The Misfit Doctrine: Integrated Enterprise in the Title VII Context

*By Monica K. Loseman**

With increasing frequency Plaintiffs' attorneys, ever in seek of the deepest pocket, are relying on the integrated enterprise doctrine to join parent or affiliate companies as defendants in Title VII and other discrimination suits against their subsidiary or sister companies, alleging that the entities' "integrated" status makes them the plaintiff's joint employer. However, the integrated enterprise doctrine, a four-part analysis originally promulgated by the National Labor Relations Board, embodies a relatively lenient approach and cannot reasonably be relied upon to yield consistent and fair results under Title VII. Developed approximately forty years before Title VII was even adopted, the integrated enterprise doctrine is slowly being questioned and rejected by some courts in favor of alternative approaches tailored somewhat more precisely to serve the policy goals of Title VII.

As the Third Circuit recently noted, there is "surface appeal" to applying the integrated enterprise doctrine in the Title VII context, as both the National Labor Relations Act and Title VII generally address employer-employee relations.[1] But the similarities end there. The NLRA was intended to lend stability to industry and to protect the collective bargaining rights of employees. The NLRA has no concern with an individual's right to equal opportunity of employment, regardless of race, color, religion, sex or national origin. Title VII, on the other hand, is a statutory mechanism for imposing liability on employers based on discriminatory classifications or activities. The individual employment relationship and actions affecting that relationship are at the heart of a Title VII matter. External business decisions that leave the employment relationship unaffected are irrelevant for purposes of Title VII liability.

The integrated enterprise doctrine employs a far more expansive examination. It focuses not on the employee/employer relationship, but on the relationship between corporate entities. The four-factor analysis focuses on (1) whether the parent had centralized control of labor relations, (2) the extent of interrelation of operations between the parent and subsidiary, (3) the degree of common management, and (4) the degree of common ownership or financial control. These factors focus on the business operations of two separate entities and to what degree they are interrelated.

The integrated enterprise doctrine also leads the courts down the dubious path of questioning business decisions and corporate strategy. The notion of limited liability is the rule, not the exception, but the integrated enterprise doctrine threatens to reverse this order. Under the integrated enterprise doctrine, it is all too easy for a parent company to face liability for its subsidiary's alleged violations of Title VII despite proper respect for separate corporate forms. Without focusing the review on the relevant employer-employee relationship, the integrated enterprise analysis incorrectly focuses the court's attention on the propriety of certain business decisions.

The focus of any inquiry into parent liability under Title VII should focus on the parent's culpability: Did the parent corporation contribute to the alleged discrimination/harassment and seek to hide behind the corporate veil of presumptive limited liability? Any test or theory of liability that avoids this central question skirts the issue. The policy behind Title VII liability is to eliminate discriminating and harassing behavior based on protected classifications. If the parent entity the plaintiff seeks to hold liable exercised no control over the employment decisions affecting the plaintiff, imposing liability on that innocent parent does not serve Title VII's purpose. It serves only to dilute the presumption of limited liability and to improperly arm plaintiffs with another source of funds for settlement or actual verdict.[2] Absent some showing of the parent's own wrongful behavior, only the entity that actively participated in the employment relationship with the plaintiff should be held to be an "employer" under Title VII.

A Possible Trend of Rejection?

The U.S. Courts of Appeals for the Third and Seventh Circuits have rejected the integrated enterprise doctrine in recent Title VII cases.

In *Nesbit v. Gears Unlimited, Inc.* (Third Circuit),[3] the plaintiff alleged that her former employer discriminated against her based on her gender. Her employer, however, employed fewer than fifteen individuals and therefore fell outside the scope of Title VII. The plaintiff argued that for purposes of satisfying the fifteen employee minimum, her employer and a related entity should be considered an integrated enterprise, jointly employing more than fifteen individuals and thereby satisfying the minimum employee re-

quirement. Both entities were owned and managed, to some extent, by the individual who fired the plaintiff.

