

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM SOUTH CAROLINA
Workers' Compensation Commission

NOV 07 2016
SC Court of Appeals

Appellate Case No.: 2016-000617

Elias Reyna, ... Respondent,

v.

Fenerly Inc. / Tony's Place of Sumter LLC, Employer, and
Foremost Signature Insurance Co., Carrier, ... Appellants.

BRIEF OF RESPONDENT

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I. The Commission correctly concluded that Reyna was entitled to workers' compensation benefits as an employee of Tony's Place LLC.

This case presents the novel issue of whether a Limited Liability Company (LLC) is treated as a corporation or as a sole proprietorship/partnership under the Workers' Compensation Act. The Appellate Panel held "Under §42-1-130 Tony's Place of Sumter LLC is a corporation and the Claimant is an employee of this corporation." [R. p. 27, lines 9 - 10]. This conclusion is supported by the evidence and correct under the law. Appellants entire argument is based on mischaracterizing the LLC as a partnership and Reyna as a partner.

The Commission made three critical findings of fact to support its legal conclusions. The Commission found "It is undisputed that the Claimant was a minority shareholder in Tony's Place of Sumter LLC." [R. p. 10, lines 4 - 7]. In their briefs to this Court and the Appellate Panel, Appellants describe Reyna as a "business partner" in a partnership rather than a shareholder in an LLC. However, as Appellants state in their own brief to the Appellate Panel, the finding Reyna is a shareholder was not appealed and is the law of the case. [R. p. 19]. See, e.g., Hudson v. Lancaster Convalescent Ctr., 407 S.C. 112, 754 S.E.2d 486 (2014)("Under the law of the case doctrine, a party is precluded from re-litigating issues decided in a lower court order, when the party voluntarily abandons its appeal of that order.")

The Commission went on to find "Mr. Reyna was also an employee of Tony's Place of Sumter, LLC, pursuant to S.C. Code Annotated Section § 42-1-130." [R. p. 10, lines 8 - 19]. The Commission noted Reyna worked as a cook, made nightly bank deposits, was paid a weekly paycheck from which taxes were withheld, and was

subject to the control of Peter Peidis as to the “means of employment, hours, income, and all other conditions of employment.” [R. p. 10, lines 8 - 19]. See Willis v. Aiken County, 26 S.E.2d 313, 203 S.C. 96 (1943)(approving dual capacity doctrine that permits executive officers to recover under workers’ compensation if the officer engaged in “manual labor or the ordinary duties of a workman,” and holding a deputy sheriff was not only an administrator but also routinely performed manual labor when discovering and destroying illegal liquor operations; thus, deputy sheriff’s injury during such a raid was compensable). This finding is also critical, as it confirm Reyna was an employee of the LLC rather than an employer (such as a sole proprietor or partner). Thus, while Reyna had the option to opt out in his dual capacity as a shareholder, he did not have to opt in to be a covered employee.

The Commission also found “Mr. Reyna did not waive entitlement to workers compensation benefits as I find he did not sign the Corporate Officer Notice to Reject Form.” [R. p. 9]. This finding was appealed to the Appellate Panel, but abandoned on appeal to this Court. As such, it to is the law of the case. Hudson v. Lancaster Convalescent Ctr., 407 S.C. 112, 754 S.E.2d 486 (2014).

Respondents do not dispute the black letter law advanced by Appellants that a sole proprietor or partner is not an employee and therefore not automatically included within the protections of the Workers’ Compensation Act, unless he affirmatively elects to be covered. That is a an accurate statement of the law. The disagreement herein lies with the false premise that Reyna is a partner who must opt in. The Commission correctly found that he is both a shareholder in a corporation and an employee of that corporation. As such, the LLC was the employer; not Reyna.

He was presumptively covered as an employee of the corporate entity, with the right as a corporate officer to opt out of coverage. The argument that he is a partner required to opt in based on a false premise, essentially a straw man whose shadow is not found in the record.

