No. 17-1084

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RHONDA NESBITT,
individually and on behalf of all others similarly situated,

Plaintiff-Appellant,

v.

FCNH, INC.,
VIRGINIA MASSAGE THERAPY, INC.,
MID-ATLANTIC MASSAGE THERAPY, INC.,
STEINER EDUCATION GROUP, INC.,
STEINER LEISURE LTD., and
SEG CORT LLC, d/b/a the "Steiner Education Group,"

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

BRIEF OF *AMICI CURIAE* THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION AND ECONOMICS/BUSINESS PROFESSORS (WILLIAM H. KAEMPFER, NADELLE GROSSMAN, PAULA COLE, AND MIRIAM CHERRY) IN SUPPORT OF PLAINTIFF-APPELLANT RHONDA NESBITT AND REVERSAL

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, *amicus curiae* The National Employment Lawyers Association (NELA) makes the following disclosure: (1) NELA is a private, non-profit organization under Internal Revenue Code § 501(c)(6); (2) NELA has no parent corporation; and (3) no publicly held corporation or other publicly-held entity owns ten percent (10%) or more of NELA.[1]

IDENTITY AND INTEREST OF AMICI CURIAE[2]

1. The National Employment Lawyers Association (**NELA**) is the largest professional membership organization in the country comprising lawyers who represent workers in labor, employment and civil rights disputes. The over 4000 members of NELA and its affiliates litigate daily in every circuit, affording NELA a unique perspective on how principles announced by the courts in employment cases actually play out on the ground. NELA strives to protect the rights of its members' clients, and has participated previously as *amicus curiae* in this Court, including in *Punt v. Kelly Servs.*, No. 16-1026 (2016) and *Salazar, et al. v. Butterball, LLC*, No. 10-1154 (2010).

As detailed below, William H. Kaempfer, Nadelle Grossman, Paula Cole, and

[1] All other *amici* are natural persons requiring no corporate disclosure statement.

[2] Pursuant to Fed. R. App. P. 29(c)(5), *amici curiae* and the undersigned counsel aver that no party and no party's counsel either authored this brief (in whole or in part) or contributed money intended to fund preparing or submitting the brief, and no person other than *amici curiae*, its members, or its counsel contributed money intended to support preparing or submitting the brief.

Miriam Cherry have been professors teaching economics or business law; they also have published and researched on topics relevant to this case. Aside from offering their expertise herein, their higher education involvement, including on curriculum and policy, gives them not only useful perspective, but also professional interest and concern, about the prevalence of schools requiring unpaid student work.[3]

2. **William H. Kaempfer** is Senior Vice Provost, Associate Vice Chancellor for Budget and Planning, and Professor of Economics at the University of Colorado Boulder. He is responsible for a variety of initiatives across the campus: academic prioritization and new degree approval; managing annual budget processes for all schools and colleges; developing new revenue sources; and strategic planning. He was responsible for the campus reaccreditation by the North Central Association in 2000. Previously, he was Chair of the Department of Economics. He received his PhD in economics from Duke University in 1979, has taught a range of economics courses, and has researched and published in the following areas, among others: the effect of cost increases on demand in particular markets; salary arbitration; federal regulatory legislation; and international trade and the effect of economic sanctions.

3. **Nadelle Grossman** is an Associate Professor at Marquette University Law School. She teaches Business Associations, Business Planning, Corporate Governance, and Contract Drafting. She has published and spoken on her research on

[3] Each professor's institutional affiliation is listed for identification purposes only.

corporate governance (including business strategic planning and long- versus short-term thinking) and alternative business organization forms. She has taught continuing legal education on legal compliance for businesses, business transaction ethics, and business concepts for lawyers. Her academic institutional and organizational work includes serving as Chair of the law school Academic Programs Committee, a past member of the law school Curriculum Committee and Admissions Committee, and a Boards of Directors member for the Wisconsin State Bar Business Law Section, the Milwaukee Bar Association, and the nonprofit organization Centro Legal. Previously, as a corporate attorney, she advised on business transactions and other business matters. She received her J.D., *magna cum laude*, from Tulane Law School and her B.S. from the University of California at Berkeley.

4. **Paula Cole** is a Lecturer in the Economics Department at the University of Denver; she previously taught in the Economics Department at Colorado State University (CSU) and elsewhere. She has taught Labor Economics, Microeconomics, Macroeconomics, Public Finance, Economics and Gender, and other courses. Research she has published and/or presented has included the following: low-wage work in America; worker child-care benefits; occupational changes after the Great Recession; gender disparities in job opportunities; and sustainability in consumer markets. She received her Ph.D. in Economics from CSU in 2011; she previously received her M.A. in Economics and Graduate Certificate in Women's Studies from CSU and her B.A. in Economics, with honors, from Central College.

