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Cal Supreme Court Reverses Horrific Decision on Administrative Exemption But Declines to Provide Much Guidance on How Exemption Should Be Applied

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This morning, the California Supreme Court issued the long-awaited decision in Harris v. Superior Court, addressing how to interpret the administrative exemption. The case reverses a decision of the court of appeal that effectively narrowed the exemption to employees who make company policy. At its narrowest, the Harris decision addresses the limited question of whether insurance adjusters can qualify as exempt under California's administrative exemption as it has existed at least since 2001 with the issuance of Wage Order 4-2001. Even on that limited question, the Cal Supremes declined to provide a definitive answer except to say that the court of appeal's analysis had been wrong.

The appellate decision below

The court of appeal decision below had issued a sweeping decision that set forth principles as to how to interpret the administrative exemption that would limit the exemption to a very small group of employees, thus creating the potential for thousands of class actions attacking the exempt status of a wide variety of white collar employees. More specifically, the court of appeal held that under the so-called "administrative/production dichotomy" an employee qualified for the exemption only if he or she performed work at the level of making company policy. The death quote from that decision was as follows: "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. That is the administrative/production worker dichotomy, properly understood."

The framework of the California Supreme Court's analysis

The Cal Supremes reversed the court of appeal and rejected that view of the dichotomy. So that's a definite win. But, the Cal Supremes ruled on very limited grounds and declined to resolve many other key issues on which lower court need guidance. As such, the opinion provides minimal guidance to courts as to how to determine whether a particular employee is exempt in any given case (including even insurance adjusters, although it looks good for their exempt status as a whole). The decision has the definite feel of a "consensus decision" that was drawn narrowly to generate a unanimous decision. Here is the basic framework the Cal Supremes set up.

(1) First and foremost, the Cal Supremes rejected the view that the administrative exemption is limited to employees who operate at the level of policy making. The Cal Supremes held that the administrative/production dichotomy is a useful but limited tool and it should not be relied upon in all cases. Without saying that the appellate decisions arising from Bell v. Farmers Insurance were wrong, the Cal Supremes noted that those were all decided under the pre-2001 Wage Order and their interpretation is not correct for cases arising post-2001. Instead, the way to interpret the administrative exemption from 2001 forward is to use the specific Department of Labor regulations that were expressly incorporated into Wage Order 4-2001 (former regulations 29 C.F.R. Sections 541.201-205, 541.207-208, 541.210, and 541.215). The Cal Supremes noted that in the statement of the basis for Wage Order 4-2001, the IWC expressly stated that those regulations and no other DOL admin exemption regulations were intended to guide interpretation of California's administrative exemption. The court of appeal erred by not following those incorporated regulations, but instead relying on other sources that were not incorporated into the IWC Wage Order.

(2) The Cal Supremes did initially set up its own gloss for the administrative exemption that sounds promising, but ultimately does not really provide much guidance. The Cal Supremes stated that "to qualify as 'administrative.' employees must (1) be paid at a certain level, (2) their work must be administrative, (3) their primary duties must involve that administrative work, and (4) they must discharge those primary

duties by regularly exercising independent judgment and discretion." This initially sounds like a fairly low standard of "administrative" that would leave the "importance" of their work to the limited question of whether they regularly exercise independent judgment and discretion. In the next breath, however, the Cal Supremes clarify that qualifying as "administrative" has both a qualitative and quantitative character. The "qualitative" character is satisfied where "white collar employees" service a business through such actions as "advising management, planning, negotiating, and representing the company," all relatively easy standards to satisfy. But the "quantitative" character is "whether work is of 'substantial importance' to management policy or general business operations." So there is an "importance" level for whether work counts as "administrative" separate and apart from whether the work involves substantial discretion and independent judgment.

The Cal Supremes expressly declined to issue any guidance whatsoever on the meaning of the "quantitative" component (i.e., what is "important"?).

(3) The Cal Supremes noted that the court of appeal had relied upon a DOL regulation that was *not* listed in Wage Order 4-2001, which was error. At the same time, the court of appeal had given short shrift to other provisions in DOL regulation such as ones stating that "adjusters" are a type of employee who typically meet the exemption. The Cal Supreme further rejected the court of appeal's adoption of statements in the Ninth Circuit's 1990 decision Bratt v. County of Los Angeles, which had held that probation officers were non-exempt because to be an exempt advisor requires the employee to "advise management about the formulation of [company] policy." The Cal Supremes noted that the Ninth Circuit had rejected that gloss of the exemption in more recent cases that expressly found insurance adjusters to be exempt, such as Miller v. Farmers Ins. Exch. (In Re Farmers Ins. Exchange, 481 F.3d 1119 (9th Cir. 2007).

(4) As perhaps the paragon example of using an empty phrase as a holding, the Cal Supremes announced that the "essence" of its 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." The Cal Supremes declined to state which other sources are appropriate (if any) or how to apply these phantom sources.

So, in effect, the Cal Supremes gave no express guidance on whether an employee who performs plainly back-office administrative work (such as someone who works on a company's computer network)-- performs work of substantial importance to management policies or general business operations. The exemption remains as unclear as it was the day before the court of appeal issued the first Harris decision.

Useful Tidbits in the Decision and Broader Takeaways

The above notwithstanding, there are a few helpful statements the Cal Supremes made that I could see employers citing in future motions arguing that the administrative exemption applies:

(1) At footnote 8, the Cal Supremes cited a slew of federal admin exemption decision that arose after 2004 and were based on provisions within the post-2004 FLSA regulations. The Cal Supremes noted that the DOL had stated that the 2004 regulations were "intended to be consistent with the old regulations." Accordingly, to the extent you want to rely upon counterparts of the old regulations in the 2004 FLSA regulations, this provides strong grounds to do so (note, this same conclusion was previously supported in the Combs v. Skyriver appellate decision).

(2) The Cal Supremes effectively throw a lot of cold water on the use of the administrative production dichotomy, by noting that it is often a "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." That sounds like something you would use to shoot down the use of the dichotomy in any knowledge industry job (e.g., staffing companies, IT, consulting).

(3) The Cal Supremes say that they generally give DLSE opinion letters "consideration and respect" they do not state that the letters are entitled to any deference: "it is ultimately the judiciary's role to construe the language [of the wage orders]." Bell was an outlier case in suggesting that DLSE opinion letters are entitled at least to limited deference.

(4) The Cal Supremes cite with approval a number of cases that held that employees fell within the administrative exemption, including Miller and the following other federal cases: Smith v. Government Employees Ins. Co. 590 F.3d 886, 897 (D.C. Cir. 2010);

Roe-Midgett v. CC Services, Inc. 512 F.3d 865, 875 (7th Cir. 2008); Cheatham v. Allstate Ins. Co. 465 F.3d 578, 585-586(5th Cir. 2006); McAllister v. Transamerica Occidental Life Ins. Co., 325 F.3d 997, 998, 1001 (8th Cir. 2003); Jastremski v. Safeco Ins. Companies, 243 F. Supp. 2d 743, 753 (N.D. Ohio 2003); Palacio v. Progressive Ins. Co., 244 F. Supp. 2d 1040, 1045, 1047 (C.D.Cal. 2002). In essence, this gives defense lawyers license to cite favorable federal decisions on the administrative exemption to argue that California's exemption is essentially the same as under the FLSA.

The main takeaway for employers is that the administrative exemption will remain a morass, but at least it is now clearer that the primary interpretation tool will be the incorporated DOL regulations, including the good parts of the 2004 update. If you have any questions about a particular case, do not hesitate to contact a Sheppard Mullin attorney for guidance.