CORPORATIONS FACE EXPANDED LIABILITIES FOR EMPLOYMENT LAW VIOLATIONS – HOW THE PARENT AND SUB CAN BE JOINTLY LIABLE AS A SINGLE ENTITY WHEN THE CORPORATE VEIL IS PIERCED

Jacqueline R. Scott*

Employment law violations by one corporation can result in liabilities being imposed against other members of the corporate group. As a result, a parent corporation can incur liabilities for the employment law violations by one of its subsidiaries. It is critical that attorneys advising employers on these matters understand the underlying corporate doctrines that can result in expanded corporate liabilities for employment law violations.

The doctrine by which corporate structures—and the associated limits and protections against legal liabilities—are disregarded is known as "piercing the corporate veil." This term of art is used when the corporate structure of an entity is disregarded, typically in order to impose legal liability on a corporation that might not otherwise have such liability. The "corporate veil" is the protective layer afforded by the separate corporate identity, and the veil is "pierced" when the law disregards the corporate structure, elevating substance over form, for purposes of assessing legal liabilities and responsibilities. Below we review the corporate veil piercing doctrine and examples of how the leading United States government enforcement agencies are employing the doctrine in the employment context and imposing expanded corporate liabilities.

I. The Corporate Veil Piercing Doctrine

As a general rule of corporate law, when an entity structures itself as a corporate entity, its owners—the shareholders—are limited in their liability.[1] Thus, a parent corporation and its subsidiary which are formed as two separate corporate entities do not generally share liability. If the subsidiary is liable, generally the liability is limited to the assets of the subsidiary, not those of its parent or the parent's shareholders. However, where there is evidence of fraud or marked noncompliance, courts are more likely to "pierce" or "rend" the veil and look to the reality of the situation, including the relationship of all related parties. This can result in the imposition of joint liability by the parent for the legal violations of the subsidiary or vice versa.

In the U.S., there is no "bright line" test for when and under what circumstances a court will pierce the veil. Instead, it is generally governed by common law. Sometimes courts employ the "alter ego" or "instrumentality rule" theories, alleging that one corporation is the alter ego or instrumentality of the

* Esq. Fortney & Scott, LLC Washington, DC.

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

other, thus validating a look behind the corporate structure. Most often, courts examine the facts and circumstances of each particular case or the "totality of circumstances" to determine whether piercing the veil and disregarding the corporate structure is warranted. The factors courts most often consider can generally be grouped into three categories:

1. Failure to maintain or evidence typical corporate indicia.
2. Intermingling of corporate and personal funds and dealings.
3. Significant undercapitalization.

Let's examine each of those categories briefly.

1. Failure to maintain or evidence typical corporate indicia.

How corporations structure themselves and operate are some of the most obvious factors that courts will consider. Thus, for example, a court will examine whether the corporation has officers, whether those officers are actually functioning officers, whether the corporation keeps appropriate corporate records, whether the corporation pays dividends and whether the corporation observes corporate formalities (*e.g.*, holds board meetings, makes resolutions with respect to corporate action).

2. Intermingling of corporate and personal funds, assets and dealings.

Courts will consider whether the shareholder(s) use the corporate assets as their own or whether they use the corporation as a façade for their personal dealings (alter ego theory).

3. Significant undercapitalization.

If a parent significantly undercapitalizes its subsidiary, it may be a red flag that the corporation is a sham or "dummy" corporation.

Of course, in each instance, there may be legitimate reasons for deviation from the norm, and a court will carefully examine the facts and circumstances to determine whether piercing the corporate veil is appropriate and justified. It is important to note that not all of these factors must be present; a court may value one or more factors as determinative, even if none of the other factors are present.

Moreover, courts generally apply the state law of the state in which the corporation is incorporated, and some states have more liberal rules about piercing the corporate veil than do others. Thus, a well-counseled company will understand exactly what the relevant state law provides with regard to respecting the corporate structure.

II. How the Veil Piercing Doctrine Applies to Employers

While the corporate veil can be pierced in the context of many disciplines of law, this article focuses on the use of the doctrine in the context of imposing liability for labor and employment law violations, and, particularly, violations by federal contractors of their nondiscrimination obligations.