A. The Commission correctly concluded that an LLC functions as a corporation for the purposes of the South Carolina Workers' Compensation Act [in response to Appellants' arguments A and B at pages 13-17].

The Commission concluded that Reyna was both a minority shareholder of the LLC and its employee. In so doing, it followed the dual capacity doctrine adopted in Willis v. Aiken County, 203 S.C. 96, 104-5, 26 S.E.2d 313, 316 (1943) (“executive officers of a corporation will not be denied compensation merely because they are executive officers if, as a matter of fact, at the time of the injury they are engaged in performing manual labor or the ordinary duties of a workman”). The Commission recognized the practical reality that while Reyna was nominally a shareholder and officer in the LLC, he actually worked as a cook at Tony’s Pizza, LLC. The Commission correctly recognized that an LLC is legally treated as a corporation under the Workers’ Compensation Act.

Appellants rely on a footnote in Hartzell for the proposition that an LLC is treated as a sole proprietorship or partnership for workers’ compensation purposes.

The footnote reads:

We exclude Stallings from this analysis because, although he worked for Employer as well as being the sole member of its limited liability company, the record does not indicate he elected to be included as an employee for workers' compensation purposes. See § 42-1-130 (“Any sole proprietor or partner of a business whose employees are eligible for benefits under this title may elect to be included as employees under the workers' compensation coverage of the business if they are

actively engaged in the operation of the business and if the insurer is notified of their election to be included.”).
Hartzell v. Palmetto Collision, LLC, 406 S.C. 233, 244 n.5, 750 S.E.2d 97, 103 n.5 (Ct. App. 2013).

Although the passage in Hartzell echoes the position argued by Appellants, it must be observed that the footnote is quintessentially dicta. Beach First Nat’l Bank v. Estate of Gurnham, 407 S.C. 194, 754 S.E.2d 875 (2014) (“statement [of the law within an opinion] constitutes dicta as it was in reference to an unpreserved appellate issue that did not serve as a basis for the Court’s decision.”). Thus, while perhaps instructive on the sentiment of the Court, it is not binding precedent. The Court made the statement in a footnote on an issue neither briefed nor argued by the Hartzell parties.¹

More importantly, the Commission made its decision in 2015 – two years after Hartzell was decided. The Commission thus was fully aware of the Court’s

¹ A review of the briefs in Hartzell shows the parties did not brief the issue of whether the members of an LLC counted as employees for jurisdictional purposes. As the issue was decided on evidence that Palmetto Collision had at least 4 other employees – none of whom were members of the LLC – a ruling was entirely unnecessary. The Court wrote the footnote *sua sponte* without input from the parties or the Commission.

In Hartzell, the corporate entity was a sole member LLC. Professor Larson has observed “Substantial, majority, and even sole stock ownership as such does not of itself defeat employee status. But when preponderant stock ownership is used so that the stockholder is for practical purposes the alter ego of the corporation, the compensation acts, which are inclined to be realistic rather than technical, will often disregard the corporate entity and treat the stockholder as the employer.” 76-7 A. Larson, *The Law of Workmen’s Compensation* § 76.03 (2013). This may have been the theory adopted by the Court. The instant case is different, in that Reyna was a minority shareholder subject to the complete control of Peidis, thus making him an employee with Peidis as the *de facto* employer (the LLC was the *de jure* employer). Furthermore, there is no basis in our law for disregarding the corporate entity as corporate officers are presumptively employees who must affirmatively opt out per the statute. S.C. Code Ann. § 42-1-520 (2007).

opinion, yet still decided this case differently. Cf. Wigfall v. Tideland Utilities, Inc., 354 S.C. 100, 111, 580 S.E.2d 100, 105 (2003)(noting the “Legislature is presumed to be aware of this Court’s interpretation of its statutes”). Their interpretation is consistent with the mandate to interpret the Act liberally to favor inclusion over exclusion.² The Commission is intimately familiar with the statutes and regulations under which it functions. The Court should defer to the Commission’s interpretation of the statute as “The construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons.” See, e.g., Sparks v. Palmetto Hardwood, Inc., 406 S.C. 124, 750 S.E.2d 61 (2013).