5. Miriam Cherry is a Professor at Saint Louis University Law School, where she teaches Business Associations, Contracts, Securities Regulation, and Virtual Work, and serves as Co-Director of the William C. Wefel Center for Employment Law. She researches and publishes on a range of business and worklaw topics, including the "gig economy" where businesses assign or offer tasks outside traditional employment relationships, markets for corporate social responsibility, and contract law. She has served on numerous university and law school committees on higher education pedagogy and compensation, including the University Task Force on Academic Standards, Teaching Methods Committee, Student Scholarships Committee, Faculty Development Committee, and Faculty Senate Compensation & Benefits Committee. Previously, she practiced corporate law, including mergers and acquisitions, securities compliance filings, venture capital, and private debt financing; she also litigated and investigated accounting fraud and securities cases. She received her J.D. from Harvard Law School and her B.A. from Dartmouth College.

SUMMARY OF ARGUMENT

The Department of Labor ("DOL") six-factor test that the District Court applied derives from cases about *businesses* not paying newly hired trainees or interns. The DOL test does not fit a claim that *school compelled its own students* to provide unpaid labor *to the school* – as other courts have noted. (Part I(A).) For such claims, courts distinguish true educational training from exploitatively conditioning diplomas on free labor by assessing the "primary beneficiary" of the work based on the "economic realities" of the "totality

of the circumstances." (Part I(B).) Yet choosing a test matters less than undertaking economically valid understandings of labor markets with unpaid work, in three key ways.

(A) **Displacement**: Inquiry into whether unpaid work "displaces" paid work should look to the *relevant labor market*, which is rarely just *one business*. (Subpart II(A) below.)

(B) **Business Net Benefits**: Inquiry into business benefit minus cost should compare (a) *marginal revenues* students generate, which are zero in many precedents, but substantial for the massages Defendants sold, and (b) *marginal costs* students impose, which are substantial in many precedents, but low here because the massages were *unsupervised*, and Defendants' *fixed costs* (*e.g.*, real estate) are not relevant marginal costs. (Subpart II(B).)

(C) **Educational Benefits**: While practical training can be valuable, courts should guard against abuse by schools conditioning diplomas on free labor by labeling it "training" – as in Defendants' for-profit operation that offered no supervision for student work providing substantial revenue. (Subpart II(C).)

ARGUMENT

I. FLSA Coverage of Students' Work for Their Schools Requires Analysis of "Economic Realities," Based on the "Totality of the Circumstances," to Determine the "Primary Beneficiary" – Entailing Close Scrutiny of Educational Benefit to Plaintiff and Business Benefit to Defendant.

A. The DOL "Internship" Test Derived from "Trainee" Cases, and is Inapt for Claims That Schools Required Inappropriate Unpaid Work from Their Own Students

The DOL six-part test is designed for "Internship Programs," covering students' claims against not their own schools, but the businesses outside their schools where they do unpaid work. U.S. Dep't of Labor, Emp't Standards Admin., Wage and Hour

Div., *Fact Sheet #71: Internship Programs Under the Fair Labor Standards Act* (April 2010).[4] "The six [DOL] criteria ... derived almost directly from *Portland Terminal*." *Reich v. Parker Fire Prot. Dist.*, 992 F.2d 1023, 1025 (10th Cir. 1993) (citing *Walling v. Portland Terminal Co.,* 330 U.S. 148 (1947)). *Parker Fire Protection District* and *Portland Terminal* addressed employers requiring their own prospective employees to start as unpaid trainees – a context even more different from schools employing their own students (as here) than businesses employing interns (as in the DOL test). The *Portland Terminal* employer offering training was the same one employing those successfully trained:

> [The] railroad has given a course of practical training to prospective yard brakemen[,] … a necessary requisite to entrusting them with the important work [of] brakemen .... An applicant ... is never accepted until ... [this] training ... [of] seven or eight days.… [T]rainees complet[ing] ... instruction satisfactorily … are included in a list from which the company can draw when their services are needed.

330 U.S. at 149-50. Similarly in *Parker Fire Protection District*, the employer required testing and training of its new firefighter employees:

> Prospective firefighters *seeking employment with defendant* had to submit applications[,] ... tak[e] a written test[,] ... [be] tested physically[,] ... [and have] oral interviews.... [A] limited number of interviewees were selected to ... the firefighting academy.... [E]mployment ... was conditioned upon satisfactory completion of the ten week long training ... Because *only the number expected to be hired were sent to the academy*, those who successfully completed the course had *every reasonable expectation of being hired*....

992 F.2d at 1025 (emphases added).

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[4] *Available at* https://www.dol.gov/whd/regs/compliance/whdfs71.htm (dated Apr. 2010) (last visited Oct. 3, 2017).

