Unpaid and Underpaid Internships May Cost Employers

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Over the past year, unpaid internships have garnered increasing attention. Ross Perlin, the author of “Intern Nation,” estimated in 2011 that more than a million people participate in internships each year in the United States, and that as many as half of internships are unpaid or paid below the minimum wage.1 Misclassifying employees as unpaid interns can result in costly litigation, civil fines, or both for employers.

The Fair Labor Standards Act (FLSA) requires the payment of minimum wage and overtime to covered, non-exempt employees. One exception to the FLSA’s minimum wage and overtime requirements is that a for-profit, private-sector employer may hire individuals for internships or training programs without compensation if the internship is primarily for the interns’ educational benefit. Because the FLSA’s definition of “employ” (“to suffer or permit to work”) is extremely broad, most workers are considered employees and the internship exception is narrowly construed.

The Department of Labor (DOL) lists six criteria that must be met for the internship exception to apply:

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 intern understand that the intern is not entitled to wages for the time spent in the internship program.

If all of these factors are met, then the employer and intern do not have an “employment relationship” and therefore, the FLSA’s minimum wage and overtime pay requirements are not applicable.

There has been a growing trend of cases filed by unpaid interns claiming violations of federal and state laws governing minimum wages and overtime. In June 2013, a federal district judge in the Southern District of New York decided that unpaid interns Eric Glatt and Alexander Footman, who worked during the production of the film “Black Swan,” were employees entitled to the protections of the FLSA and the New York Labor Law (NYLL). In Glatt v. Fox Searchlight Pictures Inc., Case No. 11-06784, Glatt and Footman said they performed tasks...
usually undertaken by paid employees, such as taking lunch orders, making deliveries, organizing file cabinets, and making photocopies. The court, following the DOL’s criteria, ruled in favor of the interns and found that they did not fall within the FLSA’s unpaid intern exception. Considering the totality of the circumstances, the court concluded that the interns were classified improperly as unpaid interns and were “employees” covered by the FLSA and the NYLL.

In *Davenport v. Elite Model Management Corp.*, Case No. 13-cv-01061, in the United States District Court for the Southern District of New York, a former unpaid intern at Elite brought a collective class action against the company for $50 million in unpaid wages, overtime pay, liquidated damages, interest and attorneys’ fees for unpaid interns. Davenport claimed that Elite violated federal and state wage statutes by intentionally misclassifying employees as interns to avoid paying them wages and overtime. On January 9, 2014, the court granted preliminary approval to a $450,000 settlement between Elite Model Management and its former interns. The settlement will pay more than 100 former interns between $700 and $1,750 each.

Unpaid interns are not the only individuals bringing these types of cases. In December 2012, in *Kozik v. Hamilton College*, Case No. 6:12-cv-01870-LEK-TWD, Benjamin Kozik, a former athletic intern who was paid a stipend, filed a class action FLSA complaint in the United States District Court for the Northern District of New York. Although he was a paid intern, Kozik claimed that the sum Hamilton College paid him was not enough to meet the minimum wage in light of how many hours he worked. He alleged that Hamilton College failed to pay minimum wage and overtime, willfully misclassified paid interns as exempt from wage and hour laws, and classified them as part-time when they were working long hours each week. The case is still pending, and trial is scheduled for May 2014.

Given the high stakes in wage and hour litigation and the challenge of establishing that individual interns are not employees, employers should tread cautiously before deciding not to pay interns or to pay them minimal amounts. Employers that wish to create an unpaid internship program should formalize the internship relationship in writing, to show that each of the DOL’s six requirements is met. Employees who pay their interns should confirm that their rate of pay complies with minimum wage and overtime requirements under the FLSA and the applicable state law. Employers should consult with counsel to ensure that an internship program is structured carefully to meet the exception to the DOL’s minimum wage and overtime requirements.

**Endnote**

OFCCP’s New Voluntary Self-Identification Requirements

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Federal contractors must invite job applicants and employees to voluntarily self-identify as individuals with disabilities using a form that was recently released by the Office of Federal Contract Compliance Programs (OFCCP). Effective March 24, 2014, federal contractors must begin using the new form unless they have an affirmative action plan (AAP) in place on that date. In that case, they may delay their compliance until the start of their next plan cycle.

