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A Union of Formalism and Flexibility: Allowing Employers to Set Their Own Liability under Federal Employment Discrimination Laws

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A UNION OF FORMALISM AND FLEXIBILITY: ALLOWING EMPLOYERS TO SET THEIR OWN LIABILITY UNDER FEDERAL EMPLOYMENT DISCRIMINATION LAWS

INTRODUCTION

Several federal employment discrimination statutes allocate protection depending on whether potential plaintiffs occupy positions of control within a business entity. Title VII of the Civil Rights Act of 1964,[1] the Age Discrimination in Employment Act (ADEA),[2] and the Employee Retirement Income Securities Act (ERISA)[3] all permit suits by "employees" against their current or former employers, but do not provide any avenue of relief for those classified as "employers."[4] For instance, the ADEA provides: "It shall be unlawful for any employer ... to limit, segregate, or classify his employees ... because of such individual's age ...."[5]

1. 42 U.S.C. §§ 2000e-2000e-17 (2000).
2. 29 U.S.C. §§ 621-634 (2000).
3. *Id.* §§ 1001-1461.
4. For the purposes of this Note, the provisions of Title VII, the ADEA, and ERISA will be considered together. This is not improper treatment because courts often look to the manner in which prior cases have interpreted corresponding provisions of these acts for help in forming their own constructions of "employee" and "employer." *See, e.g.*, Serapion v. Martinez, 119 F.3d 982, 985 (1st Cir. 1997) ("We regard Title VII, ADEA, ERISA, and FLSA [Fair Labor Standards Act] as standing *in pari passu* and endorse the practice of treating judicial precedents interpreting one such statute as instructive in decisions involving another."); Gavalik v. Cont'l Can Co., 812 F.2d 834, 847 (3d Cir. 1987) (identifying similarity between ERISA claims and employment discrimination claims brought under Title VII); Rosenblatt v. Bivona & Cohen, P.C., 969 F. Supp. 207, 214 n.5 (S.D.N.Y. 1997) (referring to a "cross-construction method" used when construing various acts, including the ADA, ADEA, and Title VII); Caruso v. Peat, Marwick, Mitchell & Co., 664 F. Supp. 144, 147 n.3 (S.D.N.Y. 1987) ("[C]ases construing the definitional provisions of [Title VII] are persuasive authority when interpreting the [ADEA].") (citation omitted). This process of borrowing established interpretations of the employment relationship has been referred to as cross-fertilization. *See* Daniel S. Kleinberger, *"Magnificent Circularity" and the Churkendoose: LLC Members and Federal Employment Law*, 22 OKLA. CITY U. L. REV. 477, 502 n.118 (1997).
5. 29 U.S.C. § 623.

Predictably, courts have not always agreed as to what differentiates an employee from an employer. Particularly with regard to innovative business forms that have risen to prominence in recent decades, the distinction between the two is confounded.[6] Statutory language defines an employee as "any individual employed by an employer."[7] A strict statutory construction, therefore, would categorically deny relief to some members of business entities organized as partnerships, yet universally afford protection to similarly situated members of incorporated entities.[8]

Traditionally, a partner could not stand in an employment relationship with his or her partnership because partners personally control the ownership interests, making them employers rather than employees. Because a partnership *is* the partners, it cannot also *employ* the partners. Stated from another angle, a partnership simply cannot employ itself. If partners cannot employ themselves, it follows that partners cannot be employees in the technical sense of the term. On the contrary, all partners are, by default, employers. As a result, partners are ineligible to seek protection from employment discrimination because employers are not members of a protected category.

Compare partnerships to incorporated entities. Unlike a partnership, a corporation is an independent legal persona existing only on paper. It exists wholly apart from even its most high-ranking officers, operates as the de facto employer, and exists in perpetuity.[9] The title of "employer" resides with either the legal persona or, ultimately, with the shareholders.[10] Thus, no person

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6. *See* Alan Ross Haguewood, Note, *Gray Power in the Gray Area Between Employer and Employee: the Applicability of the ADEA to Members of Limited Liability Companies*, 51 VAND. L. REV. 429 (1998) (discussing courts' differing analyses and results concerning whether members of a limited liability company (LLC) are employees).

7. 29 U.S.C. § 1002(6); *see also id.* § 630(f) (defining the term "employee" as "an individual employed by any employer ....").

8. Haguewood, *supra* note 6, at 449-50.

9. *See id.* at 438 n.38.

10. Note, however, that the problem presented by corporations employing their own shareholders has not been addressed. These circumstances present the best argument for application of the employer exemption to the corporate setting. If, for example, in a closely held corporation, a shareholder-employee owned enough shares to be influential in the management of the company, protection from employment discrimination would seem unnecessary. Decisions involving less influential shareholder-employees, however, have favored their status as eligible plaintiffs. *See, e.g.*, Hyland v. New Haven Radiology Assocs.,

who works for the corporation will be subject to the employer exemption, and courts will not dismiss plaintiffs' suits for lack of statutory standing.[11] Only the corporate persona itself falls into the employer exemption.[12] A strict statutory construction, therefore, only affords protection to members of incorporated entities.

Several courts have utilized this all-or-nothing approach and declined to look past a business entity's organizational form in determining worker eligibility to sue under Title VII, the ADEA, or ERISA.[13] This approach has been dubbed the "per se rule."[14] As one would predict, courts invoking the per se rule always exempt partners of firms from protection. This is referred to as the "partnership exemption."[15] A brief history of holdings implicating

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794 F.2d 793, 798 (2d Cir. 1986) (holding that "where the individual involved is a corporate employee ... every such employee is 'covered' for the purposes of the ADEA"); Johnson v. Cooper, Deans & Cargill, P.A., 884 F. Supp. 43, 45 (D.N.H. 1994) (holding that the firm had "elected to organize in the corporate form and cannot now avoid the reach of Title VII by calling its shareholder-employees partners"); *cf.* EEOC v. Dowd & Dowd, Ltd., 736 F.2d 1177, 1178 (7th Cir. 1984) (finding "no reason to treat the shareholders of a professional corporation differently for purposes of Title VII actions than [it] did partners of [an] accounting firm ...").

11. Plaintiffs can, however, fall out of the protected category in the opposite direction. Lively debate persists concerning who is an employee and who is an independent contractor. The latter would be ineligible to seek protection under the acts because independent contractors are neither employers nor employees. This Note, however, is concerned only with the opposite end of the employment spectrum (i.e., who is sufficiently empowered to justify the label of *employer* and thus ineligible to seek relief offered only to employees). Nevertheless, the doctrine that has developed around this question very closely parallels the central focus of this Note. For additional commentary on this topic, see generally Edward T. Ellis & Jessica Y. Chong, *Defining the Term "Employee" Under Federal Statutes Relating to Employment*, *in* CURRENT DEVELOPMENTS IN EMPLOYMENT LAW 1063 (ALI-ABA SG016, 2001) (commenting on the application of the common law, economic reality, and hybrid tests to determine temporary employee status under selected federal statutes); Daniel M. Feinberg, *Contingent Workers & Misclassified Employees*, *in* 30TH ANNUAL INSTITUTE ON EMPLOYMENT LAW, at 383 (PLI Litig. & Admin. Practice Course, Handbook Series No. 664, 2001) (reviewing various factors used by courts to determine independent contractor status); Phillip R. Maltin, *By Any Other Name*, L.A. LAW., Sept. 2001, at 53.

12. Note that corporate personas are nothing more than legal fictions, which, in contrast to flesh and blood partners, cannot be victims of workplace discrimination in the first place.

13. *See infra* Part II.

14. *See* Troy D. Ferguson, *Partners as Employees Under the Federal Employment Discrimination Statutes: Are the Roles of Partner and Employee Mutually Exclusive?*, 42 U. MIAMI L. REV. 699, 710-11 (1988); Haguewood, *supra* note 6, at 438-44.

15. *See* Haguewood, *supra* note 6, at 437-44.

The term "exemption" is somewhat misleading, however. It implies coverage exists, from which a dispensation is provided. Instead, the question in most the per se rule and justifications for its use is offered in Part I of this Note.

