



The AAICP Compass

Newsletter of the American Association of Independent Claims Professionals

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Are claims adjusters exempt from overtime requirements?

The foregoing is excerpted from a recent memorandum prepared by Douglas B. Mishkin, Esq. and Brittany Nelson, Esq. of the Patton-Boggs law firm in Washington, D.C. Mr. Nelson is a Partner in the law firm and is Co-Chair of the firm's Employment Law Practice. Ms. Nelson is an Associate with the firm where she represents a wide range of corporations and non-profit organizations on a variety of labor and employment issues.

Within the last six months, three courts have addressed whether insurance claims adjusters meet the "administrative" exemption from the overtime requirements of various state and federal regulations:



federal Fair Labor Standards Act ("FLSA") and seven state laws. Regarding the FLSA claims, the United States District Court for the District of Oregon ruled essentially that claims adjusters who handled "smaller" matters were non-exempt, while those

- On March 30, 2007, the United States Court of Appeals for the Ninth Circuit found claims adjusters **exempt**, saying the analysis was the same before and after the adoption of a 2004 federal regulation regarding the status of claims adjusters;
- On August 7, 2007, an Arizona federal trial court also found adjusters were exempt under pre-2004 federal law; and yet nine days later,
- On August 16, 2007, a California state intermediate appellate court found adjusters were **non-exempt** under pre-2004 federal law.

who handled "larger" matters were exempt. The Ninth Circuit reversed, and began its opinion by noting that:

For more than 50 years, the Department of Labor has considered claims adjusters exempt from the Fair Labor Standard Act's overtime requirement. In 2004, the DOL promulgated 29 C.F.R. § 541.203, which it viewed as "consistent with" existing law. Section 541.203 exempts claims adjusters if they perform activities such as interviewing witnesses, making recommendations regarding coverage and value of claims, determining fault and negotiating settlement. . . . We hold today that all of the adjusters in this case are exempt. . . . The adjusters are required to do virtually all of the very things that § 541.203 contemplates: use discretion to determine whether the loss is covered, set reserves, decide who is to blame for the loss and negotiate with the insured or his lawyer.

In each of these cases, the issue was whether the claims adjusters were administrative (i.e., exempt) or production (i.e., non-exempt) workers. The following reviews how these courts reached these conclusions, and what these conclusions might mean for members of AAICP. The bottom line conclusion? Whatever room for disagreement might have existed prior to the 2004 federal regulation, the exempt status of claims adjusters seems reasonably secure under current federal law; the result under more restrictive state laws, however, may vary.

In re: Farmers Insurance Exchange, 481 F.3d 1119 (9th Cir. March 30, 2007)

Nearly 2,000 former and current claims adjusters claimed they were misclassified as exempt under the

In re: Farmers Insurance Exchange, 481 F.3d 1119, 1124 (9th Cir. 2007). Section 541.203(a) provides that:

Insurance claims adjusters generally meet the duties requirements for the administrative exemption, whether they work for an insurance company or other type of company, if their duties include

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activities such as interviewing insureds, witnesses and physicians; inspecting property damage; reviewing factual information to prepare damages estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim; negotiating settlements; and making recommendations regarding litigation.

Finding that this regulation did not “represent a change in the law,” the court noted that the claims adjusters in this case 1) determined whether the policy covers loss; 2) recommended a reserve upon estimating [Farmers Insurance’s] exposure on the claim; 3) conducted interviews; 4) advised the company regarding fraud indicators or the potential of subrogation; and 5) negotiated settlements. In the court’s words, “as far as we are concerned, that says its all.”

The court rejected the district court’s approach of establishing exceptions for those adjusters who handled “smaller” claims, finding that such a distinction would be hard to manage on a practical level. Moreover, “nothing in the regulation suggests that ‘smaller’ claims – however that term would be defined – should be treated differently. If the DOL changes its view, it is, of course, free to amend the regulations.”

Finally, the Ninth Circuit specifically rejected the argument that because the adjusters deliver the insured “product” to its customers, they were “merely engaged in the day to day carrying out of the business’ affairs rather than running the business itself.” The court found that Farmers’ Insurance’s business was not “limited to claims adjusting; it also sells insurance products. Thus, the decisions made by claims adjusters affect [Farmers Insurance’s] customer base (e.g.,

the policyholders) in that their eligibility for continued coverage may be affected and their premium level may be affected.”

