

# California Wage/Hour Update



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## Start Me Up

### New Case holds Start-Up Company Employee Qualifies for Administrative Exemption

By John Skousen (Irvine)

In California, unless specifically exempted, an employee is presumed to be non-exempt and subject to the provisions of the applicable Wage Order. Perhaps the most frequently mentioned exemptions are the “white collar” exemptions involving executive, professional, and administrative occupations. A white-collar exemption exempts an employee from entitlements under many sections of the Wage Order, including meal & rest periods, recordkeeping, and the minimum wage and overtime provisions.

In January of 2001, the Wage Orders were amended to include greater detail with regard to what is required for an employee to qualify for a white-collar exemption. Despite these amendments, the issue of whether an employee qualifies for one of these exemptions, especially the administrative exemption, has often been the subject of cantankerous litigation fueled by employee advocates, especially in the lower courts and at hearings and audits conducted by the Division of Labor Standards Enforcement, (DLSE) the agency which enforces California’s wage & hour laws. Until recently, employers were left to guess at how the courts would interpret many of the elements of the administrative exemption test.

A recent decision by the California Fourth District Court of Appeal held that an employee working in a fast-paced start-up business operating with a “flat organization” could still qualify for the administrative exemption for salaried employees as long as all requirements for the exemption were satisfied. In the ruling, the appellate court adopted the common-sense analysis set forth by the federal regulations applicable to the “administrative exemption,” which are expressly incorporated by the Industrial Welfare Commission Wage Orders. *Combs v. Skyriver Communications*.

#### The Five-Part Test for the Administrative Exemption

An employee is employed in an administrative capacity under this exemption if the employee satisfies the following five-prong test:

- 1) the employee’s duties and responsibilities involve ... the performance of office or non-manual work directly related to management policies or general business operations of his/her employer or his/her employer’s customers;
- 2) the employee customarily and regularly exercises discretion and independent judgment;
- 3) the employee regularly and directly either a) assists a proprietor or an employee employed in a bona fide executive or administrative capacity, b) performs under only general supervision work along specialized or technical lines requiring special training, experience, or knowledge; or c) executes under only general supervision special assignments and tasks;
- 4) the employee is primarily engaged in duties that meet the test of the exemption, which means that the employee spends more than

50% of the employee’s time on the exempt tasks, or “all work that is directly and closely related to exempt work...”; and

- 5) the employee earns a monthly salary equivalent to no less than two times the state minimum wage for full-time employment (40 hours per week).

#### The “Closely Related” and Objective-Expectation Tests

To assist in the determination of the duties test, the Wage Order provides that exempt work includes all work that is “directly and closely related to exempt work” and work which is properly viewed as “a means for carrying out exempt functions.” This shows that multi-tasking need not count against an employee’s exempt status when the employee is also performing an exempt duty.

The Wage Order continues: “The work actually performed by the employee during the course of the workweek must, first and foremost, be examined and the amount of time the employee spends on such work, together with the employer’s realistic expectations and the realistic requirements of the job, shall be considered in determining whether the employee satisfies this requirement.” Under this test, an employee cannot misperform contrary to the realistic expectations of a job and thereby claim non-exempt status.

Despite guidance provided by the federal regulations, the administrative exemption is generally regarded as the most difficult to satisfy because the elements are so vague, ambiguous, and imprecise, that they are not reliable guidelines for an outcome in any specific case. The DLSE’s Enforcement Policies and Interpretations Manual has attempted to clarify the test, but this has not resolved the uncertainties. The *Combs* decision may change all of this and assist employers in properly classifying employees.

#### The Administrative-Production Dichotomy Test

To assist in the determination of whether the work is “directly related to management policies or general business operations,” courts have applied the “administrative-production” dichotomy test, which is a non-controlling test that turns on whether the employee’s duties consist of administering the business affairs of the enterprise rather than producing the goods and services that the enterprise exists to produce and market.

In *Bell v. Farmers Insurance Exchange*, the court applied the test and held that the work of insurance adjusters fell “squarely on the production side of the administrative/production worker dichotomy” because the adjusters were “ordinarily occupied in the routine of processing a large number of small claims,” and thus their responsibilities were restricted to tasks that were “routine and unimportant.” But the court further explained that the test “may not be dispositive in many cases,” and warned that it should be applied with “great caution.”

#### The Combs Case: “How can this guy not be exempt?”

Skyriver was a high-speed, wireless, broadband internet service provider. The company was described as a “young start-up company.” The employee, Mark Combs, worked as manager of capacity planning, and

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later as director of network operations. He was paid a salary ranging between \$70,000 and \$90,000. Combs later depicted his job as nothing but a glorified troubleshooter, complained that he had to carry a pager, that his meal breaks were interrupted, and that he could not take a rest break.

But if Combs were exempt, he would not have been entitled to meal and rest periods. In his resume, prepared after he left Skyriver, he detailed that, as Skyriver's director of network operations, he was responsible for a broad array of important functions, including project management, budgeting, vendor management, purchasing, forecasting; management of employees, overseas deployment of wireless data network, the integration and standardization of three networks into the Skyriver architecture; and the overseeing of day-to-day network operations of the company.

