CALIFORNIA SUPREME COURT REJECTS STRICT APPLICATION OF "ADMINISTRATIVE/PRODUCTION WORKER" DICHOTOMY

To Our Clients and Friends:

On December 29, 2011, the California Supreme Court handed down an important victory for employers in *Harris v. Superior Court*, reversing a split decision from the California Court of Appeal which held that insurance claims adjusters did not fall within the administrative exemption from the state's overtime requirements. *Harris v. Superior Court (Liberty Mutual Insurance)*, 2011 WL 6823963 (Cal.), __P.3d __. In doing so, the Supreme Court rejected strict application of the "administrative/production" dichotomy, used by many California courts in determining whether employees qualify for the administrative exemption, stating: "[T]he dichotomy is a judicially created creature of the common law which has been effectively superseded in this context by the more specific and detailed statutory and regulatory enactments[,]" *Id.* at *9.

**Background on the Dichotomy**

Over the past decade, in determining whether an employee falls within the administrative exemption for purposes of the state's overtime requirements, many California courts have looked to the "administrative/production" dichotomy for guidance—a test that was adopted in *Bell v. Farmers Insurance Exchange*, 87 Cal. App. 4th 805 (2001). This test, which finds its genesis in regulations under the Federal Fair Labor Standards Act, draws a distinction between "those employees whose primary duty is administering the business affairs of the enterprise" (exempt employees) and "those whose primary duty is producing the commodity or commodities, whether goods or services, that the enterprise exists to produce and market" (non-exempt employees). *Id.* at 821 (emphasis added). Applying this test, the *Bell* court observed that "claims adjusting is the sole mission of the 70 branch claims offices where [the claims adjusters] worked." *Id.* at 826. And it concluded that the claims adjusters were entitled to overtime, reasoning that "[t]he claims representatives are fully engaged in performing the day-to-day activities of that important component of the business" and, as such, were performing work that fell squarely on the "production" side of the dichotomy. *Id.*

In the wake of *Bell*, application of the "administrative/production" dichotomy among California courts has been inconsistent, with some courts refusing to strictly apply the test. In 2007, however, the Court of Appeal in *Harris* dealt a serious blow to the viability of the administrative exemption when, in a split decision, it endorsed a rigid application of the dichotomy and held that "production" employees cannot qualify for the administrative exemption, regardless of the employee's impact on business operations.

**The Underlying Decisions in *Harris***

In *Harris*, insurance claims adjusters brought four coordinated class actions against their employers alleging that they had been improperly classified as exempt from overtime requirements under
California law. Plaintiffs' claims were governed by two different California regulations: (1) Wage Order 4 for claims arising before October 1, 2000, and (2) Wage Order 4-2001 (which replaced Wage Order 4) for claims arising thereafter. *Harris v. Superior Court*, 64 Cal. Rptr. 3d 547, 550-551 (2007). The trial court initially certified a class on the grounds that application of the "administrative/production workers" dichotomy was a predominant issue warranting class certification. Defendants moved to decertify the class, and the trial court revisited the issue. It concluded, under *Bell*, that the administrative/production dichotomy warranted class certification for claims arising before October 2001, but decertified the class for claims arising under Wage Order 4-2001, reasoning that the changes to the Wage Order in 2001 "compel the conclusion that claims adjusters can be exempt administrative employees notwithstanding the administrative/production worker dichotomy." *Id.* at 552.

On review, in a 2-1 decision, the Court of Appeal concluded that the dichotomy plays the same role under both wage orders--both before and after 2001--and rejected the argument that the dichotomy was "an outmoded remnant of a bygone industrial age." *Id.* at 565. Applying the test, it held that the claims adjusters were primarily engaged in work that "falls on the production side of the dichotomy, namely, the day-to-day tasks involved in adjusting individual claims . . . None of that work is carried on at the level of management policy or general operations. Rather, it is all part of the day-today operations of defendant's business." *Id.* at 557-58. In concluding that the administrative exemption did not apply, the Court of Appeal directed the trial court to grant plaintiff's motion for summary adjudication and to deny defendant's motion to decertify the class in its entirety. *Id.* at 567.

The California Supreme Court granted review in 2007.

**The California Supreme Court's Decision in Harris**

Reversing and remanding the decision of the Court of Appeal, the California Supreme Court rejected use of the dichotomy as a dispositive test: "[The Court of Appeal] erred when it . . . create[d] a rigid rule . . . . [It] provided its own gloss to the administrative/production worker dichotomy and used it, rather than applying the language of the relevant wage order and regulations. Such an approach fails to recognize that the 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. . . ." *Harris v. Superior Court*, 2011 WL 6823963 at *9. These statutory and regulatory enactments specify, for example, that administrative work includes work performed by "white-collar employees engaged in 'servicing' a business as, for example, advising the management, planning, negotiating, [and] representing the company." *Id.* at *10 (citing with approval the now-superseded federal regulations formerly at 29 C.F.R. § 541.205(a)-(c), all of which are expressly incorporated into the California Wage Order). Under these regulations, the Court stated, the question of "whether work is part of the 'administrative operations' of a business depends, in part, on whether it involves advising management, planning, negotiating, and representing the company. It is not so narrowly limited as the majority below declared." *Id.*

The Court refused, however, to reject the administrative/production dichotomy in its entirety: "We do not hold that the administrative/production worker dichotomy . . . can never be used as an analytical tool. We merely hold that the Court of Appeal improperly applied the administrative/production
worker dichotomy as a dispositive test." Id. at *11. At the same time, it acknowledged the severe "limitations" of the dichotomy as an analytical tool: "As the dissent below points out, [B]ecause the dichotomy suggests a distinction between the administration of a business on the one hand, and the 'production' end on the other, courts often strain to fit the operations of modern-day post-industrial service-oriented businesses into the analytical framework formulated in the industrial climate of the late 1940's." Id.

The Court was careful to limit its decision to the question of the appropriate legal test, and did not decide whether the plaintiffs were exempt administrative employees. It did, however, observe that many federal courts, including the Ninth Circuit in a case handled by Gibson Dunn, have "held that under more recent applicable federal regulations, claims adjusters are exempt from the Fair Labor Standards Act's overtime requirements 'if they perform activities such as interviewing witnesses, making recommendations regarding coverage and value of claims, determining fault and negotiating settlements.'" Id. at *10 (citing Miller v. Farmers Ins. Exch. (In Re Farmers Ins. Exch.). 481 F.3d 1119, 1124 (9th Cir. 2007)). The Court also cited, with seeming approval, the statement of the dissenting judge below that administrative functions listed in the regulation are "what claims adjusters do--they negotiate settlements (and conclude some without seeking approval), advise management, and process claims." Id.

Although the Supreme Court's decision in Harris leaves a number of questions unanswered--including questions about other elements of the administrative exemption--it provides much needed clarification to California employers regarding application of the administrative/production dichotomy. As the Court also explained, however, application of the exemption will continue to require a case-specific factual analysis of the work actually performed by the particular employees involved: "The essence of our holding is that, in resolving whether work qualifies as administrative, courts must consider the particular facts before them and apply the language of the statutes and wage orders at issue." Id. at *12. No doubt, the fact-specific nature of this inquiry will give rise to continued litigation over the administrative exemption for years to come.

Gibson Dunn lawyers are available to assist in addressing any questions you may have about these developments. Please contact the Gibson Dunn lawyer with whom you work, or any of the following members of the firm's Labor and Employment Practice Group:

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