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Two holdings on employee counting

A recent 3rd U.S. Circuit Court of Appeals decision clarifies how employees are counted under Title VII, the Americans with Disabilities Act, the Age Discrimination in Employment Act and the Family Medical Leave Act.

In *Nesbit v. Gears Unlimited, Inc.*, the court made two significant rulings on counting employees. First, the 3rd Circuit considered whether the number of employees is a jurisdictional requirement to bringing a Title VII claim or a substantive element of the claim. Second, the court enunciated for the first time its own test on whether employees of related companies should be consolidated for the purposes of the employee minimum under Title VII.

The case involved machine operator Norma Nesbit who alleged she was fired from Gears Unlimited because of her gender. While the company did not employ sufficient employees

The court first explained why the jurisdictional/substantive question is more than just an academic exercise, giving three reasons why the distinction makes a difference. First, subject matter jurisdiction cannot be waived. Therefore, even if neither party raises the issue, a federal court has an obligation to determine whether federal-question jurisdiction is present.

Second, depending on whether the requirement is jurisdictional or substantive, the facts will be viewed very differently in a motion to dismiss. If the requirement is jurisdictional, the facts are viewed with neutrality in a Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction. On the other hand, if the requirement is an element of the cause of action, a motion to dismiss is treated as a Rule 12(b)(6) motion for failure to state a claim, and the allegations of the complaint must be accepted as true. If the same motion is brought later in the litigation, it will be treated as a Rule 56 motion for summary judgment, and the facts must be considered in the light most favorable to the complainant. Thus the jurisdictional/substantive distinction can make a significant difference in motion practice.

Third, if the number of employees is a jurisdictional requirement and the Title VII claim is dismissed for lack of jurisdiction, a federal court may not retain supplemental jurisdiction over state law claims unless there is another basis for federal jurisdiction. On the other hand, a federal court has discretion over whether to retain supplemental jurisdiction over state claims when the federal claim that allowed initial jurisdiction is dismissed on the merits. If the question is substantive, considering the lighter burden in motion practice described above, the number of employees may not be resolved until trial, and the supplemental state claims will be heard in federal court.

Split circuits

After noting the significance of the substantive/jurisdictional question, the *Nesbit* court analyzed case law and noted the split among circuits. The 2nd, 7th and D.C. circuits have held the number of employees is a substantive element, while the 4th, 5th, 6th, 9th, 10th and 11th have indicated the employee threshold is jurisdictional. (The 1st Circuit upheld a decision that held the requirement jurisdictional, but the point was not directly addressed.) Adding to the confusion are opinions from the 10th and 11th circuits that note the question is both jurisdictional *and* intertwined with the merits of the case.

In reaching its determination that the number of employees is a substantive element of a Title VII claim, the 3rd Circuit relied on the U.S. Supreme Court's decision in *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, as well as its own decision in *Growth Horizons, Inc. v. Delaware County*, 983 F.2d 1277. In *Steel Co.*, the Supreme Court rejected attempts to portray the requirement to prove all elements of a cause of action as relevant to federal courts' jurisdiction to hear a suit. If that were the case, a court would be required to dismiss a claim for lack of jurisdiction whenever the plaintiff does not prevail. In

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during the relevant time period, Nesbit argued Gears' employees should be aggregated with those at a related company, Winters Performance Products, to meet Title VII's 15-employee requirement. The facts did not present a compelling case for combining the two entities. While Winters and Gears were owned by the same family, and the companies cooperated somewhat in terms of hiring, there was little other connection. Gears and Winters did not hold themselves out to job applicants as a single employer. The two companies ran independent plants that manufactured different products, maintained separate financial records and payrolls, had their own checks and filed separate tax returns, and were under separate day-to-day management. While Nesbit occasionally worked at Winters, she received a separate paycheck when she did so and her hours at the two plants were not consolidated for overtime pay. The lower court dismissed Nesbit's claim for lack of subject matter jurisdiction after finding Gears and Winters were separate entities.

While the facts of *Nesbit* were not close, the 3rd Circuit took the opportunity to elaborate on the issue of counting employees.

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Growth Horizons, the 3rd Circuit held that a court has federal-question jurisdiction whenever a plaintiff with standing makes a non-frivolous allegation that a federal statute has been violated. Dismissal for lack of jurisdiction is appropriate only in cases where the claim is “so insubstantial, implausible, foreclosed by prior decisions of this court, or otherwise completely devoid of merit as to not involve a controversy.” The 3rd Circuit held that the question of whether there are sufficient employees is not jurisdictional, except when the number obviously falls short.

In support of its analysis, the 3rd Circuit also noted that Title VII has an explicit jurisdictional section (2000e-5(f)(3)) that provides each U.S. district court jurisdiction to hear Title VII actions. That section makes no mention of the number of employees; rather, that requirement is in the definition section for “employer.” The 3rd Circuit also noted the decisions of circuits holding the employee threshold is a matter of federal jurisdiction had made the statement without explanation or meaningful analysis. The 3rd Circuit finally undercut what it considered the most plausible argument for treating the 15-employee minimum as jurisdictional: that under the commerce clause, Title VII can be applied only to employers affecting interstate commerce. In countering that argument, the 3rd Circuit noted the definition requires an employer be “in an industry affecting commerce” as well as have “fifteen or more employees.” Thus, the commerce clause concerns are addressed in the definition because a company that does not affect commerce is not an employer under Title VII even if it has 30 employees.

Single employer

The court’s second significant holding in *Nesbit* addressed when employees of related companies should be treated as working for a single employer. The 3rd Circuit rejected the “integrated enterprise” test of the National Labor Relations Board in cases involving Title VII, because of the different policies underlying the two statutes. As explained in *Nesbit*, the purpose of the employee minimum in NLRB cases is to protect workers’ collective-bargaining rights. On the other hand, the purpose of the employee minimum under Title VII is to provide shelter for family

employers and other small businesses from the expense of complying with Title VII’s complicated requirements. In light of their differing goals, employees should be counted differently under the two statutes.

To a large extent, the 3rd Circuit adopted the test used by the 7th Circuit in *Papa v. Katy Indus.*, in which that court held companies should be considered a single employer when: 1) the company split itself to evade Title VII’s reach; 2) the parent company directed the subsidiary’s discriminatory act; or 3) a court would otherwise pierce the corporate veil. The 3rd Circuit agreed with the first two reasons, but enunciated its own third situation — the “substantively consolidated” analysis.

As explained by the 3rd Circuit, substantive consolidation under Title VII follows the same precept used in the bankruptcy context. Bankruptcy courts consider whether two enterprises are so substantively consolidated that the assets and liabilities of each should be treated as belonging to a single entity. The 3rd Circuit adopted that same concept, modifying it slightly for the employment setting to focus on operational rather than financial entanglement.

In determining whether two entities are substantively consolidated in this context, courts must consider: 1) the degree of unity with respect to ownership, management and business functions; 2) whether the companies present themselves as a single entity; 3) whether a parent company covers the salaries, expenses and losses of its subsidiary; and 4) whether one entity does business exclusively with the other. The 3rd Circuit explained substantial consolidation is an equitable concept designed to be difficult to achieve.

In conclusion, *Nesbit* contains two significant holdings on counting employees under Title VII. First, the question of the number of employees is substantive except in the most obvious situations. Second, related companies should be combined for counting employees if they were split to evade the statute, the parent directed the discriminatory act of the subsidiary or the two are “substantively consolidated.” As the federal circuits are split on both these points, it is fairly certain neither will be settled nationwide until resolved by the U.S. Supreme Court.