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Case No. S156555

SUPREME COURT
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In The Supreme Court of the State of California

FRANCIS HARRIS, et al.,
Petitioners,

v.

THE SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent;

LIBERTY MUTUAL INSURANCE COMPANY, et al.,
Real Parties in Interest,

Second Appellate District, Division One
Nos. B19512/B195370
JCCP No. 4234 (*Liberty Mutual Overtime Cases*)
The Honorable Carolyn B. Kuhl

OPENING BRIEF ON THE MERITS

SHEPPARD MULLIN RICHTER & HAMPTON LLP
A Limited Liability Partnership
Including Professional Corporations
DOUGLAS R. HART, Cal. Bar No. 115673
GEOFFREY D. DEBOSKEY, Cal. Bar No. 211557
333 S. Hope Street
48th Floor
Los Angeles, California 90071
Telephone: (213) 620-1780

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP
A Limited Liability Partnership
Including Professional Corporations
ROBERT J. STUMPF, JR., Cal. Bar No. 72851
WILLIAM V. WHELAN, Cal. Bar No. 116372
KARIN DOUGAN VOGEL, Cal. Bar No. 131768
501 West Broadway, 19th Floor
San Diego, California 92101-3505
Telephone: (619) 338-6500

Attorneys for Defendants and Real Parties in Interest

LIBERTY MUTUAL INSURANCE COMPANY
and
GOLDEN EAGLE INSURANCE CORPORATION

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I. INTRODUCTION AND STATEMENT OF THE ISSUE

The petition for review by defendants Liberty Mutual Insurance Company (Liberty Mutual) and Golden Eagle Insurance Corporation (Golden Eagle) presents this question: do claims adjusters employed by insurance companies perform duties that qualify for the "administrative exemption" defined by California's Industrial Welfare Commission (IWC) in its Wage Orders, or is the exemption limited to those few employees who perform work "at the level of policy or general operations"?

Notwithstanding the fundamental misinterpretation of the applicable regulations by the majority of a divided court of appeal below, defendants' claims adjusters perform duties that are quintessentially "administrative" in nature. The federal regulations incorporated by Wage Order 4-2001 define administrative work as "advising the management, planning, negotiating, [and] representing the company" – tasks that defendants' claims adjusters perform every day. The United States Department of Labor has recognized this to be true since it first promulgated the regulations. That claims adjusters can be exempt administrative employees is underscored by the fact that the applicable regulations list "claim agents and adjusters" as employees who can qualify for the administrative exemption.

Abundant and unanimous authority from federal courts and the United States Department of Labor interpreting the same federal regulations that the IWC made part of California law has held that insurance claims adjusters can be exempt administrative employees. Indeed, not one federal court has held that an insurance adjuster is a "production" employee. This avalanche of federal authority is especially noteworthy because one of the IWC's goals in issuing Wage Order 4-2001 was to "promote uniformity of enforcement" between state and federal law. The new Wage Order clarifies what has always been true: most insurance claims adjusters perform duties that fall within the scope of the administrative exemption.

The majority's unprecedented and unsupported opinion would nullify this well-established jurisprudence. The administrative exemption is not restricted to employees who work "at the level of policy or general operations." Nor does it automatically exclude employees whose work relates to the "day-to-day operations of the business." The controlling regulations expressly state that the exemption also includes employees whose work "affects policy or whose responsibility it is to carry it out."

None of plaintiffs' contrary arguments, including their lead argument based on the "administrative/production worker dichotomy," is persuasive. At most, the dichotomy is only one tool among many to be used in determining whether an employee is performing administrative

work. As many courts have recognized, it has limited value in today's service-oriented economy and is almost never outcome-determinative. Were it properly applied in the present case, however, it would also support the conclusion that claims adjusters perform administrative work.[1]

Accordingly, because there are, at a minimum, triable issues of fact whether defendants' claims adjusters perform administrative work, the Court should direct the trial court to reinstate its order denying plaintiffs' motion for summary adjudication. In addition, because the trial court's class certification order was based on the erroneous premise that the dichotomy could, in fact, be dispositive in this case, the Court should direct the trial court to decertify the class in its entirety.

II. STATEMENT OF THE CASE

A. Overview

The trial court certified a class in these four coordinated lawsuits consisting of "all non-management employees classified as exempt by Liberty Mutual and Golden Eagle who were employed as claims

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[1] As discussed at pages 48-49 below, performing duties that are "administrative" in nature is only one part of the test for exempt status under California's administrative exemption. To be exempt from overtime compensation, for example, an employee must also exercise "discretion and independent judgment." (Wage Order 4-2001, § 1(A)(2)(b).)

managers or performed claims-handling activities." (Exhibits in Support of Defendants' Petition for Writ of Mandate, Vol. 1, Tab 5, p. 67.)[2]

The gist of plaintiffs' claim is that as a matter of law, none of the defendants' 1,100 employees, working in 39 different job classifications, can conceivably be an exempt administrative employee. After the Court of Appeal ruled in plaintiffs' favor, this Court granted review.

B. Defendants' Claims Adjusters

Insurance plays a vital role in the economy by allowing for risks to be pooled and transferred. In exchange for premiums paid, an insurance company assumes certain risks of loss from its policyholders. (Pl. Exh. Vol. 8, Tab 33, p. 2360.) In a given policy year, most policyholders never submit a claim. (Vol. 1, Tab 11, p. 122, ¶ 6.) When an insured or third-party does make a claim, however, the insurance company must respond. It does so through its claims adjusters, who are responsible for speaking and acting on the company's behalf in investigating, analyzing, negotiating, and resolving, i.e., "adjusting," the claim.

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[2] The six volumes of Exhibits in Support of Defendants' Petition for Writ of Mandate will be cited as "Vol. ___, Tab ___, p. ___." References to the exhibits the plaintiffs filed in support of their writ petition will be cited as "Pl. Exh. Vol. ___, Tab ___, p. ___."

Defendants' claims adjusters perform a critical function, and their work is anything but routine and unimportant. There are many steps involved in adjusting an insurance claim. When a claim is made, the adjuster first analyzes whether the claim is covered or potentially covered by the insurance contract. If it is, the adjuster investigates the facts of the loss (including its causes and extent) and reaches a conclusion about who is liable. Based on this determination, the adjuster decides whether the company must pay the claim and how much. (See, e.g., Vol. 1, Tab 9, p. 115, ¶ 11; Vol. 1, Tab 12, p. 132, ¶ 14; Vol. 1, Tab 13, pp. 138, 142,¶ ¶ 4, 20; Vol. 1, Tab 15, p. 154, ¶ 16; Vol. 1, Tab 11, pp. 122-124, ¶ ¶ 7-13; Vol. 1, Tab. 12, pp. 134-136, ¶ 20.) Adjusters have absolute authority to settle claims for the company within their initial settlement authority. (See, e.g., Vol. 1, Tab 11, p. 122, ¶ 9; Vol. 3, Tab 26, pp. 530:7-8, 581:1-4, p. 582:5-10.)[3]

The average "Cost Estimate" on claims adjusted by the Liberty Mutual class members is $19,783. (See, e.g., Vol. 3, Tab 28,

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[3] As the trial court noted, both sides in this case "agree that claims handlers perform at least the following duties: gathering evidence; establishing reserves; evaluating damages and liabilities; reviewing policies for coverage; assessing credibility including attempting to identify fraud; making recommendations on claims above their authority limits; negotiating settlements; and collaborating with company counsel if the claim is in litigation." (Vol. 6, Tab 72, p. 1439.)

p. 672.) In certain adjuster teams, the average value authorized by the adjuster and paid by the company exceeds $100,000. Some of the plaintiff adjusters have authority to commit several million dollars of the company's money to pay claims. (See, e.g., Vol. 3, Tab 19, pp. 461-462, ¶ 11; Vol. 3, Tab 34, pp. 708-709, ¶ 3; Vol. 3, Tab 39, p. 726, ¶ 3, p. 730, ¶ 14; Vol. 4, Tab 42, p. 746, ¶ 23.)

If a claim is litigated, the plaintiff adjusters remain responsible for the claim and supervise the assigned attorney, sometimes even to the point of giving advice as to which questions should be asked at depositions. (See, e.g., Vol. 1, Tab 11, p. 123, ¶¶ 10-11; Vol. 1, Tab 15, p. 154, ¶ ¶16(b) and (g); Vol. 3, Tab 26, pp. 501:16-21, 543:7-14, 600:2-20, 607:7-20, 608:9-20, 609:18-20, 639:5-22.) Plaintiffs do not need a supervisor's approval to refer cases to the Special Investigations Unit, a field investigator, a vocational rehabilitation vendor, attorney, or structured settlement vendor. (See, e.g., Vol. 1, Tab 12, p. 135, ¶ 20(g); Vol. 2, Tab 16, p. 175, (58:16-61:6); Vol. 3, Tab 26, pp. 517-18, 544:11-14, 549:10-15; 629:1-22, 630:20-22, 631:13-15.) Plaintiffs have the authority to disburse company funds for temporary disability benefit payments, death benefits, wage loss payments, or permanent disability benefit payments. (See, e.g., Vol. 3, Tab 26, pp. 554:24-555:6, 556:23-25, 557:18-23, 558:23-559:16.)

