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Are Pharmaceutical Sales Representatives Exempted from the Overtime-pay Requirements of the Fair Labor Standards Act?

Anne M. Lofaso

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CASE AT A GLANCE

This case requires the Court to determine whether pharmaceutical sales representatives are exempt outside salesmen or nonexempt employees entitled to overtime pay under the Fair Labor Standards Act. To resolve that question, the Court will have to determine whether the Secretary of Labor's current interpretation of the regulatory term "sale," as requiring employees to consummate the sale of goods, is a permissible construction of the regulation.

Christopher v. SmithKline Beecham Corp.
Docket No. 11-204

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From: The Ninth Circuit

by Anne Marie Lofaso
West Virginia University College of Law, Morgantown, WV

INTRODUCTION

The Fair Labor Standards Act (FLSA) of 1938, 29 U.S.C. § 201 et seq., imposes overtime-pay requirements on covered employers. The FLSA exempts from those requirements "any employee employed … in the capacity of outside salesman (as such terms are defined and delimited from time to time by regulations of the Secretary …)." 29 U.S.C. § 213(a)(1).

The Secretary of Labor has implemented regulations to "define and delimit" the outside sales exemption. The Secretary of Labor has interpreted those regulations to find the exemption inapplicable to pharmaceutical sales representatives. A split exists between the Second and Ninth Circuits over whether this interpretation is owed deference and whether the FLSA's outside sales exemption applies to pharmaceutical sales representatives.

ISSUES

Is deference owed to the Secretary of Labor's interpretation of the FLSA's outside sales exemption and its related regulations?

Does the FLSA's outside sales exemption apply to pharmaceutical sales representatives who promote but do not sell their company's drugs to physicians?

FACTS

Petitioners-plaintiffs Michael Shane Christopher and Frank Buchanan were formerly employed as pharmaceutical sales representatives (PSRs) by respondent-defendant SmithKline Beecham Corp., d/b/a GlaxoSmithKline (the company or Glaxo), a pharmaceutical company. PSRs, such as petitioners, educate physicians within their assigned territories about Glaxo pharmaceutical products by presenting information about those products to persuade the doctors to prescribe Glaxo medications to their patients. The company trains PSRs for those visits by instructing them on how to promote its products and providing them with core messages—messages that should be included in their presentations. The company also provides them with information about the doctors' prescribing habits and medication preferences, a budget for entertaining doctors, and sample products to give to those doctors. PSRs may not, however, sell pharmaceutical products to these doctors because federal law prohibits them from selling samples, taking medication orders, or negotiating drug prices or contracts with either doctors or patients.

The company pays PSRs a fixed base salary, which amounts to approximately 75 percent of their compensation, plus incentive pay based on overall performance of Glaxo products in the PSRs' assigned territory. Incentive-based pay cannot be more precisely grounded in a particular PSR's performance because PSRs are legally forbidden from making sales; it is, therefore, impossible to determine whether a PSR's promotional work ultimately resulted in any particular sale. Although petitioners worked in excess of 40-hour weeks to meet the company's expectations and the demands of their jobs, the company never paid PSRs overtime wages.

Petitioners brought suit, on behalf of the company's PSRs, alleging that the company's failure to provide compensation for overtime work violated the FLSA. See 29 U.S.C. §§ 207(a)(1), 216(b). The district court disagreed and granted summary judgment to the company on grounds that petitioners were "outside salesmen" within the meaning of the FLSA and therefore were exempted from the act's overtime-pay requirements. Thereafter, petitioners moved to alter or amend the judgment based on the district court's failure to consider an amicus brief filed by the Secretary of Labor in a similar case then pending before the Second Circuit, *In re Novartis Wage & Hour Litig.*, 611 F.3d 141 (2d Cir. 2010). The district court rejected

petitioner's argument that the secretary's brief was entitled to deference under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984), or *Auer v. Robbins,* 519 U.S. 452 (1997). The district court noted, in any event, that the secretary's arguments summarized points argued at summary judgment. The district court concluded that the secretary's "'current interpretation,' as set forth in the amicus brief, was 'inconsistent with the statutory language and its prior pronouncements'" and also defied "common sense."