Under U.S. law, the United States Department of Labor (the "DOL"), one of the federal agencies enforcing many labor and employment laws, has sought to pierce the corporate veil in order to impose expanded liability for employment law violations where two separate corporations are, in reality and substance, co-employers. In such case, the DOL has held each corporation jointly and severally liable for the employment law violations of one of the corporations.

Thus, for example, where two corporations are owned by the same individual shareholder, and one of those corporations incurs liability for failure to adequately pay wages or overtime to its employees, the DOL, in certain circumstances, may look both to the "sister" corporation and to the individual shareholder(s) for payment of the wages and overtime. In essence, the DOL treats the several corporations as if they were a "single entity" and assigns liability to the whole.[2] Furthermore, an individual shareholder of a corporation also can be held personally liable for overtime obligations of the corporation. This was the conclusion reached by the U.S. Court of Appeals for the Second Circuit in a recent case, where the court held that an individual owner/shareholder of a grocery store chain who retained ultimate control and supervision over the corporation was himself an employer and thus personally liable to pay overtime to the company employees, even though the employees worked for the corporation and even though the owner had delegated much of the day to day operations of the business to deputies.[3] Similarly, the National Labor Relations Board (the "NLRB") has held that two separate corporations were in fact a single employer in order to "protect the collective bargaining rights of employees and to advance industrial stability."[4] The single employer doctrine has also been extended to the civil rights context.[5]

In analyzing whether the single employer doctrine is applicable to employment cases, generally, federal courts apply a four factor test to determine co-employment.

These factors are:

1. Interrelation of operations.
2. Common management, common directors and boards.
3. Centralized control of labor relations and personnel.
4. Common ownership and financial control.[6]

In essence, these factors are applied in order to determine the "fairness of imposing liability for labor infractions where two nominally independent entities do not act under an arm's length relationship."[7]

Single employer or single entity determinations also arise frequently in the context of imposition of liability against federal contractors for employment law violations. Generally, a federal contractor is a contractor who provides goods or services to the federal government. Under U.S. employment law, fede-

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[2] *See* 29 CFR § 779.218; *Dunlop v. Lourub Pharmacy*, 525 F.2d 235, 22 WH Cases 570 (6th. Cir. 1975).

[3] *Carlos Torres et al. v. Gristede's Operating Corp. et al.,* Case Number 11-4035 in the U.S. Court of Appeals for the Second Circuit, February 24, 2012.

[4] *Radio & Television Broadcast Technicians Local Union 1264 v. Broadcast Serv. of Mobile*, 380 U.S. 255, 256, 85 S. Ct. 876, 877, 13 L. Ed. 2d 789 (1965 (per curiam).

[5] *Trevino v. Celanese Corp.,* 701 F. 2d 397, 403-404 (5th Cir. 1983) (applied single employer doctrine under Title VII); *York v. Tennessee Crushed Stone Ass'n*, 684 F. 2d 360, 362 (6th Cir. 1982) (applied single employer doctrine in context of Age Discrimination in Employment Act).

[6] *Swallows v. Barnes & Noble Book Stores*, 128 F. 3d 990, 993-994 (6th Cir. 1997).

[7] *Murray v. Miner*, 74 F. 3d 402, 405 (2d Cir. 1996).

ral contractors who perform services or provide goods to the federal government pursuant to a contract—the value of which is at least $50, 000 and where the time to perform is greater than 120 days—are subject to rigorous requirements to hire women and minorities and to take other steps in furtherance of affirmative action and non-discrimination obligations. These contractor employment obligations are governed by an agency of the DOL, called the Office of Federal Contract Compliance Programs (the "OFCCP"). In determining whether a corporation is a federal contractor, and thus subject to the compliance programs that are enforced by the OFCCP, the DOL may analyze the relationship of one corporation to another, related corporation in order to determine if both corporations are, in fact, one entity. Typically, the issue of whether two or more corporations constitute a "single entity" for purposes of federal contract employment compliance arises when either the parent or the subsidiary is a party to a contract with the federal government and provides goods or services to the government, while the related corporation has absolutely no contractual relationship with the government. Again, however, if they are collectively deemed to be a "single entity", each will be held to be a federal contractor and each will be separately subject to OFFCP's compliance reach. Thus, for example, the OFCCP recently prevailed in arguing that a parent company engaged in wholesale automotive remarketing and its subsidiary dedicated to government contracting were a single entity that, combined, qualified as a government contractor. As a result, an administrative law judge ruled that both the parent and the subsidiary companies were jointly and individually liable for meeting the federal contractor requirements[8].

