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## Gray Power in the Gray Area Between Employer and Employee: The Applicability of the ADEA to Members of Limited Liability Companies

Alan R. Haguewood

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# Gray Power in the Gray Area Between Employer and Employee: The Applicability of the ADEA to Members of Limited Liability Companies

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## I. INTRODUCTION

The American populace is aging.<sup>1</sup> At the same time, modern medicine enables Americans to remain productive members of the workforce for a longer period of time.<sup>2</sup> The confluence of these two

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1. As one author ominously announced, "Last year [1996], the baby boomers . . . officially entered middle age when the eldest among them started turning 50." Lisa Stansky, *New Age Woes*, 83 A.B.A. J., Jan. 1997, at 66.

2. "By the year 2000, boomers will account for more than 70 million workers (49.2 percent of the work force). By 2004, the youngest turn 40, the magic number for protection under [the ADEA]." *Id.* at 67; see also Ron Stodghill II, *The Coming Job Bottleneck: What an*

trends augurs increased use of the Age Discrimination in Employment Act ("ADEA"),<sup>3</sup> as companies try to force aging employees to retire despite their prolonged productivity.<sup>4</sup>

Another trend within the past decade has been the rise of various hybrid corporate forms that combine the beneficial aspects of partnerships and corporations, one example of which is the limited liability company ("LLC").<sup>5</sup> This increase in the number of different

*Aging Workforce Means for Everyone Else*, BUS. WK., Mar. 24, 1997, at 184 (discussing the implications of "America's demographic reality[, that] [i]ts workforce is growing old").

3. 29 U.S.C. §§ 621-34 (1994).

4. "[F]or employers hoping to ease [baby boomers] out of the marketplace over the next two decades, [the aging of the populace] boils down to just one word: litigation. Yesterday's rebels could easily turn into tomorrow's age discrimination plaintiffs . . ." Stansky, *supra* note 1, at 66. The recent trend toward mandatory retirement policies exacerbates the problem. For an example of this trend in law firms, many of which organize as LLCs, see Paul M. Barrett, *Sixty-something Lawyer Gets a Fresh Start*, WALL ST. J., Feb. 6, 1997, at B1. Barrett details the ordeal of 65-year-old Richard Levy, a prominent partner at Kirkland & Ellis. The firm enforced against Levy its rule that 65-year-olds relinquish their lucrative partnership status or leave. The author noted that only recently have law firms enforced retirement rules, attributing the change to an increase in the emphasis on the bottom line, as law firms manage themselves more like businesses. *See id.* In addition, many firms greatly expanded in size in the late 1960s and early 1970s, creating an unusually large number of partners who are now hitting their sixties. *See id.*

5. An LLC is "a type of firm that combines partnership-type default rules with corporate-type limited liability." Larry E. Ribstein, *Possible Futures for Unincorporated Firms*, 64 U. CIN. L. REV. 319, 319 (1996). Between 1990 and 1994, "forty-nine of the fifty-one United States jurisdictions adopted LLC statutes. Texas further complicated the picture in 1992 by inventing the limited liability partnership ("LLP") . . . . Since 1992, 40 jurisdictions have adopted LLP provisions." *Id.* at 319-20. For further data on the formation of LLCs and other business entities in selected states, see Larry E. Ribstein, *Statutory Forms for Closely Held Firms*, 73 WASH. U. L.Q. 369 (1995).

Whether the LLC will be supplanted by other "hybrid" business forms is questionable. The most obvious candidate is the LLP. A related and even newer entity is the limited liability limited partnership ("LLLLP"). Because both are general partnerships in almost every respect, however, general partnership law will likely apply. Presumably, then, courts will apply the partnership exemption to LLPs and LLLPs with the same frequency as they do to general partnerships, though that topic is beyond the scope of this Note, which deals only with LLCs. Since 1992, 40 jurisdictions have adopted LLP provisions. These include Arizona (codified in scattered sections of ARIZ. REV. STAT. ANN. §§ 29-103 to 29-257 (West Supp. 1996)); California (CAL. CORP. CODE §§ 15047-15058 (West Supp. 1997)); Colorado (codified in scattered sections of COLO. REV. STAT. ANN. §§ 7-60-102 to 7-62-1104 (West Supp. 1997)); Connecticut (codified in scattered sections of CONN. GEN. STAT. ANN. §§ 34-40 to 34-81z (West Supp. 1997)); Delaware (codified in scattered sections of DEL. CODE ANN. tit. 6, §§ 1502-1552, 17-214 (Supp. 1996)); District of Columbia (codified in scattered sections of D.C. CODE ANN. §§ 41-101 to 41-148 (Supp. 1997)); Florida (codified in scattered sections of FLA. STAT. ANN. §§ 620.78-789 (West Supp. 1997)); Georgia (codified in scattered sections of GA. CODE ANN. §§ 14-8-2 to 14-8-64 (Supp. 1997)); Idaho (codified in scattered sections of IDAHO CODE §§ 53-302 to 53-343C (Supp. 1997)); Illinois (codified in scattered sections of 805 ILL. COMP. STAT. 205/2 to 205/40 (West Supp. 1997)); Indiana (codified in scattered sections of IND. CODE ANN. §§ 23-4-1-2 to 23-4-1-52 (Michie Supp. 1995)); Iowa (codified in scattered sections of IOWA CODE ANN. §§ 486.2-46 (West Supp. 1997)); Kansas (codified in scattered sections of KAN. STAT. ANN. §§ 17-2708, 17-706, 56-302 to 56-347, 56-1a102 (1994-1995 & Supp. 1996)); Kentucky (codified in scattered sections of KY. REV. STAT. ANN. § 275.015, §§ 362.155-605 (Michie 1996)); Louisiana (codified in scattered sections of LA. REV. STAT. ANN. §§ 9:3431-3435, 12:117 (West 1994 & Supp. 1997)); Maryland

types of corporate entities presents many problems, including the application of statutes, like the ADEA, created long before the advent of the various corporate forms. Facing the same discrimination experienced by some of their peers in more traditional corporate entities, aggrieved aging members of LLCs will soon enter courtrooms to claim ADEA protection. While these complainants will argue they are employees for purposes of the ADEA,<sup>6</sup> the companies will likely respond that the unique structure of the LLC makes the members *de facto* partners,<sup>7</sup> or employers, with no standing to sue under the Act.

This Note attempts to give courts the tools necessary to address this approaching dilemma. The second Part of this Note describes the rise of the hybrid corporate form, paying particular attention to the structure of the LLC. In addition, it provides a background for discussing conflicting judicial attempts to define "employee" for purposes of the ADEA. Part III examines decisions affecting the standing of principals in different types of business organizations. In doing so, it points out the effect of choosing to emphasize corporate

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(codified in scattered sections of MD. CODE ANN., BUS. OCC. & PROF. § 1-101 (Supp. 1997) and MD. CODE ANN., CORPS. & ASS'NS §§ 1-203 to 10-102 (Supp. 1997)); Massachusetts (MASS. GEN. LAWS ANN. ch. 108A, §§ 1-49 (West Supp. 1997)); Michigan (codified in scattered sections of MICH. COMP. LAWS ANN. §§ 449.15-48 (West Supp. 1997)); Minnesota (codified in scattered sections of MINN. STAT. ANN. §§ 319A.02-12, 323.02-323.47 (West 1995-1996 & Supp. 1997)); Mississippi (codified in scattered sections of MISS. CODE ANN. §§ 79-12-3 to 79-12-119 (1996 & Supp. 1997)); Missouri (codified in scattered sections of MO. ANN. STAT. §§ 358.020-510 (West Supp. 1997)); Montana (codified in scattered sections of MONT. CODE ANN. §§ 35-10-102 to 35-10-710 (1995)); Nevada (codified in scattered sections of NEV. REV. STAT. ANN. §§ 87.020-560 (Michie 1994 & Supp. 1995)); New Jersey (codified in scattered sections of N.J. STAT. ANN. §§ 42:1-2 to 42:1-49 (West Supp. 1997)); New Mexico (codified in scattered sections of N.M. STAT. ANN. §§ 54-1A-101 to 54-1A-1206 (Michie Supp. 1997)); New York (codified in scattered sections of N.Y. PARTNERSHIP LAW §§ 2-71, 121-1500 to 121-1504 (McKinney Supp. 1997)); North Carolina (codified in scattered sections of N.C. GEN. STAT. §§ 55B-9, 59-32 to 59-84.3 (1995 & Supp. 1997)); North Dakota (codified in scattered sections of N.D. CENT. CODE §§ 45-22-01 to 45-22-27 (Supp. 1997)); Ohio (codified in scattered sections of OHIO REV. CODE ANN. §§ 1775.05-1777.03 (West 1994)); Oregon (OR. REV. STAT. §§ 68.670-790 (Supp. 1997)); Pennsylvania (codified in scattered sections of 15 PA. CONS. STAT. ANN. §§ 8201-8221 (1995)); South Carolina (codified in scattered sections of S.C. CODE ANN. §§ 33-41-20 to 33-41-1210 (Law. Co-op. Supp. 1996)); South Dakota (codified in scattered sections of S.D. CODIFIED LAWS §§ 48-1-1 to 48-7-111 (Michie Supp. 1997)); Tennessee (codified in scattered sections of TENN. CODE ANN. §§ 61-1-101 to 61-1-147 (Supp. 1997)); Texas (codified in scattered sections of TEX. REV. CIV. STAT. ANN. art. 6132a-1 to art. 6132b-10.04 (West Supp. 1997)); Utah (codified in scattered sections of UTAH CODE ANN. §§ 48-1-1 to 48-1-48 (Supp. 1997)); Virginia (codified in scattered sections of VA. CODE ANN. §§ 50-43.1 to 50-73.78, 54.1-3902 (Michie 1996 & Supp. 1997)); Washington (codified in scattered sections of WASH. REV. CODE ANN. §§ 25.04.700-750 (Supp. 1997)); Wisconsin (WIS. STAT. ANN. §§ 178.01-53 (West Supp. 1997)). See generally ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG & RIBSTEIN ON LIMITED LIABILITY PARTNERSHIPS AND THE REVISED UNIFORM PARTNERSHIP ACT (1997).

6. The ADEA prohibits age discrimination in employment relationships. See *infra* notes 22-25 and accompanying text (introducing the basic purpose and application of the ADEA).

7. Specifically, employers will argue for application of the partnership exemption. For a description of this doctrine, see *infra* note 30 and accompanying text.

form or economic reality. By exploring the economic reality of the LLC as well as the nature of the ADEA itself, Part IV attempts to determine how courts should treat members of an LLC under the ADEA. Part V concludes that LLC members, as well as most principals, should be deemed employers as partners have been. Consequently, they should lack standing to sue under the ADEA.

## II. LEGAL BACKGROUND

### A. *Limited Liability Companies: Advent of the Hybrid Corporate Form*

Before the advent of hybrid business organizations such as the LLC, professional groups, including those consisting of lawyers, doctors, and accountants, organized themselves mostly as partnerships. While the partnership form offered favorable tax treatment and ease of management,<sup>8</sup> it also required that all partners be jointly and severally liable for all of the partnership's obligations.<sup>9</sup> As a result, when malpractice claims dramatically increased in the 1980s, professional groups petitioned state legislatures for an alternative organizational form. In particular, these groups sought to limit their vicarious liability while preserving their favorable tax treatment.<sup>10</sup>

State legislatures responded by creating the LLC.<sup>11</sup> As no other statutory business form had previously done, the LLC offered

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8. See CHARLES R. O'KELLEY, JR. & ROBERT B. THOMPSON, *CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS* 61-65 (2d ed. 1996) (discussing the features of general partnerships).

