

CHRISTOPHER v. SMITHKLINE BEECHAM CORP.

Patricia Quinn Robertson
Arkansas State University
Associate Professor of Business Law, and
Chairperson Department of Economics and Finance
P.O. Box 239
State University, AR 72467
probertson@astate.edu
(870) 972-2300

John F. Robertson
Arkansas State University
Professor of Accounting,
Chairperson Department of Accounting, and
Chairperson Department of Computer and Information Technology
P.O. Box 550
State University, AR 72467
jfrobert@astate.edu
(870) 972-3739

Abstract

The United States Supreme Court recently held that pharmaceutical sales representatives should not receive overtime pay under the Fair Labor Standards Act of 1938. This decision resolved a split between the federal circuit courts of appeals. The Fair Labor Standards Act does not define the term “salesperson.” The Supreme Court decision could be modified by a change in the statute or by a change in the regulations.

This article explores the pros and cons of overtime pay for such sales representatives, describes the implications of this determination for employers and employees, and concludes that Congress and the Department of Labor should allow the Supreme Court decision to stand. However, Congressional intervention may be required to prevent the Department of Labor from adopting a standard that is contrary to many years of practice.

Christopher v. SmithKline Beecham Corp.

Introduction

According to the Merriam-Webster dictionary, a salesman is “one who sells in a given territory, in a store, or by telephone” (Merriam-Webster, 2012). The definition of “salesman” is important to employers when interpreting whether the Fair Labor Standards Act (FLSA) (29 U.S.C. §§ 201 et seq.) requires payment of overtime pay to some employees. The Supreme Court of the United States recently considered differences in Circuit Court of Appeals opinions about whether pharmaceutical sales representatives (PSRs) are employees who must be paid overtime.

A. The FLSA

The FLSA was enacted to eliminate “conditions detrimental to maintaining minimum standards of living necessary for health, efficiency and general well-being of workers.” (29 U.S.C. §202(a).) The FLSA states that the continuation of such conditions “perpetuates substandard conditions among workers, burdens commerce, constitutes an unfair method of competition in commerce, leads to labor disputes, and interferes with the orderly and fair marketing of goods” (29 U.S.C. §202(a)).

The FLSA’s overtime provision reads as follows:

[N]o employer shall employ any of his employees who in any workweek...is employed in an enterprise engaged in commerce or in the production of goods for commerce, for a workweek longer than forty hours unless such employee receives compensation for his employment in excess of the hours above specified at a rate not less than one and one-half times the regular rate at which he is employed (29 U.S.C. §207(a)(1)).

B. The “Outside Salesman” Exemption

However, employers who employ “any employee employed in a bona fide executive, administrative, or professional capacity ... or in the capacity of outside salesman” are exempt from the overtime pay requirement for such employees (29 U.S.C. §213(a)(1)). The reasons for the outside salesman exemption have been described by one court as follows:

Such salesman, to a great extent, works individually. There are no restrictions respecting the time he shall work and he can earn as much or as little, within the range of his ability, as his ambition dictates. In lieu of overtime, he ordinarily receives commissions as compensation. He works away from his employer’s place of business, is not subject to the personal supervision of his employer, and his employer has no way of knowing the number of hours he works per day. To apply hourly standards primarily devised for an employee on a fixed hourly wage

is incompatible with the individual character of the work of an outside salesman (Jewel Tea Co. v. Williams, 1941, pp. 207-8).

The FLSA defines “sale” and “sell,” but does not define the term salesperson. Instead, Congress left it up to the Secretary of Labor to define this, and several other terms, in the regulations (29 U.S.C. §213(a)(1)). There are three regulations that are of interest in this issue. The first is the general regulation, 29 C.F.R. §541.500. The second is the sales regulation, 29 C.F.R. 541.501(b). The final regulation is the promotion-work regulation, 29 C.F.R. 541.503(a).

The general regulation defines “employee employed in the capacity of outside salesman” as an employee:

- (1) Whose primary duty is:
 - (i) Making sales within the meaning of section 3(k) of the Act, or
 - (ii) Obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- (2) Who is customarily and regularly engaged away from the employer’s place or places of business in performing such primary duty (29 C.F.R. §541.500).