As the trial court noted, in a class that includes more than 1,100 employees working for three different companies in three different

business lines and 39 different job classifications, there are "significant variations" in the plaintiff adjusters' duties and responsibilities. (Vol. 6, Tab 72, p 1469; Vol. 3, Tab 26, p. 497, ¶ 12.) Different team managers, for example, impose different limitations on what the claims adjusters they supervise may do without obtaining approval or notifying the team manager. (Vol. 3, Tab 19, p. 460, ¶¶ 6, 7; Vol. 3, Tab 20, p. 465, ¶ 6; Vol. 3, Tab 31, p. 697, ¶¶ 8, 10; Vol. 3, Tab 34, pp. 709-710, ¶ 5; Vol. 4 Tab 42, p. 745, ¶ 18; Vol. 4, Tab 48, p. 772, ¶ 5.) Many plaintiffs perform specialized functions. For example, a claims adjuster in the Special Investigations Unit is responsible for investigating potential fraud. Plaintiffs involved with subrogation investigate whether third parties are liable for any aspects of a claim. (Vol. 3, Tab 19, p. 462, ¶ 12; Vol. 4, Tab 48, p. 774, ¶ 12; Vol. 4, Tab 42, p. 742, ¶ 8.) Defendants also employ other claims handling personnel whom they do not classify as exempt. (See, e.g., Vol. 3, Tab 27, p. 662, ¶ 10; Vol. 4, Tab 46, p. 762, ¶ 7.)

The trial court observed that there were "significant variations in the duties of various class members in terms of their own level of authority to pay claims; the supervision others exercise over their activities and decisions; and the supervision various class members exercise over other claims representatives. Issues concerning whether class members customarily and regularly exercise 'discretion and independent judgment,' and whether they are engaged in duties that meet the test of the exemption

for more than 50 percent of their working hours, are likely to present individualized questions of fact." (Vol. 6, Tab 72, p. 1469.)[4]

Yet, the Court of Appeal held that each of the class members is non-exempt as a matter of law.

C. The IWC and California's "Administrative Exemption"

Labor Code sections 1173, 1178, and 1178.5 authorize the IWC to issue regulations concerning wages and hours for particular industries. In fulfilling this responsibility, the IWC "engages in a quasi-legislative endeavor, a task which necessarily and properly requires the commission's exercise of a considerable degree of policy-making judgment and discretion. (*Industrial Welfare Commission v. Superior Court* (1980) 27 Cal.3d 690, 702.)

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[4] The trial court's conclusion is well supported by the record. (See, e.g., Vol. 3, Tab 18, pp. 437-57; Vol. 5, Tab 55, pp. 1024-36; Vol. 6, Tab 63, pp. 1316-30; Vol. 6, Tab 69, pp. 1400-16); Vol. 3, Tab 19, p. 461, ¶¶ 9, 10; Vol. 3, Tab 20, p. 467, ¶ 13; Vol. 3, Tab 31, pp. 696, ¶ 6; Vol. 3, Tab 34, pp. 710-11, ¶¶ 6, 10; Vol. 3, Tab 39, pp. 728, 729, ¶¶ 8, 11; Vol. 4, Tab 42, p. 744, ¶ 16; Vol. 4, Tab 48, p. 773, ¶ 8 (settlement authority varies); Vol. 3, Tab 20, p. 465, ¶ 6; Vol. 3, Tab 25, p. 493, ¶ 6; Vol. 3, Tab 31, p. 697, ¶¶ 8, 10; Vol. 3, Tab 34, pp. 709, ¶ 5; Vol. 4, Tab 42, p. 747, ¶ 25) (different managerial requirements); Vol. 3, Tab 19, p. 459, ¶ 4; Vol. 3, Tab 20, p. 464, ¶ 2; Vol. 3, Tab 34, pp. 709, ¶ 5; Vol. 4, Tab 42, p. 740, ¶ 4 (claims assigned based upon experience); Vol. 3, Tab 19, p. 459, ¶ 3; Vol. 4, Tab 42, p. 743, ¶ 12) (some adjusters deal with attorneys and some do not).) Plaintiffs did not introduce any contrary evidence.

Pursuant to authority first delegated from the Legislature in 1913, the IWC has promulgated wage orders applying to 15 separate occupations. Wage Order 4, at issue in this case, applies to "Professional, Technical, Clerical, Mechanical, and Similar Occupations." Before 1947, none of the IWC's wage orders included an exemption for administrative employees. In 1947, using federal criteria as a guide, the IWC amended nine wage orders (not including Wage Order 4) to include exemptions for "women employed in administrative, executive, or professional capacities" and described the duties of such employees "in language drawn from federal regulations." (*Bell v. Farmers Ins. Exchange* (2001) 87 Cal.App.4th 805, 813.)[5]

In 1957, as part of its recodification of Wage Order 4, the IWC expanded the definition of "professional, technical, clerical, and similar occupations." It also inserted the phrase "administrative, executive, or professional" (a "triad of terms . . . plainly borrowed from parallel language" under federal law) to modify the description of the duties of exempt employees. (*Id.* at p. 814 (citation omitted).) "[T]his regulatory

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[5] Although the amendment to Wage Order 4 did not contain the reference to "administrative, executive, or professional capacities," it did include the "same description of the duties of exempt employees, drawn from federal regulations. . . ." (*Id.*)

history supports the use of federal authorities as an aid to interpretation of the administrative exemption of [Wage Order 4.]" (*Id.*)[6]

1. Wage Order 4 Before October 1, 2000

Before current Wage Order 4-2001 was adopted, Wage Order 4 did not separately define "administrative" employees, as distinguished from "executive" or "professional" employees. The exemption simply read as follows:

> (a) Provisions of sections 3 through 12 [governing hours and days of work, minimum wages, and rest periods] shall not apply to persons employed in administrative, executive, or professional capacities. No person shall be considered to be employed in an administrative, executive, or professional capacity unless one of the following conditions prevails:
>
> (1) The employee is engaged in work which is primarily intellectual, managerial, or creative, and for which the remuneration is not less than $1150.00 per month; or
>
> (2) The employee is licensed or certified by the State of California and is engaged in [the practice of a profession such as law or medicine].

More guidance was available under federal law, however, which provided that an employee is performing work in an "administrative

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[6] In 1973, the exemption in Wage Order 4 was expanded to include all employees, not just women and children. Thereafter, it only underwent

capacity" if the employee performs office or nonmanual work "directly related to management policies or general business operations of his employer or his employer's customers." (29 C.F.R.§ 541.2 (1998).)[7] Another federal regulation, 29 C.F.R. § 541.205, defined this "directly related" language, as well as the "administrative operations of the business," as follows:

> (a) The phrase "directly related to management policies or general business operations of his employer or his employer's customers" describes those types of activities relating to the administrative operations of a business as distinguished from "production" or, in a retail or service establishment, "sales" work. In addition to describing the types of activities, the phrase limits the exemption to persons who perform work of substantial importance to the management or operation of the business of his employer or his employer's customers.
>
> (b) 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. ...
>
> (c) As used to describe work of substantial importance to the management or operation of the business, the phrase "directly related to management policies or general business operations" is not limited to persons who participate in the formulation of management policies or in the operation of the business as a whole. Employees whose work is "directly related" to management policies or to general business operations include those work affects policy or whose responsibility it is to execute or carry it out. The phrase also includes a wide variety of

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minor changes until October 2000, when the IWC initially adopted what became Wage Order 4-2001. (*Id.* at p. 814.)

[7] The federal regulations were unchanged during all pertinent periods until the Department of Labor revised its regulations in 2004.

> persons who either carry out major assignments in conducting the operations of the business, or whose work affects business operations to a substantial degree, even though their assignments are tasks related to the operation of a particular segment of the business. ...

This same regulation lists "claim agents and adjusters" as examples of employees who meet the "directly related" test.[8]

2. Wage Order 4-2001

Effective October 1, 2000, the IWC adopted current Wage Order 4-2001, which provided more specific guidance in defining the administrative exemption.[9] For the first time, the new Order set forth a separate test for the administrative exemption and did so in a way that essentially tracked the language of 29 C.F.R. § 541.2 under federal law. It also expressly incorporated several specific federal regulations, including section 29 C.F.R. § 541.205, including its definition of the "administrative operations of the business" and its reference to "claim agents and adjusters" as employees who likely qualify for the administrative exemption.

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[8] "The test of 'directly related to management policies or general business operations' is also met by many persons employed as advisory specialists and consultants of various kinds, credit managers, safety directors, claim agents and adjusters, wage-rate analysts, tax experts, account executives of advertising agencies, customers' brokers in stock exchange firms, promotion men, and many others." (29 C.F.R. § 541.205(c)(5) (2002).)

[9] The IWC initially adopted Wage Order 4-2000, effective October 1, 2000, as an interim Wage Order. There are no substantive differences between the tests for the administrative exemption in the interim Order and the January 1, 2001 amendments.

3. The IWC's "Statement As to the Basis"

The IWC utilizes "Statements As to the Basis" to set forth the reasons for its decisions. (*Cal. Hotel & Motel Assn. v. Industrial Welfare Com.* (1979) 25 Cal.3d 200, 213.) The Statement As to the Basis accompanying Wage Order 4-2001 made clear that one of the IWC's goals in promulgating the new wage orders was to "provide clarity regarding the federal regulations that can be used to describe the duties that meet the test of the exemption under California law. . . ." Another was to promote "uniformity of enforcement" between state and federal law. (Vol. 5, Tab 62, p. 1292.)

The IWC made clear that "only those federal regulations specifically cited in its wage orders" in effect at the time Wage Order 4-2001 was adopted should be used to define exempt duties under California law. (*Id.*) The Statement acknowledges that the IWC "derived the duties that meet the test for the administrative exemption from language in the federal regulation 29 C.F.R. § 541.2(a)-(c), with the exception of the 'primary duty' phrase." (*Id.* at p. 1293.)