More recent decisions reflect an emerging trend, which is to consider a plaintiff's ability to protect his or her own interests within a business entity in order to determine eligibility for protection under ERISA, the ADEA, or Title VII. Courts have focused on an extensive, though not exhaustive, list of factors[16] that tend to indicate "whether the employer's control of employment opportunities places the worker in a position of dependency on the employer which may expose the worker to discriminatory conduct."[17] Courts that use this test ask whether a position of dependency within a business entity negates the presumption that a partner cannot be a victim of employment discrimination. This in-depth inquiry, spurning deference to an individual's title and focusing instead on actual powers, is referred to as the "economic realities test."[18] Part II of this Note will briefly examine representative cases that used the economic realities test as well as examine the justifications for its use.

The per se rule has received scant approval in recent years. The economic realities test has emerged as the more pragmatic, if less practicable, alternative of the two, though it is still unclear why these tests are necessary at all. Perhaps when the federal employment discrimination statutes were crafted, the distinction between employers and employees was more apparent. With the onset of various new business forms in recent decades,[19] however, this distinction has blurred. Professional corporations, limited

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> cases is whether the basic commands of the statute apply in the first place. When courts say they recognize a "partnership exemption" to employment discrimination statutes, they simply mean that the statutes do not apply to partners. In other words, they are construing the statutory term "employee" so as not to include partners.

Id. at 437 n.30.

16. *See, e.g.*, Simpson v. Ernst & Young, 100 F.3d 436, 441 (6th Cir. 1996) (indicating the Court's list of factors is not exhaustive by allowing for "other indicia of partnership status" in addition to the stated factors).

17. Nancy E. Dowd, *The Test of Employee Status: Economic Realities and Title VII*, 26 WM. & MARY L. REV. 75, 113 (1984).

18. *See, e.g.*, *Simpson*, 100 F.3d at 442; EEOC v. Dowd & Dowd, Ltd., 736 F.2d 1177 (7th Cir. 1984); Dowd, *supra* note 17, at 102; Ferguson, *supra* note 14, at 722; Haguewood, *supra* note 6, at 444.

19. *See* Haguewood, *supra* note 6, at 431.

liability companies, and limited liability partnerships, to name a few, are business forms that combine various aspects of partnerships and corporations.[20] In the modern global marketplace, applying the partnership exemption to individuals holding the office of partner, though they are deprived of powers traditionally associated with the title "partner," lacks justification and does more to undermine the goals of antidiscrimination statutes than it does to promote them.

The partnership exemption has its roots in partnership law. Partners are jointly and severally liable for partnership debts, and the actions of one can often be imputed to the others.[21] Because extensive liability can be easily incurred, courts have traditionally respected a partnership's freedom of association. For example, partners possess a nearly unfettered ability to dismiss their peers, whereas other business entities' dismissals are subject to greater levels of scrutiny regarding legality and fairness.[22] History has shown, and this Note will reiterate, that this extreme position invites abuse and runs contrary to congressional intent in formulating employment discrimination legislation.

There are insufficient justifications for granting workplace discrimination a judicial safe harbor in partnerships and similar business forms. If there are legitimate reasons to terminate a

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20. "[W]hen courts say that they are extending the partnership exemption to other principals, such as professional corporation shareholders or corporate directors, they simply mean that the same logic preventing partners from being "employees" applies to these principals." *Id.* at 437 n.30.

21. *See* UNIF. P'SHIP ACT § 15(a) (1914) (making partners jointly and severally liable for partnership debts). The Uniform Partnership Act has been adopted in every state except Louisiana. *See* Allan W. Vestal, *Choice of Law and the Fiduciary Duties of Partners Under the Revised Uniform Partnership Act*, 79 IOWA L. REV. 219 n.12 (1994) (providing citations for each state's adopted Uniform Partnership Act provisions); Howard McCoach, Note, *Applying Title VII to Partners: One Step Beyond*, 20 RUTGERS L.J. 741, 752 (1989).

22. Though the recent trend has been more activist, the judiciary has traditionally been reluctant to intervene in partnership decisions, which were seen as the partners' domain. *See, e.g.*, Hishon v. King & Spalding, 467 U.S. 69, 77-78 n.10 (1984) (analogizing partnership decisions to "choosing a wife" and citing 110 CONG. REC. 13085 (1964) and 118 CONG. REC. 1524, 2391 (1972)); Stacey B. Chervin, *Employment Discrimination: Breaking Through the Partnership Barrier in* Hopkins v. Price Waterhouse, 1992/1993 ANN. SURV. AM. L. 203, 210-11 (1994) ("Another anology which has been used to explain the reluctance of the judiciary to interfere in partnership decisions is that of a private club."). Chervin argues that "[b]y dictating [partnership appointment decisions], the court is clearly in danger of intruding upon academic or entrepreneurial freedom." *Id.* at 210.

partner, severance can be achieved without violating federal law. Otherwise, the reasons underlying the termination are inherently suspect and should be scrutinized. It is now neither appropriate to assume that partners possess the power to protect themselves from discrimination nor judicious to ignore their pleas.

Turning a blind eye to legitimate discrimination claims is imprudent; completely disregarding the sound reasons underlying the genesis of the partnership exemption is equally unwise. This Note takes the position that a solution capitalizing on the strengths of both approaches exists because concepts of workplace equality and a partnership's right to choose its members are not mutually exclusive. Allowing a business to determine for itself which of its employees are eligible for federal employment discrimination protection, subject to a threshold finding of fairness, would effectuate congressional intent in crafting employment discrimination legislation as well as respect a business entity's independence and freedom of choice.

Much like a corporation with thousands of dispersed shareholders, worldwide "partnerships" often have so many partners that it is unreasonable to expect that they will all participate fully in management decisions. Because such partners are necessarily removed from positions of actual power within a business entity, the assumption that they are beyond the reach of employment discrimination no longer holds water.[23] Extending protection to corporate employees when a lack of dependency makes protection from employment discrimination unnecessary is also unsound. Congress must modify discrimination statutes to redefine the class of individuals protected by statutes such as the ADEA, Title VII, and ERISA in order to properly effectuate their original intent.[24]

Part III of this Note proposes a new standard wherein an employer, following a prima facie showing that an employee has sufficient power within the entity with which to protect his own interests, can classify that individual as exempt from employment

23. *See Simpson*, 100 F.3d at 445-46 (Daughtrey, J., concurring) (urging Congress "to recognize ... that the realities of today's global marketplace no longer justify distinguishing between 'employees' and 'partners' in all instances"); Rhoads v. Jones Fin. Cos., 957 F. Supp. 1102 (E.D. Mo. 1997).

24. *See Simpson*, 100 F.3d at 445-46 (Daughtrey, J., concurring).

discrimination legislation. The prima facie showing will be made based upon the existence of a limited set of factors tending to show a lack of dependence on the employer and thus, limited vulnerability to employment discrimination.

Non-exempt individuals would be presumptively entitled to the full protections of federal law. Exempted employees (i.e., those holding positions classified by their employers as "exempt") would carry the burden of proof that they are in fact entitled to protection. The same shortened list of factors used in the prima facie showing to justify exemption will be used by the plaintiffs claiming protection to simplify the court's analysis of actual status. More efficient and more consistent holdings should result if exempted employees file suit to show that they should be entitled to protection despite the fact that their employer has classified them as exempt.

