

California Supreme Court Clarifies the Administrative Exemption

An Analysis of Harris v. Superior Court of Los Angeles County

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On December 29, 2011, the California Supreme Court issued its long-awaited opinion in *Harris v. Superior Court*, the first case in which it has addressed the administrative exemption under California law. The Court reversed the court of appeal's decision upholding summary judgment for a class of claims adjusters. In so holding, the Court clarified the test for the administrative exemption: lower courts may *not* use the so-called administrative/production worker dichotomy as a dispositive tool for finding employees non-exempt. Instead, they must consider the particular facts before them and apply the language of the statutes and wage orders at issue.

Background on the Administrative Exemption

Under the California Wage Orders, "persons employed in administrative, executive, or professional capacities" are exempt from the overtime requirements. Persons are employed in an administrative capacity if their duties and responsibilities involve office or nonmanual work "directly related to management policies or general business operations of [their] employer or [the] employer's customers."

Federal regulations (which are incorporated into the Wage Orders by reference) define the phrase quoted above as describing activities related to the administrative operations of a business, sometimes referred to as "the running or servicing" of the business, as distinguished from "production" or, in a retail or service establishment, "sales" work. See 29 C.F.R. 541.205(a)(former).¹ The regulations further explain that administrative operations include work done by "white collar" employees engaged in servicing a business, by, for example, advising management, planning, negotiating, and representing the company. See 29 C.F.R. 541.205(b)(former).

Overview of the Case

In the trial court, plaintiffs – claims adjusters employed by Liberty Mutual Insurance Company – brought a motion for summary judgment on defendant's affirmative defense that plaintiffs

were exempt from the overtime requirements under the administrative exemption. The plaintiffs attacked a single component of the employer's affirmative defense – that the employees' work, qualitatively, was "administrative" in character.

The trial court granted plaintiffs' motion for summary judgment, and the court of appeal affirmed, relying heavily on the so-called administrative/production worker dichotomy. The dichotomy, articulated by the California appellate court in *Bell v. Farmers Insurance Exchange*, a 2001 case, distinguishes between administrative employees who are primarily engaged in "administering the business affairs of the enterprise" and production-level employees whose "primary duty is producing the commodity or commodities, whether goods or services, that the enterprise exists to produce and market." The *Bell* court relied on the dichotomy to find that claims adjusters were properly found to be non-exempt, on the grounds that they "produced" the company's product – the handling of insurance claims. That finding, the *Bell* court held, "obviate[d] the need to inquire into plaintiffs' duties."²

The *Harris* court of appeal held that the administrative/production dichotomy was "predominant and dispositive," and determined that insurance adjusters could not qualify as exempt, because they performed "production" work. Moreover, the court of appeal set a higher bar for what type of work qualifies as "administrative": "[N]ot all activities that involve advising management, planning, negotiating, and representing the company constitute exempt administrative work. Rather, in order for the listed tasks to fall on the administrative side of the dichotomy, they must be carried on at the level of policy or general operations Plaintiffs' planning, negotiating, and presenting are likewise not carried on at the level of policy or general operations. They are all part of the day-to-day business of processing individual claims. They are production work."

Liberty Mutual appealed, and the California Supreme Court granted review.

The Issue Before the Court

The California Supreme Court's decision focused on a single issue: what standard must courts apply to determine whether work is administrative in character and, therefore, within the scope of the administrative exemption. In the process of refining that issue, the Court parsed the first prong of the exemption – which requires that employees engage in work directly related to management policies or general business operations – into two components. The first component, which the Court labeled "qualitative," addresses whether the work is administrative in nature. The second component, which the Court labeled "quantitative," addresses whether the work is of substantial importance to the management or operations of the business. As the *Harris* plaintiffs did not pursue the quantitative component of the test, the Supreme Court expressed no opinion, and instead focused exclusively on the qualitative component.

The Administrative/Production Worker Dichotomy

In the process of addressing the issue before it, *Harris* devoted considerable attention to the continued viability of the administrative/production dichotomy, concluding that it can never be used as a dispositive test, and that the lower court erred in treating it as such:

The majority below 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.

Moreover, the Court emphasized that the dichotomy is ill-suited for the modern workplace:

[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.

Accordingly, courts should use the dichotomy only as an analytical tool of last resort, when the statute and wage orders fail to provide guidance:

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. *Only if those sources fail to provide adequate guidance, as was the case in Bell II, is it appropriate to reach out to other sources.*

Whether Administrative Work Exists Only at the Policy Making Level

The Court paid special attention to the question whether the court of appeal had properly concluded that "only work performed at the level of policy or general operations can qualify as directly related to management policies or general business operations," holding that it had *not*. *Harris* emphasized that 541.205(a) must be read in conjunction with other regulations incorporated into the Wage Orders. Section 541.205(b), for example, states:

The administrative operations of the business include the work performed by so-called white-collar employees engaged in "servicing" a business as, for, example, advising the management, planning, negotiating, representing the company, purchasing, promoting sales, and business research and control. An employee performing such work is engaged in activities relating to the administrative operations of the business notwithstanding that he is employed as an administrative assistant to an executive in the production department of the business.

Thus, the activities identified in 205(b) are administrative in nature, whether they are performed at the level of policy or not.

In reaching this conclusion, the Court identified as "in doubt" the persuasiveness of the Ninth Circuit's contrary interpretation of the FLSA in *Bratt v. County of Los Angeles*, 912 F.2d 1066 (9th Cir. 1990). There, the Ninth Circuit held that "advising the management as used in [section 205(b)] is directed at advice on matters that involve policy determinations, i.e., how a business should be run or run more efficiently, not merely providing information in the course of the customer's daily business operation." Moreover, by questioning *Bratt*, the Court

implicitly drew into question the subsequent Ninth Circuit decision in *Bothell v. Phase Metrics, Inc.*, 299 F.3d 1120 (9th Cir. 2002). There, the Ninth Circuit relied on *Bratt* for the proposition that the employer must show that an employee is engaged in “running the business itself or determining its overall course or policies, not just in the day-to-day carrying out of the business’ affairs.” *Harris* clearly rejects this analysis.

What Should Employers Do?

Harris serves as a reminder that the rules regarding exempt status are complex and in a constant state of evolution. Employers now should consider whether the new guidelines announced in *Harris* expand or contract the employees that they previously have placed within the administrative exemption.



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¹ The federal regulations that the Wage Orders incorporate are those that were in effect in 2000, before their change in 2004. Although the new regulations were intended to be consistent with the former regulations, all references to federal regulations in this Alert are to their former version.

² The court revisited its decision in 2004, but did not significantly alter the result.