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### Office Locations

#### Atlanta

1500 Resurgens Plaza  
945 East Paces Ferry Road  
Atlanta, GA 30326  
phone (404) 231-1400

#### Charlotte

Suite 2020  
227 West Trade Street  
Charlotte, NC 28202  
phone (704) 334-4565

#### Chicago

1000 Marquette Building  
140 South Dearborn Street  
Chicago, IL 60603  
phone (312) 346-8061

#### Columbia

Suite 1400  
1901 Main Street  
Columbia, SC 29201  
phone (803) 255-0000

#### Dallas

Thanksgiving Tower  
Suite 4343  
1601 Elm Street  
Dallas, TX 75201  
phone (214) 220-9100

#### Denver

Suite 2800 South  
600 17th Street  
Denver, CO 80202  
phone (303) 323-4200

#### Fort Lauderdale

Suite 800  
450 East Las Olas Boulevard  
Fort Lauderdale, FL 33301  
phone (954) 525-4800

#### Houston

Two Allen Center  
Suite 2220  
1200 Smith Street  
Houston, TX 77002  
phone (713) 292-0150

#### Irvine

Suite 400  
18400 Von Karman Avenue  
Irvine, CA 92612  
phone (949) 851-2424

#### Kansas City

Suite 400  
104 West 9th Street  
Kansas City, MO 64105  
phone (816) 842-8770

#### Las Vegas

Suite 650  
3993 Howard Hughes Parkway  
Las Vegas, NV 89169  
phone (702) 252-3131

#### New Jersey

430 Mountain Avenue  
Murray Hill, NJ 07974  
phone (908) 516-1050

#### New Orleans

Suite 3710  
201 St. Charles Avenue  
New Orleans, LA 70170  
phone (504) 522-3303

#### Orlando

1250 Lincoln Plaza  
300 South Orange Avenue  
Orlando, FL 32801  
phone (407) 541-0888

#### Philadelphia

Radnor Financial Center  
Suite 650  
201 King of Prussia Road  
Radnor, PA 19087  
phone (610) 230-2150

#### Portland

Suite 1250  
111 SW Fifth Avenue  
Portland, OR 97204  
phone (503) 242-4262

#### San Diego

Suite 950  
4225 Executive Square  
La Jolla, CA 92037  
phone (858) 597-9600

#### San Francisco

One Embarcadero Center  
Suite 2340  
San Francisco, CA 94111  
phone (415) 490-9000

#### Tampa

SunTrust Financial Centre  
Suite 2525  
401 E. Jackson Street  
Tampa, FL 33602  
phone (813) 769-7500

At trial, Combs and his witnesses acknowledged his resumé was accurate. Among other things, Combs further testified on his own behalf that his "core" responsibility at Skyriver was "maintaining the well-being of the network," and that he spent 60 to 70 percent of his time working alongside other employees in carrying out that responsibility. Combs argued in part that the administrative-production dichotomy test rendered him a non-exempt employee because his work involved *production* as opposed to purely *administrative* duties. Combs submitted evidence that the company was a flat organization where "everybody worked with everybody."

### Court Rejects the Administrative-Dichotomy Test

The trial court granted Skyriver's motion for judgment, holding that, unlike the adjusters in the *Bell* case, Combs was performing tasks and functions that involved matters of substantial importance to running the business. The mere fact that he worked alongside other employees did not change the fact that he was performing exempt duties. The court declined to apply the administrative-dichotomy test, essentially holding that start-up companies by their nature had fewer employees requiring greater flexibility.

Combs appealed but the appellate court also held that the *Bell* case was both factually and legally distinguishable, and that "substantial evidence shows that Combs's exercise of discretion and independent judgment ... pertained to matters of significance."

The court reasoned that the *Bell* decision was handed down before the recent amendments to the Wage Orders which incorporated the useful interpretative guidelines of the federal regulations. Applying the federal regulations, the court further noted that Combs' own testimony and documentary exhibits, including emails, demonstrated that he was, in fact, performing primarily exempt functions. In short, although Combs strained to "dumb down" his duties, the courts understood the job for what it really was: an exempt position.

### Our Advice for Avoiding Misclassification Lawsuits

What this decision signals in practical terms is that you should carefully devise job descriptions to satisfy exemption requirements, and ensure that such jobs rationally fit the organizational structure to preserve exempt duties. Make sure the applicant's background, education and experience comports with the exempt job's duties requirements. As a hedge against wage-claim fraud, review an applicant's resume and job application setting forth the prior duties and qualifications of applicants who are intended to be classified as exempt.

Conduct periodic internal audits of all salaried exempt positions, preferably with the advice of legal counsel, to make sure that the pertinent job descriptions and expectations within the organizational structure properly set out exempt duties, then make sure by observation and practical analysis that the actual duties performed by employees in exempt jobs are consistent with the reasonable expectations of their job descriptions.

You should also require employees classified as exempt to conduct self appraisals before periodic salary reviews in order to confirm the nature of their duties consistent with their job descriptions. Finally, provide written performance reviews to employees classified as exempt identifying any noted deficiencies in an employee's performance of job duties that, if not corrected, could render the employee as non-exempt.

### The Bottom Line

This case is good news for employers. The *Combs* decision shows that you can affirmatively show that certain administrative positions are exempt if you establish by a preponderance of the evidence that an employee in question has been properly classified as exempt. Perhaps the most practical outcome is that the administrative exemption may prove to be a good default exemption if an employer is unable to successfully establish another basis for exempt status such as the executive or computer professional exemptions.

*For more information email the author at [jskousen@laborlawyers.com](mailto:jskousen@laborlawyers.com) or call 949.851.2424.*

*Fisher & Phillips LLP represents employers nationally in labor, employment, civil rights, employee benefits, and immigration matters*

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