STATE OF RHODE ISLAND & PROVIDENCE PLANTATIONS

PROVIDENCE, Sc. **DISTRICT COURT**
SIXTH DIVISION

Charles J. Fogarty, Director,	:	
Department of Labor and Training	:	
	:	
v.	:	**A.A. No. 12 - 159**
	:	
Department of Labor and Training,	:	
Board of Review	:	
(Roland Martin)	:	

O R D E R

This matter is before the Court pursuant to § 8-8-8.1 of the General Laws for review of the Findings & Recommendations of the Magistrate.

After a de novo review of the record, the Court finds that the Findings & Recommendations of the Magistrate are supported by the record, and are an appropriate disposition of the facts and the law applicable thereto. It is, therefore,

ORDERED, ADJUDGED AND DECREED,

that the Findings & Recommendations of the Magistrate are adopted by reference as the Decision of the Court and the decision of the Board of Review is AFFIRMED.

Entered as an Order of this Court at Providence on this 11TH day of February, 2013.

By Order:

_____/S/_____
Stephen C. Waluk
Chief Clerk

Enter:
____/S/_____
Jeanne E. LaFazia
Chief Judge

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F I N D I N G S & R E C O M M E N D A T I O N S

Ippolito, M. In this case the District Court is called upon to resolve a legal disagreement that has arisen between the Rhode Island Department of Labor and Training and the Department's adjudicatory arm, the Board of Review. This dispute centers on the proper interpretation to be given to a provision of the Rhode Island Employment Security Act[1] —

[1] **28-42-8. Exemptions from "employment." —** Employment does not include:
…

Gen. Laws 1956 § 28-42-8(2) — which excludes work performed for a spouse from its definition of "employment," which has the effect of excluding the employed by a spouse from partaking in the unemployment benefit system. Historically, this rule has been applied to bar benefits when the spouse was doing business as a sole proprietorship or when the claimant was employed by a partnership of which the spouse was a member, but not when the claimant was employed by a corporation in which the spouse had an ownership interest — whether full or partial.

The current controversy arose when the Department applied the spousal-employment exclusion with regard to a new business form — the limited liability company (LLC). Specifically, the Department disqualified Mr. Roland Martin, who had worked for a limited liability company (LLC)[2] which was owned by his wife. But when it considered

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(2) Services performed by an individual in the employ of his or her son, daughter, or spouse, and service by a child under the age of eighteen in the service of his or her father or mother.

[2] Limited liability companies were created as a Rhode Island business form in 1992. See P.L. 1992, ch. 280, § 1.

A dictionary definition of a limited liability company is "A company — statutorily authorized in certain states — that is characterized by limited liability, management by members or managers, and limitations

an appeal in the case, the Board of Review rejected the Department's position and determined the spousal-employment exclusion to be inapplicable; the Board held that Mrs. Martin's ownership of the LLC to be equivalent to an ownership interest in a corporation. And so, the Board decided that Mr. Martin — who was admittedly otherwise eligible — should be permitted to collect benefits.

In response, the Department's Director, Mr. Charles J. Fogarty, brought the instant complaint for judicial review, jurisdiction for appeals from the decision of the Department of Employment and Training Board of Review being vested in the District Court by Gen. Laws 1956 § 28-44-52. The parties agree, in a reversion to their customary comity, that a judicial resolution of this question is necessary because the circumstances of this case are likely to recur. And so, this matter has been referred to me for the making of Findings and Recommendations pursuant to Gen. Laws 1956 § 8-8-8.1. After considering this question, employing the standard of review applicable to appeals from the Board of Review, I find that the decision of the Board of Review is not affected

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on ownership transfer." Black's Law Dictionary, Ninth Edition (Garner ed. 1990) at 319.

by error of law; I therefore recommend that the Decision of the Board of Review be affirmed on the issue of eligibility.

