

Saint Louis University School of Law
Scholarship Commons

All Faculty Scholarship

2013

Participation as a Theory of Employment

Matthew T. Bodie
Saint Louis University School of Law

Follow this and additional works at: <https://scholarship.law.slu.edu/faculty>



Part of the [Business Organizations Law Commons](#), and the [Labor and Employment Law Commons](#)

Recommended Citation

Bodie, Matthew T., Participation as a Theory of Employment (April 17, 2013). Notre Dame Law Review, Vol. 89, 2013.

This Article is brought to you for free and open access by Scholarship Commons. It has been accepted for inclusion in All Faculty Scholarship by an authorized administrator of Scholarship Commons. For more information, please contact ingah.daviscrawford@slu.edu.



SAINT LOUIS UNIVERSITY SCHOOL OF LAW
Legal Studies Research Paper Series

No. 2013-20

Participation as a Theory of Employment

Matthew T. Bodie

Notre Dame Law Review, Vol. 89, 2013

PARTICIPATION AS A THEORY OF EMPLOYMENT

Matthew T. Bodie*

89 NOTRE DAME L. REV. (forthcoming 2013)

ABSTRACT

The concept of employment is an important legal category, not only for labor and employment law, but also for intellectual property law, torts, criminal law, and tax. The right-to-control test has dominated the debate over the definition of “employee” since its origins in the master-servant doctrine. However, the test no longer represents our modern notion of what it means to be an employee. This change has played itself out in research on the theory of the firm, which has shifted from a model of control to a model of participation in a team production process. This Article uses the theory of the firm literature to provide a new doctrinal definition for “employee” based on the concept of participation rather than control. The participation test better delineates the boundaries of employment and provides a framework for addressing the stresses on firms and workers that are rife within the modern economy.

TABLE OF CONTENTS

INTRODUCTION	2
I. THE CONCEPT OF EMPLOYMENT WITHIN THE LAW.....	6
A. Labor and Employment Law.....	6
B. Vicarious Liability in Tort.....	7
C. Criminal Liability	8
D. Intellectual Property.....	9
E. Tax	11

* Professor, Saint Louis University School of Law. I am also a reporter for the Restatement (Third) of Employment Law; this article reflects my own views alone, and not those of the ALI or my fellow reporters. Many thanks to the students in the seminar “Law and Theories of Employment” at Notre Dame Law School in Fall 2012. Their thoughts and insights provided significant contributions to this paper. Thanks as well to participants in the Notre Dame faculty workshop series, as well as Guy Davidov, Tim Glynn, Rebecca Hollander-Blumoff, and Charlie Sullivan, for very helpful comments. Special thanks to Jay Tidmarsh for lending me volume 2 of the Restatement Second of Torts.

II. THE DEFINITION OF EMPLOYMENT IN DOCTRINE AND THEORY.....	12
A. <i>Defining “Employee”</i>	12
1. <i>The Common Law “Control” Test</i>	12
2. <i>The “Economic Realities” Test</i>	22
3. <i>The “Entrepreneurial Opportunities” Test</i>	25
B. <i>Defining “Scope of Employment”</i>	26
C. <i>Perspectives on the Theories of Employment</i>	29
III. EMPLOYEES AND THE THEORY OF THE FIRM.....	30
IV. PARTICIPATION AS A THEORY OF EMPLOYMENT.....	38
A. <i>Participation as Theory</i>	38
B. <i>Participation as Doctrine</i>	40
V. THE FUTURE OF EMPLOYMENT IN THE LAW.....	49
CONCLUSION	51

INTRODUCTION

The concept of employment plays an important role in various areas of the law. Most obviously, labor and employment law protections found in local, state, and federal law are limited to those contracting parties that are defined as employees.¹ However, many other areas of law draw distinctions based on the fact that the actor was an employee, or that the actions were taken within the scope of employment. Legal doctrines in intellectual property,² criminal law,³ tort law,⁴ and tax⁵ use the concept of employment in assigning rights and liabilities. In these situations, the law is not regulating the employment relationship directly, but rather adapting certain rules and regulations based on that relationship.

¹ See, e.g., Marc Linder, *What Is an Employee? Why It Does, But Should Not Matter*, 7 LAW & INEQ. 155, 157-58 (1989) (“The variety of benefits and protections conditioned on the existence of an employment relationship is impressive: unemployment compensation, workers compensation, collective bargaining rights, minimum wages and maximum hours, social security, pensions, occupational safety and health, and anti-discrimination protection.”).

² The “work for hire” doctrine is the most prominent. See 17 U.S.C. § 201(b) (2006). For further discussion, see Part I.D.

³ The doctrine of “enterprise liability” renders an organization liable for the crimes of its employees. See *infra* Part I.C.

⁴ Employers have long been liable for the torts of their employees committed within the scope of employment under the doctrine of *respondeat superior*. See *infra* Part I.B.

⁵ Employees are treated differently within tax for a variety of purposes, including withholding, benefit plans, and social security payroll taxes. See *infra* Part I.E.

Because the same concept of “employment” is used across legal contexts, one’s intuition is that the concept would remain largely consistent. And this has largely been true. The concept of control has served as the unifying idea behind the use of “employee” and “employment in various contexts.”⁶ The common law “control test” comes out of the original conceptions of master and servant from pre-industrial English law, and the Supreme Court has used this test to define the term “employee” in a number of federal statutory contexts.⁷ However, the control test is not the unanimous answer; in fact, it may be losing its firm grip on the category. Courts have long used the “economic realities” test in interpreting the Fair Labor Standards Act (FLSA).⁸ In addition, the D.C. Circuit recently installed an “entrepreneurial opportunities” test that has received support from the Restatement of Employment Law.⁹ Foreign jurisdictions have looked to the concept of “economic dependence.”¹⁰ Other jurists and scholars have argued that there should not be any one definition of employment, and that instead the term should be adapted to fit the needs of the particular statutory, regulatory, or common law regime.¹¹

⁶ It should also be noted that the definition of “employment” is limited to those relationships that courts have deemed to be “economic” or “market-oriented” in character. For example, prison labor, work within families, and student labor has been determined not to count as employment because it does not take place within the labor market. As Noah Zatz has pointed out, “employment law systematically faces disputes over both *how* to draw a market/nonmarket distinction and *whether* that distinction matters legally.” Noah D. Zatz, *Working at the Boundaries of the Markets: Prison Labor and the Economic Dimension of Employment Relationships*, 61 VAND. L. REV. 857, 862 (2008). This article addresses the issue of whether work that is considered “economic” is conducted within or outside of an employment relationship.

⁷ See *Clackamas Gastroenterology Associates, P.C. v. Wells*, 538 U.S. 440 (2003) (interpreting employee under the Americans with Disabilities Act (ADA)); *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) (interpreting the definition of “employee” under ERISA); *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989) (interpreting the scope of the work-for-hire doctrine).

⁸ See, e.g., *Sec’y of Labor v. Lauritzen*, 835 F.2d 1529 (7th Cir. 1987) (interpreting 29 U.S.C. § 203(d), (e)(1), and (g) (2006)).

⁹ *FedEx Home Delivery v. N.L.R.B.*, 563 F.3d 492, 497 (D.C. Cir. 2009) (arguing that the Board and the circuit had “shifted the emphasis away from the unwieldy control inquiry in favor of a more accurate proxy: whether the putative independent contractors have significant entrepreneurial opportunity for gain or loss” (internal quotations omitted)); RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 1.01 (Tentative Draft No. 2 (revised), 2009), at: <http://www.ali.org/00021333/Employment%20Law%20TD%20No%20-%20Revised%20-%20September%202009.pdf>.

¹⁰ See Guy Davidov, *Who is a Worker?*, 34 INDUS. L.J. 57, 59-60 (2005) (discussing the use of the concept of “dependence” in British law).

¹¹ See, e.g., *Sec’y of Labor v. Lauritzen*, 835 F.2d 1529, 1543-45 (7th Cir. 1987) (Easterbrook, J., concurring) (suggesting that the economic realities test be exchanged for a test as to the statute’s purpose); *Lehigh Valley Coal Co. v. Yensavage*, 218 F. 547, 552-53 (2d Cir. 1914) (“It is true that the statute uses the word ‘employed,’ but it must be understood with reference to the purpose of the act, and where all the conditions of the relation require protection, protection ought to be given.”); Richard R. Carlson, *Why the Law Still Can’t Tell an Employee When It Sees One and How it Ought to Stop Trying*, 22 BERKELEY J. EMP. & LAB. L. 295, 356 (2001) (arguing that the concept of employment should be disregarded and other proxies for coverage should take its place).

This Article argues that there is a consistent meaning to the idea of employment, but it comes not from employees but rather from the firm that employs them. Ever since Ronald Coase's *The Nature of the Firm*,¹² economists and legal scholars have puzzled over why the law created firms that stand outside the market. The purpose of firms, Coase famously answered, is to avoid transaction costs by allowing the parties to organize in a hierarchical manner without the need for prices or specific contracts.¹³ As Coase put it: "If a workman moves from department Y to department X, he does not go because of a change in relative prices, but because he was ordered to do so."¹⁴ Less well known is that Coase then looked to the legal definition of employee to determine whether his transaction-costs theory was supported in practice.¹⁵ He found that it was. Since the "control" test was based on the employer's ability to require its employees to take specific actions, he concluded, "[w]e thus see that it is the fact of direction which is the essence of the legal concept of 'employer and employee,' just as it was in the economic concept which was developed above."¹⁶

Coase's approach to the theory of the firm was only the beginning. In fact, Armen Alchian and Harold Demsetz famously rejected Coase's workman example.¹⁷ Scholars have continued to place importance on the role of employees within the firm in defining what a firm is and why it has independent existence. This rich literature, however, has been largely ignored when it comes to defining the concept of employment.¹⁸ This article seeks to correct that failing. The theory of the firm contains a critical insight: the idea of employment is based not on our notions of employees, but rather on our notions of employers. There can

¹² 4 *ECONOMICA* 386 (1937).

¹³ *Id.* at 386-87.

¹⁴ *Id.* at 387.

¹⁵ "We can best approach the question of what constitutes a firm in practice by considering the legal relationship normally called that of 'master and servant' or 'employer and employee.'" *Id.* at 403.

¹⁶ *Id.* at 404.

¹⁷ Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 *AM. ECON. REV.* 777, 777 (1972) ("Telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread. I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue the relationship.").

¹⁸ A notable exception is Guy Davidov, who has discussed the concept of joint production and incomplete contracts in developing a theory of employment. Guy Davidov, *The Three Axes of Employment Relationships: A Characterization of Workers in Need of Protection*, 52 *U. TORONTO L.J.* 357, 377-87 & nn.79, 101-117 (2002). Tim Glynn has discussed how Coase's work on the firm explains the shift to smaller firms and enterprise disaggregation. Glynn argued that the rise in transaction costs from legal regulations such as labor and employment laws led many employers to outsource the employment relationship onto fly-by-night subcontractors, who often dissolve or disappear when faced with litigation. Timothy P. Glynn, *Taking the Employer Out of Employment Law? Accountability for Wage and Hour Violations in an Age of Enterprise Disaggregation*, 15 *EMP. RIGHTS AND EMP. POL'Y J.* 201, 206-15 (2011). Scott Masten examined the definition of employment in assessing the legal significance of the firm in practice. See Scott E. Masten, *A Legal Basis for the Firm*, in *THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT* 196 (Oliver E. Williamson & Sidney G. Winter eds., 1993). I endeavor to do the converse: examine the theory of the firm literature in assessing the definition of employment.

be no employee without an employer.¹⁹ And the converse is also true – there is no employer without employees. The theory of the firm literature demonstrates that the employer is a firm, and that the concept of employment is critical in determining what the firm is and why it continues to exist.

Close examination of the boundaries between employee and independent contractor may appear at first to be a tedious and inconsequential exercise. But its theoretical and practical implications are massive. The popularity of the employment relationship has seen significant erosion, as more companies seek to outsource their chain of production and more workers enjoy only temporary employment.²⁰ At the same time, nationwide firms are placing greater importance on their economic brands, and employees are critical representatives of their companies when it comes to the value and influence of the brand.²¹ We grow closer to a potential “death of employment”²² at the same time that multinational corporations have more economic power than ever. These pressures ask us to consider what, if anything, about the concept of “employment” is worth saving, and if so, how best to save it. We need to identify our theory of employment law in order to justify our understanding of it and the purpose of the category in the first place.

Using the theory of the firm literature, the Article argues that the proper definition of employee is not the control test, the economic realities test, or the entrepreneurial opportunities test. Instead, it argues that the concept of employment is generally used to differentiate between members and nonmembers of an economic firm. In other words, employees are participants in a common economic enterprise organized into a business entity. This definition provides the best rationale for the use of the “employee” category in areas of law such as intellectual property, tax, and torts. Moreover, the participation theory explains while labor and employment law protections are based on employment: these protections are designed to make the firm more responsible for its participants. Because employees participate in the common economic enterprise as organized into a firm, the firm in turn must take care of its employees within that common enterprise.

The purpose of this article seeks to establish a new definition of employment within the law based on participation, rather than control. Part I of the Article discusses where (and why) the concepts of “employee” and “employment” are used within the law. Part II sets out the various doctrinal definitions of the terms “employee” and “scope of employment,” and also examines the theories behind these definitions. Part III provides an overview the theory of the firm literature and the role of employees within that literature. Part

¹⁹ In fact, the standard statutory definition of “employee” is the following exercise in passive voice: “one who is employed by an employer.” See, e.g., 29 U.S.C. § 1002(6) (2006).

²⁰ See, e.g., Peter Coy, Michelle Conlin & Moira Herbst, *The Disposable Worker*, BLOOMBERG BUSINESSWEEK, Jan. 28, 2010, at 33 (discussing trends of temporary employment in the wake of the financial crisis).

²¹ Marion Crain, *Managing Identity: Buying Into the Brand at Work*, 95 IOWA L. REV. 1179 (2010).

²² Alan Hyde, *Employment Law After the Death of Employment*, 1 U. PA. J. LAB. & EMP. L. 99, 99 (1998).

IV uses the theory of the firm to develop a new definition of employment within the law based on participation. Finally, Part V briefly considers the future of the concept of “employment” in the law.

I. THE CONCEPT OF EMPLOYMENT IN THE LAW

The terms “employee” and “employment” are used within the law for a variety of purposes. This Part examines the role that the employment-related categories serve in the various subject areas.

A. *Labor and Employment Law*

Lawmakers have used the concept of employment to create a set of rights within the law that provide additional protections to those considered employees. The statutes that comprise federal labor and employment law all have provisions that are limited to those who serve as employees. Thus, critical protections against race, sex, age, and disability discrimination,²³ below-minimum wages,²⁴ dangerous working conditions,²⁵ retirement funding requirements,²⁶ and threats against collective activity²⁷ are limited to employees. State employment provisions such as workers compensation and unemployment compensation are also limited to employees. These statutory schemes are designed to provide protections to employees as employees and not to any other groups, even if such other groups might benefit from the scheme.

Along with using employment to define vicarious liability (discussed below in Part B), the common law also has certain doctrines that are limited to employment. The tort of wrongful discharge, for example, provides rights to an

²³ See 42 U.S.C. § 2000e-2(a) (2006) (“It shall be an unlawful employment action for an employer (1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual’s race, color, religion, sex, or national origin, or (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual’s race, color, religion, sex, or national origin.”); 29 U.S.C. § 623 (2006) (providing similar protections against age discrimination within the employment relationship); 42 U.S.C. § 12112 (2006) (providing similar protections against disability discrimination).

²⁴ See 29 U.S.C. §§ 206, 207 (2006) (providing minimum wage and overtime protections for employees).

²⁵ See 29 U.S.C. § 654(a) (2006) (requiring employers to “furnish to each of his employees employment and a place of employment which are free from recognized hazards . . .”).

²⁶ See, e.g., 29 U.S.C. § 1053 (2006) (providing for minimum vesting standards for employee retirement accounts).

²⁷ See 29 U.S.C. § 158(a)(1), (3) (2006) (“It shall be an unfair labor practice for an employer (1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 157 of this title; . . . (3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization . . .”).

employee—not an independent contractor.²⁸ And employment at-will is a common law doctrine that is arguably separate from the traditional set of rules for contract interpretation.²⁹ For these provisions to kick in, the individual must be an employee. In addition, under agency law employees have a fiduciary duty of loyalty to their employers.³⁰ This duty generally requires the employee not to compete directly with the employer while still an employee.³¹

B. Vicarious Liability in Tort

The concept of employment is used as the basic dividing line in the doctrine of *respondeat superior*. An employer is liable for the acts of its employee committed within the scope of employment, but it is generally not liable for the acts of independent contractors that are working with it.³² *Respondeat superior* has its roots in early master-servant doctrine, in which a master was liable for harms caused by the actions of his servant.³³ The doctrine continues in the modern common law, with most courts using the term “employee” in place of “servant.” Although many different justifications for the doctrine have been given, most center around the responsibility for or control of

²⁸ For a discussion of the tort of wrongful discharge, see RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 4.01 Reporters’ Notes to cmt. a (to be reclassified as § 5.01) (Tentative Draft 2, 2009) (“The vast majority of jurisdictions recognize some form of the tort of employer discipline in violation of public policy, usually in discharge cases.”), *at*: <http://www.ali.org/00021333/Employment%20Law%20TD%20No%20-%20Revised%20-%20September%202009.pdf>.

²⁹ The employment at-will rule is a default provision in employment contracts that the relationship can be terminated at any time by either party. See RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 2.01 (Tentative Draft No. 2, 2009). The at-will rule may even be considered a “sticky” default – namely, a default rule that requires more explicit or onerous expressions of intent to overcome. See Deborah A. DeMott, *Investing in Work: Wilkes as an Employment Law Case*, 33 W. NEW ENG. L. REV. 497, 498 (2011) (arguing that employment at will may be a sticky default); David Millon, *Default Rules, Wealth Distribution, and Corporate Law Reform: Employment at Will Versus Job Security*, 146 U. PA. L. REV. 975, 1028-30 (1998) (arguing that the default rule should be changed from at-will employment to a “just cause” regime because the just cause regime may better represent an efficient outcome between the parties).

³⁰ RESTATEMENT (SECOND) OF AGENCY § 387 (1957); Terry A. O’Neill, *Employees’ Duty of Loyalty and the Corporate Constituency Debate*, 25 CONN. L. REV. 681, 685 (1993) (“All employees owe a fiduciary duty of loyalty to their employer—be the employer a sole proprietor, a partnership, a close corporation, or a large, publicly traded corporation.”).