D. Procedural History

Plaintiff Frances Harris and other class members in a coordinated group of four class action lawsuits are employed as claims adjusters, in numerous and widely-differing job categories, by petitioners Liberty Mutual and Golden Eagle. (Vol. 1, Tab 2, p. 25-26.)

Between March 2001 and August 2002, plaintiffs filed four class action lawsuits challenging their classification as exempt employees and seeking damages based on overtime work for which they claim they were not properly paid. All four actions were coordinated in one proceeding by the Judicial Council. (Vol. 1, Tab 4, p. 43.) In May 2004, the trial court certified each as a class action, concluding that the so-called "administrative/production worker dichotomy" was a predominant issue that could be dispositive with regard to the administrative exemption. (Vol. 1, Tab 5, p. 66.)

A year later, plaintiffs moved for summary adjudication on liability, arguing that each class member was non-exempt as a matter of law. (Vol. 1, Tabs 7-8, pp. 71-110.) Defendants opposed the motion and also moved to decertify the class on the ground that common issues of fact and law did not predominate because of the many variations in the duties performed by class members. (Vol. 3, Tabs 17-18, pp. 434-457.)

In October 2006, accepting as controlling authority the First District's opinions in *Bell v. Farmers Ins. Exchange* (2001) 87 Cal.App.4th 805 ("*Bell II*") and *Bell v. Farmers Ins. Exchange* (2004) 115 Cal.App.4th 715 ("*Bell III*"), the court ruled that class members were probably not exempt before the effective date of Wage Order 4-2001. Noting, however, that neither of the *Bell* opinions considered Wage Order 4-2001, nor applied the analysis encompassed in the federal regulations that the new

Wage Order incorporated, the court found that for the period after October 1, 2000, "Wage Order 4-2001, the incorporated federal regulations, and case law interpreting those regulations . . . do not allow an interpretation of the administrative/production dichotomy that requires claims adjusters for insurance companies to be classified as ineligible for the administrative exemption." (Vol. 6, Tab 72, p. 1468.) It thus denied plaintiffs' motion for summary adjudication, which spanned both periods of time.

Because it believed *Bell II* and *Bell III* required the conclusion the dichotomy was likely dispositive for the period governed by Wage Order 4-1998, the court denied defendants' motion to decertify the class for the period before the effective date of Wage Order 4-2001. (Vol. 6, Tab 72, p. 1468.) However, noting the "clear premise of the [original] certification order was that the administrative/production dichotomy might be the touchstone for resolving the case" and that, if not, "individual inquiries might be necessary to assess each class member's exempt status," the court decertified the class for the period after October 1, 2000 because of the "significant variations in the duties of various class members." (Vol. 6, Tab 72, p. 1469.)

Finally, finding that the interplay between and interpretation of the old and new Wage Orders raised a controlling and unsettled question of law, the court recommended interlocutory review of its decision under Code of Civil Procedure section 166.1. (Vol. 6, Tab 72, pp. 1470-1471.)

Both plaintiffs and petitioners filed writ petitions, and the Court of Appeal issued an order to show cause. After extensive briefing and argument, the court issued a 2-1 published opinion directing the trial court to enter a new order granting plaintiffs' motion for summary adjudication of defendants' affirmative defense based on the administrative exemption and denying in its entirety defendants' motion to decertify the class. (*Harris v. Superior Court*, 154 Cal.App.4th 181, 189-190, review granted Nov. 28, 2007, S156555 ("*Harris*").)

The majority centered its analysis on the portion of the new Wage Order that describes the type of work employees must do to qualify for the administrative exemption. Specifically, it held that for work to be "administrative" in nature, it must be performed "at the level of *policy or general* operations." (*Harris*, *supra*, 154 Cal.App.4th at p. 176, italics in original.) According to the majority, "work that merely carries out the particular, day-to-day operations of the business," is "production" work, not "administrative" work. (*Harris*, *supra*, 154 Cal.App.4th at p. 177.)

Although it recognized that the plaintiff claims adjusters "investigate and estimate claims, make coverage determinations, set reserves, negotiate settlements, make settlement recommendations for claims beyond their settlement authority, [and] identify potential fraud," the majority concluded these employees could not be administratively exempt because they performed that work as part of the "particular, day-to-day

operations of the business." According to the majority, this remains true regardless of the type of work such day-to-day activity entails. (*Harris*, *supra*, 154 Cal.App.4th at pp. 177, 179.)

In a concise two-page summary, dissenting Justice Vogel explained why she reached the opposite conclusion, stating, "[t]he majority's analysis is complex. Mine is not." (*Harris*, *supra*, 154 Cal.App.4th at p. 196.) Justice Vogel noted that one federal regulation the IWC adopted as part of Wage Order 4-2001 defines the "administrative operations of the business" to include just "what claims adjusters do – they negotiate settlements (and conclude some without seeking approval), advise management, and process claims." (*Id.*) Another lists "claim agents and adjusters" as employees who do administrative work. (*Id.*)

The dissent noted that "most of the federal courts that have considered the governing federal regulations have held that claims adjusters are exempt" and that any supposed inconsistency created by the federal regulation upon which the majority relied (29 C.F.R. § 778.405) was irrelevant because that regulation is not mentioned in Wage Order 4-2001. (*Harris*, *supra*, 154 Cal.App.4th at p. 197.)

In response to defendants' petition, this Court unanimously granted review.

III. SUMMARY OF ARGUMENT

Most insurance claims adjusters perform duties that meet the test of the administrative exemption under California law. Contrary to the majority's unprecedented holding below, the administrative exemption is not limited to employees who work "at the level of policy or general operations." These conclusions follow from the plain language of Wage Order 4-2001, particularly two federal regulations it expressly adopts.

The first, 29 C.F.R. § 541.205(b), defines the essential nature of administrative work as work that involves "advising the management, planning, negotiating [and] representing the company." The record below confirms that defendants' insurance claims adjusters perform these types of tasks every day, e.g., by advising the management as to reserves, planning the processing of claims from beginning to end, negotiating with claimants and their counsel, and representing defendants in settling claims and committing defendants' resources. The second, 29 C.F.R. § 541.205(c)(5), removes any possible doubt by listing "claim agents and adjusters" as examples of employees who perform administrative work.

The unanimity of authority from federal courts and the United States Department of Labor that most insurance claims adjusters are exempt administrative employees under federal law reinforces this conclusion. Because one of the IWC's explicit goals in promulgating the new Wage Order was to "promote uniformity of enforcement" under state and

federal law, it follows that most claims adjusters also qualify for the administrative exemption under California law.

Although Wage Order 4-2001 makes these conclusions abundantly clear by expressly incorporating key federal regulations, the same conclusions were true under former Wage Order 4-1998. Those same federal regulations were in existence, and for exactly the same reasons compelled the conclusion that most insurance claims adjusters perform duties that are an integral part of the administrative operations of an insurance company's business. If the IWC had intended to make a substantive change in the law in issuing the new Wage Order, it would certainly have said so somewhere in its 21-page Statement As to the Basis. It did not. Its intention was merely to clarify, not change, the definition of the administrative exemption under California law.

None of the plaintiffs' counter-arguments has merit. The so-called "administrative/production dichotomy," which was the basis of the First District's opinions in *Bell* and the centerpiece of plaintiffs' arguments below, is but one tool among many for determining whether an employee qualifies for the administrative exemption. As numerous courts have concluded, it is of little analytic value in the modern service-based economy. Nor in any event can defendants' claims adjusters be considered "production" employees.

Significantly, the 1998 and 2003 opinion letters issued by California's Department of Labor Standards Enforcement, which adopt the dichotomy, also do not require a different conclusion. As the Court of Appeal and trial court acknowledged, such letters are not entitled to deference in interpreting an IWC Wage Order. Nor are they persuasive authority, and both pale to insignificance in light of the IWC's expressed intent in promulgating Wage Order 4-2001 to conform California law more closely to federal law.

For these reasons, the Court should hold, at a minimum, that (1) there are triable issues of fact as to whether plaintiffs perform duties that qualify as administrative work under California law, and (2) the administrative exemption has never been limited to employees who work at the level of policy or general operations. Accordingly, it should direct the trial court to reinstate its order denying plaintiffs' motion for summary adjudication on the issue of liability.

In addition, the Court should reject the central premise on which plaintiffs' class certification motion was based, i.e., that the administrative/production worker dichotomy could be determinative on the issue of whether each member of the plaintiff class qualifies for the exemption. Without the dichotomy, individualized issues of fact and law unquestionably predominate, and the Court should therefore direct the trial court to decertify the class in its entirety.

IV. ARGUMENT

A. The Plain Meaning of Wage Order 4-2001

The linchpin of the Court of Appeal's opinion, as well as its principal flaw, is its unprecedented conclusion that administrative work consists exclusively of work performed "at the level of *policy* or *general* operations." (*Harris, supra*, 154 Cal.App.4th at p. 177, italics in original.) In creating this unreasonably narrow test, the majority reasoned that defendants' claims adjusters could not be performing administrative work because instead of "giving advice about management policies or general operations" (*id.* at p. 179, fn. 7), they instead analyzed, negotiated, and made recommendations about specific claims (*id.* at p. 178), which the majority characterized as merely carrying out the "particular, day-to-day operations of the business." (*Id.* at p. 177.)

Despite the novelty and impact of defining administrative work so narrowly, the majority opined it could not imagine any other "plausible interpretation" of the distinction between administrative and production work. (*Id.*) In fact, the majority's restrictive interpretation is directly at odds with the plain meaning of Wage Order 4-2001, including the federal regulations it expressly incorporates.