Under the Final Rule announced by the OFCCP last fall, a federal contractor is required to invite an applicant to voluntarily identify whether he or she is an individual with a disability. This invitation must be provided to each applicant when the individual applies or is considered for employment. The invitation may be included with the application materials for a position, but must be retained separate from the application. Federal contractors are also required to invite applicants to identify their gender, race/ethnic and veteran status, although the requirements for capturing that information are less prescriptive.

The contractor must invite each of its employees to voluntarily inform the contractor whether the employee believes that he or she is an individual with a disability. The invitation must be extended in the first year the contractor becomes subject to the requirements of the new disability rules and every five years thereafter. During the intervening years between these invitations, the contractor must remind their employees that they may voluntarily update their disability status.


The electronic version must:

• display the OMB number and expiration date
• contain the text of the form without alteration
• use a sans-serif font, such as Calibri or Arial, and
• use at least 11-pitch for font size.

The OFCCP states: “[t]hough it may seem that specifying the size and type of font is unnecessary, OFCCP is doing so to ensure the consistency of appearance, ease of reading, and accessibility of the form. By using the OMB number and date, job applicants and employees know that the form is an officially approved government form.”

Contractors are directed to keep all information on self-identification confidential, and a data analysis file separate from the application for its use in analyzing its affirmative action efforts. According to the U.S. Equal Employment Opportunity Commission, the OFCCP’s requirement that contractors invite applicants to self-identify as individuals with disabilities at the pre-offer stage is not a violation of the Americans with Disabilities Act if the employer clearly stated that the information will be used solely in connection with the contractor’s affirmative action obligations, that the information will be kept confidential and used only in accordance with the Americans with Disabilities Act, and that an applicant’s/ employee’s refusal to provide such information will not subject the applicant to any adverse treatment.

With the final version of the disability form now published, federal contractors should begin the process of updating their procedures to gather the required information. Pepper lawyers are available to assist you in complying with the new regulations.
ACA: Employers, Non-Discrimination Rules and the ‘Cadillac Tax’

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For most employers, the substantive provisions of the Patient Protection and Affordable Care Act (the PPACA) have been implemented. Almost all plans cover an employee’s child until that child reaches the age of 26, fully cover preventive services, and have eliminated pre-existing condition exclusions. Perhaps it’s finally time to sit back, relax with friends and family and begin planning for the employer mandate that will become effective January 1, 2015.

If only life were that simple.

Starting this year, in addition to plans that may be offered by an employer, all individuals will have the ability to shop for health care coverage through newly formed health care exchanges, also referred to as health insurance marketplaces. The exchanges are organizations set up to facilitate the purchase of health insurance as required by the PPACA and are designed to offer government-regulated and standardized health care plans for individuals to purchase (with certain individuals eligible for federal subsidies in connection with that purchase).

The economic viability of the exchanges depend on a critical mass of individuals receiving coverage through the exchanges. If only those individuals who were prevented previously from securing coverage for their medical issues enroll in the exchanges, the cost of coverage in 2015 and later years will need to increase, significantly. Increases will be inevitable because this group of enrollees are likely to consume more health care than their collective premiums cover. Insurance carriers can’t be required to participate in the exchanges and can’t sustain losses indefinitely. At some point, someone must cover the cost.

To that end, there are two lingering requirements of the PPACA rules that have yet to be implemented: (1) the non-discrimination rules for fully insured health care plans and (2) the “Cadillac tax” for all health care plans.

The Non-Discrimination Testing Issue

Historically, and for the moment, employers sponsoring health plans that are insured (as opposed to self-insured) have enjoyed broad discretion in fashioning the way that health care benefits are provided. Until the enactment of the PPACA, only self-insured health care plans had been subject to the onerous non-discrimination rules imposed by Section 105(h) of the Tax Code. The PPACA seeks to impose the Section 105(h) rules to insured plans as well.