The Third Circuit analyzed the doctrine's history, comparing the doctrine's application in the NLRA context to the Title VII context and noting the divergent policy goals of the NLRA and Title VII. "If the company at issue satisfies the NLRB test, it will in many cases be required to submit to collective bargaining. . . . But if a defendant in a Title VII suit is deemed an 'employer' within the meaning of the statute, *it may be subject to liability*."[4] Moreover, the court noted that the policy goal of Title VII's fifteen-employee minimum requirement in particular was "to spare small companies the considerable expense of complying with the statute's many nuanced requirements."[5] The *Nesbit* court concluded that because the NLRA's scope and policy goals are more expansive than those of Title VII, application of the especially lenient four-factor test in the Title VII context is improper.

Though the *Nesbit* opinion focuses on the use of the doctrine to integrate two related enterprises for purposes of meeting the fifteen-employee minimum requirement, the court's opinion also likely forecloses use of the doctrine for purposes of imposing Title VII liability on a related entity. The language used throughout the opinion and the relatively broad focus of the court's subsequent inquiry suggest that the Third Circuit will not apply the four-part test for any purpose relating to a plaintiff's Title VII claim.[6]

The Seventh Circuit was the first court of appeals to reject use of the integrated enterprise doctrine in the Title VII context for any purpose, whether to meet the fifteen-employee minimum or to impose joint liability. In *Papa v. Katy Industries, Inc.*,[7] the Seventh Circuit considered two cases presenting a common question: whether to allow the plaintiffs to satisfy the minimum employee requirement by demonstrating that two related entities are integrated enterprises. Like the *Nesbit* court, the *Papa* court noted that the purpose behind the minimum employee requirement was to spare small companies the "crushing expense of mastering the intricacies of the antidiscrimination laws," and to preserve the viability of the small business.[8] This policy applies regardless of whether a small business is owned by an individual (wealthy or poor) or a corporation. The *Papa* court also noted how application of the four-factor test would only yield vague and unpredictable results, resulting in indecision where the four factors weighed equally on opposite sides of the scale, as often would be the case.[9]

In *Worth v. Tyer*,[10] the Seventh Circuit clarified the extent of its decision in *Papa v. Katy Industries, Inc.* The plaintiff argued that because the defendant employer met the minimum employee requirement independently, the integrated enterprise doctrine could still be used to impose Title VII liability on the related entities.[11] The plaintiff sought to use the doctrine to impose joint liability on an entity not party to or directly involved in the employee/employer relationship, even where her actual employer met the minimum statutory requirements. Nonetheless, the court made clear that its abrogation of the doctrine in *Papa v. Katy Industries, Inc.* applied equally to questions of related entity liability under Title VII.[12]

Other Circuit Courts Apply The Doctrine In Limited Context Or Modified Form

Other circuit courts have applied the doctrine cautiously, limiting the doctrine's application or changing the focus of the inquiry. All of the modified approaches, however, place special emphasis on the "control over labor" prong of the four-factor test, perhaps in an effort to focus the inquiry on the individual employment relationship rather than the corporate relationship between two related entities.

Though the Ninth Circuit has not rejected the test (and likely will not), in *Anderson v. Pacific Maritime Association*,[13] the court explicitly limited application of the doctrine "to judge the magnitude of interconnectivity for determining *statutory coverage*" and not liability.[14] The plaintiffs, employees of a member-entity of the Pacific Maritime Association, sought to hold the PMA directly liable for alleged racial harassment and the hostile work environment perpetrated by their employer, but the Ninth Circuit refused to apply the doctrine of integrated enterprises to hold the association liable for racial harassment allegedly perpetrated by some of its member corporations.[15]

Other courts, like the Fifth Circuit, have modified the four-part test in an effort to conform its application with the policy goals of Title VII. The Fifth Circuit places particular emphasis on the "control over labor" prong, emphasizing a critical question: "'What entity made the final decisions regarding employment matters related to the person claiming discrimination?'"[16] The Eleventh Circuit follows this same general approach, focusing the inquiry on the degree of control the corporate entity had over the action giving

rise to the Title VII claim.[17] This approach has been criticized for nullifying the effect of a *four*-part inquiry:[18] If the critical question relates only to what entity made the final decisions regarding the plaintiff's employment, what use are the other three factors? Moreover, how could the court hold anyone but the plaintiff's direct employer liable under a theory of corporate integration?