In effect, the majority created a new test that overrules the Wage Orders promulgated by the IWC and enacted by the Legislature. Limiting the administrative exemption to employees who perform work "at

the level of policy or general business operations" is contrary to the plain meaning of the applicable regulations, established practice, generations of judicial decisions, and common sense. Most administrative employees perform work that contributes to the daily operations of the business but is still "directly related to management policies or general business operations." That the majority announced a contrary conclusion does not change this fact.[10]

One of the federal regulations the IWC expressly incorporated into Wage Order 4-2001, 29 C.F.R. § 541.205(c), removes any doubt about this fundamental issue. That regulation states that administrative work is "not limited to persons who participate in the formulation of management policies or in the operation of the business as a whole." It also includes employees whose work "affects policy *or whose responsibility it is to execute or carry it out*." (29 C.F.R. § 541.205(c), italics added.) This language cannot be reconciled with the majority's

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[10] Ultimately, the majority even reached the extraordinary conclusion that "*producing the employer's product is not a necessary condition for doing production, as opposed to administrative, work*." (*Harris, supra,* 154 Cal.App.4th at p. 181, original italics.) In so doing, the majority apparently confused the concepts of doing "administrative work" with being an "exempt employee." Many employees who are not exempt (because they do not meet other aspects of the test for the administrative exemption) are still performing "administrative" work.

conclusion that "work that merely carries out the particular, day-to-day operations of the business" cannot, by definition, be administrative work.[11]

Second, as the dissenting justice correctly noted (*Harris, supra,* 154 Cal.App.4th at p. 196 (dis. opn. of Vogel, J.), the majority's conclusion is at odds with two federal regulations the IWC expressly made part of the new Wage Order: 29 C.F.R. § 541.205(b) and 29 C.F.R. § 541.205(c)(5). The first provides a general description of the types of job duties that constitute administrative work, including the work plaintiffs do every day. The second lists specific examples of the types of employees who do such work, including "claim agents and adjusters."

1. 29 C.F.R. § 541.205(b)

This regulation defines the essential nature of the "administrative operations of the business" as work performed by "white-collar employees engaged in servicing a business, as, for example, advising the management, planning, negotiating [and] representing the company." As the dissent notes, "[t]hat is what claims adjusters do – they negotiate settlements (and conclude some without seeking approval), advise

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[11] Likewise, in section 1(2)(f), Wage Order 4-2001 states that administrative work includes all work that is "directly and closely related to exempt work," as well as "work which is properly viewed as a means for carrying out exempt functions."

management, and process claims." (*Harris, supra*, 154 Cal.App.4th at p. 196 (dis. opn. of Vogel, J.).)

The record is replete with evidence showing this is so. Plaintiffs "advise management," for example, by settling claims within their authority, and by making recommendations about the settlement of claims in excess of their standard authority. (Vol. 1, Tab 11, p. 122, ¶ 9; Vol. 3, Tab 26, pp. 530:7-8, 581:1-4, 582:5-10, 628:23-24, 636-38, Vol. 3, Tab 31, p. 696, ¶ 6; Vol. 3, Tab 34, p. 710-11, ¶ 6, ¶ 8.) They also advise their companies whether an attorney or an outside investigator is needed, as well as whether there are any potential subrogation or fraud issues. (Vol. 3, Tab 26, pp. 542:1-4, 545-46, 575-76, 577-79, 627:17-19; Vol. 4, Tab 42, p. 743, ¶ 11.)

Plaintiffs are responsible for "planning" the processing of a claim from beginning to end, whether it is quickly resolved or proceeds to litigation. Such planning includes setting reserves, as well as determining when to contact witnesses and whether to appoint a field investigator. (Vol. 1, Tab 12, p. 134, ¶ 20; Vol. 1, Tab 15, p. 154, ¶ 16; Vol. 3, Tab 31, p. 698, ¶ ¶ 7, 12.) Plaintiffs also prepare, maintain, and update action plans, i.e., the steps they plan to take to bring the case to its conclusion. (See, e.g., Vol. 3, Tab 26, p. 560:14-22; Vol. 3, Tab 31, p. 698, ¶ 12.)

Likewise, plaintiffs engage in "negotiating" with claimants or their attorneys to settle claims. (Vol. 1, Tab 12, p. 136, ¶ 20(o); Vol. 1,

Tab 11, p. 122-23, ¶¶ 9-10; Vol. 3, Tab 26, p. 530:7-8, p. 561:17-19; pp. 597:6-598:10, p. 628:8-10.) They also "represent their companies" in numerous respects. (Vol. 1, Tab 11, p. 123, ¶ 11; Vol. 1, Tab 12, p.135, ¶ 20(l); Vol. 1, Tab 15, p. 155; ¶ 16(o).) If the plaintiffs settle a claim, they are spending their company's money. They also determine, on behalf of their company, whether coverage should be denied and whether a claim should be referred to the subrogation or fraud units. (See Vol. 1, Tab 11, pp. 122, 123 ¶ ¶ 7, 9, 11, 18; Vol. 1, Tab. 12, p. 134-36, ¶ 20(d); Vol. 1, Tab 15, p. 154-155, ¶ 16(f) and (l); Vol. 2, Tab 16, p. 185 (98:26-99:1); Vol. 3, Tab 19, p. 461, ¶ 9; Vol. 3, Tab 20, p. 466, ¶ ¶ 9-10; Vol. 3, Tab 26, p. 587: 1-4, 623:10-16.)[12]

By expressly incorporating 29 C.F.R. § 541.205(b), Wage Order 4-2001 makes clear that the test for determining whether work is part of the "administrative" aspects of the business is whether it involves, among other things, advising the management, planning, negotiating, and representing the company. As the record below amply demonstrates, defendants' claims adjusters do all of these things.

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[12] For additional detail regarding the duties defendants' claims adjusters perform, see Vol. 2, Tab 16; Vol. 3, Tabs 18-21, 26, 28, 31, 34, 39; Vol. 4, Tabs 42, 46, 48, 51; Vol. 5, Tabs 55, 61; Vol. 6, Tabs 63, 68, and 70.

Contrary to the majority's interpretation, nothing in this regulation limits "administrative" work to formulating or overseeing the employer's general business policies. Nor is there any language that even remotely suggests that the job functions described in this regulation should not be regarded as "administrative" work just because they are performed as part of the day-to-day operations of the business.

2. 29 C.F.R. § 541.205(c)(5)

Any conceivable doubt insurance claims adjusters can qualify for the administrative exemption disappears after reading another federal regulation that Wage Order 4-2001 expressly incorporates; specifically, 29 C.F.R. § 541.205(c)(5). This regulation states that the "directly related to management policies or general business operations" requirement is also met by persons employed as "claim agents and adjusters." By limiting "administrative work" to work performed "at the level of policy or general operations," however, the majority effectively nullifies this regulation. Almost every job the regulation lists as an example of administrative work is performed by employees engaged in the "day-to-day operations" of their employers' business.

Instead of addressing the inconsistency between its restrictive interpretation and the express language in 29 C.F.R. section 541.205(c)(5), the majority cites another federal regulation (29 C.F.R. section 778.405). This regulation lists "insurance adjusters" as examples of employees

"whose duties may necessitate irregular hours of work" and who thus may enter into contracts guaranteeing constant pay for varying workweeks that might otherwise violate applicable overtime requirements. (*Harris*, *supra,* 154 Cal.App.4th at pp. 175-176.) The majority thus presumed the Department of Labor intended to convey the message that "insurance adjusters are not exempt." (*Harris, supra,* 154 Cal.App.4th at p. 176.)

As the dissent notes, however, any apparent inconsistency created by section 778.405 is irrelevant because, unlike the regulations upon which defendants rely, Wage Order 4-2001 does not even mention, let alone adopt, section 778.405. *(Harris, supra,* 154 Cal.App.4th at p. 197 (dis. opn. of Vogel, J.).) The IWC's Statement as to the Basis accompanying Wage Order 4-2001 makes clear that "only those federal regulations specifically cited in its wage orders, and in effect at the time of promulgation of these wage orders . . . apply in defining exempt duties under California law." (Vol. 5, Tab 62, p. 1292.)

The inference the majority draws from section 778.405, namely, that insurance adjusters cannot be exempt, is also far too broad. Section 778.405 is a regulation that discusses a method of payment; it does not purport to define who is and who is not exempt from overtime requirements. It does it address the nature or scope of the administrative exemption, nor does it offer any guidance as to which employees perform job duties that qualify as administrative work. It certainly does not create a

blanket rule that all employees titled "insurance adjusters" must be treated as non-exempt.

The conclusion the majority draws from section 778.405 is also incorrect. That section allows certain employees to be guaranteed overtime pay, which is contrary to the usual rule. (See 20 C.F.R. § 778.403.) To qualify for *guaranteed* overtime, an employee's job duties must necessitate irregular hours of work. Insurance adjusters are listed as examples of employees whose duties might qualify. So are other employees, e.g., buyers and newspaper reporters, who may or may not be exempt depending upon the circumstances, (See former 29 C.F.R. §§ 541.201(a)(2)[outside buyers] and § 541.302(f)[reporters].) Section 778.405 focuses on a method of payment, not a test for exempt status.

As defendants discuss below, there is no need to speculate or guess. Interpreting its own regulations, the Department of Labor has expressly determined that claims adjusters perform administrative duties under federal law. And, every federal court to address this same issue has agreed.

