

NO. A11-1307

4

STATE OF MINNESOTA
IN COURT OF APPEALS

BUILDERS COMMONWEALTH, INC.

RELATOR,

v.

DEPARTMENT OF EMPLOYMENT AND ECONOMIC DEVELOPMENT,

RESPONDENT.

RELATOR'S BRIEF AND ADDENDUM

Michael E. Orman #127498
Orman Nord & Hurd P.L.L.P.
1301 Miller Trunk Highway, Suite 400
Duluth, MN 55811
218-722-1000
Attorney for Relator

Lee B. Nelson #77999
1st National Bank Building
332 Minnesota Street, Suite E200
St. Paul, MN 55101-1351
651-259-7117
Attorney for Respondent-Department

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

TABLE OF CONTENTS

	<u>Page</u>
Table of Authorities	ii
Statement of the Legal Issues	1
Statement of the Case	2
Statement of the Facts	2
A. Builders’ advances to members are “loans” at the time paid.	7
B. Builders’ economic realities	13
C. The Auditors did not examine Builders’ documents that would have shown that Builders’ advances are <i>not</i> wages.	16
Argument	18
Standard of Review	18
I. The Unemployment Law Judge erred in concluding that all members of the worker cooperative, Builders Commonwealth, are construction workers and employees of Builders Commonwealth, pursuant to Minnesota Statutes Sections 268.035, subdivision 9a, and 181.723, and that therefore Builders Commonwealth is an employer pursuant to Minnesota Unemployment Insurance Law.	20
A. Members of worker cooperatives are not employees.	20
B. It was an error of law to conclude that Builders’ advances (draws) against future patronage dividends, designated as loans at the time paid, are wages. ...	22
C. It was an error of law to apply Section 181.723 to Builders’ members.	32
D. It was an error of law to apply Section 181.723 to Builders’ members who do not perform building construction and improvement.	34
E. It was an error of law to apply Section 181.723 to Builders’ members to determine their classification effective before January 1, 2009.	39
F. It was an error of law to conclude that DEED was not precluded from re-litigating the issue of Builders’ status.	42
Conclusion	44
Addendum	
Appendix (separately bound)	

TABLE OF AUTHORITIES

	<u>Page</u>
<u>Abdi v. DEED</u> , 749 N.W.2d 812 (Minn. App. 2008).	18, 19
<u>Assoc. Reforestation v. State Workers' Comp. Bd.</u> , 650 P.2d. 1068 (Ore. 1982).	26
<u>Blue & White Taxi v. Carlson</u> , 496 N.W.2d 826 (Minn. App. 1993).	2, 36
<u>Chatfield v. Henderson</u> , 90 N.W.2d 227 (Minn. 1958).	19
<u>Dahlberg Hearing Systems, Inc. v. Comm'r</u> , 546 N.W.2d 739 (Minn. 1996).	19
<u>Dorman v. Bayley</u> , 10 Minn. 383 (Minn. 1865).	19
<u>Dorn v. Peterson</u> , 512 N.W.2d 902 (Minn. App. 1994).	42
<u>Employment Div. v. Surata Soy Foods Inc.</u> , 662 P.2d 810 (Ore. App. 1983).	25-28
<u>Frieler v. Carlton Marketing Group, Inc.</u> , 751 N.W.2d 558 (Minn. 2008).	37
<u>Goldberg v. Whitaker House Co-op., Inc.</u> , 366 U.S. 28 (1961).	2, 28-30, 37
<u>Graham v. Special School District No. 1</u> , 472 N.W.2d. 114 (Minn. 1991).	42
<u>Isthmus Eng. & Mfrg. Coop.</u> , S9600250MD (Wisc. L&I Comm'n 1998) (available at http://dwd.wisconsin.gov/lirc/ucdecns/201.htm).	27-29
<u>J.C. Penney Co., Inc. v. Comm'r of Econ. Sec.</u> , 353 N.W.2d 243 (Minn. App. 1984).	18
<u>Martin Homes, Inc. v. Brown</u> , 361 N.W.2d 100 (Minn. App. 1985).	18
<u>Meyers v. Postal Finance Co.</u> , 287 N.W.2d 614 (Minn. 1979).	22
<u>Nelson v. Levy</u> , 796 N.W.2d 336 (Minn. App. 2011).	2, 35-38
<u>Rucker v. Schmidt</u> , 794 N.W.2d 114 (Minn. 2011).	2, 43

Minn. Stat. §181.723	1, 2, 20, 32-39
Minn. Stat. §268.03	41
Minn. Stat. §268.035	1, 2, 13, 20-27, 31-41
Minn. Stat. §268.043	24, 36
Minn. Stat. §268.044	24
Minn. Stat. §268.07	24, 25
Minn. Stat. §268.057	19
Minn. Stat. §268.105	1, 20
Minn. R. 3315.0210	33
Minn. R. 3315.0555	36-38
Office of the Legislative Auditor, <u>Misclassification of Employees as Independent Contractors</u> , (Nov. 2007)	32
Unemployment Insurance Advisory Council Bill: House Conference Committee Report on S.F. 167 (H.F. 648), Art. 4: “Administrative Rules Incorporated into Statutes,” 85 th Leg. (May 18, 2007).	33
G. Mitu Gulati et al., <u>When a Workers’ Cooperative Works: The Case of Kerala Dinesh Beedi</u> , 49 UCLA Law Review 1417 (2002).	20
David Ellerman & Peter Pitegoff, <u>The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts</u> , 11 N.Y.U. Rev. L. & Soc. Change, 441 (1982-83).	20

STATEMENT OF THE LEGAL ISSUES

- I. Did the Unemployment Law Judge err in concluding that all members of the worker cooperative, Builders Commonwealth (“Builders”), are construction workers and employees of Builders, pursuant to Minnesota Statutes Sections 268.035, subdivision 9a, and 181.723, and that Builders is an employer pursuant to Minnesota Unemployment Insurance Law effective January 1, 2006?

In the appeal to the Department of Employment and Economic Development (“DEED”), the issue was whether the workers are employees or independent contractors or members of a cooperative which are not considered employees for purposes of the Minnesota unemployment insurance law. (T.26, App-106). The principal arguments raised in the appeal to DEED were the following: a) advances paid to Builders’ members, which are expressly designated as “loans” that members are contractually obligated to pay back (and have been required to pay back for the last four years), and which are designated as loans on the cooperative’s books at the time of payment, are *not* “wages” pursuant to Minn. Stat. §268.035, subd. 29 (e); b) as a *bona fide* cooperative, the members of Builders are neither employees nor independent contractors as contemplated by Minn. Stat. §181.723, subds. 3 and 4; and c) DEED is precluded from re-litigating Builders’ status by a 1991 decision in which the Department of Jobs and Training (DEED’s predecessor) concluded that the “remuneration” (advances) paid to members was not wages and that Builders was not an employer. Unemployment Law Judge Richard Croft concluded that members of Builders are employees of Builders and that Builders is an employer pursuant to Minnesota Unemployment Insurance Law. Builders requested reconsideration of the decision pursuant to Minnesota Statutes Section 268.105.

The most apposite cases and statutory provisions are the following:

Nelson v. Levy, 796 N.W.2d 336 (Minn. App. 2011).

Goldberg v. Whitaker House Co-op., Inc., 366 U.S. 28 (1961).

Blue & White Taxi v. Carlson, 496 N.W.2d 826 (Minn. App. 1993).

Rucker v. Schmidt, 794 N.W.2d 114 (Minn. 2011).

Minn. Stat. §268.035, subd. 29 (e). “Wages includes advances or draws against future earnings, when paid, unless the payments are designated as a loan or return of capital on the books of the employer at the time of payment.”

Minn. Stat. §181.723, subs. 3 and 4.

STATEMENT OF THE CASE

On December 6, 2010, the Department of Employment and Economic Development (“DEED”) issued a determination that members of Builders Commonwealth (“Builders”) are employees and that unemployment insurance taxes were owed effective January 1, 2006, with past due taxes and penalties for 2006-2010 in the amount of \$299,733. Builders appealed, and the issue litigated was whether members of Builders are distinct from both employees and independent contractors. The decision by Unemployment Law Judge (“ULJ”) Richard Croft, dated May 3, 2011, concluded that members are employees of Builders and that Builders is an employer pursuant to Minnesota Unemployment Insurance Law. Builders requested reconsideration of the decision. By order dated June 20, 2011, the ULJ Richard Croft affirmed the decision.

STATEMENT OF THE FACTS

Builders was organized as a cooperative under Chapter 308 in 1978 under the name “Builders and Laborers Commonwealth Cooperative Ass’n.” (Doc 17260, App-3) In 1981 they changed the name to “Builders Commonwealth, Inc.” (Doc 441202, App-57)

In 2005 Builders filed amended articles of incorporation under Chapter 308A, which governs cooperatives. (2005 Amd., App-1) Each year they renew their registration as a “Domestic Cooperative.” (Doc 0162182, App-51) Builders is a “worker” cooperative in which the member-workers have exclusive governance rights and exclusive rights to (and liabilities for) the cooperative’s earnings and losses.

