This Week's Feature

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Uncertainty in the Pharmaceutical Industry: FLSA Classification of Pharmaceutical Sales Representatives to Be Determined

by Emina Poricanin and Noreen DeWire Grimmick, Hodgson Russ LLP, Albany, New York

People often hear the phrase "the only thing certain in life is death and taxes." In the realm of labor and employment law, however, the "most certain" principle with respect to employee compensation is that employees must be paid a minimum wage. In the case of overtime, employees must be paid not less than 1½ times their regular rate under the Fair Labor Standards Act of 1938 (FLSA), a federal law that is applicable in all states. There are exceptions to these principles, however. Employers are not required to pay overtime to employees who satisfy one of the FLSA "exemptions." But determining whether an employee is overtime exempt under the FLSA can be difficult; and failure to classify an employee properly can be costly for employers. Some exemptions are well established. Doctors, for example, are overtime exempt under the FLSA. The exemption status is not as well settled for other professionals.

Currently, one of the most prominent FLSA exemption controversies involves highly compensated pharmaceutical sales representatives (PSRs), who up until recently were considered exempt. Upon review of their status under the FLSA, however, the circuit courts split on whether PSRs are exempt. Millions of dollars are at stake in this debate. American pharmaceutical companies may owe compensation to PSRs for unpaid overtime, if, in fact, they are ultimately determined to be non-exempt. In addition, liquidated damages may also be awarded for a violation of the FLSA.

Beyond monetary damages, the American pharmaceutical industry may be forced to reform its current business model if PSRs are ultimately deemed non-exempt in a decision that the United States Supreme Court is expected to issue this year. Truly, the old adage about "death and taxes" has been proven right once again as an entire industry awaits a decision and grapples with the question in the interim. The following is a brief review of the disputes that dominate the divergent analysis of the circuit courts, and hopefully, some insight for corporate counsel as well.

PSRs and the FLSA

"Outside salesmen" are defined by the Department of Labor regulations as employees whose primary duty is making sales or obtaining orders or contracts for services, for which consideration is paid by the client or customer, and who is primarily and regularly engaged away from the employer's place of business in performance of that duty. In turn, "primary duty" is defined as the principal, main, major, or most important duty that the employee performs. Work performed incidental to, and in conjunction with the employee's own outside sales or solicitation, is regarded as exempt outside sales work. Other work that furthers the employee's sales efforts, such as writing, sales reports, updating or revising the employee's sales or display catalogs, planning itineraries, and attending sales conferences, is also regarded as exempt work. Sales work, however, is different than promoting for purposes of the FLSA. Promotion work may or may not be exempt outside sales work. Like sales, promotion work is performed

by the sales person. While promotional work that is incidental to, and in conjunction with, an employee's own outside sales or solicitation is considered exempt work, promotional work that is incidental to sales made, or to be made, *by someone else* is not exempt under the "outside sales" exemption. Whether an employee's activities qualify as exempt under the FLSA is a question of law.

There is a split between the Ninth and Second Circuit Court of Appeals as to whether PSRs are exempt under the FLSA as outside salesperson. Presently before the United States Supreme Court is a decision by the Ninth Circuit, *Christopher v. Smith Kline Beecham Corp.*, 635 F.3d 383 (9th Cir. 2011), which determined that PSRs are overtime exempt under the FLSA as outside salesperson. Several months before *Christopher* was decided, however, the Second Circuit held in *In re Novartis Wage and Hour Litigation*, 611 F.3d 141 (2d Cir. 2010), that PSRs are not overtime exempt as outside salesmen under the FLSA. The United States Supreme Court will resolve the split.

The *Christopher* case was commenced by two PSRs against their former employer, a pharmaceutical company that developed, produced, marketed, and sold pharmaceutical products. The plaintiffs claimed that the company owed them overtime pay under the FLSA, but the company contended that the PSRs were outside salesmen under the law, and therefore exempt from the overtime requirement. The PSRs were hired for their sales experience and they were trained in sales methods. Their job involved visiting physicians' offices and encouraging them to prescribe the company's products to their patients. During those visits, the PSR presented physicians with information about the company's products and provided product samples. Before the PSRs visited physicians, however, the company provided them with detailed reports about the physicians they would visit. The reports also included information about the products' benefits and risks, dosage instructions, and the types of patients for whom it could be prescribed. This information was provided to the PSRs to enable them to deliver informative presentations to the physicians. The PSRs did not contact patients or market anything to them. In compliance with federal law, the PSRs could not sell samples, take orders for any medication, or negotiate drug prices or contract with either physicians or patients. Rather, the goal of a physician visit was to obtain a commitment from the physician that he or she would prescribe the company's product to patients. That was the targeted result for PSRs. No money was ever exchanged by the PSR and the physicians at the conclusion of "the deal."

