



ARE LAW FIRM PARTNERS COVERED BY ANTI-DISCRIMINATION LAWS?

Michael Delikat

mdelikat@orrick.com

ORRICK, HERRINGTON & SUTCLIFFE LLP

666 FIFTH AVENUE

New York, New York 10103

Telephone: 212-506-5230

www.orrick.com

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LAW FIRM PARTNERS AND THE DISCRIMINATION LAWS

I. Introduction.

The question of whether partners or shareholders in professional firms in the United States are employees or employers for the purposes of coverage under the antidiscrimination laws has been the subject of recent litigation. As a result of this litigation, extending to the Supreme Court of the United States and its adoption of a common law right-to-control test in *Clackamas Gastroenterology Associates v. Wells*, 538 U.S. 440 (2003), some questions have been answered. For example, it now appears clear that avoidance of coverage under the antidiscrimination statutes requires at a minimum that members of a firm have an ownership interest in the firm, are compensated according to the risks of the business, and have the degree of right to control of important firm decisions that is expected of "*bona fide* partners" in a classic partnership. It is also now clear that mere jural status as a partner in a partnership organized under state partnership law is not dispositive.

How these developments affect the discrimination law coverage of large partnerships and professional corporations, particularly those of lawyers, remains unclear. What the courts have provided is a paradigm of analysis for the issue, but they have not so far given sufficient guidance to predict how very large firms, with hierarchies of decision-making and very attenuated control by partners or shareholders at the junior level, will fare. Nor is there much guidance on where the cut-off point, if any, occurs between the level at which there is a meaningful right to control among the partners and shareholders in a large and highly elaborated management and decision-making structure, and the level at which the firm is so large, and the structure so complex, that the purported right to control is fatally nominal. The answers to those questions will have to await further developments in the law.

II. Nature and significance of the issue.

Generally speaking, the employment discrimination laws in the United States protect employees, not employers or independent contractors.¹ Thus, for example, in what is probably the best-known and most widely-used statute to remedy employment discrimination, Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e *et seq.*), the law prohibits "unlawful *employment* practices" defined as discrimination with respect to "compensation, terms, conditions, or privileges of *employment*," because of an individual's race color religion, sex or nationality, and limiting, segregating or classifying "employees or applicants for *employment*" in any way which would deprive or tend to deprive any individual "of *employment opportunities* or otherwise adversely affect his status as an employee" because of any of the same characteristics. 42 U.S.C. 2000e-2(a) (emphasis added).

¹ "Title VII does not protect employers." *Solon v. Kaplan*, 398 F.3d 629, 632 (7th Cir. 2005).

This limitation of coverage of the employment discrimination statutes to employees has at least two major consequences. First, it limits the universe of those who may seek and obtain relief under the employment discrimination statutes to those who are "employees" under the terms of the statutes. Second, the employment discrimination statutes generally are made applicable only to employers of a certain size. Thus, under Title VII, for example, the term "employer" is defined as a person engaged in an industry affecting commerce "who has fifteen or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year." 42 U.S.C. § 2000e(b).²

It becomes important both in the context of a claimant's eligibility to seek relief under the employment discrimination statutes and in the context of whether the employer is subject to those statutes to determine the employment status both of the claimant and of those who work for or with the employer.³ To this end, the employment discrimination statutes are notoriously textually unhelpful. Title VII, in phraseology that is typical of most employment discrimination statutes, defines an "employee" simply as "an individual employed by an employer." 42 U.S.C. §2000e(f).⁴

The issue has been particularly troublesome and problematical for business organizations in the learned professions – law, medicine and public accounting. Traditionally, these organizations were conceived as partnerships, and they were generally not permitted to adopt a corporate form of organization. *See Clackamas Gastroenterology Associates v Wells*, 538 U.S. 440, 447 (2003). The hallmark of the traditional partnership was "the common conduct of a shared enterprise," in which "decisions important to the partnership normally will be made by common agreement." *Hishon v. King & Spalding*, 467 U.S. 69, 79-80 (1984) (Justice Powell concurring). Legislation in most American jurisdictions has changed that, and today associations of professionals are permitted to, and often do, organize in a corporate form, in which the principal professional practitioners are shareholders and the firm is run by a board of directors – even though the principal professionals in the organization may formally be called "partners".⁵ *Clackamas* at 447. In addition, partnership itself has evolved from the

² Under the Americans with Disabilities Act ("ADA"), the threshold for coverage is the same as under Title VII. 42 U.S.C. § 12111(5). Under the Age Discrimination in Employment Act of 1967 ("ADEA"), the threshold is "twenty or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year." 29 U.S.C. § 630(b). Under the Family and Medical Leave Act ("FMLA"), the threshold is "50 or more employees for each working day during each of 20 or more calendar workweeks in the current or preceding calendar year." 29 U.S.C. § 2611(4)(A).

³ For these reasons, the ability of the Equal Employment Opportunity Commission ("EEOC"), the primary administrative enforcement agency of federal employment discrimination law, is limited in its ability to prevail in enforcement proceedings by whether the aggrieved individuals whose claims it is investigating are "employees" and whether the employing entity meets the statutory threshold in number of "employees." *See EEOC v. Sidley Austin Brown & Wood*, 315 F.3d 696 (7th Cir. 2002).