B. The Unanimous Authority From Federal Courts and the United States Department of Labor

In light of the plain meaning of the federal regulations the IWC has incorporated into California law, it is not surprising federal courts

– including the Ninth, Seventh, and Fifth Circuit Courts of Appeal – have spoken with one voice in concluding that insurance claims adjusting is an exempt administrative function:

- *In re Farmers Insurance Exchange, Claims Representatives' Overtime Pay Litigation* (9th Cir. 2007) 481 F.3d 1119, 1124 (*"In re Farmers Insurance Exchange III"*), amended Mar. 30, 2007 ("For more than 50 years, the Department of Labor has considered claims adjusters exempt from the Fair Labor Standard Act's overtime requirement.").

- *Roe-Midgett v. CC Services, Inc.* (7th Cir. Jan. 4, 2008, No. 06-3195) 2008 U.S. App. LEXIS 96, * 3 ("*Roe-Midgett*") (material damage appraisers' duties "directly relate to [the insurance company's] business operations and reflect a sufficient degree of discretion and independent judgment to qualify for the FLSA's administrative exemption.").

- *Cheatham v. Allstate Insurance Co.* (5th Cir. 2006) 465 F.3d 578, 586 (claims adjusters' "duties were directly related to and were important to Allstate's management policies and its general business operations.").

Numerous federal district courts have reached similar conclusions. (*Blue v. The Chubb Group* (N.D. Ill. July 13, 2005, No. 03C 6692) 2005 WL 1667794, *10 ("*Blue*") ["claims adjusters like Blue

typically perform administrative duties. 29 C.F.R. § 541.205(c)(5)"]; *McLaughlin v. Nationwide Mutual Insurance Co.* (D. Or. Aug. 18, 2004, No. Civ. 02-0605TC) 2004 WL 1857112, * 5 ("*McLaughlin*") ["The [claims representatives] in this case are service providers and not production workers."]; *Marting v. Crawford & Co.* (N.D. Ill. 2006) 2006 WL 681060, at p. 6; *Fichtner v. American Family Mutual Insurance Co.* (D. Or. Mar. 1, 2004, No. 02-6284-HO) 2004 WL 3106753, *3; *Jastremski v. Safeco Insurance Co.* (N.D. Ohio 2003) 243 F.Supp.2d 743, 751; and *Munizza v. State Farm Mutual Automobile. Insurance, Co.* (W.D. Wash. May 12, 1995, No. C94-5345RJB) WL 17170492, *5.)[13]

In analyzing California's administrative exemption, the Court should give the views of the United States Department of Labor the same deference and weight as a federal court would in analyzing the administrative exemption under federal law. (*Monzon v. Schaefer Ambulance Service, Inc.* (1990) 224 Cal.App.3d 16, 39 ["The Department of Labor enforces FLSA (29 U.S.C. § 204), and its interpretation of FLSA is entitled to great respect"]; *Campos v. Employment Development Dept.*

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[13] The majority acknowledged this authority, but brushed it aside as manifesting "considerable confusion" just because different federal courts reached the same conclusion in different ways. (*Harris, supra,* 154 Cal.App.4th at p. 182, n. 9.) It then rather cavalierly characterized the analysis in all the federal cases as "misguided." (*Id.*)

(1982) 132 Cal.App.3d 961, 967 [noting that "interpretations of the federal statute by federal agencies such as the Department of Labor, although not binding on the courts, are entitled to great weight"].)

In November 2002, the Department issued an opinion letter regarding the exempt status of insurance adjusters. (Vol. 3, Tab 26, pp. 646-49.) After engaging in a comprehensive analysis, the Department determined that the claims adjusters were properly classified as exempt administrative employees. The Department cited the regulation's reference to claims adjusters, and unequivocally took the position that insurance adjusters perform an administrative function: "Because [their] duties involve servicing the insurance company in the same manner that claims adjusters traditionally have done so, as is reflected in the regulatory reference to claims adjusters, we find that [the claims adjusters'] duties are administrative in nature." (*Id.* at p. 647.)[14]

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[14] As it did in rejecting the unanimous authority from federal courts, the majority dismissed the Department's 2002 letter out of hand, labeling it as neither "thorough, well-reasoned, or persuasive." (*Harris*, *supra*, 154 Cal.App.4th at p. 185.)

For good measure, the majority added it was also "not persuaded by the DOL opinion letters from 1985, 1963, and 1957" even though they were cited with approval by the Ninth Circuit in *In re Farmers Ins. Exchange III, supra,* 481 F.3d at p. 1128-1129. (See *Harris*, *supra*, 154 Cal.App.4th at p. 186, fn. 11.)

Numerous courts have applied the Department's opinion letter and found that it is "well-reasoned" and entitled to deference. (*In re Farmers Insurance Exchange Claims Representatives' Overtime Pay Litigation* (D. Or. 2003) 300 F.Supp.2d 1020, 1035 ("*In re Farmers Insurance Exchange I*"), affd. in part & revd. in part (9th Cir. 2007 481 F.3d 1119; *McLaughlin*, *supra*, 2004 WL 1857112, at p. *6; *Blue*, *supra*, 2005 WL 1667794, at p. 11; *Camp v. Progressive Corp.* (D. La. Sept. 23, 2004, No. 01-2680) 2004 U.S. Dist. LEXIS 19172, *45-46.) [15]

In 2004, the Department updated the federal regulations applicable to the overtime exemptions and made it even clearer that insurance claims adjusters typically perform duties that qualify for the administrative exemption: "Insurance claims adjusters generally meet the duties requirements for the administrative exemption, whether they work for an insurance company or other type of company . . . ." (29 C.F.R. § 541.203(a).)

Although the IWC did not have the benefit of this new regulation when it promulgated either Wage Order 4-1998 or Wage Order

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[15] In August 2005, the Department issued an opinion letter finding that adjusters who work for a third-party administrator (i.e., a company that sells claims adjusting services to other companies) were also properly classified as exempt administrative employees. (Vol. 3, Tab 26, pp. 651-58.)

4-2001, the new federal regulation is still relevant because it is a clarification (not a change) of the Department's position. In promulgating section 541.203 in 2004, the Department stated the new regulation "is consistent with existing section 541.205(c)(5)." (69 Fed. Reg. 22122, 22144 (April 23, 2004); *In re Farmers Insurance Exchange III*, *supra*, 481 F.3d at p. 1128.) Therefore, according to the Department of Labor, the regulation that serves as the basis for California's administrative exemption expressly provides that insurance adjusters generally qualify as exempt administrative employees.

C. The IWC's "Statement As to the Basis"

The Statement As to the Basis the IWC issued to explain its reasons for adopting Wage Order 4-2001 makes these federal authorities especially relevant. (Vol. 5, Tab 62, pp. 1289-1309.) Two points stand out. First, as the trial court noted, the IWC Statement makes clear that the "duties that meet the test for the administrative exemption" under California law are derived from the language of the federal regulations that the new Wage Order adopted. Specifically, it noted that "[t]hese regulations include types of administrative employees [and] categories of administrative work . . . ." (Vol. 5, Tab 62, p. 1293.) Federal authorities play an important role in deciding what job duties constitute "administrative" work

because the construct and nature of the duties that qualify for the administrative exemption in California are derived from federal law.

Second, the IWC's Statement makes clear that the reason the new Wage Order identified and adopted certain specific federal regulations was "to promote consistent enforcement practices" and "uniformity of enforcement" between state and federal law. (Vol. 5, Tab 62, pp. 1291-1292.) As discussed above, it is well-settled that most insurance claims adjusters are exempt administrative employees under federal law. The only way to achieve the uniformity of enforcement that the IWC expressly intended is to reach the same conclusion under California law.

D. Defendants' Conclusions Are Also Correct For the Period Governed by Wage Order 4-1998

Although it is particularly clear under Wage Order 4-2001 that most claims adjusters qualify for the administrative exemption under California law, the same was also true under Wage Order 4-1998. The two things that matter the most have remained the same: the nature of the duties defendants' claims adjusters perform and the two key federal regulations – 29 C.F.R. §§ 541.201(c)(5) and 541.201(b) – which the new Wage Order incorporates.

Both before and after the IWC adopted Wage Order 4-2001, as the trial court found on undisputed facts, defendants' claims adjusters'

duties were to "establish reserves, evaluate damages and liabilities, review policies for coverage, attempt to identify fraud, negotiate settlements and collaborate with counsel to pursue litigation on the company's behalf [and perform duties that] go well beyond merely providing information." (Vol. 6, Tab 72, p. 1462.)

Likewise, the federal regulations identified "claim agents and adjusters" as examples of employees who might qualify for the exemption and defined the "administrative operations of the business" to include the types of work claims adjusters perform, i.e., advising the management, planning, negotiating, and representing the company. The only difference is that Wage Order 4-1998 did not expressly incorporate these regulations. As the court in *Bell II* recognized in interpreting Wage Order 4-1998, federal authorities "are relevant to interpretation of the term 'administrative capacity.'" (*Bell II, supra,* 87 Cal.App.4th at p. 816.)

Because the new Wage Order makes it so clear that insurance claims adjusters typically qualify for the administrative exemption, and since there is no indication the IWC intended to change the nature or scope of the administrative exemption in promulgating Wage Order 4-2001, it follows that before the new Order, as afterwards, most insurance claims adjusters performed duties that qualified for the administrative exemption under California law.

E. Neither of the Plaintiffs' Main Counter-Arguments Has Merit

Below, plaintiffs mainly relied on two arguments: the so-called "administrative/production worker dichotomy" and the Opinion Letters written by the California Department of Labor Standards Enforcement (DLSE). Neither argument has merit.

1. The Administrative/Production Worker Dichotomy

Plaintiffs' principal argument below was based on the administrative/production worker dichotomy, as that concept was applied by the First District Court of Appeal in *Bell II* and *Bell III*. The dichotomy was the basis of the trial court's original ruling certifying a plaintiff class, and it figured prominently in the opinion of the Court of Appeal. As discussed below, numerous federal courts have instead held that the dichotomy is just one tool among many in deciding whether an employee is doing administrative work, and one that is of little or no relevance when applied to modern-day service-oriented businesses.

