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The Curious Case Of Pharma Sales Reps And The FLSA

Law360, New York (September 15, 2010) -- The United States Court of Appeals for the Second Circuit held in In re Novartis Wage and Hour Litigation, 2010 U.S. App. LEXIS 13708, __ F.3d __ (2d Cir. July 6, 2010), that pharmaceutical sales representatives employed by Novartis Pharmaceuticals Corp. were not exempt from the Fair Labor Standards Act's overtime requirements as either "outside sales" or "administrative" employees.

Swimming against the tide of several recent decisions in other jurisdictions, the court's opinion shifts the outside sales and administrative paradigms and signifies a major victory for the U.S. Department of Labor, as it seeks to narrow the scope of the FLSA's exemptions, as well as for the Novartis sales reps (and their attorneys) who stand to collect substantial monetary awards as a result of the decision.

Understanding the court's decision and its implications requires some background. Because the pharmaceutical industry is heavily regulated, Novartis' pharmaceutical sales representatives cannot "sell" the company's products directly to consumers. Instead, Novartis, like virtually all pharmaceutical companies, deals directly with wholesalers, who in turn sell the company's drugs to pharmacies, who then make retail sales to patients for whom doctors have written prescriptions.

Novartis' pharmaceutical sales reps endeavor to increase sales by making regular five-minute "calls" on physicians located within the reps' sales territories. These pitches are designed to generate nonbinding commitments from the physicians to prescribe Novartis' pharmaceutical products.

To increase the effectiveness of this approach, Novartis schools the sales reps on four "social styles," and encourages them to tailor their presentations to a specific physician's social style. Novartis also sets the number of times each trimester that reps should call on physicians and how often specific drugs should be promoted, and controls the "core message" that reps convey to physicians.

Although Novartis' ability to track any given physician's actual prescriptions is limited, the company establishes numerical goals for each rep's sales territory and pays the rep a bonus if the number of actual prescriptions filled in his or her territory exceeds the goal. On average, Novartis' sales reps earned $91,539.00 per year under this arrangement.

Based on similar facts, district courts in Arizona, Indiana, Texas and California each opined that while pharmaceutical sales reps may not "sell" in a technical sense, they "make sales in the sense that sales are made in the pharmaceutical industry." See, e.g., Christopher v. SmithKlein Beecham Corp., No. CV-08-1498-PHX-FJM, 2009 U.S. Dist. LEXIS 108992 (D. Ariz. Nov. 20, 2009); Schaeffer-LaRose v. Eli Lilly and Co., 663 F. Supp. 2d 674 (S.D. Ind. 2009); Harris v. Auxilium Pharm. Inc., 664 F. Supp. 2d 711 (S.D. Tex

2009); Yacoubian v. Ortho-McNeil Pharmaceutical Inc., No. SACV 07-00127-CJC(MLGx), 2009 U.S. Dist. LEXIS 27937 (S.D. Cal. Feb. 6, 2009).

Other district courts have concluded that pharmaceutical sales reps are subject to the act's administrative exemption because they exercise substantial discretion and independent judgment by deciding how best to present information about products to physicians, and control how they run their territories. See, e.g., Schaeffer-LaRose, 663 F. Supp. 2d 674.

In the Novartis case, the U.S. District Court for the Southern District of New York fell in line with both trends, concluding that Novartis' reps fit within the FLSA's outside sales exemption as well as the administrative exemption, even though other district courts within the Second Circuit had reached the opposite conclusion. See, e.g., Ruggeri v. Boehringer Ingelheim Pharms. Inc., 585 F. Supp. 2d 254 (D. Conn. 2008).

Rejecting the Novartis district court's reading of the exemptions, the Second Circuit leaned heavily on a rare amicus curiae brief filed by the Secretary of Labor. In her brief, the Secretary emphasized the Department of Labor's historical interpretation of its regulations promulgated under the FLSA.

Specifically, the Secretary noted that eligibility for the outside sales exemption has long depended upon, among other factors, whether the employee's primary duty is "making sales." In the eyes of the Secretary, the Novartis reps merely promoted products to physicians that would be sold by others, and as such did not "make sales" as the term was defined by the DOL's regulations.