⁴ The Supreme Court, in a case involving exactly the same definition of "employee" in the ADA (42 U.S.C. § 12101 et seq.) has observed that this formulation is "completely circular and explains nothing." *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 323 (1992). The same definition of "employee" governs the ADEA (29 U.S.C. § 630(f)), the Occupational Safety and Health Act of 1970 (29 U.S.C. § 652 (6)), the Fair Labor Standards Act (29 U.S.C. § 203(e)(1)), and the FMLA (29 U.S.C. 2611(3)).

⁵ Professional corporation shareholders "invite the designation 'employee' for various purposes under federal and state law." *Clackamas* at 453 (Ginsburg, J., dissenting). The physician-shareholders in

days of small fraternal groupings to large organizations of dozens, if not hundreds of partners. Such large partnership organizations come in various forms, but some of them may be run by small, centralized, self-perpetuating control groups as tightly as any large corporation.⁶

How are the "partners" in this modern professional landscape to be treated under the employment discrimination laws? Are they employees or employers? May they seek relief under those statutes? Are they to be counted in determining whether the organization is large enough to be covered by the statutes? Always? Sometimes? Under what conditions? Does the form of the business organization matter? If so, how? These are the questions the Supreme Court recently attempted to clarify in *Clackamas Gastroenterology Associates v. Wells*, 538 U.S. 440 (2003). While the Court there adopted a traditional master-servant, right-to-control test that should have swept away the artificialities of the earlier analyses, the subsequent results in the lower courts are beginning to be mixed and to indicate that the problem of characterization is still with us.⁷

III. The law prior to *Clackamas*.

The traditional rule was that "partners own and manage a firm," and hence are not employees. *Devine v. Stone, Leyton & Gershman, P.C.*, 100 F.3d 78, 80 (8th Cir. 1996); *Burke v. Friedman*, 556 F.2d 867, 869 (7th Cir. 1977) ("we do not see how partners can be regarded as employees rather than as employers who own and manage the operation of the business"). Justice Lewis Powell addressed this view in what has become a somewhat famous concurring opinion in *Hishon v. King & Spalding*, 467 U.S. 69 (1984). That case concerned a claim of sex discrimination by an associate of the firm who had been denied admittance to the partnership. *Id.* at 72. The trial court had granted a motion to dismiss to the firm, affirmed by the Eleventh Circuit, holding that Title VII was inapplicable to the selection of partners by a partnership. *Id.* at 72-73. The Supreme Court reversed on the ground that, if proved, the alleged contract to consider Hishon for the partnership "clearly was a term, condition, or privilege of her employment," and the benefit of such consideration was also a privilege of employment. *Id.* at 75-76. The Court further held that "[t]he benefit a plaintiff is denied need not *be* employment to fall within Title VII's protection; it need only be a term, condition, or privilege of employment." *Id.* at 77 (emphasis by the Court). It also rejected a per se exemption for partnership decisions from Title VII scrutiny. *Id.* at 77-78. The procedural posture of the case was important because, since the Court was being asked to rule on the validity of a

Clackamas chose the corporate form instead of partnership in order to qualify as "employees" and thereby take advantage of provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq.* *Id.* They also thereby became covered by the state workers' compensation law. *Id.*

⁶ "The question whether a shareholder-director is an employee, however, cannot be answered by asking whether the shareholder-director appears to be the functional equivalent of a partner. Today there are partnerships that include hundreds of members, some of whom may well qualify as 'employees' because control is concentrated in a small number of managing partners." *Clackamas* at 446.

⁷ Despite the language of even some very recent cases (see, e.g., *Kirleis, infra*), the Supreme Court has definitively determined that the coverage issue does not go to the subject matter jurisdiction of the federal court, but is an element of the plaintiff's claim for relief, as to which the plaintiff bears the burden of proof. *Arbaugh v. Y & H Corp.*, 546 U.S. 500, 504, 506-07, 516 (2006).

motion to dismiss, it thereby assumed that the partnership was an employer and that Hishon was an employee under Title VII on the facts before it. *Id.* at 73-75. The decision did not directly address the relationship of the partners *inter se*.

Justice Powell, however, did address that issue and took pains to emphasize "that the Court's opinion should not be read as extending Title VII to the management of a law firm by its partners." *Id.* at 79. He went on to say:

The relationship among law partners differs markedly from that between employer and employee – including that between the partnership and its associates. The judgmental and sensitive decisions that must be made among the partners embrace a wide range of subjects. The essence of the law partnership is the common conduct of a shared enterprise. The relationship among law partners contemplates that decisions important to the partnership normally will be made by common agreement.

Id. at 79-80. For these reasons, he said "the relationship among partners [need not] be characterized as an employment relationship to which Title VII would apply." *Id.* at 79. But he also cautioned: "Of course, an employer may not evade the strictures of Title VII simply by labeling its employees as 'partners.'" *Id.* at 79 n.2.