Section 3(k) of the Act provides that “‘sale’ or ‘sell’ includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition” (29 U.S.C. §203(k)). The sales regulation further provides that sales “include the transfer of title to tangible property, and in certain cases, of tangible and valuable evidences of intangible property” (29 C.F.R. §541.501(b)). The promotion-work regulation provides that circumstances dictate whether promotional work is sales (29 C.F.R. §541.503(a)). An example of promotional activities is given as manufacturer’s representatives “putting up displays and posters, removing damaged or spoiled stock from the merchant’s shelves or rearranging merchandise” (29 C.F.R. §541.503(b)).

If the promotional work is “in conjunction with the employee’s own outside sales,” then it is exempt from the overtime provisions, but promotional work “incidental to sales made, or to be made by someone else is not exempt” (29 C.F.R. §541.503(a)). The regulations further explain that the “promotional activities” of an employee whose “primary duty is making sales or contracts” are exempt from overtime if they are “directed at that employee’s own sales,” but “[p]romotional activities designed to stimulate sales that will be made by someone else are not exempt outside sales work” (29 C.F.R. §503(b)). To determine whether the employee’s primary duty is making sales, the rules state that “[e]mployees have a primary duty of making sales if they ‘obtain a commitment to buy’ from the customer and are credited with the sale” (Department of Labor, 2004, p. 22162).

C. PSRs

Recently, the question of whether pharmaceutical sales representatives (PSRs) are entitled to overtime pay has reached some courts. PSRs, also known as “detailers” or “detail men,” have been present in the pharmaceutical industry since at least as early as the 1930’s (Christopher v. SmithKline Beecham Corp., 2011, pp. 388, n. 5). The question of whether PSRs are entitled to

overtime pay is important, because “[d]etailing is a massive and expensive undertaking for pharmaceutical manufacturers, which spend billions of dollars a year to have some 90,000 [PSRs] make weekly or monthly one-on-one visits to prescribers nationwide” (Christopher v. SmithKline Beecham Corp., 2011, pp. 388, n. 6). The federal courts, in a string of cases involving the executive and administrative exceptions, have concluded that the burden of proving that an employee is exempt from overtime pay is on the employer. One of the earliest of these cases, *Helliwell v. Haberman*, was decided in 1944.

Courts have disagreed about whether PSRs are outside salesmen exempt from overtime pay under the FLSA. Most notably, in 2010, the Second Circuit Court of Appeals held that PSRs are not exempt from the overtime provisions of the FLSA because they are neither outside salesmen nor administrative employees (Novartis Wage and Hour Litigation, 2010). The U.S. Supreme Court denied certiorari in that case (Novartis Pharms. Corp. v. Lopes, 2011). In 2011, the Ninth Circuit held that PSRs are exempt from the overtime provisions of the FLSA because they are outside salesmen (Christopher v. SmithKline Beecham Corp., 2011). The Supreme Court of the United States reviewed the Ninth Circuit Court of Appeals’ decision, and, in a 5-4 decision, affirmed the appellate court (Christopher v. SmithKline Beecham Corp., 2012).

This paper analyzes arguments for and against overtime pay for PSRs. The paper will describe recent court opinions about this issue, and will discuss implications for employers and employees. Because the appellate courts were split, and the Supreme Court issued a divided opinion, it is possible that Congress will propose a legislative solution. This paper will also consider whether legislative action is justified.

I. Second Circuit Position: PSRs Should Receive Overtime Pay

In its 2010 opinion in *In Re Novartis Wage and Hour Litigation*, the U.S. Court of Appeals for the Second Circuit held that PSRs were entitled to overtime pay under the FLSA. This holding initiated a period of uncertainty for PSRs and their employers about how to handle overtime pay. Customary practice in the pharmaceutical business was not to pay overtime to PSRs, but after Novartis, this practice had to change, at least in the Second Circuit. The Second Circuit reversed the holding of the District Court in the *Novartis* case after considering two issues: (a) Are PSRs outside salesmen? and (b) Are PSRs administrative employees? The Second Circuit answered “No” to both of those questions after examining the work by PSRs (Novartis Wage and Hour Litigation, 2010, pp. 155, 157).

