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When Is a Partner Not a Partner?

BY BETTINA B. PLEVAN AND JENNIFER B. WANG

LIKE A BYSTANDER in the second half of "Don Quixote," the district court in the EEOC suit against Sidley Austin recently observed that the proceedings—which began with the much-publicized EEOC subpoena relating to the firm's demotion of 32 partners and new retirement plan in 1999—had "been of great interest not only to Sidley, but also to most other large law firms across the country." 'EEOC v. Sidley Austin,' 406 F.Supp.2d 991, 995 (N.D. Ill. 2005), aff'd, 437 F.3d 695 (7th Cir. 2006). In "Don Quixote," the eponymous character, while aware that his every move was being observed by a large audience, was barely affected—at least for a few hundred pages. Similarly, in the 'Sidley Austin' case, characters in the litigation drama over claims of age discrimination know that they are being watched closely but so far very little guidance has emerged from the case.

Suit against Sidley Austin poses questions over application of anti-discrimination laws at large firms.

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In 2002, Judge Richard A. Posner, of the U.S. Court of Appeals for the Seventh Circuit, criticized the parties for not explicating why partners should or should not be considered employees. In fairness, the court itself failed to address the issues head-on, as Judge Frank H. Easterbrook noted in his concurrence. More than three years later, after observers waited anxiously to see if the court would offer any guidance, all that has emerged is one additional decision this year on a procedural issue.

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The nation's large law firms therefore continue to lack clear guidance as to the extent to which and under what circumstances their partners could be viewed as employees for purposes of anti-discrimination and other employment laws: What are the most relevant and decisive criteria? Are state law definitions of partners now irrelevant for determining employer and employee status under the anti-discrimination laws? Will the courts differentiate between different management structures? This article will outline recent developments in the case law and examine just how many questions remain unanswered.

Before the *Sidley Austin* action, cases considering whether partners qualified as employees for purposes of the anti-discrimination laws generally fell into two categories: cases involving small, "traditional" partnerships, in which courts readily found that partners were not employees;[1] and cases involving large, nationwide partnerships, but not law firm partnerships, in which courts have held that those partners who did not have voting rights were employees.[2]

Most recently, a New York state court held that four out of five name partners in a small firm were not entitled to share in fees earned in a class action because the partners were in actuality mere employees. The judge noted that the partners were listed in payroll books as employees, did not have an ownership interest in the firm, had no share in the profits, made no contribution to capital, and had no control over firm management. *Silverman v. Keller*, No. 6019103/04 (Sup. Ct. New York Co., filed March 20, 2006). This decision follows the one consensus that seems to have emerged in the cases: The mere use of the label "partner" is not controlling.

Response to Subpoena

In the first phase of the *Sidley Austin* case, the Equal Employment Opportunity Commission sought enforcement of an administrative subpoena duces tecum pursuant to the EEOC's investigation of Sidley under the Age Discrimination in Employment Act. *EEOC v. Sidley Austin*, No. 01 C. 9635, 2002 WL 206485 (N.D. Ill. Feb. 11, 2002), vacated, 315 F.3d 696 (7th Cir. 2002). The investigation related to the firm's implementation of a plan in 1999 that changed the firm's mandatory retirement age for partners from 65 to a discretionary retirement age between 60 and 65 and demoted 32 partners—30 of whom were over age 40—to counsel or senior counsel status.

Sidley had responded to the subpoena by providing documents demonstrating that it is a partnership, but Sidley refused to provide documentation regarding the development of the retirement plan or particular information about the firm's partners, including the reasons the demoted partners were chosen for change in status. Sidley characterized its objection as "jurisdictional," arguing it was not subject to the EEOC's regulatory authority with regards to members of the Sidley partnership, because under the case law, so long as an individual meets the characteristics of a "true partner," a subpoena such as that sought by the EEOC could not be enforced. Id. at *2.

