

## 'Harris' Simplifies Classification



M. Michael Cole

California's various overtime exemptions, particularly the administrative exemption, are often difficult to interpret and apply. So when the California Supreme Court granted review several years ago in *Harris v. Superior Court (Liberty Mutual Insurance)*, 12 C.D.O.S. 129 — the first case in which the court agreed to address the administrative exemption — many eagerly anticipated some much needed guidance and clarity. As 2011 came to a close, the court finally issued its ruling in *Harris* and unanimously reversed an appellate decision that relied on the so-called "administrative/production dichotomy" to find that a class of insurance claims adjusters did not qualify for the administrative exemption under Wage Order 4-2001. Unfortunately, the Supreme Court's ruling does not provide specific guidance on how the administrative overtime exemption should be applied. On a positive note for employers, however, the decision reverses a narrow interpretation of the administrative exemption.

Wage Order 4-2001 (which, for pertinent purposes, is the same as Wage Order 4-2000, the wage order that was at issue in the case and which took effect Oct. 1, 2000) specifies that to qualify for the administrative exemption, an employee's duties and responsibilities must involve "the performance of office or nonman-

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ual work directly related to management policies or general business operations of his employer or [the] employer's customers." The wage order expressly incorporates certain federal regulations under the Fair Labor Standards Act that provide guidance on the meaning of the phrase "directly related to management policies or general business operations." In particular, the FLSA regulations distinguish between activities that relate to the "administrative operations of a business" and those which are "production' or, in a retail or service establishment, 'sales' work" — the so-called "administrative/production dichotomy." The FLSA rules 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."

As described by the court in *Harris*, the FLSA 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 of these components must be met (in addition to other requirements for the exemption) in order for an employee to qualify for the administrative exemption.

In *Harris*, plaintiffs moved for summary adjudication on defendant's affirmative defense that plaintiffs were exempt from California's overtime laws based on the administrative exemption and in particular, focused on the qualitative portion of the test, i.e., whether their work was administrative in nature. The trial court denied the plaintiffs' motion and decertified the class as to claims arising on or after Oct. 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 court of appeal held in plaintiffs' favor

and directed the trial court to enter an order granting plaintiffs' motion for summary adjudication. The 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). As noted, the "administrative/production dichotomy" distinguishes between work that is primarily "administrative" in nature and therefore qualifies for exemption, or is merely a "production" in character and does not qualify for exemption. The *Bell* court, relying on this distinction and certain key stipulated facts, concluded that claims adjusters in that action fell on the production 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 an older version of Wage Order 4 — the court of appeal in *Harris* found 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."

The court of appeal tried to bolster its decision by looking to other federal regulations (which are not incorporated into the wage order), which list "insurance adjusters" as among those who are permitted to enter into varying work week contracts under federal law, despite maximum hour limitations. By implication, the court argued, plaintiffs-adjusters were nonexempt.

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 FLSA regulations, which explain the meaning of “the performance of office or nonmanual work directly related to management policies or general business operations of [the] employer or [the] employer’s customers.” As the court stated: “[I]n 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.”

The court also took issue with the lower court’s reliance on FLSA regulations not incorporated into the wage order. The court noted that the California Industrial Welfare Commission made clear, in a statement published with the wage order, that only the federal regulations that are cited in the wage order and that were

in effect when the wage order took effect could be considered. The Supreme Court accordingly held that the court of appeal had erred in considering federal regulations other than those incorporated into the current version of Wage Order 4.

Finally, the court rejected the argument that employees qualify for the administrative exemption only when their work involves advising the company on its policies or operations. In so doing, the court rejected the lower court’s reliance on the Ninth Circuit’s decision in *Bratt v. County of Los Angeles*, 912 F.2d 1066 (1990). In that case, the Ninth Circuit concluded that probation officers were not exempt because to be exempt requires an individual to “advise management about the formulation of policy.” As the Supreme Court observed, “*Bratt’s* persuasiveness is in doubt” because a later Ninth Circuit decision, along with other federal authority, holds that, under more recent federal regulations, claims adjusters are exempt

from the FLSA’s overtime requirements.

Holding that the court of appeal misapplied the law, the court remanded *Harris* for a determination of the claims adjuster’s exemption status under the specific language of Wage Order 4-2001. While it is unfortunate that 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, the court’s rejection of the administrative/production dichotomy remains 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.