This concurring opinion has influenced all of the subsequent debate on the discrimination treatment of members of professional firms. Initially, the argument moved to the question of how shareholder-directors of firms that had adopted a corporate form of organization should be treated. The focus tended to be upon whether these individuals should be regarded as "partners", and thus not protected as employees under the federal antidiscrimination laws. Two schools of thought developed. One was focused on "economic realities", in which the view espoused was that a professional corporation was generally managed, controlled and owned much like the management, control and ownership of a partnership and so should be treated as if it were a partnership. *EEOC v. Dowd & Dowd, Ltd.*, 736 F.2d 1177, 1178 (7th Cir. 1984). The other view focused upon the formal characteristics of the business organization and held that the shareholders of a firm organized as a corporation could not under any circumstances be treated as partners for the purposes of the discrimination laws. *Hyland v. New Haven Radiology Associates, P.C.*, 794 F.2d 793 (2d Cir. 1986). Eventually, a third view developed, holding that status as a partner was not the relevant issue and that the critical inquiry was whether the principals of the firm were employees under a modified master-servant, right-to-control test. *EEOC v. Sidley Austin Brown & Wood*, 315 F.3d 696 (7th Cir. 2002). Ultimately, the Supreme Court attempted to end conflicts among the circuits and provide guidance for the resolution of the issue in *Clackamas Gastroenterology Associates, P.C. v. Wells*, 538 U.S. 440 (2003).

A. Economic Realities.

The leading case of the economic realities school of analysis as applied to business organizations of professionals was the Seventh Circuit's 1984 decision in *Dowd, supra*. The economic realities approach was borrowed for this issue from Supreme Court

cases in the 1940s distinguishing independent contractors from employees for purposes of broadly applying the National Labor Relations and the Social Security Acts. *See, e.g., NLRB v. Hearst Publications, Inc.*, 322 U.S. 111 (1944) (newsboys); *United States v. Silk*, 331 U.S. 704 (1947) (truck drivers and unloaders of coal); *Bartels v. Birmingham*, 332 U.S. 126 (1947) (dance bands and dance halls). In contrast to the common law "right to control" analysis, the economic realities test focused upon inequality of bargaining power and economic dependence. *Wheeler v. Main Hurdman*, 825 F.2d 257, 269 (10th Cir. 1987).

The Seventh Circuit decision in *Dowd* involved a law firm organized as a professional corporation under Illinois law, having three lawyer-shareholders. *Id.* at 1177-78. The issue was whether the EEOC could state a claim for sex discrimination against the firm when it was clear that, without counting the shareholders as employees, the firm would have fewer than the required threshold of fifteen employees. *Id.* at 1178. The court, relying on Powell's concurrence in *Hishon*, held the shareholders were not employees, because "[t]he role of a shareholder in a professional corporation is far more analogous to a partner in a partnership than it is to the shareholder of a general corporation." *Id.* at 1178.

Dowd was followed by the Eleventh Circuit in *Fountain v. Metcalf, Zima & Co., P.A.*, 925 F.2d 1398 (11th Cir. 1991). The defendant there was an accounting firm organized under Georgia state law as a professional association, and Fountain was a member/shareholder attempting to sue the firm for age discrimination. *Id.* at 1399. The court posed the issue to be whether Fountain was "a partner in the firm or an employee of the firm," as dispositive of whether he could sue under the ADEA. *Id.* Since the court found that Fountain, *inter alia*, shared in the profits, losses and expenses of the firm, was liable for its debts, obligations and liabilities, and had a right to vote his thirty-one percent ownership interest in all important firm business matters, the court found the "economic reality" to be that he "was a partner in the firm." *Id.* at 1401.

Likewise, the Sixth Circuit, in *Simpson v. Ernst & Young*, 100 F.3d 436 (6th Cir. 1996) essentially followed an economic realities test in determining that the plaintiff there, regardless of his title of "partner" was not a partner in reality, but an employee, and so could bring suit under the ADEA and ERISA. *Id.* at 444. Simpson was a signatory to the agreement forming the firm out of pre-merger entities and to the Ernst & Young Partnership Agreement. *Id.* at 440. Nevertheless, all of the firm's business, assets and affairs were directed exclusively by a 10 to 14 member management committee and its chairman, with Simpson and those situated similarly to him having no vote for the chairman or the members of the committee; indeed, the control group was self-perpetuating, with the management committee appointing its chairman and the chairman appointing the members of the management committee. *Id.* at 441-42. In an accounting firm of some 2000 "partners", Simpson had no authority to participate in any significant partnership or compensation decisions. *Id.* at 441. Although, under the agreements, he was jointly and individually liable for losses of the firm, the court expressed skepticism that such liability could be enforced given his utter lack of authority to control the risks to which the partnership might expose him. *Id.* at 443 n.2. Hence, he was not a co-owner, not a partner, but an employee. *Id.* at 443-44.