Novartis employed approximately 6,000 PSRs to travel to physicians’ offices and briefly meet with the physicians to promote their pharmaceuticals. Novartis is prohibited by law from selling prescription drugs directly to consumers, so Novartis typically sells the drugs to wholesalers, and the wholesalers sell them to pharmacies (Novartis Wage and Hour Litigation, 2010, p. 144). Novartis PSRs do not communicate to the patients, the pharmacies or the drug wholesalers (Novartis Wage and Hour Litigation, 2010, p. 154). Often the PSRs give the physicians free samples of the drugs, but the PSRs do not sell the drugs to the physicians in exchange for anything of value (Novartis Wage and Hour Litigation, 2010, p. 144). In addition, the physicians do not enter a legally binding contract to buying any drugs from the PSRs. After the PSR’s visit

to the physician, the physician may or may not prescribe the drugs to patients. The physician has an ethical obligation to prescribe only the drugs needed by the patient, and therefore, the physician cannot make a binding agreement to prescribe the drugs. The patient must have a physician's prescription to buy the drugs from a pharmacy (Novartis Wage and Hour Litigation, 2010, p. 147).

The Second Circuit first considered whether PSRs are outside salesmen. The court held as follows:

[W]here 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,...it is not plainly erroneous to conclude that the employee has not in any sense, within the meaning of the statute or the regulations, made a sale (Novartis Wage and Hour Litigation, 2010, p. 154).

In addition, the court in *Novartis* reviewed the issue of whether the PSRs fall within the administrative employee exemption from overtime under the FLSA. The focus was whether the PSRs "exercise ...discretion and independent judgment with respect to matters of significance" (29 C.F.R. §504.200(a)). Although the PSRs could decide matters such as the allocation of samples, order of visiting physician's office, how to get into the physician's office, and how to apportion the PSR's budget for a promotional event, Novartis controlled many of the PSRs activities. The PSRs did not have a role in planning the marketing strategy or composing the information to be given to the physicians. The court, after reviewing the duties and authority given to Novartis PSRs, determined that the Novartis PSRs did not exercise sufficient discretion to be considered "bona fide administrative employees" exempt from the overtime pay provisions of the FLSA (Novartis Wage and Hour Litigation, 2010, pp. 156-7).

II. Ninth Circuit and Supreme Court Position: PSRs Should Not Receive Overtime Pay

In 2011, the Ninth Circuit decided in favor of the employer, Glaxo, in the case of *Christopher v. SmithKline Beecham Corp.* In *Christopher*, the PSRs argued that they were entitled to overtime pay under the FLSA, but the District Court held the "PSRs 'unmistakably fit within the terms and spirit'" of the outside sales exemption under the FLSA. The Ninth Circuit affirmed the District Court. This Circuit Split injected even more uncertainty for PSRs and their employers. Also, the Circuit split meant that PSRs in some parts of the country would receive overtime pay and PSRs in other parts of the county would not. The *Christopher* District Court judge noted that PSRs earn up to \$100,000 annually and that "they receive bonuses in lieu of overtime as 'an incentive to increase their efforts.'" The District Court commented upon the unique characteristics of the pharmaceutical sales business and observed that "[a] PSR's ultimate goal is to close an encounter with a physician by obtaining a non-binding commitment from the physician to prescribe the PSR's assigned product. In this highly regulated industry, that is the most a PSR can achieve" (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 388).

The FLSA does not include a definition of “outside salesman,” but instead states that this term shall be defined by the Secretary of Labor’s regulations (29 U.S.C. §213(a)(1)). The Secretary of Labor appeared as *amicus* on behalf of the Glaxo employees, but on appeal in *Christopher*, the Ninth Circuit decided not to give deference to regulations promulgated by the Secretary of Labor and the Secretary of Labor’s *amicus* position (*Christopher v. SmithKline Beecham Corp.*, 2011, pp. 389-395). The Ninth Circuit stated that “the Secretary has used her appearance as *amicus* to draft a new interpretation of the FLSA’s language,” thus attempting to “bypass[] . . . notice-and-comment rulemaking” and, further, that “deference is not warranted because the Secretary’s position is both plainly erroneous and inconsistent with her own regulations and practices” (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 395). The Ninth Circuit stated that “[i]n view of the many similarities between PSRs and salespeople in other fields, pharmaceutical industry norms, and the acquiescence of the Secretary [of Labor] over the last seventy-plus years we cannot accord even minimal *Skidmore* deference to the position expressed in the *amicus* brief” (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 400). “The fair measure of deference to an agency administering its own statute has been understood to vary with circumstances, and courts have looked to the degree of the agency’s care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency’s position” (*Skidmore v. Swift & Co.*, 1944, p. 140).