The problem is that the existing Section 105(h) regulations are unclear at best, to say the least. It’s difficult to imagine how the IRS will interpret these existing “rules” to regulate insured arrangements. Take a simplistic example: Imagine an employer that sponsors a health care plan with two choices for employees – a very expensive point-of-service option (low co-pays and no referrals for specialists) and a low-cost HMO – and subsidizes 50 percent of the monthly cost for each employee. On the one hand, if all employees are eligible for either form of coverage and receive the same subsidy percentage (e.g., each employee must pay 50 percent of the cost of the premium of the coverage he or she selected), the plan would appear non-discriminatory.

But, consider an employer with two distinct groups – a high-paid group and a low-paid group. Under this plan, it would not be unusual for the high-paid group to choose to enroll in the much more expensive option. Because the cost of that program is higher, the subsidy results in the employer paying more, in the aggregate, for coverage for each high-paid employee. Can employee choice result in the failure of the yet-to-be issued non-discrimination rules? It remains unclear.

Now, step back and compare (A) the simplistic example of only having two distinct employee populations and two health care coverage choices against (B) the more typical, complex employee demographic and multiple health care offerings. The more complex the employee and plan demographic, the harder it may be to understand, let alone satisfy, the pending non-discrimination rules.
Cadillac Tax Issue

Assuming that the PPACA isn’t modified, beginning in 2018, all employer plans (whether fully insured or self-funded) will be assessed a 40 percent excise tax on the dollar amount of the cost of coverage that exceeds annual limits of $10,200 for individual employee coverage and $27,500 for family coverage. As a practical matter, the excise tax will present employers who wish to sponsor plans with two alternatives: (a) incorporating the tax into their pricing – by increasing employer and/or employee contribution – or (b) by cutting benefits to avoid the tax – by increasing co-payments or co-insurance paid by the employees.

Starting in 2015, abandoning coverage altogether costs an employer who is subject to the PPACA rules $2,000 per year per full-time employee. Most employees can’t purchase coverage on an exchange on a tax-free (meaning deductible) basis. Thus, for any given employer, solving the problem of dropping coverage without disadvantaging the employees is, at a minimum, complex algebra.

Math is difficult enough. But, when you add to that the unknown of the non-discrimination rules and the applicability of the Cadillac tax, it is not surprising that some employers are considering abandoning the traditional employer-plan model in favor of the exchanges.

Unionized Employers Take Note of the Recent Supreme Court Ruling Under the FLSA

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On January 27, 2014, a unanimous U.S. Supreme Court interpreted the meaning of the term “changing clothes” found in the Fair Labor Standards Act (FLSA or Act), specifically at 29 U.S.C. § 203(o). This case is significant for unionized employers in a wide range of industries, including in food processing and manufacturing, where workers are required to change in and out of various types of clothing at the beginning and end of their work days. In Sandifer v. United States Steel Corporation, the plaintiffs (and “petitioners” to the Supreme Court) were a group of current or former employees of the defendant’s steelmaking facilities who filed a putative collective action seeking back pay for time spent “donning and doffing” various pieces of clothing and protective gear. The plaintiffs asserted that U.S. Steel requires the workers to wear these items because of hazards regularly encountered in steel plants. The plaintiffs specifically set forth twelve types of protective gear that they are required to wear, such as flame retardant jackets and pants, hoods, hardhats, snoods, work gloves, leggings, steel toed boots, wristlets, safety glasses, earplugs and a respirator. The time spent “donning and doffing” these items would otherwise be compensable under the FLSA. The issue in the case is the validity of a provision in the collective bargaining agreement between the union representing the employees and U.S. Steel. The validity specifically turns upon the applicability of 29 U.S.C. § 203(o), which provides that in a unionized setting the time spent “changing clothes” may be excluded from compensable time through negotiation by parties to a collective bargaining agreement.

The District Court granted summary judgment to U.S. Steel on this issue holding that the donning and doffing of the required protective gear constituted “changing clothes” within the meaning of § 203(o). The District Court went further and held that the time spent putting on and taking off certain items that do not constitute “clothes” under the Act was “de minimis” and therefore non-compensable. This decision was upheld by the Seventh Circuit Court of Appeals. The U.S. Supreme Court granted certiorari regarding this specific issue.