In *Wheeler v. Main Hurdman*, 825 F.2d 257 (10th Cir. 1987), the Tenth Circuit applied its own economic realities test to hold that "bona fide general partners" are not employees under the antidiscrimination laws. *Id.* at 277. The case was brought by an expelled partner of an accounting partnership claiming age and sex discrimination. *Id.* at 258, 260. At the time, the firm had 3,570 personnel, of which 502 were partners. *Id.* at 260. The court noted that the firm had eighty offices and "it looks like a corporation." *Id.* at 261. Nevertheless, the court rejected arguments that, because Wheeler's work remained unchanged after she became a partner, she had the same client load, duties, responsibilities and support staff, continued to be supervised by the same department head, fees for her services were set by managing partners, her compensation was determined by the managing partner of her office, her contribution to firm capital was modest, and votes taken at partnership meetings were primarily for the purpose of ratifying decisions made by the managing partner, she should be treated as an employee. *Id.* at 261-62. The court noted no inclination by the courts to date to extend statutory discrimination protections to general partners. *Id.* at 263.

After an exhaustive review of cases, the *Wheeler* court rejected economic realities contentions that employees should be discerned among partners on a case-by-case basis if they are "so dominated in or by the organization that he or she is really like an employee, with corollary susceptibility to discrimination." *Id.* at 268-74. The court also rejected the attempt of the EEOC, which had appeared as *amicus* in the case, to rely on this "domination" test in conjunction with a traditional common-law, master-servant analysis of the right to control the means and manner of the worker's performance used to distinguish independent contractors from employees, because, *inter alia*, it said that the factors in the common law test⁸ were applicable to distinctions between those who were part of a business and those who were running a separate business but were useless for drawing lines between people who are part of the same enterprise. *Id.* at 269-72.

The *Wheeler* court, however, applied its own "economic realities" test, saying that there were important economic realities attached to the status of being a general partner that did not apply to employees, such as assumption of risks of loss and liability of the enterprise, profit sharing, contributions to capital, part ownership of partnership assets, the right to share in management subject to agreement among the partners, and governance by an entirely different body of statutes and case law applicable to partners and partnerships, involving rights and obligations foreign to corporate employees. *Id.* at 274. "These are economic realities, and no definition of 'employee' is co-extensive." *Id.* at 274.

⁸ The factors in the common law test, in addition to the overall question of the right to control the means and manner of the worker's performance, are (1) the kind of occupation, with reference to whether the work usually is done under the direction of a supervisor or is done by a specialist without supervision; (2) the skill required in the particular occupation; (3) whether the "employer" or the individual in question furnishes the equipment used and the place of work; (4) the length of time during which the individual has worked; (5) the method of payment, whether by time or by the job; (6) the manner in which the work relationship is terminated; i.e., by one or both parties, with or without notice and explanation; (7) whether annual leave is afforded; (8) whether the work is an integral part of the business of the "employer"; (9) whether the worker accumulated retirement benefits; (10) whether the "employer" pays social security taxes; and (11) the intention of the parties. *Wheeler, supra*, at 270.

The Eighth Circuit, in *Devine v. Stone, Leyton & Gershman, P.C.*, 100 F.3d 78, 81 (8th Cir. 1996), also seemed to follow a form of the economic realities analysis ("the substance of the employment relationship determines whether an individual is an employee under Title VII"). *Devine* was a sex harassment and discrimination suit by a paralegal against her law firm, and the issue was whether the shareholder/directors of the professional corporation should be counted in the numerosity threshold for coverage under the statute.

The First Circuit, in *Serapion v. Fred H. Martinez*, 119 F.3d 982 (1st Cir. 1997), a law partnership sex discrimination case, also saw the key inquiry as "the attributes of the relationship between the partnership and those whom it styles as partners," and the relevant question being "whether an individual described as a partner actually bears a close enough resemblance to an employee to be afforded the protections of Title VII." *Id.* at 986-87. The court there purported to follow *Simpson, Wheeler and Fountain* in concluding that the critical identifying marks of partnership were ownership and liability for firm debts and obligations, remuneration based upon firm profits, and the right to engage in firm governance. *Id.* at 990. The court held that the plaintiff met these requirements and was a bona fide equity partner who was ineligible to claim the protection Title VII reserves for employees. *Id.* at 992.

B. Organizational Form.

In contrast to these cases focusing upon the role of the individual in the firm, other circuits followed a *per se* rule based upon the form of organization. The leading case was the decision of the Second Circuit in *Hyland v. New Haven Radiology Associates, P.C.*, 794 F.2d 793 (2d Cir. 1986). *Hyland* was an age discrimination suit brought by a physician who had been a shareholder/employee of the defendant professional medical corporation. *Id.* at 794. The trial court had held that the professional corporation amounted to a partnership in all but name, and that the plaintiff, consequently, was a partner, not an employee. *Id.* The Second Circuit rejected this economic realities analysis and its reliance on the employer's right to control the means and manner of the employee's performance. *Id.* at 797-98. Instead, the Second Circuit held "that the use of the corporate form precludes *any* examination designed to determine whether the entity is in fact a partnership." *Id.* at 798 (emphasis added). The court continued: "Having made the election to incorporate, they should not now be heard to say that their corporation is 'essentially a medical partnership among co-equal radiologists,'" and "[w]hile those who own shares in a corporation may or may not be employees, they cannot under any circumstances be partners in the same enterprise because the roles are mutually exclusive." *Id.* at 798.

