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Supreme Court Finds Pharmaceutical Sales Representatives Exempt From Overtime; Department of Labor's Interpretation of FLSA Regulations Not Entitled To Any Deference

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In a much-anticipated decision in *Christopher v. SmithKline Beecham Corp.*, on June 18, 2012, the U.S. Supreme Court held 5-4 that pharmaceutical sales representatives are exempt from overtime under the Fair Labor Standard Act's outside sales exemption because they "make sales" under the most reasonable interpretation of the law. In its holding, the Court unanimously ruled that the Department of Labor's interpretation of its own regulations – put forward for the first time in an *amicus* brief – was not entitled to deference, and instead relied on its own analysis of the relevant FLSA provisions and regulations as to what it means to "make sales."

While the decision will immediately affect the pharmaceutical industry – which now can safely treat its sales representatives as exempt from overtime without the specter of massive amounts of retroactive back pay liability – it also could have an impact on other industries, as well as the viability of the DOL's *amicus* brief program and Administrator Interpretation letters.

Background

The Court granted certiorari to resolve a split between the Second and Ninth Circuits. In July 2010, the Second Circuit concluded that pharmaceutical sales representatives for Novartis Pharmaceuticals Corp. were not FLSA-exempt under either the outside sales or administrative exemptions and could pursue overtime claims under the federal wage and hour law. (That action was subsequently resolved and a $99 million settlement finalized and approved just a few weeks before the Court's decision.) The Ninth Circuit (in *Christopher*) reached the opposite conclusion, declining to defer to the DOL's position that the outside sales exemption did not cover the drug sales representatives and instead holding that sales representatives make the functional equivalent of sales within the realities of the highly regulated pharmaceutical industry.

Petitioners were pharmaceutical sales representatives (also called "detailers") employed by GlaxoSmithKline. They were responsible for calling on physicians in an assigned sales territory to discuss the features, benefits, and risks of an assigned portfolio of respondent's prescription drugs. Their primary objective was to obtain a nonbinding commitment from the physician to prescribe those drugs in medically appropriate cases. They were hired for their sales experience, worked away from the office with minimal supervision, and were awarded incentive pay on top of their base salaries, earning on average over $70,000 per year.

Section 13(a)(1) of the FLSA exempts from the law's overtime requirements any employee who works "in the capacity of outside salesman" and delegated authority to the DOL to implement regulations defining the term "outside salesman." The DOL issued regulations defining the term in 1938, 1940, and 1949, and reissued regulations in 2004 with only minor amendments. The DOL's regulations define an outside salesman as an employee making sales within the meaning of Section 3(k) of the FLSA who is customarily and regularly engaged in working away from the employer's place of business. Section 3(k) provides that "sale" under the statute "includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition."

The company argued that although its sales representatives did not make "sales" within the technical sense of the word (since FDA regulations preclude detailers from actually consummating sales), they did make "sales" within the practical realities of the heavily regulated pharmaceutical industry, and that a non-binding commitment from a physician to prescribe their product where medically appropriate was the functional equivalent of a sale in the industry. The company also argued that pharmaceutical sales representatives bear all the hallmarks of typical outside sales employees. In addition, the company stressed that the pharmaceutical industry had been classifying its sales representatives as exempt from overtime for over 70 years, and that the DOL had never taken the position that they were misclassified or attempted to clarify or enforce its own regulations prior to submitting uninvited *amicus* briefs with seemingly new interpretations.

The petitioners, with the DOL writing as *amicus curiae*, disagreed. In the Ninth Circuit (as it had in the Second Circuit in *Novartis*), the DOL (and petitioners) took the view that "a 'sale' for the purposes of the outside sales exemption requires a consummated transaction directly involving the employee for whom the exemption is sought." In other words, an employee covered by the outside sales exemption must be directly involved in consummating the relevant sales transaction, as opposed to merely obtaining a non-binding commitment. Interestingly, and inexplicably, when the case reached the Supreme Court, the DOL abandoned its original interpretation and instead took the more stringent position that "[a]n employee does not make a 'sale' for purposes of the 'outside salesman' exemption unless he actually transfers title to the property at issue." This position was never previously advanced by the DOL.

The Court's Holding

The Court first held that the DOL's interpretation of its own FLSA regulations – advanced for the first time in 2009 via an *amicus* brief and then modified after the Supreme Court granted certiorari – was not entitled to any deference (let alone controlling deference), and that the Court should engage in its own independent examination and analysis of the statute and relevant regulations. Significantly, even the dissent agreed that the Court should not give the DOL's current interpretive view "any especially favorable weight."

First, the DOL's 2009 clarification of its position (after more than 60 years of inactivity and seeming acquiescence) presented an "unfair surprise" to employers in the pharmaceutical industry and would result in potentially massive retroactive liability. The Court noted that despite the industry's decades-long practice of classifying detailers as exempt employees, the DOL never initiated any enforcement actions with respect to detailers or otherwise suggested that it thought the industry was acting unlawfully. "To defer to the agency's interpretation in this circumstance," Justice Alito wrote for the majority, "would seriously undermine the principle that agencies should provide regulated parties fair warning of the conduct a regulation prohibits or requires."