9. See *id.*

10. For an extensive discussion of the impetus for new hybrid forms like LLCs and LLPs, see *id.* at 67-71. See generally Robert B. Thompson, *The Taming of Limited Liability Companies*, 66 U. COLO. L. REV. 921 (1995).

11. Wyoming enacted an LLC statute in 1977, and Florida did likewise in 1982. When the Internal Revenue Service ("IRS") ruled in 1988 that LLCs could qualify for taxation as a partnership, other states followed suit and enacted similar LLC statutes. See Rev. Rul. 88-76, 1988-2 C.B. 360, 361. All 50 states have enacted LLC statutes, with Vermont and Hawaii being the last to do so. See ALA. CODE § 10-12-1 (Supp. 1996); ALASKA STAT. § 10.50.010 (Michie 1996); ARIZ. REV. STAT. ANN. § 29-601 (West Supp. 1996); ARK. CODE ANN. § 4-32-101 (Michie 1996); CAL. CORP. CODE § 17000 (West Supp. 1997); COLO. REV. STAT. ANN. § 7-80-101 (West Supp. 1997); CONN. GEN. STAT. ANN. § 34-100 (West Supp. 1997); DEL. CODE ANN. tit. 6, § 18-101 (Supp. 1996); FLA. STAT. ANN. § 608.401 (West Supp. 1997); GA. CODE ANN. § 14-11-100 (1994); HAW. REV. STAT. § 428-101 (Supp. 1996); IDAHO CODE § 53-601 (1994); 805 ILL. COMP. STAT. ANN. 180/1-1 (West Supp. 1997); IND. CODE ANN. § 23-18-1-1 (Michie Supp. 1997); IOWA CODE ANN. § 490A.100 (Supp. 1997); KAN. STAT. ANN. § 17-7601 (Supp. 1996); KY. REV. STAT. ANN. § 275.001 (Michie Supp. 1996); LA. REV. STAT. ANN. § 12:1301 (West 1994); ME. REV. STAT. ANN. tit. 31, § 601 (West 1996); MD. CODE ANN., CORPS. & ASS'NS § 4A-101 (Supp. 1997); MASS. GEN. LAWS ANN. ch. 156C, § 1 (West Supp. 1997); MICH. COMP. LAWS ANN. § 450.4101 (West Supp.

limited liability with respect to third-parties,<sup>12</sup> favored pass-through tax treatment,<sup>13</sup> and flexible governance rules. The LLC, therefore, is

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1997); MINN. STAT. ANN. § 322B.01 (West 1995); MISS. CODE ANN. § 79-29-101 (1996); MO. ANN. STAT. § 347.010 (West Supp. 1997); MONT. CODE ANN. § 35-8-101 (Smith 1995); NEB. REV. STAT. § 21-2601 (Supp. 1996); NEV. REV. STAT. ANN. § 86.011 (Michie Supp. 1995); N.H. REV. STAT. ANN. § 304-C:1 (1995); N.J. STAT. ANN. § 42:2B-1 (West Supp. 1997); N.M. STAT. ANN. § 53-19-1 (Michie 1996); N.Y. LTD. LIAB. CO. LAW § 101 (McKinney 1997); N.C. GEN. STAT. § 57C-1-01 (1993); N.D. CENT. CODE § 10-32-01 (West 1995); OHIO REV. CODE ANN. § 1705 (West 1994); OKLA. STAT. ANN. tit. 18, § 2000 (West Supp. 1997); OR. REV. STAT. § 63.951 (Supp. 1996); 15 PA. CONS. STAT. ANN. § 8901 (Supp. 1997); R.I. GEN. LAWS § 7-16-1 (1992); S.C. CODE ANN. § 33-43-101 (Law. Co-op. Supp. 1996); S.D. CODIFIED LAWS § 47-34-1 (Michie 1997); TENN. CODE ANN. § 48-201-101 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 1528n (West 1997); UTAH CODE ANN. § 48-2b-101 (Supp. 1997); VA. CODE ANN. § 13.1-1000 (Michie Supp. 1997); VT. STAT. ANN. tit. 11, §§ 3001-3154 (1997); WASH. REV. CODE ANN. § 25.15.901 (West Supp. 1997); W. VA. CODE § 31B-1-101 (1996); WIS. STAT. ANN. § 183.0102 (West Supp. 1997); WYO. STAT. ANN. § 17-15-101 (Michie 1997).

Recognizing the increasing popularity of using alternative corporate forms, the National Conference of Commissioners on Uniform State Laws adopted the Uniform Limited Liability Company Act ("ULLCA") in August 1994. As with other uniform acts, the ULLCA will serve to focus debate on and legislative reform of the proper LLC form.

12. "Naturally, the primary function of a *limited liability* company is to provide limited liability to its members." Eric Fox, Note, *Piercing the Veil of Limited Liability Companies*, 62 GEO. WASH. L. REV. 1143, 1147-43 (1994). In addition, "[t]he managers of an LLC . . . enjoy limits on personal liability." *Id.*

13. The current tax treatment of the LLC is yet another feature attractive to businesses and is largely responsible for the growing acceptance of LLCs. Corporations are subject to double taxation, while partnerships enjoy a more beneficial "single tax" scheme. Victor E. Fleischer, Note, "If It Looks Like a Duck": *Corporate Resemblance and Check-the-Box Elective Tax Classification*, 96 COLUM. L. REV. 518, 522-23 (1996) (comparing the "double tax on corporate earnings" with the tax treatment of "flow-through entities" like partnerships). Until recently, the question of whether LLCs would be taxed as partnerships or corporations was unanswered. The IRS first considered the question in 1988, when it ruled that a Wyoming LLC would be classified as a partnership for tax purposes. See Rev. Rul. 88-76, 1988-2 C.B. 360 (1988). The IRS then promulgated regulations to determine whether an unincorporated entity would be taxed as a corporation. See, e.g., Former Treas. Reg. 301.7701-2. These regulations listed six criteria to consider when determining the tax classification: "(1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests." *Id.* An entity would be taxed as a corporation "if the corporate characteristics [were] such that the organization more nearly resemble[d] a corporation than a partnership or trust." *Id.* (citing *Morrissey v. Commissioner*, 296 U.S. 344 (1935)). Because the first two criteria are elements common to both corporations and partnerships, the tax treatment of a particular entity depended on whether it met the remaining four criteria. Specifically, an entity was classified as a partnership if it lacked at least two of the four remaining criteria. See *id.* Because LLCs lack continuity of life and free transferability of interests, they were taxed as partnerships under the former IRS regulations.

The IRS recently determined that those rules had become increasingly formalistic. As a result, the IRS issued new regulations which replace the existing classification ones with a simplified elective procedure. See Treas. Reg. 301.7701-1 to -3 (1996). The regulations, also called "check-the-box" rules, were effective as of January 1, 1997, providing a special transition rule for existing entities. See Treas. Reg. 301.7701(f)(1). The regulations specify those business entities that are automatically classified as corporations and provide that any other business entity, including an LLC, may elect its classification for federal tax purposes. See Treas. Reg. 7701-2(b), -3(a).

a hybrid of the corporate and partnership forms, combining the benefits of each.<sup>14</sup>

The governance characteristics of the LLC, though still evolving, offer more flexibility than that of other organizational forms.<sup>15</sup> LLCs are owned by "members," rather than shareholders or partners. Most LLC statutory default rules assign all management function to the members,<sup>16</sup> who, as a result, have powers similar to those of partners in a general partnership.<sup>17</sup> Members may, however, desire more separation of function. To address this desire, LLC statutes usually provide a set of fall-back rules, which take away most of the management powers and authority that members would otherwise

Needless to say, under the check-the-box rules, most LLCs choose to be taxed as partnerships to avoid double taxation. For a general discussion of the check-the-box regulations, see Fleischer, *supra*, at 518.

14. To wit, it combines corporate limited liability with partnership tax benefits. *See generally* ULLCA prefatory note (1995) ("The allure of the limited liability company is its unique ability to bring together in a single business organization the best features of all other business forms—properly structured, its owners obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership.")

15. All LLC statutes allow members to choose between centralized and direct management. For a detailed discussion of governance rules in member-managed and manager-managed LLCs, see LARRY E. RIBSTEIN & ROBERT R. KEATINGE, 1 RIBSTEIN & KEATINGE ON LIMITED LIABILITY COMPANIES §§ 8.02 to 8.04 (1994).

16. *See, e.g.*, ALA. CODE § 10-12-22(a) (1994); ALASKA STAT. § 10.50.110(a) (Michie 1996); ARIZ. REV. STAT. ANN. § 29-681(a) (West Supp. 1996); ARK. CODE ANN. § 4-32-401(a) (Michie 1996); CAL. CORP. CODE § 17150 (West Supp. 1997); COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1997); CONN. GEN. STAT. ANN. § 34-130 (West Supp. 1997); DEL. CODE ANN. tit. 6, § 18-402 (Supp. 1996); FLA. STAT. ANN. § 608.422 (West Supp. 1997); GA. CODE ANN. § 14-11-304 (1994); IDAHO CODE § 53-621(1) (1994); 805 ILL. COMP. STAT. ANN. 180/15-1 (West 1997); IND. CODE ANN. § 23-18-4-1(a) (Michie 1995); IOWA CODE ANN. § 490A.702(1) (West Supp. 1997); KAN. STAT. ANN. § 17-7612 (1995); KY. REV. STAT. ANN. § 275.030 (Michie Supp. 1996); LA. REV. STAT. ANN. § 12:1311 (West 1994); ME. REV. STAT. ANN. tit. 31, § 651(1) (West 1996); MD. CODE ANN., CORPS. & ASS'NS § 4A-402 (Supp. 1997); MICH. COMP. LAWS ANN. § 450.4401 (West Supp. 1997); MO. ANN. STAT. § 347.079(1) (West Supp. 1997); MONT. CODE ANN. § 35-8-401(1) (1995); NEB. REV. STAT. ANN. § 21-2615 (Supp. 1996); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1995); N.H. REV. STAT. ANN. § 304-C:31(II) (1995); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1997); N.M. STAT. ANN. § 53-19-15(A) (Michie Supp. 1993); N.Y. LTD. LIAB. CO. LAW § 401 (McKinney Supp. 1997); N.C. GEN. STAT. § 57C-3-20(a) (Supp. 1993); OR. REV. STAT. § 63.130 (Supp. 1996); R.I. GEN. LAWS § 7-16-14 (1992); S.D. CODIFIED LAWS ANN. § 47-34-16 (Michie Supp. 1997); UTAH CODE ANN. § 48-2b-125(1) (1994); VA. CODE ANN. § 13.1-1022A (Michie Supp. 1997); WASH. REV. CODE ANN. § 25.15.150 (West Supp. 1997); WIS. STAT. ANN. § 183.0401(1) (West Supp. 1997); WYO. STAT. ANN. § 17-15-116 (Michie 1997). *But see* MINN. STAT. ANN. § 322B.606 (West 1995) (requiring use of managers); N.D. CENT. CODE § 10-32-69 (1995) (same); OKLA. STAT. ANN. tit. 18, § 2015 (West Supp. 1997) (providing for the use of managers unless otherwise provided); TENN. CODE ANN. § 48-238-101 (Supp. 1994) (containing no default for member or management control); TEX. REV. CIV. STAT. ANN. art. 1528n, art. 2.12 (West 1997) (providing for the use of managers unless otherwise provided).