³¹ *Id.* at 695 (“Until his employment is terminated, . . . he may not engage in actual competition against his employer.”). Enhanced remedies, including disgorgement of compensation paid during the period of disloyalty, are available in some jurisdictions under the “faithless servant” doctrine. See, e.g., *Astra USA, Inc. v. Bildman*, 914 N.E.2d 36 (Mass. 2009); Charles A. Sullivan, *Mastering the Faithless Servant?: Reconciling Employment Law, Contract Law, and Fiduciary Duty*, 2011 WISC. L. REV. 777, 779-80 (discussing the doctrine).

³² RESTATEMENT (THIRD) OF AGENCY § 2.04 (2006) (“An employer is subject to liability for torts committed by employees while acting within the scope of their employment.”); RESTATEMENT SECOND OF TORTS § 409 (1965) (“Except as stated in §§ 410-429, the employer of an independent contractor is not liable for physical harm caused to another by an act or omission of the contractor or his servants.”).

³³ WILLIAM BLACKSTONE, COMMENTARIES 410 (1765).

the employer over the employee.³⁴ Because the tort was committed within the scope of employment, the employing entity is also liable for the injury along with the employee. Employers can also be liable for the torts of independent contractors, but generally only under one of three conditions: (1) the employer is negligent in selecting, instructing, or supervising the contractor; (2) the employer has a non-delegable duty to the public as a whole or the particular plaintiff; or (3) the work done by the contractor for the employer is specially or inherently dangerous.³⁵ Unites States common law used to follow the “fellow servant” rule, in which the employer was absolved of liability to an employee for an injury caused by a fellow employee.³⁶ However, this rule has generally been abolished and/or rendered obsolete by workers compensation statutes.³⁷

C. Criminal Liability

As in tort law, business organizations may be held liable under criminal law under the doctrine of *respondeat superior*.³⁸ Corporations and other business entities are guilty of crimes committed by their employees if such crimes were committed in the scope of employment. In order to satisfy the *mens rea* requirement, courts have additionally required that the employee have acted with the intent to benefit the corporation.³⁹ Although the doctrine has faced steady criticism over the years, it has become “firmly entrenched as, more or less, the across-the-board rule of enterprise liability for all manner of crimes.”⁴⁰ However, the *de jure* rule masks a more complex reality. Courts and prosecutors have in practice adopted a narrower standard of liability when it comes to institutional guilt. At the front end, a series of Department of Justice memos over the last decade chronicled the attempts to demarcate when corporations should be charged

³⁴ PAGE W. KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 69, at 499–501 (5th ed. 1984) (emphasis added).

³⁵ RESTATEMENT (SECOND) OF TORTS § 409 cmt.b (1965). These are the three primary circumstances; the employer is also liable when it has performed a contract using independent contractors when those services were accepted in the belief that they were to be performed by the employer and its employees. *Id.* § 429.

³⁶ RESTATEMENT (SECOND) OF AGENCY § 474 (1957) (“A master is not liable to a servant or subservant who, while acting within the scope of his employment or in connection therewith, is injured solely by the negligence of a fellow servant in the performance of acts not involving a violation of the master’s non-delegable duties, unless the servant was coerced or deceived into serving, was too young to appreciate the risks, or was employed in violation of statute.”).

³⁷ KEETON ET AL., *supra* note PK1984, at 575-76; J.M. Balkin, *Too Good to Be True: The Positive Economic Theory of Law*, 87 COLUM. L. REV. 1447, 1486-87 (1987) (“[T]he fellow servant rule is like a mastodon preserved in a glacier—it was rendered obsolete by workers’ compensation, and, given the general trend of twentieth century tort law, there can be no question that if workers’ compensation were abolished today few courts would follow the fellow servant rule in industrial accident cases.”).

³⁸ N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 495 (1909).

³⁹ See, e.g., Standard Oil Co. v. United States, 307 F.2d 120, 128 (5th Cir. 1962).

⁴⁰ Samuel W. Buell, *The Blaming Function of Entity Criminal Liability*, 81 IND. L.J. 473, 475-76 (2006). See also Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 836 (1994) (stating that the existing legal regime closely approximates a rule of “pure strict vicarious liability”).

with crimes.⁴¹ All of these guidelines required more than mere *respondeat superior* liability.⁴² At the back end, the U.S. Sentencing Guidelines assessed punishment for corporate guilt based on whether “an individual within high-level personnel of the unit participated in, condoned, or was willfully ignorant of the offense; or tolerance of the offense by substantial authority personnel was pervasive throughout such [entity].”⁴³ Commentators have noted a change from vicarious liability to more of a negligence standard on the part of corporate management in overseeing internal investigations.⁴⁴ This move has had both supporters and critics.⁴⁵ However, the overall liability rule itself remains based on *respondeat superior*.

D. Intellectual Property

The term “intellectual property” refers to a wide range of information to which specific legal rights have attached. In some cases, intellectual property is

⁴¹ See Memorandum from Deputy Attorney Gen. Larry Thompson to Heads of Dep't Components, Principles of Fed. Prosecution of Bus. Org. (Jan. 20, 2003) [hereinafter Thompson Memorandum], available at http://www.justice.gov/dag/cftf/corporate_guidelines.htm; Memorandum from Deputy Attorney Gen. Paul J. McNulty to Heads of Dep't Components, Principles of Fed. Prosecution of Bus. Org. 4 (Dec. 12, 2006), available at http://www.justice.gov/dag/speeches/2006/mcnulty_memo.pdf; Memorandum of Deputy Attorney Gen. Mark R. Filip, Principles of Fed. Prosecution of Bus. Org. 4 (Aug. 28, 2008), available at <http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf>.

⁴² The Thompson Memorandum listed the following factors in determining when to charge a corporation: (1) the nature and seriousness of the offense; the pervasiveness of wrongdoing within the corporation; (3) the corporation's history of similar conduct; (4) the corporation's cooperation and willingness to waive attorney-client privilege and work product protection; (5) the existence of a compliance program; (6) the corporation's remedial actions; (7) collateral consequences of a charge, such as harm to shareholders, pension holders, and employees; (8) the adequacy of prosecuting the individuals involved; and (9) the adequacy of civil or regulatory enforcement. Thompson Memorandum, *supra* note TM2003. Factor 4 became quite controversial, as courts became concerned that the federal government was pressuring corporate leaders into giving up attorney-client protections for their employees in order to spare a corporate criminal charge. See, e.g., *Unites States v. Stein*, 541 F.3d 130, 135 (2d Cir. 2008) (finding that “the government deprived [employee] defendants of their right to counsel under the Sixth Amendment by causing KPMG to impose conditions on the advancement of legal fees to defendants, to cap the fees, and ultimately to end payment”).

⁴³ U.S. SENTENCING GUIDELINES MANUAL § 8c2.5g (2004).

⁴⁴ See, e.g., Kimberly D. Krawiec, *Organizational Misconduct: Beyond the Principal-Agent Model*, 32 FLA. ST. U. L. REV. 571, 572 (2005) (“[A]t least since the adoption of the Organizational Sentencing Guidelines (OSG) in 1991, the U.S. legal regime has been moving away from a system of strict vicarious liability toward a system of duty-based organizational liability.”).

⁴⁵ For support for a deterrence-based approach, see Vikramiditya S. Khanna, *Should the Behavior of Top Management Matter?*, 91 GEO. L.J. 1215, 1224 (2003) (“Corporate liability improves deterrence when agents are judgment-proof because it places corporate assets at risk and thereby forces the corporation to internalize the social costs of wrongdoing.”). For criticism of the monitoring-based approach, see Krawiec, *supra* note KK1, at 614 (2005) (“I conclude that the U.S. legal regime's move away from strict vicarious liability to internal compliance-based liability is unjustified by either theory or empirical evidence.”).

generated by a single individual: an author writing alone in her home, or an inventor toiling away in the garage. However, in many cases, intellectual property is generated by specific individuals who are working within the context of a larger firm. How the rights to that “property” are divvied up have significant legal and economic ramifications, particularly for firms and individual employees.⁴⁶

Federal law establishes ownership rights for copyrighted works. The “work-for-hire” doctrine was originally established in the 1909 Copyright Act, as that act specified that the author of a copyrighted work “shall include an employer in the case of works made for hire.”⁴⁷ The Copyright Act of 1976 continued this doctrine, specifying that the employer is considered the author of any work made for hire unless expressly agreed otherwise.⁴⁸ The 1976 Act defines “work made for hire” as “a work prepared by an employee within the scope of his or her employment.”⁴⁹ The Act does not further define employee or employment.

The default rule for patent law is that the employee who invents the patent is the author, not the employer.⁵⁰ However, the employer is free to contract with employees explicitly for the rights to all inventions created within the scope of employment. Even without an explicit contract, courts have found something akin to a work for hire doctrine when an employee is hired to work on a specific invention or problem; courts are more likely to conclude that “the employee was hired to invent and therefore the firm owned all patents” through contract.⁵¹ In addition, under the shop-right doctrine, employers enjoy a non-exclusive right to use the patent without having to compensate the employee. A shop right arises when the employee has created the invention on the job using the employer’s materials.⁵² If the employee creates the invention at work while using the employer’s tools, the employer has a right to use that invention without cost.

Trademark presents a special connection between the firm, its employees, and intellectual property. Trademark protection is what enables a group of people to join together and be recognized as a common enterprise without fearing that their reputation will be poached by outsiders. Just as patent and copyright

⁴⁶ See KATHERINE V.W. STONE, *FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE* 127-29 (2004) (discussing disputes over ownership of human capital).

⁴⁷ Copyright Act of 1909, Pub. L. No. 60-349, §23, 35 Stat. 1075, 1080 (repealed 1976).

⁴⁸ 17 U.S.C. § 201(b) (2006) (“In the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author for purposes of this title, and, unless the parties have expressly agreed otherwise in a written instrument signed by them, owns all of the rights comprised in the copyright.”)

⁴⁹ *Id.* § 101.

⁵⁰ The patent must be registered by the individual inventor. See 35 U.S.C. § 111, 115 (2006) (discussing oath taken as part of patent process that the registrant is the “original and first inventor”).

⁵¹ CATHERINE L. FISK, *WORKING KNOWLEDGE: EMPLOYEE INNOVATION AND THE RISE OF CORPORATE INTELLECTUAL PROPERTY, 1800-1930* 180 (2009). See also Dan L. Burk, *Intellectual Property and the Firm*, 71 U. CHI. L. REV. 3, 15 (2004) (“In the absence of explicit contractual terms requiring an assignment, an implied duty to assign may be found. Courts have tended to recognize such an implied duty to assign patent rights in situations where an employee hired to solve a problem engages in research, and the invention relates to that effort.”).

⁵² FISK, *supra* note CF2009, at 118; Burk, *supra* note DB2004, at 16.

protections concern the allocation of information rights between employee and firm, trademark concerns the allocation of good will and reputational rights between employee and firm.⁵³ Trademarks enable firms to transfer reputational assets over to the firm, and thus deprive individual employees of their ability to hold up the firm over their own reputational assets.⁵⁴

Finally, the prohibition against the disclosure of trade secrets is not limited to employees. The Uniform Trade Secret Act defines misappropriation of a trade secret as acquiring the trade secret either by improper means or “under circumstances giving rise to a duty to maintain its secrecy or limit its use.”⁵⁵ The Act covers any “person,” defined as “a natural person, corporation, business trust, estate, trust, partnership, association, joint venture, government, governmental subdivision or agency, or any other legal or commercial entity.”⁵⁶ However, employees are expected to keep confidential any of the employer’s trade secrets to which they are exposed during the course of employment.⁵⁷ Indeed, employees are primary targets for the protections against trade secret misappropriation. A study of trade secret litigation found that 85% of trade secret cases involved either current or former employees or business partners.⁵⁸ Employees are generally presumed to have an implied duty to keep any trade secrets to which they are exposed confidential.⁵⁹ Moreover, the doctrine of “inevitable disclosure of trade secrets” has applied in some jurisdictions to employees who leave the company but (according to the court) must inevitably use the trade secrets they have learned at their old position.⁶⁰

⁵³ Dan L. Burk & Brett H. McDonnell, *Trademarks and the Boundaries of the Firm*, 51 WILLIAM & MARY L. REV. 345, 363-64 (2009).

⁵⁴ *Id.* at 376-79.

⁵⁵ UNIFORM TRADE SECRETS ACT § 1(2) (amended 1985), 14 U.L.A. 529 (2005) [hereinafter UTSA]. The Act is model civil legislation that has been adopted at least in part by forty-seven jurisdictions. 14 U.L.A. 71-72 (Supp. 2011).

⁵⁶ UTSA, *supra* note UTSA, § 1(3).

⁵⁷ O’Neill, *supra* note TON1993, at 695 n.65 (“Courts have held that when an employer discloses its trade secret to an employee during the course of employment, the employee is bound by his fiduciary duty of loyalty not to use or reveal it for his own personal benefit.”).

⁵⁸ David S. Almeling et al., *A Statistical Analysis of Trade Secret Litigation in Federal Courts*, 45 GONZ. L. REV. 291, 294 (2010). The study also found that trade secret owners were “twice as likely to prevail on a motion for preliminary relief when they sued employees as when they sued business partners.” *Id.* However, owners were also “over 70% more likely to lose a motion to dismiss when they sued employees than business partners.” *Id.*

⁵⁹ See *Unistar Corporation v. Child*, 415 So.2d 733, 734 (Fla. 3d Ct. App. 1982) (“The law will import into every contract of employment a prohibition against the use of a trade secret by the employee for his own benefit, to the detriment of his employer, if the secret was acquired by the employee in the course of his employment.”); Derek P. Martin, Comment, *An Employer’s Guide to Protecting Trade Secrets from Employee Misappropriation*, 1993 BYU L. REV. 949, 953 (“For most employees the law presumes a confidential relationship between employer and employee for the purposes of protecting trade secrets.”).

⁶⁰ See, e.g., *PepsiCo v. Redmond*, 54 F.3d 1262 (7th Cir. 1995); Rebecca J. Berkun, *The Dangers of the Doctrine of Inevitable Disclosure in Pennsylvania*, 6 U. PA. J. LAB. & EMP. L. 157, 157 (2003) (“The doctrine of inevitable disclosure restricts an employee’s future employment if that employee will inevitably use a former employer’s trade secrets in the course of the future employment.”).

E. Tax

Firms are expected to differentiate between employees and independent contractors over a host of provisions, including whether taxes need to be withheld,⁶¹ whether the firm must pay a share of Social Security and Medicare (FICA)⁶² and unemployment (FUTA) taxes⁶³ for the worker, and whether the workers count as employees for benefit plan purposes.⁶⁴ The IRS defines employees based on the common law control test.⁶⁵ The consequences of a misclassification can be extremely costly, as the business is then subject to the mandatory back-tax formula.⁶⁶ In fact, Congress was moved to create a ‘safe harbor’ for employers when it came to the employee-independent contractor distinction.⁶⁷ The upshot of these requirements is to give the firm tax responsibilities for its employees, while giving independent contractors tax responsibilities for themselves. We thus see the differentiation between employee and independent contractor: the firm is expected to manage and even pay some taxes for its employees, while it must leave independent contractors to their own devices.

II. THE DEFINITION OF EMPLOYMENT IN DOCTRINE AND THEORY

The categories of “employee” and “the scope of employment” define certain contours within various areas of the law. For many statutory schemes, the “employee” category does all of the work; once the identity of the person as an employee has been established, that person has the rights conveyed upon employees and can bring claims for violations of those rights. In other areas of the law, however, the person and the context are relevant to establishing the legal category; therefore, both “employee” and “scope of employment” are necessary to establish. Both categories are considered below.

A. Defining “Employee”

⁶¹ 26 U.S.C. § 3402 (2006).

⁶² 26 U.S.C. § 3101 et seq. (2006).

⁶³ 26 U.S.C. § 3301 et seq. (2006).

⁶⁴ 26 U.S.C. § 410 (2006).

⁶⁵ See 26 U.S.C. § 3121(d)(2) (2006) (defining an employee as, among other definitions, “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee”); TREAS. REGS. § 31.3121(d)-1(c) (2012) (finding an employment relationship “when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished”). See also 26 U.S.C. § 3306(i) (2006) (stating that “the term ‘employee’ has the meaning assigned to such term by section 3121(d)”); REV. RUL. 87-41, 1987-1 C.B. 296.

⁶⁶ 26 U.S.C. § 3509 (2006).

⁶⁷ REVENUE ACT OF 1978, § 530.

1. *The Common Law “Control” Test.* — The “control” test is the dominant standard for employment, both nationally and internationally.⁶⁸ The test finds its historical roots in the definition of “servant” in English common law. William Blackstone describes the relationship between master and servant as one of the three “great relations in private life,” along with husband and wife and parent and child.⁶⁹ The relationship was used primarily not for contractual purposes, but rather to establish the duties each owed to the other, and to establish when a master was liable for the actions of the servant. The master was certainly liable if the servant committed the act “by the command or encouragement of the master,” but liability extended beyond such direct orders. Blackstone offered the following example, and justification: “If an innkeeper’s servants rob his guests, the master is bound to restitution; for as there is a confidence reposed in him, that he will take care to provide honest servants, his negligence is a kind of implied consent to the robbery.”⁷⁰

Under what circumstances would one who contracts for labor be liable for the acts of the laborer? The law does not render principals liable for the acts of their agents taken outside of the agent’s authority.⁷¹ Such vicarious liability is reserved for the master-servant relationship. English courts based the definition of this relationship on the notion of control. The basics of the control test are straightforward. A servant is one who is “under the duty of rendering personal services to the master or to others on behalf of the master.”⁷² In addition, the master must have the “right to control the servant’s work,” which means “being entitled to tell the servant when to work (within the hours of service) and when not to work, and what work to do and how to do it.”⁷³ This right of control is what separates master-servant from the principal-agent.

The Restatement Second of Agency is perhaps the most widely-recognized source in American law for the principal-agent and master-servant

⁶⁸ Davidov, *supra* note GD2002, at 367 (“Control/subordination is still the leading (and sometimes the single) characteristic of employment relationships in many countries.”).

⁶⁹ BLACKSTONE, *supra* note WB1765, at 410.

⁷⁰ *Id.* See also WILLIAM PALEY, A TREATISE ON THE LAW OF PRINCIPAL AND AGENT, CHIEFLY WITH REFERENCE TO MERCANTILE TRANSACTIONS 126 (3d ed. 1840) (“A master is responsible for the negligence or unskillfulness of a servant acting in the prosecution of his service, though not under his immediate direction.”). *But cf.* Harold J. Laski, *The Basis of Vicarious Liability*, 26 YALE L.J. 105, 105-06 (1916) (describing the doctrine of respondeat superior liability for the unauthorized actions of a servant as “novel” and concealing “a veritable hornets’ nest of stinging difficulties”).