Regarding plaintiffs’ state law claims, the Ninth Circuit ruled that Michigan state overtime law was the same as the FLSA, but found that the district court had not addressed whether overtime laws in Colorado, Illinois, Minnesota, New Mexico, Oregon, or Washington were substantially similar to the FLSA. In particular, the court noted that Colorado, Minnesota, and Oregon may have regulations that are truly narrower than the FLSA’s administrative exemption and indicated that “our decision today would not necessarily bar claims adjusters in those states from obtaining relief.” Therefore, the Ninth Circuit remanded the case to the district court to determine whether the administrative exemptions in these states were narrower than the FLSA’s administrative exemption. Currently, this issue is being briefed in the trial court, with all briefs due by the end of December.

In Re: Allstate Insurance Company Fair Labor Standards Litigation, 2007 U.S. Dist. LEXIS 58442 (D. Ariz. August 7, 2007)

Three former Allstate Insurance Company claims adjusters claimed they were misclassified as exempt. The court applied the DOL regulations that require 1) that the employee’s primary duty consists of the performance of office or nonmanual work directly related to management policies or general business operations of his employer or his employer’s customers,” and 2) that the employee’s duties include work “requiring the exercise of discretion and independent judgment.” See 29 C.F.R. §541.2 and §541.214.

The plaintiffs argued that their work was not directly related to Allstate’s “management

policies or general business operations” but rather that, by handling claims, they were engaged in the work of the company. The court disagreed, noting that Allstate’s product is the “writing and selling of insurance policies and that the administration of claims is only ancillary to that product.” ***In Re: Allstate Insurance Company Fair Labor Standards Litigation***, No. CV-04-0015, 2007 U.S. Dist. LEXIS 58442 at *31 (D. Ariz. August 7, 2007). The court also specifically noted that the pertinent regulation, 29 C.F.R. § 541.205(c)(5), provided that the “directly related to management policies or general business operations” test was met by “claim agents and adjusters” and that the Department of Labor (“DOL”) “acknowledged that it had long recognized that insurance claims adjusters typically perform work that is administrative in nature. That interpretation by the DOL of its own regulations is entitled to deference by the Court.”

The court also rejected plaintiffs’ argument that they “had limited authority to negotiate claims and that claims-related matters of importance were delegated to claims employees at higher levels of authority” and thus was not of substantial importance to Allstate. The court noted that “most courts have agreed that insurance adjusters, including auto physical damage adjusters, do work that is of substantial importance to the employer’s business operation and management policies.” Because the plaintiffs had “made determinations” about coverage, “set and adjusted company reserves,” “evaluated damages associated with the claim,” “made recommendations regarding the need for expert,” “negotiated final settlements,” and “made determinations regarding the potential for subrogation,” the court found that claims

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Around the Country

California

After languishing for several months, Senate Bill 936 was passed by the California Legislature in September, only to have Governor Arnold Schwarzenegger veto the controversial workers' compensation bill a month later. The bill would have revised the formula for calculating payment for injuries resulting in permanent disability using schedules that correlate the percentage of an employee's permanent disability to the number of weeks benefits would be paid factoring in the permanent disability.

The controversy began with reductions to the state's workers' compensation insurance premiums in 2004, reportedly saving employers over \$9 billion, based on downward adjustment in the permanent disability ratings. While unclear what impact the bill would have had on premiums, employer groups claimed that SB 936 would double the amount of payments above current levels over the next three years referring to the three schedules slated for use in 2008, 2009 and 2010. Employers urged the Governor to veto the bill while Labor groups urged its signing.

Governor Schwarzenegger explained his veto by stating that the bill arbitrarily doubled the number of weeks a person could be eligible to receive permanent disability benefits and would substantially increase costs for all permanent disability awards without regard to severity and without relying on empirical data to validate the increase.

Florida

Committee Substitute for Senate Bill 666 amends a Florida registration requirement relating to fiscal intermediary services organizations (FISOs). Florida's law governing HMOs also provides for the regulation of FISOs which are defined as "a person or entity which performs fiduciary or fiscal intermediary services to health care professionals who contract with health maintenance organizations, ..." Fiscal intermediary services are defined as "reimbursements received or collected on behalf of health care professionals for services rendered, patient and provider accounting, financial reporting and auditing, receipts and collections management, compensation and reimbursement disbursement services, or other related fiduciary services pursuant to health care professional contracts with a health maintenance organization..."

Prior to the passage of CS/SB 666, a Florida-licensed TPA and any entity it owned, operated, or controlled, was exempt from



the FISO registration requirement. The new law narrows that exemption to the licensed TPA only. Effective October 1, 2007, entities that are owned, operated, or controlled by a licensed TPA are no longer exempt and are required register and show proof of a fidelity bond and surety bond if they provide fiscal intermediary services in this state.