The Second Circuit essentially reaffirmed this view in *EEOC v. Johnson & Higgins, Inc.*, 91 F.3d 1529 (2d Cir. 1996). That case was an age discrimination claim by the EEOC on behalf of director/owner/employees against a large insurance brokerage organized as a corporation. *Id.* at 1531. The court, relying on *Hyland*, held that the firm could not escape suit by the EEOC on the theory that the directors were *de facto* partners, because "the partnership exemption is limited to actual *de jure* partnerships and would not be extended to closely-held corporations or other organizations whose structure

resembles that of a partnership." *Id.* at 1537-38. In a qualification, the court also noted that, while the firm could not claim its directors were "partners", it could argue that, as directors, the individuals in question were more akin to employers than employees. *Id.* at 1538. But the court found that the directors also performed traditional employee duties, were regularly employed by an entity other than themselves (the corporation), reported to someone higher in the hierarchy, and so could not escape categorization as employees. *Id.* at 1538-40.

The rule of *Hyland* was also followed by the Ninth Circuit in its decision in *Wells v. Clackamas Gastroenterology Associates, P.C.*, 271 F.3d 903, 905-06 (9th Cir. 2001), the case that led to the redefinition of the law in relation to members of professional business organizations and the discrimination laws (see below). There, a group of physician/shareholders of a medical professional corporation organized under Oregon law argued that they were essentially partners for the purpose of defeating the employee numerosity requirement for coverage by the ADA of a suit brought by a clerical employee. *Id.* at 903-04. The court rejected the argument, saying: "Because the decision to incorporate is presumably a voluntary one, there is no reason to permit a professional corporation to secure the 'best of both possible worlds' by allowing it both to assert its corporate status in order to reap the tax and civil liability advantages and to argue that it is like a partnership in order to avoid liability for unlawful employment discrimination." *Id.* at 905.

C. Sidley Austin.

In *EEOC v. Sidley Austin Brown & Wood*, 315 F.3d 696 (7th Cir. 2002), Judge Posner attempted to refocus the debate away from its fixation on whether professionals were or were not partners. *Sidley Austin* was a subpoena enforcement proceeding brought by the EEOC to investigate whether the demotion by Sidley of 32 equity partners to counsel or senior counsel positions was a violation of the ADEA. *Id.* at 698. To be able to prove a violation, the EEOC needed to be able to establish that the 32 partners were employees before their demotion. *Id.* at 698. Sidley argued that the 32 were partners, and thereby employers, under the ADEA, because their income included a share of the firm's profits, they made contributions to the capital of the firm, they were liable for the firm's debts, and they had some administrative or managerial responsibilities. *Id.* at 699.

In his analysis, Judge Posner pointed out that the antidiscrimination laws "do not exempt partnerships from coverage or deny partners, as such, the protections of the laws." *Id.* at 702. The exemption is for employers. *Id.* at 704. The relevant questions, therefore, are "are partners employers? Always? Always for purposes of Title VII or the ADEA, or the other federal laws that prohibit employment discrimination?" *Id.* at 702. To answer that question, it was necessary to look to statutory purpose. *Id.* The statutory purpose, as Judge Posner found it, for exempting some individuals in a partnership from coverage under the antidiscrimination laws was "recognition that partners ordinarily have adequate remedies under partnership law to protect themselves against oppression (including age or other forms of invidious discrimination) by the partnership." *Id.* at 704.

The court then focused upon the actual relationship of the 32 partners to the firm. What it found was that the Sidley Austin partnership was comprised of more than 500 partners, but that "all power resides in a small, unelected committee (it has 36 members)." *Id.* at 702. The executive committee was not elected by the partners, but by the committee itself, "like the self-perpetuating board of trustees of a private university or other charitable foundation." *Id.* at 702-03. The court found that while partners not members of the committee had some powers "delegated" to them by it in hiring, firing, promotion, and compensation of their subordinates, "so far as their own status [and compensation] is concerned they are at the committee's mercy." *Id.* at 699. Firm committees on which partners served were subject to control by the executive committee. *Id.* at 699.

The *Sidley Austin* court rejected arguments that the partners should be treated as employers because they shared in the firm profits, had an ownership interest in the firm, participated in management committees and were exposed to personal liability for the firm's debts. *Id.* at 703. To these contentions, it replied that many corporations also based employee compensation on corporate profits without anyone supposing such employees were employers, that the committees had only administrative functions that did not distinguish them from executive employees in corporations, that executive-level employees of corporations often owned stock in the corporations, and that exposure to the firm's debts was not enough by itself to make the partners employers. *Id.* at 703. What the court found significant was that, if the purpose of the ADEA's exemption for employers in the partnership context was recognition that partners had adequate remedies to protect themselves under partnership law, then "exposure to liability can hardly be decisive." *Id.* at 704. The court continued:

These 32 partners were not empowered by virtue of bearing large potential liabilities! The 32 were defenseless; they had no power over their fate. If other partners shirked and as a result imposed liability on the 32, the 32 could not, as partners in a conventional partnership could, vote to expel them. They had no voting power.