⁷¹ An agent can operate on behalf of the principal and can bind the principal by his or her actions. RESTATEMENT (THIRD) OF AGENCY § 2.01 (2006). An agent can act for the principal even when authority has not been expressly granted, as long as a third party reasonably believes the agent has the authority. *Id.* § 2.03. However, respondeat superior does not extend to principals’ liability for the actions of agents. As the Restatement explains: “Agents who are retained as the need arises and who are not otherwise employees of their principal normally operate their own business enterprises and are not, except in limited respects, integrated into the principal’s enterprise so that a task may be completed or a specified objective accomplished. Therefore, *respondeat superior* does not apply.” *Id.* § 2.04 cmt. b.

⁷² FRANCIS R. BATT, THE LAW OF MASTER AND SERVANT 6 (1929), *quoted in* Coase, *supra* note RC1, at 403-04.

⁷³ *Id.* at 404.

doctrines.⁷⁴ Section 220 provides the following definition: “A servant is a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other’s control or right to control.”⁷⁵ As the commentary acknowledges, however, this relationship is “one not capable of exact definition.”⁷⁶ The Restatement provides a ten-factor test to further determine whether the potential employer is exercising control:

- (a) the extent of control which, by the agreement, the master may exercise over the details of the work;
- (b) whether or not the one employed is engaged in a distinct occupation or business;
- (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
- (d) the skill required in the particular occupation;
- (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
- (f) the length of time for which the person is employed;
- (g) the method of payment, whether by the time or by the job;
- (h) whether or not the work is a part of the regular business of the employer;
- (i) whether or not the parties believe they are creating the relation of master and servant; and
- (j) whether the principal is or is not in business.⁷⁷

The Restatement Third of Agency has adapted the language of these doctrines by changing “servant” to “employee,”⁷⁸ but the doctrines remain relatively the same.⁷⁹

Master-servant doctrine makes no exceptions or differentiations based on the relative status of the “servant” vis-à-vis the master. It may seem that high-ranking employees would not meet the test, as their actions are not controlled in

⁷⁴ STEPHEN M. BAINBRIDGE, *AGENCY, PARTNERSHIPS & LLCs* 19 (2004) (“In general, the single most influential source of legal rules in this area remains the American law Institute’s Restatement of Agency.”).

⁷⁵ RESTATEMENT (SECOND) OF AGENCY § 220(1) (1957).

⁷⁶ *Id.* § 220 cmt. c.

⁷⁷ *Id.* § 220(2). These factors have significant overlap with the criteria to determine “conditions of dependency or subordination” included in a set of International Labor Organization (ILO) draft recommendations. See Davidov, *supra* GD2002, at 402.

⁷⁸ See RESTATEMENT (THIRD) OF AGENCY §7.07(3)(a) (2006) (“ . . .[A]n employee is an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work . . .”).

⁷⁹ The primary difference in language, beyond the change from servant to employee, is the removal of “physical” as a modifier for control. Compare RESTATEMENT (SECOND) OF AGENCY § 220 (1957), with RESTATEMENT (THIRD) OF AGENCY §7.07(3)(a) (2006). The Restatement Third also moves the ten-factor test into the comments section. *Id.* §7.07 cmt. f.

the same way as rank-and-file workers. However, no such exception exists. Instead, control “indicates the closeness of the relation between the one giving and the one receiving the service rather than the nature of the service or the importance of the one giving it. Thus, ship captains and managers of great corporations are normally superior servants, differing only in the dignity and importance of their positions from those working under them.”⁸⁰ The Restatement Third uses the same example but frames the justification a bit differently: “In some employment relationships, an employer's right of control may be attenuated. For example, senior corporate officers, like captains of ships, may exercise great discretion in operating the enterprises entrusted to them, just as skilled professionals exercise discretion in performing their work. Nonetheless, all employers retain a right of control, however infrequently exercised.”⁸¹ The only differentiation is that an employer may be liable for punitive damages if the agent was employed in a managerial capacity and was acting in the scope of employment, or the principal or a managerial agent of the principal ratified or approved the act.⁸²

The Supreme Court has made the common-law “control” test into the default test for “employee” whenever used without further explanation in a federal statute. In *Community for Creative Non-Violence v. Reid*,⁸³ for example, the Court said that “[i]n the past, when Congress has used the term ‘employee’ without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine.”⁸⁴ It further found it appropriate to rely on the general common-law of agency, rather than the doctrine of any particular state, in order to create a national, uniform law of copyright.⁸⁵ It thus relied on the Restatement Second of Agency in developing a multifactor test. However, the thirteen-factor test used in *CCNV* to illustrate the common law test differs from the Restatement Second of Agency’s ten-factor test in several ways.⁸⁶ The Restatement test includes these factors not included in the *CCNV* test:

- (b) whether or not the one employed is engaged in a distinct occupation or business;
- (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision; . . . [and]

⁸⁰ RESTATEMENT (SECOND) OF AGENCY § 220 cmt. a (1957).

⁸¹ See also RESTATEMENT (THIRD) OF AGENCY §7.07 cmt. f (2006) The Restatement then provides the example of a CEO who has bad vision but still wants to drive; the board can compel the CEO to use a driver when on company business, despite the CEO’s authority over the company. *Id.* § 7.07 cmt. f ex. 15.

⁸² RESTATEMENT (SECOND) OF AGENCY § 217C(c) & (d) (1957).

⁸³ 490 U.S. 730 (1989).

⁸⁴ *Id.* at 739-740.

⁸⁵ *Id.* at 740.

⁸⁶ *Id.* at 751-52.

(i) whether or not the parties believe they are creating the relation of master and servant.⁸⁷

The *CCNV* test in turn includes these six factors not included in the Restatement test:

the location of the work; . . .
 whether the hiring party has the right to assign additional projects to the hired party;
 the extent of the hired party's discretion over when and how long to work; . . .
 the hired party's role in hiring and paying assistants;
 the provision of employee benefits; and
 the tax treatment of the hired party.⁸⁸

The Court examined these factors and found the sculpture at issue in the case was made by an independent contractor, rather than an employee.⁸⁹

ERISA's nominal definition of "employee" is "any individual employed by an employer," without any further direction.⁹⁰ The Supreme Court has adopted the common law test as the basis for the Act's definition.⁹¹ The Court cited to the definition of the common law test provided in *CCNV v. Reid* and quoted the

⁸⁷ RESTATEMENT (SECOND) OF AGENCY § 220(2) (1957).

⁸⁸ *CCNV*, 490 U.S. at 751-52.

⁸⁹ The Court concluded as follows:

Examining the circumstances of this case in light of these factors, we agree with the Court of Appeals that Reid was not an employee of CCNV but an independent contractor. True, CCNV members directed enough of Reid's work to ensure that he produced a sculpture that met their specifications. But the extent of control the hiring party exercises over the details of the product is not dispositive. Indeed, all the other circumstances weigh heavily against finding an employment relationship. Reid is a sculptor, a skilled occupation. Reid supplied his own tools. He worked in his own studio in Baltimore, making daily supervision of his activities from Washington practicably impossible. Reid was retained for less than two months, a relatively*753 short period of time. During and after this time, CCNV had no right to assign additional projects to Reid. Apart from the deadline for completing the sculpture, Reid had absolute freedom to decide when and how long to work. CCNV paid Reid \$15,000, a sum dependent on completion of a specific job, a method by which independent contractors are often compensated. Reid had total discretion in hiring and paying assistants. "Creating sculptures was hardly 'regular business' for CCNV." Indeed, CCNV is not a business at all. Finally, CCNV did not pay payroll or Social Security taxes, provide any employee benefits, or contribute to unemployment insurance or workers' compensation funds.

Id. at 752-53 (citations and quotation marks omitted).

⁹⁰ 29 U.S.C. § 1002(6) (2006). See *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318, 323 (1992) (saying the definition is "completely circular and explains nothing").

⁹¹ *Id.*

thirteen-factor test used in that decision.⁹² While acknowledging that “the traditional agency law criteria offer no paradigm of determinacy,” the Court argued that the common-law test “generally turns on factual variables within an employer’s knowledge” and comports “with our recent precedents and with the common understanding, reflected in those precedents, of the difference between an employee and an independent contractor.”⁹³ The Court rejected the lower court’s definition, which was similar to the “economic realities” test, because it found that ERISA’s statutory definition was not equally expansive, as it did not include “suffer or permit to work.”⁹⁴

The federal employment antidiscrimination statutes – Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA) – all share the same definition of employee as ERISA: “an individual employed by an employer.”⁹⁵ Up until the Supreme Court’s decision in *Darden*, circuit courts had applied different tests to determine employee status. Some applied the common law test,⁹⁶ some the economic realities test,⁹⁷ and some a hybrid test looking at both control and economic realities.⁹⁸ After the Court’s holding in *Darden* that ERISA’s definition should follow the common law test, circuit courts largely saw the writing on the wall and applied the common-law test to antidiscrimination statutes.⁹⁹ The Court

⁹² *Darden*, 503 U.S. at 323 (citing *CCNV*, 490 U.S. at 751-752). The relevant quotation provided:

In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party’s right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party’s discretion over when and how long to work; the method of payment; the hired party’s role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

Id.

⁹³ *Id.* at 328.

⁹⁴ *Id.* at 325-26.

⁹⁵ See 42 U.S.C. § 2000-e(f) (2006) (Title VII); 29 U.S.C. § 630(f) (2006) (ADEA); 42 U.S.C. § 12111(4) (2006) (ADA).

⁹⁶ See, e.g., *Cobb v. Sun Papers, Inc.*, 673 F.2d 337, 339-41 (11th Cir. 1982).

⁹⁷ See, e.g., *Armbruster v. Quinn*, 711 F.2d 1132, 1340 (6th Cir. 1983). See Patricia Davidson, Comment, *The Definition of “Employee” Under Title VII: Distinguishing Between Employees and Independent Contractors*, 53 U. CIN. L. REV. 203, 219-22 (1984) (discussing the *Armbruster* case at length).

⁹⁸ See, e.g., *Mares v. Marsh*, 777 F.2d 1066, 1067 (5th Cir. 1985). The hybrid test was arguably “the favored standard for claims under both Title VII and the ADEA” prior to the *Darden* decision. Lewis L. Maltby & David C. Yamada, *Beyond “Economic Realities”: The Case for Amending Federal Employment Discrimination Laws to Include Independent Contractors*, 38 B.C. L. REV. 239, 250 (1997).

⁹⁹ *Wilde v. County of Kandiyohi*, 15 F.3d 103, 105-06 (8th Cir. 1994) (“Application of the economic realities test results in Title VII coverage for some common-law independent contractors because they are vulnerable to discrimination arising in the course of their work. Because the economic realities test is based on the premise that the term should be construed in light of Title VII’s purpose and the construction is broader than at common law, *Darden* precludes the test’s application.”); Maltby & Yamada, *supra* note MY1, at 253 (noting that “[t]he *Darden* decision has

confirmed this approach in *Clackamas Gastroenterology Associates, P.C. v. Wells*.¹⁰⁰ In *Clackamas*, the court cited to *Darden* and held that the same common-law approach should apply to the federal antidiscrimination statutes.¹⁰¹ Thus, the common-law test has now been ensconced.¹⁰² The Court specified that “[w]e think that the common-law element of control is the principal guidepost that should be followed in this case.”¹⁰³

The Court has also used common-law agency principles in establishing employer liability for acts of harassment by its employees. In the cases of *Burlington Indus., Inc. v. Ellerth*¹⁰⁴ and *Faragher v. City of Boca Raton*,¹⁰⁵ supervisors had subjected the plaintiffs to hostile work environments, and the Court needed to determine whether the employer was vicariously liable for the actions of its supervisors.¹⁰⁶ After a detailed examination of agency law in both cases, the Court unveiled the following standard:

An employer is subject to vicarious liability to a victimized employee for an actionable hostile environment created by a supervisor with immediate (or successively higher) authority over

significantly influenced judicial interpretations under Title VII and ADEA”). *But see* *Frankel v. Bally, Inc.*, 987 F.2d 86, 90 (2d Cir. 1993) (adhering to the hybrid test). The *Frankel* court found “that in practice there is little discernible difference between the hybrid test (which pre-dates and is not adopted in *Darden*) and the common law agency test.” *Id.* at 90.

¹⁰⁰ 538 U.S. 440 (2003).

¹⁰¹ *Id.* at 444-45, 447, 451.

¹⁰² The *Clackamas* decision was not an effort to distinguish employees from independent contractors; rather, it addressed the question of whether a shareholder of a professional corporation was an employee or instead an employer. And while the Court argued that “the common law’s definition of the master-servant relationship does provide helpful guidance,” it tacitly acknowledged that the usual factors to that test were inapplicable. Instead, it endorsed the EEOC’s six-factor test, purportedly based on the common law agency test:

Whether the organization can hire or fire the individual or set the rules and regulations of the individual’s work;

Whether and, if so, to what extent the organization supervises the individual’s work;

Whether the individual reports to someone higher in the organization;

Whether and, if so, to what extent the individual is able to influence the organization;

Whether the parties intended that the individual be an employee, as expressed in written agreements or contracts; [and]

Whether the individual shares in the profits, losses, and liabilities of the organization.

Id. at 449-50 (citing EEOC, COMPLIANCE MANUAL § 605:0009 (2000)). This set of factors is not exhaustive. *Id.* at 450 (“The answer to whether a shareholder-director is an employee or an employer cannot be decided in every case by a shorthand formula or magic phrase.”). The *Clackamas* decision has been criticized for creating a distinction between employees and high-level employee-managers that need not and does not exist, at least in the common law of agency. See Frank J. Menetrez, *Employee Status and the Concept of Control in Federal Employment Discrimination Law*, 63 SMU L. REV. 137, 182-86 (2010).

¹⁰³ *Id.* at 448.

¹⁰⁴ 524 U.S. 742 (1998).

¹⁰⁵ 524 U.S. 775 (1998).

¹⁰⁶ *Ellerth*, 524 U.S. at 754.

the employee. When no tangible employment action is taken, a defending employer may raise an affirmative defense to liability or damages, subject to proof by a preponderance of the evidence, see Fed. Rule Civ. Proc. 8(c). The defense comprises two necessary elements: (a) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (b) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.¹⁰⁷

The standard provides a twist on *respondeat superior* liability, in that it makes the corporation liable for actions such as sexual harassment that traditionally were not held to be within the scope of employment.¹⁰⁸ However, acknowledging that the supervisor is aided in the agency relation through her or his power over the employee,¹⁰⁹ the Court assigns liability to the business entity unless the entity provided a reasonable method of correcting the problem and the employee unreasonably failed to utilize it.¹¹⁰

OSHA offers its statutory protections to “employee[s] of an employer who is employed in a business of his employer which affects commerce.”¹¹¹ Given the similarities between this definition and the definition used in ERISA and the antidiscrimination statutes, it seems almost indisputable that the common-law agency test would apply. This has been the administrative conclusion.¹¹² However, at least one court continued to apply the “economic realities” test post-*Darden*, finding the analysis to be the same under both tests.¹¹³ Finally, courts have often relied on the federal definition of “employee” for state statutes that mirror and/or supplement federal employment protections.¹¹⁴

¹⁰⁷ *Id.* at 765; *Faragher*, 524 U.S. at 807.

¹⁰⁸ *Ellerth*, 524 U.S. at 757 (“The general rule is that sexual harassment by a supervisor is not conduct within the scope of employment.”).

¹⁰⁹ *Id.* at 760-65.

¹¹⁰ At least as to race and ethnicity discrimination, the dividing line between employees and contractors is less important, as Title VII is backstopped by 42 U.S.C. § 1981. Section 1981 provides that “[a]ll persons . . . shall have the same right . . . to make and enforce contracts.” 42 U.S.C. § 1981 (2006). Thus, the dividing line between employees and nonemployees is not relevant to the statutory protection. However, the statute has only been interpreted as prohibiting racial or ethnic discrimination. *See, e.g.,* *Sherlock v. Montefiore Med. Ctr.*, 84 F.3d 522, 527 (2d Cir. 1996); *Maltby & Yamada, supra* note MY1, at 257 (finding that “the scope of the statute . . . prohibits discrimination only on the basis of race or ethnicity, thus excluding claims based upon other grounds, most notably sex”).

¹¹¹ 29 U.S.C. § 652(6) (2006).

¹¹² OSHA, Opinion Letter to San Luis Obispo Fire Association, April 2, 1996, at: http://www.osha.gov/pls/oshaweb/owadis.show_document?p_id=22132&p_table=INTERPRETATIONS (citing to *Darden* and the thirteen-point control test discussed therein).

¹¹³ *Loomis Cabinet Co. v. Occupational Safety & Health Review Comm'n*, 20 F.3d 938, 941 (9th Cir. 1994) (“Here, the Commission used the economic realities test . . . , but determined that the result would be the same under the *Darden* test. We agree.” (citations omitted)).

¹¹⁴ *See, e.g.,* *Strother v. Southern Cal. Permanente Med. Group*, 79 F.3d 859, 866 (9th Cir. 1996) (stating that “California courts have interpreted (the California Fair Housing and Employment Act) in accordance with cases interpreting the (ADEA) and the Federal Civil Rights Act . . . (and

The NLRA's definition of "employee" does not itself provide a definition of the term. Instead, the statute simply provides a laundry list of exclusions. Excluded employees include: agricultural workers, domestically-employed healthcare or family care employees, public-sector employees, railroad, airline, and other transportation workers covered by the Railway Labor Act (RLA), independent contractors, and supervisors.¹¹⁵ The Act did not originally exclude independent contractors, and both the National Labor Relations Board and the Supreme Court originally held that so-called "newsboys" were statutory employees for purposes of the Act, even though they were considered independent contractors.¹¹⁶ The Court explicitly rejected the common law distinction between employees and independent contractors, holding that the news vendors in question were "subject, as a matter of economic fact, to the evils the statute was designed to eradicate."¹¹⁷ However, Congress rejected this interpretation of the Act and moved in 1947 to add independent contractors specifically to the list of excluded categories. The Board then adopted the common-law right to control test in excluding independent contractors. The Supreme Court sanctioned this test in *NLRB v. United Insurance Co.*,¹¹⁸ making clear that the Board had a range of discretion in implementing the test.

