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U.S. Supreme Court Holds Pharmaceutical Sales Representatives Are Exempt Outside Sales Employees and Rebukes DOL's Efforts to Regulate Via Amicus Filings

By Lisa Schreter, Richard Black, and Libby Henninger

On June 18, 2012, the U.S. Supreme Court issued its eagerly anticipated opinion in *Christopher v. SmithKline Beecham Corp.*, 2012 U.S. LEXIS 4657, slip op. No. 11–204 (2012), one of the only Supreme Court cases to address the overtime exemptions under the Fair Labor Standards Act (FLSA), and the first to address the criteria for the application of the "outside sales" exemption. In a 5-4 decision, the Supreme Court held that pharmaceutical sales representatives (PSRs) employed by GlaxoSmithKline PLC were primarily engaged in "making sales," and therefore were properly classified as exempt under the outside sales exemption. In reaching that decision, the Supreme Court rejected the U.S. Department of Labor's (DOL) narrow interpretation of the outside sales exemption, as announced by the agency for the first time through unsolicited *amicus curiae* briefing, outside of notice and comment rulemaking procedures. The Supreme Court's decision in *Christopher* represents not only a significant victory for the pharmaceutical industry and employers generally, but also will have a far-reaching effect on federal agencies by limiting their ability to effectuate new interpretations of federal statutes and applicable regulations via *amicus* briefs.

Deference to the DOL's Interpretive Position

Before addressing in detail the application of the outside sales exemption to PSRs, the majority first discussed whether the *amicus* position of the DOL – that PSRs were not properly classified as exempt under the FLSA's outside sales exemption – should be afforded deference by federal courts under *Auer v. Robbins*. That part of the Court's opinion is striking for two reasons. First, whereas the Court was divided 5-4 on the application of the outside sales exemption to PSRs, even the dissenters agreed that the DOL's opinions stated for the first time in *amicus* briefs should not be given any especially favorable weight. Second, the opinion included a scathing rebuke of the DOL's effort to impose its regulatory interpretations on the federal courts without first engaging in the type of "notice and comment rulemaking" that is the hallmark of a federal agency's ability to issue guidance interpreting statutes and regulations the agency is charged with enforcing.

In *Christopher*, the Court agreed with the U.S. Court of Appeals for the Ninth Circuit that, while *Auer* ordinarily calls for deference to an agency's interpretation of its own ambiguous regulation – even when that interpretation is advanced in a legal brief – this general rule does not apply

when the agency's interpretation is "plainly erroneous or inconsistent with the regulation," the interpretation "does not reflect the agency's fair and considered judgment on the matter," or when deference would result in "unfair surprise." It appears the Court found that all of these exceptions to the general rule applied to the DOL's position in *Christopher*. The Court was particularly troubled by the DOL's announcement of new regulatory interpretations, bypassing rulemaking and notice procedures, and creating unfair surprise for an entire industry:

> "Petitioners invoke the DOL's interpretation of ambiguous regulations to impose potentially massive liability on respondent for conduct that occurred well before that interpretation was announced. To defer to the agency's interpretation in this circumstance would seriously undermine the principle that agencies should provide regulated parties 'fair warning of the conduct [a regulation] prohibits or requires.'"

The Court took further issue with the DOL's practice of changing its regulatory interpretations mid-stream and informing the pharmaceutical industry of its view that PSRs are not exempt only in *amicus* briefs filed after private litigation had begun, stating:

> "It is one thing to expect regulated parties to conform their conduct to an agency's interpretations once the agency announces them; it is quite another to require regulated parties to divine the agency's interpretations in advance or else be held liable when the agency announces its interpretations for the first time in an enforcement proceeding and demands deference."