The issue of Builders’ status as an entity to which Chapter 268 (Minnesota’s Unemployment Insurance Law) does *not* apply was decided in October 1991 by the Commissioner of the Department of Jobs and Training. (1991 Decision, Add-78) The Department of Jobs and Training (now known as DEED¹) issued a joint decision that the advances paid to Builders’ members are *not* wages and that Builders is *not* an employer subject to the Minnesota Jobs and Training law (Chapter 268). (Add-78) The decision was filed as Appeal No. 644 T 90 and the companion Appeal No. 493 T 90. (Add-78)

The Referee/ULJ had stated the joint issue as follows:

...[t]here are...two matters to be considered here. First is the actual working relationship between the Claimant and the Employer and then the issue of whether or not the Employer’s status as a cooperative exempts the Employer from coverage under the Minnesota Jobs and Training Law or ... or whether the Claimant should be considered not eligible for benefits on the basis of his ... of his membership in the cooperative and so that it should be considered that he’s self-employed.

(1991 T.11, App-78) The Commissioner’s Representative found that there was *no* employee-employer relationship between Builders and the claimant and that the monies

¹ The Dept. of Jobs and Training was restored to its original name, the Dept. of Economic Security, in 1994, and in 2003 it was merged with the Dept. of Trade and Economic Development to create the Dept. of Employment and Economic Development.

paid the member (advances) were not wages for unemployment tax and benefit purposes.

The 1991 Decision states the following:

The decision of the Referee in Appeal No. 493 T 90 has been reversed by a decision of the Representative of the Commissioner, dated the same day as this decision [644 T 90]. That decision [493 T 90] held that there was *no employer-employee relationship* between the claimant and the employer, and *remuneration paid to the claimant by the employer does not constitute wages* under the Minnesota Jobs and Training Law for unemployment tax and benefit purposes.

(1991 Decision, Add-78) (emphasis added). In the Memorandum appended to the Decision, the Commissioners' representative further stated that:

In a companion decision, Appeal No. 493 T 90, involving the present parties, we have reversed the decision of the Referee. We found in that decision [493 T 90] that there was no employer-employee relationship between the claimant and the above-named employer. Therefore, benefit charges in the amount of \$7.71 for earnings paid the claimant were not properly charged to the employer's account for the second quarter of 1990. Therefore, the decision of the Referee in the present matter [644 T 90] is also hereby reversed.

(Add-79) The Decision is stamped as being mailed October 4, 1991. On October 14, 1991, the Department of Jobs and Training mailed a notice to Builders that summarized the joint decision as follows:

On October 4, 1991, a decision was issued by a representative of the Commissioner in Appeal No. 493 T 90 which reversed our determination that you have been in an employer-employee relationship with Bruce Ripley, SSA# The representative further decided that you are not an employer subject to the provisions of the Minnesota Jobs and Training Law.

(Notice, Add-80) Four years earlier, the Department of Labor and Industry had also determined that Builders' members were *not* employees for purposes of workers' compensation. (Aug 11, 1987, DLI, Add-81) The decision states the following:

From our investigation of Builders and Laborers Commonwealth, it is our determination that the voting members are partners of the co-op and have joint and several liability for obligation of the co-op; therefore, workers' compensation is not required. However, it is also our determination that the non-voting members are employees of the co-op and workers' compensation insurance is required for the non-voting members.

The conclusion that the voting members are partners in a joint venture while the non-voting members are employees of Builders and Laborers Commonwealth was based on our investigation, Commonwealth's records, interview with Commonwealth's personnel and consultations with attorneys concerning the relevant elements of a partnership, which the predominant element is the right of control of the business.

(Add-81)

Builders' operations have not materially changed since 1991. (T.42, App-122) For example, the testimony in the joint hearing on Appeals 493 T 90 and 644 T 90 shows that in 1991 members were paid advances designated as loans on anticipated annual patronage distributions and that they were required to pay back advances that exceeded their actual patronage distribution. (1991 T.34-36, App-101-103) In the 1991 hearing, Arno Kahn described the procedures outlined in the bylaws for members to "reimburse the co-op for monies over advanced...." (1991 T.34-36, App-101-103) Kahn also testified as to how Builders' earnings were divided among the members:

We have a personnel committee made up and elected by the members that engages in the ongoing review of the skills and productivity of the membership. And this includes all the members. And the relative value of the labor units that the members put in is adjusted by that committee and they, of course, solicit information from the other members. It's basically a consensual process where the member who's being reviewed and the other members relative to each other try to determine a fair rate relative to the skills and capabilities of the other members. That distribution is taken into our total earnings,And at the end of the year, we divide all those labor units out and determine a patronage distribution for all the members.

(1991 T.34, App-101)

In the 1991 hearing, Bruce Ripley, the claimant and former member of Builders, testified that the payments he received were loans, as follows:

I received a draw rate or a monetary compensation based on the work I did per hour, which is considered a loan or a draw subject to adjustment at the end of the fiscal year depending on whether there was a profit or a loss at the business.

(1991 T.12-13, App-79-80) Ripley also testified that he had understood when he became a member of Builders that he was joining a cooperative and would share liability for losses as well as profits. His testimony was the following:

...I had complete understanding that I was joining a group of individuals who believe in working in a cooperative, collective manner for the good of all the people in the organization. That I was self-employed. I carried...I was required to have my own liability insurance. I had my own health insurance. I had my own .. most of my own tools. The ... I had my own bench that I built that I worked on. I also understood that there were risks involved. That there was a possibility of ... of loss and also of sharing in the profits.

(1991 T.15, App-82) Ripley also testified that he had entered into the Membership Agreement (1991 T.17, App 84), and had been required to pay back over advances. The testimony was the following:

- Q. ... In this particular case it's a letter dated ... September 8th, 1989 from Arno Kahn for the management committee indicating that there was a loss and that the loss was going to need to be paid back.
- A. Correct.
- Q. Actually, it wasn't as much a loss as it was an over payment of monthly allowances, is that correct?
- A. Correct.
- Q. So in this particular letter it also sets forth a method of repayment to Builders Commonwealth the amounts that are due from each individual member.

A. Yes.

Q. And you earlier indicated that the method of the way that you get money every month from the Commonwealth was some set estimate of what you should get out of it at the end of the year depending on whether or not they made a profit.

A. Correct.

Q. Or there was enough money left over to pay everyone what they got on a bi-weekly basis.

A. Yes.

(1991 T.21-22, App-88-89) Ripley testified that the basis for his claim for unemployment benefits was that he had been employed by the Jamar company and that it was *not* based on being a member of Builders. (1991 T.23, App-90)

The 1991 decision by the Department of Jobs and Training (now DEED) and the earlier 1987 decision by the Department of Labor and Industry had both concluded that Builders was *not* an employer. The 1991 decision recognized that the advances were not wages, and the 1987 decision recognized that members are comparable to partners in a joint venture with the right of control of the business. Builders relied on these decisions and the fact that its operations—especially its advances to members designated as loans—had not changed, and did not register as an employer with DEED.

A. **Builders' advances to members are "loans" at the time paid.**

At the time of the audit by DEED in 2010, there were approximately 33 active members. (Member List, App-52) The member list shows an hourly "draw rate" for each member. (App-52) This "draw rate" is an advance on the member's anticipated annual patronage distribution. Pursuant to Minnesota Statutes Section 308A.705, "Distribution of income," Builders distributes its net income to its members on the basis of patronage

annually. To provide the members with income throughout the year, it pays members advances (or “draws”) against their anticipated annual patronage distribution. The advances are designated as loans, and the members are contractually obligated by their Membership Agreement and Builders’ Bylaws to repay any advances that exceed their annual patronage dividend.

Builders’ Membership Agreement expressly states that the bi-weekly “advances of money” the member receives are “in the nature of *loans*” that they must pay back if the member’s advances exceed the member’s share of the cooperative’s annual earnings (i.e. annual patronage dividend). Paragraph 5 of the Membership Agreement states the following:

Advances of money, or property made to me by the association out of estimated or actual revenues of the association during any fiscal accounting period of the association and before a final audit of the books and records for said period shall constitute advance payments of my share of the association revenues, **in the nature of *loans***, and as a set-off against my share of the association earnings.

(Membership Agreement, ¶5, Add-83) The Membership Agreement also states that “All members share the losses as well as the revenues of the association on a *prorata* basis according to work contributed and that the work value of members may, but need not be equal.” (Mem. Agmt. ¶3, Add-83) The members’ advance rates are determined by the personnel committee, which is comprised of two members elected by the membership. (T.37 & 43, App-117 & 123) The payments to members are estimates of what each member should get at the end of the year. Thus, by receiving advances, the members are borrowing against their end-of-year patronage dividend.

The second sentence in Paragraph 5 of the Membership Agreement specifies that payments are distributions from the cooperative. It states the following:

Any balance due me will be paid to me as a patronage dividend after the close of said fiscal year of the association as a "Qualified Written Notice of Allocation" in accordance with the provisions of Subchapter T of the U.S. Internal Revenue Code.