The Board has had occasion to rule on employee status in a variety of contexts: newspaper carriers,¹¹⁹ nightclub performers,¹²⁰ gas station operators,¹²¹ and novelty vendors.¹²² Two recurring areas of difficulty have been delivery truck drivers and taxicab operators. In both cases, the workers may own their equipment, but they often operate within a system created and regulated by one overall company. Thus the Board has found both ways on employee status

therefore) we look to federal cases in those areas that have addressed whatever an individual labelled as a partner can be considered an employee for the purpose of employment discrimination laws") (citation omitted); *Lilley v. BTM Corp.* 958 F.2d 746, 750 n.2 (6th Cir. 1992) (stating that "ADEA standards governing employment status also apply to Michigan's Elliot-Larsen Act, Mich. Comp. Laws, S 37.2101 et seq"); *Frishberg v. Esprit De Corp., Inc.* 778 F. Supp. 793, 798 (S.D.N.Y. 1991) (stating that "(s)ince New York distinguishes between employees and independent contractors in a sufficiently similar manner, the court will use the federal test for both state and federal claims") (footnote omitted).

¹¹⁵ 29 U.S.C. § 152(3) (2006).

¹¹⁶ *N.L.R.B. v. Hearst Publications, Inc.*, 322 U.S. 111 (1944).

¹¹⁷ *Id.* at 127.

¹¹⁸ 390 U.S. 254 (1968). Noting that "[t]here are innumerable situations which arise in the common law where it is difficult to say whether a particular individual is an employee or an independent contractor," the Court required courts to uphold reasonable determinations "even though a court would justifiably have made a different choice had the matter been before it *de novo*." *Id.* at 258, 260.

¹¹⁹ Compare *Philadelphia Newspapers*, 238 N.L.R.B. 835 (1978) (finding distributors to be employees) with *Glen Falls Newspapers*, 303 N.L.R.B. 614 (1991) (finding distributors to be independent contractors).

¹²⁰ *Harrah's Club v. N.L.R.B.*, 446 F.3d 471(9th Cir. 1971) (finding such performers to be independent contractors).

¹²¹ *American Oil Co.*, 188 N.L.R.B. 438 (1971) (finding operators to be independent contractors).

¹²² *ARA Leisure Servs. V. N.L.R.B.*, 782 F.2d 456 (4th Cir. 1986) (upholding the Board's conclusion that such workers were employees).

depending on variations between the structures of the jobs. In *Roadway Package Systems, Inc.*,¹²³ the Board found delivery truck drivers working for a nationwide package delivery company to be employees, based on their lack of prior experience, their (*de facto*) exclusive arrangements with the company, and the uniformity of their operating procedures. However, in a companion case, the board found the drivers in *Dial-A-Mattress Operating Corp.*¹²⁴ to be independent contractors. The Dial-A-Mattress drivers had much more flexibility in choosing and outfitting their trucks, and their trucks displayed the names of the individual trucker's company. The Board has used these two cases as lodestars in more recent analyses.¹²⁵

The Board has taken care to emphasize that the common-law agency test, although often called the "control" test, has many factors in play beyond control. Thus, while control may be important in determining employee status, it is not the controlling factor. Instead, the variety of factors listed in Restatement Second of Agency § 220 are to be considered.¹²⁶ And although it is not specifically part of the list of factors in § 220, the Board has used the presence of entrepreneurial opportunities as another factor in evaluating the independence of the workers.¹²⁷ The Board has rejected the addition of the FLSA's "economic dependence" or "economic realities" test,¹²⁸ however, despite a recent dissent.¹²⁹

Despite the doctrinal popularity of the "control" test, it remains something of an enigma. Courts and commentators continue to bemoan its inability to deliver clear answers.¹³⁰ In its initial rejection of the control test in the context of the NLRA, the Supreme Court said that "the assumed simplicity and uniformity, resulting from application of 'common-law standards,' does not exist."¹³¹

¹²³ 326 N.L.R.B. 842 (1998).

¹²⁴ 326 N.L.R.B. 884 (1998).

¹²⁵ See *St. Joseph New-Press*, 345 N.L.R.B. 474 (2005).

¹²⁶ The *Roadway Express* Board stated:

While we recognize that the common-law agency test described by the Restatement ultimately assesses the amount or degree of control exercised by an employing entity over an individual, we find insufficient basis for the proposition that those factors which do not include the concept of "control" are insignificant when compared to those that do. Section 220(2) of the Restatement refers to 10 pertinent factors as "among others," thereby specifically permitting the consideration of other relevant factors as well, depending on the factual circumstances presented.... Thus, the common-law agency test encompasses a careful examination of all factors and not just those that involve a right of control.... To summarize, in determining the distinction between an employee and an independent contractor under Section 2(3) of the Act, we shall apply the common-law agency test and consider all the incidents of the individual's relationship to the employing entity.

Roadway Express, 326 N.L.R.B. at 850.

¹²⁷ See, e.g., *St. Joseph New-Press*, 345 N.L.R.B. at 480 (considering entrepreneurial opportunities for newspaper deliverers).

¹²⁸ *Id.* at 481-82.

¹²⁹ *Id.* at 483-84 (Liebman, Mem., dissenting).

¹³⁰ See, e.g., *Carlson*, *supra* note RC2001, at 299 ("After nearly two hundred years of evolution, the multi-factored 'common law' test begs the question of employee status as much as answers it.").

¹³¹ *N.L.R.B. v. Hearst Publications, Inc.*, 322 U.S. 111, 122 (1944). The Court also said: "Few problems in the law have given greater variety of application and conflict in results than the cases

Perhaps more fundamentally, there is a concern that the idea of control is not the proper proxy for the concept of employment. For some, “control” is too expansive a term, going beyond the root notion of supervision that represents the employment relationship.¹³² For others, control is no longer critical to employment, but rather an expression from a bygone era.¹³³ Several other alternatives have arisen from various areas of the law to try to take at least some share of the control test’s domain.

2. *The “Economic Realities” Test.* — The primary alternative to the control test, particularly in the realm of employment law, is the “economic realities” or “economic dependence” test. It is generally interpreted to provide a more expansive definition to the term “employee,” one that covers more vulnerable workers who may have some aspects of independence from control but lack true economic independence. It has its roots in the interpretation of critical Neal Deal statutes soon after their passage. While clearly rejecting the common-law control test, these cases did not craft a specific and readily cognizable alternative. Instead, they looked to the purpose of the statutes and attempted to glean an approach that harmonized with that purpose. Interpreting the NLRA, the Court noted that it was “not necessary in this case to make a completely definitive limitation around the term ‘employee.’”¹³⁴ But the Court did distinguish between the traditional common law definition and a broader perspective based on the ills at which the statute was directed. In other words, the term “employee” was “to be determined broadly, in doubtful situations, by underlying economic facts rather than technically and exclusively by previously established legal classifications.”¹³⁵ That reference to “economic facts” became “economic reality” in later cases defining the category of “employee” in the context of the Social

arising in the borderland between what is clearly an employer-employee relationship and what is clearly one of independent entrepreneurial dealing.” *Id.* at 121.

¹³² The D.C. Circuit argued:

Although this “right-to-control” test requires an evaluation of all the circumstances surrounding the relationship between the company and the worker, the extent of the actual *supervision* exercised by a putative employer over the means and manner of the workers’ performance is the most important element to be considered. It is important, however, to distinguish such company supervision from company efforts merely to monitor, evaluate, and improve the results or ends of the worker’s performance. Supervision of the means and manner of the worker’s performance renders him an employee, while steps taken to monitor, evaluate, and improve the results of his work, without supervision over the means by and manner in which he does his work, indicates that the worker is an independent contractor.

C.C. Eastern, Inc. v. N.L.R.B., 60 F.3d 855, 858 (D.C. Cir. 1995).

¹³³ FedEx Home Delivery v. N.L.R.B., 563 F.3d 492, 497 (D.C. Cir. 2009) (“Gradually, however, a verbal formulation emerged that sought to identify the essential quantum of independence that separates a contractor from an employee, a process . . . where we used words like control but struggled to articulate exactly what we meant by them. . . . In other words, ‘control’ was close to what we were trying to capture, but it wasn’t a perfect concurrence. It was as if the sheet music just didn’t quite match the tune.”).

¹³⁴ N.L.R.B. v. Hearst Publications, Inc., 322 U.S. 111, 130 (1944).

¹³⁵ *Id.* at 129.

Security Act¹³⁶ and the Fair Labor Standards Act.¹³⁷ This test—lacking any factors or even specific doctrinal definition—was something of a gestalt or eyeball standard, designed to look at the overall economic relationship and determine whether Congress intended such a relationship to come under the purview of the particular statutory scheme.

Although the Court’s “economic reality” definition was overturned by statutory amendments to both the NLRA¹³⁸ and the Social Security Act,¹³⁹ it has remained in place with regard to the FLSA. That statute’s definition of employee is the circular one found in many statutes: “the term ‘employee’ means any individual employed by an employer.”¹⁴⁰ However, the Act also defines “employ” to include “suffer or permit to work.”¹⁴¹ Because employ is defined differently and more broadly, the Supreme Court has recognized that the FLSA may extend to cover workers beyond the reach of the common law agency test.¹⁴² The definition of “employee” under the FMLA incorporates the standard from the FLSA by reference,¹⁴³ and thus courts have applied the same “economic realities” test.¹⁴⁴ Outside of these contexts, however, the Supreme Court has made it clear that the “control” test is to apply as the default rule.

According to the “economic realities” test, “employees are those who as a matter of economic reality are dependent upon the business to which they render service.”¹⁴⁵ Courts have generally looked to a number of factors in calculating

¹³⁶ *United States v. Silk*, 331 U.S. 704, 713 (1947) (“We concluded that, since that end was the elimination of labor disputes and industrial strife, ‘employees’ included workers who were such as a matter of economic reality.” (discussing *N.L.R.B. v. Hearst Publications, Inc.*, 322 U.S. 111, 130 (1944))).

¹³⁷ *Goldberg v. Whitaker House Co-Op., Inc.*, 366 U.S. 28, 33 (1961) (holding that “the ‘economic reality’ rather than ‘technical concepts’ is to be the test of employment”).

¹³⁸ LABOR-MANAGEMENT RELATIONS ACT, Pub.L. 80-101, 61 Stat. 136 (June 23, 1947), as codified 29 U.S.C. § 152(3) (2006).

¹³⁹ SOCIAL SECURITY ACT OF 1948, ch. 468, § 2(a), 62 Stat. 438 (1948) (changing definition of employee to exclude those who “under the usual common law rules applicable in determining the employer-employee relationship, has the status of independent contractor”).

¹⁴⁰ 29 U.S.C. § 203(e)(1) (2006).

¹⁴¹ *Id.* § 203(g).

¹⁴² *See* *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) (noting that the FLSA “stretches the meaning of ‘employee’ to cover some parties who might not qualify as such under a strict application of traditional agency law principles”). *See also* *Tony & Susan Alamo Found. v. Sec’y of Labor*, 471 U.S. 290, 302 (1985) (“The test of employment under the Act is one of “economic reality . . .” (citing *Goldberg*, 366 U.S. at 33)).

¹⁴³ 29 U.S.C. § 2611(3) (2006) (“The terms “employ”, “employee”, and “State” have the same meanings given such terms in subsections (c), (e), and (g) of section 203 of this title.”).

¹⁴⁴ *Nichols v. All Points Transp. Corp. of Mich., Inc.* 364 F.Supp.2d 621, 630 (E.D. Mich. 2005) (“Because the statutory definition of FMLA, unlike the definition found in ERISA, incorporates the FLSA’s broader definition of ‘employee’ and ‘employ,’ the court will continue to apply the ‘economic realities’ test as described by the Sixth Circuit . . .”). According to one survey, however, courts have not applied a consistent test when it comes to individual liability under the Act. *See* Sandra F. Sperino, *Chaos Theory: The Unintended Consequences of Expanding Individual Liability Under the Family and Medical Leave Act*, 9 EMPLOYEE RTS. & EMP. POL’Y J. 175, 176 (2005) (finding that courts have utilized seven different tests in determining individual liability for owners, executives, and supervisors).

¹⁴⁵ *Bartels v. Birmingham*, 332 U.S. 126, 130 (1947) (interpreting tax provisions), *quoted in* *Mednick v. Albert Enterprises, Inc.*, 508 F.2d 297, 299 (5th Cir. 1975) (interpreting the FLSA).

coverage under the “economic realities” test. One popular test, developed in *Bonette v. California Health and Welfare Agency*,¹⁴⁶ asks whether the employer: (1) had the power to hire and fire the employee; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records.¹⁴⁷ Other circuits have more closely mirrored the control test.¹⁴⁸ But in recognition of the FLSA’s broader coverage, courts have either implicitly or explicitly looked to the “reality” of the workers’ dependence on the putative employer.¹⁴⁹ Such dependence is often manifested through the economic weakness of the workers, and the focus on economic reality is meant to cut through formalistic trappings to get at the heart of the relationship.¹⁵⁰ In *Secretary of Labor v. Lauritzen*,¹⁵¹ for example, the court held that migrant workers on a pickle farm were employees because they “depend on the [employer’s] land, crops, agricultural expertise, equipment, and marketing skills.”¹⁵²

The economic realities test remains the strongest contender in opposition to the control test. Its concern with economic dependence provides more protection to vulnerable workers.¹⁵³ However, although foreign jurisdictions have

¹⁴⁶ 704 F.2d 1465 (9th Cir. 1983), *overruled on other grounds*, *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985).

¹⁴⁷ *Bonnette*, 704 F.2d at 1470. *See also* Benjamin F. Burry, *Testing Economic Reality: FLSA and Title VII Protection for Workfare Participants*, 2009 U. CHI. LEGAL FORUM 561, 564 (“*Bonnette* factors have been utilized by most federal circuits, including the Second Circuit.”).

¹⁴⁸ *United States v. Lauritzen*, 835 F.2d 1529, 1535 (7th Cir. 1987) (“Among the criteria courts have considered are the following six: 1) the nature and degree of the alleged employer’s control as to the manner in which the work is to be performed; 2) the alleged employee’s opportunity for profit or loss depending upon his managerial skill; 3) the alleged employee’s investment in equipment or materials required for his task, or his employment of workers; 4) whether the service rendered requires a special skill; 5) the degree of permanency and duration of the working relationship; 6) the extent to which the service rendered is an integral part of the alleged employer’s business.”); *Hopkins v. Cornerstone America*, 545 F.3d 338, 343 (5th Cir. 2008) (“To aid us in this inquiry, we consider five non-exhaustive factors: (1) the degree of control exercised by the alleged employer; (2) the extent of the relative investments of the worker and the alleged employer; (3) the degree to which the worker’s opportunity for profit or loss is determined by the alleged employer; (4) the skill and initiative required in performing the job; and (5) the permanency of the relationship.”)

¹⁴⁹ *Lauritzen*, 835 F.2d at 1538 (describing economic dependence as “the focus of all the other considerations”); *Hopkins*, 545 F.3d at 346 (“As a matter of economic reality, the Sales Leaders were dependent upon Cornerstone to such an extent that they could not plausibly be considered ‘in business for [themselves].’”).

¹⁵⁰ *Mednick v. Albert Enterprises, Inc.*, 508 F.2d 297, 299-302 (5th Cir. 1975) (characterizing the ultimate inquiries as: “Is [the worker] the kind of person meant to be protected by the F.L.S.A.? Is he dependent upon finding employment in the business of others . . . , (one of) those who themselves are least able in good times to make provisions for their needs when old age and unemployment may cut off their earnings?” (quotations omitted)).

¹⁵¹ 835 F.2d 1529 (7th Cir. 1987).

¹⁵² *Id.* at 1538.

¹⁵³ COMMISSION ON THE FUTURE OF LABOR-MANAGEMENT RELATIONS, REPORT AND RECOMMENDATIONS 63 (1994), *at*: http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1004&context=key_workplace (“The definition of employee in labor, employment, and tax law should be modernized, simplified, and standardized. Instead of the control test borrowed from the old common law of master and

adopted concepts such as “dependent contractors” and “employee-like” persons, such workers have received only partial protections of the various employment regimes.¹⁵⁴ An opposing strain of cases and commentators argues that those workers who have their own entrepreneurial opportunities should not be characterized as employees, regardless of notions of dependence.¹⁵⁵ As a result, some of the most vulnerable workers may not receive protection. Finally, some have argued that the purpose of the statute should control, rather than notions of employment. This approach has not taken hold in the law, and to some extent it rejects the very idea of a common notion of employment.

3. *The “Entrepreneurial Opportunities” Test.* — Despite the Supreme Court’s explicit approval of the common-law agency test, the D.C. Circuit appears to have adopted a new test based on the “entrepreneurial opportunities” afforded to workers. The circuit first adopted this test in *Corporate Express Delivery Systems v. NLRB*,¹⁵⁶ in which it held that the determination of employee status should “focus not upon the employer’s control of the means and manner of the work but instead upon whether the putative independent contractors have a significant entrepreneurial opportunity for gain or loss.”¹⁵⁷ The court justified the shift on the following grounds:

. . . [T]he latter factor better captures the distinction between an employee and an independent contractor. For example, as the Board points out, “the full-time cook is regarded as a servant [rather than as an independent contractor] although it is understood that the employer will exercise no control over the cooking.” Restatement (Second) of Agency § 202(1) cmt. d (1957). Similarly, a corporate executive is an employee despite enjoying substantial control over the manner in which he does his job. Conversely, a lawn-care provider who periodically services each of several sites is an independent contractor regardless how closely his clients supervise and control his work. The full-time cook and the executive are employees and the lawn-care provider is an independent contractor not because of the degree of supervision under which each labors but because of the degree to which each functions as an entrepreneur - that is, takes economic risk and has the corresponding opportunity to profit from working smarter, not just harder.¹⁵⁸

In *FedEx Home Delivery v. NLRB*,¹⁵⁹ the circuit confirmed this new “entrepreneurial opportunities” test as the proper standard for evaluating

servant, the definition should be based on the economic realities underlying the relationship between the worker and the party benefiting from the worker’s services.”).

¹⁵⁴ Davidov, *supra* note GD2005, at 61 (discussing Canada and Germany).

¹⁵⁵ *FedEx Home Delivery v. N.L.R.B.*, 563 F.3d 492, 497 (D.C. Cir. 2009).

¹⁵⁶ 292 F3d 777 (D.C. Cir. 2002).

¹⁵⁷ *Id.* at 780.

