

SECOND CIRCUIT SPLITS FROM THIRD CIRCUIT TO HOLD THAT PHARMACEUTICAL SALES REPRESENTATIVES ARE NON-EXEMPT EMPLOYEES

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To Our Clients and Friends:

In February, we reported that the U.S. Court of Appeals for the Third Circuit became the first federal appeals court to weigh in on the hotly contested question of whether pharmaceutical sales representatives are exempt from overtime and other wage requirements under the Fair Labor Standards Act (“FLSA”). In that case, *Smith v. Johnson & Johnson*, the Third Circuit held that pharmaceutical sales representatives are exempt. Yesterday, the Second Circuit reached the opposite conclusion in *In re Novartis Wage & Hour Litigation*. The Second Circuit held that pharmaceutical sales representatives are non-exempt, and it reinstated consolidated class actions brought on behalf of current and former sales representatives seeking overtime pay that had been dismissed by the district court. With this circuit split, the issue clearly remains unsettled.

BACKGROUND ON FLSA COLLECTIVE ACTION SUITS

The FLSA was enacted in the wake of the Great Depression to regulate minimum wages, overtime pay and child labor standards. The FLSA requires that non-exempt employees must be paid overtime for all hours worked in excess of 40 hours per week. But dozens of categories of workers are exempted from the FLSA’s overtime pay requirements. Though many employers traditionally have assumed that any well-compensated, “white collar” or salaried employee is exempt from the wage and overtime requirements imposed by the FLSA, such assumption can be flawed. The scope of FLSA exemptions is, in fact, defined by a complex body of federal regulations, Department of Labor guidance materials and case law precedents.

In recent years, the FLSA plaintiffs’ bar has focused its attention on industries – such as brokerage houses, insurance companies and banks – employing large categories of well-compensated professionals who historically had been presumed to be exempt. Employers in such industries have been blindsided by and paid massive settlements to resolve FLSA collective action suits seeking overtime pay for workers in these categories.

The stakes in these cases can be high. Employers found to have violated the FLSA are liable for double the amount of unpaid wages and overtime pay going back two years from the date of suit, or three years in the case of a “willful” violation, as well as plaintiffs’ attorneys’ fees and costs. If plaintiffs prove that they have been retaliated against for challenging an

employer's compliance with the FLSA, the FLSA's anti-retaliation provisions allow for additional compensatory and punitive damages.

PHARMACEUTICAL SALES REPRESENTATIVE CASES

One of the latest battlegrounds is the pharmaceutical industry. Many of the major players in the industry have been hit with collective action suits seeking overtime pay for pharmaceutical sales representatives. Most, if not all, of the industry treats this category of workers as exempt.

In litigation, pharmaceutical companies have relied principally on two FLSA exemptions:

- First, under the exemption for “outside salespersons,” an employee is exempt if (i) the employee’s “primary duty” is “making sales” or “obtaining orders or contracts” and (ii) the employee “is customarily and regularly engaged away from the employer’s place or places of business in performing such primary duty.”
- Second, under the “administrative employee” exemption, an employee is exempt if (i) the employee is compensated at a rate not less than \$455 per week, (ii) the employee’s “primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer” and (iii) such “primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.”

Pharmaceutical companies have had mixed success invoking these exemptions in the district courts. Many courts have found one or both exemptions applicable, but other courts have held that pharmaceutical sales representatives are non-exempt. As to the “outside salesperson” exemption, some district courts have found it inapplicable because sales representatives do not literally “make sales” or “obtain orders or contracts.” These courts reason that, in the heavily regulated pharmaceutical industry, sales representatives, at most, provide information to encourage physicians to write more prescriptions, leading only indirectly to consumer sales. Other courts have found that pharmaceutical sales representatives are covered by the exemption. These courts hold that the activities of a pharmaceutical sales representative are functionally equivalent to those of a traditional traveling salesperson in other industries, and that the regulatory idiosyncrasies of the pharmaceutical industry should not cause salespeople in that industry to be treated differently from salespeople in other industries for purposes of the FLSA.

District court opinions on the applicability of the “administrative employee” exemption have been similarly mixed. Generally, the dispute has turned on whether pharmaceutical sales representatives “exercise discretion and independent judgment with respect to matters of

significance.” Some courts have found that they do not, focusing on the fact that pharmaceutical companies closely dictate the marketing points sales representatives make and instruct sales representatives not to deviate from those approved messages. Other courts have found the exemption to be applicable, noting that sales representatives have significant discretion in choosing which doctors to call upon, how to allocate their marketing budgets and other matters of significance.

The first – and until yesterday only – circuit court to weigh in on the question was the Third Circuit in *Smith v. Johnson & Johnson*. In *Smith*, the Third Circuit held that pharmaceutical sales representatives are exempt under the “administrative employee” exemption. The first element of the exemption – rate of pay of not less than \$455 per week – was undisputed. On the second element, the Third Circuit held that sales representatives’ “primary duty” involved the “management or general business operations of the employer” insofar as they are involved in the strategy for marketing the employer’s product. On the third element – “exercise of discretion and independent judgment with respect to matters of significance” – the Third Circuit relied heavily on evidence that J&J’s sales representatives had discretion to choose which doctors to visit in their assigned territories and to develop their own strategies and priorities for marketing within such territories. After holding that the “administrative employee” exemption applied, the Third Circuit did not address the applicability of the “outside salesperson” exemption.

IN RE NOVARTIS WAGE & HOUR LITIGATION

Yesterday, the Second Circuit reached the opposite conclusion from the Third Circuit. The Second Circuit, in *In re Novartis Wage & Hour Litigation*, relying heavily on an amicus brief submitted by the U.S. Department of Labor, held that pharmaceutical sales representatives are non-exempt and that neither the “outside salesperson” nor the “administrative employee” exemptions were applicable.

As to the “outside salesperson” exemption, the Second Circuit held that the exemption applies only to employees whose jobs literally involve “making sales.” Because pharmaceutical sales representatives merely promote products that will ultimately be sold by another person, they do not literally “make sales” and, the Second Circuit held, they therefore do not fall within the “outside salesperson” exemption.

As to the “administrative employee” exemption, the Second Circuit held that pharmaceutical sales representatives do not exercise discretion and independent judgment with respect to matters of significance. The Court rejected Novartis’ arguments that sales representatives exercise discretion and independent judgment in answering physicians’ questions about products, developing rapport with physicians and honing their promotional messages. The Court found that such skills are exercised only within strict parameters defined by the

employer because, among other things, the sales representatives have no role in formulating the core message, are not allowed to deviate from that message and are forbidden to answer any physician question for which the answer has not already been scripted.

FURTHER DEVELOPMENTS ON THE HORIZON

The question of whether pharmaceutical sales representatives are exempt obviously remains unsettled and further, likely significant, developments are imminent. A similar case is pending in the Ninth Circuit. Moreover, in light of the existing split between the Second and Third Circuits, action in the U.S. Supreme Court is a distinct possibility.

Given the significant uncertainty in this area, and the magnitude of the potential exposure, employers of large numbers of pharmaceutical sales representatives should monitor developments carefully.

Please feel free to contact us with any questions.

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