Client Alert.

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Harris v. Superior Court (Liberty Mutual): California Supreme Court Defines the Scope of the Administrative Exemption and Finds Insurance Adjusters Can Be Exempt

By Lloyd W. Aubry, Jr.

Last week the California Supreme Court, in a unanimous decision, reversed the Court of Appeal's decision that held that insurance adjusters are not exempt employees as a matter of law. In a highly technical decision involving the interplay of provisions of the Labor Code, the Wage Orders, and the incorporated Federal regulations, the Supreme Court found that the Court of Appeal had misapplied the substantive law concerning the administrative exemption. The court focused its inquiry on one aspect of the administrative exemption: "whether plaintiff's work is administrative." In its lengthy decision the Supreme Court reviewed the language in the Labor Code and in the Industrial Welfare Commission Orders dealing with the administrative exemption as well as the Federal regulations that the Wage Orders incorporate and which are to be used to "construe" the contours of the administrative exemption.

The Supreme Court held that the Court of Appeal erred by only focusing on one subpart of the Federal regulation defining the requirement that an administrative employee must be involved in non-manual work that is "directly related to management policies or general business operations of the employer or the employer's customers." Relying solely on this language and the so-called administrative/production worker dichotomy, the Court of Appeal held as a matter of law that insurance adjusters could not be exempt since they performed work that was essentially production work for the company. Stated in the reverse, as they were performing production work, they could not be exempt as administrative employees.

The Supreme Court held that elevating the administrative/production worker dichotomy to a "dispositive test" rather than simply an analytical tool was error. The Supreme Court also held that the Court of Appeal erred by not looking at the incorporated Federal regulations as a whole to determine whether insurance adjusters could be exempt. The Supreme Court pointed out that in another part of the incorporated Federal regulations insurance adjusters were specifically listed as employees who could be exempt as administrative employees. Thus, the Supreme Court reversed the Court of Appeal on the summary judgment motion, sending the case back to the trial court for action consistent with the principles stated in the opinion.

SPECIFIC HOLDING

Liberty Mutual appealed the Court of Appeal's decision to the Supreme Court which issued its decision last week. The Court resolved two issues:

(1) Do claims adjusters employed by insurance companies perform duties that qualify for the "administrative exemption" as defined by the California Industrial Welfare Commission ("IWC") in its wage orders? The Court answered yes if they meet certain criteria.

(2) Is the administrative exemption limited to those few employees who perform work "at the level of policy or general operations"? The Court answered no.

BACKGROUND

All employees in California are entitled to overtime unless they qualify for an exemption from overtime, for example, under one of the so-called white collar exemptions: the executive, administrative, or professional exemption. The exact contours of the administrative exemption from overtime under California Wage and Hour Law in general, and the exempt status of insurance adjusters under the administrative exemption in particular, have long been in dispute in California. One of the most well-known and oft-cited cases in this area, *Bell v. Farmers Insurance* originally filed in 1996, resulted in three appellate court decisions and a judgment reportedly in excess of $120 million when ultimately paid.

Those three *Bell* decisions, however, represented the high-water mark for non-exempt status for insurance adjusters as a spate of Federal court decisions and administrative interpretations from the U.S. Department of Labor, unlike *Bell*, found insurance adjusters exempt and rejected *Bell's* rigid formulation of the "administrative/production worker dichotomy" as outdated in a modern post-industrial service economy. Recent California decisions such as *Hodge v. Aon Insurance Services* (2011) 192 Cal.App.4th 1361, review granted, also rejected *Bell* and found that insurance adjusters were generally exempt as administrative employees.

A broader concern for all employers of workers classified as exempt from overtime under the administrative exemption was the Court of Appeal's decision in the *Harris* case that the administrative exemption is limited to those few employees who perform work "at the level of policy or general operations." The Federal decisions interpreting the administrative exemption under Federal law have found the administrative exemption to be much broader, as did the dissent in the Court of Appeal's decision which the Supreme Court cited with approval at several points in its *Harris* decision. The dissent in the Court of Appeal's decision was penned by Miriam Vogel, former long-time Court of Appeal Justice, who joined the Los Angeles office of Morrison & Foerster in 2008 as Senior Of Counsel.

IMPLICATIONS

The Supreme Court's decision in *Harris v. Superior Court* is good news for California employers. Plaintiffs' lawyers arguing the administrative exemption in misclassification cases invariably cite the administrative/production worker dichotomy from the three *Bell* cases as dispositive for a very narrow interpretation of the administrative exemption. The Supreme Court's decision makes it clear that the administrative/production worker dichotomy has little application in most administrative exemption cases and that any analysis must take into account all of the language in the Labor Code, the Wage Orders, and the incorporated Federal regulations. The decision essentially validates a number of previous lower Federal and state court decisions that had found insurance adjusters exempt. The decision makes it clear that the administrative exemption covers more than just the few employees performing work at the level of "policy" or "general operations." Thus, it is likely that employers will now be able to obtain summary judgment in more of these cases. To some extent this has already begun to happen as lower California cases have increasingly followed Federal court decisions on insurance adjusters and rejected strict application of the administrative/production worker dichotomy.

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