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U.S. Supreme Court Declines to Resolve Circuit Split Regarding Administrative and Outside Sales Exemptions Under the FLSA

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On February 28, 2011, the U.S. Supreme Court announced its decision to deny *certiorari* in the closely watched cases of *Novartis Pharmaceuticals Corp. v. Lopes*, No. 10-460, and *Kuzinski v. Schering Corp.*, No. 10-459. As a result, the Court will not review the Second Circuit's decision in *In re Novartis Wage and Hour Litigation*, 611 F.3d 141 (2d Cir. 2010), in which the court held that pharmaceutical sales representatives employed by Novartis did not qualify as exempt under the Fair Labor Standards Act's ("FLSA") outside sales or administrative exemptions. Observers inside and outside the pharmaceutical industry had hoped for a grant of *certiorari* to resolve a significant conflict between the circuits regarding the proper interpretation of the duties requirements of the FLSA's so-called "white collar" exemptions.

The Second Circuit Distinguishes "Sales" from "Promotion" and Imposes a Rigorous Standard for the "Exercise of Discretion and Independent Judgment."

In *Novartis*, the Second Circuit considered whether pharmaceutical sales representatives were exempt from the FLSA's overtime requirements under the outside sales and administrative exemptions.

The Outside Sales Exemption

The FLSA exempts employees whose primary duty is "making sales" from the statute's overtime requirements. The plaintiffs argued that they were not "sales" employees because they were prohibited by law from selling pharmaceuticals to end users and, thus, could not "transfer title" to Novartis' products as required to consummate a sale. By contrast, Novartis contended that its pharmaceutical sales representatives fell within the exemption because their sales activities resulted, for all practical purposes, in the ultimate disposition of the company's products with patients by persuading physicians to prefer Novartis's drugs over competitors'. Novartis also noted the Department of Labor's longstanding understanding that sales employees include, broadly, any employee who "*in*

some sense, has made sales.” Given this permissive usage, the realities of the pharmaceutical industry as highly regulated, and the industry’s longstanding practice of treating sales representatives as exempt, which had not previously been challenged by the Department of Labor, Novartis argued that its sales representatives were properly classified as exempt.

The Second Circuit reversed summary judgment for Novartis. The court gave controlling deference to the Department of Labor’s position, set forth in an *amicus* brief, that the sales representatives did not “sell” Novartis’s drugs, given their inability to transfer title to the drugs under controlling industry regulations. Rather, the court agreed with the Department of Labor that the sales representatives merely “promoted” Novartis’s products, which does not constitute “sales” for purposes of the outside sales exemption.

The Administrative Exemption

The Second Circuit also rejected the application of the administrative exemption, which applies to employees whose “primary duty is office or non-manual work directly related to management or general business operations . . . and whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.” The court’s decision hinged on its view that Novartis’ sales representatives did not exercise sufficient discretion and independent judgment. Notwithstanding its acknowledgement that the sales representatives worked largely without direct supervision and exercised discretion in arranging appointments, developing relationships with physicians, and allocating their budgets, the court noted that Novartis provided detailed training and exercised close control over the promotional materials sales representatives were permitted to use and the core sales messages the representatives were permitted to present to physicians. The court found the company’s control over the representatives’ messaging to physicians outweighed the representatives’ ability to exercise discretion and judgment.

The Ninth Circuit Interprets “Sale” Broadly to Include Employees Who “In Some Sense” Sell

In *Christopher v. SmithKline Beecham*, 2011 WL 489708 (9th Cir. Feb. 14, 2011), the Ninth Circuit disagreed with the Novartis court and held that pharmaceutical sales representatives were exempt under the outside sales exemption. Adopting the argument unsuccessfully raised by Novartis, the Ninth Circuit observed the Department of Labor’s decades-old usage that a salesperson is someone who “in some sense” sells. The court held that in light of the practical realities of sales representatives’ job duties – tailored efforts designed to achieve physicians’ commitments to use the company’s product, as the relevant “purchasers” in the pharmaceutical industry – the sales representatives’ primary duties were not merely general “promotional” activities. Rather, they were sales activities to the fullest extent permitted by the restrictions of the regulated pharmaceutical industry.

In reaching its decision, the court rejected the Department of Labor's position, accepted in *Novartis*, pointedly noting that the Department's position appeared to be merely an attempt to reinterpret the FLSA's text itself in a manner contrary to the Department's own longstanding acquiescence to the industry's well-known practice of classifying its sales representatives as exempt outside sales employees.

The Third Circuit Holds Sales Representatives Use Sufficient Discretion and Independent Judgment

The Second Circuit's decision in *Novartis* also conflicts with two decisions from the Third Circuit which recently held that pharmaceutical sales representatives were exempt under the FLSA's administrative exemption. *Smith v. Johnson & Johnson*, 593 F.3d 280 (3d Cir. 2010) and *Baum v. AstraZeneca*, No. 09-2150, 2010 WL 1063935 (3d Cir. Mar. 24, 2010), *cert. denied* 131 S. Ct. 332 (2010).

In *Smith*, the court noted that the plaintiff sales representative relied on prepared messages and visual aids provided by her employer but exercised discretion in determining the frequency and priority of her visits to physicians and had the freedom to develop her own strategic plan to use the employer's materials and information to maximize her sales. The court also noted that the plaintiff "described herself as the manager of her own business who could run her own territory as she saw fit." Rejecting the holding in *Novartis*, the *Smith* court held that these facts reflected sufficient discretion and independent judgment to support the plaintiff's classification as an exempt administrative employee. Relying on its decision in *Smith*, the Third Circuit in *Baum* likewise held that a pharmaceutical sales representative's duties, also similar to those in *Novartis*, involved sufficient discretion and independent judgment for the administrative exemption under Pennsylvania's wage and hour law.

Practical Implications for Employers

The Supreme Court's denial of review in *Novartis* will most directly affect the pharmaceutical industry, which continues to face uncertainty with respect to the exempt status of sales representatives. Perhaps more significantly, however, the decision in *Novartis* will continue to encourage analogous classification challenges by employees in other industries, particularly administrative employees. Employers should continue to pay close attention not merely to such employees' job descriptions, which cannot alone justify an exemption, but to the employees' actual job duties. Particular care should be given to fully maximize the extent to which administrative employees actually exercise discretion and independent judgment with respect to matters of significance, consistent with the employer's business realities.

Likewise, while employers with outside sales employees may take some comfort in the Ninth Circuit's decision in *Smith*, which arguably adopts the more reasonable and practical interpretation of the outside sales exemption, they should not lose sight of the risks posed by *Novartis* after this week's decision by the Supreme Court. Employers should take care to understand the actual "sales" responsibilities assigned to their sales

staff and, to the extent possible, ensure that outside sales employees have a demonstrable role in actually concluding sales as their primary duty, not just laying the groundwork for potential sales in the future.

Finally, employers should make it a practice to conduct periodic internal wage-hour classification audits to remain compliant in this fluid area of law. Dorsey's Labor & Employment practice group has extensive experience working with employers to ensure proper employee classifications, assisting with policy changes and communications plans to address the delicate issues associated with reclassification, and training human resources professionals and relevant operations managers in relevant state and federal laws, as well as deep experience defending employers in claims for wage and hour violations when litigation arises.

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