 (1962). Additionally, the California Division of Labor Standards Enforcement stated that because section 512 "does not exclude any class of employee . . . it would appear that exempt employees are also entitled to meal periods in accordance with that section." California Division of Labor Standards Enforcement, *The 2002 Update of the DLSE Enforcement Policies and Interpretations Manual* (rev. Dec. 2008).

[2] Cal. Lab. Code § 515(a); Wage Order 4-2001.

[3] *Bell v. Farmers Ins. Exchange*, 87 Cal. App. 4th 805 (2001) (Bell II) and *Bell v. Farmers Ins. Exchange*, 115 Cal. App. 4th 715 (2004) (Bell III).

[4] *Bell II*, 87 Cal. App. 4th at 821.

[5] Wage Order 4-1998.

[6] Wage Order 4-2001.

[7] *Harris v. Superior Court*, No. S156555, slip op. at 18 (Dec. 29, 2011).

[8] *Bratt v. County of Los Angeles*, 912 F.2d 1066 (9th Cir. 1990); *Harris v. Superior Court*, slip op. at 19-20.

[9] 29 C.F.R. §§ 541.201-205, 541.207-208, 541.210 and 541.25; Wage Order 4-2001(1)(A)(2)(f); *Harris v. Superior Court*, slip op. at 8.

[10] See the federal decisions listed in *Harris v. Superior Court*, slip op. at 20 n. 8.