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One Minute Memo®

Court Of Appeal Rejects Application Of "Administrative/Production Worker Dichotomy" And Holds That Insurance Claims Adjusters Can Be Exempt

On February 24, 2011, the California Court of Appeal certified for publication its decision in *Hodge v. AON Insurance Services, et al.* The case holds that insurance claims adjusters can be administrative employees exempt from California's overtime pay requirements. Of particular importance to all employers is the court's discussion of the "administrative/production worker dichotomy." This supposed dichotomy has been applied by courts to preclude exempt status for employees whose work involves providing the services their employers sell. The *Hodge* court rejected uniform application of the dichotomy, holding that it is merely "*one analytic tool*" that should "only [be used] to the extent it clarifies the [exemption] analysis."

The Insurance Claims Adjusters In *Hodge* And Their Claims

The insurance claims adjusters ("adjusters") in *Hodge* did not work directly for an insurance company. Instead, they were employed by a third-party administrator ("TPA") who contracted with self-insured businesses and government agencies to adjust claims made against those entities. In addition, the TPA contracted with insurance companies to adjust claims made under insurance policies they issued. Some adjusters handled claims exclusively for self-insured clients, while others handled claims for insurance company clients.

Although the type of claims varied, a significant portion of the TPA's business was handling workers' compensation claims. In handling these "complex" claims, adjusters investigated and reviewed evidence, including medical records, and determined the appropriate amount of reserves the client should set aside and account for across the claim's lifespan. The adjusters typically had authority to set reserves between $20,000-$100,000. Given the large number of claims each adjuster handled, their decisions on reserve amounts would tie up millions of dollars of clients' money.

In addition to interfacing with clients and health care professionals, the adjusters also managed outside workers' compensation counsel and worked with them to develop litigation strategy and to evaluate case merits. The adjusters had settlement authority up to $75,000 and instructed counsel on when to settle, or litigate, a claim.

The adjusters filed a class action complaint alleging they were improperly classified as exempt administrative employees and seeking unpaid overtime pay. The trial court found that the adjusters were properly classified and dismissed their claims.

The Court of Appeal's Exemption Analysis

The critical issue on appeal was whether the adjusters satisfied the administrative exemption's requirement that they be engaged in administrative work of "substantial importance" that is "directly related to management policies or general business operations" of either the employer or the employer's clients. As the court explained, the same issue was addressed in *Bell v. Farmers Insurance Exchange*, 87 Cal. App. 4th 805 (2001), though on very different facts.

The adjusters in *Bell* handled automobile and property damage insurance claims of nominal value (e.g., $5,000). Their settlement authority was typically under $5,000. They handled routine tasks, and important decisions were left to the adjusters' superiors. The *Bell* court applied the "administrative/production worker dichotomy" to conclude that the adjusters were mere production workers, not exempt administrative employees.

Because the facts of *Bell* were readily distinguishable, the *Hodge* court declined to apply the dichotomy, opining that it was "not workable." The important role the *Hodge* adjusters played in setting "millions of dollars" in reserves and influencing the outcome of workers' compensation litigation was clearly of substantial importance to clients' business operations. Because all the other requirements for the administrative exemption were clearly met, the court held that the adjusters were exempt administrative employees.

Notably, the *Hodge* court also held that—even if the administrative/production dichotomy were to be applied—the adjusters who handled claims exclusively for the TPA's self-insured clients (who were not in the insurance business) would nonetheless "eas[ily]" qualify as exempt administrative employees. For example, adjusting insurance claims for a client in the retail industry would not qualify as production work since a retailer sells consumer goods, not insurance claims adjustment services.

What *Hodge* Means for Employers

The exempt status of insurance claims adjusters and the proper role of the administrative/production dichotomy are issues currently before the California Supreme Court in *Harris v. Superior Court (Liberty Mutual)*. It is quite possible that the Supreme Court will grant review of *Hodge* pending its decision in *Harris*.

Nevertheless, *Hodge* is significant in that it discounts the role of the administrative/production dichotomy in an exemption analysis and makes clear it is not a bright-line test to be applied irrespective of the facts. The opinion is also significant in that it highlights the differences in duties among claims adjusters in the insurance industry, further demonstrating that the proper classification of a claims adjuster as an exempt administrative employee is a fact-specific inquiry.

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