Petitioners appealed to the Ninth Circuit, which affirmed. On the deference question, the court of appeals concluded that it owed no deference to the Secretary of Labor's interpretation of the FLSA and its related regulation in this case. The court noted that administrative deference is normally accorded to the Secretary of Labor's interpretation of the FLSA and its related regulations in cases where the statutory or regulatory language is ambiguous and the secretary's interpretation is "based on a permissible construction of the statute." *Christopher v. Beecham Corp.,* 635 F.3d 383 (9th Cir. 2011) (citing *Chevron U.S.A., Inc.* and *Auer*). The court further noted that "'an agency does not acquire special authority to interpret its own words when, instead of using its expertise and experience to formulate a regulation, it has elected merely to paraphrase the statutory language.'" (citing *Gonzales v. Oregon,* 546 U.S. 243 (2006) (denying *Auer* deference where the agency's regulation "does little more than restate the terms of the statute itself")). Applying those basic principles here, the court held that it owed no deference to the secretary's interpretation of regulation 29 C.F. R. § 541.500(a)(1), because the regulatory language merely parroted the statutory language.

On the interpretation question, the court of appeals rejected the secretary's interpretation of the regulatory and statutory language. The court noted that "[a]bsent an agency-determined result, it is the province of the court to construe the relevant statutes and regulations." Applying a commonsense approach, the court of appeals found "apparent" that PSRs fall within the "outside sales exemption" because PSRs make sales "in some sense" within the meaning of FLSA § 3(k). Citing a 1940 Department of Labor (DOL) report (*Stein Report*), the court of appeals noted that this commonsense approach is consistent with the Secretary of Labor's long-standing approach to the outside sales exemption. The court concluded that PSRs, therefore, fall within the outside sales exemption because the PSRs' primary duty is not in promoting Glaxo products but in causing particular doctors to commit to prescribing Glaxo drugs, which is itself a sales activity.

CASE ANALYSIS

The parties and the government agree on the basic administrative law principles that apply to this case. In particular, the parties agree that regulations issued under a specific congressional directive are entitled to "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* It is not disputed that Congress, through 29 U.S.C. § 213(a)(1), authorized DOL to issue regulations "defin[ing] and delimit[ing]" the scope of the term "outside salesman," a term that is not itself defined by statute. It is undisputed that DOL has "the power to fill these gaps through rules and regulations." *L.I. Care at Home, Ltd. v. Coke,* 551 U.S. 158 (2007). It is also undisputed that DOL is the agency with expertise on this matter. It is further undisputed that DOL has had long-standing regulations "defin[ing] and delimit[ing]" the term "outside salesman" and the "outside salesman" exemption and that those regulations are valid and entitled to deference—at least in the abstract. That's where the agreement ends.

The parties and the government instead dispute whether DOL's interpretation of its implementing regulations, in particular, its interpretation of what constitutes a "sale," is "plainly erroneous or inconsistent with the regulation." Petitioners and the government argue that the secretary's interpretation of DOL's long-standing regulations constitutes a permissible construction of the statute that has not changed in any relevant manner at least since 1949. Respondent contends that DOL abruptly changed its interpretation of the regulations in "uninvited *amicus* briefs" before the Second Circuit in *In re Novartis,* and that its "newly restrictive *interpretation* of its regulations" is not entitled to deference. In particular, respondent argues that DOL's current interpretation of the statutory and regulatory term "sales" requires a formal transfer of title to the goods. Because, in respondent's view, that more restrictive definition of sales is inconsistent with DOL's prior interpretation of "sales," that interpretation is "entitled to considerably less deference than a consistently held agency view." *Thomas Jefferson Univ. v. Shalala,* 512 U.S. 504 (1994).