(Mem. Agmt. ¶5, Add-83) Builders' finance manager at the time of the 2010 audit by DEED, John Thomas, testified that the money Builders' members receive is reported on the IRS 1099-PATR Form, Taxable Distributions Received from Cooperatives. (T.52, App-132) The example 1099-PATR for John Thomas shows "patronage dividends" of \$32,979.07. (1099-PATR, App-142) This patronage distribution obviously includes the advances he received during the year and is not a bonus of excess profits. The advances are not paid on anticipated revenue from each project that the member is working on and are not designated as "overhead." (T.35, App-115) Rather, the advances are paid on the anticipated annual patronage distribution. (T.35, App-115) The annual patronage dividend is based on "productivity," i.e. the "number of hours you worked in that fiscal year." (T.50, App-130) If the member's advances are more or less than the final calculated annual patronage dividend at the end of the fiscal year and the member is due more or less money, this is *not* a "bonus" based on the profitability of the cooperative in addition to the hourly advances, but rather it is the equitable distribution of earnings as outlined in the bylaws of the cooperative. The ULJ found that "profits (losses) are added (or deducted in the case of losses) to the pay of the members on a prorata basis." (5-3-11 Decision, p. 2, Add-4) This is inaccurate and incomplete.

In the Membership Agreement, each member expressly agrees to “repay” any advances that exceed the revenues. The third sentence of Paragraph 5 of the Membership Agreement states the following:

In the event that said advances during any fiscal year shall exceed the share of the association revenues to which I [am] entitled, *I agree that I will repay such excess* to the association at the times and in the manner as the Board of Directors of the association shall determine.

(Mem. Agmt., ¶5, Add-83) For fiscal years 2007 through 2010, the advances have exceeded the actual patronage dividends (profits), and members have been required to pay back the over advances. (T.50-54, App-130-134; Minutes, Add-84, 85, 87) Members are given the option of paying the entire amount at the end of the fiscal year or having a portion deducted from their advances in the coming year until the over-advance is paid off. (T.51, App-131) If a member leaves Builders, they are still obligated to pay back any outstanding over-advance. (T.53, App-133) Members accumulate equity in the cooperative. (T. 53, App-133) For a member who leaves Builders, the outstanding balance owed to Builders on the advance pay-backs is deducted from the member’s equity account before the member receives any distribution of the equity, and half of the balance of the equity account is retained until the end of the fiscal year to cover any over-advance in the year that they leave Builders. (T.54, App-134; see also “Account Detail Report,” Add-89)

Collection actions have been brought successfully by Builders to enforce the repayment of the over advances, i.e. the “loans,” by persons who were no longer members. The collection actions were referenced in the Minutes dated October 28, 2009,

as follows: "Collections have begun for past member debts owed to BCI." (Minutes 10-28-09, Add-85) In 2009, Builders commenced four actions in conciliation court against former members to enforce the Membership Agreement requiring members to pay back advances on anticipated distributions that exceeded the cooperative's earnings. (Court Docs., App-29-36) Two of the actions resulted in the parties entering into settlement agreements entered on the record, and two of the actions resulted in default judgments in favor of Builders. (See App-29-36)

In addition to Builders' Membership Agreement, the following provisions of Builders' Bylaws require members to pay back advances that exceed their patronage distribution: "Refund of Member's Equity Balance. Any equity that a member has in Builders Commonwealth will be paid in two parts. One half of a member's equity balance will be disbursed 30 days after membership termination. The initial payment will be reduced by all debts owed to Builders Commonwealth by the departing member. These include but are not limited to member accounts receivables, loans and advances." (Art. IX §6 Bylaws 2009, p.18, App-20) "Allocation of Net Loss. In the event that the Cooperative has an annual net operating loss, the Executive Committee shall have the power and authority to allocate such losses in the following manners: (a) if attributed to business done with patrons, then to apply such losses on a patronage basis against the equity credits of patrons receiving advances over \$500.00 in the fiscal year for such year or years;" (Art. XII §9 Bylaws 2009, p.24, App-26)

Builders' financial records carry the advances that members receive during the

year as a loan to each member at the time it is paid. This is shown on Builders' balance sheets. (Add-91) For example, the monthly balance sheet for June 2006 lists the following as "ASSETS":

Cash	\$73,391
<i>Advance Draws Paid to Members</i>	\$1,587,584
Accounts Receivable	\$594,246
Cost & Est Earnings in Excess of Billing	\$547,282
Inventory	\$79,607
Prepaid Expenses	\$394

(Add-91) "Advance Draws Paid to Members" are designated as "assets" on the books at the time they are paid because they are "loans" to the members, which Builders' can—and does—require be paid back if they advance (loan out) more than is available at the end of the fiscal year. (See discussion in Smithson letter, App-70)

In the May 3, 2011, decision, the ULJ found the following:

Each member is assigned an hourly rate of pay (designated as an advance rate) by the cooperative. The members of the cooperative determine these rates based on several factors. The Member is paid that rate for each hour that he/she works. At the end of the fiscal year the cooperative determines what the profits or losses were for that year. The profits (losses) are added (or deducted in the case of losses) to the pay of the members on a prorata basis. In 2010 12 percent was deducted from each member's hourly pay in order to reimburse the annual loss.

(5-3-11 Decision, p.2, Add-4) On reconsideration, the ULJ further found that "[w]hile Builders Commonwealth, Inc. has characterized certain payments as "loans" these payments are actually compensation for services which are adjusted after a profit/loss determination (similar to a draw paid to a sales representative which is adjusted at a later time)." (6-20-11 Decision, p.3, Add-10) The ULJ thus found that Builders' advances are

designated as loans and that the members are required to pay back (“reimburse”) any over advances.

B. Builders’ economic realities

Building construction and improvement is only one type of work performed by Builders’ members. Builders’ managing director (elected by the members), Arno Kahn, testified that Builders’ members perform field work (construction and improvement) and also shop work; design; and financial, administrative, and sales functions. (T.44, App-124) These categories are also shown in the minutes of membership meetings (Minutes, Add-84, 85, 87) and DEED’s audit notes showing “Shop - Kitchens & Bathrooms” and “Field - Buildings & Const” (App-37). Some members do not perform building construction and improvement work at all. Other members fluctuate between shop work and field construction and improvement. Shop work includes fabricating case work (cabinetry), furniture, and trim; and, a large percentage of the shop work is *not* for a Builders’ project. (T.46, App-126) Members also include a salesperson, an architect, and a finance manager. (T.29-30, 38, 49, App-109-110, 118, 129). In denying Builders’ request for reconsideration, the ULJ impliedly found that all of Builders’ members are “construction workers....” whose status “must be decided based on ... Section 268.035, Subdivision 9a.” (6-20-11 Decision p. 2, Add-9) This finding was not supported by the evidence.

As members of a cooperative organized under Minnesota Chapter 308A, all members are voting members, and each member has one vote. (T.32, App-112; Bylaws

Art. IX §2, App-19) Members meet quarterly. (T.44, App-124) Members elect from among themselves the members of the board of directors, executive committee (including the managing director), and personnel committee. (T.42, App-122; Bylaws, Arts. II, III, & IV, App-13-17) The personnel committee determines each member's advance rate, performs annual reviews based on feedback from other members, and deals with job performance and discipline issues. (T.43, App-123) The executive committee may only make *recommendations* to the membership regarding decisions, which the membership may affirm or reject. (T.45, App-125) Builders' Bylaws are incorporated into the Membership Agreement, which states that "I hereby agree to bound by and to comply with the provisions of the Articles of Incorporation and the Bylaws of the association" (Mem. Agmt. p.1, Add-83)

Builders does not have the right to discharge a member. The Bylaws provide that during the first year of membership, a member may be required to surrender membership only by unanimous vote of the Personnel Committee, which is comprised of other members elected by the membership, with input from other members. (Bylaws, Art. IX, §4, App-20) After the first year of membership, a member may only be required to surrender membership by a 2/3 vote of all of the members of Builders, not just the members of the Personnel Committee. (Bylaws, Art. IX §4, App-20) Although Builders has an elected managing director, Arno Kahn, he does *not* have any authority to discharge a member. (T.42, App-122) Kahn also testified that Builders does not have layoffs. (T.38, App-118)

The ULJ found that “[a] member may be removed (discharged) from the cooperative by a two-thirds vote of the members.” (5-3-11 Decision p.2, Add-4) The right of the membership by 2/3 vote to expel member is not a right of discharge. A job site coordinator may expel a member *from a job site* for non-performance. (Policies §28.33, App-66) However, no one in Builders has any authority to *discharge* a member.

