For Whose Benefit - The Legal Requirements for Paying Interns

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FOR WHOSE BENEFIT?
The Legal Requirements for Paying Interns

By: Brian E. McMath

I. INTRODUCTION

Unpaid internships have proliferated in recent years as a way to provide crucial real-world training to those wishing to be employed in a particular field. In response to the needs of employers, educational institutions have begun formalizing internship programs to ensure graduates are better prepared to enter the workforce. Employers enjoy the long-term benefits of having access to a highly-skilled talent pool and building relationships with educational programs that provide workers for their industries. Unpaid interns enjoy the short-term benefit of learning skills that make them much more marketable once they enter the workforce.

However, due to real or perceived employer abuses of unpaid internship programs, the Department of Labor and the federal courts have attempted to clarify the fuzzy line between "intern" and "employee." This distinction is important because interns are not entitled to a minimum wage and overtime pay under federal law, while employees are. Knowing this distinction is vitally important to employers because if an unpaid intern is **treated** like an employee but is not **paid** like an employee, the employer may be liable to the intern for back pay, overtime pay, liquidated damages, and attorney's fees under the Fair Labor Standards Act. In order to avoid such liability, employers must be careful in how they structure and execute their unpaid internship programs. The purpose of this document is to provide employers with guidance on how to structure such a program so that it provides benefit to the employer without incurring liability.

II. OVERVIEW OF THE RELEVANT LAW

It should be noted at the outset that the law in this area is evolving quickly and constantly. This section provides a snapshot of what the law looks like today, though new cases are being filed and decided all the time. Further, courts have determined that whether an employment relationship exists between an employer and an individual must be decided on a case-by-case basis, meaning very few bright-line rules can be applied.

A. The Fair Labor Standards Act

The Fair Labor Standards Act ("FLSA") is the federal law requiring employers to pay employees at least the federal minimum wage plus overtime. Unhelpfully, the FLSA defines an employee as "any individual employed by an employer" and defines "employ" as "to suffer or permit to work." These definitions offer little guidance as to when employers are required to pay interns as employees. Crucially, an employee's right to a minimum wage and overtime pay is **unwaivable** under the FLSA, meaning that even if an individual agrees to work for no pay, that individual may still be entitled to FLSA protections.

Individuals seeking relief under the FLSA may file a complaint with the Department of Labor's Wage and Hour Division ("WHD") or bring a private suit against their employer. Once WHD receives a complaint, the Secretary of Labor may file suit on behalf of the employee for back wages and an equal amount in liquidated damages, as well as injunctive relief. If the employee brings a private suit, the employee can sue for back pay, an equal amount in liquidated damages, and attorney's fees and costs. If the Secretary has already filed a lawsuit on behalf of the employee, the employee may not file and prosecute a separate private suit. Generally, a two-year statute of limitations applies to the recovery of back pay, while a three-year statute of limitations applies if the FLSA violation was "willful."

B. Supreme Court Decisions and WHD Guidance

The only Supreme Court decision relevant to the question of whether an unpaid intern is a "trainee" or an "employee" was decided in 1947, shortly after the FLSA was passed. In *Walling v. Portland Terminal Co.*, the Supreme Court laid out a variety of factors courts should look to when determining whether someone is an employee or not. Beginning in 1967, the Department of Labor adopted the *Walling* court's decision in its official guidelines on what constitutes a "trainee." According to the Department, an unpaid individual is truly a trainee if all six of the following factors are met:

1. The training, even though it includes actual operation of the facilities of the employer, is similar to that which would be given in a vocational school;

2. The training is for the benefit of the trainees or students;

3. The trainees or students do not displace regular employees, but work under their close observation;

4. The employer that provides the training derives no immediate advantage from the activities of the trainees or students, and on occasion his operations may actually be impeded;

5. The trainees or students are not necessarily entitled to a job at the conclusion of the training period; and

6. The employer and the trainees or students understand that the trainees or students are not entitled to wages for the time spent in training.

In April 2010, the WHD released Fact Sheet #71 (contained in the Appendix) which deals specifically with unpaid interns (as opposed to trainees). The WHD's guidance on unpaid internships mirrors almost exactly its test for trainees described above, and similarly requires that each and every factor be met in order to relieve an employer of the requirement to pay the intern.

The WHD's guidance, and its requirement that **all** six factors be met, reveals the Department of Labor's strong presumption that an employment relationship exists, and therefore

the individual is entitled to pay. The courts, however, have approached the question in a number of different (and less restrictive) ways.

C. Lower Court Decisions

Other than *Walling*, the Supreme Court has never ruled on the specific question of when an unpaid intern becomes an employee for purposes of the FLSA. However, other lower court decisions can provide some guidance. Here in the Tenth Circuit, the controlling case is *Reich v. Parker Fire Protection District,* decided in 1993. The *Reich* court followed the Department's criteria for trainees, but held that **not all elements had to be met** in order to erase the presumption that an employment relationship exists. Essentially, the *Reich* court held that courts must look to the totality of the circumstances in order to determine if an employment relationship exists or not, using the Department's guidelines as a non-exhaustive list of factors to examine. In *Reich*, the court found that even though trainees fully expected to be hired at the end of their training (WHD's Factor #5), that was not enough to outweigh its findings on the other five factors and therefore the plaintiffs were not employees and not entitled to pay.