Maryland

An insurance claims adjuster and a Baltimore city police officer were recently sentenced in connection with felony theft and conspiracy charges according to the state's Attorney General Douglas Gansier. Through a joint investigation by the state's Insurance Fraud Division and the Attorney General's office, it was found that the adjuster while employed with a large TPA, issued approximately \$153,000 in fraudulent workers' compensation payments to the police officer between May, 2003 and April, 2004. The now former police officer cashed the checks and the couple split the proceeds. The adjuster was given a 15-year suspended sentence and five years probation and is being required to pay \$153,000 in restitution. The police officer was sentenced for his part in the conspiracy as well, according to Attorney General Frasier's office.

North Carolina

North Carolina House Bill 665 relating to insurance adjusters was passed by the North Carolina Legislature earlier this year. In an earlier edition of The AAICP Compass, we reported on the state's proposal to streamline licensing procedures to enable a licensed property and casualty agent to convert his or her license to an adjuster's license without having to take the adjuster license exam. The new law is effective January 1, 2008. The DOI has published an FAQ document relating to this and other legislative changes on its website at www.ncdoi.com/ASD/LegislativeChangesResources/AgentAdjusterFAQs.pdf

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adjusters performed work of substantial importance and therefore qualified under the regulations for the administrative exemption.

Although the court used many of the factors included in the new 29 C.F.R. § 541.203(a), it did not actually cite this regulation. Instead the court observed that “the deposition testimony of the three plaintiffs establish that they were responsible for making and/or recommending various decisions similar to those found in other cases to be sufficient to meet the substantial importance test.” The plaintiffs in this case were all terminated prior to 2004, the date of the enactment of the new regulation. While *In re Farmers Insurance* both acknowledged and applied the new regulation retroactively, the court in *In re Allstate Insurance Company* did neither.

Finally, the court determined that the claims adjusters exercised discretion and independent judgment, as required for exempt status by 29 C.F.R. § 521.2(b). The court found that the employees “made key decisions on key issues that were important to both Allstate and its claimants and that they made these decisions with or without supervisory review or, if review was required, that they made recommendations that were followed most of the time.” Also, the court found that simply because the plaintiffs had to follow guidelines and use estimating software did not make them non-exempt employees. Therefore, the District Court determined that these claims adjusters were exempt employees.

***Harris v. Superior Court of Los Angeles County*, 154 Cal. App. 4th 164 (Cal. Ct. App. 2007)**

Then came *Harris v. Superior Court of Los Angeles County*, 154 Cal. App. 4th 164 (Cal. Ct. App. 2007). In a detailed, 28-page decision, a two-judge majority of a panel of California’s intermediate appellate court ruled that these claims adjusters were **non-exempt** because they were primarily involved in “production,” and thus were “not primarily engaged in work that is ‘directly related to management policies or general business operations.’” The defendants have appealed to the California Supreme

Court. What follows is a brief analysis of the intermediate appellate court’s conclusion.

Procedural Posture of the Case

Harris arises from class action lawsuits against Liberty Mutual Insurance Companies and Golden Eagle Insurance Corporation alleging that the companies improperly classified claims adjusters as exempt from the California overtime requirements. The cases hinge on the application of two California Wage Orders that provide that “persons employed in administrative . . . capacities” are exempt from the overtime compensation requirements. To qualify for the administrative exemption an employee must be “primarily engaged in” “office or non-manual work directly related to management policies or general business operations of his/her employer or his/her employer’s customers[.]” Cal. Code Regs., tit. 8, § 11040, subds. (1)(A)(2)(a) (i), (1)(A)(2)(f). The Wage Orders are based on federal law and both adopt the federal regulations regarding overtime compensation requirements interpreting the FLSA.

The Administrative/Production Worker Dichotomy

The key element of the administrative exemption relevant to these cases is the “directly related to management policies” clause. The federal regulation then in effect (i.e., prior to the 2004 enactment of 29 C.F.R. § 541.203(a)) provided:

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.

29 C.F.R. § 541.205(a). The court asked whether the claims adjusters’ work constituted management policy or general operations (i.e., administrative), and concluded that it was not:

[the claims adjusters] investigate and estimate claims, make coverage determinations, set reserves, negotiate settlements, make settlement recommendations for claims beyond their settlement authority, identify potential fraud, and so forth. None of that work is carried on at the level of management policy or general operations. Rather, it is all part of the day-to-day operation of defendants’ business.