I. FACTS AND TRAVEL OF THE CASE

The facts and travel of the case are these: Mr. Roland Martin was employed as a mason by M & M Concrete Floors, LLC, a Limited Liability Company owned solely by his wife, until early January, 2008. He filed a claim for employment security benefits effective January 6, 2008. But the Director, in a decision dated November 17, 2011, determined that Mr. Martin was ineligible for benefits. See Director's Decision, November 17, 2011, at 1. Because M & M was owned by his wife, the Director found that Mr. Martin was ineligible to receive benefits by Gen. Laws 1956 § 28-42-8(2) which provides that "Employment shall not include service performed by an individual in the employ of his or her son, daughter, or spouse …."[3]

[3] In making this determination the Director treated Mr. Martin's employment by the LLC as it would have had she owned the business directly (as a sole proprietorship) or as a member of a partnership; it is equally understood by all parties that if the business had been configured as a corporation § 28-42-8(2) would have been deemed inapplicable and Mr. Martin would have been permitted benefits.

Claimant appealed, and a hearing was set before Referee Nancy L. Howarth on December 28, 2011. Mr. Martin appeared without counsel and testified briefly. See Referee Hearing Transcript, at 7-14.

In her decision, issued on December 29, 2011, Referee Howarth made the following Findings of Fact regarding claimant's eligibility for benefits:

> **2. FINDINGS OF FACT:**
>
> The claimant was employed as a mason for a limited liability company. His spouse is the agent/manager. Although the business is registered as an LLC, it is designated as a sole proprietorship for tax filing purposes.
> …

Referee's Decision, December 29, 2011, at 1. Based on these findings, after quoting from section 28-42-8(2), the Referee announced the following Conclusion:

> **3. CONCLUSION:**
> * * *
> The wages used by the claimant to establish his claim were earned while in the employ of his spouse. Therefore, he is subject to disqualification under the above Section of the Act.

Referee's Decision, December 29, 2011, at 2. Accordingly, Referee Howarth found Mr. Martin to be disqualified from receiving benefits.

Claimant filed an appeal and the matter was considered by the Board of Review. Pursuant to section 28-44-47, it declined to hold a new hearing but issued a decision based on the record certified to it. The Board reversed the decision of the Referee. It did so unanimously.

Unlike the Referee (and the Department), the Board of Review did not find M & M's tax election to be persuasive, commenting — "The fact that the LLC is taxed as a sole proprietorship does not change the LLC into a sole proprietorship." Decision of Board of Review, July 26, 2012, at 1. It added that "The fact that the claimant's spouse is the general manager doesn't change the employer from a LLC to a sole proprietorship." Id. As a result, it concluded that "Wages earned from a Limited Liability Company cannot be excluded under Section 28-42-8(2) of the Act." Id. Thus, the Board's decision was based on the simple syllogism — Mr. Martin had been employed by an LLC — a separate organization with a separate legal identity — not his spouse. It therefore found section 28-42-8(2) inapplicable.

Thereafter, on August 20, 2012, Director Fogarty filed the instant complaint for judicial review in the Sixth Division District Court. A conference was conducted by the undersigned and a briefing schedule

set. Counsel for the Department and for the Board of Review have filed learned memoranda which I have found most helpful.

II. STANDARD OF REVIEW

The standard of review is provided by Gen. Laws 1956 § 42-35-15(g), a section of the state Administrative Procedures Act, which provides as follows:

> **42-35-15. Judicial review of contested cases.**
>
> (g) The court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact. The court may affirm the decision of the agency or remand the case for further proceedings, or it may reverse or modify the decision if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:
> (1) In violation of constitutional or statutory provisions;
> (2) In excess of the statutory authority of the agency;
> (3) Made upon unlawful procedure;
> (4) Affected by other error of law;
> (5) Clearly erroneous in view of the reliable, probative and substantial evidence on the whole record; or
> (6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

Thus, on questions of fact, the District Court "* * * may not substitute its judgment for that of the agency and must affirm the decision of the

agency unless its findings are 'clearly erroneous.' "[4] The Court will not substitute its judgment for that of the Board as to the weight of the evidence on questions of fact.[5] Stated differently, the findings of the agency will be upheld even though a reasonable mind might have reached a contrary result.[6]