Historically, the OFCCP applied its own 27 question test to determine whether two or more corporations constituted a "single entity." (See 27 Point Questionnaire, attached hereto as Attachment A). In more recent times, the 27 Point Questionnaire has been recast as a five factor test, which groups the 27 factors into five broader categories. Specifically, the current OFCCP five factor test examines:

1. Common ownership.
2. Common directors and/or officers.
3. De facto exercise of control (does one entity have de facto day-to-day control over the other through policies, management or supervision of the entity's operators?)
4. Unity of personnel policies emanating from a common source (do the personnel policies of both entities emanate from a common or centralized source?)
5. Dependency of operations (are the operations of both entities dependent on each other, *e.g.*, services are provided principally for the benefit of one entity by another and/or both entities share management, officers or other services?)

The five factor test followed by the OFCCP is closely aligned with the four factor test historically used by federal courts in the employment context, and

[8] *OFCCP v. Manheim Auctions, Inc.*, ALJ Case No 2011-OFC-5, June 14, 2011.

most practitioners rely on case law under the generally applied four factor test with respect to analyzing "single entity" under the five factor test.[9]

Of the factors considered in determining "single entity" status, the two most significant are (1) centralized control of labor relations and personnel and (2) common management, and it has been held that *the* single most important element in the determination of "single entity" status is the finding of centralized decision-making regarding labor relations and personnel.[10] Thus, where a parent corporation makes the employment decisions for itself and its subsidiary, courts may conclude that the parent and the subsidiary are a "single entity, " and therefore both are federal contractors subject to federal contractor compliance obligations. Similarly, where there is common management between a parent and its subsidiary, both may be considered to be a "single entity" subject to OFCCP compliance, even though only one of the corporations actually has entered into a contract with the federal government.

III. Strategies to Avoid Being Treated as a "Single Entity"

The first step corporations can take to minimize a finding that two corporations are actually a "single entity" is to make sure that all corporate formalities are satisfied. While the "single entity" analysis seeks to elevate substance over form, a corporation that does not at least have the outward manifestation of an independent corporate structure will be viewed as a "sham" or "dummy" entity, not a separate and independent entity.

Thus, corporations must, for example, satisfy state corporate law requirements regarding formation, capitalization, election of officers and directors, majority vote, making of resolutions authorizing corporate actions and maintenance of required records. Of course, such corporate formalities should be documented by corporate minutes, so that the corporation can prove the existence of such corporate formalities. Additionally, corporations should not commingle funds with those of another entity, especially those of a related corporation.

In addition to following required corporate formalities, specifically to address the circumstances that can result in single employer findings and resulting liabilities for employment law violations, corporations should most importantly avoid centralized personnel and labor relations. It is essential that in the case of two or more corporations, each corporation should make its own decisions about its own personnel. Typically, the inquiry about "single entity"

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[9] In fact, the DOL has indicated that the five factor test does not differ substantively or significantly from the four factor test traditionally employed by federal courts. With respect to the same five factor test used by the DOL under other employment laws, the DOL has stated that the five factor test "is intended only to summarize existing law that has developed under state corporations laws and such statutes as the NLRA[the National Labor Relations Act], the Fair Labor Standards Act (FLSA) [governing minimum wages and overtime] and the Employment Retirement Income Security Act (ERISA)." 50 Fed. Reg. 16, 045 (April 20, 1989).