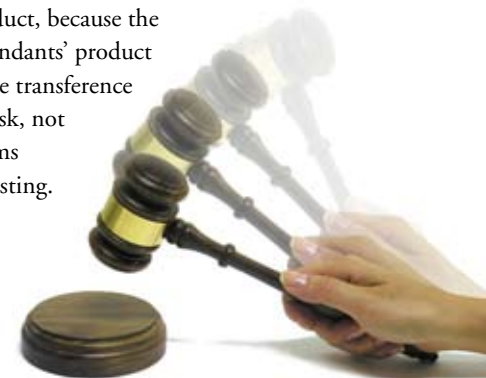
The court acknowledged that although some adjusters might at times engage in work at the level of management policy or general operations, “no evidence shows that even a single plaintiff primarily engages in such work.” This interpretation is markedly different from both *In re Allstate Insurance Company* or *In re Farmers Insurance Company*.

Defendants’ Unsuccessful Arguments

The majority rejected the following arguments of the defendants:

First, the defendants argued that the claims adjusters were involved in setting the “general policy” of the company because they “advise the management, plan, negotiate, and represent the company,” and thus were administrative as opposed to production workers. The majority rejected this argument, explaining that for such work to be exempt it must be “carried on at the level of policy or general operations.” The court found that these adjusters were performing these functions as part of the day-to-day business of processing individual claims, and not at the level of policy or general operations.

Next, the defendants argued that the plaintiffs do not produce the defendants’ product, because the defendants’ product is the transference of risk, not claims adjusting.



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The court disagreed, noting that adjusting claims is an important and essential part of transferring risk. The majority observed wryly that “[i]f defendants never paid any claims, they would not be transferring any risk; they would just be transferring their customers’ premium payments to themselves.” It does not appear that the defendants argued that the defendants’ product is selling and writing insurance claims, an argument that succeeded in *In re Allstate Insurance Company* and *In re Farmers Insurance Company*. The majority went on to explain that “producing the employer’s product is not a necessary condition for doing production, as opposed to administrative work. If it were, then the work of every office worker employed by a manufacturing enterprise would fall on the administrative side of the dichotomy.”

Finally, the defendants argued that they should prevail under 29 C.F.R. §541.205(c) (5), which provides that “[t]he 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, ...and many others.” The defendants argued that this specific reference to claims adjusters controls over the more general language concerning the administrative/production worker dichotomy.

The majority rejected this argument, reasoning that although the plain language of the regulations says that “many persons employed as . . . claims agents and adjusters” do work that meets the “directly related” requirement (emphasis added), in these cases there was no evidence that any particular member of the class was “primarily engaged in administrative, as opposed to production, work, so there is no evidence that any of them meet the “directly related” requirement.” Furthermore, the court found that the specific reference to “claims agents and adjusters” in 29 C.F.R. § 541.205(c)(5) was not controlling, because “another regulation (29 C.F.R. § 778.405) promulgated under the FLSA specifically refers to ‘insurance

adjusters’ and implies that they ordinarily are not exempt.” (This regulation deals with employees whose duties “necessitate irregular hours of work” and allows them to enter contracts with their employers guaranteeing constant pay for varying workweeks that might otherwise violate the maximum hour requirements of the statute. The court emphasized that this provision of the FLSA only applies to nonexempt employees, because it expressly refers to “the maximum workweek applicable to such employee under” the FLSA. This regulation remains in effect and has not been revised since 1968.)

New Regulations

Harris relied on a regulation that was revised in 2004, which was long before issuance of the *Harris* decision but after accrual of these plaintiffs’ claims. The former 29 C.F.R. §541.203(a) provided only that the test of “directly related to management policies or general business operations” is met by, among others, “many persons employed as . . . claims agents and adjusters” (emphasis added). The revised regulation, codified as 29 C.F.R. §203(a), eliminates the “many persons” language relied on in *Harris* and instead specifically provides that

Insurance claims adjusters generally meet the duties requirements for the administrative exemption, whether they work for an insurance company or other type of company, if their duties include activities such as interviewing insureds, witnesses and physicians; inspecting property damage;

reviewing factual information to prepare damages estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim; negotiating settlements; and making recommendations regarding litigation.

The *Harris* court seems to recognize this distinction, and in a footnote, specifically distinguishes *In re: Farmers Insurance* because it was based on a “new version of the federal regulations.” See *Harris*, 154 Cal. App. 4th at 187, n.11. Thus, the court seemed to be suggesting, without actually saying so, that the result would be different—that claims adjusters would be deemed exempt—under existing law.

