

# EMPLOYMENT LAW COMMENTARY

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## A CHANGING LANDSCAPE: UNPAID INTERNSHIPS UNDER THE DOL'S NEW PRIMARY BENEFICIARY TEST

By Maya Harel

As companies begin to think about their summer internship programs, they may want to consider the recent change in the legal landscape surrounding unpaid internships. For good reason, companies have generally been concerned about the legality of unpaid internships, given the hard stance on the issue by the U.S. Department of Labor (DOL) and several class actions brought on behalf of unpaid interns over the last ten years. However, just last month, after the Second Circuit once again refused to adopt the DOL's position, the DOL reviewed its decision and recognized the "primary beneficiary test," which takes a much more flexible, totality of the circumstances approach to analyzing whether unpaid interns should be paid as employees. The main question under the primary beneficiary test is whether the benefit the intern gets from the internship, such as skills training and professional development, outweighs any potential benefit the company receives. This move by the DOL follows a line of case law rejecting the DOL's previous

standard as too rigid and often finding that unpaid interns, based on the circumstances of each particular case, are not employees. With this changed landscape in mind, companies may want to revisit the possibility of offering unpaid internships to students. But, before hastily doing so, companies should carefully review and structure their internship program to ensure that the intern is the primary beneficiary in the relationship.

## THE COURTS REPEATEDLY FOUND THE DOL'S SIX-FACTOR TEST WAS TOO RIGID

The federal Fair Labor Standards Act (FLSA) defines an employee as “any individual employed by an employer,” and defines employ as “to suffer or permit to work.”<sup>1</sup> Under federal law, a distinction has developed between interns and trainees on the one hand and employees on the other. If an individual is determined to be an employee, he or she must be compensated for his or her services in accordance with federal and state minimum wage and overtime laws.

More than 70 years ago, the U.S. Supreme Court decided the seminal case on the issue – *Walling v. Portland Terminal Co.*, 330 U.S. 148 (1947) (“*Portland Terminal*”). *Portland Terminal* involved unpaid railroad trainees who worked alongside railroad employees. The DOL sought an injunction against Portland Terminal for failing to pay its trainees the minimum wage under the FLSA. The Supreme Court was tasked with interpreting the relatively thin provisions of the FLSA to determine whether the trainees should be considered employees. After reviewing a number of factors, the Court ruled that the trainees were not employees. In reaching its decision, the Court compared the trainees to students in an educational setting and noted that the FLSA’s definition of employer cannot be read so broadly that it includes all students as employees of the schools they attend.<sup>2</sup>

Based on the factors considered in *Portland Terminal*, the DOL identified six criteria for deciding whether trainees or unpaid interns are employees under the FLSA.<sup>3</sup> Under the DOL’s six-factor test, an individual will cross the line from “intern” or “trainee” to “employee,” unless all of the following factors are met:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training that would be given in an educational environment;
2. The internship experience is for the benefit of the intern;

3. The intern does not displace regular employees, but works under close supervision of existing staff;
4. The employer that provides the training derives no immediate advantage from the activities of the intern, and on occasion its operations may actually be impeded;
5. The intern is not necessarily entitled to a job at the conclusion of the internship; and
6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

The difficulty with the DOL’s six-factor test was that it was too rigid and too dependent on the facts in *Portland Terminal*, especially the fourth factor – the employer derives no benefit from the intern. In applying the test, many courts have concluded that the six criteria are relevant but not conclusive and have rejected the mechanistic application of the test.<sup>4</sup>

## THE NEW PRIMARY BENEFICIARY TEST PROVIDES A FLUID AND FLEXIBLE APPROACH

Recognizing that the DOL’s six-factor test was too rigid, the Second Circuit in *Glatt v. Fox Searchlight Pictures, Inc.* sought to provide guidance for a more appropriate primary beneficiary test that would provide more flexibility.<sup>5</sup> The Second Circuit articulated a list of seven non-exhaustive factors to aid courts in determining whether an intern is an employee for purposes of the FLSA, which are:

1. The extent to which the intern and the employer clearly understand that there is no expectation of compensation – any promise of compensation, express or implied, suggests that the intern is an employee – and vice versa;
2. The extent to which the internship provides training that would be similar to that which would be given in an educational environment, including the clinical and other hands-on training provided by educational institutions;
3. The extent to which the internship is tied to the intern’s formal education program by integrated coursework or the receipt of academic credit;
4. The extent to which the internship accommodates the intern’s academic commitments by corresponding to the academic calendar;

5. The extent to which the internship's duration is limited to the period in which the internship provides the intern with beneficial learning;
6. The extent to which the intern's work complements, rather than displaces, the work of paid employees while providing significant educational benefits to the intern; and
7. The extent to which the intern and the employer understand that the internship is conducted without entitlement to a paid job at the conclusion of the internship.