Id. at 704.

The court accepted the guidance of the common-law right-to-control test applied to determine whether an insurance agent was an employee or an independent contractor under ERISA in *Nationwide Mutual Ins. Co. v. Darden*, 503 U.S. 318, 322-25 (1992). It also accepted Justice Powell's observations in *Hishon* that a traditional law partnership run as a shared enterprise and by common agreement had "a structure different from the one contemplated or assumed by Title VII," and also repeated Justice Powell's caution that labeling an enterprise a partnership that does not have the traditional structure of a partnership will not immunize it from the antidiscrimination statutes. *Id.* at 706. Finally, the court held that the statutory coverage issue before it remained sufficiently murky that the EEOC should be permitted to continue its investigation and ordered compliance with the coverage portion of the subpoena. *Id.* at 707. The EEOC's controversy with Sidley

Austin continued, and the EEOC subsequently filed suit on the merits. *See EEOC v. Sidley Austin LLP*, 437 F.3d 695 (7th Cir. 2006).⁹

IV. Clackamas.

Following the decision in *Sidley Austin*, review of the Ninth Circuit's decision in *Clackamas* reached the Supreme Court of the United States. The Supreme Court rejected both the "economic realities" test based upon inequality of bargaining power and economic dependence, or analogy to partnership, and the categorical formal test that had been applied by the Second and Ninth Circuits. *Clackamas Gastroenterology Associates, P.C. v. Wells*, 538 U.S. 440, 446-47 (2003). Instead, the Supreme Court adopted a traditional common law right-to-control analysis for determining employee status under the anti-discrimination laws. *Id.* at 448. It cited *Darden, supra*, 503 U.S. at 323, and *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 739-40 (1989), for the proposition that, where Congress has used the term "employee" without defining it, the Court has concluded that Congress intended to describe the conventional master-servant relationship as understood by common-law agency doctrine. *Clackamas, supra*, at 444-45. The Court then held that "the common-law element of control is the principal guidepost that should be followed." *Id.* at 448. The right-to-control test was the position advocated before the Court by the EEOC, which argued in this professional corporation case that "'if the shareholder-directors operate independently and manage the business, they are proprietors and not employees; if they are subject to the firm's control, they are employees.'" *Id.* at 448. The Court accepted this view and then turned to and substantially approved guidelines in the EEOC Compliance Manual (2 EEOC, Compliance Manual § 605:00008-10 (2000)) that address the broad question of who is an "employee" and the narrower question of when partners, officers, members of boards of directors, and major shareholders qualify as employees. *Id.* at 448.

The EEOC guidelines relied on and adopted by the Court list six factors to be considered in answering the narrower question of "whether the individual acts independently and participates in managing the organization, or whether the individual is subject to the organization's control." *Id.* at 449. These six factors are:

- (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;

⁹ Judge Easterbrook, in his concurrence, would have held that, since the 32 partners were clearly partners under the Illinois partnership law under which the Sidley Austin partnership was organized, they were *bona fide* partners and thus employers, and that would end the inquiry as to them. *Sidley Austin* at 708-11. That view is no longer tenable under the Supreme Court decision in *Clackamas*.

- (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; and
- (6) Whether the individual shares in the profits, losses, and liabilities of the organization.

Id. at 449-50. The Court then said: "[A]n employer is the person, or group of persons, who owns and manages the enterprise. The employer can hire and fire employees, can assign tasks to employees and supervise their performance, and can decide how the profits and losses of the business are to be distributed." The answer as to whether any individual is an employer or an employee depends upon "all of the incidents of the relationship;" "no one factor being decisive." In *Clackamas* itself, the Court noted that some of the factors there indicated that the physicians were not employees: "For example, they apparently control the operation of their clinic, they share the profits, and they are personally liable for malpractice claims." *Id.* at 451. But the Court said that there might be evidence in the record contradicting those findings and remanded the case. On remand, the Ninth Circuit vacated its opinion and remanded the case to the district court for further proceedings consistent with the Supreme Court decision. *Id.* at 451.

V. Developments since *Clackamas*.

Cases since *Clackamas*, applying it, have run the gamut from professional corporations or partnerships of lawyers and doctors, to non-professional close corporations, including a family-owned diner.

Zeigler v. Anesthesia Associates of Lancaster, Ltd., 74 Fed. Appx. 197 (3d Cir.2003) (unpublished opinion).

Ziegler concerned Title VII and Equal Pay Act claims by staff professional employees of a professional corporation in which the shareholders were all anesthesiologists, all of whom also worked for the corporation. *Id.* at 198. The issue was whether the shareholder-doctors were employers or employees, because, without counting them as employees, the firm did not meet the 15-employee threshold required for coverage under the statutes. *Id.* at 198-99. The court applied the six-factor EEOC-*Clackamas* test and held that, since the physician-shareholders shared ownership, had equal voting rights in all matters, made capital contributions, received compensation tied to firm profits, were not evaluated or supervised by anyone, were limited to professional anesthesiologists, were liable for their own acts of professional negligence and for those of persons acting under their supervision, were referred to as "partners" even though they executed "employment agreements" with the firm, and also were parties to shareholder agreements, they were employers and not employees who could be counted in determining coverage under the statutes. *Id.* at 200-01.