The Ninth Circuit in *Christopher* adopted a broader “common sense” construction of the word “sale” than that desired by the plaintiffs (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 397). Section 3(k) of the FLSA provides that “‘sale’ or ‘sell’ includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition” (29 U.S.C. §203(k)). The words “other disposition” in this definition prompted the *Christopher* court to adopt this broader construction (*Christopher v. SmithKline Beecham Corp.*, 2011, pp. 395, 397). The Ninth Circuit quoted language of the U.S. Department of Labor from 1940 stating that “an employee must ‘*in some sense* make a sale’” to fall within the Section 3(k) definition of sale. The court was citing a Department of Labor document, the preamble to the 2004 revision to the regulations under 29 U.S.C. 541 (Department of Labor, 2004, pp. 22,162). The regulations under section 541 have roots that go back to 1938, the year that the FLSA was originally enacted (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2162).

The *Christopher* court considered the heavy regulation of the pharmaceutical business and “industry practice and prevailing customs” to determine that the customer for the PSR is the physician, not the patient. The court stated that “[b]ecause pharmaceutical manufacturers appreciate who the ‘real’ buyer is, they have structured their 90,000-person sales force and their marketing tactics to accommodate this unique environment.” The court stated that “binding or non-binding, a physician’s commitment to a PSR is nevertheless a meaningful exchange because pharmaceutical manufacturers value these commitments enough to reward a PSR with increased commissions when a physician increases his or her use of a drug in the PSR’s bag” (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 396).

The *Christopher* court compared PSRs to salespeople in other areas to determine whether PSRs are salespersons exempt from overtime pay (*Christopher v. SmithKline Beecham Corp.*, 2011, p.

398). The court found similarities between PSRs and salespersons who were deemed exempt in a previous case (*Jewel Tea Co. v. Williams*, 1941). These include: having assigned areas or locations, not making immediate deliveries, engaging in analysis of customers, receiving education about products for sale, preparation and planning for work with potential customers, acting with little supervision, completion of clerical work at day's end, and earning a base salary with commission (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 398).

The Ninth Circuit concluded in *Christopher* as follows:

PSRs are driven by their own ambition and rewarded with commissions when their efforts generate new sales. They receive their commissions in lieu of overtime and enjoy a largely autonomous work-life outside of an office. The pharmaceutical industry's representatives—detail men and women—share many more similarities than differences with their colleagues in other sales fields, and we hold that they are exempt from the FLSA overtime-pay requirement (*Christopher v. SmithKline Beecham Corp.*, 2011, pp. 401-2).

In 2012, the U.S. Supreme Court affirmed the Ninth Circuit's holding in *Christopher* with a 5 to 4 vote. The U.S. Supreme Court did not defer to the Department of Labor's position that PSRs are entitled to overtime pay. The Court noted that, although as a customary practice for decades pharmaceutical companies have not given overtime pay to PSRs, the Department of Labor did not take action against those companies (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2168). The Court noted that it would be unfair to the pharmaceutical industry to hold them liable for failures to pay overtime to PSRs during the time period before the Department of Labor recently announced its position that overtime should be paid (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2168). In addition, the Court held that the "other disposition" language in the FLSA's definition of sales is broad and flexible enough to include the PSRs' activities designed to obtain nonbinding commitments from physicians to prescribe certain pharmaceuticals, because this is the "most the [PSRs] were able to do to ensure the eventual disposition of the products" (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2172). The Court further stated that, contrary to the Department of Labor's position, the term "sale" may include a transfer of title, but a transfer of title is not always required for a sale (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2169). In its 2012 *Christopher* opinion, the U.S. Supreme Court settled the split between the circuit courts.