I. THE PER SE RULE

A. History

In 1977, the Seventh Circuit laid the groundwork for the per se rule in *Burke v. Friedman*[25] when it declined to "expand the definition of employee to include a partner."[26] Other circuits soon followed suit. In *Hishon v. King & Spalding*,[27] the plaintiff brought suit against her law firm claiming discrimination on the basis of her gender following the firm's refusal to make her a partner. The Eleventh Circuit held that Title VII protections did not extend to partnership decisions[28] and affirmed the district court's dismissal for lack of subject matter jurisdiction.[29] Although the Supreme Court reversed on the grounds that the plaintiff had stated a claim cognizable under Title VII,[30] the Court declined to expressly reject

25. 556 F.2d 867 (7th Cir. 1977).
26. *Id.* at 870.
27. 678 F.2d 1022 (11th Cir. 1982), *rev'd on other grounds*, 467 U.S. 69 (1984).
28. *Id.* at 1028 ("[W]e are unwilling to dictate partnership decisions under the guise of employee promotions protected by Title VII.").
29. *Id.* at 1030.
30. Hishon v. King & Spalding, 467 U.S. 69, 78-79 (1984).

the per se rule.[31] Furthermore, in a concurring opinion often cited in support of the per se rule, Justice Powell stated that "the relationship among law partners differs markedly from that between employer and employee [because] [t]he essence of the law partnership is the common conduct of a shared enterprise."[32] This statement has been interpreted to mean that partners and employees are mutually exclusive categories.[33]

In *Wheeler v. Main Hurdman*,[34] the Tenth Circuit declined to scrutinize the relationship between the plaintiff and her firm, despite the fact that her termination came a mere seventeen months after her promotion to partner.[35] Wheeler claimed that her support staff, supervisors, clients, and duties all remained the same following promotion, and that she was no more at liberty to establish her own fees than before her elevation to partnership status.[36] Furthermore, she claimed that the organizational structure of the firm more closely resembled a corporation than a partnership because the firm was controlled primarily by a managing partner and a policy board.[37]

Essentially, Wheeler argued that because her employer was a nationwide entity governed by a board on which she was not represented, she was too far removed from the nexus of control to justify the assumption that she could protect her own interests within the firm. The Tenth Circuit cited *Hishon* for support[38] and denied Wheeler's requests for a more precise inquiry. Instead, the court held that to not follow *Hishon* would "ignore or unacceptably

31. *Id.* at 77-78.

32. *Id.* at 79-80 (Powell, J., concurring).

33. Chervin, *supra* note 22, at 212 ("Some appellate courts have since used Justice Powell's concurrence to preclude former partners, who claim that they were terminated on a discriminatory basis, from prevailing in Title VII suits."); Larry E. Ribstein, *Law Partner Expulsion*, 55 BUS. LAW. 845, 879 (2000) ("[A] concurring opinion by Justice Powell [] noted that the employment discrimination laws probably do not regulate a partnership's employment decisions involving partners.").

34. 825 F.2d 257 (10th Cir. 1987).

35. *Id.* at 258.

36. *Id.* at 261.

37. *Id.*

38. *Id.* at 263-65, 276.

diminish the essential attributes of partnership, [and such a test would be] incapable of rational application."[39]

In the corporate setting, however, plaintiffs are regularly deemed to fall within the scope of federal employment discrimination laws despite possessing powers and duties analogous to those traditionally associated with partnership status. In *Hyland v. New Haven Radiology Associates, P.C.*,[40] a suit brought under the ADEA, the Second Circuit faced circumstances similar to those in *Hishon*. Despite the fact that the professional corporation in *Hyland* functioned more like a partnership than a corporation, the plaintiff was deemed an employee by the court because "[t]he fact that certain modern partnerships and corporations are practically indistinguishable in structure and operation ... is no reason for ignoring a form of business organization freely chosen and established."[41] In other words, choice of corporate form forecloses the application of the partnership exemption in the Second Circuit.

Several district court holdings have also embraced the per se rule. In *Holland v. Ernst & Whinney*,[42] the District Court for the Northern District of Alabama held that the "ADEA applies only to discrimination in the context of employment and has no application in the context of this case."[43] In so holding, the court implied that the defendant's choice of business form (partnership), considered in tandem with the plaintiff's title (partner), created a relationship that could not be correctly characterized as one of employment within the meaning of the ADEA.[44] The suit was dismissed for failure to state a claim upon which relief could be granted.[45]

In *Maher v. Price Waterhouse*,[46] the District Court for the Eastern District of Missouri held that partners of an accounting firm could not qualify as employees within the meaning of the ADEA. Notably, however, the court recognized a narrow exception to the per se rule and imposed a requirement that the partner's position in the firm

39. *Id.* at 276.
40. 794 F.2d 793 (2d Cir. 1986).
41. *Id.* at 798.
42. 35 Empl. Prac. Dec. (CCH) ¶ 34,653 (N.D. Ala. Aug. 17, 1984).
43. *Id.*
44. *See id.*
45. *Id.*
46. No. 84-1522 C (2), 1985 WL 9500 (E.D. Mo. Apr. 8, 1985).

be genuine.[47] The court implied that employees granted partnership status in name only and not in substance would be considered employees for the purposes of the ADEA.[48] Particularly, the court had in mind firms seeking only to sidestep federal antidiscrimination laws by labeling their employees "partners" while leaving unchanged the actual features of the employment relationship. Though the court stopped short of urging an economic realities analysis, the holding nevertheless recognized the increasing appeal of an economic realities test.

Though the popularity of the per se rule has been fading in recent years, it is still operative. The most recent Ninth Circuit decision on the issue rejected the notion that corporate employees could ever be beyond the reach of employment discrimination laws. By negative implication, the court had to presume that partners could be exempt from such laws. In *Wells v. Clackamas Gastroenterology Associates, P.C.*,[49] the court stated that:

> [W]e find *Hyland's* reasoning to be considerably more persuasive .... Because ... there is no reason to permit a professional corporation to secure the "best of both possible worlds" by allowing it both to assert its corporate status in order to reap the tax and civil liability advantages and to argue that it is like a partnership in order to avoid liability for unlawful employment discrimination.[50]

The court approved the use of the economic realities test to determine whether a partner's label (in a partnership) is accurate. The court, however, disapproved of the economic realities test, opting instead for the per se rule, whenever corporate form is involved.[51] In other words, the court adopted the "labels are destiny"

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47. *Id.*; *see also Hishon*, 467 U.S. at 79-80 (Powell, J., concurring) (warning employers that deliberate attempts to evade the scope of employment discrimination laws through misleading labels would forfeit the protection afforded by the employee-employer distinction embedded in such laws).

48. *See Maher*, No. 84-1522C(2), 1985 WL at *2.

49. 271 F.3d 903 (9th Cir. 2001).

50. *Id.* at 905.

51. The court explained:

> It is one thing to apply an "economic realities" test to determine that a nominal partner should, under appropriate circumstances, be considered an "employee"

approach,[52] where choice of organizational form is determinative, although only where noncorporate forms are involved.

B. Support for the Per Se Rule

There are several arguments in favor of the continued application of the per se rule to partnerships. At the very least, it offers predictability. Both potential plaintiffs and employers alike have an interest in knowing the extent to which they are protected by federal employment discrimination laws and exposed to statutory liability, respectively. A bright line rule conserves judicial resources that would inevitably be lost in a more in-depth review of the circumstances giving rise to the litigation.

Furthermore, contractual freedom is sure to produce an infinite number of gradations with regard to the interests and control that a particular business associate may have within any type of entity.[53] Because an analysis of the economic realities test factors in order to determine eligibility for protection under the statutes would yield no bright line rule and, most likely, yield inconsistent decisions, it would offer predictability to non-litigants likely to be affected by such decisions.

Business entities may value very highly the right to expel business associates for any reason. This might not only factor prominently into an entity's choice of business form, but the choice of business form would then in turn provide notice of who has standing to sue under employment discrimination laws. "[T]here is something to be said for allowing a limited type of opt-out through partnership law from the otherwise mandatory employment discrimination laws."[54]

Finally, diminishing the scope of the "employer" exemption from antidiscrimination statutes by broadly construing the term "employee" may adversely affect a business entity's power to

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> in order to prevent a firm from labeling the bulk of its employees as partners simply to insulate itself from liability for discrimination. It is quite another thing, however, to apply the "economic realities" test in order to classify shareholder-employees of a corporate enterprise as partners.

Id. (citation omitted).

52. Kleinberger, *supra* note 4, at 546.

53. *Id.*

54. Ribstein, *supra* note 33, at 880.

regulate its own members and undermine the logic behind the partnership exemption. "[Adding] a layer of scrutiny to expulsion decisions .... could reduce firms' ability to discipline partners and maintain their reputations."[55] Not only would the broad construction create intra-firm regulatory and control problems, but, at least theoretically, the additional protections provided by federal employment discrimination law might be unnecessary because market forces should provide an adequate safeguard against unfair dealing.[56] In other words, a business with a reputation for improperly discriminating against its own members will surely face the ensuing recruiting, retention, and employee loyalty problems created by its own conduct.[57]

The per se rule reflects a hands-off approach to employment regulation. It is assumed that the business, having chosen its own form, cannot then be held to the standards of the form not chosen. It is further assumed that the per se rule will not cripple a business' efforts to regulate internally, and market forces will operate to protect employees from discrimination. Additionally, the per se rule fosters consistency and predictability. Although these factors all weigh strongly in favor of the per se rule, the rule's success has been compromised by its rigidity.

