

January 4, 2011

California Supreme Court Rules on the Administrative Exemption from Overtime

Last week, the California Supreme Court issued its much-anticipated decision in *Harris v. Superior Court (Liberty Mutual Insurance Co.)*, Case No. S15655 (Dec. 29, 2011), addressing the white collar administrative exemption from overtime. The Court unanimously reversed a court of appeal's decision that applied the "administrative/production dichotomy" to find that a class of insurance company claims adjusters did not qualify for the administrative exemption under Wage Order 4-2001. While the new ruling does not provide specific guidance on how the administrative exemption should be applied, it reverses a narrow interpretation of the exemption, providing some hope for employers in relying on the exemption.

Wage Order 4-2001 (which, for pertinent purposes, is the same as an earlier one which took effect October 1, 2000) specifies that to qualify for the administrative exemption, an employee's duties and responsibilities must involve "the performance of office or nonmanual work directly related to management policies or general business operations of [their] employer or [the] employer's customers." The Wage Order expressly incorporates certain federal regulations that provide guidance on the meaning of the phrase "directly related to management policies or general business operations." In particular, the federal regulations distinguish between activities that relate to the "administrative operations of a business" from those which are "'production' or, in a retail or service establishment, 'sales' work." The federal regulations also specify that the work must be of "substantial importance to the management or operation of the business of [the] employer or [the] employer's customers."

Thus, the federal regulations set up a two-part test to determine whether work is "directly related" to management policies or general business operations. First, there is a qualitative test of whether the duties are "administrative" in nature, and second, there is a quantitative test of whether the work is "of substantial importance." Both must be met (in addition to other requirements for the exemption) in order for an employee to qualify for the administrative exemption.

111 SUTTER STREET
SUITE 700
SAN FRANCISCO
CA 94104
415 464 4300 T
415 464 4336 F

In *Harris*, plaintiffs-claims adjusters moved for summary adjudication on defendant's affirmative defense that plaintiffs were exempt from California's overtime laws based on the administrative exemption. The trial court denied the plaintiffs' motion and decertified the class as to claims arising on or after October 1, 2000. (Conversely, the court granted the plaintiffs' motion as to claims arising before that date, which are governed by an older, less specific version of Wage Order 4.)

In an ensuing writ proceeding, the California Court of Appeal relied on the so-called "administrative/production dichotomy," as previously applied by a California court of appeal in *Bell v. Farmers Insurance Exchange*, 87 Cal. App. 4th 805 (2001). The "administrative/production dichotomy" distinguishes between work that is primarily "administrative" in nature -- and therefore qualifies for exemption -- or is merely "production" in character -- and does not qualify for exemption. In *Bell*, the court concluded that a group of claims adjusters fell on the production (nonexempt) side because they were merely engaged in the "routine and unimportant" work of producing the company's services, *i.e.*, the handling of insurance claims.

Agreeing with the *Bell* analysis -- even though *Bell* involved the older version of Wage Order 4 and was based on certain stipulated facts -- the court of appeal in *Harris* ordered the trial court to grant summary adjudication in the plaintiffs' favor, finding the administrative/production dichotomy dispositive. In so doing, the appellate court, setting a considerably high bar for qualifying for the administrative exemption, further held that "only work performed at the level of policy or general operations can qualify as 'directly related to management policies or general business operations.'" In contrast, work that merely carries out the particular day-to-day operations of the business is production, not administrative work."

Now, the California Supreme Court has rejected the use of the administrative/production dichotomy as a dispositive tool for determining whether an employee qualifies for the administrative exemption. The Court held that while the administrative/production distinction may be useful in some cases, it cannot supplant the specific wage order language and incorporated federal regulations, which explain the meaning of "the performance of office or nonmanual work directly related to management policies or general business operations of [their] employer or [the] employer's customers." The Court also rejected the argument that employees qualify for the administrative exemption only

when their work involves advising the company on policies or operations. Holding that the court of appeal misapplied the law, the Court remanded the case for a determination of the employees' exemption status under the specific language of Wage Order 4-2001.

Unfortunately, the Supreme Court's decision does not provide guidance on how Wage Order 4-2001 should be applied, either to the particular facts of *Harris* or more generally. Still, the Court's rejection of the administrative/production dichotomy is a positive development for employers because it makes clear that the dichotomy is not dispositive in making an exemption determination and should not be applied rigidly. Furthermore, although *Harris* dealt only with Wage Order 4, it should be applicable more generally given that other wage orders contain the same language. Finally, the case serves as an important reminder regarding the complexity of applying the overtime exemptions under California law. Employers should remain cautious when engaging in any such analysis and seek counsel as appropriate.

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