¹⁵⁸ *Id.*

¹⁵⁹ 563 F.3d 492 (D.C. Cir. 2009).

employee status. The majority allowed that the common-law agency test remained the proper standard, but argued that entrepreneurial opportunities was “an important animating principle by which to evaluate [the common-law agency] factors.”¹⁶⁰ The court explicitly rejected control as the primary factor, citing its indefiniteness as well as its failure to capture the essence of employee status.¹⁶¹ The dissent found that the majority’s “entrepreneurial opportunities” test failed to follow the Supreme-Court-approved common-law test,¹⁶² a contention supported by other commentators.¹⁶³ However, the test has gained the support of the Restatement Third of Employment Law, which defines “employee” as one who works in the interests of the employer when “the employer’s relationship with the individual effectively prevents the individual from rendering the services as part of an independent business.”¹⁶⁴ The Restatement defines this as follows: “An individual renders services as part of an independent business when the individual in his or her interest exercises entrepreneurial control over the manner and means by which the services are performed.”¹⁶⁵ The Restatement commentary agrees with the *FedEx* court that the common-law right to control test “looks not only to the principal’s control of the physical details of how the service provider performs the work but also to other factors relevant to whether the service provider has entrepreneurial control over the manner and means by which the services are performed.”¹⁶⁶ Thus, the essential question is: does the individual perform the work as part of the employer as a firm or separately through a different and independent business entity?¹⁶⁷

B. Defining “Scope of Employment”

Unlike the competing definitions for the term “employee,” the term “scope of employment” has not been the subject of various theoretical approaches. The term is not generally used in labor and employment statutes, as in most cases the nature of the rights provided to employees guarantees that they concern activities

¹⁶⁰ *Id.* at 497.

¹⁶¹ *Id.* (“It was as if the sheet music didn’t quite match the tune.”).

¹⁶² *Id.* at 510 (Garland, J., dissenting).

¹⁶³ See, e.g., Jeffrey M. Hirsch, *Employee or Entrepreneur?*, 68 WASH. & LEE L. REV. 353, 357 (2011) (arguing that the D.C. Circuit’s new test “directly contradicts Supreme Court precedent”).

¹⁶⁴ RESTATEMENT (THIRD) OF EMPLOYMENT LAW, § 1.01(1) (Tent. Draft, 2009). The full definition is: “Unless otherwise provided by law or § 1.02 or § 1.03, an individual renders services as an employee of an employer if: (1) the individual acts, at least in part, to serve the interests of the employer, (2) the employer consents to receive the individual’s services, and (c) the employer’s relationship with the individual effectively prevents the individual from rendering the services as part of an independent business.”

¹⁶⁵ *Id.* § 1.01(2). Entrepreneurial control is further defined as “control over important business decisions, including whether to hire and where to assign assistants, whether to purchase and where to deploy equipment, and whether and when to service other customers.” *Id.* § 1.01(3).

¹⁶⁶ *Id.* § 1.01 cmt. a.

¹⁶⁷ As the Restatement frames it: “Employees do not provide their services as an independent business.” *Id.*; see also *id.* § 1.01 cmt. d (“The key question is whether a service provider functions as an independent business while performing services on the principal’s behalf.”).

within the scope of employment.¹⁶⁸ The one primary exception is workers' compensation, which only provides protections against injuries incurred within the scope of employment.¹⁶⁹ Outside of labor and employment law, employers are only liable for the torts and crimes of their employees in such actions are taken within the scope of employment.¹⁷⁰ And intellectual property protections generally only apply to works made within the scope of employment.¹⁷¹

The general definition for scope of employment is that zone of employee conduct in which the employee is performing her job duties.¹⁷² Efforts to define employees' duties as excluding all torts, statutory violations, or criminal activity have generally been unavailing.¹⁷³ Under the doctrine of *respondeat superior*, if

¹⁶⁸ For example, the NLRA concerns the rights of employees to bargain with their employer; Title VII of the Civil Rights Act specifically addresses discrimination in the context of employment; ERISA involves pension and healthcare rights within the employment relationship; and FLSA involves mandatory terms within the employment relationship. Once it is established that the party is an employee and that the firm is the employer, there is no need to further establish that the actions in question took place within the scope of employment—they do by the very nature of the statutory protections.

¹⁶⁹ See Note, *Compensating Victims of Occupational Disease*, 93 HARV. L. REV. 916, 918 (1980) ("To qualify for workers' compensation, the employee must suffer a personal injury 'by accident' arising out of and in the course of employment.").

¹⁷⁰ See *supra* Part I.B, C.

¹⁷¹ See *supra* Part I.D.

¹⁷² See, e.g., *McGrail v. Dep't of Labor & Indus.*, 190 Wash. 272, 277, 67 P.2d 851 (1937) ("The test for determining whether an employee is, at a given time, in the course of his employment, is whether the employee was, at the time, engaged in the performance of the duties required of him by his contract of employment or by the specific direction of his employer, or, as sometimes stated, whether he was engaged at the time in the furtherance of the employer's interests.").

The doctrinal definition for "scope of employment" can be quite detailed. For example, Restatement Second of Agency has two provisions devoted to defining scope of employment, both with lengthy lists of factors. See Restatement Second of Agency § 228(1) (defining conduct as within the scope of employment "if, but only if: (a) it is of the kind he is employed to perform; (b) it occurs substantially within the authorized time and space limits; (c) it is actuated, at least in part, by a purpose to serve the master, and (d) if force is intentionally used by the servant against another, the use of force is not unexpected by the master"); *id.* § 229(2) ("In determining whether or not the conduct, although not authorized, is nevertheless so similar to or incidental to the conduct authorized as to be within the scope of employment, the following matters of fact are to be considered: (a) whether or not the act is one commonly done by such servants; (b) the time, place and purpose of the act; (c) the previous relations between the master and the servant; (d) the extent to which the business of the master is apportioned between different servants; (e) whether or not the act is outside the enterprise of the master or, if within the enterprise, has not been entrusted to any servant; (f) whether or not the master has reason to expect that such an act will be done; (g) the similarity in quality of the act done to the act authorized; (h) whether or not the instrumentality by which the harm is done has been furnished by the master to the servant; (i) the extent of departure from the normal method of accomplishing an authorized result; and (j) whether or not the act is seriously criminal.") Like the control test, however, these factors are in service to an overriding principle: namely, whether the employee was acting as an employee or in her personal capacity.

¹⁷³ See, e.g., *Faragher v. City of Boca Raton*, 524 U.S. 775, 800-803 (1998) (rejecting the notion that supervisor sexual harassment takes place outside of the scope of employment because it is against company policy or motivated by personal desires). But see Note, "Scope of Employment" Redefined: Holding Employers Vicariously Liable for Sexual Assaults Committed by their Employees, 76 MINN. L. REV. 1513, 1521-1522, and nn. 33, 34 (1992) (collecting non-Title VII cases in which sexual assaults are determined to fall outside the scope of employment).

the employee is on the job or within a zone of activity related to the employment duties, the employer will generally be liable for the employee's tort, regardless of the employer's efforts to define such conduct as outside of the employee's duties or authority. Instead, courts have adopted something along the lines of a foreseeability test, in which the employer is liable if the employee's actions are in some way foreseeable. In two famous cases involving drunken sailors, both Judge Hand and Judge Friendly found employers liable for acts of violence to person and property taken by intoxicated employees.¹⁷⁴ In both cases, however, the courts found that the actions were taken within the sailors' overall context of employment and that therefore the employer was liable. Moreover, an employer may be liable for employee actions taken outside of the scope of employment if the master retains some level of responsibility (through intent, recklessness, or nondelegable duty) or if the employee was aided in some way by apparent authority or the agency relationship itself.¹⁷⁵ Given "the proclivity of seamen to find solace for solitude by copious resort to the bottle while ashore," their acts of violence—while regrettable and unauthorized—were sufficiently foreseeable to be part of the costs of doing such business.¹⁷⁶

Thus, the overriding notion for "scope of employment" categorization questions has usually concerned not whether the particular employee is following the script of her particular contractual relationship with the employer, but rather whether the activity is part and parcel of the overall employment relationship.¹⁷⁷ The employer is expected to absorb the costs of doing business as a firm, which includes a certain level of employee activity that may not directly inure to the employer's benefit. As the Restatement Second of Agency put it, the "ultimate question" in determining the scope of employment is "whether or not it is just that the loss resulting from the servant's acts should be considered as one of the

¹⁷⁴ *Ira S. Bushey & Sons, Inc. v. United States*, 398 F.2d 167 (2d Cir. 1967) (Friendly, J.); *Nelson v. American-West African Line*, 86 F.2d 730 (2d Cir. 1936) (Hand, J.).

¹⁷⁵ RESTATEMENT (SECOND) OF AGENCY § 219(2) (1957) ("A master is not subject to liability for the torts of his servants acting outside the scope of their employment, unless: (a) the master intended the conduct or the consequences, or (b) the master was negligent or reckless, or (c) the conduct violated a non-delegable duty of the master, or (d) the servant purported to act or to speak on behalf of the principal and there was reliance upon apparent authority, or he was aided in accomplishing the tort by the existence of the agency relation.").

¹⁷⁶ *Bushey*, 398 F.2d at 172. The Restatement Second of Agency has a complex set of interrelated provisions attempting to define scope of employment. Along with a ten-factor test for determining whether certain kinds of unauthorized acts may fall within the scope of employment, RESTATEMENT (SECOND) OF AGENCY § 229(2) (1957), the Restatement has separate provisions on criminal or tortious conduct, *id.* § 231, failures to act, *id.* § 232, conduct not for the purpose of serving the master, *id.* § 235, and instrumentalities of employment used outside of the relationship, *id.* § 238. Another instance along this boundary is whether the employer is liable to an unauthorized passenger. See *Rahman v. State*, 246 P.3d 182 (Wash. 2011) (finding employer liable for injury to unauthorized passenger); 2011 WASH. LEGIS. SERV. Ch. 82 (absolving employer of liability for unauthorized passenger).

¹⁷⁷ See Alan O. Sykes, *The Boundaries of Vicarious Liability: An Economic Analysis of the Scope of Employment Rule and Related Legal Doctrines*, 101 HARV. L. REV. 563 (1988) ("The scope of employment limitation upon respondeat superior liability may be understood in many instances as a way to limit the employer's liability to torts that are 'caused' by the business enterprise.").

normal risks to be borne by the business in which the servant is employed.”¹⁷⁸ Or, as then-Judge Cardozo put it, “The risks of injury incurred in the crowded contacts of the factory through the acts of fellow workmen are not measured by the tendency of such acts to serve the master's business. Many things that have no such tendency are done by workmen every day. . . . The test of liability is the relation of the service to the injury, of the employment to the risk.”¹⁷⁹

C. Perspectives on the Theories of Employment

The existing common law doctrine defining “employee” has been routinely criticized along two major axes. First, it is frequently accused of being a formless multi-factor test that yields disparate results over time.¹⁸⁰ The proliferation of multifactor tests, both from courts and from the Restatements, has shifted the traditional test away from the notion of “control” to something closer to a formless standard.¹⁸¹ As a result, the “control” test no longer really focuses solely on control (if it ever really did, after Blackstone). Although courts often refer to control as a “touchstone” or a “primary factor,” the other factors have come into play as well. In fact, the same criticism can be leveled at the “economic realities” test, which is often framed as a collection of factors with an overall “economic gestalt” factor thrown in at the end.¹⁸² Even the “entrepreneurial opportunities” test has been framed as a reconception of the common law test.¹⁸³

Second, the common-law test is attacked for its general applicability. Because the test serves as an across-the-board definition of “employee,” it is not specifically tailored towards the purposes that particular legal regimes are designed to address. As such, the very idea of employment has come under fire;

¹⁷⁸ RESTATEMENT (SECOND) OF AGENCY § 229 cmt. a (1957).

¹⁷⁹ *Leonbruno v. Champlain Silk Mills*, 128 N.E. 711, 712 (N.Y. 1920).

¹⁸⁰ *See, e.g., N.L.R.B. v. United Ins. Co., of America*, 390 U.S. 254, 258 (1968) (“There are innumerable situations which arise in the common law where it is difficult to say whether a particular individual is an employee or an independent contractor”); *N.L.R.B. v. Hearst Publications, Inc.*, 322 U.S. 111, 121 (1944) (“Few problems in the law have given greater variety of application and conflict in results than the cases arising in the borderland between what is clearly an employer-employee relationship and what is clearly one of independent entrepreneurial dealing.”); *FedEx Home Delivery v. N.L.R.B.*, 563 F.3d 492, 496 (D.C. Cir. 2009) (“While this seems simple enough, the Restatement's non-exhaustive ten-factor test is not especially amenable to any sort of bright-line rule, a long-recognized rub.”); *Kisner v. Jackson*, 159 Miss. 424, 427-28, 132 So. 90 (1931) (“There have been many attempts to define precisely what is meant by the term ‘independent contractor’; but the variations in the wording of these attempts have resulted only in establishing the proposition that it is not possible within the limitations of language to lay down a concise definition that will furnish any universal formula, covering all cases”); Carlson, *supra* note RC2001, at 298-99 (arguing that the common-law doctrine “encourages ambiguity” and has become “more complex” and “less predictable”).

¹⁸¹ *See id.* at 310 (discussing how courts had added most of these factors by the end of the nineteenth century).

¹⁸² *See, e.g., Sec’y of Labor v. Lauritzen*, 835 F.2d 1529, 1535 (7th Cir. 1987) (discussing six factors, in addition to economic dependence, that go into the “economic realities” test).

¹⁸³ *FedEx Home Delivery v. N.L.R.B.*, 563 F.3d 492, 497 (D.C. Cir. 2009) (“In other words, ‘control’ was close to what we were trying to capture, but it wasn't a perfect concurrence. It was as if the sheet music just didn't quite match the tune.”).

as one commentator has asked, “why should employee status matter at all?”¹⁸⁴ Instead of creating a category of “employee” that applies in a variety of different situations, critics contend that courts, regulators, and legislators should focus instead on the particular purpose of a particular legal regime and should tailor coverage to meet that purpose. In discussing the statutory definition of employee within the FLSA, Judge Easterbrook argued that the statutory purposes of that statute were quite different from the common-law concerns at issue in the control test.¹⁸⁵ Instead of having a uniform definition across legal regimes, it would be more appropriate, argued the judge, to develop definitions based on the functions of the particular law.

Arguably, the Supreme Court began using the functional approach for the New Deal statutes. Along with discussing the “economic reality” at hand, the Court in *NLRB v. Hearst Publications*¹⁸⁶ said that the definition of employee in the NLRA “must be read in light of the mischief to be corrected and the end to be attained.”¹⁸⁷ However, Congress soon moved to amend both the NLRA and the Social Security Act to reinstate the common-law control test.¹⁸⁸ The deeper theoretical problem for the purpose test is its abandonment of any common notion of employment. If certain regimes are based on the notion of “employee” to determine the extent of coverage, then arguably the concept of employment is part of the overall system of regulation. The purpose-oriented approach seeks to deny, to a greater or lesser extent, the theoretical basis for this commonality. And yet the concept of employment retains rhetorical and policy force. Indeed, even proponents of the function or purpose test concede that Congress has continually gone back to the “employee” category to shape the contours for various areas of the law.¹⁸⁹ As such, the biggest problem for the purpose-oriented theory of employment is that it has no theory of employment at all.

III. EMPLOYEES AND THE THEORY OF THE FIRM

¹⁸⁴ Carlson, *supra* note RC2001, at 299.

¹⁸⁵ See *Sec’y of Labor v. Lauritzen*, 835 F.2d 1529, 1543-45 (7th Cir. 1987) (Easterbrook, J., concurring). Judge Easterbrook described the three purposes of the FLSA as preventing workers from working abnormally long hours, spreading work and thereby reduce unemployment, and protecting the overtime workers from themselves. In contrast, he described the purpose of vicarious liability as creating proper incentives to take care against harm and to potentially spread the risk of loss. *Id.* He argued: “The reasons for blocking vicarious liability at a particular point have nothing to do with the functions of the FLSA.” *Id.* at 1544.

¹⁸⁶ 322 U.S. 111 (1944).

¹⁸⁷ *Id.* at 124 (quoting *S. Chicago Coal & Dock Co. v. Bassett*, 309 U.S. 251, 259 (1940)).

¹⁸⁸ LABOR-MANAGEMENT RELATIONS ACT, Pub.L. 80-101, 61 Stat. 136 (June 23, 1947), as codified 29 U.S.C. § 152(3) (2006); SOCIAL SECURITY ACT OF 1948, ch. 468, § 2(a), 62 Stat. 438 (1948) (changing definition of employee to exclude those who “under the usual common law rules applicable in determining the employer-employee relationship, has the status of independent contractor”).

¹⁸⁹ See Carlson, *supra* note RC2001, at 300 (“The courts, of course, cannot abandon employee status as a test as long as Congress and state legislatures continue to make employee status the clearly stated basis for statutory coverage.”).

Although we think of employees and employment as involving work or labor, the legal definitions of those terms has much more to do with the relationship between the individual worker and the person or entity for whom she works. Employment is not simply labor; it is labor within a particular context. And that context requires an employer. In the modern economy, employees always work within the context of an economic firm. In fact, it is my contention that it is the very existence of a firm that creates the employment relationship. In this Part, I examine how the theory of the firm in economic and organizational literature has focused on the employment relationship, and how being an “employee” really means providing one’s labor within the context of a firm.

Employees have been central to our conception of the firm from the start. In early neoclassical economics, the theory of firm was quite rudimentary; it simply saw the firm as a black box which took in inputs and produced outputs. No further dissection was undertaken. However, this theory did differentiate between what was inside the firm and what was outside: employees and capital assets were inside, while customers and suppliers were outside.¹⁹⁰ Although this conception of the firm was useful in early economic modeling and retains that purpose even today, it was ripe for a reinvestigation that endeavored to give it substance.

Ronald Coase started the exploration of the internal workings and purpose of the firm in *The Nature of the Firm*.¹⁹¹ In an oft-quoted passage, Coase framed the issue this way:

Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm these market transactions are eliminated, and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production. It is clear that these are alternative methods of coordinating production. Yet, having regard to the fact that, if production is regulated by price movements, production could be carried on without any organization at all, well we might ask, why is there any organization?¹⁹²

Coase’s answer was that the price mechanism can be costly. For certain transactions, it is cheaper to simply direct the production to occur rather than contracting separately for it. In order to avoid the transaction costs of contracting, such transactions will occur within a firm rather than on an open market.¹⁹³

Of course, the firm-based transactions described by Coase involve the purchase of labor for a particular endeavor. In explaining these transactions, Coase stated: “If a workman moves from department Y to department X, he does

¹⁹⁰ Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1631 (2001).

¹⁹¹ Coase, *supra* note RC1.

¹⁹² *Id.* at 388.