Builders’ members set their own schedules and hours worked. (1991 T.26-27, App-93-94) There is no provision in the Policies and Guidelines manual—or anywhere else—regarding a standard work week or regular working hours. Members determine how many weeks each year they want to work. (T.38, App-118) The evidence does not support the ULJ’s finding that “[m]embers ... are responsible to work for the cooperative except in the case of illness or unavoidable temporary absences.” (5-3-11 Decision p.3, Add-5) Among the provisions in Builders’ policy manual that the ULJ relied upon, the only section dealing with time off is Section 30.01, which only provides that a member “must give at least two weeks’ notice to the appropriate manager before taking time off, if possible.” (Policies, §30.01; App-67)

Builders does not have supervisors or foremen on the projects. (T.38, App-118) Each project has a coordinator who is responsible for interfacing with the owner, subcontractors, and the architect, who is also a member. (T.38, App-118) Members work as a team to get the work completed. (T.45, App-125) Members are not paid to attend training meetings: members in the carpentry area gather twice a month for a safety and training meeting, without receiving any payment for the time spent in the meetings.

(T.41, App-121) Members are not reimbursed for mileage: members working at a location more than 60 or 70 miles away are reimbursed for the cost of food and lodging, but not mileage. (T.36-37, App-116-117) All members supply their own tools: Builders does not buy tools for its members—they procure their own tools. (T.47, App-127)

The ULJ found that Builders' "members/workers work under essentially the same conditions as employees who work for a corporation or an individual proprietor." (5-3-11 Decision p. 4. Add-6) This finding is *not* supported by the evidence. Members must pay back advances that exceed their actual annual patronage distributions. No one in Builders has the right to discharge another member. Members are self-governing, electing from among themselves the executive and personnel committees. Members provide their own tools. Members are not reimbursed for mileage when working out of town. Members are not paid when they attend in-house training. Members share in the profits *and losses*. These are not the same conditions as an employee.

C. The Auditors did not examine Builders' documents that would have shown that Builders' advances are *not* wages.

A joint audit by the Department of Revenue (auditor Cathy Kippola) and DEED (auditor Jon Korpi) was conducted on September 22, 2010. (DR Questionnaire, p.1, App-44; DEED Audit Notes, App-37; DEED Audit Narrative, App-40) During the audit, they interviewed Builders' finance manager, John Thomas. (T.55, App-135) Based on the audit documents, it is apparent that the auditor for DEED did not have the Membership Agreement and did not examine the general ledger, which would have shown that advances are designated as loans at the time paid and the actual payback of advances.

The section of DEED's "Audit Narrative" titled "Examination of the detailed general ledger/chart of accounts" states "General Ledger Not Available." (Audit Nar., p.2, App-41) The Audit Narrative shows that the "patronage dividends [were] picked up by auditor as wages during years 2007 2008 2009." (Audit Nar., p.2, App-41) This was without determining how advances were designated at the time paid. The DEED auditor's handwritten notes state "members paid bi-weekly draws-(No Advances)" and make no mention of the requirement that members pay back advances that exceed patronage dividends. (Audit Notes, p.1, App-37) The Department of Revenue "Initial Interview Questionnaire" does *not* include any facts regarding the Membership Agreement expressly stating that advances are loans and that members agree to pay back advances that exceed patronage distributions. (Questionnaire, p. 3, App-46) The copy of the Questionnaire is partially illegible, however, it appears that Question 5 reads "How are the member[s] paid? Do they receive advances/draws?" The answer incorrectly states "No Advances" and also states "Bi-weekly draw. Hourly rate determined by personnel committee." (App-46) Part (a) of Question 5 asking "If they receive advances, what if the advances are more than the entitled dividends at the end of the year?" is *blank*. (Questionnaire p. 3, App-46) This was critical information that the auditors did not have. If the auditors had known that the advances are designated as loans that must be repaid if advances are more than the entitled patronage distributions at the end of the year, it no doubt would have established that Builders does *not* pay wages.

ARGUMENT
STANDARD OF REVIEW

This is an appeal of a decision that members of Builders are employees under Minnesota's unemployment insurance statutes. *De novo* review is therefore appropriate. See Abdi v. DEED, 749 N.W.2d 812, 815 (Minn. App. 2008) (reversing ULJ's decision). "Statutory interpretation is a question of law, which we review *de novo*." Id. (citation omitted). In reviewing a decision by an unemployment law judge ("ULJ"), this court must "exercise ... independent judgment in reviewing questions of law *de novo*." Id. at 814-15. Findings of fact are reviewed in the light most favorable to the ULJ's decision. Id. However, "if the evidence does not sustain the findings" or if a conclusion of law "does not have reasonable support in the findings," the decision must *not* be affirmed. Martin Homes, Inc. v. Brown, 361 N.W.2d 100, 103 (Minn. App. 1985) (citations omitted) (reversing ULJ's decision that worker was an employee). A decision that a worker is an employee is a conclusion of law. Id.

DEED is *not* entitled to deference in its interpretation of a statute or regulation. Abdi, 749 N.W.2d at 815. "When a decision turns on the meaning of words in a statute or regulation, a legal question is presented," and therefore "reviewing courts are not bound by the decision of the agency and need not defer to agency expertise'...." Id. (citation omitted). "A court ... is not bound by an agency's interpretation of statutory language where the statute is phrased in common, rather than exceedingly technical, terms.... Administrative interpretations are not entitled to deference when they contravene plain statutory language, or where there are compelling indications that the agency's

interpretation is wrong.” J.C. Penney Co., Inc. v. Comm’r of Econ. Security, 353 N.W.2d 243, 246 (Minn. App. 1984) (holding rules were invalid to the extent that they contravened express language of statutes).

The “plain and ordinary meaning” of an unambiguous statute must be applied. Abdi, 749 N.W.2d at 815. “Where the legislature’s intent is clearly discernable from plain and unambiguous language, statutory construction is neither necessary nor permitted and we apply the statute’s plain meaning.” Id. (citation omitted). There is no ambiguity when the language is subject to only one reasonable interpretation. Id. (citation omitted).

Any doubt as to whether Builders is an employer subject to unemployment insurance taxes must be resolved in favor of Builders. The unemployment insurance statutes impose taxes and penalties. E.g., Minn. Stat. §268.057. Such statutes must be strictly construed against the taxing authority and in favor of the taxpayer. See Dahlberg Hearing Systems, Inc. v. Commissioner, 546 N.W.2d 739, 743 (Minn.1996) (stating that any doubt or ambiguity in tax statute must be resolved in favor of the taxpayer); Chatfield v. Henderson, 410, 90 N.W.2d 227, 232 (Minn. 1958) (stating that statutes imposing a penalty must be strictly construed). “A strict construction of our revenue act is peculiarly incumbent on the court, because its violation is followed by severe penalties. The rule that penal statutes shall be strictly construed, has its foundation in reason and justice, and is too well settled to admit of doubt or require the citation of authorities to support it.” Dorman v. Bayley, 10 Minn. 383, 1865 WL 3032 *1 (Minn. 1865). Although the unemployment program is remedial as to an unemployed worker, it is a revenue measure

and a penal statute as to Builders.

“The Minnesota Court of Appeals may affirm the decision of the unemployment law judge or remand the case for further proceedings; or it may reverse or modify the decision if the substantial rights of the petitioner may have been prejudiced because the findings, inferences, conclusion, or decision are: ... (4) affected by other error of law; [or] (5) unsupported by substantial evidence in view of the entire record as submitted....”

Minn. Stat. §268.105, subd. 7(d).

I. The Unemployment Law Judge erred in concluding that all members of the worker cooperative, Builders Commonwealth, are construction workers and employees of Builders Commonwealth, pursuant to Minnesota Statutes Sections 268.035, subdivision 9a, and 181.723, and that therefore Builders Commonwealth is an employer pursuant to Minnesota Unemployment Insurance Law.

A. Members of worker cooperatives are not employees.

“A worker cooperative... is an economic enterprise in which the workers have both the exclusive control rights and the exclusive claims to the firm’s residual earnings. Further, the residual interests and control rights are distributed equally among the workers and are possessed by all or almost all of the workers (especially those at the lowest rungs of the organization’s hierarchy).”² “A worker cooperative can be defined theoretically as a firm where the membership rights are *personal rights* attached to the functional role of working in the firm.”³ Members of a worker cooperative, such as Builders, do *not*

² G. Mitu Gulati et al., When a Workers’ Cooperative Works: The Case of Kerala Dinesh Beedi, 49 UCLA Law Review 1417, 1421-21 (2002).

³ David Ellerman & Peter Pitegoff, The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts, 11 N.Y.U. Rev. L. & Soc. Change, 441, 444 (1982-)

provide services to the cooperative and do not sell their labor to the cooperative—they are neither employees, nor independent contractors, nor owners:

[W]orker-members of a worker cooperative are not employees in the sense of sellers of labor. They sell not their labor but the fruits of their labor. Instead of being ‘employees’ of a worker cooperative corporation, the workers are the corporation; it is their legal embodiment. The workers, in their corporate body, own the positive fruits of their labor (the produced outputs) and are liable for the negative fruits of their labor (the exhausted nonlabor inputs). Instead of selling their labor for a wage or salary, the worker-members are selling their outputs in return for the revenues and are paying the costs of the nonlabor inputs. The labor income of the worker-members is not the market value of their labor as a commodity but is the net market value of the positive and negative fruits of their labor (revenues minus nonlabor costs). The workers are members, not owners. Workers’ cooperatives have worker-members, not employee-owners.⁴

A worker cooperative is *not* comparable to an employee-owned corporation. Id.

