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Client Alert

National Appellate Practice Group
Labor and Employment Practice Group

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Supreme Court Refuses to Defer to Department of Labor, Holds That Pharmaceutical Sales Representatives Are Not Entitled to Overtime Pay

On June 18, the Supreme Court decided *Christopher v. Smithkline Beecham Corp.* King & Spalding LLP submitted *amicus* briefs on behalf of PhRMA, the association representing the nation's leading pharmaceutical and biotechnology companies, in support of SmithKline Beecham Corp. (GSK) both at the certiorari stage (brief available **here**) and on the merits (brief available **here**). By a vote of 5–4, the Court held in favor of GSK that pharmaceutical sales representatives are not entitled to overtime pay under the Fair Labor Standards Act because they come within the Act's exemption for "outside salesmen." In reaching that conclusion, the Court refused to defer to a contrary interpretation advanced by the Department of Labor. The Court's decision eliminates a major source of potential liability for pharmaceutical companies.

The decision is also likely to have broader implications for the deference that courts will afford to regulatory interpretations offered by DOL and other federal agencies. *Christopher* has raised the bar for agencies to obtain "controlling deference" to their regulatory interpretations under *Auer v. Robbins*, 519 U.S. 452 (1997). The Court made clear that such deference is not warranted when the agency's interpretation would result in "unfair surprise" by imposing retroactive liability or upsetting reasonable expectations, including expectations built upon the agency's seeming acquiescence in the conduct at issue. The Court also expressed concern about allowing agencies to regulate via *amicus* briefs filed in pending litigation, suggesting that this practice may deprive regulated entities of fair notice and frustrate the public-participation purposes of rulemaking. Although the Court did not overrule *Auer*, it did lay down important markers that may limit the circumstances in which courts will afford deference to agency interpretations under both *Auer* and *Chevron*.

Background

Pharmaceutical companies employ tens of thousands of sales representatives, sometimes termed "detailers," who call on doctors in an effort to persuade them to prescribe their companies' prescription drug products where medically appropriate. Legally and ethically, these employees cannot transfer title to prescription drugs, nor can they obtain a binding commitment from a

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doctor to prescribe a particular drug. They are typically limited to asking the doctor for a "nonbinding commitment" to prescribe the drug in medically appropriate cases. In *Christopher*, two former pharmaceutical sales representatives sued GSK for failing to pay them overtime. The FLSA generally requires employers to pay employees time-and-a-half for any hours worked in excess of 40 per week. Certain kinds of employees, however, are exempt from the FLSA's overtime requirements, including certain executive, administrative, and professional employees. In recent years, current and former (mostly former) pharmaceutical sales representatives have filed dozens of similar suits — most styled as class actions — against pharmaceutical companies under the FLSA. Taken together, these suits seek hundreds of millions of dollars in backpay and liquidated damages.

In this case, GSK argued that its pharmaceutical sales representatives were not entitled to overtime pay because they came within the FLSA's exemption for workers "employed … in the capacity of outside salesman." The term "outside salesman" is not defined in the statute, but the Department of Labor has issued regulations relating to the exemption. The district court agreed with GSK that the outside sales exemption applied and entered summary judgment on that basis. Meanwhile, in a similar action then pending in the Second Circuit, DOL filed an *amicus* brief arguing that the outside sales exemption, as defined in DOL regulations, did not apply to pharmaceutical sales representatives because the nonbinding commitment they seek does not qualify as a "sale." That *amicus* brief argument came out of the blue; the Second Circuit had not invited DOL to file an *amicus* brief, and DOL had never before taken the position that pharmaceutical sales representatives were not exempt from overtime. The plaintiffs in *Christopher* then moved the district court for reconsideration, arguing that the court was required to defer to DOL's interpretation of its regulations. The district court denied that motion, and the Ninth Circuit affirmed, concluding that (1) DOL's interpretation was not entitled to deference, and (2) the outside sales exemption applies to pharmaceutical sales representatives. The Supreme Court granted certiorari to resolve the resulting split between the Ninth Circuit and the Second Circuit, which had held that DOL's view was entitled to controlling deference. The Court heard oral argument in April 2012.

