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Are Pharma Sales Reps Entitled to Overtime Pay?

U.S. Supreme Court grants certiorari to end circuit split

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Are pharmaceutical sales representatives covered by the “outside sales” exemption under the federal Fair Labor Standards Act? For decades the pharmaceutical industry has been left without any clear guidance in answering this question. The wider implication, of course, is that, without any guidance, pharmaceutical companies have been left to determine on their own whether thousands of “sales reps” across the country are entitled to overtime compensation. Finally — now that the legal landscape relative to this issue has reached maximum levels of confusion as the Ninth and Second Circuits recently took diametrically opposed positions — the Supreme Court has agreed to review the issue and provide the industry with some clarity and certainty. Well, sort of.

On Nov. 28, 2011, the United States Supreme Court agreed to review the decision of the Court of Appeals for the Ninth Circuit in *Christopher v.*

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Smithkline Beechman Corp., 635 F.3d 383 (9th Cir. 2011). The Supreme Court was presented with two questions: (1) whether deference is owed to the Secretary of the Department of Labor’s interpretation of the Fair Labor Standards Act’s (FLSA) sales exemption and related regulations; and (2) whether the FLSA’s outside sales exemption applies to pharmaceutical sales reps.

The answer to the first question will inform the answer to the second. At the same time, the answer to the second question may or may not provide closure on the issue of whether pharmaceutical sales reps are entitled to overtime compensation. If the Supreme Court answers the second question in the affirmative, then the debate is over — pharmaceutical sales reps will not be entitled to overtime compensation under federal law (state law might still provide them with the right to overtime compensation; however, at least in the State of New Jersey, state law mirrors the federal law). If, on the other hand, the Supreme Court answers in the negative, then the debate is not quite over. While pharmaceutical companies would have more guidance, they will still lack a bright-line rule applicable to all sales reps in all cases.

Under the FLSA, 29 U.S.C. 201,

et. seq., employers must pay their “non-exempt” employees one-and-a-half times their regular wages for all hours worked above 40 in a regular workweek (i.e., they must be paid “overtime”). 29 U.S.C. 201. One of the more complicated considerations is determining whether employees are “exempt” or “non-exempt.” The following are the two most commonly cited exemptions for pharmaceutical sales reps: (1) “outside sales,” and (2) “administrative.” 29 U.S.C. 213(a)(1).

Under the “outside sales” exemption, an employee’s primary duty must be “making sales” or “obtaining orders,” and the employee must be “customarily and regularly engaged away from the employer’s place or places of business.” 29 C.F.R. 541.500(a).

The term “sales” is broadly defined by the regulations and includes “any sale, exchange, contract to sell, consignment for sale, shipment for sale or other disposition.” 29 C.F.R. 541.501. In the realm of pharmaceutical sales, the first portion of the test is easily met. Sales and promotion are generally the primary duty of sales representatives, and they generally spend the majority of their workweek out of the office. The part most heavily litigated is whether sales reps are actually “making sales,” and the courts have not taken a unanimous position on this.

Prior to the Ninth Circuit’s recent ruling in *Christopher*, the Court of Appeals for the Second Circuit issued a drastically different decision in which it came to the opposite conclusion relative to the outside sales exemption. In *In re Novartis Wage & Hour Litigation*,

611 F.3d 141 (2d Cir. 2010), the court determined that pharmaceutical sales reps are not covered by the outside sales exemption because they do not “make sales.” The *Novartis* court summarized its reasoning by noting that a sales rep “promotes a pharmaceutical product to a physician but can transfer to the physician nothing more than free samples and cannot lawfully transfer ownership of any quantity of the drug in exchange for anything of value, cannot lawfully take an order for its purchase, and cannot lawfully even obtain from the physician a binding commitment to prescribe it”

In *Christopher*, however, the Ninth Circuit held that pharmaceutical sales reps do “make sales” as that phrase is utilized in the pharmaceutical industry. The court rejected the plaintiffs’ argument that sales reps do not “sell” to doctors, noting that such an argument “ignores the structure and realities of the heavily regulated pharmaceutical industry.” Indeed, the court summarily rejected the plaintiffs’ “suggest[ion] that despite being hired for their sales experience, being trained in sales methods, encouraging physicians to prescribe their products, and receiving commission-based compensation tied to sales, their job cannot ‘in some sense’ be called selling.” The court noted that “this view ignores the reality of the nature of the work of [sales reps], as it has been carried out for decades.”

The *Christopher* court further concluded that the relevant “purchasers” in the pharmaceutical industry “are not the end-users of the drug but, rather, the prescribing physicians whom they importune frequently.” Indeed, “unlike conventional retail sales, the patient is not at liberty to choose personally which prescription pharmaceutical he desires.”

The court determined that it simply could not ignore the reality of the pharmaceutical industry. As such, it determined that sales reps are covered under this exemption and not entitled to overtime compensation.

Interestingly, despite being petitioned, the Supreme Court declined to review the Second Circuit’s *Novartis* decision. The timing of the Court’s decision not to review the *Novartis* decision has led to much speculation in the pharmaceutical and legal industries as it came down a few weeks *after* the Ninth Circuit’s decision in *Christopher*. Thus, many speculate that the Supreme Court will reverse the Ninth Circuit’s decision. For now though, the pharmaceutical industry must wait.

However, in the event that the Supreme Court effectively bars pharmaceutical companies from classifying their sales reps as exempt under the outside sales exemption, there is still the possibility that those same sales reps might still be exempt under the administrative exemption. This issue was litigated in *Smith v. Johnson & Johnson*, 593 F.3d 280 (3rd Cir. 2010). Briefly, the administrative exemption covers any employee who fits the following criteria: (1) salaried at a rate of not less than \$455 per week; (2) “primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers”; and (3) “primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.” 29 C.F.R. 541.200.

In *Smith*, the Third Circuit declared that Patty Lee Smith was not entitled to overtime because she met the three-prong test for the administrative exemption. The court credited much of the plain-

tiff’s own deposition testimony in reaching its decision. The first prong was not disputed. According to the court, the key factor in finding that the second prong was met was the plaintiff’s testimony that she was required to form a strategic plan designed to maximize sales in her territory. The court noted that this act involved a high level of planning and foresight and guided the execution of the employee’s remaining duties. As for the final prong, the court once again noted the plaintiff’s own testimony in that she “executed nearly all of her duties without direct oversight” and, in fact, described herself as “the manager of her own business who could run her own territory as she saw fit.”

While waiting for a determination on whether pharmaceutical companies can continue to use the outside sales exemption to classify their sales reps, the administrative exemption is still available — if the sales rep meets the test. Pharmaceutical companies should keep in mind that the more discretion and independence provided to sales reps, the more likely that a company will prevail in a dispute over whether they are exempt from overtime under the administrative exemption. In general, three factors should be considered before classifying a sales rep as administratively exempt: (1) level of supervision over the sales rep; (2) level of discretion provided to the sales rep; and (3) whether compensation is linked to sales.

This is a highly fact-sensitive inquiry and, for the time being, there is no one-size-fits-all solution to the issue of exemption from overtime compensation for pharmaceutical sales reps. Pharmaceutical companies should keep a close eye on the Supreme Court’s review of *Christopher*, as it will likely have significant consequences for the industry. ■