The *Bell* court misconstrued and unduly exaggerated the importance of the dichotomy in applying it to the "restricted record" in that case. So did the Court of Appeal below, which equated "day-to-day work" with "production work" and reached the remarkable conclusion that "*producing the employer's product is not a necessary condition for doing*

production, as opposed to administrative, work." (*Harris v. Liberty Mutual, supra,* 154 Cal.App.4th at p. 182, italics in original.)

Were the dichotomy to be correctly applied in the present case, however, it would support the conclusion that plaintiffs perform administrative work. Because the essential "product" of insurance companies is the transfer of risk, not the administrative task of claims adjusting, defendants' claims adjusters cannot be placed on the "production" side of the dichotomy. Moreover, defendants' claims adjusters perform work that 29 C.F.R. § 541.205(b) lists as being part of the "administrative operations of the business."

a. The Dichotomy and *Bell*

In *Bell II*, plaintiffs were a class of former and current claims representatives with Farmers Insurance Exchange. Relying heavily on Farmers' admission that these employees only performed "routine and unimportant" tasks, the court upheld the trial court's summary adjudication that they did not qualify for the administrative exemption under Wage Order 4-1998. (*Bell II*, 87 Cal.App.4th at p. 828.) Three years later, after a jury awarded substantial damages, *Bell III* held the "law of the case doctrine" precluded it from reconsidering its earlier decision. (*Bell III*, 115 Cal.App.4th at p.739.) Neither opinion analyzed Wage Order 4-2001.

Although it acknowledged that federal authorities construing parallel provisions of federal law were relevant to construing the

administrative exemption, *Bell II* declined to consider the federal regulations as a whole, or even any single regulation in its entirety. It focused instead on the so-called "administrative/production worker dichotomy" that is derived from language in one subsection of one federal regulation (29 C.F.R. § 541.205(a).) That section distinguishes between the "administrative operations of a business" and "production" work: "The phrase 'directly related to management policies or general business operations of his employer or his employer's customers describes those types of activities relating to the administrative operations of a business as distinguished from 'production' or, in a retail or service establishment, 'sales' work."

The dichotomy is not a legal test. It is an analytic "tool toward[]answering the ultimate question, whether work is 'directly related to management policies or general business operations' (29 C.F.R. § 541.2(a)(1)), not as an end in itself." (*Bothell v. Phase Metrics, Inc.* (9th Cir. 2002) 299 F.3d 1120, 1127.) In answering this "ultimate question," courts "must construe the statutes and applicable regulations as a whole." (*Id.*) The dichotomy is only determinative if the "work falls squarely on the 'production' side of the line." (*Id.*; see also *Bell III*, 115 Cal.App.4th at p. 731.)

The dichotomy arose at a time when the American workplace was primarily divided into two categories: so-called blue-collar

"production workers," and white-collar "administrative workers." (See *Marting v. Crawford & Co., supra, 2006 WL 681060, * 6.)* When *Bell II* and *Bell III* were decided, there were few cases construing the administrative exemption under California law. No California court had evaluated the applicability of the dichotomy in an insurance adjuster case. Unlike current Wage Order 4-2001, Wage Order 4-1998 provided little specific guidance and did not expressly incorporate any federal regulations.[16]

Since then, however, the nationwide boom in wage and hour class actions has resulted in numerous administrative exemption cases. Many have correctly characterized the dichotomy as "outmoded," "outdated," and certainly not determinative:

- *McLaughlin, supra,* WL 1857112, at p. *5: "[T]his court declines plaintiff's invitation to analyze the present situation under an outdated line of reasoning. As amply shown by defendants, the [claim

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[16] The trial court noted the *Bell II* court "had very few definitive resources to assist in the task of interpreting the administrative exemption so starkly stated in unamended Wage Order 4. The unamended Wage Order merely states that wage and hour restrictions 'shall not apply to persons employed in administrative, executive, or professional capacities.'" (Vol. 6, Tab 72, p. 1451.)

representatives] in this case are service providers and not production workers."

- *Roe-Midgett, supra,* 2008 U.S. App. LEXIS 96, at p. *18: "[T]he so-called production/administrative dichotomy – a concept that has an industrial age genesis – is only useful by analogy in the modern service-industry context. . . . The analogy is not terribly useful here. . . ."

- *Blue, supra,* 2005 WL 1667794, at p. *10: "The typical example of the production/administrative dichotomy is a factory setting where the 'production' employees work on the line running machines, while the administrative employees work in an office communicating with the customers and doing paperwork."

- *In re Farmers Insurance Exchange II, supra,* 336 F. Supp. 2d at p. 1087, affd. in part, *In re Farmers Insurance Exchange III, supra*, 481 F.3d 1119: "Because the regulations suggest a distinction between the administration of a business on the one hand, and the 'production' end of a business on the other, courts have often strained to fit the operations of modern-day post-industrial service-oriented businesses into an analytical framework formulated in the industrial climate of the late 1940s."

- *Robinson-Smith v. Government Employees Insurance Co.* (D.D.C. 2004) 323 F.Supp.2d 12, 23, fn. 6: "Like Judge Jones in *In re Farmers*, this Court declines to analyze the current situation under an

outmoded line of reasoning. Attempting to force the current situation into a production analogy makes no sense."

- *Marting v. Crawford & Co.*, *supra*, 2006 WL 681060, at p. *5: The federal district court noted "[plaintiff's] argument is meant to suggest that she was like an assembly line worker who creates widgets according to a detailed set of instructions."

In updating the federal regulations in 2004, moreover, the Department of Labor stated that one of its goals was to "to reduce the emphasis on the so-called 'production versus staff' dichotomy in distinguishing between exempt and nonexempt workers." (69 Fed. Reg. 22121, 22140 (2004).) In commenting on the updated regulations, the U.S. Chamber of Commerce observed that the dichotomy "does not fit in today's workplace" because the "decline in manufacturing and the rise in the service and information industries has rendered the production dichotomy an artifact of a different age." (*Id.*)

Even *Bell II* cautioned that the dichotomy, although a "useful approach to construing a statutory term," demands "further refinement in some cases." (*Bell II, supra,* 87 Cal.App.4th at p. 820.) It characterized the dichotomy as a "somewhat gross distinction that may not be dispositive in many cases" and commented that "California courts must use great caution in granting summary judgment or summary adjudication on the basis of

such a broad distinction as the administrative/production worker dichotomy." (*Id.* at pp. 826-827.)[17]

Despite such reservations, *Bell II* concluded that Farmers' admission regarding the limited role of its claims adjusters permitted it to apply the dichotomy and find that these particular adjusters were non-exempt production workers: "Nevertheless, we are persuaded the trial court properly granted summary adjudication in the present case on the basis of FIE's characterization of the claims representative's role in the company. The regional claims manual of the Farmers Insurance Group states, 'We have made a deliberate decision to vest the responsibility for our operations upon the branch and regional claims managers, and it is necessary that these officials accept this in its full sense. Again, *the actual handling of the routine and unimportant may be delegated, but questions of importance must be decided by the branch claims manager, and at a higher level by the regional claims manager.'"* (*Bell II*, 87 Cal.App.4th at p. 827 (original italics).)

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[17] *Bell II* recognized such caution was particularly appropriate "[i]n the absence of detailed interpretive regulations [under California law] comparable to those in federal cases . . . " (*Id.* at p. 827.) By expressly incorporating certain federal regulations, including 29 C.F.R. § 541.205, Wage Order 4-2001 now provides such "detailed interpretive regulations."

The *Bell* court took great care to emphasize that its decision was confined to the unique facts of that case: "[W]e found that the evidence *in the record before us* was sufficiently clear to justify the trial court's summary adjudication. Our opinion in *Bell II* was based on the restricted record before us and cannot be read out of that context." (*Bell* III, 115 Cal. App. 4th at p. 730 (emphasis in original).) Based on Farmers' admission that its adjusters performed only "routine and unimportant" work, *Bell II* concluded that "[t]his characterization of their role in the company places plaintiffs in the sphere of rank and file production workers." (*Bell II*, 87 Cal.App.4th at p. 828.) As a result of the "undisputed evidence," in the "restricted record" before it, the *Bell* court concluded the work performed by Farmers' claims representatives fell "squarely on the production side of the administrative/production worker dichotomy." (*Id.* at p. 826.)

Perhaps because it focused so narrowly on the dichotomy, Bell *II* gave little attention to considering the guidance in other federal regulations, including two that directly contradicted its reasoning.[18] First, it

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[18] Although *Bell II* considered federal law "relevant" to interpreting California's wage orders, it did not believe it appropriate to incorporate the "entire corpus of federal regulations construing the administrative exemption" in interpreting Wage Order 4-1998. Instead, it looked to federal law "only for insights and general methodology in construing the term 'administrative capacities.'" (*Bell II, supra,* 87 Cal.App.4th at p. 820.)

gave short shrift to 29 C.F.R. § 541.205(c)(5), which specifically identified "claim agents and adjusters" as employees who meet the "directly related" test. (*Bell II*, 87 Cal.App.4th at p. 827.) Disregarding this specific reference is inconsistent with the regulatory scheme and violates the general rule that specific language controls over more general language. (See *Dept. of Alcoholic Beverage Control v. Alcoholic Beverage Control Appeals Board* (1999) 71 Cal.App.4th 1518, 1524; *Friends of the Library of Monterey Park v. City of Monterey Park* (1989) 211 Cal.App.3d 358, 370-371.)