Tracing the regulatory evolution of the outside sales exemption, and following the Secretary's lead, the Second Circuit noted that the term "sale" has been defined "as involving the transfer of title" and the term "outside sales" explicitly excludes work done to promote an employer's products or to stimulate sales that will be made by someone else.

In the end, the Second Circuit concluded that the DOL's interpretation of the outside sales exemption, as applied to the pharmaceutical sales reps, was not plainly erroneous or inconsistent with its regulations, declining to adopt a more flexible industry-specific approach.

Accordingly, the court accorded "controlling" deference to the Secretary's reading of the operative regulation, and beyond that plainly signaled its concurrence with the Secretary's view, explaining that, "where the employee promotes a pharmaceutical product to a physician but can transfer to the physician nothing more than free samples and cannot lawfully transfer ownership of any quantity of the drug in exchange for anything of value, cannot lawfully take an order for its purchase, and cannot lawfully even obtain from the physician a binding commitment to prescribe it, we conclude that it is not plainly erroneous to conclude that the employee has not in any sense, within the meaning of the statute or regulations, made a sale."

Consequently, the Court of Appeals determined that the outside sales exemption did not apply to the Novartis reps.

The court also endorsed the Secretary's take on the administrative exemption, agreeing that Novartis' strict oversight and detailed work assignments precluded reps from exercising the degree of discretion or independent judgment in matters of significance necessary to qualify as exempt administrative employees.

Specifically, the court emphasized that Novartis dictated how many times reps visited each physician, promoted certain drugs, and held promotional events, and prohibited reps from going outside of their scripts to answer physicians' questions. Also of importance to the court was the fact that the reps had no input on Novartis' marketing strategy or the "core messages" that drove their sales presentations.

The court was not swayed by Novartis' argument that reps exercised discretion by deciding (1) the sequence in which to visit doctor's offices, (2) how best to gain access to those offices, (3) how to allocate their Novartis budgets for promotional events, and (4) how to allocate samples. Novartis reps' interactions with doctors, the court observed, were predicated largely on skills gained or honed during training sessions run by Novartis and were not the product of independent thinking.

The potential fallout from the Second Circuit's decision cannot be overstated, and extends well beyond the pharmaceutical industry. The myopic view — Novartis is required to pay overtime to approximately 2,500 employees who worked for the company from March 2000 through April 2007 — reveals the staggering exposure employers face in FLSA overtime litigation.

However, employers must not lose sight of the big picture, which has been made even bleaker by this decision. The Secretary of Labor's amicus brief — which was clearly the driving force behind the Second Circuit's decision in Novartis — was, historically speaking, an uncommon move for the DOL, but is indicative of the agency's wholesale effort to promote a narrowing of the FLSA's overtime exemptions and put more teeth in the statute.

Indeed, in March 2010, the DOL announced an entirely new regulatory approach and issued an initial "administrator interpretation," wherein the department opined that mortgage loan officers, commonly treated as exempt by financial institutions, did not qualify for the administrative exemption, thereby reversing the view espoused by the Bush administration in a pair of opinion letters.

Novartis may well be ushering in a trend toward a narrowing of the FLSA's exemptions, as would appear to be the DOL's objective. However, the Second Circuit's decision follows on the heels of the Third Circuit's Feb. 2, 2010, opinion in Smith v. Johnson & Johnson, 593 F.3d 280 (3rd Cir. 2010), where the Court of Appeals — without input from the Secretary of Labor — concluded that a Johnson & Johnson pharmaceutical sales rep exercised sufficient discretion and independent judgment to meet the requirements of the administrative exemption.

The Third Circuit based its decision on the fact that the rep at issue was "required ... to form a strategic plan designed to maximize sales in her territory," a core task directly related to the management or general business operations of Johnson & Johnson. The court similarly found that the Johnson & Johnson rep exercised discretion or independent judgment in that she functioned without direct supervisory oversight, although the opinion does not speak to whether Johnson & Johnson issued guidelines or provided training as to how, and how often, reps were to call on physicians, as Novartis does.