17. In fact, LLC statutes are largely patterned after the Uniform Partnership Act ("UPA"); consequently, many scholars predict that courts will draw heavily on partnership law precedents governing similar provisions and situations for LLC's. *See generally* O'KELLEY & THOMPSON, *supra* note 8, at 70-71.

possess and assign them to “managers.”<sup>18</sup> These rules allow the managers to function like officers in a corporation. At the formation of the LLC, the members may invoke this fall-back rule by designating in the articles of organization that the LLC shall be managed by managers, not members.<sup>19</sup> In effect, then, current LLC statutes authorize two governance forms: the “member-managed” LLC, which is analogous to a partnership, and the “manager-managed” LLC, which is analogous to a corporation.<sup>20</sup> Indeed, which form is chosen is likely the most important factor in deciding whether an LLC’s members are employees or partners for purposes of the ADEA.<sup>21</sup>

### B. Defining “Employee” Under the ADEA

The ADEA prohibits age discrimination in employment relationships.<sup>22</sup> While courts have construed the ADEA broadly in light of

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18. For statutory provisions for LLC management by managers, see, for example, ALA. CODE § 10-12-22(b) (1994); ALASKA STAT. § 10.50.110(b) (Michie 1996); ARIZ. REV. STAT. ANN. § 29-681(b) (West Supp. 1996); ARK. CODE ANN. § 4-32-401 (Michie 1996); CAL. CORP. CODE § 17151 (West Supp. 1997); COLO. REV. STAT. ANN. § 7-80-401 (West Supp. 1997); CONN. GEN. STAT. ANN. § 34-140(b) (West Supp. 1997); DEL. CODE ANN. tit. 6, § 18-402 (1993); FLA. STAT. ANN. § 608.422 (West Supp. 1997); GA. CODE ANN. § 14-11-304 (1994); IDAHO CODE § 53-621(2) (1994); 805 ILL. COMP. STAT. ANN. 180/15-1 (West Supp. 1997); IND. CODE ANN. § 23-18-4-1(b) (Michie 1995); IOWA CODE ANN. § 490A.705 (West Supp. 1997); KAN. STAT. ANN. § 17-7612 (1995); KY. REV. STAT. ANN. § 275.165 (Michie Supp. 1996); LA. REV. STAT. ANN. § 12:1312 (West 1994); ME. REV. STAT. ANN. tit. 31, § 651(3) (West 1996); MD. CODE ANN., CORPS. & ASS’NS § 4A-402(a)(1) (Supp. 1997); MICH. COMP. LAWS ANN. § 450.4402 (West Supp. 1997); MO. ANN. STAT. § 347.079(2) (West Supp. 1997); MONT. CODE ANN. § 35-8-402(2) (1995); NEB. REV. STAT. § 21-2615 (Supp. 1996); NEV. REV. STAT. ANN. § 86.291 (Michie Supp. 1995); N.H. REV. STAT. ANN. § 304-C:31(I) (1995); N.J. STAT. ANN. § 42:2B-27 (West Supp. 1997); N.M. STAT. ANN. § 53-19-15(B) (Michie Supp. 1996); N.Y. LTD. LIAB. CO. LAW § 408(a) (McKinney Supp. 1997); N.C. GEN. STAT. § 57C-3-24 (Supp. 1993); OR. REV. STAT. § 63.135 (Supp. 1996); R.I. GEN. LAWS § 7-16-15 (1992); S.D. CODIFIED LAWS § 47-34-16 (Michie Supp. 1997); UTAH CODE ANN. § 48-2b-125 (Supp. 1997); VA. CODE ANN. § 13.1-1024 (Michie Supp. 1997); WASH. REV. CODE § 25.15.150 (West Supp. 1997); W. VA. CODE § 31B-4-405 (1996); WIS. STAT. ANN. § 183.0401(2) (West Supp. 1997); WYO. STAT. ANN. § 17-15-116 (Michie 1997).

19. See *supra* note 15 (discussing the statutory choice of management forms for LLCs).

20. Most members will probably choose to manage the LLC directly. Because LLC interests are not freely transferable, the members will likely feel a greater need to participate in management to ensure profitability. In addition, if the LLC chooses to use centralized management, the number of corporate attributes increases, which would have made its partnership tax treatment less certain under the old entity-classification rules. Of course, the check-the-box rules have supplanted the old regulations, see *supra* note 13, but most existing LLCs organized and chose their governance form under the supplanted treasury regulations.

21. See *infra* Part IV.B (discussing the effects of choosing the different governance options for LLCs).

22. There are certain statutory exemptions, however, where age is a relevant employment factor. For instance, where age is a bona fide occupational qualification reasonably necessary to the normal operation of a particular business, the employer may justify a facially discriminatory action. See 29 U.S.C. § 623(f)(1) (1994).



its remedial nature,<sup>23</sup> the statute expressly applies only to discrimination by an employer against an employee or an applicant for employment.<sup>24</sup> Thus, defining "employee" for purposes of the ADEA determines whom the Act protects.<sup>25</sup> The statute itself offers courts no guidance; it defines "employee" in circular fashion, as "an individual employed by an employer."<sup>26</sup> Congress's failure to provide a workable definition has spawned much litigation.<sup>27</sup> As one might expect, courts have employed different tests and have reached different outcomes on almost identical facts. For example, when distinguishing between independent contractors and employees, courts developed three tests, resulting in seemingly incongruent decisions.<sup>28</sup>

Courts also disagree about the Act's applicability to principals of certain business entities. Specifically, courts disagree as to whether partners in a partnership, shareholders in a professional corporation, and directors in a corporation are "employees" and thereby receive ADEA protection.<sup>29</sup> Although courts have consistently

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23. See, e.g., *Lilley v. BTM Corp.*, 958 F.2d 746, 750 (6th Cir. 1992) ("The term 'employee' is to be given broad construction in order to effectuate the remedial purpose of the ADEA"). The Supreme Court, however, recently cast doubt on the validity of this interpretative canon in *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992). There, the Court expressly abandoned its earlier emphasis on construing the term employee "in light of the mischief to be corrected and the end to be attained." *Id.* at 325 (quoting *United States v. Silk*, 331 U.S. 704, 713 (1947)).

24. See 29 U.S.C. § 623(a)(1). This form of discrimination is the only one expressly recognized under the ADEA.

25. Defining "employee" is also important in determining who may be liable under the ADEA. The Act specifies that only employers employing at least 20 workers are covered by the ADEA. See *id.* § 630(b) (defining employer as "a person engaged in an industry affecting commerce who has twenty or more employees for each working day of twenty or more calendar weeks in the current or preceding year"). Thus, whether LLC members are treated as employees will affect the ability of an LLC's nonmembers to claim an ADEA violation.

26. *Id.* § 630(f).

27. In most of these cases, the company's policy or action, such as a mandatory retirement policy, would clearly violate the Act if the plaintiff were deemed an employee. Therefore, the company argues only that persons affected by the concededly discriminatory policy are not employees.

28. See, e.g., *Hayden v. La-Z-Boy Chair Co.*, 9 F.3d 617, 622 (7th Cir. 1993) (applying an "economic reality" test); *Frankel v. Bally, Inc.*, 987 F.2d 86, 90 (2d Cir. 1993) (applying a "common law agency" test); *Oestman v. National Farmers Union Ins. Co.*, 958 F.2d 303, 305 (10th Cir. 1992) (applying a "hybrid" test). In 1992, however, the Supreme Court settled the issue, choosing the common law agency test as the appropriate test for distinguishing between independent contractors and employees for purposes of federal employment discrimination statutes. See *Darden*, 503 U.S. at 323.

29. See *infra* Part III (discussing courts' applications of the statutes to different organizational forms). See generally Troy D. Ferguson, Comment, *Partners as Employees under the Federal Employment Discrimination Statutes: Are the Roles of Partner and Employee Mutually Exclusive?*, 42 U. MIAMI L. REV. 699 (1988) (analyzing federal antidiscrimination statutes and the status of partners as employees); Rebecca R. Luchok, Comment, *Coming of Age in the Professional Corporation: Liability of Professional Corporations for Dismissal of Members Under the Age Discrimination in Employment Act*, 48 U. PITT. L. REV. 1185 (1987) (analyzing the applicability of the ADEA to professional corporations); John Narducci, Note, *The*

recognized the existence of a partnership exemption,<sup>30</sup> finding that bona fide partners are not employees and thus lack standing to sue under the ADEA, courts have had a more difficult time applying the partnership exemption outside the pure partnership form. Courts have struggled to determine whether the exemption properly applies to shareholders of a professional corporation<sup>31</sup> or to directors of a corporation.<sup>32</sup>

The creation and increased use of hybrid corporate forms like the LLC exacerbates the uncertainty in the intended coverage of the ADEA. Just as the ADEA does not address whether partners, shareholders, or directors are employees, it also does not state whether members of an LLC are employees. The LLC stands in the middle between the partnership and the corporation, combining the beneficial elements of each.<sup>33</sup> Therefore, members of an LLC are in some ways similar to both partners and corporate employees.<sup>34</sup> Courts will soon

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*Application of Antidiscrimination Statutes to Shareholders of Professional Corporations: Forcing Fellow Shareholders Out of the Club*, 55 *FORDHAM L. REV.* 839 (1987) (discussing the ability of partners to sue under federal discrimination statutes); Leigh Pokora, Comment, *Partners as Employees Under Title VII: The Saga Continues—A Comment on the State of the Law*, 22 *OHIO N.U. L. REV.* 249 (1995) (discussing the different theories used by courts to determine if partners are employees).

30. See *infra* Part III.A (discussing partners and the partnership exemption). This Note often refers to a “partnership exemption” and its application to be consistent with the language of existing case law. The term “exemption” is somewhat misleading, however. It implies coverage exists, from which a dispensation is provided. Instead, the question in most 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. Similarly, when 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. Likewise, when this Note asserts that LLC members should be deemed de facto partners or that the partnership exemption should apply to LLCs, it simply argues that the same logic preventing partners from being considered “employees” applies with equal force to LLC members.

31. See *infra* Part III.B (analyzing courts’ treatment of claims that shareholders in professional corporations are employees).

32. See *infra* Part III.C (analyzing courts’ treatment of claims that directors of corporations are employees). For example, while the Eighth Circuit did not hesitate to apply the partnership exemption to a professional corporation, see *Devine v. Stone, Leyton & Gershman, P.C.*, 100 F.3d 78, 82 (8th Cir. 1996) (using a balancing test to find that relevant factors for the application of the exemption existed), *cert. denied*, 117 S. Ct. 1694 (1997), the Second Circuit held that the partnership exemption to the ADEA is limited to actual partnerships. See *EEOC v. Johnson & Higgins, Inc.*, 91 F.3d 1529, 1537 (2d Cir. 1996) (limiting exemption to actual de jure partnerships), *cert. denied*, 118 S. Ct. 47 (1997).

33. LLCs combine partnership tax rules with corporate limited liability. See *supra* Part II.A. (discussing the LLCs hybrid form).

34. As one author noted, “[i]t is not clear whether LLC members will be treated more as employees or partners under the employment discrimination laws.” Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 *BUS. LAW.* 1, 44 (1995). “[A]n LLC member does not seem clearly like either a partner or an employee.” *Id.* at 45.

be forced to decide whether to extend the ADEA's partnership exemption to graying members of LLCs.

Because no precedential case law exists defining the status of LLC members under the ADEA, the only guidance available to courts considering the question comes from cases dealing with other entities such as partnerships and professional corporations.<sup>35</sup>

### III. DECISIONS IN THE GRAY AREA

To establish standing in an employment discrimination case under the ADEA, a plaintiff must prove he is an "employee."<sup>36</sup> Courts have uniformly recognized the existence of a partnership exemption, pursuant to which certain "partners" are not employees for purposes of federal employment discrimination statutes.<sup>37</sup> In deciding when, if at all, to apply the exemption to corporations resembling partnerships or to partnerships resembling corporations, however, courts are deeply divided. Typically, courts focus on either the form of organization or the economic reality of the relationship between the plaintiff and the organization. Which of these competing considerations a court emphasizes determines whether it will regard the plaintiff as an employee for purposes of the ADEA.

