

Law Firm Partners – Employers or Employees?

BY LAZAR EMANUEL

This article discusses the potential impact on the mandatory retirement policies of many law firms of a case which is still wending its way through the federal courts. In 1999 - eight years ago - Sidley Austin (Sidley) reclassified 32 of its equity partners and relegated them to the status of "counsel" or "senior counsel." The firm acknowledged that this constituted a demotion and an adverse personnel action as defined in the antidiscrimination laws, but claimed that the demotions were due to inadequate performance, not to age.

The EEOC began an investigation to determine whether age had been an inducing element in the demotions and, therefore, whether the demotions had violated the Age Discrimination in Employment Act ("ADEA"). The EEOC's investigation has prompted three decisions by the federal courts, two in the district court and one in the Court of Appeals for the Seventh Circuit (*E.E.O.C. v. Sidley Austin Brown & Wood*, 315 F.3d 696 (2002)). A call last week to John C. Hendrickson, Regional Attorney for the EEOC, confirmed that the matter is still pending and that discovery is ongoing.

The ADEA protects against age discrimination all persons who qualify as "employees" of an "employer" and who are over the age of 40. Its definition of the term "employee" is "an individual employed by an employer." Its definition of "employer" is "a person engaged in an industry affecting commerce who has twenty or more employees." The lines are clearly drawn: employees on one side - employers on the other. But where is the line to be drawn in a law firm, especially one like Sidley, which has 15 offices and 1,700 lawyers, 400 of them in New York City?

Certainly, employees who are not lawyers are "employees" of a law firm. Lawyers who are not equity partners are also unquestionably employees. The central question becomes: are equity partners in a law firm which is covered by ADEA -i.e., a law firm engaged in commerce with more than 20 employees or employers? Are some of them employees, and some employers? If there is a difference among the partners, how do we determine which of them are employees and which employers? After all these years, these issues are still unresolved. Why is the issue so important?

The issue is important in resolving much of what a law firm may do in matters involving employment. Many federal and state statutes on employment utilize the same definition of "employee" as the ADEA (e.g., ADA, ERISA). Although the ADEA is concerned only with discrimination on account of age, any ADEA case which defines the term "employee" as it relates to law firms will have a major influence on many of the employment practices engaged in by these firms.

One of the most widespread of these employment practices is the imposition of mandatory retirement on lawyers who reach a prescribed age, usually at age 70.

Mandatory Retirement Policies

In a recent Report on Mandatory Retirement Practices (*see*, NYPRR, March 2007, p. 8), an NYSBA Special Committee on Age Discrimination studied the impact of age on mandatory retirement policies in law firms. Among other data, it cited a study reported by the National Law Journal which revealed that 37% of law firms surveyed had adopted mandatory retirement policies based on age. The Special Committee had this to say about these policies:

....mandatory retirement policies adopted by most private and public sector employers, including law firms, and made applicable to entire classes of employees who reach a certain age are generally considered unlawful under New York and federal laws against age discrimination.

Further, as the Special Committee pointed out, DR 1-102(A)(6) defines as "misconduct" any steps by a law firm to:

Unlawfully discriminate in the practice of law, including in hiring, promoting or otherwise determining conditions of employment, on the basis of age, race, creed, color, national origin, sex, disability, marital status, or sexual orientation.

Under this Rule, a determination that a firm has violated the Rule which is final and enforceable and is no longer appealable or subject to review, constitutes prima facie evidence of professional misconduct in a disciplinary proceeding. However, as the Committee reported, "There does not appear to be any case law treatment of the discrimination prohibitions of DR 1-102(A)(6) in the context of lawyers within a law firm, whether in the context of partners vis-à-vis non-partner lawyers or partners vis-à-vis other partners."

EEOC v. Sidley

The action by EEOC against Sidley may well be the case which supplies some of the answers. The proceeding began after Sidley had demoted 32 of its equity partners and EEOC determined that Sidley had failed to supply it with all the documents it needed to complete its ensuing investigation. EEOC served a subpoena *duces tecum* on Sidley requiring production of documents relating to two issues: 1. coverage (were the 32 equity partners "employees" or "employers?"); and 2. Discrimination (was age a factor in their demotion?).

In response, Sidley provided most of the documents relating to coverage, but no documents relating to age. It argued that the documents submitted were enough to establish that the 32 partners had been "real partners" (*i.e.*, "employers"), and that because coverage did not exist, EEOC was precluded from further inquiry. EEOC applied to the district court for an order to compel production of the remaining documents; the court granted the application; and Sidley appealed.

