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California eAuthority

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State High Court Clarifies Administrative Employee Exemption

On December 29, 2011, the California Supreme Court issued its long-awaited decision in a case involving the application of the “administrative/production dichotomy” in determining if an employee meets the requirements for the administrative employee exemption from overtime under the California Wage Orders. In a very limited unanimous opinion, the state’s high court reversed and remanded a lower court ruling that held that certain insurance company claims adjusters are not exempt employees and thus, were entitled to overtime compensation under the California Labor Code and regulations of the California Industrial Welfare Commission (IWC). *Harris v. The Superior Court of Los Angeles County*, No. S156555, Supreme Court of California (December 29, 2011).

Factual Background

A group of claims adjusters employed by Liberty Mutual Insurance Company and Golden Eagle Insurance Corporation filed four class action lawsuits (later consolidated into one suit) alleging that their employers incorrectly classified them as exempt administrative employees. The suit sought damages for unpaid overtime work. The trial court certified 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.

The trial court later decertified the class in part, depending on whether the adjusters’ claims arose before or after October 1, 2000, the date the IWC replaced an earlier version of Wage Order 4. For claims arising before October 1, 2000, the trial court decided that the claims adjusters were non-exempt. The court decertified the class as to all claims arising after October 1, 2000, the effective date of the new wage order. On review, the Court of Appeal concluded that, under the terms of that wage order, the claims adjusters could not be considered exempt employees, either before or after the order’s amendment. The case eventually reached the California Supreme Court.

Legal Analysis

Under the California Labor Code to qualify as an exempt administrative employee, employees must (1) be paid at a certain level, (2) their work must be administrative, (3) their primary duties must

involve that administrative work, and (4) they must discharge those primary duties by regularly exercising independent judgment and discretion. The issue in this case involved the second point – whether the employees’ work is administrative – in light of the state Labor Code, the applicable wage orders, and incorporated regulations listed in the federal Fair Labor Standards Act (FLSA).

To argue that the test for the administrative exemption could not be met, the claims adjusters emphasized the so-called “administrative/production worker” dichotomy, which was applied by the court in *Bell v. Farmers Ins. Exchange* (2001) and *Bell v. Farmers Ins. Exchange* (2004). The state supreme court found that while the use of the dichotomy test is still viable in very limited cases, the proper test is a two-part test to determine if the work performed by the employee is “directly related” to management policies or general business operations as required by the Federal Regulations specifically incorporated into the Wage Orders by the IWC. That two-part test is that the work: (1) “must be qualitatively administrative,” and (2) “quantitatively, it must be of substantial importance to the management or operations of the business.”

The California Supreme Court found that the Court of Appeal erred in finding that the claims adjusters were non-exempt under the “qualitative” portion of the test and reversed and remanded the case for the court to examine the remaining “quantitative” portion of the test with respect to the work performed by these employees.

Unfortunately, the justices avoided the opportunity to provide a much needed detailed analysis of the how the lower courts should generally apply the administrative exemption, leaving this to the courts to continue to struggle with on a case-by-case basis.

Practical Impact

According to [Robert A. Jones](#), who is Of Counsel in Ogletree Deakins’ San Francisco office: “While not an outright win for the employers, the strict application of the administrative/production dichotomy test appears to have been effectively disposed of which should make it easier for employers to qualify employees for the administrative exemption along the lines of what is currently required under the FLSA.”

Additional Information

Should you have any questions about this decision or its impact on your workplace, contact the Ogletree Deakins attorney with whom you normally work or the Client Services Department at 866-287-2576 or via email at clientservices@ogletreedeakins.com.