Parker Fire Protection District and other precedent carefully adopted the DOL test for *only* the new hire contexts in which *Portland Terminal* (for trainees), then the DOL (for interns), adopted those factors. 992 F.2d at 1025 ("The *only issues* on appeal are *the proper test for distinguishing between trainees and employees under FLSA*, how strictly we should apply [the DOL] six factor[s]," and the propriety of summary judgment) (emphases added). *Accord Glatt v. Fox Searchlight Pictures, Inc.*, 811 F.3d 528, 536 (2d Cir. 2015) ("Like the parties and amici [including DOL], we limit our discussion to internships at for-profit employers."). As the Eleventh Circuit noted in rejecting the DOL test for student challenges to school-mandated unpaid work, DOL views on 1940s industrial training cases are unhelpful guidance for twenty-first-century school programs:

> [W]ith all due respect to the Department of Labor, it has no more expertise in construing a Supreme Court case than … the Judiciary. *Portland Terminal* is nearly seven decades old and ... a very different factual situation involving a seven-or-eight-day, railroad ... training program ... by a specific company for ... a labor pool for its[elf].... [W]e do not believe ... strict comparison to ... *Portland Terminal* allows us to identify the primary beneficiary of a modern-day internship for academic credit and professional certification.

Schumann v. Collier Anesthesia, P.A., 803 F.3d 1199, 1203 (11th Cir. 2015).

The District Court thus took a lonely stance in declaring the DOL test applicable; as one recent case on students' work for their own schools noted, "*no circuit* presented with the question ... has outright adopted the DOL factors." *Hollins v. Regency Corp.*, 144 F. Supp. 3d 990, 996 (N.D. Ill. 2015) (emphasis added), *aff'd*, 867 F.3d 830, 835 (7th Cir. 2017) (approving of *Schumann* and *Glatt* rejecting "Department of Labor ... six-factor

'test' that (it thinks) ... distinguish[es] between an employee and an unpaid trainee"; calling district court "rightly skeptical about the utility of this plethora of 'factors'").

Review of various DOL factors confirms that the above cases were correct in deeming the test inapt for analyzing student claims against their own schools.

- Factor 1 is whether "[t]he 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"; in claims against schools, this (a) nonsensically asks whether *a school* is "similar to … *an educational environment*," and (b) incorrectly assumes "the facilities of *the employer*" are *not* those of *the school*.

- Factor 5 is whether "students are not necessarily entitled to a job at the completion of the training"; for schools using their own students' labor, asking whether students are "entitled to a job" is not a logical question.

- Factor 6, whether the parties "understand" the students "are not entitled to wages," is off-point for the key question: whether a school's mandate of unpaid work abuses its control over students.[5]

A list with half inapt factors is not just unhelpful, but a distraction from the core question: is the disputed work more like (a) practical training that primarily benefits the student or (b) ordinary labor that primarily benefits the employer.

B. The Proper Test for Schools Requiring Unpaid Student Work is a Totality-of-Circumstances "Economic Realities" Inquiry into the "Primary Beneficiary" – Entailing Close Scrutiny of Educational Benefit to Plaintiff and Business Benefit to Defendant.

Unlike in new-hire trainee cases, the Tenth Circuit analyzes whether "student[s]

[5] U.S. Dep't of Labor, Emp't Standards Admin., Wage and Hour Div., *Fact Sheet #71: Internship Programs Under the Fair Labor Standards Act* (April 2010), *available at* https://www.dol.gov/whd/regs/compliance/whdfs71.htm.

working at the[ir] [c]ollege would be within the scope of the FLSA" *not* with the DOL test, but with "the '*economic reality*' test announced in *Rutherford Food Corp. v. McComb*, 331 U.S. 722 ... (1947), [which] ... declared that the determination of employment under the FLSA ought *not depend on isolated factors* but upon the '*circumstances of the whole activity*.' 331 U.S. [722,] 730 [1947]." *Marshall v. Regis Educ. Corp.*, 666 F.2d 1324, 1327-28 (10th Cir. 1981) (emphases added). "This test is controlling in the case at bar," *Marshall* held for FLSA claims by students working as resident assistants in school dormitories. *Id.* at 1325. Plaintiff's claim here is far more similar to the *Marshall* claim than to the *Parker Fire Protection District* claim that aspirants for firefighter jobs had to start unpaid.

The *Marshall* students actually were compensated (just not as FLSA wage and recordkeeping rules require)[6] and lost their claim, but the Tenth Circuit expressly instructed that students working for a school *can* qualify as FLSA employees, especially if (as when students provide labor the school charges for, as here but unlike in *Marshall*) it is "more like sales" than "other campus programs":

> Our holding that RA's are not employees does not require the conclusion that no student working at the College would be.... No such inference should be drawn.... The query is whether [student workers] ... are more like sales clerks or more like students in other campus programs receiving financial aid.

Id. at 1327-28. Other rulings for defendants caution similarly: "certainly, in some

[6] "In exchange for the performance of the[ir] duties, RA's received a reduced rate on their rooms, the use of a free telephone, and a $1,000 tuition credit." *Id.* at 1325.

circumstances student trainees may truly be employees," *Randolph v. Budget Rent-A-Car*, 97 F.3d 319, 326 (9th Cir. 1996), because "[t]hese cases normally turn on the facts of the particular relationship and program, and so we should not be understood as making a one-size-fits-all decision about programs that include practical training," *Hollins v. Regency Corp.*, 867 F.3d 830, 837 (7th Cir. 2017).