The EEOC responded that it "certainly" had jurisdiction over Sidley and that it was up to the EEOC whether the affected partners were "covered" by the ADEA based on a six-factor test: (1) whether the organization can hire or fire the individual or set the rules and regulations of the individual's work; (2) whether and, if so, to what extent the organization supervises the individual's work; (3) whether the individual reports to someone higher in the organization; (4) whether and, if so, to what extent the individual is able to influence the organization; (5) whether the parties intended that the individual be an employee, as expressed in written agreements or contracts; (6) whether the individual shares in the profits, losses, and liabilities of the organization. Id. at *3.

Although the Illinois district court did not explicitly hold which standard was appropriate, it noted that it could not "find with utter confidence that there are no facts that could be contained within the subpoenaed information that would make a difference such that, in effect, Sidley is now entitled to judgment as a matter of law." Id. at *3. Thus, the court ordered that Sidley comply with the subpoena in full.

The U.S. Court of Appeals for the Seventh Circuit also rejected Sidley's jurisdictional argument, holding that the EEOC was entitled to the information it thought necessary to "formulate its theory of coverage." *EEOC v. Sidley Austin*, 315 F.3d 696 (7th Cir. 2002). Writing for the majority, Judge Posner stated that the court would need to "choose" between the two theories only if the EEOC had requested clearly irrelevant information could Sidley avoid the subpoena. Id. at 700.

On appeal, the firm argued that the individual was not an employee if an individual met four criteria: (1) his or her income included a share of firm profits, (2) he or she made a contribution to the capital of the firm, (3) he or she was liable for the firm's debts, and (4) he or she had some administrative or managerial responsibilities. 315 F.3d at 699. The EEOC argued only that individuals' classifications under state law as partners was not dispositive of their status under federal anti-discrimination laws.

Judge Posner articulated his own view of the arguments for both sides. As a "functional" argument, he reasoned that an individual classified as a partner for state law purposes might still be characterized as an employee for the statutory purposes underlying federal anti-discrimination laws because otherwise, firms seeking to avoid EEOC scrutiny could simply relabel employees as partners without changing the relationship. Id. at 705-707. On the other hand, Judge Posner suggested that one could argue that partnership law provides effective remedies against discrimination by other partners, that partnerships would be "poisoned" by allowing such litigation, and that relationship among partners "is so intimate that they should be allowed to discriminate." He also noted that a functional test of employer status might be too uncertain for law firms and other partnerships to determine in advance of their exposure to discrimination suits. Id. at 702-703.

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As to Sidley in particular, he observed that, although the firm had over 500 partners, "all power resides in a small, unelected committee" of 36 members. He was "[p]articularly unconvinc[ed]" by Sidley's assertion that the entire partnership directed the firm solely by executive committee simply because the committee exercised its "absolute power by virtue of delegation by the entire partnership in the partnership agreement," which he characterized as similar to labeling a dictatorship a democracy on the basis of one election. 315 F.3d at 702-703. And while he acknowledged that partners could commit the firm (for example, with opinion letters), he did not find that fact persuasive, since employees of a corporation "regularly commit" corporations to contracts or tort liability.

With regards to the partners' sharing of firm profits, Judge Posner likened the partners to executive employees of corporations, and noted that courts have found shareholders of professional corporations to be employees for purposes of federal anti-discrimination laws. Id. at 703.

The only element of Sidley's partnership that Judge Posner considered truly "partneresque" (as opposed to corporate) was the partners' personal liability for firm debts. In particular, Sidley did not have limited liability so that each partner was liable to creditors of the firm for the firm's entire debt. Even as to this element, however, Judge Posner was skeptical. He cited without explanation Tenth and Eleventh Circuit cases that had "come close[]" to finding unlimited liability to be dispositive as to a partner's status as an employer, but noted that even those decisions did not "deny the necessity of considering other factors." 315 F.3d at 703. He then noted that the Ninth and Sixth Circuits had reasoned otherwise, and included a lengthy section from the Sixth Circuit's decision in *Simpson v. Ernst & Young*, 100 F.3d 436, 442 (6th Cir. 1996), which considered a variety of factors before concluding that an Ernst & Young partner was not a "bona fide partner" and therefore fell under the protections of anti-discrimination laws. 315 F.3d at 703-704.