II. THE ECONOMIC REALITIES TEST

The economic realities test has not been uniformly applied by all courts that employ it. Historically, courts have freely engineered various hybrid versions of the economic realities test in their

55. *Id.* at 879; *see also* Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 947-49 (1984) (arguing that legal action is an insufficient substitute for freedom of association).

56. Ribstein, *supra* note 33, at 879-80.

57. Following an administrative tribunal's finding that the law firm of Baker & McKenzie's discharge of an associate with AIDS was motivated by discrimination, the firm was banned from recruiting on New York University Law School's campus. *See* Edward A. Adams, *NYU Bans Baker & McKenzie's New York Office From Recruiting*, 213 N.Y. L.J., Mar. 14, 1995, at 1. Another act of discrimination by the same firm in the late eighties earned similar recruiting bans from Georgetown, Chicago, and Berkeley law schools as well as a year probationary status with Harvard. *Id.* Some students decide not to consider employment with firms that have a discriminatory reputation. *See, e.g.*, Barbara Steuart, *Concerned Students May Still Give Baker & McKenzie a Try*, THE RECORDER, Sept. 12, 1994, at 1.

holdings. In *Jones v. Baskin, Flaherty, Elliot & Mannino, P.C.*,[58] for example, the District Court for the Western District of Pennsylvania applied a hybrid test that "'looks at the economic realities of the situation but focuses on the employer's right to control the employee as the most important factor in determining employee status.'"[59] In holding that a shareholder-employee of a professional corporation had standing to sue under the ADEA, the court combined elements of the straightforward economic realities test and the common law agency test.[60]

The District Court for the Western District of New York applied a more straightforward economic realities test in *Caruso v. Peat, Marwick, Mitchell & Co.*[61] The court looked to the plaintiff's actual duties and status within the firm and held that, although a bona fide partner could not qualify as an employee under the ADEA, a partner whose position within the firm more closely resembled that of a typical salaried worker with a fancy job title did fall within the ADEA's employer exemption.[62] Judge Walker, writing for the majority, explained that an employee's particular classification could not be dispositive because such an approach would grant employers free reign "to strip employees of their ADEA rights simply by denoting all employees as 'partners,' without giving these employees any actual decision-making authority or job security."[63] He recognized that an inherent fault in any bright line rule is its inflexibility, resulting in a susceptibility to technical limitations.

Recent decisions invoking the economic realities test are *Hull v. Rose, Schmidt, Hasley & DiSalle P.C.*[64] and *Simpson v. Ernst & Young*.[65] Though the court in *Hull* held that a partner was ineligible to seek relief under a state antidiscrimination statute due to an employer exemption analogous to the one found in the ADEA, it

58. 670 F. Supp. 597 (W.D. Pa. 1987).

59. *Id.* at 601 (quoting EEOC v. Zippo Mfg. Co., 713 F.2d 32, 37 (3d Cir. 1983)).

60. *Id.* at 601-02 (using a hybrid approach, and holding, "we find [Jones] meets the hybrid standard for an employee under the ADEA").

61. 664 F. Supp. 144 (S.D.N.Y. 1987).

62. *Id.* For more discussion on this case, see Charles S. Caulkins & James J. McDonald, Jr., *Lawyer Terminations: Increasingly the Subject of Employment Discrimination Suits*, 65 FLA. B.J., Feb. 1991, at 27, 28-29.

63. *Caruso*, 664 F. Supp. at 148.

64. 700 A.2d 996 (Pa. Super. Ct. 1997).

65. 100 F.3d 436 (6th Cir. 1996), *cert. denied*, 520 U.S. 1248 (1997).

only did so following an inquiry "[c]onsidering the approved usage and plain meaning of the word 'partner' in the context of the facts averred ... increased earnings, ownership status, and exposure to liability and change in management control ... qualities that are commonly associated and used in conjunction with the term 'employer.'"[66] Other courts have similarly applied the economic realities test and yet held that the plaintiff was beyond the reach of federal employment discrimination legislation.[67]

The Sixth Circuit in *Simpson* held that an Ernst & Young partner should be considered an employee for the purpose of the ADEA and ERISA.[68] The court identified and applied the following factors for determining eligibility of partners to sue as employees under the acts:

> the right and duty to participate in management; the right and duty to act as an agent of other partners; exposure to liability; the fiduciary relationship among partners; use of the term "co-owners" to indicate each partner's "power of ultimate control;" participation in profits and losses; investment in the firm; partial ownership of firm assets; voting rights; the aggrieved individual's ability to control and operate the business; the extent to which the aggrieved individual's compensation was calculated as a percentage of the firm's profits; the extent of that individual's employment security; and other similar indicia of ownership.[69]

The factors identified by the court were derived from the common law principles of employment codified in the Uniform Partnership

66. *Hull*, 700 A.2d at 1000.

67. *See, e.g.*, Fountain v. Metcalf, Zima & Co., 925 F.2d 1398 (11th Cir. 1991) (focusing on the traditional role of partners, the role of partners relative to concepts of control and ownership, and plaintiffs' conformity therewith); Rhoads v. Jones Fin. Cos., 957 F. Supp. 1102, 1110 (E.D. Mo. 1997) ("The evidence before the Court shows that at the time of plaintiff's alleged discriminatory discharge, plaintiff was a bona fide partner and not an employee of the partnership."); *see also* Scott L. Cummings, *Developing Cooperatives as a Job Creation Strategy for Low-Income Workers*, 25 N.Y.U. REV. L. & SOC. CHANGE 181, 208 n.119 (1999) ("Where there is strong evidence of partner ownership of the business and partner participation in firm governance, and where partner compensation is based on a percentage of the firm's profits, a partner is deemed to have a 'proprietary' interest in the business that precludes her treatment as an 'employee.'").

68. Simpson v. Ernst & Young, 100 F.3d 436, 443-44 (6th Cir. 1996).

69. *Id.*

Act.[70] An analysis of the stated factors led to the court's holding that Simpson was, in reality, an employee rather than a bona fide partner.[71]

> Simpson had no authority to direct or participate in the admission or discharge of partners or other firm personnel; participate in determining partners or other personnel compensation predicated upon performance levels, responsibility, and years of service with the firm, including his own; participate in the vote for the chairman or the members of the Management Committee; or participate in the firm's profits and losses or share in unbilled uncollected client accounts ("UBT's"). Simpson had no right to examine the books and records of the firm except to the extent permitted by the Management Committee. He was required to execute a will which mandated that his heirs accept as binding the accounts provided by Ernst & Young with no right of inspection or verification. He had no authority to sign promissory notes on behalf of the firm, or pledge, transfer, or otherwise assign his interest in the firm. He was refused access to data concerning various client accounts. He was denied participation in annual performance reviews and other indicia of partnership status.[72]

The trial court had held that "[f]or all practical purposes, [Simpson] was an employee with the additional detriment of having promised to be liable for the firm's losses."[73] The Court of Appeals for the Sixth Circuit affirmed this decision.

The strongest justification for the economic realities test can be found in the remedial nature of the federal employment discrimination statutes themselves. The purposes of the statutes are to protect those vulnerable to employment discrimination and shield them from workplace inequities, which warrant a liberal construction of statutory language defining employees subject to protection. As Professor Ferguson writes:

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70. *Id.* at 443.
71. *Id.* at 442.
72. *Id.* at 441.
73. Simpson v. Ernst & Young, 850 F. Supp. 648, 665 (S.D. Ohio 1994).

> One can make a strong argument ... that the expansive interpretation of the term "employee" under the economic realities test comports with Congress' intent in enacting Title VII [and] the ADEA .... Congress easily could have included a more restrictive definition, but it did not do so because such a definition would have impaired the broad purpose of the statutes.[74]

Though courts had already begun used the economic realities test to determine employee status, Congress declined to amend the statutory definition included in the ADEA, Title VII, or ERISA. This inferred tacit approval of the economic realities test would have remained conjectural had Congress not actively amended other statutes where judicial use of an economic realities test was disfavored.[75] Congress' inaction in the context of the ADEA, Title VII, and ERISA has evidenced approval of the economic realities test and ratified a broad construction of the term "employee."