The Tenth Circuit requires the plaintiff to demonstrate that the parent controlled the day-to-day employment decisions of its subsidiary in order to satisfy the essential "control over labor" portion of the four-part test.[19] The Tenth Circuit, however, focuses its overall inquiry on whether there was an absence of an arm's-length relationship between the two corporate entities, lending some weight to the other three factors.[20] The Tenth Circuit has only applied the integrated enterprise test where the parties agreed to do so, or because, even under the test, the facts were clearly insufficient to support the imposition of liability on the parent company.[21]

The First Circuit has adopted the more "flexible" approach used by the Second Circuit. Those courts focus the integrated enterprise inquiry on the "control over labor" prong, "but only to the extent that the parent exerts 'an amount of participation that is sufficient and necessary to the total employment process, even absent total control or ultimate authority over hiring decisions.'"[22] The Sixth Circuit, though it has not explicitly adopted one interpretation or another, has generally cited decisions of the various circuit courts and determined that "control over labor relations is a central concern."[23] Other courts of appeals have applied the integrated enterprise test without modification.

The Third And Seventh Circuits' Alternative Approaches To The Single Employer Question

The Third and Seventh Circuits have proposed alternative approaches to the single employer question. They agree that two related entities should be considered a single employer where the entities have organized in an attempt to evade Title VII's statutory reach. They also agree that where the parent company directs the subsidiary to act in an unlawfully discriminatory or retaliatory manner, parent liability is appropriate. But each court reaches for a different approach based on the degree of interrelation to support an imposition of liability on the parent corporation or related entity.

The Third Circuit borrows from the bankruptcy context, employing the equitable remedy of substantive consolidation. Essentially, "the question is whether the 'eggs' – consisting of the ostensibly separate companies – are so scrambled that we decline to unscramble them." Though the circuit courts adopt varying approaches to the remedy of substantive consolidation in the bankruptcy context, the Third Circuit's approach for purposes of Title VII focuses on the degree of operational entanglement – "whether operations of the companies are so united that nominal employees of one company are treated interchangeably with those of another."[24] The open-ended analysis includes the following considerations (1) the degree of unity between the entities with respect to ownership, management (both directors and officers), and business functions (*e.g.*, hiring and personnel matters), (2) whether they present themselves as a single company such that third parties deal with them as one unit, (3) whether a parent company covers the salaries, expenses, or losses of its subsidiary, and (4) whether one entity does business exclusively with the other."

Though the court emphasizes that such a showing is difficult to achieve, one wonders whether the inquiry is much of a change from the rejected doctrine. The questions are narrower and perhaps more concise, but the substantive consolidation analysis still bears little relation to the policy goals of Title VII. Moreover, the factors are admittedly open-ended and unweighted, and tend to encourage second-guessing of legitimate business decisions. Though the factors may lead to a different, somewhat improved analysis, it is unclear how substantive consolidation is any more relevant to the policy of prohibiting discrimination and harassment in the workplace than the rejected integrated enterprise doctrine. The court needs to take the analysis one step further to show some connection between the parent or related entity and the employment of the complaining individual.

The Seventh Circuit adopted an approach that requires the Title VII plaintiff to pierce the corporate veil to hold the parent or related entity responsible for the employing subsidiaries' actions. "[F]irst, there must be such unity of interest and ownership that the separate personalities . . . no longer exist; and second, circumstances must be such that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice."[25] The Seventh Circuit takes the inquiry one step further than the Third Circuit; the plaintiff must demonstrate that proper respect for the corporate form and its presumption of limited liability will result in fraud or injustice.

The Solution: A Better Tailored Approach

The Seventh Circuit's approach is the better one. Corporate entities that abuse the corporate form waive their right to a presumption of limited liability, but the plaintiff that seeks to impose liability on the parent company must demonstrate that the presumption is somehow onerous and would perpetrate a wrong or violate the policy of Title VII. Rather than focusing the inquiry solely on the relationship between two corporate entities, the test should require some relation to the employment relationship allegedly damaged as a result of discriminatory or harassing conduct. The plaintiff should have to demonstrate that the wrong is somehow related to her allegations of violation of Title VII. By better tailoring a joint employer analysis, the presumption of limited liability can be maintained in harmony with the policy goals of Title VII.

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Footnotes

[1] Nesbit v. Gears Unlimited, Inc., 347 F.3d 72, 85 (3d Cir. 2003), *cert. denied,* Nesbit v. Gears Unlimited, Inc., 124 S.Ct. 714 (2004).