In an employee-owned corporation, the voting rights, net income rights, and net book value rights are owned by the shareholders, who are also employees, as property rights in proportion to the number of shares owned. Id. at 467. In a worker cooperative such as Builders, the voting rights and net income rights are membership rights held by the workers as personal rights, and net book value rights are internal capital accounts. Id.

A worker cooperative is analogous to a joint venture.⁵ The Minnesota Department of Labor and Industry recognized the similarity in 1987 when it determined that Builders’

83) (discussing worker cooperatives).

⁴ Id. at 463.

⁵ See, generally, Uniform Limited Cooperative Association Act, 2007 (discussing Israel Packel, *The Organization and Operation of Cooperatives* p. 5-6 (4th ed. 1970) and *Moore v. Hillsdale County Tel. Co.*, 137 N.W. 241 (Mich. 1912) (categorizing an unincorporated telephone cooperative as a joint venture)).

“voting members are partners in a joint venture....” (Add-81) “[A] joint adventure is created when two or more persons combine their money, property, time, or skill in a particular business enterprise and agree to share jointly, or in proportion to their respective contributions, in the resulting profits and, usually, in the losses.” Meyers v. Postal Finance Co., 287 N.W.2d 614, 617 (Minn. 1979) (citation omitted). Members of a joint venture are neither employees nor independent contractors performing services for the joint venture. Rather, the members *are* the joint venture. Likewise, Builders’ members have combined their time and skill in a particular business enterprise and agreed to share in proportion to their respective contributions in the resulting profits and losses.

B. It was an error of law to conclude that Builders’ advances (draws) against future patronage dividends, designated as loans at the time paid, were wages.

Advances (or “draws”) against future patronage dividends paid to Builders’ members, which are designated as loans (“assets”) on Builders’ books at the time of payment (Balance sheet, Add-91) and are expressly designated as “in the nature of loans” in the Membership Agreement (Add-83), are *not* “wages” pursuant to Minn. Stat.

§268.035, subd. 29 (e) (Add-44). Paragraph 5 of the Membership Agreement states the following:

Advances of money, or property made to me by the association out of estimated or actual revenues of the association during any fiscal accounting period of the association and before a final audit of the books and records for said period shall constitute advance payments of my share of the association revenues, **in the nature of loans**, and as a set-off against my share of the association earnings. Any balance due me will be paid to me as a patronage dividend after the close of said fiscal year of the association as a “Qualified Written Notice of Allocation” in accordance with the provisions of Subchapter T of the U.S. Internal Revenue Code. In the event

that said advances during any fiscal year shall exceed the share of the association revenues to which I [am] entitled, *I agree that I will repay such excess* to the association at the times and in the manner as the Board of Directors of the association shall determine.

(Membership Agreement, ¶5, Add-83) The agreement has been enforced in conciliation court. (App-29) Section 268.035, subdivision 29(e) provides the following exclusion from “wages”: “‘Wages’ means all compensation for services, ... except:.... Wages includes advances or draws against future earnings, when paid, *unless the payments are designated as a loan* or return of capital on the books of the employer at the time of payment.” (Add-44) (emphasis added)

The ULJ’s conclusion that Builders’ advances are wages based on his interpretation that Section 268.035, Subdivision 29(e) only “precludes actual loans and return of capital from being wages” (Decision 6-10-11, p. 3, Add-10) *was an error of law*. The plain meaning of the language “advances or draws against future earnings ... designated as a loan ... at the time of payment” cannot reasonably be interpreted to mean an actual loan, such as with a promissory note. The legislature described an “actual loan” requiring evidence of a promissory note in the paragraph immediately following the paragraph describing advances: “For a subchapter “S” corporation, wages does not include: (1) a *loan* for business purposes to an officer or shareholder *evidenced by a promissory note* signed by an officer before the payment of the loan proceeds and recorded on the books and records of the corporation as a loan to an officer or shareholder;....” Minn. Stat. 268.035, subd. 29(f) (emphasis added) (Add-44). If the legislature had intended the exclusion of “advances or draws against future earnings ... designated as a loan ... at the

time of payment” in paragraph (e) to be an “actual loan” with a promissory note, it would have said so, as it did in the following paragraph (f).

The ULJ found that there is an “adjustment of wages (based on profits or losses)....” (Decision 6-10-11, p.4, Add-11) This is inaccurate. The ULJ failed to consider the evidence that members are contractually obligated to repay any advances that exceed their annual patronage dividend. (E.g. Mem. Agmt. Add-83) If a member withdraws from membership before repaying advances, the debt is subtracted from their equity account. (E.g. Add-89) Members may choose to have a certain percentage deducted from their future advances to repay the previous year’s over-advance. However, this is not an “adjustment”—it is repaying the loan over time.

A determination of “employer” status requires a finding that “compensation constitutes wages.” See Minn. Stat. §268.043(a) (“Determinations of coverage. (a) The commissioner ... must determine if that person is an employer or whether services performed for it constitute employment and covered employment, or whether any compensation constitutes wages....”) (Add-68) Minnesota’s unemployment insurance program is based on “wages.” The amount of the weekly unemployment benefit is based on a worker’s “average weekly wage” during a “base period.” Minn. Stat. §268.07, subd. 2a. Only compensation that constitutes “wages” paid to a worker is taxable under Minnesota’s unemployment insurance program. Minn. Stat. §268.035, subd. 24(a) (Add-35) Employers are required to submit a “quarterly wage detail report” for each employee, documenting “the total wages paid to the employee.” Minn. Stat. §268.044, subd. 1.

Minnesota's unemployment insurance program is based on quarters—not a fiscal year. The base period is the first four quarters of the five quarters immediately preceding the date a worker applies for unemployment benefits. Minn. Stat. §268.035, subd. 4(b). To be eligible to receive unemployment-compensation benefits, an applicant must have earned wages in at least two quarters. Minn. Stat. § 268.07, subd. 2(a). The unemployment base period is *not* reconcilable with a cooperative's fiscal year where each member's patronage dividend—and the amount the member must repay from the advances loaned during the year—is not known until after the end of the fiscal year. An average weekly wage for a base period cannot be determined. The fact that the advances Builders pays to members are designated as loans, and therefore are not "wages," should be dispositive of the entire issue of Builders' status.

Whether the members of a worker cooperative are employees of the cooperative appears to be a case of first impression in the Minnesota Court of Appeals. Further, there are no reported court decisions in other jurisdictions with unemployment insurance statutes sufficiently similar to Minnesota's or with facts that are sufficiently close in point. The only reported decision appears to be from Oregon, whose unemployment insurance statutes differ significantly from Minnesota's as to advances. See Employment Division v. Surata Soy Foods Inc., 63 Ore. App. 221, 662 P.2d 810 (Ore. App. 1983). Minnesota excludes advances or draws on future earnings that are designated as loans from the definition of wages—Oregon does *not*. Minn. Stat. §268.035, subd. 29(e) *Cf.* Ore. Stat. §657.105(1). Further, the worker cooperative in Surata differed significantly

from Builders in that the payments made by the Oregon cooperative, although based on anticipated annual income and hours worked, were not advances that members were required to pay back. However, the court's reasoning may be helpful.

In Surata, the issue was whether a worker cooperative was required to pay unemployment insurance contributions for six workers who were members of the cooperative. The decision, that an employer-employee relationship existed between the cooperative and its members, was based on Oregon's unemployment insurance statutes that defined an "employee" as "any person employed for 'remuneration' under a contract of hire by an employer" and defined "employment" as "services performed by an individual for 'remuneration'." Surata, 63 Ore. App. at 225 (citing Ore. Stat. §§657.015 & .040). The Surata court held that patronage dividends were "'remuneration' within the meaning of ORS 657.015." As noted above, Oregon's definition of remuneration is substantially different from Minnesota's definition of "wages." Oregon defines "wages" as "all remuneration for employment"—and *advances designated as loans are not included in the few exceptions*. Ore. Stat. §657.105(1). The "remuneration" paid by the cooperative in Surata did not consist of advances that were designated as loans and which the members were required to pay back. The remuneration was based on an estimate of the annual net income and the hours contributed, and appears to have varied during the year depending on the projected net income. The Surata court cited a similar Oregon case that had recently held that patronage dividends were "remuneration" for purposes of workers' compensation. Id. at 225 (citing Assoc. Reforestation v. State Workers' Comp.

Bd. (“Hoedads”), 650 P.2d. 1068, review denied (Ore. 1982)). The court stated that the basis of its decision was the “broad word ‘remuneration’” used in the statute to define an employer. Id. It cannot be over emphasized that, unlike Minnesota, the Oregon legislature did *not* exclude “advances or draws against future earnings... designated as a loan ... on the books of the employer at the time of payment.” Further, the facts of Hoedads case did not state that members of the cooperative were required to repay advances that exceeded income. Members of Builders *are* contractually required to repay advances that exceed their patronage dividend.

