

With each passing year it seems that claims departments operate under greater pressure. Those who are responsible for strategy and budgets face greater challenges daily. This is the inaugural issue of a newsletter addressed to claims management and the solutions that claims managers and executives will need to perform at required levels.

*Our first issue is devoted to a legal decision that has the potential to impact the cost structure on which the handling of claims has been based. In *Bell vs. Farmers Insurance Exchange* the court ruled that adjusters were not exempt from overtime. Already many California claims personnel are punching a clock and getting time and a half for overtime. Both costs and adjusting capacity are changing.*

CLASS ACTION EMPLOYMENT LITIGATION IN CALIFORNIA:

LESSONS FROM THE FARMERS VERDICT

I. INTRODUCTION

On Tuesday, July 10, 2001, an Alameda County Superior Court jury in Oakland, California, awarded \$91,000,000 in overtime compensation to a class of claims adjusters at Farmers Insurance Exchange. Attorney fees, interest, and costs may add another \$30,000,000, bringing the total to over \$120,000,000.

On June 1, 2001, a San Diego County Superior Court gave tentative approval to a \$25,000,000 settlement against Rite Aid Corporation for alleged overtime violations in a suit brought by thousands of managers-in-training, assistant managers, and managers.

On July 13, 2001, hundreds of delivery workers employed by the distributor of Alhambra and Sparkletts bottled water settled overtime claims in a class action lawsuit for approximately \$8,000,000.

It is estimated that every employer in California with over 500 employees will be sued sooner or later for overtime pay in a California "class action" under the Labor Code, or a "mass action" under the Business & Professions Code.

In just the last year and a half, between 150 and 200 class action lawsuits alleging overtime violations have been filed in California against California employers. Some of the most publicized overtime class action claims are against many of the largest and best known California employers, including Starbucks coffee chain, 21st Century Insurance Group, U-Haul rental company, Taco Bell restaurants, Auto Zone, Pepsi-Cola, and the like.

It is anticipated that many other large and small companies operating in California will be hit with mass action and class action lawsuits for allegedly improperly classifying their claims adjusters, delivery persons, or middle managers as exempt, and requesting millions of dollars in overtime pay, penalties, interest, attorney fees, and costs.

II. THE FARMERS CASE

In *Bell v. Farmers Insurance Exchange*, Alameda County Superior Court Case No. 7740013, decided July 10, 2001, the defending employer decided to take its chances before an Oakland jury rather than settle the case. Several years ago prior to that verdict, the trial judge ruled at the first trial that Farmers was liable for overtime pay claimed by its 2,400 current and former claims adjusters. In the second trial, the jury was asked to determine the amount of overtime damages due the members of the class. Farmers asserted that, if it were liable at all for overtime, the amount should be limited to \$67,000,000. The jury apparently agreed with the class and its representatives that some \$91,000,000 in overtime was due.

For the roughly 2,400 claims adjusters involved in the class, each will receive an average of approximately \$37,500. Liability for the company stretched over several years, from October 1993 until June 2001. (The statute of limitations is three years for a Labor Code class action and four years for a Business & Professions Code mass action.)

The defendant, Farmers Insurance Exchange, a part of Farmers Insurance Group, which is managed by Farmers Group, Inc. of Los Angeles, California, itself owned entirely by Zurich Financial Services, Europe, has publicly indicated that it will appeal all the way to the California Supreme Court if necessary in order to obtain clarification of its overtime obligations, since the company operates both inside and outside California. One of the defendant company's arguments on appeal is expected to be that historically the insurance industry throughout the United States, including many large and small insurers not just Farmers, has traditionally classified claims adjusters as exempt from overtime regulations. They are exempt because they are purportedly treated as professionals, enjoy a certain amount of independence, and can set their own hours of work. Clearly, the company will want to find arguments on appeal to reduce its liability for this \$91,000,000 verdict, said to be the largest amount ever granted in a California class action overtime lawsuit.