Second, although *Bell II* found persuasive the "insights and general methodology" of the dichotomy derived from subsection (a) of 29 C.F.R. § 541.205, it made no mention of subsection (b) of that same regulation, which specifies activities that constitute the "administrative operations of a business." (*Bell II, supra,* 87 Cal.App.4th at p. 820; see *Fichtner v. American Family Mutual Insurance Co.* (D. Or. Mar. 1, 2004, No. 02-6284-HO) 2004 WL 3106753, *5) ["Negotiating on behalf of and

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As the trial court correctly noted, after the enactment of Wage Order 4-2001, "the language of the entire federal regulation must be considered, not just the 'insights and a general methodology' from federal law embraced by the *Bell* decisions." (Vol. 6, Tab 72, p. 1457 n. 1 (citation omitted).)

representing defendant is the kind of work the regulations view as administrative."].)

Further, the *Bell* court only applied Wage Order 4-1998, which did not expressly incorporate the federal regulations. Thus, the court noted it operated "[i]n the absence of detailed interpretative regulations comparable to those in federal cases." (*Bell II*, *supra*, 87 Cal.App.4th at p. 827.) By incorporating certain specific federal regulations into Wage Order 4-2001, the IWC provided this Court with the "detailed interpretative regulations" that the *Bell* court acknowledged it did not have.

Given that *Bell II* declined to follow the straightforward analytic path set forth by the operative regulations, it is not surprising numerous courts have either distinguished or rejected *Bell's* approach as applied to insurance claims adjusters. (*McLaughlin*, *supra*, 2004 U.S. Dist. LEXIS 21841, at p.*7, fn. 3 ("*Bell*'s focus on the administrative/production dichotomy appears to have skewed the court's overall view of defendant's business activities and the [claims representative's] place in those activities."); *Camp v. Progressive Corp.*, *supra*, 2004 U.S. Dist. LEXIS 19172, at p. 42, fn. 5; *Jastremski v. Safeco Insurance Co.*, *supra*, 243 F. Supp. 2d at p. 753; *Marting v. Crawford & Co., supra,* 2006 WL 681060, at p.*7, fn. 5); and *Palacio v. Progressive Insurance Co.* (C.D. Cal. 2002) 244 F. Supp. 2d, 1040, 1051.)

The Ninth Circuit, too, has rejected *Bell II*'s emphasis on the dichotomy as "form over substance": "'That FIE's adjusters represent the 'claims handling arm of the Farmers Insurance Group of Companies,' (citation omitted) does not mean they fall on the production side of the 'administrative/ production worker dichotomy.' To place them there would elevate form – corporate form, to be precise – over substance." (*In re Farmers Insurance Exchange III*, *supra*, 481 F.3d at p. 1132.)

Unlike the trial court, this Court is not bound by *Bell* for the period before the effective date of Wage Order 4-2001. Properly characterizing the dichotomy as but one part of the analysis and dispositive in only the clearest cases, the Court should hold that both before and after the effective date of Wage Order 4-2001, there is unquestionably a triable issue as to whether plaintiffs perform duties that qualify for the administrative exemption.[19]

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[19] In addition, in finding that Farmers' claims adjusters were "production" workers, the *Bell II* court found it "particularly significant that FIE performs a substantial amount of claims handling work for other companies within the Farmers Insurance Group of Companies and is reimbursed for the cost of these services." (*Bell II, supra,* 87 Cal.App.4th at p. 824.) Such is not the case with Liberty Mutual or Golden Eagle.

In any event, this distinction makes no difference. Another regulation that Wage Order 4-2001 expressly incorporates, 29 C.F.R. § 541.205(d), provides that employees may qualify for the administrative exemption "regardless of whether the management policies or general business

b. The Dichotomy and *Harris*

Below, the Court of Appeal was also not bound by *Bell.* Rather than rejecting *Bell's* analysis, or at least putting it in context, the court applied the dichotomy even more expansively. Although it acknowledged defendants' claims adjusters performed duties that involved advising management, planning, negotiating, and representing the company – activities that 29 C.F.R. § 541.205(b) defines as the "administrative operations of the business" – the court characterized these duties as "production work" because they are not carried out "at the level of policy or general operations."

Without support, the court simply announced its unprecedented view that the "day-to-day business of processing individual claims" is by definition "production" work, even if it involves "planning, negotiating, and representing the company." (*Harris, supra,* 154 Cal.App.4th at p. 181.) Still further, the court opined that "producing the employer's product is not a necessary condition for doing production, as opposed to administrative, work." (*Id.*) [20]

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operations to which their work is directly related are those of their employer's clients or customers or those of their employer."

[20] The authority the majority cites for its conclusion, *Martin v. Cooper Electric Supply Co.* (3d Cir. 1991) 940 F.2d 896, does not hold that

These conclusions are contrary to the applicable regulations and the ordinary meaning of words. Work that the regulations specifically define as "administrative," e.g., planning, negotiating, and representing the company, cannot reasonably be considered "production work." Nor does it make sense to define "production work" to include work that does not involve "producing the employer's product." Or to conclude that all "day-to-day" work, regardless of its nature, automatically falls on the "production" side of the dichotomy.

In reaching these conclusions, the *Harris* majority apparently confused the concepts of doing "administrative work" with being an "exempt employee." Doing work that is administrative in nature is only one part of the test for exempt status under California's administrative exemption. To be exempt under Wage Order 4-2001, an employee must also exercise "discretion and independent judgment." (Wage Order 4-2001, § 1(A)(2)(b).) Conversely, an employee who is not exempt (for other reasons) may still be doing work that is administrative in nature. By conflating these two concepts, the *Harris* majority misapplied the

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"production work" extends beyond work involved in producing a company's product. *Martin* simply held that in a wholesale sales establishment, "production work" could extend beyond *manufacturing* activities. (*Id.* at 903-904.)

dichotomy and reached conclusions that contradict the plain meaning of the Wage Orders.[21]

At a minimum, the record below, the express language of the applicable regulations, and the uniform federal authority holding that insurance claims adjusters can be exempt administrative employees preclude a finding that defendants' adjusters perform work that falls "squarely on the 'production' side of the line." (*Bell II, supra,* 87 Cal.App.4th at p. 826.)

Simply stated, *Bell* and *Harris* apply the dichotomy in a way that dramatically overstates its importance and greatly exaggerates its proper use, which is to serve a limited purpose, in the clearest cases, as one analytic tool among many. It is almost never dispositive, either before or after the effective date of Wage Order 4-2001.

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[21] Concluding that "the phrase 'administrative/production worker dichotomy' is misleading," the majority did not attempt to fit defendants' claims adjusters into the traditional construction of the dichotomy. It redefined the dichotomy as a contrast "between office or nonmanual work that is at the level of policy or general operations and office or nonmanual work that is not." (*Harris*, *supra*, 154 Cal.App.4th at p. 182, n.8

c. In any Event, Defendants' Claims Adjusters Are Not "Production" Employees

Were the Court to apply the dichotomy in the present case, it would find one more reason to characterize defendants' claims adjusters as administrative employees under California law. Simply stated, defendants' "product" is the transfer of risk, not claims adjusting. In urging the opposite conclusion below, plaintiffs principally relied on the DLSE's 1998 Opinion Letter, which in conclusory fashion declared that, "[t]he processing and resolution of claims constitutes the principal product of an insurance company, so that an insurance company claims adjuster is nothing more than a line worker, engaged in the 'production' of his or her employer's principal product...." (Pl. Exh., Vol. 4, Tab 26, pp. 1048-1049.)

The DLSE's opinion reflects a fundamental misunderstanding of the insurance business. Numerous courts have rejected the notion that the "product" of an insurance company is claims adjusting. For example, in *McLaughlin, supra,* 2004 WL 1857112, at p. *5, the court held that the defendant insurance companies were "in the business of designing and creating insurance policies and selling them to customers" and that such "policies are the product created and generate defendant's revenues." Although the court acknowledged that the defendant insurers "receive[d] claims and do claims processing on a fraction of their policies," it held that doing so was simply a "cost of doing business and not a product."

Likewise, in *Reich v. John Alden Life Insurance Co.* (1st Cir. 1997) 126 F.3d 1, 9, the First Circuit observed, in applying the dichotomy, that "the 'products' generated by [the insurance company] are the insurance policies themselves."[22] The court added that because the plaintiff marketing representatives were "in no way involved in the design or generation of insurance policies, the very product 'that the enterprise exists to produce and market' (citation omitted), they cannot be considered production employees."[23]

In most instances, consumers who purchase insurance and incur a loss are indifferent as to how much their insurance company spends to resolve claims made against them by third parties. As the court in *McLaughlin* noted, claims processing is a "cost of doing business," not a

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[22] But see *Bell III, supra*, 115 Cal.App.4th at p. 737, which characterized this language as dicta and, in footnote 10, observed that "[i]t is not difficult to find judicial recognition of claims adjusting as an important component of an insurance business."

[23] See also *Roe-Midgett, supra,* 2008 U.S. App. LEXIS 96, at p. *17 ("CCS's customers are insurance companies in the business of selling policies, and employees who process claims against those policies are performing an administrative function for CCS's customers (i.e., a task that administers the policies "produced" by the insurers); *Jastremski*, *supra*, 243 F.Supp.2d 743, 753 ("The insurance company was in the business of producing insurance policies, not settling claims."); and *Palacio v. Progressive Insurance Co.*, *supra*, 244 F.Supp.2d at p. 1047 (plaintiff insurance claims representative was exempt because her job was "related to

"product." (*McLaughlin*, *supra*, 2004 WL 1857112, at p. *5.) That a claims adjuster's role is to "represent the company," not produce a product, is even more apparent when an insured makes a first party claim for damage to an insured's own property. There, the adjuster's role is to investigate the claim and attempt to negotiate a settlement, on behalf of adjuster's employer, with the insured. The "product" the insured purchases in these circumstances is obviously protection against risk, not the administrative task of negotiating with an insurance adjuster to resolve a claim.[24]

For all these reasons, plaintiffs' lead argument that the dichotomy is dispositive because defendants' claims adjusters are so clearly "production" workers is a nonstarter.