#### A. *Partners and the Partnership Exemption*

While the ADEA does not address whether partners in a general partnership are subject to protection, courts have generally agreed that bona fide partners are not employees for purposes of the ADEA.<sup>38</sup> Consequently, in litigation involving partners under the ADEA or other federal employment discrimination statutes,<sup>39</sup> the

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35. For a discussion of these cases, see *infra* Part III.

36. See *supra* note 24 (noting that ADEA prohibits age discrimination in employment relationships).

37. See *supra* note 25 (discussing the reason to debate who is an employer); see also *infra* Part III.A (discussing the partnership exemption as applied to partners).

38. This partnership exemption is probably grounded in the aggregate theory of partnership, which maintains that a partnership does not exist apart from its partners. Under this theory, the partnership is not an employer; instead, the partners are deemed the employers. Consequently, the partner is denied employee status because he cannot be an employee of himself. For an examination of the conflict between the aggregate and entity theories of partnership, see generally Ladry Jeusen, *Is a Partnership Under the Uniform Partnership Act an Aggregate or an Entity?*, 16 VAND. L. REV. 377 (1963) (concluding that both theories are unsatisfactory).

39. Such an analysis is used in other federal employment discrimination statutes. The substantive prohibitions of the ADEA were derived verbatim from Title VII. See *Lorillard v.*

question is often whether an individual is a nominal partner or one that possesses all of the indicia of partnership status.

One of the earliest cases in which a court wrestled with the question of whether partners can qualify as employees under federal employment discrimination laws is *Burke v. Friedman*.<sup>40</sup> In that case, the Seventh Circuit established a per se rule that partners are not employees, explaining that it failed to understand how partners who own and manage a business can be considered employees rather than employers.<sup>41</sup>

Similarly, the Eleventh Circuit recognized the partnership exemption in *Hishon v. King & Spalding*.<sup>42</sup> In that case, Hishon initiated a Title VII suit against King & Spalding, a law firm, contending that the firm had refused to invite her into its partnership on the basis of her gender.<sup>43</sup> To establish the necessary employment relationship under Title VII, Hishon asserted that the firm treated its partners in a way that was similar to the way a corporation treats its employees.<sup>44</sup> The district court, however, held Title VII inapplicable to partnership decisions and dismissed the case.<sup>45</sup> On appeal, Hishon exhorted the court to use an economic reality test to determine whether the partners were employees.<sup>46</sup> The Eleventh Circuit, however, affirmed the lower court's dismissal, finding "a clear distinction between employees of a corporation and partners of a law firm."<sup>47</sup>

Finding the partner/employee distinction irrelevant, the Supreme Court reversed the judgment of the Eleventh Circuit on the grounds that Hishon was not yet a partner, but was instead an associate being considered for partnership.<sup>48</sup> The Court reasoned that in some circumstances, "partnership consideration may qualify as a term, condition, or privilege of a person's employment with an employer large enough to be covered by Title VII."<sup>49</sup> The Court thereby avoided Hishon's argument that the partners of the defendant law

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Pons, 434 U.S. 575, 584 (1978) ("[T]he prohibitions of the ADEA were derived *in haec verba* from Title VII."). Moreover, the definition of "employee" is the same in both statutes: an individual employed by an employer. See 42 U.S.C. § 2000e(f) (1994). Consequently, decisions under Title VII are persuasive authority for cases under the ADEA.

40. 556 F.2d 867 (7th Cir. 1977).

41. See *id.* at 869.

42. 678 F.2d 1022 (11th Cir. 1982), *rev'd on other grounds*, 467 U.S. 69 (1984).

43. See *id.* at 1024-25.

44. See *id.* at 1026.

45. See *id.* at 1024.

46. See *id.* at 1027 n.9. For an example of the economic reality test, see *infra* text accompanying note 77.

47. *Id.* at 1028.

48. See *Hishon v. King & Spalding*, 467 U.S. 69, 77 (1984).

49. *Id.* at 77-78 n.10.

firm were employees rather than owners.<sup>50</sup> Thus, the Supreme Court left open the question of whether partners may qualify as employees under federal employment discrimination laws.

Although the majority opinion did not directly address whether partners are exempt from Title VII coverage, Justice Powell, in a concurring opinion, clarified that *Hishon* did not extend Title VII to the management of a law firm by its partners. Powell emphasized that the Court's reasoning did not characterize the relationship among partners as an "employment" relationship for purposes of Title VII.<sup>51</sup> By emphasizing that "the relationship among law partners differs markedly from that between employer and employee [for] [t]he essence of the law partnership is the common conduct of a *shared enterprise*,"<sup>52</sup> Justice Powell validated the partnership exemption for federal employment discrimination laws.<sup>53</sup>

Powell's concurrence seems to support a per se rule that the roles of partner and employee are mutually exclusive. Although the majority in *Hishon* did not expressly share Justice Powell's views, courts in subsequent cases have used Justice Powell's dicta from *Hishon* to justify decisions to deny partners the right to invoke federal employment discrimination statutes like the ADEA.<sup>54</sup>

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50. See *id.* at 74 n.4.

51. See *id.* at 79 (Powell, J., concurring).

52. *Id.* at 79-80 (Powell, J., concurring) (emphasis added).

53. See *supra* note 39 (discussing Title VII's relation to the ADEA).

54. See *infra* text accompanying notes 55-70 (discussing the subsequent cases). In *Holland v. Ernst & Whinney*, 35 Empl. Prac. Dec. (CCH) ¶ 34,653 (N.D. Ala. Aug. 17, 1984), another case in which a court invoked the partnership exemption to the ADEA, the plaintiff attempted to bring an ADEA action against a partnership in which he had been a partner for 11 years before his dismissal for allegedly discriminatory reasons. See *id.* The court dismissed the plaintiff's action. See *id.* The court opined that the plaintiff's role as partner in the defendant partnership did not constitute employment and since the "ADEA applies only to discrimination in the context of employment, [the Act] has no application in the context of this case." *Id.* Similarly, in *Maher v. Price Waterhouse*, No. 84-1522C(2), 1985 WL 9500, at \*1 (E.D. Mo. Apr. 8, 1985), a district court applied the partnership exemption. In that case, the plaintiff brought an ADEA action against the accounting firm at which he was formerly a partner. See *id.* The court granted the defendant's motion for summary judgment. See *id.* Relying principally on *Burke* and Justice Powell's concurring opinion in *Hishon*, the court held that partners are not employees under the ADEA. See *id.* That same court recently applied the partnership exemption again in *Rhoads v. Jones Financial Co.*, 957 F. Supp. 1102 (E.D. Mo. 1997). There, the plaintiff brought Title VII and ADEA claims against the limited partnership where she had been a general partner for 10 years before her termination. See *id.* at 1103. The plaintiff argued that she could not be considered a general partner because she was not personally involved in business decisions of the partnership and other general partners controlled her work. See *id.* at 1109. The court rejected this argument and dismissed her claims, holding that "[p]ossessing a few indicia of employee status [does] not destroy plaintiff's status as a partner[.]" *id.* at 1110, and, of course, "[p]artners in a partnership are not employees and thus cannot avail themselves of the benefits of the antidiscrimination statutes." *Id.* at 1106.

In *Wheeler v. Main Hurdman*, for example, the Court of Appeals for the Tenth Circuit cited *Hishon* as support for its holding that a partner in an accounting firm was not an employee with standing to bring suit under the ADEA.<sup>55</sup> In that case, Marilyn Wheeler was fired seventeen months after her promotion to partner at Main Hurdman, the defendant accounting firm.<sup>56</sup> Wheeler brought an action under the ADEA and Title VII.<sup>57</sup> Main Hurdman contended that Wheeler, as a partner in the firm, was not an employee, and accordingly, it moved to dismiss her complaint.<sup>58</sup> Wheeler conceded that she was a partner under state partnership law; however, she argued that her status at the firm was, in economic reality, that of an employee.<sup>59</sup> For instance, after she attained partner status, her work changed very little.<sup>60</sup> Furthermore, Wheeler argued that Main Hurdman's organizational structure was similar to that of a corporation.<sup>61</sup>

Notwithstanding Wheeler's argument, the Tenth Circuit denied her request for application of an economic reality test.<sup>62</sup> The court stated that any such test would "ignore or unacceptably diminish the essential attributes of partnership, [and would be] incapable of rational application."<sup>63</sup> Instead, the court espoused a per se rule that bona fide general partners are not employees under the federal employment discrimination acts.<sup>64</sup> Conceding that many aspects of a partner's work environment may be indistinguishable from that of a corporate employee, the court nevertheless concluded that the sum of partnership characteristics was sufficient to prevent general partners from being considered employees under the statute.<sup>65</sup>

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55. 825 F.2d 257, 258, 263-64 (10th Cir. 1987) (citing *Hishon*, 467 U.S. at 78 n.10).

56. *See id.* at 261-62.

57. *See id.* at 258.

58. *See id.*

59. *See id.* at 261.

60. She maintained the same client load, the same duties and responsibilities, and the same support staff. *See id.* In addition, the same department head supervised her work. *See id.* The firm continued to maintain a personnel file on her, and the managing partner established the amount charged for her services. *See id.*

61. This structure included a managing partner and a policy board with primary responsibility for the management and control of the partnership. Main Hurdman had 80 offices nationwide and over 500 "partners." In other words, Main Hurdman looked and acted like a corporation. *See id.*

62. *See id.* at 276.

63. *Id.*

64. *See id.* at 277.

65. *See id.* The court emphasized that a partner's "participation in profits and losses, exposure to liability, investment in the firm, partial ownership of firm assets, and . . . voting rights . . . clearly place[s] her in a different economic and legal category [than an employee]." *Id.* at 276.

In *Serapion v. Martinez*, the Court of Appeals for the First Circuit similarly held that bona fide partners are not employees under federal antidiscrimination laws.<sup>66</sup> In that case, when Serapion's three former partners dissolved her former law firm and simultaneously forged a new partnership, she sued them and their new firm for sex discrimination in violation of Title VII.<sup>67</sup> The defendants responded by asserting the applicability of the partnership exemption.<sup>68</sup> Serapion argued that she was not a bona fide partner, notwithstanding that she "had an ownership interest in the Firm; that her compensation depended substantially on the Firm's fortunes; and that she enjoyed significant voting rights."<sup>69</sup> The court held, however, that no reasonable factfinder could conclude that she was not a bona fide equity partner; therefore, Serapion could not claim Title VII protection.<sup>70</sup>

On the other hand, the United States District Court for the Southern District of New York held in *Caruso v. Peat, Marwick, Mitchell & Co.* that a partner in an accounting and consulting firm was an employee for purposes of the ADEA.<sup>71</sup> In that case, Caruso brought an age discrimination suit under the ADEA against Peat Marwick, which in turn argued that Caruso's status as a partner precluded him from being considered an employee.<sup>72</sup> The court acknowledged that a central corporate figure or controlling owner is not an employee under the ADEA definition;<sup>73</sup> however, it stressed that an employee with an impressive title, such as partner, does not necessarily lack ADEA protection.<sup>74</sup>

The court noted that some courts follow a per se rule that anyone denoted as a partner is not within the ADEA definition of employee.<sup>75</sup> The *Caruso* court declined to follow that rule,<sup>76</sup> however,

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66. See 119 F.3d 982, 986 (1st Cir. 1997), cert. denied, 118 S. Ct. 690 (1997).