Despite his clear preference for a functional approach, Judge Posner did not hold that such an approach required partners to be covered by federal anti-discrimination laws. Instead, he simply concluded that the coverage issue was "murky" in Sidley's case, and that Sidley should therefore comply with the subpoena insofar as it requested information as to coverage. 315 F.3d at 707.

In so holding, Judge Posner reasoned that because the EEOC had failed to argue the purpose of excluding employers from the ADEA, it had not "earned the right" to force Sidley to produce information on the merits of the claim. Interestingly, Judge Posner criticized the EEOC as not "having proposed a standard or criterion to guide the determination," but never mentioned in his opinion the EEOC's six-factor test for determining whether a partner is an employee or an employer.

Mandatory Retirement Age

Judge Easterbrook's concurrence criticized the majority opinion as missing an opportunity to decide the question of whether large firms can adopt mandatory-retirement rules. 315 F.3d at 708. In Judge Easterbrook's view, the circular definition of employee in the anti-discrimination laws is not insurmountable. He noted that the U.S. Supreme Court had assumed in *Hishon v. King & Spalding*, 467 U.S. 69 (1984), that a "bona fide partner of a large law firm is not an 'employee' for purposes of Title VII." Id. at 708. Moreover, the Court had concluded that traditional state agency law criteria for master-servant relations should be incorporated into the Employee Retirement Income Security Act (ERISA) in determining the definition of employees. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992).

Judge Easterbrook interpreted the *Darden* opinion as calling for "symmetry" between federal law and the master-servant principles of state law. 315 F.3d at 711. Thus, the majority had erred, in his opinion, in allowing the possibility that a bona fide partner under agency principles could also be an employee under federal law. Id. at 709. In Judge Easterbrook's view, the Illinois definition of a bona fide partner was the standard under which to determine if the Sidley partners were covered by the ADEA. Id. Under Illinois law, participation in profits is the defining characteristic of a bona fide partner.

As a result, because the Sidley partners (1) participated in profits and "had to pony up if Sidley incurred a loss," (2) had capital accounts that were at risk if Sidley "foundered," (3) were personally liable for the firm's debts, and (4) were the only individuals who had an equity interest in the firm, Judge Easterbrook concluded the Sidley partners were not employees. Id. at 710. However, he concurred in the judgment because not every lawyer who Sidley designates as a partner is necessarily a bona fide partner, but under Sidley's retirement policy, every partner faces a mandatory retirement age. Thus, the EEOC was entitled to investigate whether such a policy was lawful.

Judge Easterbrook rejected the de facto corporation label; instead, he insisted that "a member of a large partnership including smaller associations remains a partner rather than an employee in both economic and legal senses." 315 F.3d at 710. He pointed to the then-upcoming Supreme Court decision in *Clackamas Gastroenterology Associates v. Wells*, 538 U.S. 440 (2003), as an opportunity for the court "to resolve some or all of the problems that govern the classification of Sidley's members." Id. at 711.

In *Clackamas*, the Supreme Court held that physicians actively engaged in medical practice as shareholders and directors of a professional corporation should be counted as "employees" for the purposes of the Americans with Disabilities Act of 1990 (ADA). After observing that the ADA's definition of the term "employee"—"an individual employed by an employer"—is "completely circular and explains nothing," the Supreme Court held that "when Congress has used the term 'employee' without defining it, we have concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine." Id. at 444-445.

After noting the common law's focus defining the master-servant relationship based on the master's control over the servant, the Supreme Court held that "the answer to whether a shareholder-director is an employee depends upon all of the incidents of the relationship with no one factor being decisive." Id. at 451.

The holding of *Clackamas* is not limited to the ADA context. To the contrary, in explaining its decision to grant certiorari to resolve the conflict over the term "employee," the Court explicitly stated that "[t]he disagreement in the Circuits is not confined to the particulars of the ADA." 538 U.S. at 444 n.3. Thus, it would appear that under *Clackamas*, the question of whether large law firms' partners are "employees" hinges on the common-law notion premised upon control.