The inclusion of an LLC as a corporation is consistent and fits logically within the structure of the Workers’ Compensation Act. The Act does not address limited liability companies by that term, as the relevant statutes were written before South Carolina adopted the Uniform Limited Liability Company Act in 1996. S.C. Ann. § 33-44-101 et seq. (1996). Sole proprietorships, partnerships and corporations are the traditional forms of business. The LLC Act was passed to allow smaller

² “The general policy in South Carolina is to construe the Workers’ Compensation Act in favor of coverage, and any reasonable doubts as to construction should be resolved in favor of the claimant. . . . Where employer and employee are subject to the compensation act, . . . injured employee should not be excluded from the benefits of the law upon the ground that the accident did not arise out of and in the course of his employment when there is substantial doubt (arising from the proven facts) of the propriety of such conclusion. . . .These words are construed broadly and should continue to be so construed. Common sense indicates that a compensation law passed to increase workers’ rights (because their common law rights were too narrow) should not thereafter be narrowly construed.” Pierre v. Seaside Farms, Inc., 689 S.E.2d 615, 386 S.C. 534 (2010)(internal citations and quotation marks omitted).

businesses to benefit from the corporate entity without being hidebound by the added complexity of traditional corporate formalities.

The Workers' Compensation Act treats the self-employed individuals who comprise sole proprietorships and partnerships as employers. A corporation – because it has an independent existence – is treated as an employer. See S.C. Code Ann. § 42-1-40 (2007). Corporate managers and officers are necessarily employees of the corporation, thus cannot themselves be considered employers. The Act grants a degree of flexibility to business owners – allowing sole proprietors and partners to opt in to coverage and allowing corporate officers to opt out. S.C. Code Ann. § 42-1-130 (2007); § 42-1-520 (2007).

As to partnerships, the individual partners are considered employers (as a sole proprietor is considered an employer) because they are self-employed individuals. It is for this reason South Carolina and virtually every other state holds that “working partners” cannot be employees. Our courts recognize “that section 42-1-130 creates a narrow exception to the general rule by allowing an independent contractor or subcontractor [or sole proprietor or partner] to become an ‘employee’ by electing coverage under his business’s workers’ compensation benefits.” Smith v. Squires Timber Co., 311 S.C. 321, 428 S.E.2d 878 (1993). Allowing a partner to opt in as an “employee” is a legal fiction designed to expand coverage to as many workers as possible.

The federal government follows the same rules defining partners as self-employed individuals rather than as employees:

Bona fide members of a partnership are not employees of the partnership within the meaning of the Federal Insurance

Contributions Act, the Federal Unemployment Tax Act, and the Collection of Income Tax at Source on Wages . . . Such a partner who devotes his time and energies in the conduct of the trade or business of the partnership, or in providing services to the partnership as an independent contractor, is, in either event, a self-employed individual rather than an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.³

Revenue Ruling 69-184, 1969-1 C.B. 256.

State and federal law confirm that Reyna is an employee of a corporate entity – not a partner in a partnership.

Appellants “contend the only evidence in the record supports a finding of fact that Tony’s Place of Sumter, LLC is a partnership.” [Brief of Appellants, p. 6]. Appellants are mistaken – both on the facts and the law.