67. See *id.*

68. See *id.*

69. *Id.* at 992.

70. See *id.*

71. See 664 F. Supp. 144, 150 (S.D.N.Y. 1987).

72. See *id.*

73. See *id.*

74. See *id.*

75. See *id.* at 147. One example of a court following a per se rule is the Tenth Circuit in *Wheeler v. Main Hurdman*, 825 F.2d 257 (10th Cir. 1987). See *supra* notes 55-65 and accompanying text (discussing *Wheeler*).

76. The court noted that a per se rule that the ADEA cannot apply to individuals employed under the title of partner is inconsistent with *EEOC v. Peat, Marwick, Mitchell & Co.*, 775 F.2d 928 (8th Cir. 1985). In that case, the Eighth Circuit Court of Appeals held that an EEOC investigation to determine whether individuals classified as partners fall within the definition of "employee" for purposes of the ADEA was legitimate and could proceed.

opting instead for a three-part "economic reality" test. The test focused on three factors that, in reality, indicate whether an individual is a partner or an employee in an enterprise: the extent of the individual's ability to control and operate the business, the extent to which the individual's compensation is calculated as a percentage of business profits, and the extent of the individual's employment security.<sup>77</sup> The court found these three factors to be more important than the fact that Peat Marwick had organized as a partnership with Caruso as one of its partners.<sup>78</sup> As a result, the court held that Caruso was an employee for purposes of the ADEA.

In *Simpson v. Ernst & Young*, the Court of Appeals for the Sixth Circuit held that a former partner in an accounting and consulting firm was an employee for purposes of the ADEA.<sup>79</sup> There, after Ernst & Young asked Simpson to resign, Simpson brought suit under the ADEA, claiming that the firm had discriminated against him because of age.<sup>80</sup> The firm responded that Simpson was a partner, not an employee, and therefore was beyond the reach of the ADEA.<sup>81</sup> Nonetheless, because he held none of the rights usually associated with true partnership, the court decided that he was an employee, regardless of any title he held.<sup>82</sup>

The Sixth Circuit affirmed the lower court's decision that the plaintiff "had few, if any, meaningful attributes of a partner [and] [f]or all practical purposes, he was an employee."<sup>83</sup> The appellate court acknowledged the existence of a partnership exemption, stating "it is significant to observe that *bona fide* independent contractors and

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Interestingly, the *Caruso* court also cited Justice Powell's *Hishon* concurrence as support for rejecting the per se rule exempting partners from coverage by the ADEA. See *Caruso*, 664 F. Supp. at 147-48. Of course, Justice Powell's opinion in *Hishon* is most frequently cited as establishing the existence of a partnership exemption to ADEA coverage. See, e.g., *Wheeler*, 825 F.2d at 257 (noting that the significance of the Powell opinion might be limited). In an important footnote, however, Justice Powell cautioned that "an employer may not evade the strictures of Title VII simply by labeling its employees as 'partners.'" *Hishon v. King & Spalding*, 467 U.S. 69, 79 n.2 (1984) (Powell, J., concurring). The court in *Caruso* argued that this footnote underscored the inherent weakness of the per se rule exempting partners from the protection of the ADEA. See *Caruso*, 664 F. Supp. at 147-48. "Such a rule," the court concluded, "would allow employers to strip employees of their ADEA rights simply by denoting all employees as 'partners.'" *Id.* at 148.

77. See *Caruso*, 664 F. Supp. at 149-50.

78. "Caruso largely lacked any control[,] . . . [his] salary [varied] little with the firm's profits, [and] Peat Marwick in no way considered him a permanent member of the firm." *Id.* at 150.

79. See 100 F.3d 436, 439 (6th Cir. 1996), *cert. denied*, 117 S. Ct. 1862 (1997).

80. See *id.*

81. See *id.*

82. See *id.*

83. *Id.* at 442.



*partners* are employers, not employees; and as employers, neither come within the entitlement protection or coverage of [the ADEA].”<sup>84</sup> The court, however, ignored Simpson’s “partner” label and instead emphasized the economic reality of Simpson’s relationship with Ernst & Young.<sup>85</sup> In particular, the court focused on Simpson’s lack of control and authority.<sup>86</sup> Eschewing a *per se* rule in favor of an “economic reality” test, the court, therefore, concluded that Simpson was not a *bona fide* partner, but was instead an employee of the firm.<sup>87</sup>

These cases illustrate that while all courts recognize the partnership exemption, courts remain divided as to whether to examine the *bona fides* of the plaintiff’s classification as “partner.” Regardless, *true* partners are not employees and thus have no standing under the ADEA.

### B. Shareholders in a Professional Corporation

Courts uniformly acknowledge the partnership exemption; however, they disagree not only as to whether to review a classification of “partner,” but also as to whether to deny ADEA coverage to people other than partners. For example, as with the debate over whether a person labeled a partner is, in fact, an employee,<sup>88</sup> circuits are split as to whether shareholders of professional corporations should ever be treated as *de facto* partners for purposes of standing under federal employment discrimination statutes.<sup>89</sup>

#### 1. Courts That Emphasize Economic Reality

In most cases, courts have used employment discrimination statutes to deny standing to professional corporation shareholders

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84. *Id.* at 443 (emphasis added). The court also noted that this issue was one of first impression not yet addressed by the Supreme Court. *See id.*

85. *See id.*

86. Simpson was under virtually absolute control by Ernst & Young’s management committee. He had no authority with respect to the admission or discharge of other partners, could not vote for members of the management committee, could not participate in the firm’s profits, and could not freely examine the books and records of the firm. *See id.* at 443 n.2.

87. *See id.* at 444.

88. *See supra* part III.A (discussing the contrasting classification tests for partners).

89. Compare *EEOC v. Dowd & Dowd, Ltd.*, 736 F.2d 1177 (7th Cir. 1984) (applying partnership exemption to shareholders in a professional corporation) with *Hyland v. New Haven Radiology Assocs., P.C.*, 794 F.2d 793 (2d Cir. 1986) (refusing to apply partnership exemption to shareholders in a professional corporation).

For a general discussion of the history and structure of professional corporations, see Luchok, *supra* note 29, at 1194-95, and Narducci, *supra* note 29, at 851-56.

who function as de facto partners. For instance, the Seventh, Eighth, and Eleventh Circuits have each held that professional corporations so closely resemble partnerships that their shareholders should be treated as partners for purposes of federal employment discrimination statutes.<sup>90</sup> As with some courts' approaches in the partnership context,<sup>91</sup> these courts have been willing to look beyond the form of organization and focus instead on the economic reality of the professional corporation.

In *EEOC v. Dowd & Dowd, Ltd.*, the Court of Appeals for the Seventh Circuit addressed the question of whether a professional corporation's shareholders are employees of that corporation for purposes of Title VII.<sup>92</sup> The court concluded that they are not employees and, thus, have no standing under Title VII.<sup>93</sup> Specifically, the court focused on the economic reality of the professional corporation, concluding that "[t]he role of a shareholder in a professional corporation is far more analogous to a partner in a partnership than it is to the shareholder of a general corporation."<sup>94</sup> Accordingly, the court invoked the partnership exemption it had recognized earlier in *Burke*.<sup>95</sup>

Similarly, in *Fountain v. Metcalf, Zima & Co., P.A.*, the Court of Appeals for the Eleventh Circuit followed the reasoning set forth in *Dowd*, holding that a shareholder of a professional corporation functioned as a partner, not an employee, and thus lacked standing to sue for violation of the ADEA.<sup>96</sup> In reaching its conclusion, the court focused on the shareholder's actual role in corporate operations and the relationship between that role and traditional management, control, and ownership concepts.<sup>97</sup> Applying this economic reality test,<sup>98</sup> the court reasoned that the management, control, and ownership of a professional corporation parallels that of a partnership.<sup>99</sup> Therefore, the court held that professional corporation shareholders should be treated as partners under the ADEA and have no standing to sue.<sup>100</sup>

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90. See *infra* notes 92-103 and accompanying text (discussing the courts' holdings).

91. See *supra* Part III.A (discussing application of exemption in partnership context).

92. 736 F.2d 1177 (7th Cir. 1984).

93. See *id.* at 1177.

94. *Id.* at 1178.

95. See *id.*

96. See 925 F.2d 1398, 1401 (11th Cir. 1991).

97. See *id.* at 1400-01.

98. This test is similar to the "economic reality" test set forth by the court in *Caruso*. See *supra* text accompanying note 77.

99. See *id.* at 1401.

100. See *id.*

The Court of Appeals for the Eighth Circuit likewise extended the partnership exemption to shareholders of a professional corporation. That court, in *Devine v. Stone, Leyton & Gershman, P.C.*, looked past the organizational form and focused on the substance of the employment relationship.<sup>101</sup> Applying an economic reality test to the facts of *Devine*, the court found that the shareholders participated in all management decisions and set firm policy.<sup>102</sup> Citing *Fountain and Dowd*, the court concluded that the professional corporation shareholders acted as partners and thus should not be classified as employees.<sup>103</sup>

## 2. Courts That Emphasize the Organizational Form

Some courts, however, consider the form of organization to be decisive, and, consequently, find that all individuals working for a professional corporation are per se employees. The Court of Appeals for the Second Circuit has adopted this per se approach. In *Hyland v. New Haven Radiology Associates, P.C.*, the court refused to look beyond the form of organization to discern the true nature of the employment relationship.<sup>104</sup> In that case, Hyland alleged that he was forced to resign as an employee, officer and director of defendant New Haven Radiology Associates ("NHRA") because of his age. In response to Hyland's ADEA claim, NHRA asserted that Hyland should be considered a partner because the company was a professional corporation, which is more like a partnership than a corporation.<sup>105</sup> The district court, at NHRA's urging, had applied an economic reality test and found that NHRA amounted to a partnership in everything but the name.<sup>106</sup>

The Second Circuit, however, rejected the economic reality test in favor of a per se rule focusing exclusively on the corporate form. According to the court, "[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*

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101. 100 F.3d 78, 80, 82 (8th Cir. 1996), *cert. denied*, 117 S. Ct. 1694 (1997).

102. *See id.* at 82.

103. *See id.* at 80.

104. *See* 794 F.2d 793, 798 (2d Cir. 1986).

105. *See id.* at 795. When Hyland and four other radiologists organized NHRA as a professional corporation, each contributed the same capital and received equal shares in the corporation and an equal voice in management. Profits and losses were divided evenly among the members, all of whom served as corporate officers and directors. Every shareholder, including Hyland, signed a separate employment agreement with the corporation. *See id.* at 794-95.

106. *See id.* at 794.

*freely chosen and established.*"<sup>107</sup> Therefore, the court limited the partnership exemption to actual de jure partnerships and held accordingly that shareholders of professional corporations are always employees under the ADEA.<sup>108</sup>

### C. Directors in a Corporation

The circuits have also disagreed as to whether directors of corporations are employees for purposes of employment discrimination statutes.<sup>109</sup> The Seventh and Eighth Circuits, as well as two district courts, have concluded that directors, even those who also serve as officer-employees, are not employees for purposes of federal employment discrimination legislation.<sup>110</sup> Rather than focus on the "employee" title assigned by the corporation, these courts look at the economic reality of acting as a director in a corporation.

For instance, the Court of Appeals for the Seventh Circuit has twice ruled that directors are not employees for purposes of Title VII or ADEA coverage. In *Zimmerman v. North American Signal Co.*, the court held that the term "employee" does not include persons who are only directors of the corporation.<sup>111</sup> In so holding, the court relied on its earlier decision in *Burke*, where it had ruled that partners are not

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107. *Id.* at 798 (emphasis added).