The PSRs usually worked outside of the employer's office, visiting 8 to 10 physicians each day. But, the plaintiffs in *Christopher* claimed that they also worked 10 to 20 hours every week outside of normal business hours and that they were entitled to overtime wages for that time.

The PSRs received two forms of compensation; a salary and incentive pay. The latter was paid if the company's market share for a particular product increased in the PSR's territory, sales volume for the product increased, sales revenue increased, or the dose volume increased. Generally, 25 percent of the PSR's total compensation was based on the incentive pay.

What is a sale? That was the key question in *Christopher*. The FLSA regulations define a salesperson as someone who either makes sales or obtains orders or contracts. Since the PSRs did not obtain orders for anything, *Christopher* examined whether the "sales" element was met. A sale is defined as any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition. In *Christopher*, the PSRs claimed that, by not transferring any product to physicians, they were not selling pharmaceuticals, only "promoting" them.

The Ninth Circuit rejected that interpretation of the FLSA. The Ninth Circuit held that the PSR's contention that they did not "sell" to physicians ignored the reality of the heavily regulated pharmaceutical industry. Federal law prohibited pharmaceutical manufacturers from directly selling prescription medications to patients. Therefore, the ultimate consumer, the patient, could not purchase the product from a PSR. Given the reality of the nature of the work performed and the pharmaceutical industry regulations, the Ninth Circuit held that the buyers, for purposes of this exemption, were not patients, the end users of the product, but rather the prescribing physicians. Additionally, the court noted that unlike conventional retail sales, physicians' patients are not at liberty to choose which pharmaceutical product he or she desires. The physicians prescribed medication and acquired the medication from the pharmaceutical

manufacturer. Therefore, the patient could not "fairly" be characterized as a buyer. The court concluded that in the pharmaceutical industry, the "sale" was the exchange of commitment between the PSR and the physician at the end of a visit.

The Ninth Circuit also rejected the argument that the PSRs only promoted, not sold, products. The court noted the PSRs did not *generally* promote sales. The primary duty of a PSR was not promoting the product in general, or teaching physicians drug development. Those were preliminary steps toward the end goal of causing a particular physician to commit to prescribing more of the employer's drugs. Rather, the PSRs directed their sales efforts only toward certain products, toward a discrete group of physicians, and only within a defined geographic area. Targeting the physicians was not based on general advertisements or mass appeals—it was the result of a personalized review of each physician's prescribing habits and history. The process, like any sales process, was tailored to the customers' preferences. Without the physicians' commitment to prescribe the company's products, and the concomitant increase in sales, the PSR would not receive his or her commission salary and would not remain employed.

Six months before the Ninth Circuit issued its decision in *Christopher*, the Second Circuit addressed the same issue in *In re Novartis Wage and Hour Litigation* and decided that PSRs do not fall within the "outside sales" exception. The *Novartis* case was a class action commenced by approximately 2,500 former PSRs who sought overtime compensation. The duties performed by the PSRs in *Novartis* were generally the same to those performed by the PSRs in *Christopher*.

The Second Circuit reversed the decision of the U.S. District Court for the Southern District of New York, which had concluded that the PSRs were exempt based on an analysis that was largely adopted by the Ninth Circuit in *Christopher*. The *Novartis* decision was primarily based on the court's deference to the amicus position of the Secretary of Labor. The Secretary argued that PSRs do not and cannot "make sales," as defined by the FLSA's "outside salesman" exemption. Rather, according to the Secretary, the PSRs promoted pharmaceutical products to physicians. The Secretary also argued that transactions between physicians and PSRs were not "sales." While acknowledging that the FLSA stated that a sale could be some "other disposition," a catch-all that could have an expansive connotation, the Second Circuit nonetheless granted deference to the Secretary's position that the exchanges between physicians and PSRs were not sales under that section of the FLSA. In sum, the Second Circuit adopted a strict constructionist view of the issue, deferring to the Secretary of Labor. Though the decision was appealed, the Supreme Court denied certiorari in February 2011.

Conclusion

In the wake of *Christopher* and after more than 70 years of "business as usual," the custom, practice and business model of the pharmaceutical sales industry has been left in a state of uncertainty on the issue of how its PSRS should be classified and compensated. The employees in *Christopher* are two of approximately 90,000 sales representatives employed in the American drug industry who visit doctors' offices. A ruling that the PSRs are owed overtime under the FLSA would be staggering. Some trade groups speculate that the potential retrospective liability from cases pending in federal court could reach $100 million. If that is the case, the industry as a whole would face potential liability in the billions of dollars and would lead to restructuring of how the industry does business and more costs to the ultimate consumer.

Emina Poricanin
Noreen DeWire Grimmick
Hodson Russ LLP
Albany, New York
(518) 465-2333

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