Thus, the mere "labeling" of work as "vocational" does not insulate against the economic realities inquiry:

> [C]oncluding that students are not employees simply because they are students at a vocational school is precisely the type of labeling courts must resist. Such an approach bypasses any real consideration of the economic realities ... and is antithetical to settled jurisprudence calling for consideration of the totality of the circumstances.... Indeed, courts have in the past determined that students in vocational training programs were nevertheless employees under the FLSA.

Solis v. Laurelbrook Sanitarium & Sch., Inc., 642 F.3d 518, 524 (6th Cir. 2011) (citing *Reich v. Shiloh True Light Church of Christ*, 895 F. Supp. 799, 818-19 (W.D.N.C. 1995), *aff'd*, 85 F.3d 616 (Table), 1996 WL 228802 (4th Cir. 1996)) (other citations omitted).

Illustrating how the economic realities can require FLSA wages for those in a "Vocational Training Program," the plaintiffs won in *Reich v. Shiloh True Light Church of Christ* because "substantial evidence in the record" proved "the primary beneficiary" of the program was the defendant, which "benefit[ted] greatly from the work" because it "enjoyed the benefit of experienced labor without incurring any cost in wages" – and thus, in economic reality, "the program has been ... a commercial enterprise competing with other contractors" in the market. 85 F.3d 616 (Table), 1996 WL 228802, at *3-*4.

Consistent with *Marshall*'s totality-of-circumstances economic realities inquiry, and the above caselaw stressing that calling work "vocational" does not preclude that inquiry: recent student claims have "concentrated on evaluating the 'primary beneficiary' of the training or school program," in inquiries aimed at "reveal[ing] the 'economic reality' of the situation ... [by] consider[ing] the entirety of the circumstances." *Schumann*, 803 F.3d at 1203. *Schumann* stressed the need to scrutinize the economic realities closely because "we recognize the potential for some employers to maximize their benefits at the unfair expense and abuse of student[s]," *id.* at 1211, and "we can envision a scenario where a portion of the student's efforts constitute a bona fide internship that primarily benefits the student, but the employer also takes unfair advantage," *id.* at 1215. For student interns, *Glatt* similarly rejected the DOL test in favor of a "primary beneficiary" test, for reasons similarly applicable to student labor for their own schools – that while "properly designed" programs assigning work-like tasks "can greatly benefit" students, they "can also exploit" by "using their free labor without providing ... appreciable benefit in education or experience," and consequently, "there are circumstances in which someone who is labeled an unpaid intern is actually an employee entitled to compensation under the FLSA":

> [T]he proper question is ... [who] is the *primary beneficiary of the relationship*. The primary beneficiary test has three salient features. First, it focuses on *what the intern receives* ... for his work. Second, it ... *examine[s] the economic reality* ... between the intern and the employer. Third, it acknowledges that ... the intern enters ... with the *expectation of receiving educational or vocational benefits* that are not necessarily expected with all forms of employment (though such benefits may be a product of experience on the job).

811 F.3d at 535-36 (emphases added).

Moreover, while *Parker Fire Protection District* applied the DOL test in the new-hire trainee context, it still rejected "strict" application of enumerated factors in favor of a test closer to the holistic analysis of *Marshall*, *Schumann*, and *Glatt* – "an assessment of the totality of the circumstances … [and] 'economic realities'":

> the six factors are meant as an assessment of the totality of the circumstances.... [N]o one ... factor[] in isolation is dispositive; rather, the test is based upon a totality of the circumstances.… [W]e must look to the economic realities of the relationship.… [D]eterminations of employee status ... are not subject to rigid tests but rather to ... a number of criteria in their totality.

992 F.2d at 1027 (citations and internal quotation marks omitted).

Thus, the benefits to each party are key to not only the primary beneficiary test, but also the DOL test as applied in *Parker Fire Protection District*, which analyzed "whether the training was for the benefit of the trainees, and whether defendant derived an immediate advantage," then added that (a) "consider[ing] these two factors together, weighing the relative benefits to each party, ... is both permissible and helpful," and (b) "educational validity of the training program may enter into the calculus of relative benefits." *Id.* at 1028 (citations omitted). While this brief advocates a totality-of-circumstances "economic reality" analysis of the "primary beneficiary" of work schools require, the below analysis of the benefits to each party applies whichever test is used.

II. To Assess the Primary Beneficiary Based on the Economic Realities, Close Analysis is Required of (A) Displacing Paid Work with Unpaid Work, (B) Business Costs versus Benefits, and (C) Educational Benefits.