108. *See id.* For another case in which a court, following *Hyland*, refused to extend the partnership exemption to a professional corporation, see *Rosenblatt v. Bivona & Cohen*, 969 F. Supp. 207 (S.D.N.Y. 1997). In that case, Rosenblatt sued the law firm, a professional corporation, where he was a nonequity "partner." *See id.* at 209. He claimed the firm terminated him because of his interracial marriage. *See id.* The law firm asserted that Rosenblatt did not qualify as an employee for purposes of Title VII. *See id.* at 214. The court disagreed, applying *Hyland's* per se rule that "having made the election to incorporate, the defendant professional corporation could not later call itself a partnership in substance." *Id.* at 215 (quoting *Hyland*, 794 F.2d at 798). The court therefore held that "where defendant is admittedly a professional corporation of which plaintiff is a non-equity partner, plaintiff is a corporate employee for Title VII purposes." *Id.*

In another case, *Johnson v. Cooper, Deans & Cargill, P.A.*, 884 F. Supp. 43, 45 (D.N.H. 1994), the United States District Court for the District of New Hampshire, citing *Hyland*, held that a professional corporation shareholder was an employee for purposes of federal employment discrimination statutes. The defendant professional association argued that it possessed all the attributes of a partnership despite its corporate form, and that the plaintiff, as a de facto partner, was an employer rather than an employee. *See id.* The court disagreed, holding that "the defendant corporation, having elected to do business in the corporate form, was precluded from asserting that economic reality entitled it to be treated as a de facto partnership for Title VII purposes." *Id.*

109. Compare *Zimmerman v. North Am. Signal Co.*, 704 F.2d 347, 352 (7th Cir. 1983) (holding that directors are not employees) with *EEOC v. Johnson & Higgins, Inc.*, 91 F.3d 1529, 1537-40 (2d Cir. 1996) (holding that directors can be employees), *cert. denied*, 118 S. Ct. 47 (1997).

110. *See infra* text accompanying notes 111-15 (discussing cases).

111. 704 F.2d 347, 352 (7th Cir. 1983).

employees.<sup>112</sup> In *Chavero v. Local 241*, the same court concluded that “[w]hile courts generally construe the term ‘employee’ broadly under [the federal employment discrimination statutes], members of boards of directors are not employees . . . under any standards.”<sup>113</sup> In reaching this conclusion, the court emphasized that board members do not have duties traditionally performed by employees.<sup>114</sup> Likewise, in *McGraw v. Warren County Oil Co.*, the Court of Appeals for the Eighth Circuit held that directors of a corporation were not employees within the meaning of the ADEA.<sup>115</sup>

Although the Sixth Circuit agreed that directors “have traditionally been viewed as employer rather than employee positions,” the court warned that directors can become employees for purposes of the ADEA if “their primary role [is] as employees.”<sup>116</sup> In *EEOC v. First Catholic Slovak Ladies Ass’n*, that court found that directors who perform duties traditionally performed by employees are employees under the ADEA.<sup>117</sup>

The Second Circuit took a stronger stance and held directors of a corporation to be employees under the ADEA, following a per se rule that the partnership exemption may never be extended beyond actual partnerships. In *EEOC v. Johnson & Higgins*, the EEOC brought an ADEA action challenging Johnson & Higgins’s (“J & H’s”) mandatory retirement policy for directors.<sup>118</sup> The EEOC argued that the ADEA was applicable insofar as J & H’s directors were also officers of the corporation. J & H argued for application of the partnership exemption, maintaining that its directors were co-owners of the company

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112. *See id.*

113. 787 F.2d 1154, 1156 (7th Cir. 1986).

114. *See id.* at 1157.

115. 707 F.2d 990, 991 (8th Cir. 1983).

Similarly, the United States District Court for the Central District of California held that directors and trustees of a performing arts center were not employees for purposes of the ADEA. In *Schoenbaum v. Orange County Center for Performing Arts, Inc.*, 677 F. Supp. 1036, 1038 (C.D. Cal. 1987), the court decided that “[t]he functions performed by the directors in this case, such as raising capital funds and hiring an executive officer, are more similar to traditional functions of corporate board of directors than traditional functions of an employee.” Noting that the “determination of whether an individual is an employee does not center on the label given by the organization, but instead turns on an examination of the facts of each case,” the court concluded that those who perform traditional functions of directors cannot be employees. *Id.* Finally, in *Lattanzio v. Security National Bank*, 825 F. Supp. 86, 90-91 (E.D. Pa. 1993), the United States District Court for the Eastern District of Pennsylvania followed *Chavero* and *Schoenbaum* in holding that so long as directors performed traditional director duties, they cannot be regarded as employees for purposes of the federal employment discrimination statutes.

116. *EEOC v. First Catholic Slovak Ladies Ass’n*, 694 F.2d 1068, 1070 (6th Cir. 1982).

117. *See id.* at 1070. These traditional employee duties included maintaining records, preparing financial statements, and managing the office. *See id.*

118. *See* 91 F.3d 1529, 1533-34 (2d Cir. 1996), *cert. denied*, 118 S. Ct. 47 (1997).

and were more like partners than employees.<sup>119</sup> Rejecting J & H's argument for application of an economic reality test, the court strictly emphasized J & H's chosen form of organization and found that "the partnership exemption from the ADEA was unavailable to a corporate enterprise."<sup>120</sup> The court reaffirmed its *Hyland* holding, where it had stated that "the partnership exemption is limited to actual de jure partnerships and would not be extended to closely held corporations or other organizations whose structure resembles that of a partnership."<sup>121</sup>

#### D. Two Competing Emphases in the Gray Area: Form and Economic Reality

In summary, when construing "employee" for purposes of federal employment discrimination statutes, a few courts blindly adhere to the form of organization. These courts always apply the partnership exemption to entities organized as partnerships,<sup>122</sup> never to incorporated entities.<sup>123</sup> In these circuits, therefore, the applicability of federal employment discrimination statutes depends solely on how the parties chose to organize themselves. This per se rule provides predictability in this murky area of the law and offers parties the ability to control the application of the federal employment discrimi-

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119. See *id.* at 1534. J & H stressed that its stock was owned almost exclusively by its directors. Moreover, if a director left the board for any reason, including retirement, he was required to surrender his stock, which was then allocated to the others. See *id.* at 1532.

120. *Id.* at 1538.

121. *Id.* at 1537 (quoting *Hyland v. New Haven Radiology Assocs., P.C.*, 794 F.2d 793, 797 (2d Cir. 1986)). Although the Second Circuit restricted the partnership exemption to actual partnerships, it recognized that directors can nonetheless be employers, and thus not employees, for purposes of ADEA coverage. See *id.* at 1538. Despite this recognition, the court deemed J & H's directors to be employees. For a discussion of the three-factor test the court employed in making this finding, see *infra* note 168.

122. These courts draw a distinct line between who is an employee and who is a partner. Accordingly, they developed a per se rule under which the concepts of employee and partner are mutually exclusive. See, e.g., *Hishon v. King & Spalding*, 678 F.2d 1022, 1028 (11th Cir. 1982) (stressing the "clear distinction between employees . . . and partners"); *Burke v. Friedman*, 556 F.2d 867, 869 (7th Cir. 1977) ("[W]e do not see how partners can be regarded as employees rather than as employers who own and manage the operation of the business."); *Holland v. Ernst & Whinney*, 35 Empl. Prac. Dec. (CCH) ¶ 34,653, at 34,653 (N.D. Ala. Aug. 17, 1984) ("The ADEA applies only to discrimination in the context of employment and has no application in the context of [a partnership].").

123. When courts choose to emphasize the form of organization, they not only apply the partnership exemption to partnerships that closely resemble corporations, but also refuse to apply the exemption to professional corporations and corporations that closely resemble partnerships. Indeed, another per se rule exists, pursuant to which some courts refuse to recognize any corporation as a de facto partnership and, thus, refuse to extend the partnership exemption beyond actual partnerships. See, e.g., *Johnson & Higgins*, 91 F.3d at 1529; *Hyland v. New Haven Radiology Assocs., P.C.*, 794 F.2d 793, 793 (2d Cir. 1986).

nation statutes. If parties to the formation of a company wish to avoid ADEA liability as to one another, they need only organize themselves as a partnership, not a corporation.<sup>124</sup>

Most courts reject this *per se* rule, however, and look beyond the chosen form to the economic reality of the relationship among the partners, shareholders, or directors. As a result, these courts do not always apply the partnership exemption to entities organized as partnerships<sup>125</sup> and are often willing to apply the exemption to incorporated entities.<sup>126</sup> In these circuits, application of the exemption thus depends upon how closely the relationship among the principals resembles that of a true partnership or a "shared enterprise."<sup>127</sup> Specifically, these courts focus on the extent to which the partners or those acting as "partners" own and manage the entity.<sup>128</sup>

124. This theory assumes the parties will consider employment discrimination liability as to one another when forming the entity. In reality, however, entrepreneurs too often assume there will always be harmony and consequently do not consider the potential deterioration of their relationships with each other. Instead, concerns about the relationship with the government through taxation and their relationship with outsiders through vicarious liability most often drive their choice of entity. For a discussion of what motivates choice of entity, to wit, tax and liability, see Thompson, *supra* note 10, at 929 ("[T]he desire for this new form is not governance driven, but rather an effort to achieve limited liability from state government and pass-through tax benefits from the federal government.").

125. While bona fide partners are exempt from ADEA coverage, most courts have been willing to look beyond the "partnership" label before denying standing. Accordingly, before applying the partnership exemption to a general partnership, most courts apply an economic reality test to ensure the "partner" possesses the essential characteristics that make a person a bona fide partner: ownership, management, and shared profits and losses. See, e.g., *Serapion v. Martinez*, 119 F.3d 982, 987 (1st Cir.) ("A court must peer beneath the label and probe the actual circumstances of the person's relationship with the partnership."), *cert. denied*, 118 S. Ct. 690 (1997); *Caruso v. Peat, Marwick, Mitchell & Co.*, 664 F. Supp. 144, 149-50 (S.D.N.Y. 1987) (applying economic reality test to determine employee status of a partner).

126. While it may be tempting to limit the partnership exemption to actual partnerships, many courts have been willing to extend the exemption to corporate entities that resemble partnerships. In doing so, these courts have applied an economic reality test. They often conclude that the economic reality of a particular corporate entity is such that its shareholders or directors function as partners and, thus, should be treated as such for purposes of federal employment discrimination statutes. See, e.g., *Devine v. Stone, Leyton & Gershman*, 100 F.3d 78, 80-81 (8th Cir. 1996), *cert. denied*, 117 S. Ct. 1694 (1997); *Fountain v. Metcalf, Zima & Co., P.A.*, 925 F.2d 1398, 1400-01 (11th Cir. 1991); *EEOC v. Dowd & Dowd, Ltd.*, 736 F.2d 1177, 1178-79 (7th Cir. 1984).

127. See *Hishon v. King & Spalding*, 467 U.S. 69, 80 (1984) (Powell, J., concurring) (discussing the key factors of a partnership).

128. "The central concept of general partnerships is *co-ownership*: all of the partners have an equal say in the *management* of the partnership, and each partner *shares in the net profits* of the partnership." Harry H. Weil, *General Partnerships*, in *PARTNERSHIPS* 1, 5 (Pa. Bar Institute ed., 1988) (emphasis added). "A partnership interest is comprised of three components: the right to *participate in profits, losses, distributions and proceeds* of the partnership ('Economic Interest'); the right to participate in the *management* of the partnership ('Management Interest'); and the *ownership* share in partnership property as a tenant-in-partnership." *In re Cardinal Indus., Inc.*, 116 B.R. 964, 970-71 (Bankr. S.D. Ohio 1990) (emphasis added).