The opinion on appeal was written in his usual embroidered style by 7th Circuit Judge Posner. The first few pages of his opinion establish the link between the EEOC proceeding and mandatory retirement policies:

The Commission also appears to be seeking information on whether Sidley may be forcing other partners whom the Commission suspects may also be employees within the meaning of the age discrimination law to retire on account of their age, contrary to the abolition of mandatory retirement

by the age discrimination law. But the parties appear to have assumed that if the 32 are (as Sidley contends) employers, so are all of Sidley's other partners. So we need not consider the mandatory retirement issue separately.

In other words, if none of Sidley's equity partners can be considered "employees" under the ADEA, then a mandatory retirement policy based on age and limited to equity partners cannot be challenged. Nor, as Sidley argued, did the EEOC have jurisdiction in the case of the 32 demoted partners because as equity partners, they were all "employers." As Judge Posner summarized the Sidley argument:

The Commission has no jurisdiction in this case because a partner is an employer within the meaning of the anti-discrimination laws if (a) his income included a share of the firm's profits; (b) he made a contribution to the capital of the firm; (c) he was liable for the firm's debts; and (d) he had some administrative or managerial responsibilities.

But, Judge Posner said, "Sidley can obtain no mileage by characterizing the coverage issue as 'jurisdictional'."

It is the law that the EEOC cannot protect employers; and it is also the law that like any agency with subpoena powers the EEOC is entitled to obtain the facts necessary to determine whether it can proceed to the enforcement stage. Among these are the facts bearing on whether the 32 demoted partners were employees within the meaning of the age discrimination law.

The Facts in Sidley

As the Court knew them at the time of its opinion, the facts showed that Sidley was controlled by an executive committee of 36 members who were not elected by the other partners but were self-perpetuating; that although the other partners had limited powers in hiring and firing delegated to them by the executive committee, they were "at the committee's mercy" on issues of their own employment the committee could hire them, fire them, demote them, raise or lower their pay, etc.; and that they had been permitted to vote on a firm-wide policy issue only once in many years "and that vote took place after the EEOC began its investigation."

The average capital contribution of the 32 demoted partners was \$400,000. Under the firm's rules, all partners were liable for the firm's debts in proportion to their capital accounts. Income to each partner was distributed according to a system under which the executive committee assigned to each partner a percentage of the firm's profits. Although all partners served on one or more committees, all committees were subject to control by the executive committee.

Under Illinois state law governing the Sidley partnership, it was clear that all 32 demoted lawyers were partners of the firm. "...if we looked there, we would find that Sidley was indeed a partnership and the 32 demoted partners were indeed partners before their demotion. Sidley has complied with all the formalities required by Illinois law to establish and maintain a partnership; the 32 were partners within the meaning of the applicable partnership law."

However, Judge Posner said, "Although the EEOC does not concede that the 32 were bona fide partners even under state law, it is emphatic that their classification under state law is not dispositive of their status under federal antidiscrimination law."

The antidiscrimination laws do not exempt partnerships from coverage (Sidley concedes that) or deny partners, as such, the protection of the laws. Employers are not protected by discrimination laws such as Title VII and the ADEA, but are partners employers? Always? Always for purposes of Title VII or the ADEA, or the other federal laws that prohibit employment discrimination? Statutory purpose is relevant.

Comparing Partners & Corporate Employees

Judge Posner found the facts in Sidley especially relevant. He compared them to the facts in cases involving corporations, especially because all power in Sidley "resides in a small, unelected committee," similar to "the self-perpetuating board of trustees of a private university or other charitable foundation." In the same way as partners at Sidley, including the 32 who were demoted, employees of a corporation regularly commit the corporation to contracts within the scope of their employment. Many corporate employees share in the profits of the company without re-classification as employers. Corporate employee serves on corporate committees without becoming employers.

And corporate employees often own stock in the corporation, just as the Sidley partners owned some of the firm's capital.

Replying to Sidley's argument that the 36-partner executive committee served by delegation from the entire partnership under the firm's partnership agreement, and that, therefore, all the partners should be treated as if they were directing the firm, Judge Posner said:

That would be like saying that if the people elect a person to be dictator for life, the government is a democracy rather than a dictatorship. The partners do not even elect the committee. They have no control, direct or indirect, over its composition.

The one "partneresque" feature the Judge found was the partners' personal liability for the firm's debts. Unlimited liability is not unique to partnerships, however. It exists also in limited partnerships and in sole proprietorships, but it is "the most salient practical difference between the standard partnership and a corporation." (In passing, Judge Posner commented that although the Sidley partnership provided for pro-rata liability among the partners that would not prevent a creditor of the firm from suing any partner for his entire claim. But, he asked, "Is this [unlimited liability] enough to pin the partner tail on the donkey." He found a partial answer in *Simpson v. Ernst & Young*, 100 F.3d at 441-42, a case involving a nominal partner in an accounting firm. The Simpson court had treated partners as employees "in circumstances broadly similar to, though distinguishable from, those of the present case." The Simpson court said:

...because these individuals actually had no bona fide ownership interest, no fiduciary relationship, no share in the profits and losses, no significant management control, no meaningful voting rights, no meaningful vote in firm decisions, and no job security, they were not bona fide partners. Therefore

Ernst & Young was obligated not to discriminate against them because of their age, sex, race, religion, national origin or handicap.