III. Analysis

The situation involving PSRs indicated a split in the circuits over the interpretation of definitions in the Department of Labor's regulations interpreting the statute. The Supreme Court ruling in the *Christopher* case does provide some stability.

The Secretary of Labor has her own interpretation of the department's regulations. In the *Novartis* and *Christopher* cases, the Secretary argued that "...a sale" for purposes of the outside sales exemption requires a consummated transaction directly involving the employee for whom the exemption is sought" (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2158). The

Christopher court chose not to give deference to this position, stating that such deference “...would sanction bypassing of the Administrative Procedures Act and notice-and-comment rulemaking” (*Christopher v. SmithKline Beecham Corp.*, 2011, p. 395). The Secretary reinterpreted the regulation for the Supreme Court. The new interpretation provides that “[a]n employee does not make a ‘sale’ . . . unless he actually transfers title to the property at issue” (*Christopher v. SmithKline Beecham Corp.*, 2012, pp. 2158-9). The Supreme Court found “[t]he DOL’s current interpretation . . . is quite unpersuasive. It plainly lacks the hallmarks of thorough consideration . . . there was no opportunity for public comment, and the interpretation that initially emerged . . . proved to be untenable. The interpretation is also flatly inconsistent with the FLSA” (*Christopher v. SmithKline Beecham Corp.*, 2012, p. 2160).

Several things could happen as a reaction to the Supreme Court holding. One possibility is that The Department of Labor could simply propose new regulations that modify the definition of “salesperson.” Although these regulations would have to go through notice-and-comment rulemaking, the department is within the authority granted to it by Congress to promulgate such regulations.

Another possibility exists. 29 U.S.C. §213 contains numerous exemptions from the minimum wage and overtime requirements. Congress has changed these exemptions several times over the years. The *Novartis* court stated that “[t]o the extent that the pharmaceuticals industry wishes to have the concept of ‘sales’ expanded to include [PSR activities] . . . , it should direct its efforts to Congress, not the courts” (*Novartis Wage and Hour Litigation*, 2010, p. 155). A statutory change would be the most straightforward way to permanently clarify the position of PSRs. They could be specifically excluded from the definition of “salesperson.” On the other hand, Congress could act in a different way and PSRs could be given a specific exemption. The reasoning of the Ninth Circuit Court of Appeals and the Supreme Court of the United States is compelling. In this regulated industry, the PSRs are the closest thing to salespeople. A change to treat them differently from other outside salespeople seems unwarranted. Since the Secretary of Labor has already shown that her interpretation differs from the federal courts’, Congress might be pressed to act to preserve the treatment that has been clarified by the Supreme Court in *Christopher*.

A final option is that the pharmaceutical industry could change the relationships between its employers and their employees. The industry could change the way it compensates these employees to include overtime pay. This is the result that was required for firms operating in the Second Circuit from 2010 to 2012. This particular solution would be cumbersome since PSRs are not used to recording hours worked, and typically management approval is required for hourly workers when overtime is necessary. Many of the tasks described in both the *Christopher* and *Novartis* cases are tasks that are normally carried out after business hours. If management will not approve overtime for these tasks, then it is unlikely that the PSRs will continue to do them. The pharmaceutical industry might also consider a complete change in the way PSRs are compensated, and could eliminate commissions from the compensation package. However, it is not clear how this will affect the pharmaceutical business, including incentives and productivity of PSRs and pricing of pharmaceuticals. As an alternative, the industry could design job

descriptions and employment duties to clearly fall under the administrative exception to the FLSA.

IV. Conclusion

As noted above, there are several options available to deal with the situation. A single set of standards is preferable, but do we have the best standard? PSRs are highly paid, are often college educated, are compensated in part on the basis of sales in their territory, operate away from the office and outside the direct supervision of management, are able to set their own hours and daily routine, and exercise their own judgment in many aspects of the job. PSRs have been treated as outside salespersons for decades, and there is no pressing reason to change their status. The best solution would be for Congress to add a specific exemption for PSRs to the FLSA.

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