Wisconsin’s Department of Labor and Industry considered a similar issue in 1998. Isthmus Eng. & Mfrg. Coop., S9600250MD (Wisc. L&I Com’n 1998) (available at <http://dwd.wisconsin.gov/lirc/ucdecsns/201.htm>). However, Wisconsin’s unemployment insurance statutes (like Oregon’s) also differ significantly from Minnesota’s as to advances. Like Oregon, Wisconsin unemployment insurance statutes do *not* exclude advances against future earnings that are designated as loans at the time they are paid from the definition of “wages.” Minn. Stat. §268.035, subd. 29(e) *Cf.* Wisc. Stat. §108.02(26). Like Oregon, Wisconsin defined “wages” as “every form of remuneration payable ... to an individual for personal services”—and advances designated as loans are *not* included in the exceptions. Also like the Oregon worker cooperative, the Wisconsin cooperative differed significantly from Builders in that there is no mention that the cooperative designated advances as loans.

The Isthmus cooperative argued that its members were not employees based on the

nature of a worker cooperative, rather than any statutory provision. The cooperative argued that there should be a common-law policy exception for worker cooperatives. The Commissioner rejected this argument and followed the reasoning of the Oregon courts in Surata and Hoedads. As noted above, Wisconsin and Oregon had similar statutes in which paying any kind of “remuneration” made the entity an “employer.” The Commissioner in Isthmus cited the following from Hoedads: ““The legislature chose the broad word ‘remuneration’ to define a subject employer; we see no reason that the recompense that a worker receives for his labor should not be considered remuneration just because the amount varies with the profits of the organization.”” Isthmus (citing Hoedads, 59 Ore. App. at 354-55). The Wisconsin Commissioner stated that the key to the decisions in Hoedads and Surata was that although members of a worker cooperative ““may be thought of as having a proprietary interest in the cooperative, ... this is not inconsistent with what remains in essence an employer-employee relationship.”” Isthmus (quoting Surata, 63 Ore. App. at 225). The Commissioner noted that the Oregon court’s statement echoed the reasoning of the U.S. Supreme Court in Goldberg v. Whitaker House Co-op.: ““[t]here is nothing inherently inconsistent between the coexistence of a proprietary and an employment relationship.”” Isthmus (quoting 366 U.S. 28, 32 (1961)). The Commissioner stated that Surata, Hoedads, and Goldberg all looked at the “economic realities of the relationship between worker cooperatives and their workers and [saw] that it [was] in practical effect not distinguishable from employment, in terms of all the risks which the programs involved are intended to address.” Isthmus. (As will be shown

below, the economic realities of the relationship of Builders and its members is distinguishable from the employment relationship found in Goldberg.)

The Commissioner in Isthmus rejected the cooperative's policy argument and relied only on Wisconsin's unemployment compensation statutes, including the definition of an "employee" in Section 108.02(12): "any individual who is or has been performing services for an employing unit, in an employment, whether or not the individual is paid directly by such employing unit...." Unlike Builders here, Isthmus did not dispute that the members performed services for Isthmus and conceded that they were not independent contractors. The Commissioner in Isthmus also relied on the definition of "wages," which mirrored Oregon's: "Wages' means every form of remuneration payable, directly or indirectly, for a given period...by an employing unit for an individual for personal services.'" Isthmus, at n.5. Therefore, the Commissioner concluded that—based on the application of the statutory language—Isthmus was an employer and was required to make contributions on the payments made to its members. (The Commissioner also noted a 1980 decision by Minnesota's Department of Employment Security, Chronic Electronic Corp., holding that no employment relationship existed between a worker cooperative and its members—and also noted that Minnesota's commissioner had "repudiated" the decision in 1990. Isthmus at n. 4.)

Neither the statutory provisions nor the facts in Wisconsin's Isthmus decision are on point with Minnesota's unemployment insurance statutes and Builders. The advances made to Builders' members are designated as loans at the time paid, and members are

contractually obligated to pay back advances that exceed the annual patronage dividend. Wisconsin's unemployment statutes are much broader than Minnesota's and do not include an exception to the definition of "wages" for advances designated as loans. Also, considering the "economic realities," the designation of payments as loans and their repayment makes the relationship of Builders' members *inconsistent* with an employment relationship.

Builders' designation of advances as loans and the members' obligation to repay any advance that exceeds their patronage dividend, is in sharp contrast to the facts in Goldberg where there was no provision that a member was required to pay back advances. Goldberg, 366 U.S. at 30. Goldberg involved approximately 200 members of a cooperative who did knitting, crocheting and embroidery piece work at home. Id. at 28. In Goldberg the bylaws provided that excess receipts *might* be distributed to the members, at the discretion of the board. Id. In contrast with Builders' bylaws, they did not *require* that the excess receipts be distributed to the members and—the critical difference—the bylaws in Goldberg did not require that members pay back advances if they exceeded revenues. Id. The Goldberg court noted that the members were "not liable for [the co-op's] debts." Id. at 30. Also in Goldberg, *management* determined the rate the workers were paid, and *management* had the right to fire the workers. Id. at 33. The Goldberg Court found that the members could be "expelled at any time by the board of directors if they violate any rules or regulations or if their work is substandard." Id. at 29. Builders' management does not determine the hourly rates—a personnel committee elected by the

members determines the hourly rates. Builders' management does not have the right to fire a member. During the first year, a new member may be expelled only if the personnel committee unanimously votes to require surrender of membership. After the first year of membership, a member of Builders may only be expelled if 2/3 of the entire membership votes to require the surrender of membership. Further, Builders' members provide their own tools, are not supervised, and are not reimbursed for mileage.

Minnesota's legislature, unlike Oregon and Wisconsin, excluded advances or draws against future earnings that are designated as loans at the time paid from the definition of wages. The provisions in Builders' Membership Agreement that expressly state that the advances are "in the nature of loans" and that require that the advances be repaid establish that the advances are designated as loans on Builders' books at the time of payment. The Account Detail Report for Lars Keuhnow and the collection actions further establish that the advances are designated as loans on Builders' books at the time of payment. On Builders' balance statement, the advances are listed as "assets" because they are designated as loans. Losses are not merely deducted from future hourly payments to members, as the ULJ found. While members may elect to repay the loan by having an amount deducted from future advances over time, some members elect to repay the loan over-advance in a lump sum and persons who are no longer members are required by the bylaws to repay the loan over-advance from their equity account and also face collection actions for repayment. Profits are not added to the future hourly payments. They are distributed at the end of the fiscal year as a distribution from the

cooperative. As expressly stated in the Membership Agreement, the payments are advances that are loans against anticipated distributions from the cooperative at the end of the fiscal year. Builders does not pay its members wages, as defined by Section 268.035, subdivision 29(e). For that reason, none of Builders members are employees and Builders is not an employer of its members.

C. It was an error of law to apply Section 181.723 to Builders' members.

Section 181.723 (the construction independent contractor certification statute) does not abrogate the exclusion of advances designated as loans from the definition of wages to determine a worker's classification. Therefore, Section 181.723 does *not* apply to members of a worker cooperative where advances or draws against future earnings are designated as loans at the time paid—because the advances are *not* wages. The Minnesota legislature enacted Section 181.723 in 2007. (Laws 2007, c. 135, art. 3, § 15) As of January 1, 2009, for purposes of unemployment insurance, Section 181.723 requires an individual performing building construction or improvement services for a person to meet specific criteria and obtain an exemption certificate to be classified as an independent contractor and not an employee. Minn. Stat. 181.723, subs. 2-4 (Add-13-14). None of Builders' members are the unskilled, seasonal, and powerless workers that Section 181.723 is intended to protect. See Office of the Legislative Auditor, "Misclassification of Employees as Independent Contractors," p. 18 (Nov. 2007)⁶

⁶ Available at www.auditor.leg.state.mn.us. "Knowledgeable staff at DEED told us that worker misclassification is more common in some industries than others. According to these staff, some characteristics of industries more prone to misclassification include: use of unskilled labor, minimal capital investment requirements, and seasonal business

In the same 2007 session in which it enacted Section 181.723, the Minnesota legislature *added* the exclusion of advances designated as loans to the definition of wages in Section 268.035, at the request of DEED. See Unemployment Insurance Advisory Council Bill: House Conference Committee Report on S.F. 167 (H.F. 648), Art. 4: “Administrative Rules Incorporated into Statutes,” 85th Leg. (May 18, 2007)⁷. The Committee report shows that the exclusion of advances designated as loans from the statutory definition of “wages” was based on the existing administrative rule adopted and used by DEED:

This article incorporates various provisions from current administrative rules governing unemployment insurance into the statutes. The department wants to incorporate these provisions into the statutes because the department believes doing so will clarify current practices. The incorporation of these rules is not intended to affect the application or interpretation of these provisions. Wages. Modifies the definition of wages to state that “wages” include: ... advances or draws against future earnings when paid (unless the payments are designated as a loan or return of capital on the employer’s books when paid);

Id. DEED’s administrative rule that was incorporated as subdivision 29(e) was the following:

Wages include the monetary value of: ...I. Advances or draws against future earnings, when paid, unless the payments are designated as a loan or return of capital on the books of the employer at the time of payment.

