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Management Update

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Ninth Circuit Finds Pharmaceutical Sales Reps Not Entitled to Overtime Pay

Considering the issue for the first time, the Ninth Circuit has held that pharmaceutical sales representatives (PSRs) fall within the "outside sales" exemption to the Federal Fair Labor Standards Act (FLSA)'s overtime requirements. *See Christopher v. SmithKline Beecham Corp.* (9th Cir. Feb. 14, 2011). Accordingly, the court rejected the claims of two former employees of GlaxoSmithKline (Glaxo) that the company violated the FLSA by classifying them as exempt. In determining that the PSRs were properly classified as exempt under the outside sales provision, the court rejected the Secretary of Labor's interpretation that this provision does not cover PSRs, finding it "plainly erroneous and inconsistent with her own prior regulations and practices."

Industry Practice

In determining whether PSRs should be considered exempt outside sales people, the court analyzed how Glaxo sells its prescription-only products to an ultimate user. The ultimate user of a prescription drug – the patient – cannot purchase the drug without first obtaining a physician's authorization. Thus, because Glaxo is proscribed from selling prescription-only drugs directly to the public, it sells them to distributors or retail pharmacies, which then dispense those products to the ultimate user, as authorized by a licensed physician's prescription. Glaxo employs PSRs to make "calls" on physicians to encourage them to prescribe Glaxo products. On calls, PSRs typically present physicians with a variety of information about Glaxo products, provide product samples,

and attempt to convince the physicians to prescribe Glaxo products, when medically appropriate, over competitor products. PSRs also try to build business relationships with physicians, respond to their concerns, and recruit them to attend Glaxo-organized dinners and conventions. Each PSR is responsible for a particular "drug bag" of medications he or she tries to induce physicians to prescribe.

Glaxo recruits applicants with prior sales experience and provides them with more than a month of training that focuses on making presentations, learning about Glaxo products and building interpersonal skills. The company also trains PSRs on how to obtain a commitment from a physician to prescribe Glaxo products if the physician believes the medication is appropriate.

PSRs receive a salary and also receive incentive-based compensation. Incentive-based compensation is paid if Glaxo's market share for a particular product increases in a PSR's territory or if sales volume, sales revenue or dose volume increases. The court noted that PSRs carry out essentially the same business functions regardless of which drug manufacturers they represent.

The FLSA's Outside Sales Exemption

The FLSA requires employers to pay non-exempt employees at least the minimum wage and, for all hours worked in excess of forty in one workweek, an overtime premium of time and one-half their regular rate of pay. There are some exceptions to these requirements, including one for workers employed as outside sales people. The FLSA does not define the term "outside sales" but instead gives the Department of Labor (DOL) the authority to issue implementing regulations defining the scope of the exemption.

The DOL regulations define an "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 primarily and regularly engaged away from the employer's place or places of business in performing such primary duty.

Rejection of DOL's Regulation and Amicus Brief Argument

The Secretary of Labor filed an amicus brief in this case, arguing that PSRs do not meet the primary duties test for the outside sales exemption because "when an employee promotes to a physician a pharmaceutical that may thereafter be purchased by a patient from a pharmacy . . . the employee does not in any sense make the sale." Although the Second Circuit adopted the DOL's interpretation in *In re Novartis Wage & Hour Litig.*, 611 F.3d 141 (2d Cir. 2010), the Ninth Circuit held that the DOL's regulation and interpretation are neither controlling nor persuasive.

The court held that the DOL's outside sales regulation, which merely cross-references sales under Section 3(k) of the FLSA, does not clarify the meaning of Section 3(k) and "merely incorporates the very undefined, undelimited term the Secretary seeks to clarify." The court further held that a "definition dependent almost entirely on Congress's seventy-two-year old statutory language is not an example of the DOL employing its 'expertise' to elucidate meaning to which we owe" controlling deference.

The court further held that the Secretary's interpretation that the outside sales exemption does not apply to PSRs, which was set forth in her *amicus* brief, is a new interpretation of the statutory language and is not entitled to deference. Additionally, the court found this interpretation both "plainly erroneous and inconsistent with [the Secretary's] own regulations and practices."