In applying these factors, courts should consider the totality of the circumstances. No one factor is dispositive, every factor need not point in the same direction, and other factors beyond this list may be considered.

The touchstone of the primary beneficiary test recognized by the Second Circuit is that it weighs the tangible and intangible benefits provided to the intern against the intern's contribution to the company's productivity. The test has three salient features. First, it focuses on the benefit the intern gets from the internship. By focusing on the educational aspects of the internship, the test more clearly reflects the role of internships in today's economy.<sup>6</sup> Second, it provides courts with the flexibility to examine the economic realities as they exist between the intern and the company. The test acknowledges that the company may get some benefit from the internship program; indeed, students want to engage in projects and tasks that contribute to the professional work of the organization. But the totality of the circumstances approach allows courts to sniff out employers that exploit unpaid interns by using their free labor without providing the interns with an appreciable benefit in education or experience. Third, the test acknowledges that the intern-employer relationship is different and should not be analyzed in the same way as the standard employee-employer relationship.<sup>7</sup>

Other courts have followed suit, rejecting the DOL's stringent six-factor test and instead applying the flexible primary beneficiary test. Recently, on December 8, 2017, the Second Circuit applied the primary beneficiary test and found that unpaid interns of various magazines owned by the Hearst Corporation were not employees under the FLSA.<sup>8</sup> On December 19, 2017, the Ninth Circuit similarly applied the primary beneficiary test and found that cosmetology students who provided services in the school's salon clinics did not qualify as employees under the FLSA, Nevada law, or California law.<sup>9</sup>

In response to the move away from the DOL's six-factor test, on January 5, 2018, the DOL issued a new release, replacing its prior guidance, indicating that the test for unpaid interns and students working for "for profit" employers should be the primary beneficiary test.<sup>10</sup> The DOL recognized that the test is a flexible test with no single factor being determinative and stated that the analysis will necessarily depend on the unique circumstances of each case.

Based on the affirmative acknowledgment of the primary beneficiary test by both courts and the DOL, it is safe to say that this test should be applied when analyzing unpaid internship programs going forward.

### IS CALIFORNIA LAW REGARDING UNPAID INTERNS DIFFERENT?

Although no California state court has affirmatively applied the primary beneficiary test, it is likely that a California court would do so or, at the very least, apply a similar test that is appropriate for the occupational training setting. California federal courts have recognized that "although California law defines the scope of the employment relationship more broadly than the FLSA, there is no indication that California courts have or will depart from federal law on this issue."<sup>11</sup>

Moreover, in a 2010 opinion letter, the California Division of Labor Standards Enforcement (DLSE) stated that it "has historically followed federal interpretations which recognize the special status of trainees and interns who perform some work as part of an educational or vocational program" as falling outside California's minimum wage laws if there is "a sufficient showing that the intern/trainee is enrolled in a bona fide internship or training program."<sup>12</sup> The opinion letter stated that "it is reasonable and appropriate for the DLSE to look to the factors used by the DOL in determining the exemption for purposes of coverage of state minimum wage coverage for trainees/interns in the absence of a state statute or regulation on the matter."<sup>13</sup> With the DOL's recent adoption of the primary beneficiary test in January 2018, it is expected that the DLSE and California courts will do the same.

### THE IMPORTANCE OF PROPERLY CLASSIFYING AN INTERN

In considering whether to provide an unpaid internship program, companies should understand the potential liability they may face if an unpaid intern is found to be an employee. In addition to the potential exposure to unpaid wages, including overtime, under state and federal labor laws, an adverse ruling could also implicate other laws in the employee-employer context, such

as discrimination laws, immigration laws, employee benefits, workers' compensation coverage, unemployment benefits, and tax issues. For this reason, it is important for California employers to ensure that their unpaid internship programs are in compliance with federal and state laws.

