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Pharmaceutical Sales Representatives Qualify for the “Outside Sales” Exemption to the Fair Labor Standards Act, Supreme Court Says

In its first ruling on a so-called white collar exemption under the Fair Labor Standards Act (“FLSA”), a sharply divided Supreme Court ruled on June 18, 2012, in the case of *Christopher v. Smithkline Beecham Corp.*, that pharmaceutical sales representatives qualify for the “outside sales” exemption under the FLSA. As a result, these sales representatives are exempt from the overtime protections and increased payment requirements of the federal wage and hour laws.

Even though pharmaceutical sales representatives only encourage physicians to prescribe the use of their employer’s pharmaceutical products rather than actually sell those products to physicians, the Supreme Court applied a functional rather than formal inquiry into the employees’ responsibilities and found them to act “in the capacity of outside salesman,” as the statute requires for the exemption to apply. Notably, the Court refused to give controlling deference to the Department of Labor’s (“DOL”) recent shift in position that such employees are not FLSA-exempt, especially because for decades the pharmaceutical sales representatives had been characterized as exempt from overtime pay, without objection from the DOL. The Court’s broad reading and common-sense interpretation of the statutory language and the DOL’s regulations mark not only a significant victory for employers in the pharmaceutical industry, but

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also provide ammunition for employers in other industries to argue for the application of the exemption to their sales employees.

The “Outside Sales” Exemption:

By way of background and as a general matter, employees are entitled to a 1.5 payment multiplier on those hours worked in excess of forty hours in a week, unless the employer can identify a statutory “exemption” which eliminates the overtime payment obligation. Relevant to the *Christopher* case, an employee falls under the “outside sales” exemption – and thus cannot claim overtime pay – if (1) the employee’s primary duty is “making sales” for his or her employer within the meaning of the statute, and (2) the employee is customarily and regularly engaged in working away from the employer’s place of business. The DOL had stressed that outside sales persons make their own sales whenever an employee “in some sense make[s] a sale.” In addition, the FLSA provides that “sale” or “sell” under the statute includes “any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition.”

The Case Facts and Court Decision:

The issue before the Court in *Christopher* was whether the plaintiffs, who had worked for their employer as pharmaceutical sales representatives for nearly four years, were “making sales” within the meaning of the FLSA’s “outside sales” exemption. Because the prescription drug industry is heavily regulated and requires that prescription medication only be dispensed based on a physician’s prescription, the pharmaceutical companies have long focused their marketing efforts on the medical practitioners with authority to prescribe the drugs, rather than on the retail pharmacies who dispense them. As a result, rather than actually selling prescription drugs, the plaintiff-employees “promoted” their



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employer's prescription drugs by regularly calling on physicians at their offices, educating the physicians in connection with the prescription drugs, and requesting, and often obtaining, "non-binding commitments" from the physicians to prescribe the promoted drugs for their patients when it was medically appropriate. Each week, the plaintiffs spent approximately forty hours in the field calling on physicians, plus another ten to twenty hours attending events and engaging in other ancillary tasks.

In rejecting the plaintiffs' and the DOL's arguments that sales representatives were not "making sales" – because they were precluded by federal drug-industry laws from obtaining sales orders or binding commitments from the physicians – the Supreme Court first decided the threshold issue of whether to give particular deference to the DOL's interpretation that an employee does not make a "sale" for the purposes of the "outside sales" exemption unless the employee "actually transfers title to the property at issues." The court rejected the DOL's interpretation – which the DOL first announced in the amicus briefs filed in this case – and noted that such interpretation would create an "unfair surprise" to the defendant-employer when, for decades, the industry-wide practice had been to exempt the pharmaceutical sales representatives from overtime pay. Such an interpretation thus would impose massive retroactive liability for actions that occurred well before the DOL announced its interpretation. Indeed, until the DOL announced in 2009 its view that pharmaceutical sales representatives were not FLSA-exempt, the DOL had never initiated any enforcement actions regarding such employees in the pharmaceutical industry, and the only plausible explanation for the DOL's inaction for decades was that the DOL acquiesced in this practice to treat these sales representatives as exempt. Applying "traditional tools of interpretation," the Court found the DOL's determination that a "sale" must involve the transfer of title to the property at issue "quite unpersuasive."



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Next, the Supreme Court analyzed the text of the FLSA and the DOL's corresponding regulations. In finding that the pharmaceutical sales representatives qualified as exempt outside sales persons, the Court reasoned that the plaintiffs were "making sales" because they obtained commitments from the physicians to prescribe particular drugs in appropriate circumstances. Because obtaining a non-binding commitment was "the most" that the plaintiffs were able to do to ensure the disposition of their employer's product, this kind of arrangement fell within the FLSA's broad definition of "sale." Specifically, the Court ruled that this sales activity fell within the FLSA catchall phrase concerning "other disposition" of the company's product, as expressly provided in the statute. The Court explained that requiring the plaintiffs to consummate actual sales not only was inconsistent with a realistic approach to the duties and constraints relating to the pharmaceutical sales representative position, but also would have rendered the general FLSA statutory language meaningless. Because nothing in the language of the FLSA and the DOL's regulations required a narrow construction of the statutory definition of "sale," the Court concluded that "an employee who functions in all relevant respects as an outside salesman should not be excluded from that category based on technicalities."

Takeaways:

In addition to the extremely favorable implications for employers in the pharmaceutical industry, the Supreme Court's focus on "function" rather than "formality" in the interpretation of the FLSA's language and the DOL's regulations reflects the Court's willingness to avoid the constraints of narrowly-interpreted exemptions. The *Christopher* decision, in turn, opens the door for lower courts to take a broader approach to the interpretation and application of the exemptions to the FLSA, rather than be strictly confined by perceived technicalities and formalistic interpretations. Such a



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realistic and functional approach may enable courts to expand the reach of other exemptions to the FLSA, which include the executive, administrative and professional exemptions, which could have a widespread and employer-favorable effect on the future interpretation and application of the FLSA and the DOL's regulations.