Following the Third Circuit's lead, on July 19, 2010, the U.S. District Court for the District of New Jersey held that Alpharma Inc.'s pharmaceutical sales reps qualified for the administrative exemption. Jackson v. Alpharma Inc., 3:07-CV-03250-GEB-DEA, 2010 U.S. Dist. LEXIS 72435 (D.N.J. July 19, 2010). The court found that Alpharma's reps exercised discretion and independent judgment by drafting reports and business plans, detecting sales trends, and generating ideas for growing the business. In so doing, the court declined to address the Second Circuit's opinion in Novartis as it was bound by the Third Circuit's ruling in Smith.

While it is unclear whether the Third Circuit would have reached the same decision in the Smith case had the DOL weighed in, or if it had the benefit of the Second Circuit's thinking in Novartis, what is clear is that the DOL is aggressively pursuing an agenda that aims to constrain the scope of the FLSA's exemptions.

The DOL obviously intends to promote an interpretation of the FLSA and its regulations that limits the exemptions, and appears ready to take an active role in advancing its narrow interpretations. Having procured the Second Circuit's stamp of approval with respect to its position on a highly divisive issue, the department is almost certain to continue injecting itself into FLSA litigations.

Indeed, on Aug. 10, 2010, the DOL filed another amicus brief arguing against the application of the outside sales or administrative exemptions to pharmaceutical sales reps in an appeal of the District of Arizona's Christopher decision, which is currently pending in the Ninth Circuit.

One question left unanswered by Novartis is whether pharmaceutical sales reps earning at least $100,000.00 per year are exempt from the FLSA's overtime provisions as "highly compensated employees." Because the district court found that Novartis' reps qualified for the administrative exemption, it passed on the issue. However, in light of the Second Circuit's holding, the question is ripe for a determination on remand.

Based on the district court's determination that Novartis' reps performed administrative duties, and its prior holding in Amendola v. Bristol-Myers Squibb Company, 558 F. Supp. 2d 459 (S.D.N.Y. 2008) that applicability of the highly compensated exemption does not depend upon the exercise of discretion or independent judgment, the district court may well hold that the reps meet the relaxed duties standard for highly compensated employees.

While it remains to be seen how many of Novartis' reps meet the exemption's salary threshold, the highly compensated employees exemption may prove to be a boon to employers feeling the squeeze of the Second Circuit's narrow application of the administrative exemption.

In the pharmaceutical sales arena, Novartis effectively precludes virtually all industry employers within the Second Circuit — and other Circuits that afford the DOL a similar level of deference — that focus their pharmaceutical sales initiatives on persuading physicians to write prescriptions for their company's drugs sold at pharmacies, from invoking the outside sales exemption.

This means that for pharmaceutical sales reps to be exempt as outside salespersons, the structure of the marketing initiative or business model will have to be different than in Novartis, which may not be realistic for many pharmaceutical companies; otherwise, the reps will almost certainly need to qualify for the administrative or highly compensated employee exemption if overtime pay is to be averted.

Pharmaceutical firms would therefore be wise to take their cue from Smith and, to the extent possible, vest sales reps with discretion to develop strategic plans and permit them substantial control over when and how to direct their sales activities, including the discretion to devise their own sales strategies with as little oversight as practicable.

Finally, it is important to note that Novartis is merely symptomatic of a much larger shift in FLSA enforcement. An unusually active DOL, one that appears to have adopted an increasingly employee-friendly reading of the FLSA, has no doubt been one factor in the recent uptick in FLSA related litigation, although the reverse, i.e., the uptick in litigation awoke a sleeping giant, is also possibly true.

Regardless, the number of FLSA lawsuits is up more than 25 percent over the same period last year and employers everywhere are embroiled in time-consuming and expensive legal battles while trying to recover from a recession. Now more than ever, employers seeking to avoid costly litigation — or worse, even more costly awards to prevailing plaintiffs and their attorneys — would be well advised to take a hard look at their exempt employees to ensure strict compliance with the letter of the law.

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