## IV. THE ECONOMIC REALITY OF LIMITED LIABILITY COMPANIES

Just as the ADEA does not explicitly address whether partners, shareholders, or directors are employees, it also does not answer whether members of an LLC are employees. Moreover, no case law exists considering LLC members' status under the ADEA. Consequently, the only guidance comes from the cases applying the discrimination statutes to other entities such as partnerships and professional corporations.<sup>129</sup>

These cases reveal a two-step procedure that courts should use to analyze the applicability of the ADEA to LLC members.<sup>130</sup> First, the court must decide whether the LLC may even argue that its members are de facto partners and, thus, outside the protection of the ADEA.<sup>131</sup> In other words, the court must first determine whether the partnership exemption should be applied outside actual partnerships to LLCs. Second, the court must examine the facts of the particular case to determine whether the members in question are the equivalent of bona fide partners.<sup>132</sup> In both steps, the court should focus on the economic reality: first, of members and LLCs generally; second, of the particular members in question and their relationship with their LLC.<sup>133</sup>

*A. Step One: Members as De Facto Partners*

An LLC, if sued by one of its members or former members for an ADEA violation, will likely assert the applicability of the partnership exemption both to LLCs generally and to itself specifically. Accordingly, it will argue that its members are de facto partners and thus lack standing to sue under the ADEA. In response, the aggrieved member will likely try to exalt the "corporate form" of the LLC over its economic substance. He will argue that courts should not extend the partnership exemption to corporate entities like LLCs that do not have the partnership label. This argument will probably find favor in the Second Circuit, which has held that an entity's use of a corporate form precludes any further judicial inquiry to determine

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129. See *supra* Parts III.A and III.B (discussing the application of the statutes to partnerships and professional corporations).

130. See Marshall B. Paul et al., *Workplace Liability Laws May Affect LLC Use by Professionals*, 1 J. LIMITED LIABILITY COMPANIES 118, 123-25 (1994) (noting and describing this two-step analysis).

131. See *id.* at 124.

132. See *id.* at 124-25.

133. See *infra* Part IV.A and IV.B (discussing the application of the two-step test).



whether the entity is a de facto partnership.<sup>134</sup> The Second Circuit would, thus, end its inquiry before reaching the second step in the two-step analysis, finding that the partnership exemption would be per se inapplicable to LLCs. Consequently, LLC members would have standing to sue under the ADEA.

Instead of adopting the Second Circuit's label test in the first part of the analysis, courts should instead focus on the economic reality of LLCs. Label tests are inconsistent with the overwhelming weight of authority in ADEA cases, which requires courts to look beyond an individual's job title to determine standing.<sup>135</sup> Although most ADEA cases rejecting label tests consist of business entities attempting to avoid liability by labeling plaintiffs as something other than employees,<sup>136</sup> courts should also refuse to use labels to provide standing to plaintiffs who are not, in substance, employees. The Seventh, Eighth, and Eleventh Circuits, in *Fountain*, *Devine*, and *Dowd* respectively, followed this reasoning.<sup>137</sup> In those three cases, the courts properly rejected the Second Circuit's label test in favor of an economic reality test, under which they applied the partnership exemption to professional corporations.

Courts should follow *Fountain*, *Devine*, and *Dowd* and retain the discretion to apply the partnership exemption to LLCs. Most

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134. See *Hyland v. New Haven Radiology Assocs., P.C.*, 794 F.2d 793, 798 (2d Cir. 1986); see also *EEOC v. Johnson & Higgins*, 91 F.3d 1529, 1537 (2d Cir. 1996) (quoting *Hyland*), *cert. denied*, 118 S. Ct. 47 (1997).

135. See *supra* Part III (discussing various courts' substantive analyses of employment status for ADEA purposes).

136. See *Hishon v. King & Spalding*, 467 U.S. 69, 79 n.2 (1984) (Powell, J., concurring) ("[A]n employer may not evade the strictures of Title VII simply by labeling its employees as 'partners.'"); *Serapion v. Martinez*, 119 F.3d 982, 987 (1st Cir.) ("[P]artnerships cannot exclude individuals from the protection of Title VII simply by draping them in grandiose titles which convey little or no substance."), *cert. denied*, 118 S. Ct. 690 (1997); *Simpson v. Ernst & Young*, 100 F.3d 436, 439 (6th Cir. 1996) (noting the district judge's observation that the label of "partner" did little to describe the actual nature of the plaintiffs' employment), *cert. denied*, 117 S. Ct. 1862 (1997); *Caruso v. Peat, Marwick, Mitchell & Co.*, 664 F. Supp. 144, 150 ("[T]he mere fact that an employee holds a job carrying an impressive title does not mean that this employee loses the protection of the ADEA.").

137. See *Devine v. Stone, Leyton & Gershman, P.C.*, 100 F.3d 78, 80-81 (8th Cir. 1996) (holding that looking at the substance of the employment relationship to determine whether an individual is an employee under Title VII is a better approach than a rigid per se rule that stresses organizational form over substance because employment relationships vary greatly and often defy easy categorization), *cert. denied*, 117 S. Ct. 1694 (1997); *Fountain v. Metcalf, Zima & Co., P.A.*, 925 F.2d 1398, 1400-01 (11th Cir. 1991) (holding that labels are inadequate because they provide extremely limited evidentiary value); *EEOC v. Dowd & Dowd, Ltd.*, 736 F.2d 1177, 1178 (7th Cir. 1984) (holding that the role of a shareholder in a professional corporation is far more analogous to a partner in a partnership than it is to a shareholder of a general corporation and, hence, should not be treated as an employee for purposes of Title VII).

LLCs undoubtedly have very few corporate attributes,<sup>138</sup> as limited liability is the only corporate characteristic LLCs are likely to exhibit.<sup>139</sup> In all other respects, most LLCs closely resemble general partnerships.<sup>140</sup> In particular, the members often directly take part in management,<sup>141</sup> lack the ability to transfer their interests freely,<sup>142</sup> possess the right to cause a dissolution of the entity,<sup>143</sup> and share equally in profits and losses.<sup>144</sup> The state statutes under which LLCs are formed support the strong relationship between LLCs and partnerships, as they merely permit entrepreneurs who would otherwise organize as a partnership to use the corporate form solely to receive the benefit of limited liability while retaining favorable partnership tax treatment.<sup>145</sup>

Courts that unduly emphasize choice of organization may reason that members should not be permitted to take advantage of the LLC form while avoiding its disadvantages by conveniently claiming partnership status. As one author has noted, however, this reasoning

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138. See Paul, et al., *supra* note 130, at 124 (noting that "most professional LLCs will likely be decidedly uncorporate-like in their structure").

139. See *id.*

140. First, LLCs meet the common law definition of partnership: "A partnership is generally said to be created when persons join together their money, goods, labor or skill" for profit. *Commissioner v. Tower*, 327 U.S. 280, 286 (1946); see 1 ALAN R. BROMBERG & LARRY E. RIBSTEIN, *BROMBERG AND RIBSTEIN ON PARTNERSHIP* § 1.03, at 1:28 (1997) (discussing the aggregate approach of common law definition of partnership). Also, as one author noted, "[t]he Discussion Draft of the Uniform Limited Liability Company Act is based on a partnership paradigm." Sandra K. Miller, *What Standards of Conduct Should Apply to Members and Managers of Limited Liability Companies?*, 68 ST. JOHN'S L. REV. 21, 70 (1994). For a complete discussion of the similarities between partnerships and LLCs and the differences between corporations and LLCs, see *id.* at 66-72 (concluding that "the partnership model for standards of conduct [is] a logical choice for the limited liability company").

141. See *id.* § 404(a)(1), 6A U.L.A. 457 ("[E]ach member has equal rights in the management and conduct of the company's business.").

142. See *id.* § 502, 6A U.L.A. 468 ("A transfer of a distributional interest does not entitle the transferee to become or to exercise any rights of a member.").

143. See *id.* § 602(a), 6A U.L.A. 474 ("[A] member has the power to dissociate from a limited liability company at any time, rightfully or wrongfully, by express will . . ."); *id.* § 801(b)(3), 6A U.L.A. 481 (stating that a limited liability company is dissolved, and its business must be wound up upon dissociation of a member-manager or, if none, a member of an at-will company).

144. See *id.* § 405(a), 6A U.L.A. 459 ("Any distributions made by a limited liability company before its dissolution and winding up must be in equal shares.").

145. As an example, most existing businesses that reorganize as LLCs were previously organized as general partnerships, not corporations. See Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393, 404-05 (1996) (showing statistical correlation between rise of LLCs and decline of partnerships).

Indeed, LLC governance rules show that an LLC is not as much a corporation as it is a partnership that is permitted to assume corporate status for liability purposes. See *supra* notes 11-13 and accompanying text (discussing corporate-type limited liability and tax treatment of LLCs).

is specious.<sup>146</sup> An LLC, even if viewed as a partnership, would still not be absolved of all liability to its members. Members who are denied protection under the ADEA can usually seek relief for breach of fiduciary duty by majority members. Although courts have not yet addressed the extent of the fiduciary duty LLC members owe to one another, the duty would at least equal that owed to a stockholder in a close corporation.<sup>147</sup> Certainly, any attempt by the majority members to "squeeze out" a minority member through compulsory retirement would be a breach of this fiduciary duty. Although there is little case law in this area, it seems LLC members who lack standing under the ADEA would still have an action for breach of fiduciary duty when they are forced to retire from the LLC.<sup>148</sup> Because this cause of action remains available, applying the partnership exemption to LLC's would not be inequitable.<sup>149</sup>

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146. First, the complaining [party] is also enjoying the corporate advantages of limited liability and lower taxes, therefore, he should not be handed the windfall of an ADEA . . . claim. Second, ADEA . . . liability is not a disadvantage of the corporate form—it is a disadvantage of being an employer. Persons who are truly the employees of a P.C. have standing to sue their employer under [the ADEA].

Narducci, *supra* note 29, at 856 n.113. Although the author was writing in the context of a professional corporation, his argument is equally applicable to LLCs.

In the case of law firms, these employees would include associates, paralegals, and secretaries.

147. Indeed, some commentators argue that the duty owed by an LLC member to his fellow members should be that of a partner to his fellow partners: the highest form of fiduciary duty. See generally Miller, *supra* note 140, at 21 (concluding that members should owe one another a partnership-type fiduciary duty).

148. See *id.*

149. Courts should extend the partnership exemption and narrowly construe "employee" under the ADEA for other reasons also. The ADEA prohibits discrimination on a ground not recognized in the Constitution, as age is not a suspect class protected by the Equal Protection Clause. As the Supreme Court put it, "old age does not define a 'discrete and insular' group . . . in need of 'extraordinary protection from the majoritarian political process.' Instead, it marks a stage that each of us will reach if we live out our normal span." *Massachusetts Bd. of Retirement v. Murgia*, 427 U.S. 307, 313-14 (1976).

As a consequence, the individuals protected by the ADEA differ sharply from those protected by earlier statutes such as Title VII of the Civil Rights Act of 1991. In particular, ADEA claims are most often brought by wealthy, white men. See George Rutherglen, *From Race to Age: The Expanding Scope of Employment Discrimination Law*, 24 J. LEGAL STUD. 491, 491 (1995) ("An examination of empirical data reveals that claims under the ADEA are brought predominantly by white males who hold relatively high-status and high-paying jobs."). "By every measure, plaintiffs in ADEA cases are better off than plaintiffs in other employment discrimination cases." *Id.* at 509. Claims under the ADEA more closely resemble claims for wrongful discharge than any other employment discrimination claims. See *id.* at 516-20 (comparing ADEA claims to claims of wrongful discharge). Because the ADEA does not protect a disfavored and relatively powerless minority group from discrimination, one commentator has argued that the ADEA "can no longer be applied to all of the prohibitions against different forms of discrimination." *Id.* at 520-21.