Partnership is a term of art – defined in common law and statute. The term cannot be slung around as loosely as Appellants desire. Under the common law, a partnership is a “voluntary contract between two or more competent persons to place their money, effects, labor, and skill, or some or all of them, in lawful commerce or

³ Federal common law rules for determining if a worker is an employee or an independent contractor are similar to South Carolina common law, with the focus on the employer’s right of control. The federal courts examine the following five factors: (1) the extent of the employer’s control and supervision over the worker, including directions on scheduling and performance of work, (2) the kind of occupation and nature of skill required, including whether skills are obtained in the workplace, (3) responsibility for the costs of operation, such as equipment, supplies, fees, licenses, workplace, and maintenance of operations, (4) method and form of payment and benefits, and (5) length of job commitment and/or expectations. Of several factors to be considered, the employer’s right to control is the most important when determining whether an individual is an employee or an independent contractor. See, e.g., Knight v. United Farm Bureau Mut. Ins. Co., 950 F.2d 377, 379 (7th Cir. 1991). South Carolina uses a similar test, albeit with four factors which determine the right of control: 1) direct evidence of the right or exercise of control; 2) furnishing of equipment; 3) right to fire; and 4) method of payment. Wilkinson ex rel. Wilkinson v. Palmetto State Transp. Co., 382 S.C. 295, 676 S.E.2d 700 (2009).

business, with the understanding that there shall be a proportional sharing of the profits and losses between them.” Black’s Law Dictionary 1120 (6th ed. 1990). The statutory definition states: “A ‘partnership’ is an association of two or more persons to carry on as co-owners a business for profit and includes, for all purposes of the laws of this State, a registered limited liability partnership.” S.C. Code Ann. § 33-41-210 (1994). For purposes of this case, the more important definition specifies what is *not* a partnership, to wit: “[A]ny association formed under any other statute of this State . . . is not a partnership under this chapter . . .” Id. As Tony’s Place of Sumter, LLC was formed under the Uniform Limited Liability Company Act, it manifestly is *not* a partnership.

The record confirms that this particular LLC is not a partnership, nor is it tantamount to a partnership. The Articles of Organization list both Peidis and Reyna as “organizers” of the limited liability company known as “TONY’S PLACE OF SUMTER LLC.” [R. p. 187]. The BUSINESS PURCHASE AGREEMENT refers to Peidis as Seller and Reyna as Buyer of “a restaurant business for eat-in and take-out food known as Tony’s Place of Sumter, LLC. . .” [R. p. 190, lines 7 - 8]. Neither document uses the term partner or partnership, nor can either be construed to refer to a partnership under some other name.

As to the workers’ compensation policy, the parties – including the Carrier – treated Tony’s Place LLC as a corporation. The Carrier’s agent requested and obtained “Corporate Officer Notice to Reject” forms from Peidis. [R. p. 205]. When the policy was issued, it contained an endorsement purportedly excluding Elias

Reyna as an “Excluded Executive Officer.”⁴ [R. p. 173]. There is nothing in the policy indicating the agent or the carrier viewed the LLC as a partnership requiring the “partners” to affirmatively opt in to coverage. The Court should not lightly reject the intent of the Employer and Carrier in insuring the LLC as a corporation.

Appellants’ primary legal argument for treating an LLC as a partnership is to look at the LLC’s tax status. Specifically, Appellants argue “Tony’s Place LLC is a domestic LLC – an entity created by state statute – that is classified as a partnership for federal income tax purposes when, as in this case, no Form 8832 has been produced that indicates an affirmative request for treatment as a corporation.”⁵ [Brief of Appellants, pp. 15 - 16]. Appellants mix up the distinction between a legal entity (LLC and corporation) and a tax entity (sole proprietor/partnership versus C-corporation versus S-corporation). A tax entity classification is simply the way the IRS (and the Department of Revenue) taxes the entity. The legal entity classification is how everybody else (i.e. courts, state, contractual partners) treats the entity. A corporation (legal entity) is assigned a corporation (C-corporation or S-corporation)

⁴ The agent who sold the policy, Byron Kinney, testified “[The Notice to Reject form] is not necessary. It’s just we’ve always done it in our agency as an extra layer of protection for an insured, to have the *officer* sign the form to say they are choosing to be excluded even though they are automatically included.” [R. p. 124, line 18 - p. 125, line 4 (emphasis added)]. This self-serving statement was made at a deposition when Kinney was fully aware of the issue at stake, as well as the difficulty the policy created for the carrier. Kinney’s unqualified opinion testimony was properly disregarded by the Commission and played no role in the decision below.