A. "Displacement" of Paid Work by Unpaid Work Addresses Not Just One Defendant, But the Labor Market.

1. Legislative History and Early Caselaw: "Displacement" Means "Spreading and Perpetuating Such Substandard Labor Conditions" Across "the Labor Market."

Whether unpaid work "displaces" paid workers is part of both the primary beneficiary test and the DOL six-factor test. *Parker Fire Protection Dist.*, 992 F.2d at 1026 (in DOL test, whether "trainees … displace regular employees"); *Glatt*, 811 F.3d at 536 (in primary beneficiary test, whether an "intern's work complements, rather than displaces, the work of paid employees"). The District Court appeared to analyze whether plaintiffs' work displaced paid work *at only the defendant*, not *in the relevant labor market* – too narrow an inquiry in two ways.

First, analyzing paid work displacement at just one employer lets defendants using *only* unpaid labor fare better than those paying *some* employees. A massage business relying on a *mix* of paid and unpaid labor seems less likely an FLSA violation than one relying *entirely on unpaid* labor – yet the latter, because it has no paid workers, would fare better in the "displacement" analysis. Thus, if courts analyze paid work displacement at only the particular defendant, they will reach (as in the decision below) a curious outcome: the more a defendant's business model relies on unpaid work, the less likely it violates the FLSA, and (conversely) the more a business does pay workers,

the more likely it commits an FLSA violation by using limited unpaid labor – essentially punishing greater compliance and rewarding total noncompliance.

Second, the FLSA targets low wages not just to protect workers *at one employer*, but to inhibit "spread" of low wages *at "competitors" in the "the labor market*," as the following explanations from three Supreme Court cases illustrate.

> [FLSA] set up a comprehensive legislative scheme for preventing ... conditions detrimental to the maintenance of the minimum standards … necessary for health and general well-being; and to prevent ... *spreading and perpetuating such substandard labor conditions among the workers of the several states*.[7]

> FLSA was enacted to prevent ... substandard wages ... to prevent employers from producing goods at such low cost that they could undersell competitors who paid what Congress deemed to be a decent wage. The concern ... was the ongoing business with its continuing *impact on both the labor market and the commercial market*.[8]

> If an exception ... were carved out for employees willing to testify that they performed work "voluntarily," ... [s]uch exceptions ... would *affect many more people than those workers directly at issue in this case* and would be likely to *exert a general downward pressure on wages in competing businesses*.... "[I]f the prohibition cannot be made, *the floor for the entire industry falls* and ... destroys the right of the much larger number ... to receive the minimum wage."[9]

Given these consistent declarations about the market-wide, not employer-specific, focus of the FLSA, the question is not whether unpaid work displaces paid work at just the one business being sued (as the District Court held). Rather, the question is

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[7] *United States v. Darby*, 312 U.S. 100, 109-10 (1941) (emphasis added).

[8] *Citicorp Indus. Credit, Inc. v. Brock*, 483 U.S. 27, 40 n.1 (1987) (emphasis added) (discussing legislative purpose underlying enactment of FLSA)

[9] *Tony & Susan Alamo Found. v. Sec'y of Labor*, 471 U.S. 290, 302 (1985) (citation omitted).

whether unpaid work displaces paid work in "the labor market" (*Citicorp Indus. Credit, supra*) by "spreading ... substandard labor conditions" (*Darby, supra*) and thereby "exert[ing] a general downward pressure on wages in competing businesses" (*Tony & Susan Alamo Found., supra*). As detailed below, proper economic analysis confirms that the labor market at issue here is the sort in which it is more, not less, plausible that one business not paying minimum wages may "affect many more people than those workers directly at issue in this case" by making "the floor for the entire industry fall[.]" *Id.*

2. Labor Economics: Minimum Wages Are Undercut by "Uncovered" Sectors of Labor Markets – Especially Those with Certain Features of the Massage Labor Market

Because one business's lower labor costs let it undercut competitors, the Supreme Court noted that it is "to prevent employers from producing goods at such low cost that they could undersell competitors" that the FLSA targets "impact on *both* the *labor* market and the *commercial* market." *Citicorp Indus. Credit, Inc.*, 483 U.S. at 40 n.1 (emphases added). Basic labor economics supports this point.

A "partially covering minimum wage law" – one that leaves certain work (like free revenue-generating labor a for-profit school requires) lawful in an "uncovered sector" of the labor market – "might serve to shift employment out of the covered [and in]to the uncovered sector," as one labor economics text explains as a matter of theory,[10]

[10] Ronald Ehrenberg & Robert Smith, *Modern Labor Economics*, at 115 (Pearson Educ., Inc., 8th ed. 2003).

and as various empirical studies confirm:

- a study of one market found that even for similar work, "[b]lue- and white-collar labor are substitutes," and as a business's cost structure changes, the "share of more-skilled, white-collar workers compared with that of less-skilled, blue-collar workers" can change due to substitution between less- and more-skilled labor;[11]