III. FEDERAL AND STATE OVERTIME LAWS

Both the federal Fair Labor Standards Act and the California Labor Code require the payment of overtime compensation to employees who work non-exempt rank-and-file type jobs. California employers are generally required to comply with whatever provisions of federal or state law are more liberal. This means California employers will usually have to comply with the more pro-employee California Labor Code.

If an employee is "exempt" under California law, the employer need not comply with various California regulations regarding that employee pertaining not only to overtime compensation, but also the minimum wage, and regulations on cash shortages, payment for uniforms and equipment, and various record keeping requirements. California employers must follow the more restrictive provisions when state and federal overtime regulations conflict.

In California, one of the ways an employer can defend against mass action or class action overtime lawsuits is to assert that the involved employees are exempt from overtime pay because they are administrators, executives, professionals, or outside salespersons. These exemptions are outlined below.

A. Administrative Exemption

The Farmers case is unique. It went to trial on the damage issue, a rare occurrence in California. Most class action overtime claims settle before a jury verdict. In addition, the employer relied on the administrative exemption as one of its defenses.

To meet the administrative exemption, a California employer must satisfy a five part test:

1. The employee must perform non-manual or office work directly related to the general business operations of the employer or the employer's customers, or directly related to the employer's management policies; or the employee must perform work functions in the administration of a school system, educational institution, or educational establishment, or one of the subdivisions or departments of such an establishment or system, and perform work directly related to that establishment's or system's academic training or instruction.

2. The employee must regularly and customarily exercise discretion and independent judgment.

3. The employer must prove that the employee executes special tasks or assignments under only general supervision, performs work along technical or specialized lines under only general supervision which work requires special knowledge, experience, or training, or directly and regularly assists an employee in a bonafide administrative or executive capacity, or regularly and directly assists a proprietor.

4. The employer must prove that the employee is primarily engaged in the above-noted duties. This means that the employee can perform non-exempt, routine, rank-and-file type production or clerical work, so long as the majority of the time (more than half) the

employee is engaged in exempt-type work noted above or work that is closely and directly related to exempt-type work that is properly viewed as a means for carrying out exempt functions.

5. Finally, the employer must prove that the involved administrative employee earns a salary each month that is no less than two times the state minimum wage for full time employment. The state minimum wage is currently \$6.25 per hour (higher than the current federal minimum wage of \$5.15 per hour. The California minimum wage is going to go up to \$6.75 per hour on January 1, 2002.). This means that a California employer currently seeking to establish the administrative exemption must prove that the involved employee receives no less than \$2,166.66 per month or \$26,000 per year. (The monthly minimum salary will rise to \$2,340 on January 1, 2002, when the State of California minimum wage goes to \$6.75 per hour.)

B. Management Exemption

California employers also have available to them what is known as the managerial/executive exemption. A six part test must be met. Generally speaking, this exemption involves the performance of duties such as directing work, disciplining employees, distributing work, providing safety for employees, interviewing employees, training employees, selecting employees, adjusting pay rates, setting pay rates, setting and adjusting work hours, recommending pay rates, recommending work hours, keeping production records, evaluating employees, handling employee complaints, planning work, determining work, controlling the flow of supplies and merchandise, and deciding on types of supplies and merchandise.

The six part test includes the following:

1. The employer must establish that the manager has responsibilities and duties involving the management of the company, or one of its subdivisions or departments.

2. The involved manager, manager-in-training, or assistant manager must regularly and customarily direct the work of two or more employees.

3. The employer must prove that the involved executive or manager has the authority to fire or hire others, or make recommendations and suggestions that are given weight as to the firing or hiring of others and as to the promotion and advancement or other change in status of employees of the enterprise.

4. The employer must prove that the involved manager, etc., regularly and customarily exercises the noted discretionary authority in the performance of his or her duties.

5. The involved employer must prove that the assistant manager, etc., earns, per month, the sum noted above, currently \$2,166.66 per month, rising to \$2,340 per month on January 1, 2002.

6. Finally, the involved executive manager must spend more than half his or her work time engaged in exempt work or work that is directly and closely related to exempt work and that is properly viewed as a means of carrying out exempt functions.

