Decision Against Novartis Has Implications Beyond Pharmaceutical Industry (Updated 08/21/10)

Insights
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In a major decision with possible relevance outside of the pharmaceutical industry, the 2nd Circuit U.S. Court of Appeals (Connecticut, New York, and Vermont) gave strong deference to a U.S. Labor Department legal brief and overruled a lower court in deciding that Novartis's pharmaceutical sales reps were not exempt from overtime as outside salespersons or as administrative employees under the federal Fair Labor Standards Act or applicable state laws. On the same day, the 2nd Circuit also summarily ruled against Schering in a similar case.

The exemption status of pharmaceutical sales reps (who frequently earn substantial compensation) has been hotly litigated with varying results in recent years. Consider the following unofficial scorecard: By our count, prior to the *Novartis* decision, pharmaceutical companies had an 86% win rate (6 out of 7 cases) in federal district court decisions finding that the FLSA's administrative exemption was applicable. Pharmaceutical companies had a 71% win rate (12 out of 17 cases) in federal district court decisions finding that the FLSA outside-sales exemption applied to their sales reps. Many of those cases are on appeal.

On February 2 and March 24, 2010, the 3rd Circuit (Delaware, New Jersey, Pennsylvania, and the U.S. Virgin Islands) found that a pharmaceutical sales rep at Johnson & Johnson and sales reps at AstraZeneca were exempt under the administrative exemption. The court did not rule on the FLSA's outside-sales exemption.

The unique, highly-regulated circumstances of the pharmaceutical-sales environment has contributed to the split among the courts deciding these cases, particularly the fact that federal regulations bar the consummation of a sale between a pharmaceutical sales rep and a physician. As the 2nd Circuit highlighted in finding that Novartis's reps were not primarily engaged in "making sales" but instead merely promoted drugs to physicians, (1) they could only give free samples; (2) they could not lawfully transfer drug ownership in exchange for anything of value; (3) they could not lawfully take an order for the purchase of drugs; and (4) they could not obtain a physician's binding commitment to prescribe drugs. Even though the physician is widely considered to be the "linchpin" in the process of choosing drugs to prescribe, federal regulations bar the consummation of a sale between a pharmaceutical sales rep and a physician – the court concluded that fully consummated sales by pharmaceutical companies are made to wholesalers, rather than to physicians.

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Several other courts (including the lower court in Novartis's case) have taken a "common sense" approach and held that the pharmaceutical sales reps "make sales in the sense that sales are made in the pharmaceutical industry" and thus qualified for the FLSA's outside-sales exemption. Moreover, the *Novartis* lower court found that sales reps were not "robots" or "automatons," as they contended, but that instead they exercised judgment in tailoring presentations to physicians and qualified for the FLSA's administrative exemption.

The 2nd Circuit disagreed as to both exemptions. Significantly, the Circuit was heavily influenced by the DOL's interpretations in DOL's friend-of-the-court legal brief supporting the sales reps. The court believed itself required to grant "controlling deference" to the brief because the DOL's interpretations were not "plainly erroneous or inconsistent with the [DOL's] regulation" on the issues.

These wage-hour battles in the pharmaceutical field are not over, but some of the lessons for employers in *any* industry include these:

- Beware so-called "outside sales" employees who are not really making sales within the meaning of the FLSA's outside-sales exemption (such as those who only promote products or services that are actually sold by others).
- Beware "promotion" or "marketing" employees who are not exercising "discretion and independent judgment in matters of significance" within the meaning of the FLSA's administrative exemption but are instead exercising only "skill in applying well-established techniques, procedures, or specific standards."
- Because DOL guidance documents and legal briefs can affect the outcome of litigation, think ahead about how DOL might be expected to interpret FLSA exemption rules in the future.

UPDATE 7/23/10: On July 19, 2010 the U.S. District Court for the District of New Jersey ruled for the employer in *Jackson v. Alpharma, Inc*., finding that the pharmaceutical sales representatives there were exempt under the FLSA's administrative exemption. The District of New Jersey is within the 3rd Circuit, and the court therefore followed the Circuit's February decision in *Smith v. Johnson & Johnson* which applied the administrative exemption to a pharmaceutical sales rep.

The *Jackson* court chose not to address the outside sales exemption. Interestingly, the court also said, "in light of the 3rd Circuit's clear opinion in Smith . . ., the Court does not find it necessary to discuss" the 2nd Circuit's more-recent *Novartis* decision. Further, the court did not mention DOL's amicus brief which was filed in the *Novartis* appeal and which the 2nd Circuit said was entitled to "controlling deference" on the administrative exemption in a similar setting. As *Jackson* shows, pharmaceutical companies continue to fare better (in terms of percentages) with the FLSA's administrative exemption than with the outside sales exemption.

UPDATE 8/21/10: In *Christopher v. SmithKline Beecham Corp. d/b/a GlaxoSmithKline*, 9th Cir., No. 10-15257, the U.S. Labor Department has filed a "Friend of the Court" brief urging the U.S. Court of

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Appeals to overturn a lower court's finding that Glaxosmithkline pharmaceutical sales representatives qualified for the FLSA's "outside salesman" exemption.

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