¹⁹³ *Id.* at 390-92.

not go because of a change in relative prices, but because he was ordered to do so.”¹⁹⁴ The relationship between the entrepreneur-coordinator and the employee is the primary distinction between the firm and the market. It is the reason for the firm’s existence. Coase seemed to be arguing that firms would be unnecessary but for the need to remove the employment relationship from the vagaries of market transactions.

This conclusion is cemented when Coase considered “whether the concept of a firm which has been developed fits in with that existing in the real world.”¹⁹⁵ His answer? “We can best approach the question of what constitutes a firm in practice by considering the legal relationship normally called that of ‘master and servant’ or ‘employer and employee.’”¹⁹⁶ He then quoted at length from a treatise concerning the common law “control” test, which provides that “[t]he master must have the right to control the servant’s work, either personally or by another servant or agent.”¹⁹⁷ He concluded: “We thus see that it is the fact of direction which is the essence of the legal concept of ‘employer and employee,’ just as it was in the economic concept which was developed above.”¹⁹⁸ For Coase, the firm was defined by the employer-employee relationship.¹⁹⁹

In an important response to Coase’s work, Armen Alchian and Harold Demsetz also focused on the relationship of employees with other participants within the structure of the firm.²⁰⁰ However, they argued that Coase’s focus on control, authority, and direction was misleading.²⁰¹ Instead, they framed their argument in these terms:

Telling an employee to type this letter rather than to file that document is like my telling a grocer to sell me this brand of tuna rather than that brand of bread. I have no contract to continue to purchase from the grocer and neither the employer nor the employee is bound by any contractual obligations to continue the relationship. Long-term contracts between employer and employee are not the essence of the organization we call a firm.²⁰²

Alchian and Demsetz’s critique of Coase’s theory does not mean that employees are no longer central to the idea of the firm. Instead, they argue that the importance of the firm (as separate from the market) stems from the need to

¹⁹⁴ *Id.* at 387.

¹⁹⁵ *Id.* at 403.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* at 404.

¹⁹⁸ *Id.*

¹⁹⁹ See Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL’Y REV. 265, 296-97 (1998).

²⁰⁰ Alchian & Demsetz, *supra* note AD1, at 777 (“When a lumber mill employs a cabinetmaker, cooperation between specialists is achieved within a firm, and when a cabinetmaker purchases wood from a lumberman, the cooperation takes place across markets (or between firms)”).

²⁰¹ *Id.* (“To speak of managing, directing, or assigning workers to various tasks is a deceptive way of noting that the employer continually is involved in renegotiation of contracts on terms that must be acceptable to both parties.”).

²⁰² *Id.*

coordinate production in the midst of a variety of inputs. The need for a system of team production is what separates firms from markets. Alchian and Demsetz defined team production as “production in which 1) several types of resources are used and 2) the product is not a sum of separable outputs of each cooperating resource.”²⁰³ As a result, team production is used when the team method increases productivity, after factoring out the costs associated with monitoring and disciplining the team.²⁰⁴

Alchian and Demsetz’s model seems even more focused on the role of the employee within the firm than Coase’s model. The primary concern of team production is making sure that the team members do not shirk their responsibilities to the team. The inability to measure individual contributions to productivity is what makes the firm an efficient alternative to markets, but it is also the firm’s central governance problem. Alchian and Demsetz argued that a specialized, independent monitor may be the best way of insuring that the team members all contribute appropriately and are rewarded appropriately.²⁰⁵ That central monitor – the recipient of the residual profits – would be the firm. Although Coase as well as Alchian and Demsetz personified this monitor in the role of an entrepreneur-coordinator, such a collapse of powers into one human being is only possible in the smallest of firms. In order to meet the criteria set down by the model,²⁰⁶ the central component of team production is the firm itself: a “person” who contracts for all other team inputs.

It could be argued that Alchian and Demsetz conceived of a firm detached from employees, since the Alchian-Demsetz monitor must be outside the production process while being able to negotiate with all team members for their input and compensation. However, unless the “firm” is a sole proprietor, that monitor is merely a mechanism for providing coordination of inputs. And employees are the primary source of the inputs.²⁰⁷ Thus, the Alchian-Demsetz

²⁰³ *Id.* at 779.

²⁰⁴ *Id.* at 780.

²⁰⁵ *Id.* at 782-83.

²⁰⁶ Alchian and Demsetz set forth the following characteristics of the firm: (a) joint input production, (b) several input owners, (c) one party is common to all the contracts of the joint inputs, (d) who has the rights to renegotiate any input’s contract independently of contracts with the other input owners, (e) who holds the residual claim, and (f) who has the right to sell his central contractual residual status. *Id.* at 783.

²⁰⁷ Alchian and Demsetz seem to believe that the firm will be represented by a central figure who has claim to the entire residual, and thus an interest in coordinating the firm most efficiently. But they say nothing about who can appoint such a central figure, and they express skepticism about the ability of shareholders to perform the monitoring function. Rather than characterize shareholders as owners, they argue that shareholders should be viewed merely as investors, like bondholders, albeit “more optimistic” ones. They ask:

In sum, is it the case that the stockholder-investor relationship is one emanating from the *division of ownership* among several people, or is it that the collection of investment funds from people of various anticipations is the underlying factor? If the latter, why should any of them be thought of as the owners in whom voting rights, whatever they may signify or however exercisable, should reside in order to enhance efficiency? Why voting rights in any of the outside, participating investors?

team production model does not exclude employees from the definition of the firm. Although their model, with its focus on “inputs,” broadens the scope of the firm to include investors as well as employees, the purpose of the Alchian-Demsetz firm remains the management of employees through the coordination of team production.

As theorists moved beyond these foundational works and into empirical research, the identification of transaction costs, monitoring costs, and team production have remained central concepts. Using the transaction-costs model, Oliver Williamson and others have identified the types of contractual difficulties which are likely to lead to firm governance, rather than market solutions.²⁰⁸ In situations where contributions and compensation can be harder to define, the parties will be left with incomplete contracts that require a governance structure to prevent opportunism. This opportunism will be particularly problematic where one or both of the parties must invest significant resources in assets specific to the particular firm, project, or transaction. This asset specificity makes the parties susceptible to hold-ups from their contractual partners in the absence of a system of governance. Firms can be useful in providing the structures that deter opportunism.²⁰⁹

The focus on assets has carried over into the “property rights” theory of the firm. This theory, developed in a series of articles by Grossman, Hart, and Moore, argues that firms are necessary as a repository of property rights for assets used in joint production.²¹⁰ By owning the property outright, the firm prevents the problem of the commons (in which no one holds property rights over valuable assets) as well as the problem of the anticommons (in which property rights are divvied up amongst too many disparate actors). The Grossman-Hart-Moore model dictates that the firm should be owned by those who contribute the most valuable and most asset-specific property to the joint enterprise. They are not only most necessary to the firm’s success; they are also the most vulnerable to hold-up problems as the joint enterprise moves forward in time.

These theories have not focused on the role of the employee in the firm, instead focusing on contracts and property rights. But the role of the employee in these models still remains critical. Although the property rights discussed in the model are generally nonhuman assets, the assets are “the glue that keeps the firm together”²¹¹ and thus keep employees within the firm. Hart poses the following

Id. at 789 n.14.

²⁰⁸ OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985); Jeffrey T. Macher & Barak D. Richman, *Transaction Cost Economics: An Assessment of Empirical Research in the Social Sciences*, 10 *BUS. & POL.* 1 (2008) (discussing transaction costs approach).

²⁰⁹ See WILLIAMSON, *supra* OW1985, at 114-15; OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 47-48 (1996).

²¹⁰ See OLIVER HART, *FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE* (1995); Sanford Grossman & Oliver Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 *J. POL. ECON.* 691 (1986); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 *Econometrica* 755 (1988); Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 *J. POL. ECON.* 1119 (1990).

²¹¹ HART, *supra* note OH1995, at 57.

hypothetical: if firm 1 acquires firm 2, what is to stop workers at former firm 2 from quitting and forming a new entity?

For firm 1's acquisition of firm 2 to make any economic sense, there must be some source of firm 2 value over and above the workers' human capital, i.e. some 'glue' holding firm 2's workers in place. The source of value may consist of as little as a place to meet; the firm's name, reputation, or distribution network; the firm's files, containing important information about its operations or its customers; or a contract that prohibits firm 2's workers from working for competitors or from taking existing clients with them when they quit. . . . [W]ithout something holding the firm together, the firm is just a phantom.²¹²

Thus, the property-rights theory of the firm is designed in part to explain why the firm's employees remain with the firm.²¹³

In the transaction costs model, employees' contributions must be recognized as assets of both the firm and the employee – often described as “human capital.” Some types of human capital are transferable, such as education or general skills, but other types are specific to the firm and generally worthless outside it. To the extent an employee has invested in firm-specific skills, she is subject to opportunistic behavior, since she has little leverage to get the full value of those skills. In the transaction-cost model, employees may be precisely the vulnerable yet valuable contributors to the joint enterprise who are most vulnerable to opportunistic behavior.²¹⁴

Along these lines, Rajan and Zingales have proposed an “access” model of power within the firm.²¹⁵ The model defines a firm “both in terms of unique assets (which may be physical or human) and in terms of the people who have access to these assets.”²¹⁶ Access to the unique assets is what defines the power of the individuals within and without the firm. Rajan and Zingales define access as “the ability to use, or work with, a critical resource.”²¹⁷ Examples of critical resources include machines, ideas, and people. As Rajan and Zingales make clear, “[t]he agent who is given privileged access to the resource gets no new residual rights of control. All she gets is the opportunity to specialize her human

²¹² *Id.*

²¹³ *But cf.* Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387, 388 (1998) (“The property rights view does not consider employees part of the firm because, given that employees cannot be owned, there is no sense in which they are any different from agents who contract with the firm at arm's length.”).

²¹⁴ Indeed, Margaret Blair offers the following critique: “The tendency of the transactions costs literature has been to recognize that firm-specific human capital raises similar questions, but then to sidestep the implications of these questions for corporate governance.” Margaret M. Blair, *Firm-Specific Human Capital and Theories of the Firm*, in *EMPLOYEES AND CORPORATE GOVERNANCE* 58, 66 (Margaret M. Blair & Mark J. Roe eds., 2000).

²¹⁵ Rajan & Zingales, *supra* note RZ1998.

²¹⁶ *Id.* at 390.

²¹⁷ *Id.* at 388.

capital to the resource and make herself valuable.”²¹⁸ Combined with her right to leave the firm, access gives the employee the ability to “create a critical resource that she controls: her specialized human capital.” Control over this critical resource is a source of power. Rajan and Zingales argue that “[s]ince the amount of surplus that she gets from this power is often more contingent on her making the right specific investment than the surplus that comes from ownership, access can be a better mechanism to provide incentives than ownership.”²¹⁹ Given the importance of access, the role of the firm is to allocate access efficiently amongst the firm’s agents.²²⁰

Recent scholarship has taken the role of human capital even further. One aspect of this capital—knowledge—has served as the basis for a new set of approaches to the firm.²²¹ Knowledge is defined as both explicit sets of formal information as well as the ability to apply a wealth of unspecified information in developing an answer or approach to a particular problem.²²² As one set of knowledge-based theorists explains, “[t]he way the firm develops the knowledge it will use in its production process and the extent that firm can bind this knowledge to its structure will influence its organizational structure.”²²³ Rather than emphasize the ownership of physical assets, which can be fungible and non-specific, the knowledge-based theory focuses on the need to produce, distribute, and ultimately retain valuable knowledge-based assets within the firm.²²⁴ Choices between centralized and multi-divisional organizational structures,²²⁵ or between covenants not to compete and employee stock options,²²⁶ are based on the management of knowledge within the firm. Along the same lines, a capability-based theory of the firm focuses on firm-specific knowledge and learning that can

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.* at 391.

²²¹ See Érica Gorga & Michael Halberstam, *Knowledge Inputs, Legal Institutions, and Firm Structure: Towards a Knowledge-Based Theory of the Firm*, 101 NW. U. L. REV. 1123 (2007); Sarah Kaplan et al., *Knowledge-Based Theories of the Firm: A Review and Extension*, 23 ACAD. MGMT. REV. 242 (2002). See also Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721 (2002) (discussing legal conceptions that govern the ownership of human capital within the workplace).

²²² For a discussion of explicit versus tacit knowledge, see Ikujiro Nonaka et al., *A Theory of Organizational Knowledge Creation: Understanding the Dynamic Process of Creating Knowledge*, in HANDBOOK OF ORGANIZATIONAL LEARNING & KNOWLEDGE 491, 494 (Meinolf Dierkes et al. eds., 2001). Gorga and Halberstam classify knowledge into three types: knowledge embedded in physical assets, knowledge embedded in the organizational structure or the group of individuals that constitute the firm, and specialized knowledge embedded in the individual. Gorga & Halberstam, *supra* note GH2007, at 1141-42.

²²³ *Id.* at 1140.

²²⁴ *Id.* at 1137 (criticizing the property rights theory for failing to account for the importance of employees as assets).

²²⁵ *Id.* at 1173-83.

²²⁶ *Id.* at 1183-92. Cf. Oren Bar-Gill & Gideon Parchomovsky, *Law and Boundaries of Technology Intensive Firms*, 157 U. PA. L. REV. 1649, 1686-88 (2009) (discussing the role of covenants not to compete in managing innovation within the firm).

be translated into joint production.²²⁷ This theory also emphasizes the role of employees as holders of the firm's capabilities.²²⁸

Knowledge-based theories of the firm serve as something of a bridge between the economic, organizational, and sociological theories as to the nature of the firm.²²⁹ Management historians such as Alfred Chandler have long considered the actual roles of employees within the firm to be the centerpiece of firm dynamics.²³⁰ Organizational theory has built upon these insights and carried them over to today's firms, which generally offer flatter hierarchical structures and more work in teams. In fact, one set of scholars examined the role of the firm as a "collaborative community" in which employees work together toward common goals.²³¹ Such a firm must have a shared ethos of contribution to a collective purpose and the success of others;²³² it must be structured so as to allow for flexible organizational boundaries but highly specialized knowledge;²³³ it must base status on knowledge and expertise, rather than hierarchy;²³⁴ and it must create an identity of independence and personal consistency.²³⁵ Such collaborative community firms are contrasted with the traditional hierarchical firms, which manage employees with a traditional command-and-control structure,²³⁶ as well as market-based firms, which break down traditional firm barriers through outsourcing and contingent workers.²³⁷ This analysis to the future of the firm seeks to develop the optimal approach to the relationship between a firm and its employees. Indeed, the driving consideration seems to be managing employees in a knowledge-based economy in the most efficient and productive way possible.²³⁸

There are theories of the firm, such as the "nexus of contracts" approach, that do not single out employees for special primacy of place.²³⁹ On the whole,

²²⁷ Thomas McInerney, *Theory of the Firm and Corporate Governance*, 2004 COLUM. BUS. L. REV. 135.

²²⁸ *Id.* at 139.

²²⁹ See, e.g., Rajan & Zingales, *supra* note RZ 1998, at 424-25 (arguing that there is "ample opportunity for gains from trade" between economics and sociology, as sociologists have studied the role of power within organizations "in some detail"); D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1, (2009) (comparing organizational theories to the traditional legal and economic theories of contract and firm).

²³⁰ See, e.g., ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* 1-12 (1977) (discussing the role of middle- and upper-management in coordinating large firms and their employees).

²³¹ See Paul S. Adler & Charles Heckscher, *Towards Collaborative Community*, in *THE FIRM AS COLLABORATIVE COMMUNITY: RECONSTRUCTING TRUST IN THE KNOWLEDGE ECONOMY* (Charles Heckscher & Paul S. Adler eds., 2006)

²³² *Id.* at 39-43.

²³³ *Id.* at 44.

²³⁴ *Id.*

²³⁵ *Id.* at 54-59

²³⁶ *Id.* at 64-65 (discussing the Wal-Mart approach).

²³⁷ *Id.*

²³⁸ See, e.g., *id.* at 74 ("One major danger is the hardening of the current dualistic structures: strong mechanisms of collaboration and community for high-end 'knowledge workers' alongside coercive hierarchical and market control over the lower tier of the workforce.").

²³⁹ Tellingly, perhaps, the theory of the firm which has had the most purchase on corporate law cares least about the role of employees within the firm. The "nexus of contracts" theory argues

however, approaches to the nature of the firm within a market economy have focused in on the role of employees and employment within the firm, as opposed to “independent” contracting parties outside of the firm. This insight has been recognized from Coase up through the knowledge-based theories of the present. As such, theories of the firm can serve as an intellectual foundation for the concept of “employee” and “employment” within the law. The following Part is an initial effort at building this foundation.

IV. EMPLOYMENT AS PARTICIPATION IN A FIRM

A. *Participation as Theory*

Coase recognized that in looking for the theory of the firm out in the real world, one should look not at the law of entities, but rather the law of employment. Although business organizations are the “firms” considered in Coase’s musings, business organizations themselves did not represent the natural boundaries of a firm for economics purposes. Rather, firms were represented by the relationship between the legal entity and its employees. The relationship between employer and employee was the “non-market” interaction that justified the creation of the firm in the first place.

The weakness in Coase’s analysis, however, was his overemphasis on the concept of “control” within the firm. Yes, an employee can be directed to work on one task rather than another, and an employer can dictate the details of that work in a very close manner. But the nature of the supervision need not be significantly different than the close oversight a general contractor provides to a subcontractor. Moreover, given that most employment contracts are at-will, both the employer and the employee are free to walk away from the relationship at any

that the firm is merely a central hub for a series of contractual relationships. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). Jensen and Meckling emphasize that the firm is a “legal fiction;” it is “*not an individual*” and has no real independent existence. *Id.* Although Jensen and Meckling’s model focuses on agency costs, it largely ignores employees as a whole. The agents in question are the upper-level managers who are tasked to do the bidding of principals. Their theory defines agency costs as the costs associated with monitoring by the principal, bonding expenditures by the agent, and the residual loss. *Id.* at 308. The monitoring they describe does look a lot like the “control” that Coase focused on as the key element in defining the firm. However, Jensen and Meckling turn their attention to the relationship between shareholders (principals) and management (agents), rather than the relationship of employees to the firm. Their model seeks to describe the finance structure of the firm in conjunction with the management structure of corporate governance. The nexus of contract theory is thus not really a theory of the firm at all, but rather a theory of agency costs within a certain type of firm. *See, e.g.*, Oliver Hart, *An Economist’s Perspective on the Theory of the Firm*, 89 COLUM. L. REV. 1757, 1759 (1989) (“Principal-agent theory . . . fails to answer the vital questions of what defines a firm and where the boundaries of its structure are located.”); Thomas F. McInerney, *Implications of High Performance Production and Work Practices for Theory of the Firm and Corporate Governance*, 2004 COLUM. BUS. L. REV. 135, 137–38 (“Scholars working in this paradigm do not offer theories of the firm so much as theories of who controls the firm.”); Rock & Wachter, *supra* note RW2001, at 1624 (“Jensen and Meckling, despite the title, did not really offer a full-fledged theory of the firm. Rather, they offered a theory of agency costs within firms . . .”).

time. The potential long-term nature of an at-will employment relationship seems even more fragile than a long-term indefinite contract between two corporations. But Coase believed the employment relationship is outside the market, while the long-term contract is not.