In this regard, the Court noted that until 2009, the pharmaceutical industry had little reason to suspect that it was not in compliance with the FLSA in treating PSRs as exempt employees. In particular, the Court observed that the FLSA and applicable regulations did not provide clear notice that this practice violated the FLSA and, "[e]ven more important, despite the industry's decades-long practice, the DOL never initiated any enforcement actions with respect to [PSRs] or otherwise suggested that it thought the industry was acting unlawfully." Accordingly, the Court concluded that the only plausible explanation for the DOL's inaction was acquiescence to the well-known practice of classifying PSRs as exempt from the FLSA's overtime requirements. In reversing course after some 70 years of acquiescence, and initiating a new, sharply constrained interpretation of the term "sales" through the filing of *amicus* briefs, the Court found that the DOL's interpretation was "quite unpersuasive," and "flatly inconsistent" with the FLSA and, in effect, an end-run around the rulemaking process. The DOL's reinterpretation was not entitled to controlling deference under *Auer* because, according to the Court, granting deference in such circumstances would circumvent the procedural safeguards of the agency rulemaking process. Strikingly, the dissenting opinion did not contest the majority's position on the deference issue and instead agreed with the majority that "we should not give the Solicitor General's current interpretive view any especially favorable weight."

The Court's decision on the deference issue was not only highly significant to the ultimate outcome in *Christopher*, but also appears to have narrowed the circumstances under which courts will defer to an agency's interpretations of their own ambiguous regulations. That is, in the wake of *Christopher*, where an agency interpretation will result in substantial liability to a business, the DOL and other agencies should be prepared to establish that they gave "fair warning" to those affected by their regulatory interpretations. Indeed, the unwillingness of any justice to afford the DOL's *amicus* rulemaking deference in this case should impact the use of *amicus* briefs by federal agencies to influence court decisions involving the interpretation of agency regulations across a wide swath of industries, federal agencies, and areas of law.

Standard to Be Applied in Interpreting an FLSA Exemption

Addressing the standard courts should apply in determining the applicability of FLSA exemptions, the majority noted that "[i]n the past, we have stated that exemptions to the FLSA must be 'narrowly construed against the employers seeking to assert them and their application limited to those [cases] plainly and unmistakably within their terms and spirit.'" Significantly, though, the majority expressly declined to follow this oft-stated standard, holding instead that the language of the FLSA and its regulations should not be "narrowly construed" against employers seeking to assert them "where, as here, we are interpreting a general definition that applies throughout the FLSA." In sum, the majority seems to have broken with prior Supreme Court precedent requiring that overtime exemptions should be narrowly construed. The Court's discussion of the term "capacity" in FLSA Section 13(a)(1) (noting that employees employed "in the capacity" of outside sales are exempt) is telling on this point. As discussed below, the Court noted that Congress's use of the term "capacity" in defining who qualified for the outside sales exemption was an important interpretive clue that supported a more functional, rather than formalistic, interpretation of the exemption. The Court's endorsement of a functional inquiry that takes into account the unique nature of work performed in particular industries when applying the FLSA's exemptions is consistent with the Court's earlier statement placing limits on the general notion that the statute

should be "narrowly construed." This notable departure from past precedent could be significant for employers in the future as there may be other situations that lend themselves to a more expansive, practical and flexible view of an exemption's application.

The Outside Sales Exemption

Having decided that no special weight would be afforded to the DOL's *amicus* positions, the majority opinion addressed the issue at the heart of the case – whether PSRs were properly classified as exempt from the FLSA's overtime requirements under the outside sales exemption. On appeal, the PSRs argued that rather than actually making "sales," they merely engaged in "detailing" – that is, PSRs "provide medical professionals who prescribe pharmaceuticals with the 'details' of pharmaceutical products, seeking to educate the prescribers with the ultimate goal of influencing their prescribing decisions." The PSRs further argued that, in promulgating applicable regulations, the DOL expressly defined an "outside salesman" as an "employee with the 'primary duty' of 'making sales'" and that the DOL purposefully drew a sharp distinction between employees who sell something themselves versus those who "promote" products to stimulate sales made by *someone else*. The PSRs claimed they fit cleanly into the category of those who undertake "promotional work that is incidental to sales made, or to be made, by someone else" and, as such, were not primarily engaged in sales.