Recent Developments

After receiving documents in accordance with court orders, the EEOC determined, pursuant to its own six-factor test, that Sidley had violated the ADEA by downgrading some partners on account of their age and by maintaining a mandatory retirement age. After unsuccessful conciliation discussions with Sidley, the EEOC filed suit on Jan. 13, 2005, seeking monetary damages and injunctive relief.

Most recently, the Seventh Circuit addressed the issue of individual relief but again failed to provide guidance on the broader issues. The district court denied Sidley's motion for partial summary judgment as to the individual relief for the affected partners. *EEOC v. Sidley Austin*, 406 F.Supp.2d 991 (N.D. Ill. 2005), aff'd 437 F.3d 695 (7th Cir. 2006). Sidley argued that the EEOC could not obtain such relief because, while the EEOC received a confidential request for an investigation, the partners had not filed charges under the ADEA and were time-barred from bringing individual suits.[3]

The Seventh Circuit had held in *EEOC v. North Gibson School Corp.*, 266 F.3d 607 (7th Cir. 2001), that the EEOC could not recover individual relief under the ADEA if none of the alleged victims had filed a timely charge of discrimination. However, the Supreme Court subsequently ruled in *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 291 (2002), that the EEOC could seek monetary relief for individuals whose ADA claims were barred because the ADA had made the EEOC "the master of its own case" and "confer[red] on the agency the authority to evaluate the strength of the public interest at stake." Moreover, the Court stated that the EEOC could seek "to vindicate a public interest…even when it pursues entirely victim-specific relief." Id. at 296.

The *Sidley* district court thus concluded that *Waffle House* afforded the EEOC the right to seek relief for individuals such as the Sidley partners "who could not, for a variety of reasons, do so themselves"; such a right "goes beyond that of the individual and reaches the territory of public interest." 406 F.Supp.2d at 994.

In the most recent decision, the Seventh Circuit affirmed the denial of partial summary judgment for Sidley Austin. *EEOC v. Sidley Austin*, 437 F.3d 695 (7th Cir. 2006). In a terse opinion by Judge Posner, the court stated only that its decision in *North Gibson* was "scuttled" by the Supreme Court in *Waffle House*, and the district court was therefore correct to hold that the EEOC could obtain monetary relief on behalf of the Sidley Austin partners, despite the partners' failure to exhaust their remedies. Id. at 696. The court did not mention the Supreme Court's decision in *Clackamas* nor provide additional guidance as to the principles discussed in the Seventh Circuit's own previous opinion.

Hopefully, in the near future, decisions in the *Sidley* case will provide much needed guidance for large national law firms as to the applicability of the federal anti-discrimination laws to their firms' partners. In the meantime, what observers can conclude, based on dicta, is that in law firm governance structures, the ability of partners to select leadership is a key factor: If there is a small leadership group, is that group self-perpetuating, as in Sidley's case, or voted on? Additionally, the method of expulsion is important: Are such decisions made by firm management, rather than a vote of the partners? Similarly, in predicting liability in federal court, law firms should examine whether all partners vote on important matters, or if a governing committee makes all such decisions.

Finally, a word of warning for law firms that observe the Sidley proceedings and conclude that the lack of guidance can be viewed as acquiescence: Partnership creates a fiduciary relationship. Thus, even if the *Sidley* case finally concludes that large law firm partners are "employers" for purposes of the anti-discrimination laws, the fiduciary relationship itself could encompass a prohibition against discrimination based on the duty of good faith and fair dealing in the context of partner expulsions.

1. See, e.g. *Ehrlich v. Howe*, 848 F.Supp. 482 (S.D.N.Y. 1994); *Serapion v. Martinez*, 119 F.3d 982 (1st Cir. 1997), cert. denied, 522 U.S. 1047 (1998).

2. See, e.g. *Simpson v. Ernst & Young*, 100 F.3d 436 (6th Cir. 1996), cert. denied, 520 U.S. 1245 (1997).

3. Indeed, a month prior to the district court's decision, seven of the 32 partners sought unsuccessfully to sever themselves from the EEOC suit. The judge's denial of these requests on the basis of the partners not being parties that could be severed portended his decision.