⁵ The interesting side note to this argument is that the logical extension that if an LLC elects to be taxed as a corporation, then it becomes a *de jure* corporation for workers’ compensation. In any event, there is no evidence in the record regarding the tax status of Tony’s Place of Sumter LLC. Presuming the LLC elected to be taxed as a partnership would be speculation.

designation as a tax entity. An LLC (legal entity) can elect its tax entity. An LLC can elect to be taxed as a sole proprietor/partnership, as a C-corporation, or as an S-corporation. As there is no true LLC specific tax entity, an LLC is assigned one of the traditional business designations. In this sense, an LLC has greater flexibility and can choose the tax identity that most benefits its members. It does not alter the overriding fact that an LLC is not a sole proprietorship or partnership. An LLC is a corporate entity.

An LLC is considered a corporation under the Act because it has the characteristics of a corporation – most particularly that is a corporate entity which employs employees and can conduct business only through its employees. An LLC has an independent legal existence with the capacity to sue and be sued in its own name. Conversely, a partnership has no legal capacity to sue or be sued in its own name, thus to properly commence a suit the individual partners as well as the partnership must be named. See Marvil Properties v. Fripp Island Development Corp., 273 S.C. 619, 258 S.E.2d 106 (1979). LLC shareholders receive the protection of limited liability – the same protection enjoyed by shareholders of traditional corporations. In virtually every aspect, our courts describe an LLC as a “corporate entity” and treat it as a corporation.⁶

⁶ See, Eg., Hansen v. Fields, 409 S.C. 541, 763 S.E.2d 31 (2014)(characterizing an LLC as a “corporate entity” and holding “[b]ecause a corporation is not liable for preformation acts of its promoter, [promoter of LLC] cannot be liable in tort for . . . preformation acts.”); Dutch Fork Dev. Group II, LLC v. SEL Props., LLC, 406 S.C. 596, 753 S.E.2d 840 (2012)(referencing law of corporations to determine whether manager of an LLC could be held individually liable for a claim of tortious interference with a contract); Oskin v. Johnson, 400 S.C. 390, 735 S.E.2d 459 (2012)(analysis of evidentiary requirement to “pierce the corporate veil” of a limited liability company).

Respondent does not dispute Appellants' recitation of the law as it applies to sole proprietorships and partnerships. The central dispute is over Appellants repeated mischaracterization of this LLC as a "partnership" and Reyna a "partner." No matter how many times Appellants repeat the phrase "Claimant Reyna was a business partner," the fact remains he was an employee of the LLC.

B. The Commission correctly concluded Reyna was an employee and shareholder who did not and could not opt out of coverage. [in response to Appellants' argument C at pages 17-19].

Appellants argue that Reyna was a partner who did not opt in to coverage, such that he should be excluded. As discussed in Part B, Appellants' premise is fundamentally wrong. Reyna was both a minority shareholder of the LLC (a corporation) and its employee.

As an additional sustaining ground, the Court should consider the position in which Reyna was placed. He had worked as a cook for Tony's Place LLC when the restaurant opened in 1999. Reyna was primarily a Spanish speaker with limited English and minimal business sophistication.

On April 3, 2012, Peides and Reyna signed the Articles of Organization creating Tony's Place of Sumter LLC. [R. pp. 187 - 188]. On April 24, 2012, Reyna signed the Business Purchase Agreement wherein he became a 30% shareholder of the LLC. None of these documents would lead him to believe that he was entering into a partnership nor would they inform him that he was giving up his right to workers' compensation coverage.

He apparently never saw the actual workers' compensation policy. It is an undisputed fact that Reyna never read or signed the "Corporate Officer Notice to Reject" form. [R. p. 205].