The majority of other circuits, however, have applied a different test from *Reich*. The Fourth Circuit, Sixth Circuit, Eighth Circuit and, most recently, the Second Circuit have applied **the "primary beneficiary" test**. In a nutshell, if the **employer** is the primary beneficiary of the individual's efforts, then the individual is an employee and is entitled to pay. If the **individual** is the primary beneficiary, then the individual is a trainee or intern and therefore not entitled to pay.

In January of 2016, the Second Circuit decided *Glatt v. Fox Searchlight Pictures, Inc.*, in which the court provided a non-exhaustive list of factors it found persuasive in determining who the primary beneficiary of an internship program was:

1. The extent to which the intern and the employer clearly understand that there is **no expectation of compensation** since 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.

While *Glatt* is not the law of the land in New Mexico, the court's reasoning provides a glimpse into how federal courts examine internship programs under the "primary beneficiary" rubric, despite the Department of Labor's more stringent guidelines.

III. HOW TO STRUCTURE AN INTERNSHIP PROGRAM

With all of the different standards and decisions, it can be difficult for an employer to decide which rules to follow. Bear in mind that if your internship program adheres to the Department of Labor guidelines in Fact Sheet #71, it is highly unlikely that the Department will file a suit against you on behalf of an intern who is claiming back pay (though, of course, private suits will always be a risk). If your internship program adheres only to the less-restrictive *Reich* or "primary beneficiary" standards, then you run a greater risk of the Department suing you,

even though you are still likely to prevail in court. Since staying out of court is preferable to winning in court, and because litigation outcomes are never certain, you should consider structuring your internship program in conformity with the Department of Labor guidelines as much as possible, with a special eye towards who the primary beneficiary of the program actually is. The following is a non-exhaustive list of ideas and considerations for building a successful internship program:

A. Never guarantee a job to interns in return for their participation, and always get a signed agreement stating that they know they are not entitled to compensation or a job.

1. While these two elements alone are not enough to eliminate the presumption of an employment relationship, these are the two biggest concerns both the courts and the Department of Labor have with most internship programs.

2. It is acceptable to indicate to interns that they will be more desirable job candidates if they participate in the program (assuming they will be), but beware of the "implied promise" of employment following the internship.

B. Coordinate with local trade schools, colleges, and high schools to set up internship programs in concert with them, rather than taking an *ad hoc* approach.

1. Try to make sure interns can receive school credit for their efforts. While this is not necessary for an internship program, it helps eliminate any argument that the intern is "working for nothing."

2. Coordinate your internship program to coincide with academic calendars. This increases your "educational tie-in" and also prevents interns from working for you long after the "beneficial learning" period.

3. If possible, get documentation from the intern's school approving your program or in some way indicating that the school is involved. Once again, while school approval or involvement alone is not sufficient, it helps to tip the "primary beneficiary" scale towards the intern, rather than towards the employer.

C. If possible, determine what the interns want to learn and what they want to get out of the program, and try to deliver that (within reason).

1. A happy intern is a non-litigious intern!

2. Follow up with your interns regularly. Make sure your interns feel like they are getting value from the program. If they aren't (or even if they feel they aren't), that tilts the "primary beneficiary" scale towards the employer.

3. Remember: The training still has to be similar to that which they would receive in an educational environment.

D. Provide regular mandatory training sessions or a mandatory training program for interns where they learn skills that you would find desirable in an employee.

1. Documented training sessions are a great way to show that your company is investing time and energy into teaching interns new skills.

2. Make the sessions mandatory so interns cannot argue later that you valued their work more than their training.

3. Training can be self-paced and individual, but if you go that route you should plan on providing lots of follow-up and on holding interns accountable for completing their training.

E. Stress the educational value of the projects that interns work on.

1. Interns can certainly complete actual work for you, but the interns should be getting more in educational value out of the work than you are getting in business value.

2. Avoid giving interns strictly (or even mostly) menial or administrative tasks to perform that someone of their eventual education level would not be expected to perform. While it is important for interns to learn marketable skills, including those associated with administrative tasks, this is where most interns stop getting the skills and experience they bargained for.

F. If possible, try to have regular employees manage interns, rather than managers.

1. This helps show that the interns are not replacing regular employees, but rather are complementing regular employees.

2. If interns are "even" with paid employees on the organizational chart, that makes it easier to argue that they are replacing paid employees.

G. Document costs and impediments to your business as a result of having the internship program to show that you are deriving no immediate business advantage.

1. Any money or time expended by your business is a detriment, which helps tilt the "primary beneficiary" scale in favor of the intern.

2. These costs can include, but are not limited to:

a. Time spent reviewing/revising an intern's work;

b. Time spent training an intern;

c. Money and time spent on recruitment, interviews, background checks, etc.; or

d. Money and time spent on seminars, training materials, education, etc.

H. Once the intern has learned everything you can teach them, either move them to a new department/unit or terminate them from the program.

1. They are working in exchange for skills and knowledge. If they are not receiving new skills and knowledge, they are becoming more of an employee than an intern.

2. Limiting your internships to single academic semesters is a good strategy.

IV. CONCLUSION

Unpaid internships are a good thing, and if properly executed they can provide significant short-term benefits to the intern as well as long-term benefits to you and your industry.

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