High Court Rules Pharmaceutical Sales Reps Are Exempt From FLSA’s Overtime Requirements

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On June 18, 2012, with Justice Samuel Alito writing for a 5-4 majority, the U.S. Supreme Court considered whether the term “outside salesman,” as defined by Department of Labor (DOL) regulations, encompasses pharmaceutical sales representatives. The Court ruled that these sales representatives qualify as outside salesmen and thus, are exempt from the overtime compensation requirements of the Fair Labor Standards Act (FLSA). Given “the industry’s decades-long practice of classifying pharmaceutical detailers as exempt employees” and the DOL’s failure to initiate any enforcement actions with respect to sales representatives, the Court found that a decision to the contrary “would result in precisely the kind of ‘unfair surprise’ against which our cases have long warned.” Although a critical decision for the pharmaceutical industry in its own right, the case generally has been viewed more importantly for its insight as to the weight the Supreme Court would give to agency views of the laws they enforce. *Christopher v. SmithKline Beecham Corp., DBA GlaxoSmithKline*, No. 11-204, U.S. Supreme Court (June 18, 2012).

**Factual Background**

SmithKline Beecham Corporation develops, manufactures, and sells prescription drugs. Pharmaceutical companies, such as SmithKline, promote their drugs to physicians through a process called “detailing,” whereby their employees (“detailers” or “pharmaceutical sales representatives”) provide information to physicians about the company’s products in hopes of persuading them to write prescriptions. These representatives’ primary duty is to obtain nonbinding commitments from physicians to prescribe their employer’s prescription drugs.

SmithKline pharmaceutical sales representatives spend approximately 40 hours each week calling on physicians to discuss benefits, features, and risks of certain drugs. Outside of normal business hours, the representatives spend an additional 10 to 20 hours each week attending events, reviewing product information, returning phone calls, responding to emails, and performing other miscellaneous tasks. SmithKline did not pay the representatives time-and-one-half wages when they worked in excess of 40 hours per week.

Several of SmithKline’s pharmaceutical sales representatives brought suit against the company arguing that SmithKline violated the FLSA by failing to compensate them for overtime hours worked. The trial judge ruled in favor of SmithKline. The representatives filed a motion to alter or amend this judgment, contending that the trial judge had erred in failing to accord controlling deference to the DOL’s interpretation of the pertinent regulations. The trial judge rejected this motion and
the Ninth Circuit Court of Appeals affirmed, agreeing that the DOL’s interpretation was not entitled to controlling deference. The case eventually reached the U.S. Supreme Court.

**Legal Analysis**

While the FLSA obligates employers to compensate employees for hours in excess of 40 per week at a rate of one-and-one-half times the employees’ regular wages, it exempts workers “employed . . . in the capacity of outside salesman.” Congress did not define the term “outside salesman,” but it delegated authority to the DOL to issue regulations to define the term. Under what the Court called the DOL’s “general” regulation (29 CFR §541.500) an outside salesman is any employee whose primary duty is making any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition.

The Court noted that the DOL first announced its view that pharmaceutical detailers are not exempt outside salesmen in an amicus brief filed in the Second Circuit in 2009. However, the agency changed and narrowed its views on what constitutes a “sale” for the purposes of the outside sales exemption. The DOL’s new position is 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.” As such, the representatives argued that obtaining a nonbinding commitment to prescribe drugs does not constitute a sale. Both the representatives and the DOL argued that this interpretation is entitled to deference.

This new interpretation, the Court found, is “fla[tly inconsistent with the FLSA,” which defines “sale” to mean a “consignment for sale” that does not involve the transfer of title. The Court concluded that the DOL’s interpretation is neither entitled to deference “nor persuasive in its own right.”

The Court noted that the definition of outside salesman in the DOL’s regulation includes a “broad catchall phrase: ‘other disposition.’” This phrase, the Court concluded, “is most reasonably interpreted as including those arrangements that are tantamount, in a particular industry, to a paradigmatic sale of a commodity.”

Obtaining a nonbinding commitment from a physician to prescribe a drug, which was “the most that petitioners were able to do to ensure the eventual disposition” of SmithKline’s products “comfortably falls within the catch-all category of ‘other disposition.’” Based on this interpretation, the Court ruled that the SmithKline representatives made sales for purposes of the FLSA, and therefore are exempt outside salesmen within the meaning of the DOL’s regulations.

The Court bolstered its conclusion by reasoning that the representatives “bear all of the external indicia of salesmen,” insofar as they are hired for their sales experience, are trained to close sales, work away from the office with minimal supervision, and receive incentive compensation. Finally, the Court noted that its holding comports with the apparent purpose of the FLSA’s exemption for outside salesmen. In this regard, the Court noted that the representatives, who earned an average of more than $70,000 per year and who worked on their assigned portfolio of drugs between 10 and 20 hours outside of normal business hours, “are hardly the kind of employees that the FLSA was intended to protect.” Concluding that the representatives qualify as outside salesmen under the most reasonable interpretation of the DOL’s regulations, the Court affirmed the Ninth Circuit’s ruling in SmithKline’s favor.

**Practical Impact**
According to Steven F. Pockrass, a shareholder in Ogletree Deakins' Indianapolis office and co-chair of the firm's Wage and Hour Practice Group: "This is a significant victory for employers. Not only did the Court hold that the DOL's interpretation of its outside sales representative regulations in this case was not entitled to deference, but it also held that the DOL's interpretation was wrong."

Pockrass continued: "The Court's decision demonstrates that common sense and fair play need not be thrown by the wayside when interpreting the FLSA. The Court recognized that the plaintiffs were not low-paid employees, but well-compensated individuals, and the industry had engaged in a decades-long practice of classifying employees in these positions as exempt outside salespeople without any challenge by the DOL. It was only after the plaintiffs' bar attacked this practice that the DOL announced its position in amicus briefs. As the Supreme Court noted, giving deference to the DOL's interpretation would have imposed massive liability for conduct that occurred well before that interpretation was announced and would not have provided fair notice."

"Although employers in industries that have not been the targets of DOL enforcement actions or the subjects of DOL opinion letters can take some comfort in this decision, the ruling certainly is not going to shut the door on wage and hour lawsuits by the plaintiffs' bar."

"The decision also is not going to stop the DOL from trying to find ways to challenge employers. For example, we may see the DOL's Wage and Hour Division start issuing FLSA Administrator Interpretations again, as it first began doing in 2010, so that it can make a 'fair notice' argument. The Wage and Hour Division also has targeted several industries for enforcement actions, and this ruling may spur it to take on more targets so that it has a record of contending that a certain practice was unlawful prior to taking a stance in litigation or in amicus briefs."

According to Alfred B. Robinson, Jr., a shareholder in Ogletree Deakins' Washington, D.C. office, co-chair of the firm's Wage and Hour Practice Group, and former acting Administrator of the Wage and Hour Division of the DOL: "This decision is significant not only for the pharmaceutical industry but also for other industries that utilize the outside sales employee exemption in their business models. In its analysis of what constitutes a sale, the Court recognized that the definition attempts 'to accommodate industry-by-industry variations in methods of selling commodities.' The Court viewed this definition as an industry specific standard of sales activities that are tantamount to the sale of a commodity."