In terms of his duties, Reyna simply continued to work as a cook – and perhaps an operational manager of Tony's Pizza of Sumter. There is no evidence he had anything to do with the business or financial side of the LLC. In fact, he continued to be paid a salary. [R. pp. 197 - 202]. There is no evidence he received a draw or distribution in addition to his pay for working in the restaurant.

In short, even as a minority shareholder, Reyna continued to the same cooking job he had always done. He never knew Peidis took steps to remove him from the workers' compensation policy and certainly had no choice in the matter.

Unless Reyna knew of and agreed to a new employer-employee relationship, replacing the one theretofore existing with Tony's Pizza LLC, his rights under the Worker's Compensation Act against were unabridged. See Chavis v. Watkins, 256 S.C. 30, 180 S.E.2d 648 (1971); Addison v. Dixie Chevrolet Co., 246 S.C. 86, 142 S.E.2d 442 (1965). "Employment, like any other contract, presupposes understanding. The new relation cannot be thrust upon the servant without knowledge or consent." Holloway v. G. O. Cooley & Sons, 208 S.C. 234, 243, 37 S.E.2d 666, 670 (1946). Although Reyna bought into the LLC, there is no evidence he was informed that he would no longer be a covered employee of the LLC. The Commission found Reyna had not signed the Corporate Officer Election Form – instead finding that it had not been presented to him and his putative signature had

been forged. See S.C. Code Ann. § 42-1-620 (2007)(“No agreement by an employee to waive his rights to compensation under this title shall be valid.”)

Therefore, Reyna remained a covered employee of Tony’s Pizza of Sumter LLC. The Decision and Order of the Commission should be affirmed.

II. The Commission correctly concluded that Reyna was an employee of Tony’s Place LLC [in reply to Appellants’ arguments at pages 19-20].

Appellants argue that it was inconsistent and contrary to South Carolina law for the Commission to find “that Claimant Reyna was somehow both a business partner [sic] and an employee of Employer.” [Brief of Appellants, p. 20]. Appellants overlook the fact that our Supreme Court long ago recognized the dual capacity doctrine specifically recognizing that a shareholder of a corporate entity is considered an employee when doing the work of the corporation. See Willis v. Aiken County, 203 S.C. 96, 104-5, 26 S.E.2d 313, 316 (1943)(“executive officers of a corporation will not be denied compensation merely because they are executive officers if, as a matter of fact, at the time of the injury they are engaged in performing manual labor or the ordinary duties of a workman”). As they have throughout this case, Appellants persist in mischaracterizing Reyna as a “partner” in a “partnership” when the unappealed finding of the Commission was that he is a shareholder in an LLC. [R. p. 10, lines 4 - 7].

Although not directly appealed by Appellants, the evidence overwhelmingly confirms the Commission correctly found that Reyna worked as a cook, made nightly bank deposits, was paid a weekly paycheck from which taxes were withheld, and was subject to the control of Peter Peidis as to the “means of employment, hours, income,

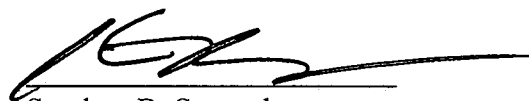
and all other conditions of employment.” [R. p. 10, lines 8 - 19]. These factors all weigh heavily towards confirming that Reyna was an employee of the LLC. See Wilkinson ex rel. Wilkinson v. Palmetto State Transp. Co., 382 S.C. 295, 676 S.E.2d 700 (2009).

The decision below should be affirmed.

CONCLUSION

Public policy confirms that the result reached by the Commission was the correct one. Our law favors inclusion over exclusion. The Commission recognized that the newer business form of an LLC was equivalent to a corporation under the Workers' Compensation Act – as did the Employer and Carrier in contracting for insurance coverage. The Commission's wise decision should be affirmed by this Court.

Respectfully Submitted,



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CERTIFICATE OF COUNSEL

The undersigned certifies that this Final Brief of Respondent complies with
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