And so it is with the control test for employment. There are two primary criticisms of the control test that mirror our concerns with Coase's theory. First, "control" seems to overstate the power exercised by the employer within the relationship, at least with respect to supervision. An employee can be given a relative degree of freedom on the job but still be considered an employee, while an independent contractor can be given exacting specifications and still be outside the firm. Even the Restatement Second of Agency recognizes that the degree of actual supervisory control is a poor proxy for employment.²⁴⁰ Second, the issue of "control" implies that those employees with more power within the organization are less like other employees, as they are less controlled than they are controlling. However, when it comes to traditional agency doctrine, the power of the employee within the organization is irrelevant to their status as an employee. As the Restatement confirms, "ship captains and managers of great corporations are normally superior servants, differing only in the dignity and importance of their positions from those working under them."²⁴¹

So if the concept of control is not the best proxy for the employment relationship, what provides a better touchstone? We can look to the Alchian-Demsetz critique of Coase for some answers. Alchian and Demsetz took on Coase's notion of control by arguing that employees received market direction just as other economic participants did. Perhaps the direction was more oblique, but it came nevertheless. Instead, Alchian and Demsetz argue that the critical purpose behind the firm in the coordination of joint production. In their model, team production is defined as "production in which 1) several types of resources are used and 2) the product is not a sum of separable outputs of each cooperating resource."²⁴² Firms are used when the team method increases productivity, after factoring out the costs associated with monitoring and disciplining the team.²⁴³

The critical insight is that employment is defined not by control, but by participation—participation in team production. It is not that employees are controlled by the firm that makes them employees. It is rather that they are part of a process of joint production, acting together within one unit. This unit—the firm—has cast its lot together to engage in economic activity that would otherwise be extremely difficult to tease out into separate contracts. Because

²⁴⁰ RESTATEMENT (SECOND) OF AGENCY § 202(1) cmt. d (1957) ("[T]he full-time cook is regarded as a servant [rather than as an independent contractor] although it is understood that the employer will exercise no control over the cooking.").

²⁴¹ *Id.* § 220 cmt. a. The Restatement Third of Agency seems to recognize this problem more overtly: "In some employment relationships, an employer's right of control may be attenuated. For example, senior corporate officers, like captains of ships, may exercise great discretion in operating the enterprises entrusted to them, just as skilled professionals exercise discretion in performing their work. Nonetheless, all employers retain a right of control, however infrequently exercised." RESTATEMENT (THIRD) OF AGENCY §7.07 cmt. f (2006).

²⁴² Alchian & Demsetz, *supra* note AD1, at 779.

²⁴³ *Id.* at 780.

these players are all working together, they are treated as a unit for certain purposes.²⁴⁴ The firm is responsible for the actions of its members, and it has responsibility to those members vis-à-vis the fruits of its production process.

This insight is borne out in subsequent theories of the firm. Both the transaction costs model of the firm and the property rights model of the firm focus on the assets of the firm, but these assets can include human capital.²⁴⁵ One of the primary functions of the firm under these theories is to organize assets such that employees continue to work at and invest their human capital in the firm. Thus, the point is to manage employee participation, rather than employee control. Similarly, the “power” model of the firm developed by Rajan and Zingales revolves around the power of access to critical resources. Both the critical resources and the access provided to them involve the participation of various players within the process.²⁴⁶ Finally, knowledge-based theories of the firm look to understand how firms manage the production and utilization of knowledge within the firm.²⁴⁷ Such processes are best understood within the lens of joint production and employee participation.

Thus, employment is not about the employer’s control over a particular worker; control is not necessary or sufficient to the employment relationship. Instead, what is needed is placement of the worker within the boundaries of the firm. Such a worker is an employee; one who works outside those boundaries is an independent contractor. Going forward, then, we should look to participation, not control, for our touchstone in the legal doctrine of employment.

B. Participation as Doctrine

If the key to our understandings of employment is participation—participation, that is, in an ongoing economic enterprise as organized into a firm—then how do we operationalize this as legal doctrine? What would a “participation” test look like? As it turns out, much of the doctrine has already moved in the direction of participation; it just has not been recognized as such. Although the notion of control has dominated the common-law test, most of the factors in that test show the degree of participation in the enterprise. Look at these other factors in the Restatement (Second) of Agency’s test:

- (b) whether or not the one employed is engaged in a distinct occupation or business;

²⁴⁴ Guy Davidov has recognized that the concept of employee requires a governance structure (such as a firm) outside of the market. He argues that structure is necessary as “a direct result of two combined factors: first, our inclination to join forces and work together with others; and second, the need to coordinate production to an extent that the market cannot satisfy.” Davidov, *supra* note GD2002, at 377-78.

²⁴⁵ See *supra* Part III.

²⁴⁶ See Rajan & Zingales, *supra* note RZ1998, at 388.

²⁴⁷ See, e.g., Gorga & Halberstam, *supra* note GH2007, at 1128 (“We show how the management of knowledge resources required in mass production and high-tech firms differentially affects their decisional hierarchies, and in certain instances also their ownership and compensation structure.”).

- (c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
- (d) the skill required in the particular occupation;
- (e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
- (f) the length of time for which the person is employed;
- (g) the method of payment, whether by the time or by the job;
- (h) whether or not the work is a part of the regular business of the employer;
- (i) whether or not the parties believe they are creating the relation of master and servant; and
- (j) whether the principal is or is not in business.²⁴⁸

These elements, particularly (b), (e), (f), (h), (i), and (j), indicate whether the worker at issue is a participant in a continuing enterprise or instead an economic actor that works outside of the firm. They are about firm boundaries. Employees are those within the firm, while independent contractors are without. Participation, not control, is the common theme.

The “participation” standard also synchronizes better with the modern movement toward an “entrepreneurial opportunities” test for employee status. The entrepreneurial-oriented test seeks to determine whether the employee is located within the firm or outside of it. For example, the Restatement (Third) of Employment Law describes employees as those who work in the interests of the employer when “the employer’s relationship with the individual effectively prevents the individual from rendering the services as part of an independent business.”²⁴⁹ Non-employees, on the other hand, exercise “entrepreneurial control over the manner and means by which the services are performed.”²⁵⁰ This test may at first seem related to the degree of control exercised by the employer over the details of work, since it discusses control over the manner and means of performance. However, the overall test seems designed to capture whether the worker is engaged with the firm’s business or rather operating independently of the firm. In other words, is the worker part of the firm or part of an independent business? The D.C. Circuit’s description of its “entrepreneurial opportunities” test is even more explicitly firm-oriented: it counsels that the determination of employee status should “focus not upon the employer’s control of the means and manner of the work but instead upon whether the putative independent contractors have a significant entrepreneurial opportunity for gain or loss.”²⁵¹

²⁴⁸ RESTATEMENT (SECOND) OF AGENCY § 220(2) (1957).

²⁴⁹ RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 1.01(1) (Tent. Draft, 2009).

²⁵⁰ *Id.* § 1.01(2).

²⁵¹ See *Corporate Express Delivery Systems v. N.L.R.B.*, 292 F3d 777, 780 (D.C. Cir. 2002) (holding that the determination of employee status should “focus not upon the employer’s control of the means and manner of the work but instead upon whether the putative independent contractors have a significant entrepreneurial opportunity for gain or loss”).

Participation within a firm should not be confused with formalistic determinations such as whether the employee is on the payroll or is categorized as an employee by the firm itself. These labels are obviously useful but do not tell the whole story. After all, some firms will use disingenuous categories with the purpose of avoiding the consequences of employment under the law.²⁵² On the other hand, a broad definition of participation will engulf a variety of non-employees, including members of another firm that is engaging in a joint venture or even a simple contractual relationship with the “employer” firm. For example, a painting company with its own painter employees is arguably “participating” in the economic enterprise of the firm that hires the company. A critical component of the participation standard, however, is that an employee must be participating in the ongoing economic enterprise as organized into a firm. A painter hired to work at the firm through an independent company may be doing the same painting as an employee hired by the firm itself. But the first painter is an employee of the independent painting firm, while the second is part of the ongoing enterprise of the firm itself. Factors in the common law test such as the length of the engagement, the parties named to the contract, the method of payment, and the parties’ beliefs about the relationship all point to the differences between an employee and an independent contracting party, because they show whether the employee is actually an ongoing participant in the enterprise.²⁵³ Of course, line-drawing problems remain. In particular, workers who would generally be seen as part of the employer’s regular business but have been outsourced to a clearly separate firm would pose tough questions about the meaning of “participation.” However, the participation standard would not override existing boundaries to include workers who were clearly outside the firm, even if the outsourcing were done for purposes of escaping legal ramifications of employment.²⁵⁴

²⁵² See Carlson, *supra* note RC2001, at 298 (“[T]he advantages (to employers) of employing workers who are plausibly not employees motivate a good deal of arbitrary and questionable ‘non-employee’ classification.”); Davidov, *supra* note GD2002, at 363 (“Deliberate misclassification is becoming more and more common as a result of an increased emphasis on flexibility and the new pressures of globalization.”).

²⁵³ See RESTATEMENT (SECOND) OF AGENCY § 220(2)(b), (f), (g), (i), (j) (1957).

²⁵⁴ For an argument that an employer’s decision to shift work from employees to outside independent contractors should in some cases constitute a violation of the underlying labor and employment law regime, see Noah D. Zatz, Noah D. Zatz, *Beyond Misclassification: Tackling the Independent Contractor Problem Without Redefining Employment*, 26 ABA J. LAB. & EMPL. L. 279, 289 (2011) (“If I am correct, then the right question to ask is not who is an employee, but instead to what extent should firms be able to choose organizational structures that preclude unionization by avoiding having employer-employee relationships at all.”). See also Davidov, *supra* note GD2002, at 395-98 (discussing “dependent contractors” as a classification of workers that are not employees but deserve some labor- and employment-type protections); Brian A. Langille & Guy Davidov, *Beyond Employees and Independent Contractors: A View from Canada*, 21 COMP. LABOR L. & POL’Y J. 7, 22-29 (1999) (discussing the category of dependent contractors in Canadian law).

A participation theory of employment could be used to justify considering certain types of labor relationships to be within the firm, even if such workers are employed by outside firms. Such joint employer relationships could justify coverage as “employees,” even if the employees were also in separate firms. Cf. Zatz, *supra*, at 286 (discussing the difficulty of categorizing joint-

Looking at the areas of law in which employment plays a role, the concept of “participation” arguably does a better job of defining employee status than does control. The doctrine of *respondeat superior* dictates when a firm is liable for the actions of one of its participants. If control were the touchstone, then liability issues would focus on the extent to which the employees’ actions were controlled by the firm in carrying out the tortious act. Instead, courts have generally provided broad berth to employee actions in finding that they were taken within the scope of employment. Firms are liable for the actions of their employees not because the employees were being controlled, but because the employees were part of a joint enterprise, and that enterprise should bear the costs created by its participants. This justification matches up with the standard theoretical defenses for *respondeat superior*, which justify the doctrine based on risk-allocative or retributivist theories.²⁵⁵ As argued in the Prosser & Keeton treatise:

A multitude of very ingenious reasons have been offered for the vicarious liability of a master: he has a more or less fictitious “control” over the behavior of the servant; he has “set the whole thing in motion,” and is therefore responsible for what has happened; he has selected the servant and trusted him, and so should suffer for his wrongs, rather than an innocent stranger who has had no opportunity to protect himself; it is a great concession that any man should be permitted to employ another at all, and there should be a corresponding responsibility as the price to be paid for it—or, more frankly and cynically, “In hard fact, the reason for the employers' liability is the damages are taken from a deep pocket.” None of these reasons is so self-sufficient as to carry conviction, although they are all in accord with the general common law notion that one who is in a position to exercise some general control over the situation must exercise it or bear the loss . . .

What has emerged as the modern justification for vicarious liability is a rule of policy, a deliberate allocation of a risk. The losses caused by the torts of employees, which as a practical matter are sure to occur in the conduct of the employer's enterprise, are placed upon that enterprise itself, as a required cost of doing business. They are placed upon the employer because, having engaged in an enterprise, which will on the basis of all past experience involve harm to others through the torts of employees, and sought to profit by it, it is just that he, rather than the innocent injured plaintiff, should bear them; and because he is better able to absorb them, and to distribute them, through prices, rates or

employer structures in the FLSA context). However, such an approach would deserve a more sustained and extensive treatment outside of the scope of this paper.

²⁵⁵ See, e.g., THOMAS BATY, VICARIOUS LIABILITY 100 (1918); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 188 (7th ed. 2007).

liability insurance, to the public, and so to shift them to society, to the community at large.²⁵⁶

In other words, because the firm is the locus of joint production, and the employee is engaged in that joint production, the firm should bear the risk.²⁵⁷ A similar theory applies to criminal enterprise liability: the firm is blamed if one of its participating employees engaged in the criminal activity within the scope of employment and with the intent to benefit the firm. It does not matter whether the employee was “controlled” by the firm in his or her criminal activity; it only matters that the employee was participating in the work of the firm when committing the crime.

The role of employment in intellectual property doctrine also accords more closely to a participation theory than a control theory. Under the work-for-hire doctrine, the employee marks the boundaries of the firm; works made by employees within the scope of their employment are considered property of the firm, while works made by independent contractors are not (by default). Under the shop-right doctrine, employers enjoy a non-exclusive right to use a patent created by an employee without having to compensate the employee. A shop right arises when the employee has created the invention on the job using the employer’s materials.²⁵⁸ Once again, the firm provides the context: if the employee creates the invention at work while using the employer’s tools, the employer has a right to use that invention without cost. Because the employee has been engaged in the process of joint production, under circumstances where it may be difficult to separate out each individual contributor’s contributions, the employee has (impliedly) agreed that their joint property belongs to the firm. It is their participation within the firm—not their control by the firm—that justifies the transfer of property rights from individual to group.

The participation approach matches up with other recent scholarship considering IP rights from the perspective of the theory of the firm.²⁵⁹ This scholarship uses both the transaction-costs model and the property-rights model in demonstrating the connections between intellectual property, employees, and the firm. Using the transaction-costs model, Robert Merges points to the concern about employee opportunism and holdups to explain why employers generally

²⁵⁶ KEETON ET AL., *supra* note PK1984, at 499–501.

²⁵⁷ *See also* Ira S. Bushey & Sons, Inc. v. United States, 398 F.2d 167, 171-72 (2d Cir. 1967) (“The proper test here bears far more resemblance to that which limits liability for workmen’s compensation than to the test for negligence. The employer should be held to expect risks, to the public also, which arise out of and in the course of his employment of labor.” (citations and quotation marks omitted)).

²⁵⁸ FISK, *supra* note CF2009, at 118.

²⁵⁹ Bar-Gill & Parchomovsky, *supra* note BP2009; Burk, *supra* Note DB2004; Dan L. Burk & Brett H. McDonnell, *The Goldilocks Hypothesis: Balancing Intellectual Property Rights at the Boundary of the Firm*, 2007 U. ILL. L. REV. 575; Dan L. Burk & Brett H. McDonnell, *Patents, Tax Shelters, and the Firm*, 26 VA. TAX REV. 981 (2007); Burk & McDonnell, *supra* note BM2009; Paul J. Heald, *A Transaction Costs Theory of Patent Law*, 66 OHIO ST. L.J. 473 (2005); Robert P. Merges, *The Law and Economics of Employee Inventions*, 13 HARV. J.L. & TECH. 1 (1999); Joseph Scott Miller, *Standard Setting, Patents, and Access Lock-In: RAND Licensing and the Theory of the Firm*, 40 IND. L. REV. 351 (2007).

hold intellectual property rights over employee inventions.²⁶⁰ Comparing a system of registered patents to a system based solely on trade secret protection, Paul Heald argues that patent law makes it easier to buy and sell the information at issue. The patent buyer need not enter into a costly array of contractual protections in order to keep others (especially the sellers) from using the information and thereby saves on transaction costs.²⁶¹ He also argues that patent facilitates the creation of technical information and the use of that information in team production. Patents enable the critical information to be used within the team without fear that one of the team members will defect. The alternative would again be costly contracts with all employees in the team.²⁶² Without the need to monitor these contracts, the firm can facilitate team production more efficiently.²⁶³

The property-rights theory of the firm explicitly alludes to the importance of intellectual property. In describing the theory, Oliver Hart uses forms of intellectual property as examples of the “glue” that binds employees to the firm.²⁶⁴ The protections for this type of property are designed to manage not only the interactions between firms, but also between the firm and its employees. Dan Burk and Brett McDonnell similarly highlight the way that intellectual property rights balance property interests between firms as well as within firms.²⁶⁵ Employees have an interest in exploiting information they have created on the job, both within the firm and outside the firm when on the job market.²⁶⁶ Patent, copyright, and trade secrets each balance the firm’s needs and the individual employee’s needs in separating employee information “assets” from firm assets. Burk and McDonnell point out that this division mirrors that of agency law and the corporate opportunity doctrine, in that the critical factors are whether the information/opportunity arose in the context of employment with the use of firm resources.²⁶⁷ Moreover, they point out that the weakest form of intellectual property protection – trade secrets protection – applies to the type of information most likely to overlap with an employee’s own information capital.²⁶⁸ This balancing of rights within firms and between firms leads to their “Goldilocks” hypothesis: the level of legal protection of intellectual property rights that minimizes transaction costs will be somewhere between a system that provides

²⁶⁰ Merges, *supra* note RM1999, at 12-37.

²⁶¹ Such contractual efforts would likely encounter difficulties, for example, if one of the seller’s former employees sought to use the information.

²⁶² *Id.* at 487-88.

²⁶³ Heald, *supra* note PH2005, at 480-84. Heald also notes that some companies use patent applications, which must be filed by individuals, as a way of monitoring employee performance. *Id.* at 492-493.

²⁶⁴ HART, *supra* note OH1995, at 56-57.

²⁶⁵ Burk & McDonnell, *supra* note BM2007ILL, at 613-24.

²⁶⁶ *Id.* at 592.

²⁶⁷ *Id.* at 595-97.