The Supreme Court of Rhode Island recognized in Harraka v. Board of Review of the Department of Employment Security, 98 R.I. 197, 200, 200 A.2d 595, 597 (1964) that a liberal interpretation shall be utilized in construing and applying the Employment Security Act:

> * * * eligibility for benefits is to be determined in the light of the expressed legislative policy that "Chapters 42 to 44, inclusive, of this title shall be construed liberally in aid of their declared purpose which declared purpose is to lighten the burden which now falls upon the unemployed worker and his family." G.L. 1956, § 28-42-73. The legislature having thus declared a policy of liberal construction, this court, in construing the act, must seek to give as broad an effect to its humanitarian purpose as it reasonably may in

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4 Guarino v. Department of Social Welfare, 122 R.I. 583, 584, 410 A.2d 425 (1980) citing R.I. GEN. LAWS § 42-35-15(g)(5).

5 Cahoone v. Board of Review of the Department of Employment Security, 104 R.I. 503, 246 A.2d 213 (1968).

6 Cahoone v. Board of Review of the Department of Employment Security, 104 R.I. 503, 246 A.2d 213 (1968). Also D'Ambra v. Board of Review, Department of Employment Security, 517 A.2d 1039 (R.I. 1986).

> the circumstances. Of course, compliance with the legislative policy does not warrant an extension of eligibility by this court to any person or class of persons not intended by the legislature to share in the benefits of the act; but neither does it permit this court to enlarge the exclusionary effect of expressed restrictions on eligibility under the guise of construing such provisions of the act.

III. ANALYSIS

Customarily, the "Analysis" section of an opinion in an unemployment appeal begins with an examination of the facts of record, to see if they support the findings made by the Board of Review. In this case this duty need not detain us long, since the operative facts of this case are few. To recap — Mr. Martin worked for M & M Concrete Floors, LLC, a firm owned by his wife; due to a lack of work he was laid off and applied for unemployment benefits. These facts are not in dispute.

On the other hand, the parties do disagree heartily on the legal implications of these circumstances. And not only is this a case of first impression in Rhode Island, it is one for which there appears to be a dearth of precedents to be found nationally. And so, a resolution of this case will require substantial analysis.

A. Review of Positions of the Parties.

Let us first begin the analytic process with a review of the positions of the parties.

1. The Director's Position.

The Director's position is somewhat complicated. Because the Director's Decision was brief, as initial Department determinations invariably are, we must look to the Complainant's memorandum to provide the particulars of the Director's analysis.

The Director begins his analysis by noting that — under subdivision 28-42-8(2) — services provided in the employ of one's spouse are not considered "employment." Id. Director's Memorandum of Law, at 3. To this point it adds that LLC's are taxed for unemployment purposes according to their Internal Revenue Service (IRS) filing status and that M & M Concrete files as a sole proprietorship. Id., at 3. By extension, the Director argues that M & M should be treated as a sole proprietorship for non-tax issues as well. Director's Memorandum of Law, at 4. He urges that any other construction would be contrary to the purpose and intent of the Employment Security Act. Director's Memorandum of Law, at 5.

2. The Board of Review's Position.

The Board of Review's position is well and concisely presented in its Decision. The Board's analysis is straightforward. Mr. Martin did not work for his wife but for a separate entity — M & M Concrete Flooring — an LLC. The Board's Memorandum of Law is helpful and expands upon the four corners of the Decision in an explanatory way. Of course, it does not go beyond the Decision by adding new arguments — as, of course, it could not.

The Board's Memorandum of Law is helpful and expands upon the four corners of the Decision in an explanatory way. From a reading of the section itself and the federal statutes referenced therein, the Board urges that the Director's reliance on section 28-42-8(2) was completely misplaced. Board of Review Memorandum, at 3. The Board also rejected the persuasive value of a U.S. Department of Labor Program Letter which the Director had cited, believing it to did not provide clear direction. Id. Thus, it submits that the Director's position is without supporting authority.