What Does This Mean To You a/k/a: So What?

This side-by-side analysis of these three cases yields several observations. First, the 2004 adoption of 29 C.F.R. §541.203 seems to reaffirm the relatively widely held view under federal law that claims adjusters are exempt. Next, claims adjusters might conceivably be non-exempt in states which construe their own exemption more strictly than federal courts and the United States Department of Labor construe the FLSA. Finally, with respect to California in particular, the *Harris* court’s rejection and/or distinguishing of various federal cases and DOL opinion letters gives rise to the question whether that court was construing federal law more strictly than those federal authorities have done. The California Supreme Court may shed further light on that question.

Check it out!
www.aaicp.net

Have you checked out the AAICP website lately? If not, you should. The AAICP has recently updated its website with new information about “Who We Are” and what “Our Issues” are.

Under these tabs you will find a current listing of member companies and you can read more about the how AAICP is participating in discussions with regulators and legislatures on issues affecting your industry. The website also has the latest edition of The AAICP Compass, as well as highlights of the AAICP “In the News.” Don’t be in the dark!



Around the Country *(continued from page 3)*

Texas

Texas House Bill 472 was passed by the Texas Legislature amending provisions of the Insurance Code and establishing a new requirement that TPAs administering workers' compensation programs be licensed by the Department of Insurance. The law establishes requirements for contracts between administrators and insurers and sets out an insurer's responsibilities when using an administrator's services. Insurers will also be required to conduct regular reviews and on-site audits of an administrator's operations.

Early versions of the bill contained language that would have prevented an employer from directly compensating a TPA. The AAICP retained a local lobbyist and provided written testimony before the House Committee on Business and Industry, advocating amendments to allow compensation for a TPA's services to come from either an insurer or employer. In its testimony, the AAICP

asserted that such a requirement was in direct contrast to existing industry practices, where certain types of compensation are made directly from a corporate client to a TPA, rather than routing through an insurer. Citing the example of a corporate client with a large deductible workers' compensation policy paying a TPA directly for services rendered in adjusting claims within the deductible, the AAICP successfully lobbied for this change.

An annual report, including financial statements, are required to be filed by all TPAs every June 30. Certain change of control in the ownership of a TPA must also be reported to the Department of Insurance. Provisions of HB 472 relating to TPAs are effective January 1, 2008. The Texas Department of Insurance has advised that administrative rules implementing the new law may not be final in April, 2008. The DOI has published a comprehensive FAQ document on its website at www.tdi.state.tx.us/licensing/agent/

NAIC NEWS

Regulators Consider More Changes to TPA Model Act

The National Association of Insurance Commissioners, (NAIC), has continued to review and discuss possible changes to its model law regulating to licensure and conduct of certain TPAs. Since its adoption in 1976, a version of this model act has been enacted in approximately 25 states and the NAIC version has been further amended by that body three times. A working group of state regulators have again been asked to consider amending the NAIC model to expand its applicability to TPAs that handle workers' compensation programs. The current model applies only to life, health and disability lines of insurance.

According to materials recently distributed by the NAIC, the review has proven to be more complex than regulators originally thought. They have identified areas in the original model that are unrelated to the original plan of expanding applicability to workers' compensation but which they believe merit "improvement". The AAICP has been actively involved in the dialogue and has provided written comment to enhance versions under consideration to ensure that final language is clear and appropriately addresses issues that may impact its members.

In keeping with new procedures governing the adoption of model acts (See NAIC Suspends Work on Model Law for Independent

Adjusters in the Spring 2007 edition of the AAICP Compass); the NAIC has reclassified its work as a review of "guidelines" rather than an amendment of a "model act". This means that the resulting work product, while instructive for state departments of insurance, may not have the "clout" typically associated with an NAIC Model Act. In other words, state legislatures may now be less inclined to enact standards for regulating TPAs in a more uniform manner across the country. The AAICP will continue to advocate for more uniform and reciprocal treatment of TPAs among the states and report developments as they are available.

Independent Adjuster Licensing Discussions

The NAIC's Producer Licensing Working Group also met recently with the hope of adopting its revised set of independent adjuster licensing guidelines. The AAICP similarly provided written comment to this group to ensure clarity and increased uniformity in this area. One regulator on this working group raised concerns about the definition of "independent adjuster" which is fundamental to the scope and applicability of the new guidelines. Unfortunately, after significant discussion, the working group was unable to reach a consensus on the language and consideration of this matter was further deferred. At the time of this writing, the working group had not reconvened to address this issue. We will continue to monitor progress and report developments as they are available.