²⁶⁸ *Id.* at 609. Employee covenants not to compete are also included, since their impact intersects with intellectual property, particularly trade secrets. *Id.* at 628-33; *see also* Bar-Gill & Parchomovsky, *supra* note BP2009, at 1686-88.

strong rights to firms and a system of weak rights for firms.²⁶⁹ And this calibration of legal rights is necessary to balance individual participation with group production; the degree of control over the participants is largely irrelevant. Finally, the participation theory of employment has explanatory power in areas of labor and employment law. The ability of the firm's supervisory authorities to control the minute details of work, as opposed to the overall scope of a project, does not explain why employees should be singled out for protection. An employee can still be given largely free reign to create and produce within the firm, and an independent contractor's work can still be closely supervised and monitored. However, the notion that employees are participating in a common enterprise explains why that enterprise would have certain obligations to those employees within that relationship.²⁷⁰ The firm is not only responsible for the effects of the acts of its employees; it is also responsible to those employees as well. Employment laws are designed to enforce upon employers certain types of responsibility for their participants. Within the common boundaries of the firm, employers have an obligation to pay for minimum wage and overtime; provide family and medical leave; avoid discrimination; bargain with collective representatives; adhere to certain requirements as to retirement and health care benefits; and provide insurance in case of unemployment. Employers have the responsibility to provide these things because employees are participants in the employers' common enterprise.²⁷¹ Team production justifies obligations from the team to the individual members.²⁷²

At the same time, participation theory might help us articulate why our definition of "employee" seems too crabbed or limiting when it comes to certain types of labor and employment protections. For example, employers at the fringes of the labor market have used the structure of the firm to regulate their exposure to wage and hour protections.²⁷³ Because the FLSA uses a definition of "employ" that includes "to suffer or permit to work,"²⁷⁴ courts have expanded its definition of "employee" to include workers with some degree of independence from a traditional firm relationship. This exception to the general dominance of the "control" test may signal that different definitions of employment are

²⁶⁹ Burk and McDonnell would calculate the level for interfirm transactions independently from the level for intrafirm transactions, although these levels could overlap or even be identical once calculated. *Id.* at 620-21. Moreover, they indicate that employees are critical not only to intrafirm analysis, but also to interfirm analysis. *Id.* at 632.

²⁷⁰ See Timothy P. Glynn, *Taking Self-Regulation Seriously: High-Ranking Officer Sanctions for Work-Law Violations*, 32 BERKELEY J. EMP. & LAB. L. 279, 324 (2011) ("[Work law] focuses instead on enterprise liability: the employing firm, rather than individual decision-makers acting on behalf of the enterprise, is accountable for violations of labor and employment laws.").

²⁷¹ Cf. Davidov, *supra* note GD2002, at 375-76 (arguing that "labour and employment laws are generally designed to protect workers who appear to require this protection in their relationship with an identifiable employer" (emphasis in original)).

²⁷² Cf. *id.* at 394 ("[P]rotective labour and employment laws can be understood to share a basic purpose . . . to minimize the extent of democratic deficits and dependency in work relations and to correct unwanted outcomes of these phenomena.").

²⁷³ For an extensive discussion of this phenomenon, see Glynn, *supra* note TG2011Emp, at 207-15.

²⁷⁴ 29 U.S.C. § 203(g) (2006).

appropriate—or one could argue instead that certain wage and hour violations should protect workers beyond the employment relationship. Other countries have taken the approach of expanding such protections to include so-called “dependent contractors,” who may have independence from the firm but not true independence from the economic relationship.²⁷⁵ Rather than lumping these dependent contractors into the employment relationship, it may make more sense to recognize that wage and hour protections should run to contractual as well as firm relationships.²⁷⁶ Similarly, protections against discrimination are arguably justifiable for employees as well as partners, although Title VII only applies to the former. Labor and employment laws provide a diversity of regulatory schemes, and there may be good reasons to extend some of those schemes beyond the common definition of employment.²⁷⁷ However, it is important to first establish a common notion of employment, in order to give meaning to the category beyond a chameleon-esque placeholder. Participation theory provides the best common definition for the category.

In addition, participation explains why employees themselves have a duty to the firm. The fiduciary obligations of corporate directors are well-established: directors owe duties of loyalty, care, and good faith in the exercise of their responsibilities. Delaware recently extended these obligations to corporate officers as well.²⁷⁸ However, the common law has long maintained that even lower-level employees owe fiduciary obligations to their employer.²⁷⁹ These obligations are explored in the Restatement Third of Employment Law, which provides that “[e]mployees owe a duty of loyalty to their employer in matters related to the employment relationship.”²⁸⁰ Employees breach the duty of loyalty by disclosing or using the employer's confidential information, competing with the employer, or appropriating the property of the employer or engaging in self-dealing.²⁸¹ Under a control theory of employment, these obligations do not really make any sense—why should those who are more controlled by the firm have an obligation of loyalty to the firm? But the participation theory nicely explains why

²⁷⁵ See Davidov, *supra* note GD2002, at 395-98 (discussing “dependent contractors” as a classification of workers that are not employees but deserve some labor- and employment-type protections); Langille & Davidov, *Beyond supra* note LD1999, at 22-29 (discussing dependent contractors in Canadian law).

²⁷⁶ See Glynn, *supra* note TG2011Emp, at 227-35.

²⁷⁷ Guy Davidov has arrayed the justifications for workplace regulatory regimes along a spectrum from selective (as to employees) to universalist (as to society as a whole). He cautions that while universalist justifications have a broad appeal, they are insufficiently tethered to the employment relationship to justify workplace regulation. Guy Davidov, *The Goals of Regulating Work: Between Universalism and Selectivity*, U. TORONTO L.J. (forthcoming 2013), at: <http://ssrn.com/abstract=2205000>.

²⁷⁸ *Gantler v. Stephens*, 965 A.2d 695, 708-09 (Del. 2009) (“In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold.”); Glynn, *supra* note TG2011Berk, at 326.

²⁷⁹ RESTATEMENT (SECOND) OF AGENCY § 387 (1957); O’Neill, *supra* note TON1993, at 685 (“All employees owe a fiduciary duty of loyalty to their employer—be the employer a sole proprietor, a partnership, a close corporation, or a large, publicly traded corporation.”).

²⁸⁰ RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.01(a) (Tent. Draft 2011).

²⁸¹ *Id.* § 8.01(b).

individual firm members would owe duties to the ongoing enterprise of which they are a part.²⁸²

Admittedly, participation theory does not solve a number of extant issues with the definitions of employee and employment. It does not explain why some participants in a common enterprise—family members, for example, or prisoners—are not considered to be employees despite their compensated labor.²⁸³ It also does not differentiate between employees who are simply employees and those who are labeled as supervisors, managers, or officers and thus are excluded from the definition of “employee” for certain purposes.²⁸⁴ “Control” is sometimes used as a distinguishing factor in this context: those who are controlled by the firm are employees, while those who control the firm (and/or their coworkers) are not.²⁸⁵ But employees from the bottom to the top of the firm’s hierarchy are all participants in the ongoing economic enterprise; those who have more power within the firm may, in fact, be even more closely associated with it. The purpose of the participation standard for employment is to distinguish between employees and independent contractors—between those who are inside and outside of the firm. It does not distinguish between employees as to their roles within the firm; it does not say which employees can be considered the “employer” for purposes of certain labor and employment law regimes. In those cases, control may be a more appropriate guide.²⁸⁶ However, the fact that courts have used the control test to distinguish both between employees and independent contractors, as well as between employees and employers, provides some indication of the inherent incoherence of the test as currently constituted.

Control is not necessary in finding a worker to be part of an organization. Although commentators such as Guy Davidov have included the notion of being controlled as critical to the concept of employment,²⁸⁷ such a requirement (in my

²⁸² *But cf.* Davidov, *supra* note GD2002, at 386 (arguing that the employee’s duty to “obey” makes the employment relationship “one-sided”).

²⁸³ *See* Zatz, *supra* note NZ2008, at 884-92 (discussing determination by courts that prison labor is not employment because it is “noneconomic” in nature); Noah D. Zatz, *Prison Labor and the Paradox of Paid Nonmarket Work*, in *ECONOMIC SOCIOLOGY OF WORK* 369, 370 (Nina Bandelj ed., 2009) (same).

²⁸⁴ *See, e.g.*, 29 U.S.C. § 152(3) (2006) (excluding supervisors from the definition of employee); 29 U.S.C. § 2614(b)(2) (2006) (providing an exception to certain FMLA requirements for salaried employees who are “among the highest paid 10 percent of the employees employed by the employer within 75 miles of the employee’s facility”).

²⁸⁵ *See, e.g.*, *Clackamas Gastroenterology Associates, P.C. v. Wells*, 538 U.S. 440, 449-50 (2003) (using the control test to determine whether doctors who were shareholders in a professional corporation counted as employees or were instead employers and thus not employees).

²⁸⁶ Davidov, *supra* note GD2002, at 381 (“[C]ontrol is the concept most central to understanding the organizational aspect of employment relationships.”).

²⁸⁷ Davidov has argued that the lack of participation in the control of the enterprise—which he terms “democratic deficits”—is one of the three “axes” of the employment relationship, along with dependency on the relationship for the fulfillment of certain social and psychological needs and economic dependency that renders it difficult to spread risks. *Id.* at 394. However, he specifies that control “does not necessarily mean control of the employer over every aspect of the production process.” *Id.* at 381. Instead, control means “the superior power of the employer *vis-à-vis* the employee within their relationship and the resulting inability of the employee to control her own (working) life.” *Id.* Although Davidov acknowledges that these democratic deficits

view) is unnecessary and limiting. An employee remains an employee whether in an extremely hierarchical workplace or in a more collaborative and democratic environment.²⁸⁸ In fact, the notion that employees must be controlled—must be deprived of power within the firm—has perhaps been a self-fulfilling prophecy.²⁸⁹ Viewing employees as participants rather than pawns will not only accord better with the economic reality of the modern workplace,²⁹⁰ but will also send a signal about the proper role of employees within the organization.

V. THE FUTURE OF EMPLOYMENT IN THE LAW

The preceding discussion assumes the continuing vitality of the concept of employment within the law. However, both the employment relationship and the firm itself—at least, in its most common legal persona of the corporation—have questionable long-term prospects. The corporation is under siege by a plethora of new organizational structures, most notably the limited liability company (LLC). When the Treasury moved to “check-the-box” taxation for these new entities, they became viable alternatives to the corporation in a variety of different fields.²⁹¹ The flexibility of the LLC form is in contrast to many of the requirements, state and federal, placed upon the corporation.²⁹² It seems, perhaps, as if Jensen & Meckling’s “nexus of contracts” model is coming to life in the LLC, and the corporation’s failure to live up to their model is bringing it down.

The employment relation is moving from firm to market as well. In the mid-twentieth century, labor economists identified internal labor markets as a deviation from neoclassical labor market theory.²⁹³ These economists found that employees largely stayed within one firm for their lifetime of employment, and that firms generally used internal promotion to fill vacancies. These findings established an empirical basis for Coase’s notion of the importance of the employment relation to the firm. Moreover, internal labor markets are an instantiation of the separateness of the firm from the market; they demonstrate

cannot be justified on the grounds of efficiency or expertise, he nevertheless believes that “democratic deficits exist (to different extents) in any employment relationship.” *Id.* at 380.

²⁸⁸ See Adler & Heckscher, *supra* note AH2006, at 59-63 (discussing the existence of collaborative workplace communities within certain firms).

²⁸⁹ Cf. Zatz, *supra* note NZ2008, at 866-67 (discussing the “constitutive role for employment law with respect to the boundaries of economic life”); Zatz, *supra* note NZ2011, at 288 (discussing the constitutive role of law in how firms shape their organizational structures).

²⁹⁰ See Adler & Heckscher, *supra* note AH2006.

²⁹¹ See TREAS. REG. § 301.7701-1-3 (2004); LARRY E. RIBSTEIN, *THE RISE OF THE UNINCORPORATION* 121 (2010).

²⁹² Moreover, when it comes to the public corporation, commentators have suggested that more firms have gone private because of the regulatory requirements layered upon the public corporation. William J. Carney, *The Costs of Being Public after Sarbanes-Oxley: The Irony of “Going Private,”* 55 EMORY L.J. 141, 142 (2006) (discussing evidence that smaller issuers are being forced out of public markets). *But see* Robert P. Bartlett III, *Going Private But Staying Public: Reexamining the Effect of Sarbanes-Oxley on Firms’ Going-Private Decisions*, 76 U. CHI. L. REV. 7, 10-11 (2009) (arguing that Sarbanes-Oxley is not to blame for the high-profile “going private” transactions of the last decade).

²⁹³ STONE, *supra* note KS2004, at 51-63.

that the firm is truly a different set of relationships. However, economists are finding that the importance of internal labor markets has been dwindling. Beginning in the 1970s, firms began to hire more temporary and contingent workers.²⁹⁴ This trend accelerated through the 1990s, and continues apace. Recent reports indicate that the 2008 recession has turned many employees into “permanent” temporary workers, with as much as 26 percent of the workforce now having “nonstandard” jobs.²⁹⁵ And the effects go beyond low-skill and low-wage employment; executive officers, lawyers, and scientists are all among the temporarily employed.²⁹⁶ Moreover, “outsourcing” – a word of relatively recent vintage – continues to break down relationships that were traditionally within the firm.²⁹⁷ What Alan Hyde said in 1998 continues to be true today: “Increasingly, labor is hired through short-term, market-mediated arrangements that may not be ‘employment’ relations in any legal or technical sense of that word.”²⁹⁸

If the corporation is giving way to a more contractually-oriented form of business enterprise, and the employment relationship is dissolving back into the market, then perhaps corporations (or their successor organizational forms) will exist only to structure financial relationships and confer limited liability. There is reason to believe, however, that the firm and the corporation will remain relevant to our economic system. From the organizational perspective, the role of the “uncorporation” remains limited under current law.²⁹⁹ It seems likely that not only will the public corporation survive, but it will be made even less contractual after the passage of finance reform legislation.³⁰⁰ And in the employment context, the flight from employment seems driven by an effort to avoid employment-related regulations and restrictions, rather than the disappearance of the firm itself. In fact, many employers are looking to tie their employees even more closely to the firm and its image. The importance of “brand” for businesses means that employees are critical to reifying and promoting the brand, especially in service industries. Firms have used branding to draw out psychological commitments from employees that are not reciprocal on the part of the employer.³⁰¹ Participation by enthusiastic employees is becoming more important to the role of the firm, not less.

²⁹⁴ *Id.* at 68-70.

²⁹⁵ Coy, Conlin & Herbst, *supra* note CCH2010.

²⁹⁶ STEVEN GREENHOUSE, THE BIG SQUEEZE: TOUGH TIMES FOR THE AMERICAN WORKER (2008); Coy, Conlin & Herbst, *supra* note CCH2010.

²⁹⁷ Margaret M. Blair & Erin O’Hara, *Outsourcing, Modularity and the Theory of the Firm*, Working Paper No. 09-19, Vanderbilt University Law School, Law & Economics Series, available at: <http://ssrn.com/abstract=1318263>; George S. Geis, *An Empirical Examination of Business Outsourcing Transactions*, 96 VA. L. REV. 241 (2010); George S. Geis, *The Space Between Markets and Hierarchies*, 95 VA. L. REV. 99 (2009).

²⁹⁸ Hyde, *supra* note AH1998, at 99.

²⁹⁹ RIBSTEIN, *supra* note LR2010.

³⁰⁰ The legislation paves the way for new regulations on compensation committees, say-on-pay proposals, and proxy access for director nominations. DODD-FRANK ACT, Pub. L. 111-203, §§ 951-52, 971.

³⁰¹ Scholars have criticized this branding as too invasive, as it dictates what employees wear, what they say, and what they do when not on the job. See Dianne Avery & Marion Crain, *Branded:*

In fact, it may be that the tide is turning back to a more employee-oriented workplace. Popular management literature emphasizes the importance of the employee.³⁰² Small startups, particularly in the tech industry, are once again blurring the line between entrepreneur and employee.³⁰³ Academia is evolving, as well. As discussed earlier, recent research into the theory of the firm has focused on the importance of knowledge-based assets and the distribution of access to those assets within the firm.³⁰⁴ As we learn more about the importance of trust, norms, and procedural justice within the corporation, employees will grow even more in importance.³⁰⁵

It is possible to envision a radically individualized future, in which each worker is a “corporation” unto herself and firms are merely temporary agglomerations within the global market. It is also possible to envision a future in which employees participate at the highest levels of governance, and corporations are tools of team production rather than investor enrichment. Perhaps both of these futures are in store, to varying degrees within different industries. Further exploration into the role of the firm will enable us to better understand these changes and manage them efficiently through the legal system.

CONCLUSION

To better understand the meaning of employment, we need to look to the organizational structures that create the employment relationship. We recognize a category of “employees” because we recognize the employers that harness their collective labor in pursuit of a common economic enterprise. By looking to the literature on the theory of the firm, we can better understand the importance of “employment” as an economic and legal concept, and we can better define that role to meet the definitional needs of various doctrines. At this point in our history, it makes sense to consider an employee to be one who participates in joint production within the context of a firm, rather than one who is controlled by an employer. Such a conception of employment as participation will enable us to better understand the reasons why we have a common conception of employment that ribbons throughout our law. Because employees participate within a firm, they are responsible to the firm, and the firm is responsible both to and for them.

We currently are a nation largely of employees. But that could change. In the end, it will be our approach to the concept of firms that will dictate whether the employment relationship—as defined in law—is a historical anachronism or a

Corporate Image, Sexual Stereotyping, and the New Face of Capitalism, 14 DUKE J. GENDER LAW & POL’Y 13 (2007); Crain, *supra* note MC2010.

³⁰² See, e.g., TONY HSIEH, *DELIVERING HAPPINESS: A PATH TO PROFITS, PASSION, AND PURPOSE* (2010) (discussing Zappos’s approach to employee service).

³⁰³ See, e.g., Doree Shafir, *Tweet Tweet Boom Boom*, N.Y. MAG., April 26, 2010, at 34.

³⁰⁴ See Rajan & Zingales, *supra* note RZ1998; Gorga & Halberstam, *supra* note GH2007.

³⁰⁵ TOM R. TYLER & STEVEN L. BLADER, *COOPERATION IN GROUPS: PROCEDURAL JUSTICE, SOCIAL IDENTITY, AND BEHAVIORAL ENGAGEMENT* (2000); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001).

basis for continued common production. By better understanding the nature of employment, and better framing it as a legal concept, we can understand its strengths and limitations as a legal tool, and employ that tool properly in the future.

0
/\n/\n