- a study of one market where (as here) "low-productivity (mostly young)" workers are "uncovered" by the minimum wage until they "gain enough experience" found that while such policy made it easier to gain experience, it was "detrimental for the less skilled workers" overall, by diverting labor into the uncovered sector.[12]

To be sure, uncovered (*i.e.* non-minimum-paid) work *might not* displace covered (*i.e.*, minimum-paid) work, depending on two features of the markets at issue: displacement is less likely to the extent that either:

(A) higher-skill covered and lower-uncovered workers are not readily substitutable for each other – in economic terms, if employers' cross-elasticity of labor demand is low; or

(B) the consumer market for what the workers provide lacks competition – in economic terms, if the price elasticity of consumer demand is low.[13]

Massages offered to the public for pay are the type of service with multiple competitors and in which experienced and new workers are substitutable. Admittedly,

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[11] James D. Adams, *The Structure of Firm R&D, the Factor Intensity of Production, and Skill Bias*, The Review of Economics and Statistics, Vol. 81, No. 3, pp. 499-510, at 499, 505 (Aug., 1999) (noting findings from data on jobs in the chemicals industry).

[12] Mauricio Larraín & Joaquín Poblete, *Age-Differentiated Minimum Wages in Developing Countries*, Journal of Development Economics, Vol. 84, pp. 777–97, at 779-80, 792 (2007).

[13] Ehrenberg & Smith, *Modern Labor Economics*, *supra*, at 102-09.

experienced and new masseuses could have different skill levels, productivity, or ability to provide higher-priced services. That means only that experienced and new masseuses are not *perfect* substitutes – but they need not be; there must merely be just enough employer cross-elasticity of labor demand for unpaid new masseuses to drive down the wages of paid experienced masseuses and/or ultimately decrease their available jobs.

- Unionized garment workers at established factories, and cheaper labor usable only by moving a factory to a new lower-wage locale, are a classic example of sufficient cross-elasticity of demand for low-wage labor to displace more experienced high-wage labor.[14]

- Teen and adult workers in the same field are another such example, even though businesses may have to "alter their production techniques … [when] teenagers are more heavily used."[15]

- In contrast, airline pilots are a common example of a labor market in which "substitution possibilities are limited[, because] there is little room to substitute unskilled labor for skilled labor."[16]

Unpaid new masseuses and paid experienced masseuses are more similar to (a) distant new garment workers and experienced local garment workers, or (b) new teen labor and experienced adult labor, than to (c) airline pilots not readily replaceable with inexperienced labor. Thus, the labor market for masseuses seems one in which it is more, nor less, likely that a free-labor competitor would undercut an FLSA-compliant one. The District Court not only reached the opposite conclusion, but did not even

[14] Ehrenberg & Smith, *Modern Labor Economics*, *supra*, at 104-05.

[15] *Id.* at 108.

[16] *Id.* at 105.

analyze what labor economics and the Supreme Court alike deem the correct unit of "displacement" analysis: the labor market, not just the one employer sued.

B. Business Net Benefit: The Inquiry Cannot Balance Benefits of Student Labor with *Fixed* Costs Not Increased by that Labor; the Proper Balance is the *Marginal* Costs and Benefits of Student Labor.

Preliminarily, the question is not whether, in a court's judgment, the benefits of unpaid labor make it worth the cost to the business. If a business benefits from labor, then that labor cost is just another factor in its production of services or goods. It is backwards to say a cost-benefit analysis could show there is not sufficient profit to warrant paying for certain work; any work that helps produce revenue comes at a cost for the business to pay *before* calculating what funds, if any, it retains for other needs. Thus, the cost-benefit question is limited: does student labor generate such additional costs, disproportional to its benefits, that the business is not using student labor as a factor of production, but instead is helping students learn as a non-profit-generating endeavor? Accordingly, the cost question is one of *marginal costs*: what costs does the student labor itself generate, on top of whatever fixed costs the business already incurs?

The decision below credited the defense as to the cost of student labor that requires providing both supervision and space for massages. But whether adding a certain kind of labor (or other investment) is beneficial, on the net, depends on not the business's *total* costs and revenues, but the *marginal* costs and revenues that particular labor (or investment) generates – because it is basic microeconomics that an activity is worthwhile if its "marginal cost" (*i.e.*, its incremental additional cost) is "below [the]

marginal revenue" it generates (*i.e.*, the incremental additional revenue generated by incurring that additional cost).[17] A business may lose money in the short run due to high fixed costs such as real estate, yet still would find it worthwhile to hire more labor, as long as the marginal cost of the additional labor is lower than the marginal revenue it generates. That is why it is erroneous to analyze whether student labor is beneficial by comparing its revenue to a list of costs that includes fixed real estate costs. Including fixed real estate costs can make sense only to the extent that providing student massages imposed extra real estate costs (thus increasing marginal costs) – but here, the analysis credited below appeared to find student labor lacked a net benefit only by adding a significant fraction of the defendant's entire fixed real estate costs into the analysis. Thus, the analysis below based on a cost analysis that was, in economic terms, inflated and not a valid way to analyze the net benefit of student labor.