Second, the Court – including the dissent – was similarly concerned by the fact that the DOL's own interpretation had changed since 2009.

Third, the Court found the DOL's interpretation of its regulations to be "quite unpersuasive." The agency's new theory that a "sale" is not completed unless there is actually a transfer of title, the Court wrote, is "flatly inconsistent" with the text of the FLSA, which defines a "sale" to include a "consignment for sale" – which does not involve a transfer of title. In addition, because that interpretation was promulgated in a series of *amicus* briefs, rather than via notice and comment, it lacked "the hallmarks of thorough consideration."

Rather than relying on the DOL's interpretation, the Court instead employed "traditional tools of interpretation" to address the FLSA exemption issue. It found that the DOL's argument for its new interpretation of the Act and its regulations was in fact "much too narrow." It found that the catchall phrase "other disposition" in Section 3(k) was most reasonably interpreted as including "those arrangements that are tantamount, in a particular industry, to a paradigmatic sale of a commodity."

Applying this interpretation of the term "other disposition," the Court found that sales representatives met the definition of Section 3(k) and were therefore FLSA-exempt outside salespeople. "Obtaining a nonbinding commitment from a physician to prescribe one of respondent's drugs is the most that petitioners were able to do to ensure the eventual disposition of the products that respondent sells," Justice Alito wrote. "This kind of arrangement, in the unique regulatory environment within which pharmaceutical companies must operate, comfortably falls within the catchall category of 'other disposition.'"

The Court concluded that its holding was consistent with the purpose of the FLSA's exemption for outside salesmen who were exempt from overtime because they bore all the external indicia of outside salesmen, "typically earned salaries well above the minimum wage" and received other benefits that "[s]et them apart from. . . nonexempt workers entitled to overtime pay." Justice Alito wrote, "Petitioners -- each of whom earned an average of more than $70,000 per year . . . are hardly the kind of employees that the FLSA was intended to protect."

The Dissent

Justice Breyer wrote the dissent, joined by Justices Ginsburg, Sotomayor and Kagan. While they agreed with the majority that the DOL's interpretation of its regulations was not entitled deference, they concluded that detailers should not be exempt from the FLSA's overtime requirements because their work is ultimately promotional or informational, not sales. The detailer's job, the dissent wrote, is not to sell or dispose of products, but rather to promote activities designed to stimulate sales by someone else (*e.g.*, a pharmacist or wholesaler). "What the detailer does is inform the doctor about the nature of the manufacturer's drugs and explain their uses, their virtues, their drawbacks, and their limitations," Justice Breyer wrote. "Where in the process does the detailer *sell* the product?" The dissent also noted that the Pharmaceutical Research and Manufacturers of America Code on Interactions with Healthcare Professionals described detailers as "delivering accurate, up-to-date information to healthcare professionals," but "nowhere refers to detailers as if they were salesmen, rather than providers of information, nor does it refer to any kind of commitment." In sum, the dissent concluded, "detailers do not promote their own sales, but rather sales made, or to be made, by someone else. Therefore, detailers are not 'outside salesmen.'"

Key Takeaways

- First, pharmaceutical sales representatives are exempt from overtime under the FLSA's "outside sales" exemption.
    - The pharmaceutical industry has avoided the potential for massive retroactive back pay liability, and will continue to employ and classify its sales representatives as exempt from overtime.

There will be no need for the Supreme Court to resolve yet another Circuit split over the applicability of the administrative exemption to pharmaceutical sales representatives.

- Instead, the applicability of the administrative exemption to other employees engaged in sales and the promotion of sales (but who do not otherwise meet the outside sales exemption) will likely remain heavily disputed and litigated.

- Second, the DOL's interpretation of the FLSA and/or its regulations, articulated for the first time in an *amicus* brief rather than through notice and rulemaking, is not entitled to controlling deference or any special weight.
  - This could signal the end of the DOL's Amicus Program, in which it files *amicus* briefs in private cases to attempt to influence courts as to the inapplicability of the so-called "white-collar" exemptions.
  - In addition, the decision raises significant questions about the weight to be accorded to the DOL's Administrator Interpretation letters (which are not authorized by statute), including its recent letter taking an arguably new and narrower interpretation of the administrative exemption and concluding that mortgage loan officers are not exempt. The Administrator Interpretation letters replaced the historic Wage-Hour Opinion Letters which were fact-specific and authorized by the Portal-to-Portal Act.
- Third, the Court's willingness to look at the realities of the pharmaceutical industry and to broaden the definition of what it means to be a "sale" within the meaning of the FLSA beyond its purely technical meaning, will likely lead to attempts to expand the outside sales exemption to employees in other industries who do not make sales in the traditional sense but nevertheless act like outside salespeople. In addition, courts could begin to take a more pragmatic, real world, and less overly technical view of the white-collar exemptions – particularly where the DOL has been silent and/or seemingly acquiesced to industry-wide practices of classifying well-paid employees as exempt from overtime.

If you have any questions about this client alert, please contact your Proskauer relationship lawyer or any of the members of Proskauer's Employment Law Counseling and Training or Class/Collective Actions Practice Groups.

*Special thanks to associate **Latoya Moore** for her assistance in drafting this client alert.*

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