The employer argued that the primary duty of its PSRs was indeed sales. In this regard, the employer argued that while it was true that federal law barred PSRs from selling prescription products directly to end users (patients), PSRs engaged in "selling" to physicians – the real "customers" given that they are the only people authorized under federal law to write prescriptions and thus facilitate sales to an end user. The fact that no tangible product was "sold" in the sense that it changed hands between PSRs and physicians was immaterial to the fact that a PSR's primary duty was to sell by encouraging physicians to write prescriptions for the company's products which, in turn, resulted in a sale.

The Court affirmed the decision of the Ninth Circuit that the PSRs, in fact, were primarily engaged in the duty of "making sales" and thus were properly classified as exempt under the FLSA's outside sales exemption. The majority opinion rooted its analysis in the language of the FLSA itself, noting that the FLSA "exempts anyone 'employed … *in the capacity* of [an] outside salesman."

Contrary to the formalistic interpretation of the statutory language advocated by the PSRs and DOL, the Court thus stated that "The statute's emphasis on the 'capacity' of the employee counsels in favor of 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." This analysis was critical to the Court's ultimate holding that PSRs are exempt under the outside sales exemption. Ironically, in many of the outside sales exemption cases PSRs have argued that the very regulations in the pharmaceutical industry that prohibited them from obtaining binding commitments to purchase products also precluded them from satisfying the outside sales exemption requirements. The Supreme Court turned this argument on its head. The Court held that, given the uniquely regulated nature of the industry in which PSRs work, "[o]btaining 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. This kind of arrangement, in the unique regulatory environment within which pharmaceutical companies must operate, comfortably falls within the catch-all category of 'other disposition.'"

Looking further at the definition of "sale" in the FLSA ("any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition"), the Court observed that Congress's inclusion of the catchall phrase "other disposition" cut against the DOL's position that a sale was a "contract for the exchange of goods or services in return for value" and, instead, lent further support to the view that Congress intended that the FLSA be interpreted to "accommodate industry-by-industry variations in methods for selling commodities." The Court concluded 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."

Interestingly, in his dissent, Justice Breyer did not discuss the DOL's position that an actual transfer of title of goods was required for the outside sales exemption to apply. Rather, Justice Breyer opined that the outside sales exemption requires a sales person to "obtain a firm commitment to buy the product." Thus, though the decision on the applicability of the outside sales exemption to PSRs was a narrow one, the difference between the majority and dissenting opinions is even narrower and appears to boil down to how much of a commitment is necessary for something to qualify as a "sale" (the majority's "nonbinding commitment" or the dissent's "firm commitment").

The majority also gave short shrift to the distinction between "promoting" and "selling" relied upon so heavily by the PSRs in their arguments before the Court and rejected the argument that "an employee is properly classified as a nonexempt promotional employee whenever there

is another employee who actually makes the sale in a technical sense." Again, the Court found this formalistic approach inconsistent with the broad concept of sales under the FLSA.

The majority buttressed its holding by looking to the way in which PSRs perform their jobs. Like the Ninth Circuit before it, the Court observed that the PSRs at issue: were "hired for their sales experience;" "trained to close each sales call by obtaining the maximum commitment possible from the physician;" "worked away from the office;" worked "with minimal supervision;" were "rewarded for their efforts with incentive compensation;" earned significant salaries and incentive compensation; and "spent 10 to 20 hours outside normal business hours each week performing work related to his assigned portfolio of drugs in his assigned territory." Such employees, said the Court, were "hardly the kind of employees that the FLSA was intended to protect," particularly since the exemption "is premised on the belief that exempt employees 'typically earned salaries well above the minimum wage' and enjoyed other benefits that '[s]et them apart from the nonexempt workers entitled to overtime pay."

Though the decision in *Christopher* is facially limited to the application of the outside sales exemption to PSRs, the majority opinion in the case will undoubtedly have far-reaching effects on the interpretation and application of the FLSA's overtime exemptions. First, the Court debunked the notion, oft-cited by plaintiffs in wage and hour cases, that the language of an FLSA exemption should be "narrowly construed" against the employer. Rather, where the application of the exemption depends on the interpretation of general definitions that apply "throughout the FLSA," narrow construction simply does not apply. Second, the FLSA exemption analysis should, in the wake of *Christopher*, reflect a "functional" inquiry "that views an employee's responsibilities in the context of the particular industry in which the employee works," as opposed to a rigid, "formal" inquiry that fails to take the particulars of the employee's work into consideration.