PSRs Engage in Sales

In determining that PSRs engage in sales, the court considered the structure and realities of the pharmaceutical sales industry and noted that in this industry, unlike most others, the law prohibits the actual exchange of goods for sale. Thus, in the pharmaceutical sales industry, the "sale" is the exchange of non-binding commitments between the PSR and physician at the end of a successful call. The fact that a physician's commitment to prescribe a certain drug when medically appropriate is non-binding is irrelevant; the commitment to a PSR is a meaningful exchange because pharmaceutical manufacturers value these commitments enough to reward the PSR with increased commissions when a physician increases his or her use of a drug in a PSR's "bag."

The court noted that for over seventy years, the DOL has employed the open-ended concept that a salesman is someone who "in some sense" sells and found that the agency's current "about-face regulation, expressed only in ad hoc *amicus* filings," is not enough to overcome this consistent message. Accordingly, the court held that the PSRs are exempt from the FLSA's overtime pay requirement.

Employers' Bottom Line

Although the Ninth Circuit's decision is not binding on courts outside of the Ninth Circuit's jurisdiction, the decision is instructive because it examines the applicability of the outside sales exemption in the context of the requirements of the particular industry rather than imposing an inflexible standard to be applied regardless of the circumstances. •

Court Challenges to Health Care Reform Law

Although numerous lawsuits have been filed challenging the 2010 health care reform law (the Patient Protection and Affordable Care Act) (PPACA), a federal trial court in Florida recently became the first federal court to strike down the entire law as unconstitutional. In *Florida v. United States Department of Health and Human Services* (N.D. Fla. Jan. 31, 2011), Judge Roger Vinson held that Congress exceeded the power granted to it under the Commerce Clause when it enacted the individual mandate provision of the PPACA. The court also held that the individual mandate cannot be severed from the other provisions of the Act, thus the entire law is unconstitutional.

The Court's Decision

The Act's individual mandate provision requires that, beginning in 2014, everyone (with certain limited exceptions) must purchase federally-approved health insurance or pay a monetary penalty. Congress relied on its Commerce Clause power in enacting this provision and the court found that the individual mandate was not a proper exercise of this power.

The court held that the Commerce Clause only gives Congress the power to regulate "activity" that substantially affects interstate commerce. According to the court, it would be a "radical departure from existing case law to hold that Congress can regulate inactivity under the Commerce Clause." The court found that if Congress can compel an otherwise passive individual into a commercial transaction with a third party merely by asserting that compelling the actual transaction itself substantially affects interstate commerce "it is not hyperbolizing to suggest that Congress could do almost anything it wanted."

The court also held that the failure to purchase insurance is not "activity"; instead, the individual mandate regulates inactivity. The court rejected the defendants' argument that because of the "uniqueness" of the health insurance industry individuals who do not purchase health insurance are not inactive. The court stated that "uniqueness is not an adequate limiting principle as every market problem is, at some level and in some respects, unique."

The court also rejected the defendants' argument that the uninsured have made the "economic decision" to engage in market timing and try to finance their future medical needs out-of-pocket rather than through insurance, which is tantamount to "activity." The court found that this legal rationale "would essentially have unlimited application" because "there is quite literally no decision that, in the natural course of events, does not have an economic impact of some sort." The court held that permitting Congress to regulate the so-called economic decision not to purchase health insurance now in anticipation of future consumption is a "bridge too far," without "logical limitation" and far in excess of the existing legal boundaries established by Supreme Court precedent.

The court also held that the individual mandate cannot be severed from the remaining statutory provisions, because although many of those provisions can function independently from the individual mandate, they would not constitute a law that would function the way Congress intended when it enacted the statute. Comparing the Act to a "finely crafted watch," the court held that when one essential piece (the individual mandate) is defective and must be removed, the Act cannot function as originally designed.

Impact of the Decision

This decision could complicate implementation of the PPACA in the 26 states that brought suit challenging the law. The court did not issue an injunction when it entered the declaratory judgment, based on the "long-standing presumption" that a declaratory judgment against federal officials is a *de facto* injunction. However, the Obama administration indicated that it intended to continue implementation of the law. Subsequently, on March 3, 2011, the court issued an order clarifying that it intended its prior declaratory judgment to have immediate injunction-like effect, which would prohibit the law from going forward while it is on appeal. In that same order, the court issued a stay of its decision, conditioned on the defendants filing an appeal within seven days of the order seeking expedited appellate review either in the federal appeals court or with the U.S. Supreme Court pursuant to that Court's rules.