The Supreme Court's Decision

The Supreme Court affirmed the Ninth Circuit's decision in favor of GSK in an opinion by Justice Alito that was joined by Chief Justice Roberts and Justices Scalia, Kennedy, and Thomas. The Court first addressed the deference due to DOL's position that pharmaceutical sales representatives do not qualify as outside salesmen because they do not "actually transfer[] title to the property at issue." While acknowledging that *Auer* "ordinarily calls for deference to an agency's interpretation of its own ambiguous regulation, even when that interpretation is advanced in a legal brief," the Court emphasized that "this general rule does not apply in all cases." Slip op. at 10. Deference was unwarranted in this case, the Court held, because deferring to DOL's newly announced interpretation would result in "unfair surprise" and because DOL's *amicus*-brief view "lack[ed] the hallmarks of thorough consideration." *Id.* at 13–14.

The Court explained that the pharmaceutical industry had engaged in a "decades-long practice of classifying pharmaceutical detailers as exempt employees" with "little reason to suspect that its longstanding practice … transgressed the FLSA." *Id.* at 12. Importantly, DOL had "never … suggested that it thought the industry was acting unlawfully," and the agency's "lengthy period of conspicuous inaction" indicated its "acquiescence" in the industry's practice. *Id.* at 12–13. Under these circumstances, the Court concluded, it would be inappropriate to defer to a new interpretation by DOL that threatened to "impose potentially massive liability" on pharmaceutical companies "for conduct that occurred well before that interpretation was announced." *Id.* at 10. Consequently, the Court was required to interpret the statute and regulations for itself, rather than deferring to DOL's view.

Using "traditional tools of interpretation," the Court determined that the plaintiffs were exempt outside salesmen. Because DOL's regulations incorporated the FLSA's definition of "sales," the Court examined the statute and concluded that Congress had sought to define sales broadly to "accommodate industry-by-industry variations in methods of selling commodities." *Id.* at 19. Sales under the FLSA therefore include "those arrangements that are tantamount, in a particular industry, to a paradigmatic sale of a commodity." *Id.* In light of the "unique [FDA] regulatory environment within which pharmaceutical companies must operate," the Court held that obtaining a "nonbinding commitment from a physician to prescribe" a drug constitutes a sale in the pharmaceutical industry. *Id.* at 20–21.

Justice Breyer, joined by Justices Ginsburg, Sotomayor, and Kagan, dissented. The dissent agreed that DOL's view did not merit "any especially favorable weight." Dissent at 2. Nevertheless, it concluded that pharmaceutical sales representatives are not exempt because their "'primary duty' is informational, as opposed to sales-oriented." *Id.* at 6.

Ramifications

- **For Pharmaceutical Companies.** The most obvious and direct impact of *Christopher* will be on the pharmaceutical industry, which no longer faces hundreds of millions of dollars in potential liability for failing to pay its sales representatives overtime. Dozens of pending FLSA actions against pharmaceutical companies should be dismissed in short order, without any need to litigate the applicability of other exemptions (such as the administrative exemption) on a case-by-case basis. But one important caveat is in order: To make certain that they benefit from *Christopher*, pharmaceutical companies should review their sales representative training programs and ensure that those programs make clear that the representative's goal is to obtain a doctor's nonbinding commitment to prescribe the company's products where appropriate. The Supreme Court's analysis focused on the obtaining of such commitments as the "arrangement" that qualified as a sale for FLSA purposes, and the Court emphasized that the plaintiffs' "end goal" as sales representatives for GSK had not been "merely to make physicians aware of the medically appropriate uses of a particular drug," as the dissent argued, but rather "to convince physicians actually to prescribe the drug in appropriate cases." Slip op. at 24.