The Supreme Court closely examined the meaning of the word “clothes” in the Act and relied upon a number of sources, including dictionaries from the time period that § 203(o) was enacted in 1949, and concluded that the word should be interpreted taking its “ordinary, contemporary, common
The Court determined that contemporaneous dictionaries defined “clothes” as “items that are both designed and used to cover the body and are commonly regarded as articles of dress.” The plaintiffs argued that the word “clothes” would necessarily exclude items designed and used to protect against workplace hazards, thereby trying to create a distinction between “protection” and “decency and/or comfort.” The Supreme Court rejected this definition and explained that “protection” and “comfort” are terms that “are not incompatible, and are often synonymous.” The varying interpretations of the word “clothes” among several of the Circuit Courts had prompted the Supreme Court to grant certiorari.

The Supreme Court rejected the definition proposed by both the employees and the employer holding that the employees’ definition was much too narrow and, conversely, the employer’s definition was a “capacious construction” as it proposed that the “entire outfit that one puts on to be ready for work” is encompassed in “clothes.” Although Justice Scalia, who wrote the Opinion for the Court, conceded that the employer’s interpretation would be “more readily administrable,” it nevertheless was even further afield from the textual foundation of the FLSA than plaintiffs’ offering. Accordingly, the definition set forth by the Court “leaves room for distinguishing between clothes and wearable items that are not clothes, such as some equipment and devices,” but also “does not exclude all objects that could conceivably be characterized as equipment.”

Having settled upon the meaning of “clothes,” the Court then considered the meaning of the word “changing.” Plaintiffs argued that items of protective gear that were put on “over” their street clothes were not within the meaning of § 203(o). The Court disagreed with the plaintiffs’ position that changing clothes only meant “substitution,” finding that the additional meaning of “alter” was also a common meaning at the time of § 203(o)’s enactment. Therefore, the Court determined that “changing clothes” includes not only substituting clothing but also time spent in “altering dress.” Returning to the facts of the case and the plaintiffs’ designation of the twelve particular items, the Court found that nine of the items would fit into its definition of “clothes” and that, by contrast, the three remaining items – safety glasses, earplugs and respirator – would not fall within the Court’s definition because “they are not commonly regarded as articles of dress.”

The Court then turned to the issue of whether the time putting on and off these items outside of the definition of “clothes” should be deducted from the non-compensable time. The courts below invoked the doctrine of de minimis non curat lex (the law does not take account of trifles) on this issue and found that they could simply declare the few minutes actually spent donning and doffing these items as non-compensable. The Supreme Court rejected the use of the de minimis doctrine since it considered that the statute itself to be “all about trifles – the relatively insignificant periods of time in which employees wash up and put on various items of clothing needed for their job.” Underlying the Court’s reasoning was that this interpretation of § 203(o) would “convert federal judges into time-study professionals” and instead framed the question for the courts as to “whether the period at issue can, on the whole, be fairly characterized as time spent in changing clothes or washing.” Accordingly, the Court said that if the “vast majority” of time can be allotted to the changing of “clothes,” as defined by the Court, then “the entire period qualifies, and the time spent putting on and off other items need not be subtracted.” Conversely, if the vast majority of time is spent donning and doffing equipment or other items that do not fall within the Court’s definition, then the entire period expended by each employee would not be covered by § 203(o) and would therefore be compensable.

Will the Sandifer case, although a favorable decision for unionized employers, be the end all in the application of § 203(o)? Certainly an employer who has negotiated that § 203(o) precludes payment for donning and doffing will be buoyed by this particular case, as it may make plaintiffs’ counsel think twice before bringing this type of class action under the FLSA. In reality, federal courts faced with these cases will still have to make a determination as to whether a number of items used by employees in various industries are within the definition of “clothes” or not. What if “clothes” or other items falling outside the Supreme Court’s definition do not constitute a “vast majority” one way or the other? Will the trial courts be forced to consider expert reports to make this determination?

In conclusion, although this decision can be considered a “win” for unionized employers there are still questions open to interpretation in future cases concerning § 203(o) of the FLSA.