Rodal v. Anesthesia Group of Onondaga, P.C., 369 F.3d 113 (2d Cir. 2004).

Rodal also involved a medical professional corporation, in which one of the shareholder-physicians was suing the firm for disability discrimination under the ADA. *Id.* at 116-17. The district court, which had issued its decision before the Supreme Court's ruling in *Clackamas*, had found the plaintiff/shareholder to be an employee under the Second Circuit's rule in *Hyland*. *Id.* at 117. The reviewing court simply referred to the EEOC-*Clackamas* six factor analysis and reversed and remanded the case for re-examination of the plaintiff's status as an employee under *Clackamas*, and whether he was entitled to the protection of the ADA. *Id.* at 122-23. There appears to be no substantive subsequent history in this case.

Solon v. Kaplan, 398 F.3d 629 (7th Cir. 2005).

Solon concerned a claim against a law partnership under Title VII and the ADEA by a former partner of the partnership. *Id.* at 630-31. The plaintiff had been the managing partner of the firm which, at the time of the events complained of, had three other partners. *Id.* at 630-31, 633. The question on summary judgment was whether the plaintiff was an employee of the firm and so entitled to rights under Title VII. *Id.* at 630. As managing partner of the firm, the plaintiff was the only general partner authorized to draw on the firm's bank accounts, had extensive knowledge of the firm's financial condition, handled its banking relationship, applied for and signed financing agreements on behalf of the firm, managed the firm's relationship with its landlord and was trustee of its 401(k) account. *Id.* at 630-31. At a point, the plaintiff stepped down as managing partner but continued to direct some administrative matters, including signing a letter of credit on behalf of the firm. *Id.* at 631. Sometime later, the two other partners voted to terminate the plaintiff's interest in the firm. *Id.* at 631.

As to whether the plaintiff was an employee, the court applied the six-factor EEOC-*Clackamas* analysis. *Id.* at 632. The plaintiff argued that he had no real control as general or managing partner because the other partners "ignored the partnership agreement so frequently that it no longer had any legal effect, that any leverage conferred upon him by the agreement was illusory;" and that the defendants ignored the partnership agreement when distributing firm profits. *Id.* at 633-34. The court rejected these arguments, noting that the plaintiff had one quarter of the voting power in the partnership, that he exercised substantial control over allocating the firm's profits, requiring additional capital contributions, making financial commitments, amending the partnership agreement, and dissolving the firm, that he had a unilateral veto over new admissions, that he had an equity interest in the firm, shared in its profits, attended partnership meetings, and had access to private financial information, and that, even though he had stepped down as managing partner, he continued to handle the firm's banking and landlord issues. *Id.* at 633. Although the plaintiff complained that compensation decisions were sometimes made at informal meetings in his absence, the court pointed out that he had the right to call for a meeting of all the general partners to revisit the issue. *Id.* at 634. The court observed: "Plaintiff's assertion that he consulted with his fellow partners before making major decisions may demonstrate that he was passive, but it does not show that he was powerless. Nor does his contention that he was outvoted

undermine the conclusion that he was an employer." *Id.* at 634. The court concluded that the plaintiff "substantially controlled the direction of the firm, his employment and compensation, and the hiring, firing and compensation of others," and so was an employer. *Id.* at 634.

Simons v. Harrison Waldrop & Uhereck, L.L.P., 2006 U.S. Dist. LEXIS 43968 (S.D. Tex. June 14, 2006).

Simons concerned an age discrimination claim under the ADEA, filed by a former office manager against a law firm limited liability partnership. *Id.* at **1-2. The issue was whether the firm had a sufficient number of employees to qualify as an employer under the ADEA. *Id.* at *3. There were two issues: (1) whether four retired partners who continued to provide occasional services to the firm were independent contractors or employees, and (2) whether three other partners who had the smallest partnership shares were in fact subject to the control of the more senior partners and hence were not employers but employees. *Id.* at **14, 22.

As for the retired partners, the court applied the *Darden* independent contractor inquiry and found disputed issues of fact as to the level of control the firm exercised over the retired partners' work. *Id.* at **14-22. The plaintiff, who as office manager presumably had personal knowledge, had contended that the firm assigned the retired partners specific work and supervised them to an extent similar to its supervision of the work of other professional employees. *Id.* at **16-22. In addition, two of the retired partners were carried on the firm's books as "employees" for income tax, workers' compensation and payroll purposes. *Id.* at *16, 20.