The actual marginal cost of deploying student labor is twofold. First, each student-provided massage requires materials such as sheets, cleaning supplies, etc.; analysis of such record facts is beyond the scope of this *amicus* brief, but based on the record and common sense, such materials costs seem slight compared to the main cost of a massage – the skilled labor of the masseuse, which is zero here.

The second marginal cost of student labor is supervision cost. Material

[17] Robert Pindyck & Daniel Rubinfeld, *Microeconomics*, at 258-59 (Prentice Hall Int'l, 5th ed. 2001).

supervision costs were key facts in many cases in which student claims lost. *See, e.g.*, *Hollins v. Regency Corp.*, 867 F.3d 830, 831 (7th Cir. 2017) (cosmetology school did not require students to perform unpaid services alone or unsupervised; it provided "both classroom instruction and practical instruction in a ... [s]alon"); *Schumann v. Collier Anesthesia, P.A.*, 803 F.3d 1199, 1204 (11th Cir. 2015) ("[T]he school requires daily evaluations ... [by] the CRNA [nurse] or anesthesiologist who supervises the student. Every day, the supervising CRNA or anesthesiologist must grade the student in several areas."); *Solis v. Laurelbrook Sanitarium & Sch., Inc.*, 642 F.3d 518, 530–31 (6th Cir. 2011) ("[I]instructors must spend extra time supervising ... at the expense of performing productive work ... [and] were it not for ... supervisory responsibilities, instructors would ... complete more productive tasks in less time").

The record here shows little or no supervision cost: unlike in the above three cases, the students worked in massage rooms alone, with no contemporaneous instruction, grading, or reporting on their work quality.[18] The marginal cost of supervision thus was at or near zero. The District Court stressed that Defendants did no less supervision than accreditation requires, but whether some accrediting agency is strict or lax does not determine the merits of an FLSA claim. The pertinent question is whether *student labor* entailed *materially greater supervision costs* than *other labor* – because if so, that would undercut a finding that the students acted as employees who should be

[18] Or so plaintiff's evidence shows, which should suffice on summary judgment.

paid. Here, the students received no greater supervision than any business provides for junior employees who must be shown the ropes briefly before performing unsupervised work – which is to say the cost of supervising the students was not higher than the cost of supervising any new masseuse working for any for-profit massage business.

While the marginal costs of deploying student labor were low, the marginal benefit – revenue per unit of labor – was high: Defendants' for-profit operation charged for the massages that they required the students to provide. In none of the student-labor cases finding for school defendants were students assigned simply to sell services or goods to customers who paid the school directly; certain such decisions expressly noted the materiality of the fact that the students were *not* doing mere selling of services for which the school charged. *E.g.*, *Marshall v. Regis Educ. Corp.*, 666 F.2d 1324, 1327-28 (10th Cir. 1981) (noting, "[t]he query is whether the RA's at Regis are *more like sales clerks* or more like students in other campus programs receiving financial aid," and finding the latter) (emphasis added); *Hollins v. Regency Corp.*, 867 F.3d 830, 831 (7th Cir. 2017) (cosmetology students performed not just service-selling, but the full range of tasks they needed to learn, and with supervision, because such tasks are both "part of the job of the cosmetologist" and "tested subject[s] on the ... cosmetology licensing exam").

C. Educational Benefits: The Inquiry Must Consider the Decreasing Marginal Benefit of Unsupervised, Unobserved Work, to Recognize the Possibility of Schools (Especially For-Profit Ones) Exploitatively Conditioning Diplomas on Providing Free Labor

Though practical training *in general* has its uses, a court assessing a *particular* claim

should not do what the decision below appeared to do: merely assume material educational benefits, despite contrary evidence, while ignoring the diminishing marginal benefits of extensive unsupervised work.

Given the evidence the unpaid work was not supervised, nor even observed, the finding of educational benefit appears more of an *assumption* than a review of the evidence in this particular case. Unsupervised and unobserved work is more like *independent practice* than actual *training*. Independent practice can be useful, but makes little sense unless those practicing have already learned the task they are to practice – so Defendants' deployment of masseuses to practice unsupervised is, implicitly, a concession that they already learned what they need about massaging.

