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Alert

Second Circuit Adopts New 'Primary Beneficiary Test' for Determining Whether Unpaid Interns Are Employees

July 27, 2015

A recent wave of multimillion-dollar lawsuits brought against employers by unpaid interns demanding compensation for their work has resulted in settlements but no definitive word from the federal courts on when interns should be considered employees. Despite the volume of litigation in this area, the factors that federal district courts have considered to determine whether an intern must be paid have varied, leaving the issue unsettled — until this month, when the U.S. Court of Appeals for the Second Circuit ruled on the issue. On July 2, 2015, the Second Circuit in *Glatt v. Fox Searchlight Pictures* held that a new test — the "primary beneficiary test" — should be used to determine whether an intern must be considered an employee and thus paid.

In 2014, NBCUniversal settled a class action brought by approximately 9,000 unpaid interns for $6.4 million. Other companies such as Viacom, Condé Nast, Warner Music Group and Lionsgate have similarly settled class action lawsuits for amounts ranging from $1 million to $7.2 million.[1] In reaction to the increasing number of lawsuits and multimillion-dollar settlements, companies have been terminating their unpaid internship programs or paying interns at least minimum wage.[2] Students have been left with fewer and more competitive internship options.

In *Glatt*, three unpaid interns filed complaints against Fox Searchlight Pictures Inc. and Fox Entertainment Group Inc., claiming they were entitled to compensation as employees under the Fair Labor Standards Act (FLSA) and New York Labor Law (NYLL). Specifically, the plaintiffs alleged that the defendants had violated these laws by failing to pay them as employees during their internships, as required by minimum wage and overtime provisions of the statutes. One plaintiff sought to certify a nationwide class.

Determining Employment Status

The Second Circuit rejected the U.S. Department of Labor's (DOL) fact sheet guidelines on unpaid interns working in the for-profit private sector. The DOL's fact sheet, issued in 2010, set forth a rigorous, intern-

[1] Many of the major lawsuits concerning unpaid interns have been in the media industry, likely because large numbers of unpaid internships tend to be much more prevalent in "high-prestige creative fields like music, media, and fashion." Neil Howe, "The Unhappy Rise of the Millennial Intern," *Forbes* (April 22, 2014). Unpaid interns, however, are utilized across all industries. Employers are bound by federal and state labor laws and the case law construing these laws.

[2] *See* Rachel Feintzeitgh and Melissa Korn, "Colleges, Employers Rethink Internship Policies," *The Wall Street Journal* (April 22, 2014); Melissa Schorr, "The Revolt of the Unpaid Intern," *The Boston Globe* (Jan. 12, 2014).

friendly test. The guidelines provided that there is no employment relationship only if *all* of the following six requirements are met:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which 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.

In 2010, the New York State Department of Labor (NYDOL) adopted the DOL's six-factor test and added five additional factors. NYDOL Opinion RO-09-0189 (Dec. 21, 2010). The NYDOL provides, just like the DOL in its guidelines, that an employment relationship does not exist only if all criteria are met.

In *Glatt*, the district court used a version of the DOL's six-factor test. The lower court balanced the factors and found that four weighed in favor of finding that the interns were employees and the other two against, ultimately concluding that the interns were employees.

On appeal, neither party argued that the DOL's guidelines should be applied. The plaintiffs argued that when an employer receives an "immediate advantage" from an intern's work, the intern should be considered an employee. The defendants urged the court to adopt a "primary beneficiary test" in which the benefits to the intern are weighed against the value provided by the intern to the employer. The DOL filed an amicus brief urging the court to abide by the six-factor test.

The court agreed with the defendants and adopted the "primary beneficiary test." The court wrote, "The primary beneficiary test has two salient features. First, it focuses on what the intern receives in exchange for his work … [S]econd, it also accords courts flexibility to examine the economic reality as it exists between the intern and the employer." Here, the Second Circuit articulated a list of non-exhaustive factors for courts to consider when determining whether the intern or the employer is the primary beneficiary of the relationship:

1. The extent to which the intern and 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 education 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.
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.

The court stated that no one factor is dispositive, and not every factor needs to point in the same direction to find that an intern is not an employee. The court emphasized that this decision reflects "a central feature of the modern internship — the relationship between the internship and the intern's formal education." This approach allows courts to look to the totality of the circumstances, weighing and balancing all of the considerations at play in each unique case.

Class Action Certification

In addition, the court held that determinations under the primary beneficiary test are "highly individualized inquir[ies]," meaning common, generalized proof required for certification of class actions would likely not be capable of answering the questions the court articulates in the test. Therefore, the court vacated the district court's orders certifying the plaintiffs' proposed class and the conditional certification of a nationwide collective action.

Conclusion

The primary beneficiary test adopted by the Second Circuit emphasizes the educational aspects of internships and provides greater clarity to employers as to when unpaid internship programs are permitted. The court's decision is welcome relief for employers within the Second Circuit, including New York and Connecticut employers, that have traditionally offered opportunities to students via internship programs.

The court's rejection of any class or collective action in this case is a win for employers. Although the new standard does not explicitly preclude intern class actions, the individualized nature of the test makes it unlikely an employer will face lawsuits by large groups of current and former unpaid interns, such as those that led to the *Glatt* decision and the Viacom, NBCUniversal and other recent multimillion-dollar settlements.

If you have any questions about the court's ruling, or any FLSA or NYLL provisions, please contact your attorney at Schulte Roth & Zabel. You may also contact Mark E. Brossman, Ronald E. Richman, Holly H. Weiss or Scott A. Gold.

The firm thanks summer associate Carly Halpin for her contributions on this Alert.

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