At the very least, courts should strictly construe the ADEA term "employee" so as not to include the powerful, and predominantly white and male, principals of business organizations. As more women and minorities become principals in business organizations, courts possibly

*B. Step Two: Applying the Partnership Exemption to a Particular LLC*

The second step of the two-part analysis should also depend on the economic reality of the relationship between the aggrieved member and his LLC. Given that ownership, profit sharing, and management are the key elements in distinguishing the corporation and partnership,<sup>150</sup> an economic reality test designed to ascertain the specific LLC member's right to sue under the ADEA should focus on the degree to which the member's relationship with the LLC embodies these elements.<sup>151</sup> An analysis of most members' relationship with

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should delimit the partnership exemption to effectuate the purpose of Title VII. Courts should give "employee" a broader interpretation under Title VII than under the ADEA to protect these disfavored groups. Whether and when courts should recognize a partnership exemption to Title VII is beyond the scope of this Note, however.

Although Congress did not explicitly define "employee" for ADEA purposes, it has implicitly revealed an intent not to protect those with power. First, the ADEA contains an exemption for bona fide executives. See 29 U.S.C. § 631(c)(1) (1994) ("Nothing . . . shall be construed to prohibit compulsory retirement of any employee . . . employed in a bona fide executive or a high policymaking position."). By analogy, if officers, employees who may not own and manage their companies, are not protected, how can those that own and manage their companies be? Second, Congress explicitly exempted policy-making state officials from protection. See *id.* § 630(f) ("[T]he term 'employee' shall not include . . . an appointee on the policymaking level . . ."), thereby further indicating that it did not intend to protect those in power. Last, the ADEA is the only federal employment discrimination statute the coverage of which Congress did not extend in the Civil Rights Act of 1991. See Judith J. Johnson, *Semantic Cover for Age Discrimination: Twilight of the ADEA*, 42 WAYNE L. REV. 1, 3 (1995) ("[In the Civil Rights Act of 1991,] Congress expanded almost all rights protected by federal civil rights statutes. Congress, however, failed to include the ADEA in the substantive changes made by the Civil Rights Act of 1991."). A strict construction of "employee" under the ADEA in light of the above would certainly support excluding LLC members from that definition.

150. See *supra* note 128 (discussing ownership, profit-sharing and management elements of a partnership). Indeed, profit-sharing and control are the two factors emphasized in the UPA's test for determining the existence of a partnership. Section 101(4) of the UPA defines partnership as "an association of two or more persons to carry on as co-owners a business for profit." U.P.A. § 101(4), 6 U.L.A. 10 (1995). Indeed, two of the most important elements of co-ownership are profit sharing and control. See generally 1 BROMBERG & RIBSTEIN, *supra* note 140, § 2.07(b)-(c), at 2:79 to 2:98 (discussing profit sharing and control sharing).

151. Other tests exist for determining whether a partnership exists. Among these is the test formerly used by the IRS. See *supra* note 13 (discussing IRS tests to classify entities for taxation purposes). Under that test, the IRS regarded LLCs as partnerships, granting them favored pass-through tax treatment. Although the IRS considered some of the same factors as the UPA test, its test was not an appropriate standard by which to determine whether an LLC member was an employee or partner for purposes of the ADEA. A closer examination of the IRS test illustrates the basis for this conclusion. The IRS examined four characteristics found in a "pure corporation," which distinguished it from other organizations: (1) continuity of life; (2) centralization of management; (3) liability for corporate debts limited to corporate property; and (4) free transferability of interest. See Former Treas. Reg. § 301.7701-2(a). Centralization of management was the only factor common to both the IRS and economic reality tests. The remaining elements of the IRS test did not explore the daily interaction between the entity and its principals and thus had less relevance in determining LLC members' entitlement to protec-

their LLCs reveals that most LLC members should not be considered employees under the ADEA.<sup>152</sup>

First, LLC members own the business. They each own a share of LLC property and are entitled to the value of their shares upon liquidation.<sup>153</sup> Moreover, members have provided their own risk capital that can be used in future business endeavors, and their success depends on their own initiative, unlike employees who are solely dependent on a salary for their livelihood.

Next, most members, like partners, receive an approximately equal share of the profits.<sup>154</sup> The members are usually paid according to a predetermined formula for profit and loss sharing and thus are co-owners of the business.<sup>155</sup> Finally, in most LLCs, members have total management power.<sup>156</sup> Statutory default rules assign all management function to the members;<sup>157</sup> although LLC statutes do provide an alternative "manager-managed" form, most members will choose to manage the LLC directly.<sup>158</sup> Even members of LLCs with centralized management should not necessarily be considered employees.

First, those LLC members who elect to have separate managers control the daily operations will likely retain control over important management decisions, such as electing the managers.<sup>159</sup> Also, each member retains the right to dissolve the firm at any time and

tion under ADEA. For example, the availability of limited liability did not reveal how the entity functioned.

152. Although the typical LLC member should lack standing to sue under the ADEA, the mere denomination "LLC," like all labels, should not automatically preclude ADEA protection of LLC members. See *infra* text accompanying notes 153-55 (stating that LLC members own the business and receive equal shares of profits, like partners).

153. See U.L.L.C.A. § 701(a)(1), 6A U.L.A. 476 (1995) ("A limited liability company shall purchase a distributional interest of a member of an at-will company for its fair value.").

154. See *id.* § 405(a), 6A U.L.A. 458 ("Any distributions made by a limited liability company before its dissolution and winding up must be in equal shares.").

155. As with ownership, equal distribution of profits need not exist for members to be deemed partners under the ADEA. A member who does not share in profits on an approximately equal basis, however, is unlikely to participate enough to protect herself adequately from discrimination. Consequently, a member who does not share approximately equally in the LLC's profits would exhibit a characteristic of an employee.

156. Management should carry the greatest weight in determining whether an LLC member should be considered a partner or employee for purposes of the ADEA. The greater the stratification of control in the LLC, the more likely that those at the lower end of the spectrum need the protections of the ADEA to shield against discriminatory practices.

157. See *id.* § 404(a)(1), 6A U.L.A. 457 ("[E]ach member has equal rights in the management and conduct of the company's business.").

158. See *supra* note 15 (discussing statutory provisions allowing choice of forms of governance).

159. See *infra* text accompanying note 164 (discussing control retained by members in manager-managed LLC).

demand liquidation.<sup>160</sup> Further, even if the purpose of centralized management is to exclude some members from control, all the members should be on notice of possible exclusion from a role in governance, as management centralization requires unanimous consent.<sup>161</sup> Moreover, separation of ownership and management does not necessarily make an LLC less like a partnership; both LLCs and partnerships are governed by operating agreements, and even a partnership agreement may provide for centralized management.

In addition, an LLC's size by itself should not dictate whether its members are deemed partners under the ADEA.<sup>162</sup> Although maintaining the characteristics of a bona fide partnership may become more difficult as the LLC increases in size, a large LLC will not necessarily have more corporate governance features.<sup>163</sup> Even if a large LLC has elected an executive committee to oversee day-to-day operations, its members can control and operate the firm so long as they retain an equal right to vote on major decisions: admission and removal of members, compensation, and election of managers.<sup>164</sup>

LLCs may, however, be structured like corporations.<sup>165</sup> Thus, a court should not regard all LLCs as de facto partnerships under the ADEA.<sup>166</sup> Instead, just as many courts emphasize economic reality and reject the conclusion that a person is a bona fide partner merely because he is classified as a "partner," courts should also consider each LLC and its members on a case-by-case basis.

In summary, bona fide partners are not considered employees for purposes of the ADEA, for they manage, control, and own their business. The management, control, and ownership of most LLCs by its members more closely resembles that of partnerships than corpo-

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160. An LLC agreement cannot provide for centralized management and entity permanence without losing favorable partnership tax treatment. *See supra* notes 13 and 151 (discussing taxation of LLCs). In other words, a right of easy exit removes the risk of lack of control over management.

161. *See id.* § 404(c)(1), 6A U.L.A. 457 ("The only matters of a [limited liability] company's business requiring the consent of all the members are: (1) the amendment of the operating agreement . . ."); *id.* § 203 cmt. ("A company will be member-managed unless it is designated as manager-managed under Section 203(a)(6) [in the operating agreement].").

162. *See Paul, et al., supra* note 130, at 125 (arguing that an LLC's size should not control whether its members are considered to be employees for purposes of discrimination statutes).

163. *See id.*

164. *See id.* On the other hand, if the members lack that power, the members may be employees regardless of the size of the firm. *See id.*

165. *See id.* at 124 ("For example, many statutes permit LLCs to provide in their operating agreements that interests can be freely transferred, that members cannot cause a dissolution of the entity, and that management will be centralized.")

166. Most courts, however, do not even regard all general partnerships as partnerships under the ADEA either. *See supra* Part III.A (discussing courts' treatment of partnerships).

rations. As a result, the use of the corporate form should not preclude the application of a test to determine the economic reality of the relationship between the member and the LLC to ascertain if the LLC member lacks standing under the ADEA because he is more like a partner than an employee.

*C. Members as Employers Even Without Analogy to Partnership*

Although application of the partnership exemption to LLCs is appropriate, one need not extend the partnership exemption to LLCs to conclude that members lack standing to sue under the ADEA. Regardless of whether LLC members are "de facto partners," they clearly more closely resemble employers than employees. Although the Second Circuit confined the partnership exemption to actual partnerships, it did recognize that directors of corporations can still be employers and thus not covered by the ADEA.<sup>167</sup> Similarly, LLC members, even if not considered partners, can still be employers and thus not employees under the ADEA. In fact, according to the test the Second Circuit developed in *Johnson & Higgins*,<sup>168</sup> most LLC members are employers. First, most members do not undertake "traditional" employee duties. On the contrary, they own and manage the company like employers. Also, members do not report to anyone higher in the hierarchy, for there is no such person. Therefore, under the *Johnson & Higgins* test, LLC members are employers and, therefore, cannot sue themselves under the ADEA.

## V. CONCLUSION

The Second Circuit notwithstanding, most courts appear willing to disregard labels and examine economic reality to determine whether a partner, shareholder or director is a bona fide owner and controller of the entity or a mere employee. Accordingly, whether the entity in question is a partnership, professional corporation, corpora-

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167. See *EEOC v. Johnson & Higgins, Inc.*, 91 F.3d 1529, 1538 (2d Cir. 1996) ("While *Hyland* prevents J & H from claiming that its directors are 'partners,' that case does not preclude the argument that J & H should be exempt from the ADEA on account of their position as directors . . . . If J & H's directors are more akin to employers than employees then they should be exempt . . . .") (emphasis added).

168. The Second Circuit prescribed a three-factor test: "(1) whether the director has undertaken traditional employee duties; (2) whether the director was regularly employed by a separate entity; and (3) whether the director reported to someone higher in the hierarchy." *Id.* at 1539.

tion, or LLC, or whether the person is called "partner," "shareholder," "director," or "member" should not matter for purposes of the ADEA. The test should be the same in every case. Examining the economic reality of the relationship among the partners or members in question, courts should consider them employers so long as they have sufficient ownership and control of their entity, be it a partnership or LLC. Most LLC members, like most partners, have sufficient ownership and control to be deemed employers and denied standing under the ADEA.

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