## CONSIDERATIONS FOR STRUCTURING AN UNPAID INTERNSHIP PROGRAM

Companies with unpaid internship programs or companies seeking to establish an unpaid internship program should take a moment to reassess the program under the primary beneficiary test. Based on the non-exhaustive factors articulated by the Second Circuit, some useful considerations include:

1. Requiring that the intern receive academic credit from his or her academic institution for the internship so that it is tied to the intern's formal education program;
2. Incorporating substantive trainings and other educational, classroom-like components into the internship program;
3. Including additional benefits for the intern, such as a mentorship program and shadowing opportunities;
4. Limiting the internship program to a specified length of time, such as a semester, so that it corresponds to the intern's academic calendar and is not so long that the intern is no longer provided with beneficial learning;
5. Ensuring that interns understand from the beginning that the internship is unpaid and that they should not have any expectation of employment with the company following the conclusion of the internship – it may be useful to have interns acknowledge their understanding in writing; and
6. Keeping tabs on the work performed by the interns to ensure that the work provides significant educational benefits to the intern and keeping a record of the work performed.

And, of course, the underlying purpose of the primary beneficiary test should always be kept in mind, so companies should ask this question about their programs: Does our internship program primarily benefit our interns?

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1 29 U.S.C. § 203(e)(1).

2 *Walling v. Portland Terminal Co.*, 330 U.S. 148, 152-53 (1947).

3 In 1967, the DOL issued informal guidance on trainees as part of its *Field Operations Handbook*. See DOL, Wage & Hour Div., *Field Operations Handbook*, Ch. 10, ¶ 10b11 (Oct. 20, 1993), available at [https://www.dol.gov/whd/FOH/FOH\\_Ch10.pdf](https://www.dol.gov/whd/FOH/FOH_Ch10.pdf). In 2010, the DOL published similar informal guidance for unpaid interns working in the for-profit private sector. See DOL, Wage & Hour Div., *Fact Sheet #71: Internship Programs Under the Fair Labor Standards Act*, Apr. 2010; see also U.S. Dep't of Labor Opinion Letter Fair Labor Standards Act, 2001 WL 1558755 (Jan. 30, 2001).

4 See, e.g., *Otico v. Hawaiian Airlines, Inc.*, 229 F. Supp.3d 1047, 1050 (N.D. Cal. 2017); *Benjamin v. B&H Education, Inc.*, 877 F.3d 1139, 1148 (9th Cir. 2017); *Glatt v. Fox Searchlight Pictures, Inc.*, 811 F.3d 528, 536 (2d Cir. 2016); *Schumann v. Collier Anesthesia, P.A.*, 803 F.3d 1199, 1203, 1209-11 (11th Cir. 2015); *Solis v. Laurelbrook Sanitarium and School, Inc.*, 642 F.3d 518, 525 (6th Cir. 2011) (finding the DOL's test "to be a poor method for determining employee status in a training or educational setting").

5 *Glatt*, 811 F.3d at 536-37.

6 See, e.g., Nat'l Ass'n of Colleges & Emp'rs, Position Statement: U.S. Internships (July 2011), available at <http://www.nacweb.org/about-us/advocacy/position-statements/position-statement-us-internships/> (defining the term "internship" as "a form of experiential learning that integrates knowledge and theory

learned in the classroom with practical application and skills development in a professional setting" that "give students the opportunity to gain valuable applied experience and make connections in professional fields they are considering for career paths; and give employers the opportunity to guide and evaluate talent").

7 *Glatt*, 811 F.3d at 536.

8 *Wang v. Hearst Corporation*, 877 F.3d 69 (2d Cir. 2017).

9 *Benjamin*, 877 F.3d 1139.

10 See DOL, Wage & Hour Div., *Fact Sheet #71: Internship Programs Under the Fair Labor Standards Act*, Jan. 2018, available at <http://www.dol.gov/whd/regs/compliance/whdfs71.pdf>. This publication of Fact Sheet #71 replaced the April 2010 publication, which is no longer available.

11 *Ford v. Yasuda*, 2017 WL 4676575 (C.D. Cal. June 20, 2017); see also *Otico*, 229 F. Supp. 3d at 1049 (finding the FLSA and California law to appear to be the same for purposes of determining if an intern qualifies as an employee); *Benjamin*, 877 F.3d at 1148-50 (concluding that "the California Supreme Court would not apply the DOL factors that the federal courts have rejected as too rigid, but would instead apply a test more similar to the FLSA primary beneficiary test").

12 David Balter, Cal. Dep't Of Indus. Relations, Div. Of Labor Standards Enforcement, Op. Letter No. 2010.04.07 (Apr. 7, 2010), at 4, available at <https://www.dir.ca.gov/dlse/opinions/2010-04-07.pdf>.

13 *Id.* at 6.

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