The parties also agree on the basic employment law principles but disagree on whether applying those principles results in PSRs being classified as exempt outside salesmen or nonexempt employees. The parties acknowledge that the FLSA requires employers to pay overtime rates to nonexempt employees. The FLSA requires covered employers to pay their employees a minimum wage for all hours worked. 29 U.S.C. § 206. The FLSA further requires those employers to pay their employees at a rate of one and one-half times their regular pay rate for time worked in excess of 40 hours in a workweek. 29 U.S.C. § 207. Those minimum-wage and over-time pay requirements do not apply to "[a]ny employee employed … or in the capacity of outside salesman (as such terms are defined and delimited from time to time by regulations of the Secretary. …" 29 U.S.C. § 213(a)(1). This case presents the question whether PSRs fall within this "outside salesman" exemption.

The Secretary of Labor promulgated regulations interpreting the "outside salesman" exemption in 1938, 1940, and 1949. By 1949, those regulations distinguished between exempt outside salesmen, who consummated their own sales, and nonexempt promoters, who stimulated sales but did not consummate their own sales. The DOL has also issued two reports discussing this distinction—the *Stein Report* (1940) and the *Weiss Report* (1949). In both reports, the DOL declined to interpret the exemption to include promotional activities. Instead, the DOL concluded that "the test is whether the person is actually engaged in activities directed toward the consummation of his own sales, at least to the extent of obtaining a commitment to buy from the person to whom he is selling."

In 2004, the DOL revised its "outside salesman" exemption through notice-and-comment rulemaking. 29 C.F.R. 541.500-504. Those revisions continued to maintain the distinction between exempt sales work and nonexempt promotional work. In particular, those regulations continued to define an outside salesman as any employee

"(1) [w]hose primary duty is: (i) making sales within the meaning of section 3(k) of the Act; … and (2) [w]ho is primarily and regularly engaged away from the employer's place or places of business in performing such primary duty." 29 C.F.R. § 541.500(a). The question whether petitioners regularly engaged away from the employer's place of business is not at issue here. The question whether petitioners' primary duty was to make sales within the meaning of FLSA § 3(k) is at issue.

FLSA § 3(k) defines "sale" to "include[ ] any sale, exchange, contract to sell, consignment for sale, shipment to sell, or other disposition." 29 U.S.C. § 203(k). DOL regulations define the sale of goods as exemplified by "the transfer of title to tangible property." 29 C.F.R. § 541.501(b). Those regulations also continue to distinguish between exempt sales work and nonexempt promotional work by defining "promotional work that is incidental to sales made, or to be made, by someone else" as nonexempt. 29 C.F.R. § 541.503.

The parties disagree on the resolution of whether PSRs are exempt outside salesmen or nonexempt sales promoters. Petitioners and the government argue that the PSRs are nonexempt sales promoters. To support that conclusion, petitioners and the government contend that the secretary's interpretation of the statutory and regulatory term "sales" requires that the "employee actually consummate the sale himself, either by entering into a contractual exchange between the employer and the customer or at a minimum by obtaining a commitment to purchase." Because, in petitioners' and the government's view, that construction of the term "sale" is reasonable, the regulations are valid. Applying that view, petitioners and the government argue that PSRs are nonexempt employees entitled to overtime pay because they are forbidden by law to consummate sales. At most, PSRs engage in promotional work in support of sales by other employees, work that does not constitute sales within the DOLs interpretation of that term.

Respondent argues that, until recently, DOL construed the term "sale" in a broad, flexible manner according to which an employee need only engage in a sale "in some sense" to be covered by the "outside salesman" exemption. Under this approach, in respondent's view, PSRs comfortably fell within the exemption. In addition to arguing that the Court should not defer to DOL's construction of the term "sale" because it constitutes a newly minted construction of that term that is inconsistent with its previous interpretation of that term (see above), respondent also argues that this newly minted construction should be abandoned as impermissible. In respondent's view, DOL's construction does not represent a natural reading of the term "sale," represents an internally incoherent construction of that term as it appears in the statute and regulations, and ignores the practical realities of the pharmaceutical industry.