Despite the "freedom of association" logic underlying the partnership exemption, the broad purpose of the statutes may be frustrated if the characteristics of the modern partner no longer justify the presumption of sufficient power and control in a business entity to protect the partner's own interests.[76]

As noted by Judge Daughtrey in her concurring opinion in *Simpson*:

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74. Ferguson, *supra* note 14, at 724; *see also* Dunlop v. Carriage Carpet Co., 548 F.2d 139 (6th Cir. 1977); Dowd, *supra* note 17, at 89-95.

75. *See* 29 U.S.C. §§ 151-52 (2000) (codifying amendments to the National Labor Relation Act of 1935, specifically implementing a more narrow definition of "employee" by requiring courts to construe the term "employee" by using the common law right-to-control test); Armbruster v. Quinn, 711 F.2d 1332, 1341 (6th Cir. 1983) ("In that Congress was specifically aware of the judicial construction accorded the term 'employee' absent an explicit limitation, we now refuse to *imply* such a restriction into the otherwise broad terms of Title VII.") (footnote omitted).

76. The Equal Employment Opportunity Commission (EEOC) is currently investigating the forced demotion or discharge of several older partners in the law firm of Sidley, Austin, Brown & Wood. The EEOC claims that Sidley is run by a small management committee (eight members) and executive committee (thirty-six members), which make all the important decisions in the firm. Only about ten percent of the partners sit on either committee, and other partners do not have the right to elect their representatives. *See* David Koeppel, *When Is a Partner Not Really a Partner?*, N.Y. TIMES, Mar. 10, 2002, at 12.

> In an era of small, closely-operated partnerships, it may have been logical to conclude that an employer/partner could not and would not discriminate in employment decisions against himself or herself or against a close friend and business associate. In a world-wide organization like Ernst & Young that employs almost 2200 "partners," however, the nominal co-owners of the company are, by necessity, so far removed from the seat of actual power as to be subject to the reach of the invidious acts that employment discrimination statutes seek to remedy.[77]

The purposes of employment discrimination legislation could be further circumscribed if companies were allowed to place their employees beyond the reach of the statutes merely by giving them fancy job titles while leaving their rights, duties, and workload unchanged.[78] Once again, where the distinction between partners and employees is rendered meaningless, blind adherence to form over substance is unwarranted.

Professor Ferguson offers several additional arguments in favor of the economic realities test. First, he argues that a broad construction of the term "employee" will reduce dependence on government assistance.[79] Society, therefore, will benefit when individuals are not disadvantaged by artificial barriers to equal employment.[80] Second, he argues that Congress purposefully declined to offer a more specific definition of a "employee" because the broad purpose of the statute would be better served by a less restrictive definition.[81]

A partner who lacks the traditional powers associated with his position does not receive the benefits that courts presume when they deny him protection from workplace discrimination. Because he presumptively possesses these powers, the fact that he is beyond the reach of the statutes does not seem to be problematic. This double-edged sword presents a problem when partners-in-name, employees-in-substance, "are twice deprived merely because of the partnership label; i.e., they do not receive the full benefits

77. *Simpson*, 100 F.3d at 445 (Daughtrey, J., concurring); *see also* Caulkins & McDonald, *supra* note 62, at 27.

78. *See* Ferguson, *supra* note 14, at 729 n.186.

79. *Id.* at 723.

80. *Id.*

81. *Id.*

of partnership, nor are they afforded the protection given to employees."[82]

Finally, it is clear that the partnership ranks of worldwide organizations are so large and consequently elevations to partnership status so commonplace that the partnership agreement is necessarily a predrafted document. The firm cannot bargain with each associate and produce a unique partnership agreement for each of them. This would create an unmanageable situation in which firm members holding equivalent offices could possess an infinite number of employment relationships with the firm. An associate who has worked with the firm for several years in order to earn an invitation to join the partnership will be reluctant to turn down the partnership agreement and look elsewhere, despite the imposed terms. The associate, devoid of bargaining power, will almost inevitably sign the agreement rather than start over somewhere else.[83]

The fact that this has become accepted practice is not objectionable per se. The fact that associates now sign partnership agreements resembling contracts of adhesion, however, allows a firm to grant powers to the rising partner at its discretion.[84] If the powers granted are inferior to the powers typically associated with partnership, it is inequitable and runs contrary to the purposes of employment discrimination legislation to leave the partner twice deprived.

In conclusion, the purposes of employment discrimination legislation cannot be served by a narrow construction of statutory language. A narrow construction does not provide adequate

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82. *Id.* at 730-31.

83. *Id.* at 726; James B. Porter, *Modern Partnership Interests as Securities: the Effect of RUPA, RULPA, and LLP Statutes on Investment Contract Analysis*, 55 WASH. & LEE L. REV. 955, 975 (1998).

> One might think it unlikely that a prospective general partner would sign a partnership agreement providing almost no power with which to protect his partnership interest. In some very large partnerships in which prospective partners have weak bargaining positions, they must agree, however, to have limited power if they want to become a partner.

Id.

84. "Ernst & Young was free to draft its Partnership Agreement and U.S. Agreement in such a way as to generate the belief in its employees that they enjoyed partnership status and to permit them to represent themselves as partners." Simpson v. Ernst & Young, 850 F. Supp. 648 (S.D. Ohio 1994).

safeguards against circumvention of the statutes and denies protection to a class of individuals who are nevertheless subject to discriminatory conduct. The changing nature of modern business entities has stripped employees of bargaining power with which to negotiate their own partnership agreements and granted firms license to create nontraditional partners who more closely resemble employees that are unprotected by federal laws. Partners-in-name but employees-in-substance are twice deprived because they lack the power to protect their own interests and, under the per se rule, lack the power to seek protection from the federal government. Because this outcome is clearly at odds with the goals of the statutes, it necessitates the broad construction of the term "employee" which can better be accomplished through judicial use of some variation of the economic realities test.

III. STATUTORY REMODELING

The widespread rejection of the per se rule reflects the conclusion that, although a bright line rule can offer consistency and predictability, no rigid standard can prevent those wishing to escape the reach of employment discrimination legislation from doing so by way of technical limitations. The economic realities test prevents employers from falsely characterizing those who are employees in practice as partners and thus effectuates congressional intent. The strongest criticism of the economic realities test, however, is that it necessitates an extensive inquiry involving numerous factors, resulting in a time-consuming investigation that wastes judicial resources and produces inconsistent results. The goal of any new standard clearly must be the universal application of a simplified test that maintains flexibility.[85]

In order to maintain flexibility, some version of the economic realities test must prevail. To simplify the test, the most relevant factors must be identified and judicial inquiries shortened to include only those factors that are truly probative of the issue in

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85. *See* William D. Frumkin et al., *Benefits Litigation: Spotting ERISA Issues in General Employment Disputes and the Impact of Recent Supreme Court Decisions*, 29 ANN. INST. ON EMP. L. 881, 910 (2000) ("The application of these different tests has resulted in rulings on worker classifications that lack conformity or a particular blueprint to guide employers and employees alike.").

question. Finally, to foster universal application, the test must be convincing; it must produce consistent holdings and perform well within different business settings.

This Note suggests that allowing an employer to determine for itself which of its employees is eligible for protection will create a more workable standard. Under the proposed system, an employer could exempt individuals holding predetermined offices from protection, subject to a threshold showing of status (i.e., somewhat analogous to a "partner" under the economic realities test). Sufficient status to qualify an individual for exemption at the discretion of his employer would be determined by a simplified version of the economic realities test, except the proposed test would seek to show that an individual is exemptible rather than a partner; nonexempt rather than an employee.

This Note will propose a shortened list of factors to simplify the economic realities test and give reasons why they are more determinative of status than other factors currently in use. A look at how the suggested test should fare in practice will follow, by way of an application to a hypothetical suit within a limited liability company. The new test should allow employers to predict which of its employees can legally be exempted from federal employment discrimination protections.

A. *The Factors*

In order to succeed, the exemption test must identify those factors deemed most determinative of actual status. The results of the shortened inquiry would be used both by employers to identify individuals subject to exemption, and by courts in suits brought challenging an employer's choice to exempt the holder of a certain office.

Under the exemption test, the individual's right to challenge employer decisions concerning exemptions must be exercised before the partnership agreement or comparable pact between contracting parties is executed. Post hoc determinations of employee status will necessarily entail some degree of unpredictability, and allowing ex ante exemption challenges seems to be the best way to harmonize an employer's need for predictability and desire to set its own liability with the employee's similar need for predictability and right to remain free from imposed contract terms.