C. Computer Professional Exemption

The exemption for computer professionals in effect in 2001 requires the involved employer to prove that the professional meets the following five part test:

1. The employee is employed in a computer field and is primarily engaged in work that is creative or intellectual.

2. The computer professional must exercise independent judgment and discretion.

3. The computer professional must be shown to be engaged in one or more of the following duties: documenting, testing, creating, or modifying computer programs related to the design of software or hardware for computer operating systems; the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or systems function specifications; or the documentation, development, analysis, design, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to, user or system design specifications.

4. The employer must prove that the involved computer professional is proficient and highly skilled in the practical application of and theoretical application of highly specialized information to computer system analysis, software engineering, and programing.

5. Finally, the computer professional must be paid at least \$41 per hour in the year 2001.

D. Professional Exemption

Other kinds of professionals such as those licensed or certified by California in architecture, dentistry, optometry, engineering, teaching, accounting, medicine, and law may be exempt if they are primarily engaged in the practice of one of those professions. Uncertified accountants, dental hygienists for the most part, nurses, paralegals, drafters, and junior engineers are not included within the exemption; in other words, they must be paid overtime when they work overtime. Physician assistants and dental hygienists may at times be exempt from overtime regulations, depending on the circumstances. Also included within the professional exemption would be anyone else primarily engaged in an occupation that is commonly recognized as an artistic or learned profession.

In addition, the involved professional must earn a monthly salary of no less than \$2,166.66 per month (rising to \$2,340 on January 1, 2002), and must regularly

and customarily exercise independent judgment and discretion in the performance of his or her duties.

E. Salesperson Exemption

One final exemption worth mentioning is the salesperson exemption.

To qualify, an outside sales person must be at least 18 years old or older, and spend more than 50% of involved work time away from the employer's place of business. The outside salesperson must be involved in selling products, services, or the use of facilities, or obtaining orders for products, services, or the use of facilities. Correction work or delivery work, if incidental, is not exempt work. This means that maintenance work, repair work, or delivery work would not be included. There is no minimum salary requirement for this exemption. (Furthermore, it is possible under certain limited circumstances for an inside salesperson such as a car salesman to be exempt only from overtime regulations but not other wage and hour requirements.)

IV. DEFENSES

California employers are not without certain limited defenses to overtime claims. In addition to the exemptions noted above for professionals, administrators, managers, executives, computer professionals, and salespersons, California employers can defend against overtime claims by asserting that involved employees are independent contractors rather than employees.

Another defense is that the involved employees are covered by a collective bargaining agreement, barring the overtime claim under Labor Code section 229.

Furthermore, the employer can assert that the overtime hours claimed by the employees in the class are not "hours worked" within the meaning of California overtime regulations, such that overtime compensation should not be paid for those particular hours. 8 C.C.R. §§ 11010-11150.

A possible rule of thumb for use by California employers can be found in the California Court of Appeal's decision issued after the first Farmers trial in *Bell v. Farmers Insurance Exchange*. The First District Court of Appeal ruled that administrative employees (with no right to overtime) are those who perform work directly related to management policies or the general business operations of the employer or the employer's

DM&A

David Morse & Associates

We provide claims services designed to reduce loss adjustment expense, control severity and improve customer satisfaction. These include TPA and claims overload services, total loss settlements and subrogation specialists. For further information email us at mburns@davidmorse.com or call (818) 550-6800.

customers, while production employees (who must be paid overtime) are those whose primary duty is producing the commodity or commodities that the enterprise exists to produce. See *Balheim v. KDFW-TV* (5th Cir. 1990) 918 F.2d, 1220,1230.