Minn. R. 3315.0210 (Add-71). Accordingly, Section 268.035, subd. 29 (“Wages”) was

cycles. In theory, businesses that rely on unskilled labor will find it easier to use “independent contractors” as business needs increase instead of employing the labor permanently. In addition, workers that can be easily replaced may have less ability to negotiate for employee status.”

⁷ Available at www.house.leg.state.mn.us/hrd/bs/85/SF0167.html

rewritten in 2007 (Laws 2007, c. 128, art. 4, §§2 to 4) to include the exclusion of advances in 29(e)⁸. During that same 2007 session, the legislature repealed Section 268.035, subd. 9, which codified common law factors to determine if a construction worker was an independent contractor, effective January 1, 2009. (Laws 2007, c. 135, art. 3, § 42) In 2009, the legislature then replaced subdivision 9 with subdivision 9a, requiring independent contractor certification under Section 181.723 for workers in building construction. (Laws 2009, c. 78, art. 4, §§3 to 7) The codification of the exclusion of advances designated as loans from the definition of “wages” in the same session in which the independent contractor certification statute was enacted shows that they are meant to be consistent. Builders’ members are not employees because they are not paid “wages.” They are not required to meet the criteria and obtain an independent contractor certificate under Section 181.723 to avoid being classified as employees.

D. It was an error of law to apply Section 181.723 to Builders’ members who do not perform building construction and improvement.

Section 181.723 expressly does not apply to Builders’ members who do not perform building construction and improvement. Some members do not perform building construction and improvement work *at all*. Other members fluctuate between shop work and field construction and improvement. Shop work includes fabricating case work (cabinetry), furniture, and trim; and, *a large percentage of the shop work is not for a Builders’ project.* (T.46, App-126) Members also include a salesperson, an architect, and

⁸ “Wages includes advances or draws against future earnings, when paid, unless the payments are designated as a loan or return of capital on the books of the employer at the time of payment.” Minn. Stat. §268.035, subd. 29 (e)

a finance manager. (T.29-30, 38, 49, App-109-110, 118, 129). It was an error of law for the ULJ to conclude that all members were employees based on a finding that they had not obtained independent contractor certification when they do not all perform building construction and improvement. In denying Builders' request for reconsideration, the ULJ stated that "[w]hether these construction workers are covered by the Minnesota Unemployment Insurance Law...must be decided based on ... Section 268.035, Subdivision 9a." (Decision 6-20-11 p. 2, Add-9) (Section 268:035, subdivision 9a, provides that "section 181.723 determines whether a worker is an independent contractor or an employee when performing public or private sector commercial or residential building construction or improvement services.") This finding was not supported by the evidence. Both Section 268.035, subdivision 9a and Section 181.723 expressly apply only to workers doing "building construction and improvement." Minn. Stat. §181.723, subd. 2. Further, Section 181.723 has been held to apply expressly only to individual human beings doing building construction and improvement. Nelson v. Levy, 796 N.W.2d 336, 342, 342 n.3 (Minn. App. 2011) (stating that Section 268.035, subd. 9a is a "category of workers for which the legislature has created a specific framework to determine whether a worker is an independent contractor or an employee" and that "section 181.723 'only applies to individuals' and an "[i]ndividual" means a human being.") (quoting Minn. Stat. §181.723, subs. 1(d) & 2). The ULJ's apparent finding that all Builders' members are construction workers is not supported by the evidence, which showed that some members are salespersons, accountants, cabinet makers,

architects, and designers. (T.29-30, 38, 44, 46, 49, App-109-110, 118, 120, 129; DEED Audit Notes, App-37) Determining the status of individual members not doing building construction and improvement based on Section 181.723 was an error of law.

For individuals *not* covered by a specific statute, Rule 3315.0555, enacted by DEED, sets forth the factors to distinguish employees from independent contractors. See Blue & White Taxi v. Carlson, 496 N.W.2d 826, 828 (Minn. App. 1993). Of the five factors in Rule 3315.0555, two are the most important: the right to control the means and manner of performance and the right to discharge the worker without incurring liability. Minn. R. 3315.0555, subpt. 1(A)(B) (1991). Builders does not have the right to discharge a member. The Bylaws provide that during the first year of membership, a member may be required to surrender membership only by unanimous vote of the Personnel Committee, which is comprised of other members elected by the membership, with input from other members. (Bylaws, Art. IX, §4, App-20) After the first year of membership, a member may only be required to surrender membership by a 2/3 vote of all of the members of Builders, not just the members of the Personnel Committee. (Id.) The ULJ incorrectly concluded that this was a right to discharge without incurring liability. In doing so, the ULJ failed to consider the Department's guidelines on what constitutes a right to discharge. Subpart 3.G of Rule 3315.0555 describes the right to discharge as follows: "The right to discharge is a very important factor indicating that the right to control exists *particularly if the individual may be terminated with little notice, without cause, or for failure to follow specified rules or methods.*" (emphasis added) The

procedure to expel a member by 2/3 vote of the membership does not fit the Department's guidelines. In fact, it is the same procedure provided in the U.S. Constitution for removal of a member of Congress—a 2/3 vote of the members of the House. U.S. Const. §5, cl.2. This is not a right to discharge. It is in sharp contrast to the facts in Goldberg where a member could be expelled at any time merely by the vote of the board of directors.

Goldberg v. Whitaker House Co-op., Inc., 366 U.S. 28, 30 (1961).

Builders' Bylaws, Article IX state the following: "After the first year of membership, a Member shall be required to surrender membership in the Cooperative only by a vote of 2/3 of the membership." (Bylaws, Art. IX, §4, App-20) This is not a right to discharge. It is a contractual right protecting each member. As a corporation organized as a cooperative, Builders can only act through its agents. See, e.g., Frieler v. Carlton Marketing Group, Inc., 751 N.W.2d 558, (Minn. 2008) (considering MHRA). "[T]he overwhelming majority of employers are artificial entities, such as corporations ..., who can act only through their agents. As a result, concepts of agency law are an inherent part of the actions of employers." Id. (citations omitted). Neither Builders' managing director, a coordinator, nor any other agent in Builders has any authority to discharge a member. (Section 28.33 of Builders' policies, relied upon by the ULJ, merely allows a job site coordinator "to expel a member *from the work site* for non-performance." (Policy p.30, App-66) Any attempt to discharge a member could result in liability for breach of the Membership Agreement, which incorporates the Bylaws.

Other "essential factors" are: the mode of payment, furnishing of materials and

tools; and control over the premises where the services are performed. Minn. R. 3315.0555, subpt. 1(B). The mode of payment also establishes that Builders' members are not employees. Each members' share of the annual profits is determined by the personnel committee, which is elected by the members, and the advances loaned against the anticipated distribution of profits are not wages. By the Department's own rule in effect before 2007 and now codified in Section 268.035, Builders' advances or draws to members against future earnings, designated as loans and enforced as loans, are *not* "wages." All members supply their own tools. (T.47, App-127) Builders does not have supervisors or foremen on the projects. (T.38, App-118) Each project has a coordinator who is responsible for interfacing with the owner, subcontractors, and the architect, who is also a member. (T.38, App-118) Members work as a team to get the work completed. (T.45, App-125) A significant additional factor is the realization of profit or loss.

Minn.R. 3315.0555, subpt. 2C, states the following: "An individual who is in a position to realize a profit or suffer a loss as a result of the individual's services is generally independent, while the individual who is working in employment is not in that position."

Id. Builders members' advances against future patronage dividends are a *prorata* share of the cooperative's profits. The Membership Agreement states that "[a]ll members share the losses as well as the revenues of the association on a prorata basis according to work contributed" (Mem. Agmt. ¶3, Add-83) Based on Rule 3315.0555, Builders' members who do not perform building construction and improvement are *not* employees.

E. It was an error of law to apply Section 181.723 to Builders' members to determine their classification effective before January 1, 2009.

Section 181.723 requires a dual analysis before and after January 1, 2009, to determine a *construction* worker's classification. Nelson, 796 N.W.2d at 339 (analyzing issue whether worker in building construction was an employee or independent contractor in two time frames before and after January 1, 2009). The ULJ affirmed DEED's determination that Builders was an employer effective January 1, 2006. Section 268.043 *limits* (it does not *require*) the effective date to no more than four years prior to the date of determination, absent a finding of fraud. "No person may be initially determined an employer, or that services performed for it were in employment or covered employment, for periods more than four years before the year in which the determination is made, unless the commissioner finds that there was fraudulent action to avoid liability under this chapter." Minn. Stat. 268.043(b). Determining the classification of *any* Builders member based on Section 181.723 for years prior to January 1, 2009, was an error of law. If Builders' members are required to prove that they are independent contractors, and Section 181.723 is applied to Builders' members who perform building construction and improvement, then the facts as to those members doing construction work must be analyzed under the law in effect prior January 1, 2009, and separately analyzed under Section 181.723 after January 1, 2009. Nelson at 339.