The employee, by executing the employment agreement, implies acceptance of the exemption status of the new office. Post hoc challenges should not be banned altogether, but such challenges must overcome a presumption of fairness in favor of the employer.

The following factors will be discussed in turn: the right and duty to participate in management, exposure to liability and sharing in firm losses, fiduciary relationship among partners, investment in the firm and ownership of firm assets, the right and duty to act as the agent of other partners, use of the term "co-owners," extent of an individuals employment security, and voting rights. These factors have been identified in many cases because they are drawn from the "common-law principles as codified in the [Uniform Partnership Act] ...."[86] Following discussion of the factors listed above, this Note will suggest two more: the ability to determine the salaries of others and the ability to make decisions outside of an individual's immediate scope of influence.

1. The Right and Duty to Participate in Management

Courts' current application of the factor of the right and duty to participate in management is too vague. It fails to identify exactly what constitutes management. Is any type of management sufficient? Controlling lower level employees is indicative of both managerial right and duty, but it does not necessarily establish a sufficient state of independence from which one could draw the conclusion that the individual cannot be a victim of employment discrimination. Perhaps higher-level managerial decisions involving firm-wide decisions would be more indicative of independency. The application of this factor should be renamed so a court need only examine one or two species of higher-order managerial duties rather than the whole gamut of possible managerial functions.

Courts assessing an individual's ability to control and operate the business will likely encounter the vagueness problem. Floor

86. Simpson v. Ernst & Young, 100 F.3d 436, 443-444 (6th Cir. 1996), *cert. denied*, 520 U.S. 1248 (1997) (citing Fountain v. Metcalf, Zima & Co., P.A., 925 F.2d 1398, 1400-01 (11th Cir. 1991), Wheeler v. Main Hurdman, 825 F.2d 257, 276 (10th Cir. 1987), and Caruso v. Peat, Marwick, Mitchell & Co., 664 F. Supp. 144 (S.D.N.Y. 1987)).

managers often have an ability to control and operate the day-to-day business of the firm, but this establishes neither partnership status nor independence. In a more general sense, an individual's power to control the firm (or, at the very least resist domination by it) is the criterium the economic realities test uses to determine eligibility for certain protections.[87] If an individual's power to control was easy to quantify, however, these other factors would not be needed. Saying that a court should consider an individual's right to control and operate the business, therefore, merely restates the obvious that the court should employ the economic realities test. Such an analysis gives no guidance, however, as to the substance of making such a determination.

2. *Exposure to Liability and Sharing in Firm Losses*

Exposure to liability and sharing in firm losses are factors that courts should disregard altogether because they serve no purpose in determining whether a business associate is a bona fide partner in a firm. Employers seeking to reduce liability under discrimination laws by mislabeling employees as partners have only an increased incentive to make those employees jointly liable for business debts as well. For example, in *Simpson*, "'[f]or all practical purposes, [Simpson] was an employee with the additional detriment of having promised to be liable for the firm's losses.'"[88] Despite the discussion concerning liability, the court's statement implicitly rejects liability for business debts as a good indicator of actual status; the court recognized that an employee can be liable for losses but still be no closer to real partnership.[89]

As in *Simpson*, liability can be imposed by a partnership agreement that grants none of the additional rights traditionally associated with partnership status. A factor such as individual liability clearly makes the subject *look* like a partner, but a superior indicator of actual status would be the traditional benefits associated with partnership, not the disadvantages. Employers have nothing to lose and everything to gain from imposing the

87. *See* Dowd, *supra* note 17, at 102.
88. *Simpson*, 100 F.3d 442 (quoting Simpson v. Ernst & Young, 850 F. Supp. 648, 665 (S.D. Ohio 1994)).
89. *See id.*

drawbacks of partnership status on associates while withholding the benefits.

The modern partnership agreement imposes terms that are not necessarily bargained for.[90] Assuming the firm grants powers to the rising partner at the firm's discretion, leaving the partner twice deprived is inequitable and runs contrary to the purpose of employment discrimination legislation.[91] Any test assessing the fairness of withholding federal protections not should take into account the control a firm exercises over the individual, but rather the power that the *individual* wields over the firm.

3. Fiduciary Relationship Among Partners

The fiduciary relationship existing within the partnership should also be afforded less weight than it currently is because fiduciary duties vary based on the nature of the business entity rather than the power of the individuals operating within it. Although fiduciary duties between the parties are substantially indicative of the employment relationship[92] and are not subject to easy manipulation, they also may be impossible to measure. Economic realities analysis accepts the premise that proper classification should reflect the rights and duties of an employee rather than assume they exist by virtue of the classification. History dictates neither the present nor the future; relationships can evolve or regress over time. A proper inquiry should center on the state of affairs at the time the partnership agreement or analogous document was negotiated and executed.

4. Investment in the Firm and Ownership of Firm Assets

Generally, firm assets may be included in a compensation package, or title to them may be otherwise transferred completely independent of an employment relationship. Employees commonly

90. *See supra* note 83 and accompanying text.

91. *See supra* notes 74-84 and accompanying text.

92. *See* Bret L. Grebe, *Fidelity at the Workplace: The Two-Faced Nature of the Duty of Loyalty Under* Dalton v. Camp, 80 N.C. L. REV. 1815, 1819 (2002) ("[T]he employment-agency relationship gives rise to some fiduciary duty of loyalty, the breadth and scope of which depends on the nature of the employment relationship.").

own stock in the company for which they work—this does not make them partners, nor does it demonstrate a per se ability to protect their employment interests.[93] Ownership of firm assets, therefore, is not necessarily indicative of status. Although an individual owning a significant block of firm assets more justifiably could be regarded as having sufficient power to protect those interests, such an individual rarely will fail to satisfy the prima facie exemption threshold as it would be determined by alternative factors suggested below. In short, there are factors at the courts' disposal that are more dispositive on this issue than investment and ownership.[94]

5. The Right and Duty to Act as an Agent of Other Partners

Agency should be an important factor in determining status, notably because the partnership exemption itself rests upon the foundation of agency liability.[95] Acts of one partner can be imparted to the others, exposing all partners to substantial risk. Accordingly courts have made the right to act as an agent of the partnership an important element of the analysis. The Sixth Circuit found it very telling that, in *Simpson v. Ernst & Young*, "[Simpson] had no authority to sign promissory notes on behalf of the firm, or pledge, transfer, or otherwise assign his interest in the firm."[96]

Vicarious liability, however, operates to bind the partnership in the same manner as agency liability. An employee acting within the scope of his or her employment can expose the employer in the same way one partner can expose the other partners, yet that employee is no closer to partnership status. Furthermore, modern partnership statutes provide for the inadvertent creation of partnerships[97]

93. Only inside investors are included in this inquiry, as outside investors are by definition neither employees nor partners.

94. *See infra* Part III.B. Note that corporate employees who are also shareholders present a problem beyond the scope of this Note. *See supra* note 10.

95. *See supra* note 21 and accompanying text.

96. 100 F.3d 436, 441 (6th Cir. 1996).

97. *See* UNIF. P'SHIP ACT § 202 cmt. 1 (1997), 6 U.L.A. 93 (2001) (noting that co-owners of a business for profit "may inadvertently create a partnership despite their expressed subjective intention not to do so").

and the creation of partnerships by estoppel for liability purposes.[98] Though probative, the ability of an agent to expose the partnership to liability is not dispositive of status, nor does it conclusively show an individual's ultimate power of control within a business entity.

It is also worth noting that in limited liability firms, personal liability is a less salient issue. As a result, the agency-liability underpinnings of the partnership exemption weaken, and an individual's ability to subject his or her associates to liability loses much significance. In limited liability settings, the right and duty to act as an agent of other partners should be afforded no substantial weight.

6. *Use of the Term "Co-Owners"*

Co-owners of a business for profit can be deemed de facto partners even if contrary to their intent.[99] Similarly, there is no requirement that the term be used only where the reality of the situation is less than equal ownership and participation. The economic realities test replaced the per se rule because courts and the legislature preferred a test based on reality to a test based on identity. Use of the term "co-owners," therefore, should not be afforded much weight in the determination of employment status and eligibility for benefits under Title VII, the ADEA, or ERISA.

