



For your information

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Supreme Court Upholds Outside Sales Exemption for Pharmaceutical Sales Representatives

On June 18, 2012, the United States Supreme Court held that pharmaceutical sales representatives are outside salesmen and, thus, are overtime-exempt under the Fair Labor Standards Act.

Background

The Fair Labor Standards Act (FLSA) requires employers to pay a minimum wage and overtime to employees who are engaged in, or are employed in an enterprise engaged in, commerce or the production of goods for commerce. Unless otherwise exempt, covered employees must be compensated at a rate not less than one-and-one-half times their regular rate for hours worked in excess of 40 per week.

The FLSA exempts certain broad groups of employees from its minimum wage and overtime requirements, including white-collar employees who work as executives, administrators, professionals, computer professionals, or outside salesmen. Unlike other white-collar employees, outside salesmen can qualify as exempt under the FLSA without satisfying minimum salary requirements.

The FLSA does not define the term “outside salesman.” Rather, Congress left it to the Department of Labor (DOL), which enforces the FLSA’s wage-hour rules, to issue regulations defining the term. DOL regulations define an outside salesman as an employee who: (1) has as a primary job duty making sales or obtaining orders or contracts for services to be paid for by the client or customer; and (2) customarily and regularly works away from the employer’s place(s) of business. Until recently, the DOL did not challenge the pharmaceutical companies’ long-standing treatment of their sales representatives as exempt from the FLSA’s overtime requirements.

Christopher v. SmithKline Beecham Corp.

SmithKline Beecham develops, manufactures, and sells prescription drugs. Under applicable federal regulation, prescription drugs can only be dispensed with a doctor’s prescription. For that reason, pharmaceutical companies such as SmithKline Beecham cannot sell prescription-only drugs directly to the public. Rather, they sell those drugs to distributors or retail pharmacies to dispense.

Pharmaceutical companies employ detailers or sales representatives to promote their drugs by calling on physicians to provide them with relevant information and encourage them to prescribe the products.

Michael Christopher and Frank Buchanan worked as pharmaceutical sales representatives for SmithKline Beecham from 2003 to 2007. Each week, they called on doctors during normal business hours and spent time outside normal business hours attending events, reviewing product information, and responding to phone calls and emails. They received a base salary and incentive pay based on sales of their assigned products in their assigned sales territories, earning on average more than \$72,000 annually. They did not receive overtime pay.

Lower Court Decisions

Messrs. Christopher and Buchanan brought suit in the U.S. District Court for the District of Arizona challenging SmithKline Beecham's failure to pay them overtime. Finding that the pharmaceutical sales representatives "unmistakably fit within the terms and spirit of the [outside sales] exemption," the district court [granted](#) SmithKline Beecham's motion for summary judgment. On appeal, the U.S. Court of Appeals for the Ninth Circuit [affirmed](#), concluding that the sales representatives' efforts in obtaining a "non-binding commitment" from physicians to prescribe their company's drugs constituted sales.

INSIGHT

Lower courts and other appellate courts have been split on this issue. The U.S. Court of Appeals for the Second Circuit [held](#) in *In Re Novartis Wage and Hour Litigation* that pharmaceutical sales representatives qualify for overtime under the FLSA, viewing "what occurs between physicians and Reps as less than a 'sale'." The U.S. Courts of Appeals for both the [Third](#) Circuit and the [Seventh](#) Circuit held that pharmaceutical sales representatives satisfy the FLSA's administrative exemption.

Supreme Court's Decision

In a 5-4 decision, the Supreme Court ruled in [Christopher v. SmithKline Beecham](#) that pharmaceutical sales representatives are outside salesmen under the FLSA and, thus, are exempt from the law's overtime requirements.

The DOL argued in *amicus* briefs in both the *Novartis* litigation and in the Ninth Circuit that the FLSA's outside sales exemption is inapplicable because only a "consummated transaction directly involving the employee for whom the exemption is sought" is a "sale." Before the Supreme Court, the DOL argued for the first time that a sale for purposes of the outside sales exemption only occurs when the salesman transfers title to the property. The Court rejected this view as flatly inconsistent with the statute, finding that the FLSA requires a broad view of "sale" that includes a "consignment for sale" that does not involve the transfer of title.

Ordinarily, courts defer to an agency's interpretation of its own ambiguous regulations. In considering whether pharmaceutical detailers are outside salesmen, the Court weighed whether the DOL's interpretation of its regulations is entitled to controlling deference. Unlike the Second Circuit in *Novartis*, the Supreme Court declined to defer to the DOL's most recent interpretation of the outside sales regulation in its *amicus* briefs because it would cause "unfair surprise" and impose potentially massive retroactive liability on the pharmaceutical industry. In reaching that conclusion, the Court focused on the fact that the DOL's position was not clear from the statute or regulations, that the DOL historically did not institute enforcement proceedings involving pharmaceutical sales representatives, and that the DOL did not seek to change its regulations through the rulemaking process.

Having decided that the DOL's interpretation of the outside sales regulation was not entitled to deference, the Court turned to the language of the FLSA itself. The FLSA exempts those employed "in the capacity of outside salesman." The Court concluded that the statute's emphasis on capacity requires "a functional, rather than a formal, inquiry, one that views an employee's responsibilities in the context of the particular industry in which the employee works." The FLSA provides that "'Sale' or 'sell' includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition." (emphasis supplied) Construing this language, the Court found as follows: (1) that the enumerated transactions were illustrative rather than exclusive; (2) that the use of "any" and "other disposition" requires a broad view of sales under the FLSA; and (3) that "the catchall phrase 'other disposition' is most reasonably interpreted as including those arrangements that are tantamount, in a particular industry, to a paradigmatic sale of a commodity." Recognizing that the outside sales exemption is meant to accommodate "industry-by-industry variations in methods of selling commodities," the Court found that the pharmaceutical sales representatives were properly classified as exempt outside salesmen "under the most reasonable interpretation of the DOL's regulations."

COMPLIANCE ALERT: State laws, some of which do not follow federal law, also affect the exempt/non-exempt classification of employees. Thus, employers must ensure that they have taken all applicable laws into account in their compensation practices.

Conclusion

The Supreme Court's ruling clarifies that the outside sales exemption applies to pharmaceutical sales representatives and upholds long-standing industry pay practices. The decision will affect overtime suits brought by pharmaceutical sales representatives across the country. Although the ruling addresses an industry-specific practice and an estimated 90,000 pharmaceutical sales representatives, it may have ramifications in other industries as well.

Buck Can Help

- Evaluate the impact of this decision on your compensation policies and practices
- Review exempt/non-exempt classifications and overtime policies
- Train and educate managers and supervisors on applicable wage-hour laws