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ARE LAW FIRM PARTNERS "EMPLOYERS" FOR PURPOSES OF DISCRIMINATION LAW?
A Federal Court of Appeals Suggests They May Not Be

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Recently, the U.S. Court of Appeals for the Seventh Circuit suggested that some law firm partners may qualify as "employees" for purposes of federal anti-discrimination law. The colorful opinion, written by Judge Richard Posner, was issued in the case of *EEOC v. Sidley Austin Brown & Wood*.

The decision is certain to inspire fear in law firms across the country. If partners indeed qualify as firm "employees," that means they can sue their firms under laws such as the Age Discrimination in Employment Act (ADEA); Title VII, the major federal anti-discrimination statute; and other federal laws that only "employees" can invoke.

Partners could then use claims under these statutes to try to invalidate a variety of law firm practices, including mandatory retirement rules, which now could be challenged under the ADEA. (The ADEA protects employees 40 and over from age-related employment discrimination.)

Historically, firms have been virtually immune from lawsuits based on their decisions relating to their own partners. That immunity would be gone.

The case arose when the law firm of Sidley Austin Brown & Wood decided to demote 32 equity partners (most of whom were over age 50) to "counsel" or "senior counsel."

The EEOC subsequently began an investigation. It issued a subpoena to Sidley, seeking information relating to two issues: First, did the demoted partners qualify as employees under the ADEA? Second, were the demotions undertaken on the basis of age? The EEOC sought information relating not only to the demotions, but also to the firm's mandatory retirement policy as well.

With respect to the first issue the subpoena addressed, Sidley complied only in part. It argued that the EEOC had sufficient information to determine that the partners were "true partners," and, therefore, were not protected as employees under the ADEA.

With regard to the second issue, Sidley provided no information, on the theory that because the partners were not "employees," the EEOC had no jurisdiction to conduct the investigation, since none of the statutes the agency enforced could apply.

The EEOC then applied for an order to enforce the subpoena, and the district court ordered the firm to comply in full. The firm appealed the order, and the dispute - which at base raised the issue of who constitutes an employee under the ADEA - thus came to the Seventh Circuit under the guise of a technical question about the EEOC's subpoena authority.

Who Is An "Employee" Under Federal Anti-Discrimination Laws?

The EEOC's subpoena was not enforceable unless Sidley's demoted partners could be considered "employees" for purposes of the ADEA. Could they?

The answer is not crystal clear. And anti-discrimination statutes typically offer little to define the two terms "employee" and "employer," beyond circular definitions of an "employee" as "an individual employed by an employer."

Fortunately, though, in most cases it is obvious whether an individual is an "employee" who is protected by the law, or, alternatively, an "employer" who is liable under it. But at the margins, certain types of workers are hard to classify.

Are Partners "Employees"? In Modern Law Firms, Perhaps

But what about law firm partners? Do they, by virtue of being "members" of a firm, occupy a different status?

The conventional wisdom has been that they do. Courts have traditionally assumed that partners are employers because - unlike support staff and associates - they own a share of the firm, participate in major firm decisions, and share in the firm's profits and losses.

The structure of the modern law firm, however, necessitates that this assumption be revisited. Law firms have grown in size, and with that, many have centralized power and decisionmaking authority, devolving it on only a small executive or management committee, or even a single managing partner.

Many have also created multiple tiers of partnership, including non-equity partners who are salaried and own no share of the firm. Those changes make it far less clear whether some partners - those who are not full equity partners, or who do not belong to the committee that, in practice, runs the firm - should be considered "employees."

Sidley's firm structure is a good example of such a modern firm. The firm has more than 500 partners, of whom only a select few sit on the self-perpetuating executive committee. Arguably only these powerful few are truly "employers" and not "employees."

The executive committee at Sidley delegates authority to other partners to hire, fire, promote, and determine compensation for their subordinates. But the other partners themselves work at the mercy of the executive committee: Based on the unappealable decision of the executive committee, partners can be fired, demoted (as in this case), or have their pay lowered.

At Sidley, important decisions all come from the executive committee. The firm has taken only one firm-wide vote in the last twenty-five years. That vote - on whether to merge with another firm - took place after the EEOC filed this case. Otherwise, the executive committee has exercised full control.

Sidley's partnership presents a good case for reexamining the general rule that equity partners cannot be employees. The demoted partners in the Sidley case had many of the incidents of partnership--such as ownership of a share of the firm, profit sharing, and liability in proportion to capital contribution. But they lacked other important ones, such as co-equal control and power over the firm.