The Nelson court applied nine criteria found in Section 268.035, subd. 9 (2007), to determine the worker's status as an employee or independent contractor prior to January 1, 2009. Id. The court concluded that the worker's status was an independent contractor

prior to January 1, 2009. After that date, the worker had formed a limited liability company. The worker had continued performing the same types of construction and improvement services (tile installation), only now the payments were made to his limited liability company, rather than directly to the individual worker. The Nelson court found that because Section 181.723 applied only to workers who are human beings, the LLC could not obtain an independent contractor certificate. Id. at 342. The court therefore concluded that the “independent contractor vs. employee distinction” was not applicable to LLCs in the construction industry, and therefore the LLC was not an employee. Id. The court rejected DEED’s argument that the “corporate trappings” of a worker operating as an LLC should be ignored and that an independent contractor certificate was required for the worker. Id. (stating that “DEED’s argument was inconsistent with the plain language of the statute.”)

Before January 1, 2009

DEED’s determination, affirmed by the ULJ, was that Builders is an employer pursuant to Minnesota Unemployment Insurance Law effective January 1, 2006. Because Builders’ advances are *not* wages, this should be dispositive of the entire issue for all members for all years. They are neither employees nor independent contractors. However, if Builders’ members must show that they are independent contractors, then before January 1, 2009, the factors in Section 268.035, subdivision 9, applied to distinguish employees from *construction* independent contractors. Nelson, 796 N.W.2d at 339-40. Section 268.035, subdivision 9, listed nine conditions for construction independent contractors, all of which were required:

- (1) maintains a separate business with the independent contractor's own office, equipment, materials, and other facilities;
- (2) holds or has applied for a federal employer identification number or has filed business or self-employment income tax returns with the federal Internal Revenue Service based on that work or service in the previous year;
- (3) operates under contracts to perform specific services or work for specific amounts of money under which the independent contractor controls the means of performing the services or work;
- (4) incurs the main expenses related to the service or work that the independent contractor performs under contract;
- (5) is responsible for the satisfactory completion of work or services that the independent contractor contracts to perform and is liable for a failure to complete the work or service;
- (6) receives compensation for work or service performed under a contract on a commission or per job or competitive bid basis and not on any other basis;
- (7) may realize a profit or suffer a loss under contracts to perform work or service;
- (8) has continuing or recurring business liabilities or obligations; and
- (9) the success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.

Minn. Stat. §268.035, subd. 9 (2006). Builders' members performing construction work provide their own tools (T.47, App-127), file self-employment tax returns (T.52, App-132), control the means of performance without supervisors (T.38, App-118), and realize a profit or loss and share in the liabilities (Mem. Agmt. ¶3, Add-83).

These "economic realities" of the situation are *inconsistent* with an employment relationship and require a conclusion that Builders' members are not employees. This conclusion is also supported by a finding that Builders' members do not require the protection of Minnesota's unemployment insurance laws. The purpose of Chapter 268 is to provide a partial wage replacement to workers who are unemployed through no fault of their own. Minn. Stat. §268.03, subd. 1. Builders' members have the contractual promise that they cannot be dismissed: it requires a 2/3 vote of all the members to require the

surrender of membership. (Bylaws, Art. IX, §4, App-20) Builders' members are not the workers that Minnesota's unemployment insurance program is intended to protect.

F. It was an error of law to conclude that DEED was not precluded from re-litigating the issue of Builders' status.

The 1991 Decision concluded that "there was no employer-employee relationship between the claimant and the employer, and remuneration paid to the claimant by the employer does not constitute wages under the Minnesota Jobs and Training Law for unemployment tax and benefit purposes." (1991 Decision, Add-78) In 1991 Builders' advances were designated as loans at the time paid (e.g. 1991 T.12, App-79) and were found not to be wages under the laws in effect in 1991. In 2011 Builders' advances are still designated as loans at the time paid and the law that such payments are *not* wages is still in effect. It should be noted that the 1991 Decision does *not* state that it concluded the member was an independent contractor. The issues stated on the record in 1991 included the relationship between Builders and the member and also whether Builders' "status as a cooperative exempts the Employer from coverage under the Minnesota Jobs and Training Law." (1991 T.11, App-78)

Claim preclusion (*res judicata*) and issue preclusion (collateral estoppel) apply to administrative decisions that are "quasi-judicial." Graham v. Special School Dist. No. 1, 472 N.W.2d 114, 115-16 (Minn. 1991). Unemployment compensation hearings are "quasi-judicial." Dorn v. Peterson, 512 N.W.2d 902, 906 (Minn. App. 1994). The elements of claim preclusion (*res judicata*) are the following: "Res judicata applies as an absolute bar to a subsequent claim when: (1) the earlier claim involved the same set of

factual circumstances; (2) the earlier claim involved the same parties or their privies; (3) there was a final judgment on the merits; and (4) the estopped party had a full and fair opportunity to litigate the matter.” Rucker v. Schmidt, 794 N.W.2d 114, 117 (Minn. 2011)

This appeal by Builders involves the same issue (i.e. employer status), the same set of factual circumstances, the same law, and the same parties as its 1990 appeal that was decided in 1991. In this appeal in 2011, the ULJ concluded that preclusion did not apply because the parties here (Builders and DEED) are not the same as Builders and Ripley in the 1991 decision. (5-3-11 Decision, pp. 3-4, Add-5-6) This was an error of law. The party to be estopped may be in privity with the party in the previous action. Privity includes identity of interests, a party who controlled the action or whose interests were represented by the party in the previous action, and a party who represents the same legal right. Rucker, 794 N.W.2d at 118. The Referee/ULJ in 1990 identified the interests and legal rights as both the relationship between Ripley and Builders and also whether Builders’ status as a cooperative exempted it from Minnesota’s unemployment insurance law. (1991 T.11, App-78) DEED’s interests and legal rights in this 2011 appeal, i.e. determination of Builders’ status and collection of unemployment insurance taxes, were represented by Ripley in the 1990 appeal. The ULJ’s decision in 2011 that preclusion did not apply based on the identity of the parties was an error of law.

The ULJ also concluded that preclusion did not apply because “the law relating to whether a worker in the construction industry is an employee has changed significantly since 1991,” referring to Section 181.723 (the construction independent contractor statute

effective January 1, 2009). (Add-5-6) However, the 1991 decision does not state that it was based on Builders' members being classified as "independent contractors." Rather, it found that the member (Ripley) was not an "employee" and that the "remuneration" paid by Builders did "not constitute wages under the Minnesota Jobs and Training Law for unemployment tax and benefit purposes." (Add-78) Enactment of the construction independent contractor statute Section 181.723 does *not* change the law that compels a conclusion that Builders does not pay its members "wages," and therefore is not an employer subject to Minnesota's unemployment insurance law. The law that advances designated as loans are not wages has *not* changed. Prior to its codification in 2007 as Section 268.035, subd. 29(e), that exception from "wages" was a DEED administrative rule (Minn. R. 3315.0210). The facts are the same, the rule that advances designated as loans are not wages is the same, and the conclusion must be same: Builders is not an employer of its members.

CONCLUSION

Pursuant to Minnesota Statutes Section 268.035, subd. 29(e), Builders' advances paid to members are *not* wages subject to unemployment insurance taxes. The advances are designated as loans at the time they are paid, and members are contractually obligated to pay back monies borrowed as advances that exceed their share of the actual fiscal income for the cooperative (i.e. their patronage distribution). The advances members receive based on hours worked are merely an attempt to fairly distribute the cooperative's anticipated earnings throughout the fiscal year. The advances are loans against the anticipated earnings and must be paid back if they exceed the monies available for

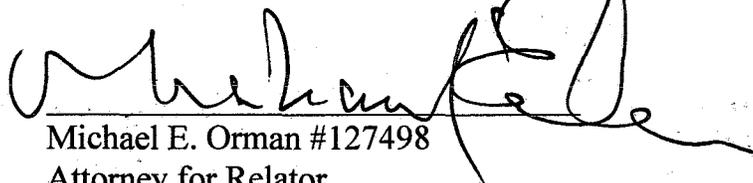
distribution at the end of the fiscal year. Applying the definition of "wages" in Section 268.035, subd. 29(e), to these facts compels a determination that Builders does not pay its members wages and Builders is *not* an employer of its members.

The law to determine the status of a cooperative that does not pay its members wages has *not* changed. Builders finds it an appalling abuse that DEED, with the Department of Revenue, can conduct a flawed audit of its business and then issue (and its ULJ affirm) an assessment of taxes, plus arrearages and penalties for four prior years, that is contrary to DEED's prior 1991 decision. Builders should not be liable for any unemployment insurance tax arrearages or penalties, because it relied on the 1991 decision that the advances were not wages and that it was *not* an employer of its members. Builders seeks relief from the ongoing prosecution by DEED and DOR.

Builders respectfully requests that this Court reverse the decision of the ULJ that Builders is an employer of its members.

Dated: 10/17/11

ORMAN NORD & HURD P.L.L.P.



Michael E. Orman #127498

Attorney for Relator

1301 Miller Trunk Highway, Suite 400

Duluth, MN 55811

218-722-1000