3. Summary of Positions.

Thus, we can see the opposing positions clearly. The Board's position is that Claimant Martin was employed not by his wife but by the LLC, a separate organization with a separate identity; therefore, claimant could not be disqualified, section 28-42-8(2) being inapplicable. The Department's position is that LLC's must be evaluated on a case-by-case basis — and those that are treated as sole proprietorships for tax purposes must be treated as sole proprietorships for unemployment insurance purposes; therefore, claimant must be disqualified since he had been, in fact and law, working for his wife.

B. Evaluating the Board's Position.

Thus, we can now see the opposing legal arguments with some clarity. In my view, the Board's position is more appealing. But now is the time to begin the laborious task of examining the legal merits of the two positions. I believe we should commence with the position of the Board, since it stands as the decision in the case unless set aside.

1. Effect of the LLC Form on the Result in this Case.

In my view the Board's decision rests on two underlying assumptions: (1) a corporation has a separate identity and so a corporation owner working for a corporation may be a participant in the employment security system and (2) an LLC also has a separate identity from its owners and it should be treated alike. Can these predicate assumptions be validated? I believe they can.

Both the Board and the Department agree that a corporation must be treated as a separate entity for all purposes under the Employment Security Act. Specifically, they agree that a worker for a corporation owned by a spouse may be deemed to be employed within the meaning of the Act. Nevertheless, it is only proper that we should validate the truth vel non of their joint understanding.

a. The Corporate Form.

This validation is easily accomplished by making reference to a case decided by the Rhode Island Supreme Court, Rector v. Director of Department of Employment Security, 120 R.I. 802, 390 A.2d 370 (1978). Mr. John Rector was denied unemployment benefits because he was working for a corporation of which he was a 50% owner; in light of this

circumstance, the Department regarded him as being self-employed. The Supreme Court stated:

> The defendant director alternatively argues that because plaintiff owned a 50 percent interest in the corporation he was self-employed and therefore per se ineligible for benefits. Self-employment describes that work situation in which in which one carries on a trade or business as an individual or as a member of a partnership. A corporation, however, is a legal being separate and apart from its stockholders and officers. Therefore, the concept of self-employment is inappropriately raised in the case at bar. See G.L. 1956 (1969 Reenactment) § 7-1.1-4; Olney v. Conanicut Land Co., 16 R.I. 597, 18 A. 181 (1889). For the foregoing reasons, we conclude that plaintiff totally unemployed within the meaning of § 28-42-3(15).[7]

Rector, 120 R.I. at 808; 390 A.2d at 374. Thus, we may conclude that a corporation's owner who is employed by the firm is a participant in the unemployment system and may collect benefits if terminated.

b. The Limited Liability Company.

What is a limited liability company — or LLC, as it is commonly known? The Rhode Island Limited Liability Company (LLC) Act — Chapter 16 of Title 7 of the General Laws — does not provide a short

[7] The subdivision defining "total unemployment" to is now codified as § 28-42-3(27); this is not a reference to the subdivision included in the Appendix.

definition of this relatively new business form,[8] but defines it in many sections which establish the characteristics of an LLC. For instance, the Act declares that a limited liability company "… has the purpose of engaging in any lawful business;"[9] it possesses various powers, including the power to sue and be sued, to transact business, to make contracts, to sell and purchase property;[10] it is formed by delivering articles of organization for filing with the secretary of state;[11] its members and managers enjoy limited liability;[12] the company must file an annual return with the tax administrator.[13]

Having discerned the nature of an LLC, we must now determine how M & M should be treated in this case — as a corporation or as sole

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[8] Gen. Laws 1956 § 7-16-2(15), in circular fashion, defines a limited liability company to be "… an entity that is organized and existing under the laws of this state pursuant to this chapter."

[9] Gen. Laws 1956 § 7-16-3.

[10] Gen. Laws 1956 § 7-16-4.

[11] Gen. Laws 1956 § 7-16-5. The necessary particulars of the articles of organization are enumerated in § 7-16-6.

[12] Gen. Laws 1956 § 7-16-23.