V. MASS ACTIONS

Under Business and Professions Code section 17200 et seq., and recent California case law in *Cortez v. Purolator, etc.* (2000) 23 Cal.4th 163, large groups of employees and ex-employees can bring "mass action" lawsuits without having to satisfy requirements for bringing a class action lawsuit. They simply allege a violation of any business practice that is within the broad definition of unfair competition. Violations of the California Labor Code, in particular overtime requirements, are often alleged in both mass action and class action lawsuits. California law allows a plaintiff, a mass of plaintiffs, or a class of plaintiffs to use the Business and Professions Code to assert that any unlawful business practice or act, such as a violation of California's overtime regulations under the California Labor Code, is an act or practice in the ordinary course of business that violates the law.

VI. CHANGES IN 2001

Aside from all of the other concerns noted above, California employers must be aware that California law became more liberal in 2000-2001. Through various statutes, court decisions, and administrative regulations, all private employers in California now have an obligation to pay overtime and double time on a daily basis and a weekly basis, meaning overtime pay is required after 8 hours in a day and after 40 hours in a week. Furthermore, the professional, administrative, and executive exemptions noted above have been narrowed when compared to previous interpretations. Finally, those who are responsible for deficient overtime wage payments will be subject to new penalties, including penalties applicable not only to the employer but directly on the employees of the employer who are personally responsible for those errors.

VII. WHAT'S AN EMPLOYER TO DO?

The two Farmers trials, the Court of Appeal's decision in the Farmers case, the \$91,000,000 (potentially expanding to \$120,000,000) award against Farmers, the Rite Aid settlement, the Sparkletts/ Alhambra settlement, and the 150 to 200 new class actions in California since January 2000, including claims against 21st Century Insurance Group, U-Haul, Auto Zone, Starbucks, Taco Bell, Pepsi, etc., noted above, should have set off alarms by now in board rooms, management suites, and in-house attorney's offices of all California employers. It is estimated that many California employers are vulnerable to these kinds of mass action and class action lawsuits because of misclassification of employees as exempt from overtime regulations over the years. At LeBeau - Thelen, we recommend that all

California employers conduct a human resource audit to determine possible overtime violations and misclassifications of company employees. If the audit is performed by your attorneys, it could become privileged from disclosure to third parties, including plaintiff's attorneys.

California employers should routinely review the activities actually performed by employees and the job descriptions that outline those duties to determine whether employees are properly classified. The agreement of the parties and the title or job description given employees does not shield you from these expensive overtime claims. Exempt status is defined by law not by agreement of the parties.

Annually check the salaries of exempt employees to determine whether those salaries meet the monthly minimums noted above.

If part of the work force is out of compliance with federal and California overtime regulations, consult counsel for the development of a plan to bring your work force into compliance as soon as possible. Although compliance may raise your cost of doing business, hopefully those costs in the form of higher insurance premiums or higher prices charged for your goods and services can be recouped. Certainly it's better than a \$120,000,000 judgment against you.

Bear in mind that recent California and U.S. Supreme Court decisions make it much easier for employers to require employees to arbitrate all employment disputes. Ask your attorney to draft an arbitration agreement with your employees that specifically covers class action and mass action claims.

All California employers should purchase Employment Practices Liability Insurance (EPLI). If you are hit with a class mass action overtime claim, tender your defense and indemnification for damages under that claim to all carriers that insure you under a D&O policy, EPLI policy, GL policy, etc.

VIII. CONCLUSION

Remember that just because you pay your employees a salary or just because the rest of your industry treats certain employees as exempt, does not mean they will be exempt under the federal and/or California law. Consult competent employment counsel experienced in wage and hour class action and mass action litigation to determine whether you are currently in violation of overtime regulations that have the potential to bankrupt even the largest employers.

*Paul LaFranchise, Esq.
LeBeau-Thelen, LLP
5001 East Commercenter Drive #300
Bakersfield, CA 93309
Telephone: (661) 325-8962
Fax: (661) 325-1127*

Paul LaFranchise has over 20 years experience as an employment attorney. He represents employers involved in employment disputes in state and federal courts, and administrative agencies, throughout the State of California. Mr. LaFranchise has extensive experience in defending wrongful termination cases, handling employment discrimination and harassment matters and providing consultation and advice to employers in public and private sectors in California.