7. *Extent of the Individual's Employment Security*

The fact that an employment relationship cannot be characterized as employment-at-will speaks volumes about an individual's ability to protect his or her interest within a business entity.[100]

98. *See* UNIF. P'SHIP ACT § 308 (1997), 6 U.L.A. 128 (2001) (imposing partnership liability on a person who has been held out as a partner and who has consented to that representation).

99. *See* UNIF. P'SHIP ACT § 202(a) (1997), 6 U.L.A. 92 (2001) ("[T]he association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership.").

100. "The employment at-will doctrine permits employers to terminate employees at any time and for any reason, or more importantly, for no reason at all ...." James E. Defranco, *Modification of the Employee at-will Doctrine—Balancing Judicial Development of the Common Law with the Legislative Prerogative to Declare Public Policy*, 30 ST. LOUIS U. L.J. 65, 65 (1985). Where the employment is not at-will, the employee cannot be terminated in

Employment security, however, is not dispositive of partnership status. It is possible for an employee to have a twenty-year or even a lifetime employment contract and still lack the traditional indicia of partnership status.

Employment security may also be impossible to measure. Admittedly, many of the factors discussed in this Note are difficult to gauge or are volatile (another reason to keep the number of factors involved at a minimum), but employment security is even more complex and shifting than most. First of all, job security must take into account more than just an employee's work. Relationships with superiors and clients, ability to bring new work to the firm, name recognition, and type of work must all be considered. The weight given each is likely to change significantly depending on the company, and a change in company management, the economy, or client list could affect job security overnight. In short, this is merely another factor that helps courts identify true partners, but could be replaced by other factors more indicative of actual status.

8. Voting Rights

Voting rights seem to be a fairly good indicator of an individual's ability to protect his or her own interests. Furthermore, voting rights are part of a traditional bundle of rights associated with equity partners.[101] The right to vote on business decisions may not protect an individual's interest as clearly as it may first appear.

A right to vote does not necessarily correlate with a right to be heard. Voting rights may become merely nominal if others, whether possessing greater or lesser voting rights, wield a greater share of influence. In other words, company dynamics other than the best judgement of the majority of those eligible to cast their ballots may contribute to the outcome of a vote. Tactics that may weaken voting rights include the use of weighted votes or the requirement of supermajority approval.[102] Under these circumstances, those

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the absence of just cause. *Id.* at 67.

101. *See* Dennis B. Arnold, *Creditors' Rights and Partnership Debtors: Selected Issues in Structuring Partnership Debt and an Approach to Workouts*, 19 ANN. INST. ON REAL EST. L. 351 (1990).

102. *See* Jonathan Shub, Comment, *Shareholder Rights Plans—Do They Render Shareholders Defenseless Against Their Own Management?*, 12 DEL J. CORP. L. 991, 1004

occupying the actual seats of power—the majority—obtain a stranglehold on the controls and voting rights may become illusory.

B. Some Suggested Factors

1. Ability to Determine the Salaries of Others

This factor works well to single out those possessing true power within a business entity with one qualification; the salaries an individual is empowered to set must be those of employees with substantial value to the firm. An individual may determine what his or her secretary gets paid, but this right does not necessarily correlate with the power or ability to protect one's own interests. An ability to set the salaries of a block of employees or of crucial employees is more indicative of an individual's status.

This factor combines the elements of several other factors. Establishing compensation levels on behalf of the firm indicates a right and duty to act as an agent of the firm (the established compensation level will bind the firm) as well as a right and duty to participate in management. Furthermore, it provides less incentive for manipulation than some of the other factors used by courts. Firms would be less likely to grant this right to their employees in an effort to falsely designate them as partners because of the importance of the duty. Unlike a grant of voting rights, for example, this power cannot be made illusory by other arrangements.

2. Ability to Make Decisions Outside of One's Own Ambit

An individual with influence across the spectrum of a business is empowered beyond one who merely carries influence within his or her own ambit. Influence beyond one's own ambit could be defined as cross-departmental control. A marketing executive's ability to influence decisions made in other departments, such as information technology, human resources, or research and development, is exercising influence beyond his or her own ambit. One who oversees

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(1987) (discussing the use of "phased" voting rights, superior voting rights, and supermajority voting plans to defend against takeovers by diluting an acquirer's voting power).

multiple departments will almost certainly satisfy this test. In a partnership, the partners equally share the broad powers of the business. Identifying an individual's ability to make decisions normally lying beyond the range of that individual's immediate sphere of influence thus seeks to identify relationships replicating the form of a true partnership.

This inquiry is not limited by business form. A court trying to determine whether it is inequitable to deny protection to an individual based on an assessment of true partnership power can determine the scope of an individual's influence regardless of the nature of the entity involved. Cross-departmental control is possible in a limited liability partnership (LLP), limited liability company (LLC), professional corporation (PC), or any other modern business form.

Unlike other factors currently in use, the answer can be given either in the affirmative or the negative. There is no gradient or balancing test involved. Take, for example, investment in the firm. How much is enough? Thresholds will vary by circuit, by court, and by state, producing the sort of inconsistent decisions that mar the application of the economic realities test. As a result, using an individual's scope of decision-making ability to determine status will decrease litigation relative to other gradient-oriented approaches, thereby conserving judicial resources. Not only will the inquiry be shorter and more simplified for courts, but employers will be able to more accurately predict which employees should be eligible for benefits and which employees can be justifiably exempted.

Finally, this factor is nearly devoid of an incentive to manipulate. Firms will be unlikely to grant this right to their employees in an effort to falsely designate them as partners for two primary reasons. First, the concession does not justify the gain. Allowing an employee to influence the course of the business, not only in his or her own realm but in others' as well, is too much power to grant an employee simply to remove them from the reach of employment discrimination legislation.

Second, the number of individuals within a firm empowered to make decisions is naturally limited. If everyone were permitted a say in firm-wide decisions, it would be analogous to the case of voting rights, which may offer illusory power, and a court would not be satisfied that an exemption is valid. If only certain individuals are empowered to make such decisions, however, the number of employees will outweigh the number of decisions to be made and the category of individuals possessing that broad discretionary power must be limited.

In short, a large firm cannot designate too many of its employees as true partners by assigning them all broad decision-making ability because the result would be chaotic and, once again, the concession would not justify the gain. A smaller firm, however, could designate a large number of its employees as true partners. In such a case, assuming voting power is real, it may be proper to conclude that all members are subject to exemption.

C. A Shortened List of Factors

For the reasons stated above, the most telling factor, as well as the simplest to apply, is an individual's right to make decisions beyond his or her own ambit. Another factor courts may use to supplement a simplified economic realities test is an individual's right to determine the compensation levels of crucial employees. Although both of these factors are relevant, a strong showing of one should be enough to subject an employee to exemption. It is difficult to imagine a situation in which an individual will possess these rights and not possess many or all of the myriad factors traditionally used in the economic realities test. For example, individuals who qualify for an exemption under the two suggested factors will also most likely possess a substantial degree of employment security, a right to vote on key issues, a right and duty to participate in firm profits and losses, and a right to act as an agent of other partners. The proposed factors identify individuals with a right to control and operate the business and to participate in management, only in a more concrete fashion. In other words, the inquiry is more likely to be answered objectively by applying these tests than by requiring a judge to make a subjective determination whether the power to control and manage is sufficient to justify exemption.

D. Application of the Exemption Test

Limited liability companies present a difficult case for several reasons. First, they are relatively new, so there is little case law to guide an inquiry.[103] Professor Kleinberger also points out two additional complexities:

> [T]he hybrid nature of an LLC (part partnership and part corporation), and the resulting difficulty in extrapolating from cases dealing with analogous issues in the context of partnerships and corporations; and ... the dichotomous nature of any LLC member who actively works for an LLC—one part capitalist owner, one part laboring service provider. The [latter] source is especially problematic because the available case law has had difficulty handling that dichotomy in the context of well-established entities—i.e., partnerships and corporations.[104]

The nature of the entity, consisting of both corporate and partnership elements, as well as the nature of the member, who is at once an owner and an employee, generally make LLCs a hotbed of employment law questions.