[13] Gen. Laws 1956 § 7-16-67.

proprietorship. The Employment Security Act offers no direct assistance. Accordingly, I have also reviewed the Rhode Island Limited Liability Act, which does.

A provision of the Act, section 7-16-73 — entitled "Construction With Other Laws," furnishes us with strong guidance. It provides:

> (a) Unless the provisions of this chapter or the context indicates otherwise, each reference in the general laws to a "person" is deemed to include a limited liability company, and each reference to a "corporation," except for references in the Rhode Island Business and Nonprofit Corporation Acts, and except with regard to taxation, is deemed to include a limited liability company.

Thus, subsection (a) directs us to regard LLC's as corporations, unless the context indicates otherwise. If applied, this interpretive command determines the outcome of the case. But before declaring the instant controversy at an end, let us focus on the penultimate clause of subsection (a), which reads — "and except with regard to taxation."

Subsection (b) thus makes very clear that taxation issues will be treated differently. And subsection (b) explains how LLC's will be treated on taxation issues:

> (b) As to taxation, a domestic or foreign limited liability company shall be treated in the same manner as it is treated under federal income tax law.

As can be clearly seen, subsection (b) mandates that, in tax issues, LLC's will be treated in the manner they are treated for federal income tax purposes. Of course, this is the same election that the Department has asserted to be determinative since the outset of this controversy. Thus, it would seem, the ultimate question to be answered is — Is the unemployment law a tax law?

I believe it is not. I believe the Employment Security Act, although it requires employers to make "contributions" — which they may fairly view to be taxes — is, at its essence, a social welfare program whose purpose is "to lighten the burden which now falls upon the unemployed worker and his family. G.L. 1956, § 28-44-73." Harraka, 98 R.I. at 197, 200 A.2d at 595, quoted supra at 8.[14]

[14] See also Gen. Laws 1956 § 28-42-2, titled Declaration of Policy, which pronounces "Economic insecurity, due to unemployment, being a serious menace to the health, morale, and general welfare of the people of this state, is, therefore, a subject of interest and concern to the community as a whole, warranting appropriate action by the general assembly to prevent its spread and to lighten the burden which now falls on the unemployed worker and his or her family …. Chapters 42 — 44 of this title are designed to meet in some measure this situation by providing for the accumulation of a fund to assist in protecting the public against the ill effects of unemployment which may arise in future years."

Therefore, I find the exception found subsection 7-16-73(b) to be immaterial to the issue at bar and the general rule announced in subsection 7-16-73(a) to govern the resolution of the issue before us. As a result, I must conclude that the Board's ruling that M & M Concrete Floors, LLC should be treated as a separate entity (as a corporation would be) to have firm support in Rhode Island law.

C. Evaluating the Director's Position.

In light of my previous finding — that the Board's ruling has a firm basis in Rhode Island law — one may fairly ask: Why proceed further to evaluate the Director's position? I believe we should do so, out of general deference to the Director's authority as administrator of the unemployment system, but, in particular, because the Director expressly relies on federal law to a great extent. This places on us a duty to make sure that these federal laws do not require a contrary result based on the invocation of supremacy clause considerations.

After a close inspection of the Director's position, I have concluded that I cannot validate its legal underpinnings. The Director urges that the federal government requires an LLC owned by a spouse which is treated as a sole proprietorship for tax purposes to be treated in

a like manner for unemployment purposes. Director's Memorandum of Law, at 3. In support of this proposition, it cites a federal program letter. However, I cannot find this to be binding authority, since our Supreme Court has made it emphatically clear it does not consider itself bound by federal administrative interpretations. See University of Rhode Island v. Department of Labor and Training Board of Review, 691 A.2d 552, 555 (R.I. 1997).

In any event, I believe it relies on bootstrapping. It cites federal law to determine that wages earned by partners are exempt from unemployment taxes and it assumes that federal law requires us to treat LLC owners as sole proprietors.