2. The DLSE Opinion Letters

Below, plaintiffs also relied heavily on two opinion letters written by a staff attorney with the DLSE. The first, written on October 5, 1998, in response to a request from the *Bell* plaintiffs, applies the

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servicing the business" "even though those activities can be viewed as ancillary to the provision of a good or service").

[24] Likewise, this Court and the American Institute for Chartered Property Casualty Underwrites have opined that the purpose of an insurance policy is to transfer risk from policyholders to the insurer. (*Cates Construction,*

administrative/production worker dichotomy and concludes the claims adjusters described by the Bell plaintiffs' attorneys were non-exempt production workers. (Pl. Exh., Vol. 8, Tab 30, pp. 2120-2132.)[25] The second, written by the same attorney on May 23, 2003, generally concludes the dichotomy analysis remains viable even after the IWC adopted new Wage Order 4-2001. (Pl. Exh., Vol. 12, Tab 53, p. 3367.) Neither letter is persuasive, let alone binding.

As the trial court and Court of Appeal acknowledged, DLSE Opinion Letters are "not entitled to deference and [do] not have the force of law." (*Harris, supra*, 154 Cal.App.4th at p. 186; Vol. 6, Tab 72, pp. 1457-1458, citing *Arementa v. Osmose, Inc.* (2005) 135 Cal.App.4th 314, 324.) As this Court held in *Tidewater Marine Western, Inc. v. Bradshaw* (1996) 14 Cal.4th 557, 576, the DLSE's views for determining how to apply IWC

Inc. v. Talbot Partners (1999) 21 Cal.4th 28, 44; Vol. 8, Tab 33, pp. 2299-2300.)

[25] Because the 1998 letter was written in response to facts articulated by the *Bell* plaintiffs' counsel, to some degree it likely reflected plaintiffs' point of view. The DLSE now prohibits this approach by requiring anyone soliciting an opinion to represent that, "this opinion is not sought by a party to a pending private litigation concerning the issue addressed herein." (See Division of Labor Standards Enforcement Web site, at http://www.dir.ca.gov/dlse/DLSE_OpinionLetters.htm.)

In addition, *Bell II* did not rely upon the 1998 letter in applying the dichotomy. It simply cited it as authority that federal law is relevant to

Wage Orders are "void for failure to comply with the [Administrative Procedure Act]." Unlike the Department of Labor, which drafted the federal regulations, the DLSE enforces – but did not draft – California's Wage Orders.

Although courts may view DLSE Opinion Letters as instructive, they are not required to do so. Indeed, courts have often disagreed with the views expressed in DLSE opinion letters. (See, e.g., *Conley v. Pacific Gas & Electric Co.* (2005) 131 Cal.App.4th 260, 271; *Hudgins v. Neiman Marcus Group, Inc.* (1995) 34 Cal.App.4th 1109, 1121; and *Medrano v. D'Arrigo Brothers Co. of California* (N.D. Cal. 2004) 336 F.Supp.2d 1053, 1058.)

There are a number of reasons why neither of the DLSE's opinion letters is persuasive, or even instructive, in this instance. First, although both letters look to federal law for the general concept of the administrative/production worker dichotomy, neither considers all the relevant federal law, either before or after Wage Order 4-2001. Neither can be squared with the plain meaning of the applicable Wage Orders,

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interpreting California's administrative exemption. (*Bell II, supra,* 87 Cal.App.4th at p. 816.)

especially in light of the federal regulations that Wage Order 4-2001 expressly incorporates.

Second, in urging a divergence from well-established federal law, the DLSE letters contradict the IWC's stated intent in adopting Wage Order 4-2001 to promote "uniformity of enforcement" between state and federal law. (Vol. 5, Tab 62, pp. 1291-1292.) Moreover, in purporting to interpret the applicable federal regulations, the DLSE reached conclusions that contradict those reached by the author of such regulations – the Department of Labor.

Third, the 1998 letter only interpreted Wage Order 4-1998, not Wage Order 4-2001. It also did not have the benefit of later authority from federal courts that interpreted the same regulatory language.

Fourth, to the extent the 2003 letter affirms the notion the federal regulations continue to be relevant after the effective date of Wage Order 4-2001, defendants agree. Notably, this letter cautions the "the *Bell* court recognized the dichotomy's limitations." (Pl. Exh., Vol. 12, Tab 53, p. 3376.) It also rejected the contention the DLSE could make an across-the-board finding regarding an entire occupation. What is required is, among other things, "a factually intensive determination that looks to exactly what work is performed by the employee. . . ." (Pl. Exh. Vol. 12, Tab 53, p. 3388.) This, of course, was the same reasoning the trial court used in denying the plaintiffs' motion for summary adjudication.

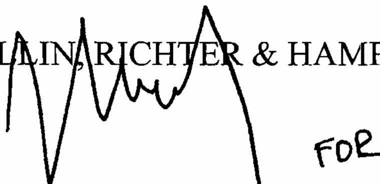
V. CONCLUSION AND REQUESTED DISPOSITION

For these reasons, defendants respectfully urge the Court to hold that (1) at a minimum, there are triable issues of fact as to whether plaintiffs perform duties that qualify as administrative work under California law, and (2) the administrative exemption has never been limited to employees who work the level of policy or general operations. It should therefore direct the trial court to reinstate its order denying plaintiffs' motion for summary adjudication on the issue of liability.

In addition, the Court should hold that because the plaintiffs' motion for class certification was based on the assumption the dichotomy could be outcome-determinative as to liability in this case – a premise that is both legally erroneous and factually unsupported in this case – the trial court should decertify the class in its entirety.

DATED: January 25, 2008

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP



By ______________________ FOR

DOUGLAS R. HART
Attorneys for Defendants and Real Parties in Interest
LIBERTY MUTUAL INSURANCE COMPANY and
GOLDEN EAGLE INSURANCE CORPORATION

CERTIFICATE OF WORD COUNT

(Cal. Rules of Court, Rule 8.504 (1)(d))

The text of this petition consists of 12,402 words, including all footnotes, as counted by the computer program used to generate this brief.

DATED: January 25, 2008

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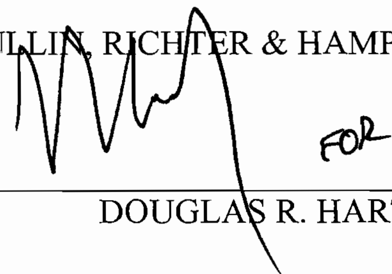

By ______________________________

DOUGLAS R. HART

Attorneys for Defendants and Real Parties
LIBERTY MUTUAL INSURANCE
COMPANY and GOLDEN EAGLE
INSURANCE CORPORATION

PROOF OF SERVICE
STATE OF CALIFORNIA, COUNTY OF SAN FRANCISCO

I am employed in the County of San Francisco; I am over the age of eighteen years and not a party to the within entitled action; my business address is 4 Embarcadero Center, 17th Floor, San Francisco, CA 94111-4109.

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OPENING BRIEF ON THE MERITS

on the interested party(ies) in this action by placing true copies thereof enclosed in sealed envelopes and/or packages addressed as follows:

See attached list.

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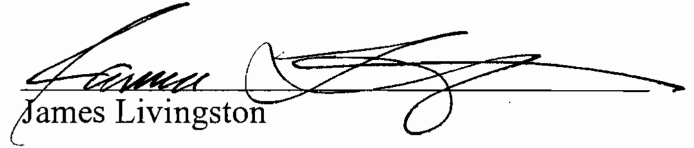
Executed on **January 25, 2008**, at San Francisco, California.



James Livingston

SERVICE LIST

Ira Spiro, Esq. Katherine J. Odenbreit, Esq. Justian Jusuf, Esq. Spiro Moss Barness LLP 11377 W. Olympic Blvd., 5th Floor Los Angeles, CA 90064-1683 Telephone: (310) 235-2468 Facsimile: (310) 235-2456	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Steven W. Pepich, Esq. LERACH COUGHLIN STOIA GELLER RUDMAN & ROBBINS LLP 655 West Broadway, Suite 1900 San Diego, CA 92101 Telephone: (619) 231-1058 Facsimile: (619) 231-7423	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Timothy Cohelan, Esq. COHELAN & KHOURY 605 C Street, Suite 200 San Diego, CA 92101-5305 Telephone: (619) 595-3001 Facsimile: (619) 595-3000	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Michael L. Carver Law Offices of Michael L. Carver 1600 Humbolt Road, Suite 3 Chico, CA 95928-8100 Telephone: (530) 891-8503 Facsimile: (530) 891-8512	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Ronald A. Reiter Supervising Deputy Attorney General Consumer Law Section Office of the Attorney General 455 Golden Gate Avenue, Suite 11000 San Francisco, CA 94102 Telephone: (415) 703-5500	Attorneys for Non-Party, State of California
Consumer Law Section Los Angeles District Attorney 210 West Temple Street, Suite 1800 Los Angeles, CA 90012-3210 Telephone: (213) 974-3512 Facsimile: (213) 974-1484	Attorneys for Non-Party, County of Los Angeles