PSRs and the Administrative Exemption

Of related interest to the Supreme Court's decision in *Christopher*, the Seventh Circuit recently held that pharmaceutical sales representatives from two other companies – Abbott Laboratories, Inc. and Eli Lilly & Company – were properly classified as exempt under a different FLSA exemption: the administrative exemption. In *Schaefer-LaRose v. Eli Lilly & Co.*, the Seventh Circuit issued a consolidated opinion on two cases in which federal district courts had reached opposite results. Once the Seventh Circuit concluded the administrative exemption applied, and in light of pending Supreme Court review on the application of the outside sales exemption to PSRs in *Christopher*, the Seventh Circuit declined to address the applicability of the outside sales exemption.

As it had in other PSR cases, the DOL filed an *amicus* brief on behalf of the PSRs advocating the DOL's position that the PSRs did not qualify for either exemption. In its decision, the Seventh Circuit did not directly address the level of deference owed to DOL's *amicus* position. Instead, the court concluded that because there was no question of regulatory clarification in applying the administrative exemption, the DOL's position was immaterial because the court viewed itself as being "simply tasked with the application of an unambiguous regulation to the particular facts." The Seventh Circuit did note, however, that the issue of deference would be applicable if the interpretation of the regulations were at issue, as they potentially were with respect to the outside sales exemption. Clearly, in the wake of *Christopher*, any suggestion that the Seventh Circuit or the underlying federal district court erred by not deferring to the *amicus* position of the DOL is unavailing.

In applying the requirements of the administrative exemption to the job duties of the PSRs, the Seventh Circuit first found that the sales representatives' primary duty was the performance of work directly related to the general operations of the employers' business. In this regard, the court noted that the sales representatives "are the principal ongoing representatives of the company to the professional community that is in a unique position to make, or deny, a viable market for the company's product … [and] are one of the principal, and perhaps the main conduit by which physicians provide meaningful feedback to the company on the actual effectiveness, and limitations, of the product."

In addressing the level of discretion and independent judgment exercised by the PSRs, the Seventh Circuit concluded that, despite the regulatory constraints imposed on representatives in the pharmaceutical industry, PSRs are sent into physicians' offices with "minimal supervision to engage in conversation with the prescribing physicians who, as a practical matter, are in the most direct position to determine whether their companies' products have a viable market." In those discussions, the court noted, PSRs did not work from scripts, but instead were responsible for tailoring their messages to respond to each particular circumstance and set of concerns or questions. The court found it significant that the sales representatives were largely unsupervised, extensively trained and needed to exercise professional judgment to know when the physicians' questions required the response of a more knowledgeable person. The court was also persuaded by the discretion the sales representatives employed in planning for sales calls, including which physicians to visit and the degree of frequency and priority of those visits.

It is expected that the PSRs in the Seventh Circuit case will ask the Supreme Court to review that decision – particularly as it signifies a split amongst the federal appellate courts on the application of the administrative exemption to PSRs. Whether the Supreme Court will grant *certiorari* is unknown, as it has now already held that PSRs are exempt from the FLSA's overtime requirements on an entirely independent basis.

In the meantime, between the Supreme Court's decision in *Christopher* and the Seventh Circuit's decision in *Schaefer-LaRose*, pharmaceutical industry employers now have two strong arguments at their disposal in classifying pharmaceutical sales representatives as exempt from the FLSA's overtime requirements.

Lisa Schreter, Co-Chair of Littler Mendelson's Wage and Hour Practice Group, is a Shareholder in the Atlanta office; Richard Black is a Shareholder, and Libby Henninger is an Associate, in the Washington, D.C. office. If you would like further information, please contact your Littler attorney at 1.888.Littler or info@littler.com, Ms. Schreter at lschreter@littler.com, Mr. Black at rblack@littler.com, or Ms. Henninger at lhenninger@littler.com.