- **For Other Employers Subject to the FLSA.** The Supreme Court's broad, functional interpretation of the outside sales exemption will affect other litigation over the boundaries of that exemption and other FLSA exemptions. The Court cabined its holding to the situation where "an entire industry is constrained by law or regulation from selling its products in the ordinary manner," but it is possible that employees in other industries may be found to perform a function that is "tantamount … to a paradigmatic sale of a commodity" within that industry's regulatory environment and thus to come within the outside sales exemption as interpreted in *Christopher*. More generally, the Court's rejection of a bright-line "transfer of title" requirement and its reasoning that the FLSA attempts to "accommodate industry-by-industry variations" may encourage lower courts to read the Act's other exemptions in a more pragmatic, less formalistic manner. Employers in other industries should consider whether *Christopher* opens the door to an argument that an exemption applies.

- **For Agency Litigation in General.** The Court's refusal to defer to DOL's view makes *Christopher* a very important administrative law decision with ramifications far beyond the FLSA context. Many federal agencies routinely demand "controlling deference" under *Auer* for regulatory interpretations advanced in briefs filed in pending litigation. *Christopher* raises the bar significantly for agencies to obtain such controlling deference.

First, *Christopher* makes clear that an agency's view may not be eligible for *Auer* deference when it threatens significant retroactive liability for regulated entities, especially if the agency had previously acquiesced — even tacitly, as was the case in *Christopher* — in the conduct at issue. Previous Supreme Court decisions had suggested such an "unfair surprise" limitation on *Auer* deference, but *Christopher* is the first case in which the Supreme Court has actually rejected an agency's position on that rationale.

Second, *Christopher* reinforces the requirement that the agency's *amicus*-brief view must "reflect[] the agency's fair and considered judgment" on the issue. Slip op. at 10. When an agency has announced an interpretation through a formal process such as rulemaking, there is usually little reason to doubt that it reflects the agency's fully and fairly considered judgment. When an agency announces a new interpretation in an *amicus* brief, in contrast, there is a heightened risk that the agency is circumventing notice-and-comment requirements and taking a procedural shortcut to try to dictate a preferred result. The Court expressed concern that DOL's choice to announce its position in *amicus* briefs meant that "there was no opportunity for public comment." *Id.* at 14. Also, DOL's position had changed somewhat between the courts of appeals and the Supreme Court, which called into question whether DOL's current view was fully and fairly considered. *Id.* at 8–9; Dissent at 2.

For these reasons, although the Court did not overrule *Auer*, it did impose important limitations on agencies' ability to obtain controlling deference under *Auer* to interpretations of their regulations. Even beyond the specific factors at issue in *Christopher*, the Court voiced concern that "deferring to an agency's interpretation of its own ambiguous regulations … creates a risk that agencies will promulgate vague and open-ended regulations that they can later interpret as they see fit, thereby frustrating the notice and predictability purposes of rulemaking." Slip op. at 13. The Court's emphasis on the importance of notice and predictability should be helpful to regulated entities even outside the specific context of agency regulatory interpretations governed by *Auer*. For example, if an agency announced a new and surprising interpretation of a statute (as opposed to a regulation) in an enforcement action, the *Christopher* Court's concern with fair notice and agency circumvention of notice-and-comment requirements would apply even more acutely. See, e.g., *United States v. Franck's Lab, Inc.*, 816 F. Supp. 2d 1209, 1253 (M.D. Fla. 2011) (rejecting FDA's attempt to prohibit compounding of animal medications via an enforcement action and stating that FDA "cannot simply upset the expectations it helped to create through decades of inaction"), appeal pending, No. 11-15350-BB (11th Cir.).

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In short, employers subject to the FLSA and regulated actors across the spectrum of industries should find *Christopher* helpful in defending against agency attempts to regulate via *amicus* briefs rather than by promulgating actual regulations and in other situations where agencies take shortcuts or overreach and then seek refuge in principles of deference.