D. Resolution.

Pursuant to Gen. Laws 1956 § 42-35-15(g), the decision of the Board must be upheld unless it was, inter alia, contrary to law, clearly erroneous in light of the substantial evidence of record, or arbitrary or capricious. When applying this standard, the Court will not substitute its judgment for that of the Board as to the weight of the evidence on

questions of fact.[15] Stated differently, the findings of the agency will be upheld even though a reasonable mind might have reached a contrary result.[16] Accordingly, the Board's decision that claimant was eligible for benefits because he was laid off from his employment at M & M Concrete Floors LLC is well-supported by the evidence of record and should be affirmed.[17]

CONCLUSION

Upon careful review of the evidence, I recommend that this Court find that the decision of the Board of Review was not affected by error

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[15] Cahoone v. Board of Review of the Dept.of Employment Security, 104 R.I. 503, 506, 246 A.2d 213 (1968).

[16] Cahoone, supra n. 16, 104 R.I. at 506, 246 A.2d at 215 (1968). See also D'Ambra v. Board of Review, Department of Employment Security, 517 A.2d 1039, 1041 (R.I. 1986). See also Gen. Laws 1956 § 42-35-15(g), supra at 7 and Guarino, supra at 7, fn.4.

[17] My recommendation in this case should not be construed as a rejection of the Director's fundamental argument — that it is simply unfair for an LLC to file income taxes as an individual but participate as a corporation in the unemployment system. As the Department has noted, the LLC is therefore allowed to "have it both ways." But I have concluded that this equitable argument cannot supersede the statutory language quoted above. The Director's equitable argument is one which may well be found persuasive by the policy-making body of our state government — the General Assembly.

of law. Gen. Laws 1956 § 42-35-15(g)(3),(4). Further, it was not clearly erroneous in view of the reliable, probative and substantial evidence on the whole record or arbitrary or capricious. Gen. Laws 1956 § 42-35-15(g)(5),(6).

Accordingly, I recommend that the decision of the Board of Review be AFFIRMED.

/s/
Joseph P. Ippolito
MAGISTRATE
FEBRUARY 11, 2013

APPENDIX

28-42-3 Definitions. — The following words and phrases, as used in chapters 42 — 44 of this title, have the following meanings unless the context clearly requires otherwise:

…

(15) "Employer" means:

(i) Any employing unit that was an employer as of December 31, 1955;

(ii) Any employing unit which for some portion of a day on and after January 1, 1956, has or had in employment within any calendar year one or more individuals; except, however, for "domestic service employment", as defined in subdivision (13) of this section;

(iii) For the effective period of its election pursuant to § 28-42-12, any other employing unit which has elected to become subject to chapters 42 — 44 of this title;

(iv) Any employing unit not an employer by reason of any other paragraph of this subdivision for which, within either the current or preceding calendar year, service is or was performed with respect to which that employing unit is liable for any deferral tax against which credit may be taken for contributions required to be paid into this state's employment security fund; or which, as a condition for approval of chapters 42 — 44 of this title for full tax credit against the tax imposed by the Federal Unemployment Tax Act, 26 U.S.C. § 3301 et seq. is required, pursuant to that act, to be an employer under chapters 42 — 44 of this title;

…

(17)(i) "Employment," subject to §§ 28-42-4 — 28-42-10, means service, including service in interstate commerce, performed for waged or under any contract for hire, written or oral, express or implied; provided, that service performed shall also be deemed to constitute employment for all the purposes of chapters 42—44 of this title, if performed by an individual in the employ of a nonprofit organization as described in subdivision (24) of this section except as provided in § 28-42-8(7). **(ii)** Notwithstanding any other provisions of this section, "Employment" also means service with respect to which a tax is required to be paid under any federal law imposing a

tax against which credit may be taken for contributions required to be paid into this state's employment security fund or which as a condition for full tax credit against the tax imposed by the Federal Unemployment Tax Act is required to be covered under chapters 42—44 of this title;

…

(28) "Wages" means all remuneration paid for personal services on or after January 1, 1940, including commissions and bonuses and the cash value of all remuneration paid in any medium other than cash, and all other remuneration which is subject to tax under a federal law imposing a tax against which credit may be taken for contributions required to be paid into a state employment fund. …