In the 1984 case of *Hishon v. King and Spalding*, the Supreme Court addressed the question whether an associate being considered for partnership still qualified as an "employee" for Title VII purposes. The Court said yes.

Justice Powell concurred, writing separately to suggest that decisions regarding partners made after they had joined the partnership would not be constrained by Title VII. Thus, according to Justice Powell, a law firm could not be taken to task for deciding to unfairly compensate, demote, or mandatorily retire an employee - even if that decision was clearly based on age, sex, race, or some other characteristic protected by Title VII. (Partners discriminated against on the basis of race may independently have a claim under section 1981, which, as I discussed in a prior column, is a federal statute prohibiting race discrimination in employment contracts, among other things.)

Hishon, however, did not resolve the issue of whether partners may under some circumstances be protected by federal anti-discrimination laws. For one thing, it is not clear how many, if any, other Justices shared Justice Powell's view. For another thing, the issue was not squarely presented in the case, which involved a firm's decision as to who would be a partner, not its decision about a current partner's fate.

Lower Courts Have Found that Partners Can Function As "Employees" At Times

Since *Hishon*, courts have struggled with the boundary between "employer" and "employee" with respect to partners (in law firms as well as other types of partnerships). Many have adopted a general rule that partners are not employees. But many also recognize that exceptions might be made, based on a functional analysis of the partner's role in the firm or the firm's structure. Under such exceptions, a partner may indeed be deemed an "employee" under certain circumstances.

Some courts have drawn bright lines: Partners in firms that have incorporated are employees, while those in unincorporated partnerships are not.

Likewise, many courts distinguish between equity partners, who profit-share, and non-equity partners, who are paid a fixed salary, and treat the latter - and only the latter - as "employees."

Other courts have adopted a more fact-intensive approach such as the "economic realities" test. That test asks whether a person who is formally labeled a "partner" in fact bears the incidents of partnership: the ability to participate in the control and operation of the business, compensation based on profits, and long-term job security.

The Appellate Decision in The Sidley Case: Suggesting Partners Are Employees

First, the majority was swayed by the fact that virtually all the power in the firm was concentrated in a relatively small (36-partner), unelected, self-perpetuating committee. Judge Posner rejected Sidley's argument that because the partners delegated their authority to this unelected committee, they, rather than just the small committee, were managing the firm: "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," he explained.

Second, one of the justifications for excluding partners from the protection of federal discrimination laws is that they have other mechanisms under partnership law to protect themselves. Here, however, the partners who were not on the executive committee had essentially no voting power. Thus, they could not, for example, vote to expel partners who were engendering unnecessary liability for them.

Third, Sidley partners do not appear to share what Justice Powell found significant in a traditional law partnership--an understanding that decisions affecting the firm will be made by agreement or consent among all the partners. And a firm that lacks this type of co-equal decisionmaking does not necessarily deserve the immunities granted to traditional partnerships.

Based on these reasons, the majority ordered Sidley to fully comply with the subpoena, to the extent it sought evidence of the partners' functional status, producing responsive documents. Moreover, the majority held that if the documents produced were to show a truly unequal partnership - in which some partners clearly "employ" others - then the EEOC would be entitled to get a response to that part of its subpoena relating to the merits of the age discrimination claim as well.

Judge Easterbrook, who concurred in the result, wrote separately. While he believed that the 32 demoted partners, who maintained capital accounts and profit-shared, were clearly beyond the reach of the ADEA, he thought the EEOC was entitled to determine whether that was true of every partner in the firm. Since all partners were subject to the firm's mandatory retirement rule, the status of each partner was relevant to the EEOC's investigation.

Why The Decision Matters: New Rights for Women, Minorities, and Older Lawyers

Granted, the majority did not ultimately hold that these particular 32 law firm partners are employees for purposes of federal anti-discrimination laws. But it strongly suggested they might be - and even more strongly suggested that some partners, in some circumstances, would be. It decisively rejected any argument that partners are, by their nature, not employees. Instead, it suggested, the nature of partners' status would be determined by the facts.

That idea was previously unthinkable to most law firms. Law firms partnerships have always operated in private, and partners dealt a bad hand have, until now, had relatively little recourse against fellow partners.

This decision may signal a whole new ball game - one that is more fair for women and minorities, who have historically been excluded from the partnership ranks of elite law firms, and continue to suffer discrimination. Older partners, who may fear being edged out by the very lawyers they once mentored, may also benefit.

The EEOC even has the right to vindicate the public interest in eradicating employment discrimination when the individual victims have waived their own right to sue in court - as the Supreme Court held this year in *EEOC v. Waffle House*.

Partnerships thus need to be wary not only of their own members, but of the EEOC as well.

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