[2] The statutory cap for compensatory and punitive damages is based on the total number of individuals employed by the offending entity. 42 U.S.C. § 1981a (b) (2003). A plaintiff can dramatically increase her settlement leverage by satisfying the upper statutory cap where she can apply the integrated enterprise doctrine to increase the aggregate number of employees.

[3] 347 F.3d 72.

[4] *Id.* at 85 (internal citation omitted) (emphasis added).

[5] *Id.*

[6] *See, e.g.*, *id.* ("Thus we deem there is little reason to refer to the NLRB's test in deciding whether two entities should together be considered an 'employer' for Title VII purposes.").

[7] 166 F.3d 937 (7th Cir. 1999).

[8] *Id.* at 940.

[9] *Id.* ("There is enough uncertainty about the standard to warrant a fresh look. This is especially appropriate because of the vagueness of three of the four factors (all but 'common ownership' and it, as we shall see, is useless); because, being unweighted, the four factors do not yield a decision when, as in the two cases before us, they point in opposite directions....").

[10] 276 F.3d 249 (7th Cir. 2001).

[11] The distinction is even more significant where the fifteen-employee minimum is considered a jurisdictional requirement. Where the minimum employee requirement is considered jurisdictional rather than an element of the claims or defenses to be proved at trial, the court must evaluate the merit of the jurisdictional argument on its own, weighing supporting evidence without deference to any party as required by Fed. R. Civ. P. 56. *See, e.g.*, *Nesbit,* 347 F.3d at 76-77. And given the uncertain nature of the four-factor test, such a factual inquiry would likely yield uncertain and inconsistent results.

[12] *Id.* at 260 ("[In *Papa v. Katy industries, Inc.*], [w]e stated that the 'integrated enterprise' test was too amorphous to be applied consistently. . . . Such inconsistencies made it difficult for a corporation to determine when it could be held liable for the actions of its affiliate. Therefore, we held that the 'integrated enterprise' test should be abrogated in Title VII cases.").

[13] 336 F.3d 924 (9th Cir. 2003).

[14] *Id.* at 928-29 (emphasis added).

[15] The plaintiffs voluntarily dismissed suit against their actual employers, instead pursuing their claims against the Union and PMA. The sole defendant considered on appeal was PMA.

[16] Trevino v. Celanese Corp., 701 F.2d 397, 404 (5th Cir. 1983) (*quoting* Odriozola v. Superior Cosmetic Distribs., *Inc.*, 531 F. Supp. 1070, 1076 (D.P.R.1982); *see also* Skidmore v. Precision Printing & Packaging, Inc., 188 F.3d 606, 617 (5th Cir. 1999) (finding that the plaintiff's factual allegations concerning the integration of her employer and its parent were insufficient to establish parent liability where she failed to present evidence regarding the primary factor, whether the parent controlled the subsidiaries labor decisions).

[17] Llampallas v. Mini-Circuits, Inc., 163 F.3d 1236, 1244-45 (11th Cir. 1998) (*citing McKenzie v. Davenport-Harris Funeral Home*, 834 F.2d 930, 933 (11th Cir. 1987)).

[18] Romano v. U-Haul Int'l, 233 F.3d 655, 666 (1st Cir. 2000).

[19] Frank v. U.S. West, Inc., 3 F.3d 1357, 1362 (10th Cir. 1993).

[20] Knowlton v. Teltrust Phones, Inc., 189 F.3d 1177, 1184 (10th Cir. 1999).

[21] For example, in *Knowlton*, the court applied the test only because the parties and the district court had done so: "Consequently, that test, *right or wrong*, controls this appeal." *Id.* (emphasis added). *See also* Lockard v. Pizza Hut, Inc., 162 F.3d 1062, 1070-71 (10th Cir. 1998).

[22] *Romano*, 233 F.3d at 666 (*quoting* Cook v. Arrowsmith Shelburne, *Inc.*, 69 F.3d 1235, 1240 (2d Cir. 1995)).

[23] Swallows v. Barnes & Noble Book Stores, 128 F.3d 990, 994 (6th Cir. 1997).

[24] *Nesbit*, 347 F.3d at 87.

[25] *Worth*, 276 F.3d at 260.