SIGNIFICANCE

This case could become interesting from an administrative law point of view if the Supreme Court decides to examine the extent to which it owes deference to an agency's construction of its own regulations as presented in an amicus brief. Whether that question will surface depends on whether the court finds that DOL actually changed its long-standing position in an amicus brief. Even then, the Court could avoid the administrative law question altogether if it decides that DOL did not wander from its long-standing interpretation or if it sides with petitioners on the merits.

Respondent's commonsense point—that PSRs are the type of employee that the exemption was designed to capture—makes some sense. If petitioners emerge victorious, the pharmaceutical industry will have to figure out what constitutes work time. Is taking wealthy doctors out to dinner work time? Are golf outings with doctors work time? Presumably yes.

Nevertheless, this case does not seem to present the type of significant policy issues that respondent claims—at least not in the way that respondent claims. According to respondent, a ruling in petitioners' favor could negatively impact workers by displacing a system that rewards outstanding performance and flexible hours. Yet it remains unclear how paying workers time and a half for work performed in excess of 40 hours per week abolishes that system. Such a ruling certainly would not preclude companies from continuing to pay employees bonuses for promotional work that the company believes has contributed greatly to sales volume.

Nor is it clear who the winners and losers will be if the Supreme Court adopts petitioners' position. For example, respondent suggests that employees with young children or with other personal obligations are better off being classified as exempt and foregoing overtime pay. But the truth of that observation is far from crystal clear. Rather, respondent's observation seems to confound employer's overtime-pay obligations with flexible work interests. Employees with personal obligations need flexible hours. It is unclear which of those types of workers are better off being classified as exempt. To be sure, companies may restructure compensation plans for PSRs in response to this ruling. Indeed, compensation plans might have already changed in anticipation of this ruling. Those changes are likely to result in winners and losers among employees. But just who those winners and losers are will depend on the personal preferences and economic circumstances of the affected employees. For example, such restructuring may result in fewer hours for workers in these types of positions, which might attract parents with small children. Fewer hours for workers might make room for a larger workforce. This, of course, is one of the policies behind overtime-pay requirements—to incentivize employers to spread around the work by making it more expensive to work employees long hours. Accordingly, such restructuring could have a beneficial economic impact on areas with high unemployment rates.

What is clear is that a ruling in petitioners' favor will result in overtime liability. This is something that companies who employ these types of workers should be concerned about in the short run. In the long run, however, companies would respond to this hypothetical ruling as they do to all legal rulings—by using the laws in a manner that is most advantageous to their values and bottom lines.

Anne Marie Lofaso is the associate dean for Faculty Research and Development and a professor of law at the West Virginia University College of Law in Morgantown, West Virginia. She can be reached at anne.lofaso@mail.wvu.edu or 304.293.7356.

PREVIEW of United States Supreme Court Cases, pages 260–263.

ATTORNEYS FOR THE PARTIES

For Petitioner Michael Shane Christopher (Thomas C. Goldstein, 202.362.0636)

For Respondent SmithKline Beecham Corp., d/b/a GlaxoSmithKline (Paul D. Clement, 202.234.0090)

AMICUS BRIEFS

In Support of Petitioner Michael Shane Christopher

Certified Class of Pharmaceutical Representatives from Johnson & Johnson (Aashish Y. Desai, 949.474.3004)

Medical Professionals (Sarah M. Shalf, 404.712.4652)

National Employment Lawyers Association (Paul W. Mollica, 312.263.0272)

Pharmaceutical Representatives (Michael R. DiChiara, 201.746.0303)

United States (Donald B. Verrilli Jr., Solicitor General, 202.514.2217)

In Support of Respondent SmithKline Beecham Corp., d/b/a GlaxoSmithKline

Center for Constitutional Jurisprudence (John C. Eastman, 714.628.2500)

Chamber of Commerce of the United States of America (Matthew W. Lampe, 212.326.3939)

Equal Employment Advisory Council (Rae T. Vann, 202.629.5624)

National Federation of Independent Business Small Business Legal Center (Kevin Michael Kraham, 202.423.2404)

Pharmaceutical Research and Manufacturers of America (Jeffrey S. Bucholtz, 202.737.0500)

Washington Legal Foundation (Cory L. Andrews, 202.588.0302)