Comparing the 32 demoted lawyers in Sidley to the accountant in Ernst & Young, Judge Posner commented:

The matter of liability for partnership debts illustrates the importance of referring the question whether a partner in a particular firm is an employer or an employee for statutory purposes. ...These 32 partners were not empowered by virtue of bearing large potential liabilities. The 32 were defenseless; they had no power over their fate....To repeat, the issue is not whether the 32 before their demotion were partners, an issue to which their liability for the firm's debts is germane; the issue is whether they were employers.

The two classes, partners under state law and employers under federal antidiscrimination law, may not coincide.

Wells v. Clackamas

One case cited by Judge Posner to support his analysis was *Wells v. Clackamas Gastroenterology Associates, P.C.*, 271 F.3d 903 (9th Circuit 2001), cert. granted U.S.L.W. 3625 (U.S. Oct. 1, 2002). Wells was a bookkeeper in a professional corporation which ran a medical clinic. The shareholders were 4 doctors. To avoid coverage for Wells under the ADA, which requires that the employer have at least 15 employees, the doctors argued that they were not employees themselves. The district court agreed, on the basis of the "economic realities" test, that the doctors were "more analogous to partners in a partnership than to shareholders in a general corporation" and were not employees. The 9th Circuit reversed. Rejecting the "economic realities" test, it held that any use of the corporate form, including use as a professional corporation, precluded "any examination designed to determine whether the entity is in fact a partnership."

Following Judge Posner's citation of the Clackamas decision by the 9th Circuit, the Supreme Court, proceeding under the writ of certiorari, returned the case to the Circuit Court for further proceedings. Writing for the Court, Judge Stevens instructed the Court of Appeals not to limit its inquiry to whether a shareholder-director is the "functional equivalent of a partner," but to apply instead the common law examination into whether the shareholder exercised control over the business. Judge Stevens wrote:

We are persuaded by the EEOC's focus on the common-law touchstone of control....and specifically by its submission that each of the following six factors is relevant to the inquiry whether a stockholder director is an employee. (The Court listed six common-law factors taken from the EEOC Compliance Manual §605-0009.)

In encouraging use of the "economic realities" test, Judge Stevens was using the same reasoning as the 7th Circuit had itself used in the earlier case of *EEOC v. Dowd & Dowd, Ltd.*, 736 F.2d 1177 (7th Cir. 1984). Recalling the decision in Dowd, Judge Posner ordered Sidley to comply with that part of the EEOC subpoena which related to coverage (*i.e.*, whether the 32 demoted partners were employees or employers. "All that is clear amidst this welter of cases is that the coverage issue in the present case remains murky despite Sidley's partial compliance with the subpoena.")

Inquiry Limited to Coverage

What the Commission particularly wants to know is how unevenly the profits are spread across the entire firm. Are profits so concentrated in members of the executive committee, or in some smaller or larger set of partners, in relation to the profits that the executive committee allocated to the 32, that the latter occupied the same position they would have if they had been working at a comparable rank for one of the investment banks that once were partnerships but now are corporations? This might not be decisive but it would bear on the unavoidably multi-factored determination of whether this large law firm.... should for purposes of anti-discrimination law be deemed the employer of some at least of the individuals whom it designates as partners.

Judge Posner explained why he was limiting the EEOC's inquiry to the issue of coverage.

Without having proposed a standard or criterion to guide the determination, the Commission has not earned the right to force the law firm not merely to finish complying with the coverage portion of the subpoena but to go on and produce the voluminous and sensitive documentation sought relating to the question whether, if these 32 partners were employees, they were demoted on account of their age and therefore in violation of the age discrimination law....

We hold only that there is enough doubt about whether the 32 demoted partners are covered by the age discrimination law to entitle the EEOC to full compliance with that part, at least, of its subpoena.

The doubt expressed by Judge Posner has yet to be resolved.

[Editor's note: The EEOC investigation of Sidley has spawned other litigation. After the Posner opinion was issued, the EEOC filed an ADEA suit against Sidley. The district court ruled that the EEOC could obtain monetary relief on behalf of partners who were barred from bringing their own suits because they had failed to file timely administrative charges under the ADEA. Sidley moved for partial summary judgment, which the district judge denied. Sidley appealed to the 7th Circuit. Speaking for the Court again, Judge Posner affirmed the lower court's decision. EEOC v. Sidley Austin LLP. No. 06-8002 7th Cir. February 17, 2006.)]

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