

FEDERAL APPEALS COURT HOLDS THAT PHARMACEUTICAL SALES REPRESENTATIVES ARE EXEMPT EMPLOYEES

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To Our Clients and Friends:

The question of whether pharmaceutical sales representatives are exempt from overtime and other wage requirements under the Fair Labor Standards Act (“FLSA”) is being aggressively litigated in courts around the country, and it remains decidedly uncertain. In 2009, several federal district courts addressed the question, and they have reached a diverse and conflicting range of views. On February 2, 2010, the Third Circuit became the first federal appeals court to weigh in. In the case of *Smith v. Johnson & Johnson*, the Third Circuit held that pharmaceutical sales representatives are exempt.

While the *Smith* decision is undoubtedly a welcome development for employers in the pharmaceutical industry, the issue is far from settled. Cases raising the same questions are currently pending in other circuits and decisions are expected later this year.

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 IN THE DISTRICT COURTS

One of the latest battlegrounds is pharmaceuticals. 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, employers 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 (including the District of Connecticut) 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 is the functional equivalent 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.

SMITH V. JOHNSON & JOHNSON

Until the decision earlier this week, in *Smith*, no circuit court had yet weighed in on the question of whether pharmaceutical sales representatives are exempt.

Patty Lee Smith was a Senior Professional Sales Representative for a subsidiary of Johnson & Johnson. As described by the Third Circuit, her job “required her to travel to various doctors’ offices and hospitals where she extolled the benefit of J&J’s pharmaceutical drug Concerta to the prescribing doctors.” Smith filed a lawsuit in the District of New Jersey seeking overtime pay under the FLSA. After discovery, Johnson & Johnson moved for summary judgment, arguing that Smith was not entitled to overtime pay under the FLSA because she was exempt under either the “outside salesperson” or “administrative employee” exemption. In the decision appealed from, the district court held that Smith was not exempt under the “outside salesperson” exemption because her primary duty did not involve “making sales.” The district court held, however, that Smith was exempt under the “administrative employee” exemption.

The Third Circuit affirmed that Smith was 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 Smith’s “primary duty” involved the “management or general business operations of the employer” insofar as she was 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 Smith’s own deposition testimony regarding the level of discretion she exercised. Although the Third Circuit opinion notes that Smith was required to work off a scripted “message” when calling on doctors and was required to use only pre-approved visual aids, the Third Circuit relied on her testimony that she had discretion to choose which doctors to visit in her assigned territory and generally “to run the territory the way [she] wanted to.”

After holding that the “administrative employee” exemption applied, the Third Circuit did not address the applicability of the “outside salesperson” exemption.

FURTHER DEVELOPMENTS ON THE HORIZON

Although *Smith* is the first – and, for now, the only – circuit court decision addressing the question of whether pharmaceutical sales representatives are exempt, the question still remains very unsettled and further, likely significant, developments are imminent.

Similar cases are currently pending in both the Second and the Ninth Circuits. The Department of Labor recently filed an *amicus* brief in the Second Circuit, arguing that neither the “outside salesperson” nor the “administrative employee” exemptions should apply to pharmaceutical sales representatives. In *Smith*, the Third Circuit expressly noted the pendency of the similar cases in the Second and Ninth Circuits and cautioned that the decision in *Smith* focused on “the specific facts developed in discovery in this case.” The Third Circuit “recognize[d] that based on different facts, courts, including this Court, considering similar issues involving sales representatives for other pharmaceutical companies, or perhaps even for J&J, might reach a different result than we reach here.”

The question, therefore, very much remains open. There is, at present, no circuit court guidance on the applicability of the “outside salesperson” exemption. The Second and Ninth Circuits could go either way on that issue, and, of course, they may split. As to the “administrative employee” exemption, either the Second or Ninth Circuits, or both, may split from the Third. Even within the Third Circuit, *Smith* expressly leaves open the possibility that the “administrative employee” exemption may be inapplicable for a pharmaceutical sales representative in a case where there is a less robust record demonstrating that the employee exercised discretion and independent judgment on matters of significance.

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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