Most LLC statutes grant the organizers freedom to set the management powers vested in each member.[105] Management can be centralized, as in a corporation, or all members can retain management rights, which essentially means that control is dispersed equally among members as in a partnership.[106] LLCs can be member managed or non-member managed, though members

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103. *See* Susan Kalinka, *Assignment of an Interest in a Limited Liability Company and the Assignment of Income*, 64 U. CIN. L. REV 443, 443 (1996) ("It is difficult to describe the characteristics of an LLC with perfect accuracy because a Uniform Limited Liability Company Act has not been widely adopted ....") (footnote omitted); Kleinberger, *supra* note 4, at 481.

104. Kleinberger, *supra* note 4, at 481.

105. *See, e.g.*, Missouri Limited Liability Company Act §§ 359.745-.746, MO. ANN. STAT. §§ 347.079-.081 (West 2001). The Missouri approach is based on the American Bar Association Draft Prototype LLC Act. Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, But Heading Where?*, 45 SYRACUSE L. REV. 1193, 1206 (1995).

106. *See* Nimrod T. Chapel, Jr., *The Limited Liability Company: Small Business Applications in Missouri*, 53 J. MO. B. 348 (1997), *available at* http://www.mobar.org/journal/1997/novdec/chapel.htm (last visited Feb. 3, 2003).

commonly reserve management powers for themselves.[107] There are, therefore, an infinite number of gradations with regards to the power each individual member of the LLC may possess; a case-by-case inquiry using scores of factors is simply inefficient and impractical.

Choice of management structure is contemporaneous with formation. Centralized management in an LLC functions much like a corporate board of directors.[108] If centralized management is chosen, all those occupying the seats of power would by definition possess the ability to make cross-departmental decisions. Members not on the central managerial board would not be expected to participate in firm-wide management. Any member with a right to make firm-wide decisions falling beyond the scope of his or her area of specialization, therefore, would occupy a position of influence sufficient to show a lack of dependence on the employer and limited vulnerability to employment discrimination.

The company could exempt the member managers from federal protection and the burden would then shift to the plaintiff-member to rebut the prima facie showing of influence beyond the member's ambit and/or ability to set the salaries of others. If this is not done, the member will forfeit standing. Post hoc suits would be allowed to proceed only on the limited grounds that assurances of management participation and salary control were illusory—i.e., never materialized or influence was greatly diluted by factors unknown to the employee at the time of the execution (such as a weighted voting system, etc.). Any member not represented on the management board would probably be nonexempt, as he or she would likely possess none of the attributes used to demonstrate lack of dependency under the exemption test this Note proposes.

Where an LLC opts out of centralized management, no well defined group of individuals within the company occupies the seat of power.[109] If decisions are truly made by all members, then all

107. *See id.*

108. *Id.* at 352 n.102 ("An LLC that provides for centralized management is similar to a corporation electing a board of directors."); *see also* Treas. Reg. § 301.7701-2(c) (as amended in 1993).

109. If, in the alternative, the LLC elects centralized management, a well-defined group of individuals will occupy the seat of power. Centrally managed (also called member-managed) LLCs are governed by a body analogous to a corporate board of directors. *See, e.g.*, Kalinka, *supra* note 103, at 453 ("The managers, who are chosen by the members, can be

members would possess the powers sufficient to subject their offices to exemption.[110] If, on the other hand, certain members have the final say in firm-wide decisions, then the facade of independence may give way to the justification for federal protections on behalf of the less privileged members. If, for example, senior members were given the final say on firm-wide policy issues, then newer members would become exemption-proof even in the absence of centralized management. The burden in a suit would then shift back to the company to rebut the prima facie showing of dependency by showing that the member does possess legitimate influence in decision making outside the scope of his or her ambit and/or can set the salaries of crucial employees. If the company fails to exercise this option prior to the execution of the employment agreement, it must later overcome a presumption in favor of the employee by showing that, regardless of the original intent, such employee did enjoy those powers.

The exemption test allows companies to retain freedom of choice in two ways. First, it allows a company to determine in its formative stages the permissible scope of autonomy from federal regulations. If a firm wishes to retain carte blanche with regard to employment decisions, then it need only extend to those members employed solely at the employer's discretion sufficient powers with which to protect their own interests. Otherwise, the company is on notice that federal regulations apply. Employees will no longer be deprived of both power and the protection of federal discrimination laws. Instead, employees will knowingly forfeit federal protections in exchange for greater power.

Second, a firm may wish to extend federal employment discrimination protection to employees even if the employees are nonexempt. Though at first glance it may appear that management would cripple its own interests by opening the door to increased litigation, competition for skilled employees in the workforce may drive employers to offer greater job security to gain a competitive edge in recruitment. Because workplace discrimination should be

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compared to the directors of a corporation whom the shareholders elect to manage the corporation's business and affairs.") (citations omitted).

110. Note that, as described above, all members may have a vote but, in a large LLC, the weight of that vote may be so diluted that it would be a stretch to say that the employee is making decisions. In these cases, nobody, not everybody, would be subject to exemption.

discouraged in the first place, any system wherein employers were precluded from providing additional protection to their employees despite a desire to do so would be counterproductive. Employers, therefore, should retain a right to construe all of their employees as nonexempt, and to draft employment contracts offering additional job security at their discretion.

CONCLUSION

For the purpose of determining eligibility for protection under employment discrimination legislation, courts must determine who qualifies as an employee and who is more accurately characterized as a partner or employer. Courts have in the past used two different measures to make this determination, the per se rule and the economic realities test.

The per se rule is generally a formalistic approach in which a business entity's choice of organizational form is dispositive. Courts utilizing the per se rule universally offer protection to plaintiffs litigating against entities in corporate form. Partners of a business in partnership form, on the other hand, are exempted from protection on the grounds that they are employers rather than employees. Labels are conclusive proof of ineligibility, though some courts may look further to determine if partnership status is equitable or merely nominal.

The economic realities test rejects the formalistic per se rule in favor of a more flexible standard offering protection to both nominal partners and employees who do not share the traditional rights and duties of partners. In other words, where reality does not evidence an individual's ability to protect his or her own interests, the economic realities test recognizes that exemption from federal protections is unwarranted. Traditional economic realities tests use many factors and an extensive inquiry to determine whether fancy job titles reflect one's actual ability to defend oneself against adverse employment actions.

The per se rule offers predictability for both employers and employees, and thus conserves judicial resources. It also provides firms with the ability to self-regulate and respects their freedom to choose their own associates and opt out of exposure to certain types of liability through choosing partnership over corporate form. The economic realities test effectuates congressional intent by extending protection to those who need it, regardless of status. It also prevents firms from easily circumventing federal legislation through false designation and may reduce dependency on government assistance.

Modern business forms blur the line between partnership and incorporation, and modern partnership agreements resemble contracts of adhesion rather than arms-length bargaining arrangements. Thus, a formalistic approach is no longer justified, though any new test should not ultimately disregard the strengths of the per se rule, including predictability and economy.

Of all the economic realities test factors that a court might consider, the right and duty to make decisions outside an individual's own ambit and the right and duty to set the compensation levels of others are the most indicative of status sufficient to justify exemption from federal employment discrimination laws. Not only do these factors encompass more specific inquiries (i.e., investment in the firm), they also are the most indicative of more general inquiries vis-á-vis other proposed factors (i.e., ability to control and operate the business and the right and duty to participate in management).

Under the exemption test proposed in this Note, an employer could exempt individuals holding predetermined offices from protection, subject to a rebuttable threshold showing of true partner status. In the event of an ex ante challenge to exemption status, sufficient power to qualify an individual for exemption at the discretion of his employer will be determined by a simplified version of the economic realities test, involving only two factors: an individual's right and duty to make business decisions beyond his or her range of specialization, and the right to set the compensation levels of non-trivial employees.

Post hoc challenges would only be permitted on the grounds that actual duties differed from those reasonably anticipated by the moving party, and must still overcome a presumption in favor of the nonmoving party.

The exemption test would conserve judicial resources and foster predictability among both employees and employers. It would also allow firms to opt out of exposure to certain types of liability by designating certain employees as exempt and, consequently, beyond the scope of employment discrimination laws. The exemption test, however, does not frustrate congressional intent because it does not refuse protection to those who need it; partners ineligible for exemption fall within the protections of federal law. It also prevents firms from easily circumventing the legislation through thus endowing their employees with bogus titles. The exemption test combines the desirable elements of both the per se rule and the economic realities test.

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