Because independent practice does not provide new information like supervised clinical work does, any educational benefit surely diminishes as students perform more and more massages, under the basic economic "law of diminishing marginal returns": that even worthwhile investments generate less and less value as there are more and more of them, so "a point will eventually be reached at which the resulting additions to output" – with "output" here being educational benefit – "decrease."[19]

The limited, decreasing value of independent practice calls into heavy doubt the educational benefit of a school mandating, and earning sales revenue from, never-observed unpaid services. Reversing a grant of summary judgment on students' FLSA

[19] Pindyck & Rubinfeld, *Microeconomics*, *supra*, at 185.

claims against their school and school officials, the Eleventh Circuit in *Schumann v. Collier Anesthesia* issued an on-point caution: that courts should not accept the label "student" blindly, and instead should scrutinize whether requiring free student labor, from which school defendants benefit monetarily, goes too far:

> [W]e recognize the potential for some employers to maximize their benefits at the unfair expense and abuse of student interns. And that is a problem.... [C]ourt[s] should consider whether the duration ... is grossly excessive in comparison to the period of beneficial learning.... [T]hat would be an indication that the employer may have unfairly taken advantage of or otherwise abused the [students] and that they should be regarded as "employees" under the FLSA....
>
> [W]e can envision a scenario where a portion of the student's efforts constitute a bona fide internship that primarily benefits the student, but the employer also takes unfair advantage of the student's need to complete the internship by making continuation of the internship implicitly or explicitly contingent on the student's performance of tasks or his working of hours well beyond ... what could fairly be expected to be a part of the internship.

803 F.3d 1199, 1211-15 (11th Cir. 2015).

The evidence here – hours of unsupervised independent practice providing a for-profit entity substantial revenue – matches this caution from *Schumann:* that despite the value of hands-on training generally, courts must guard against the rogue school that "takes unfair advantage of the student's need to complete" anything the school requires. *Id. Accord Reich v. Shiloh True Light Church of Christ*, 85 F.3d 616 (Table), 1996 WL 228802, at *3-*4 (4th Cir. 1996) (affirming judgment for plaintiffs against a church that assigned construction work as "Vocational Training Program," because defendant "enjoyed the benefit of experienced labor without incurring ... wages," making the program

effectively "a commercial enterprise competing with other contractors").

The District Court's holding that no reasonable jury could find abusive a for-profit school's demand of substantial unpaid work providing no genuine educational benefit, yet providing the school substantial sales revenue, effectively insulates from scrutiny any unpaid labor an accredited school requires – contrary to *Schumann*, *Shiloh True Light Church of Christ*, and other cases recognizing that, "certainly, in some circumstances student trainees may truly be employees," *Randolph v. Budget Rent-A-Car*, 97 F.3d 319, 326 (9th Cr. 1996), and that courts "should not be ... making a one-size-fits-all decision about programs that include practical training," *Hollins v. Regency Corp.*, 867 F.3d 830, 837 (7th Cir. 2017).[20] Affirmance thus would depart from the law of other circuits, by amounting to a Tenth Circuit approval of not undertaking the same careful FLSA scrutiny other circuits require, and by approving a DOL test no circuit uses.

[20] Defendants' law firm has agreed (elsewhere) that the labels "intern" and "student" do not insulate against scrutiny of student-employer relationships, posting on its "Insights" webpage this caution: "Unpaid Internships May End Up Costing Employers," because "employers should be aware that *simply labeling* … as an internship *does not necessarily create an exemption* from legal *obligations to pay compensation for services* performed." Terence P. McCourt, *Intern or Employee?*, GT Alert (Apr. 4, 2012) (emphases added), *available at* https://www.gtlaw.com/en/insights/2012/4/intern-or-employee-unpaid-internships-may-end-up-costing-employers (last visited Oct. 3, 2017).

CONCLUSION

To avoid giving for-profit schools carte blanche to require lucrative unpaid work from students, to avoid dissonance with extensive appellate authority refusing to grant such carte blanche, and to assure that this case is decided upon a proper analysis of relevant factors, this Court should reverse and remand for analysis of the economic realities, based on the totality of the circumstances, to determine the primary beneficiary of the students' work – a test comporting with the most on-point precedent, *Marshall v. Regis Educational Corp.*, 666 F.2d 1324 (10th Cir. 1981), and other appellate caselaw.

Dated: October 4, 2017

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) because it contains 6,473 words according to the word count feature of Microsoft Word, excluding the portions of the brief exempted by Rule 32(f).

2. This brief complies with the typeface requirements on Fed. R. App. P. 32(a)(5) and type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in 14-point Garamond, a proportionally spaced font.

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ANTI-VIRUS CERTIFICATION FORM

I, Scott A. Moss, certify that I scanned for viruses the PDF version of the Brief of Amici Curiae submitted in this case, *Nesbitt v. FCNH, Inc., et al.*, Docket No. 17-1084, with Windows Defender and found it to be virus-free.

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CERTIFICATE OF DIGITAL SUBMISSION

I hereby certify as follows: (1) all required privacy redactions have been made per 10th Cir. R. 25.5; and (2) if required to file additional hard copies, the ECF submission is an exact copy of those documents.

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CERTIFICATE OF SERVICE AND FILING

The undersigned hereby certifies that on October 4, 2017, a true and correct copy of the foregoing Brief of Amici Curiae, and the contemporaneous and accompanying Motion for Leave to File as Amici Curiae, were electronically filed using the Court's CM/ECF system, which will send notification of such filing to all counsel of record at their below addresses of record:

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