Expedited Appellate Review of Other PPACA Decisions Granted

In *Virginia ex rel. Cuccinelli v. Sebelius*, the district court for the Eastern District of Virginia held that the individual mandate is unconstitutional but severed that provision from the remainder of the statute. The Fourth Circuit granted expedited review of both *Cuccinelli* and a decision from the Western District of Virginia, *Liberty University Inc. v. Geithner*, which upheld the constitutionality of the statute. Both of these cases are tentatively scheduled for oral argument in the Fourth Circuit between May 11 and May 13, 2011. Additionally, in *Thomas More Law Center v. Obama*, the Sixth Circuit Court of Appeals granted expedited review of an appeal from a decision of the Eastern District of Michigan upholding the individual mandate. The Sixth Circuit announced that it will hear oral argument sometime between May 30 and June 10.

Supreme Court Review Sought

In *Cuccinelli*, the Virginia Attorney General asked the U.S. Supreme Court to rule on the constitutionality of the Act prior to a ruling by a federal appeals court. Although the petition was filed in *Cuccinelli v. Sebelius*, the petition asked the Court to expand certiorari to include the decision in Florida after an appeal has been filed in that case. The Justice Department has stated that it opposes expedited Supreme Court review.

While possible, is appears unlikely that the Supreme Court will agree to review the case before an appellate court issues an opinion.

Bottom Line

We will likely see more court challenges to the PPACA as well as Congressional efforts to amend the law. However, at this point employers should continue to comply with the provisions that are currently in effect and take the steps necessary to be ready to comply with those that take effect in the future. •

NLRB Finds "Preemptive Strike" Discharge Illegal

In a 2-1 decision, the National Labor Relations Board recently held that an employer's discharge of an employee to prevent her from discussing her wages and conditions of employment with other employees was a "preemptive strike" that was unlawful under the National Labor Relations Act (NLRA), regardless of whether the employee had actually engaged in protected concerted activity. *See In re Parexel Int'l, LLC, 356 NLRB* No. 82 (January 28, 2011). By imposing liability without a finding that the employee actually engaged in protected concerted activity, the Board's decision expands the scope of the NLRA's protection.

Facts

The employee, Neuschafer, had a conversation with a South African co-worker who led her to believe he and his wife had received raises and that the manager of clinical operations, who was also South African, "is going to look after us." By "us" Neuschafer believed the co-worker meant the company's South African employees. Neuschafer told her supervisor about this conversation and the supervisor reported it to the clinical operations manager. Subsequently, the clinical operations manager and a human resources consultant met with Neuschafer, who told them about her conversation with the co-worker and stated that she thought the employer was paying South Africans higher wages and was going to continue to favor South Africans in that manner. The

clinical operations manager asked Neuschafer if she had discussed the conversation with anyone other than her supervisor and she stated that she had not. A few days later, the employer discharged Neuschafer, who then filed an unfair labor practice charge based on her termination.

Holding

The Board rejected the ALJ's determination that there was no violation of the NLRA because Neuschafer had not yet engaged in concerted activity. According to the ALJ, an employee must have already engaged in protected concerted activity in order to find that she was unlawfully discharged to prevent protected concerted activity. The Board disagreed, holding that if an employer acts to prevent protected concerted activity – to "nip it in the bud" – that action interferes with and restrains the exercise of Section 7 rights and "is unlawful without more."

The Board noted that management questioned Neuschafer about two things: 1) what she and her co-worker discussed; and 2) whether Neuschafer had discussed the substance of the conversation with anyone other than her supervisor. The Board then found that the employer, "[s]atisfied that Neuschafer had not yet stirred up any concern about wages or possible discrimination among other employees," discharged Neuschafer before she could do so.

The Board held that Neuschafer's discharge restricted her own further protected discussions with other employees regarding wages and possible discrimination and, accordingly, interfered with her Section 7 rights. Further, the Board held that Neuschafer's discharge had the effect of keeping other employees in the dark about these matters, thus preventing them from discussing and "possibly inquiring further or acting in response to, substandard wages or perceived wage discrimination." Accordingly, the Board found that the employer's discharge of Neuschafer violated Section 8(a)(1) of the Act.

Employers' Bottom Line

The Board's decision in *Parexel* essentially creates a new type of unfair labor practice – the "preemptive strike." It is clear from this decision that the Board will look closely at the

employer's intent when evaluating unfair labor practice charges based on a termination. Employers in both unionized and union-free workplaces must ensure they do not discharge employees to prevent them from discussing their terms or conditions of employment with other employees. Additionally, employers should ensure that their policies and practices do not have the effect of "chilling" such employee discussions. •