[10] *Trevino v. Celanese Corp.*, *supra*; *Murray v. Miner*, *supra*, (the policy underlying the single entity test is "most implicated where one entity actually had control over the labor relations of the other entity, and thus, bears direct responsibility for the alleged wrong").

status arises in the context of hiring employees, so it is imperative that each corporate entity hire its own personnel. In this regard, it is often useful to have written policies that reflect hiring practices and procedures and that establish the specific personnel who will have responsibilities for hiring. In the case where there is common management, corporations should, where reasonably feasible, strive to grant hiring authority to individuals who are NOT common officers or directors. Additionally, each corporation should have its own set of personnel policies and practices, including a handbook that specifically addresses the working environment and business of that particular corporation. Of course, corporations should strive to minimize common officers and directors, although this is not always feasible.

In summation, based on the DOL's stated enforcement policy of ongoing enterprise-wide liabilities for violators of a wide range of labor and employment laws, we can expect to see an increasing number of expanded claims by the DOL, seeking to pierce the corporate veil in order to treat related corporations as a "single entity."

ATTACHMENT A

The 27 Point Questionnaire

THE 27 POINT QUESTIONNAIRE[11]

Note: The following 27 questions were taken verbatim from an unofficial OFCCP document. Answers to the 27 questions are useful to help contractors determine whether the relationship of two corporate entities (perhaps a parent and a subsidiary) are sufficiently closely related that it is fair to say that they operate as a "single-entity, " each sharing the responsibilities and rights of the other.

The 27 questions are:

1. What percentage of the stock of the subsidiary or affiliate is owned by the parent corporation?
2. How many directors are on the Board of parent corporation?
3. How many directors are on the Board of both the parent and the subsidiary corporations?
4. How many individuals are officers of both the parent and the subsidiary corporations?
5. How many individuals are employees of both the parent and the subsidiary corporations?
6. What positions do the individuals in No. 5 hold in each corporation?
7. Does the parent corporation pay the wages of any of the subsidiary's employees?
8. Does the parent corporation pay any other expenses of the subsidiary? If yes, please list which expenses are paid.
9. In advertisements, is the subsidiary referred to as a part of the parent corporation?
10. In financial statements of either corporation, is the subsidiary described as a department or division of the parent corporation?

[11] Fox, John C., *Affirmative Action Workbook*, § 8 pp. 43-45, (NELI 1996).

11. Does the same in-house legal staff serve both the parent and subsidiary corporation?

12. Are any services provided by the parent corporation for the subsidiary corporation or vice versa?

If yes, what service?

13. Are the books and/or financial records of the parent and subsidiary kept separately?

14. Does the parent corporation control the hiring practices and procedures of the subsidiary? For example:

(a) Does the parent corporation set hiring standards for the subsidiary?

(b) Does the parent corporation set any hiring rules for the subsidiary?

(c) Does the parent corporation set equal employment opportunity policy for the subsidiary?

15. Does the parent review and/or control the labor practices of the subsidiary? For example:

(a) Does the parent negotiate and/or take part in the negotiation of collective bargaining agreements of the subsidiary?

(b) Does the parent sign the collective bargaining agreements of the subsidiary?

16. Is there ever an exchange of personnel between parent and subsidiary?

If yes, does the individual who transfers retain the same seniority date used at the transferor corporation for purposes of benefits, promotions, layoffs and/or recall?

17. Does the parent recruit personnel for the subsidiary or vice versa?

18. Does the parent hire the subsidiary's top management officials or vice versa?

19. Are minority employees of the subsidiary listed on the EEO-1 reports of the parent?

20. Has there ever been an infusion of capital from the parent to the subsidiary or vice versa?

If yes, list dates and amounts.

21. What percentage of the subsidiary's business is with the parent?

22. What percentage of the parent's business is with the subsidiary?

23. Does either the parent or the subsidiary use any of the property of the other?

24. Is the product or service of either the parent or the subsidiary essential to the conduct or operation of the other's business?

If yes, list the product(s) or service(s).

25. Does either the parent or the subsidiary provide any marketing service for the other?

26. Would either the parent or the subsidiary be unable to function if the other ceased to exist?

27. If the answer to questions 7, 8, 9, 10, 11, 12, 13, 14, 15, 17, 18, 19, 23, 24, 25 or 26 was negative, state separately for each such negative answer whether the answer would have been affirmative if the question was asked for the last five (5) year period.