As for the three junior partners, however, the court found them to be employers. *Id.* at *25. The court rejected the argument that *Clackamas* meant "that a partner in a partnership may be designated as an "employee" merely because some other partner has been granted more of the rights, privileges and responsibilities traditionally attendant to partnership." The court found that the three junior partners "had more than a nominal ownership interest in the firm and could exercise their interest in the form of votes to influence the management of the firm and the composition of the partnership," that they were members of the governing body to which they reported, and that they were not closely supervised. *Id.* at *27. The court found that the facts showed this to be "a picture of a traditional professional partnership with six equity partners and somewhere between seventeen and twenty-one employees," and that "each partner in the firm enjoyed the rights, privileges, and responsibilities attendant to the role of a 'bonafide' partner." *Id.* at *28.

The court concluded: "The *Clackamas* inquiry is not intended to be applied in lieu of a traditional understanding of partnership, but in order to distinguish traditional partnerships from more modern business associations in which many individuals are only nominally partners." *Id.* at *28.

Smith v. Castaways Family Diner, 453 F.3d 971 (7th Cir. 2006).

Smith was a Title VII suit by a part-time waitress against a family-owned diner. *Id.* at 972. The issue was whether, without counting two managers, the diner employed the fifteen employees necessary to qualify it as an employer under Title VII. *Id.* at 972. The sole proprietor of the diner was one Gonzalez, who did not work there and did not supervise the diner. *Id.* at 972. The restaurant was managed on a day-to-day basis instead by her mother and her husband, who had no ownership interest. *Id.* at 972-73. There was a contention that the husband shared in the profits and losses of the restaurant, but there was nothing in the record to reveal how, why or to what extent he did so. *Id.* at 973.

The district court had held, applying *Clackamas*, that the husband and the mother were not employees, relying on the fact that the owner did not exercise any control over them, and that they "ran the show." *Id.* at 974. The Seventh Circuit reversed, pointing out that the issue was not the autonomy of the managers, but whether they were employers rather than employees. *Id.* at 976. For this reason, the court said that an analysis based upon the *Darden* test for independent contractors was irrelevant. *Id.* at 976. Rather, what was important, based upon *Clackamas*, was that because they had no ownership interest, the managers did not have the *right* to control the business. *Id.* at 977-78. All that they had was authority *delegated* to them by the owner to run the business, which was not sufficient to make them employers. *Id.* at 978-79. The court rejected the argument that the *Clackamas* test might be applied to managers, supervisors and other highly placed employees, saying, "[a]t a fundamental level, then, a supervisor or manager, however highly placed, is still an employee." *Id.* at 977-79. The court added: "By contrast, the owner of a business, even if he chooses not to exercise it, always has the right to control the direction and operation of the business." *Id.* at 980. For support, the court cited its pre-*Clackamas* decision in *Schmidt v. Ottawa Med. Ctr., P.C.*, 322 F.3d 461, 467 (7th Cir. 2003), in which it had held that a shareholder-director in a professional medical corporation was to be treated as an employer under the ADEA because of his equal right both as shareholder and director to participate in the governance of the corporation. *Castaways* at 983.

Mehta v. HCA Health Services of Florida, Inc., 2006 U.S. Dist. LEXIS 79536 (M.D. Fla. Oct. 31, 2006).

Mehta was a claim under Title VII for national origin discrimination and retaliation. *Id.* at **8-9. The facts were somewhat complicated. Mehta was a radiologist who had constituted himself a professional association sole and, as such, was also a partner in a partnership called Spring Hill Radiology. *Id.* at *2. Spring Hill Radiology had a contract to provide radiological services as Oak Hill Hospital, the entity through which the defendant did business. *Id.* at **2-3. Mehta became involved in a personal conflict with an influential physician employed by Oak Hill Hospital, who uttered racial slurs at Mehta and attempted to have Spring Hill Radiology and Mehta removed from Oak Hill Hospital. *Id.* at **4-5.

The court first dismissed Mehta's claims of discrimination and retaliation against Oak Hill that were based upon the non-renewal of Spring Hill's contract. *Id.* at *9. The court did so because it found Mehta's relationship to Oak Hill to be that of independent contractor, not employee. *Id.* at *9.

The court also ruled, however, that Mehta could proceed with his Title VII claim that, by not renewing the Spring Hill contract, Oak Hill had potentially interfered with Mehta's employment opportunities with Spring Hill. *Id.* at *9. The issue then became whether Mehta's relationship with Spring Hill was one of employment. *Id.* at **12-14. The court held that it was not, finding that, as a partner in Spring Hill, he was part of the group that managed it, shared in its profits and liabilities and was compensated based upon how well the partnership performed, with his partners exercised supervision and control of all important management and employment decisions of Spring Hill, and was party to a partnership agreement with Spring Hill. *Id.* at *17. Accordingly, he was not an employee and could not maintain an action under Title VII. *Id.* at **17-18.

DeJesus v. LTT Card Services, Inc., 474 F.3d 16 (1st Cir. 2007).

DeJesus, like *Castaways*, extended the *Clackamas* analysis to a close corporation that was not an organization of professionals. The defendant was a corporation that sold cards for cellular phones, and the plaintiff was a collection officer-employee of the firm attempting to bring pregnancy discrimination claims under Title VII and the ADA. *Id.* at 18. The issue was whether the firm had the requisite number of employees to qualify as an "employer" for purposes of coverage under these statutes. *Id.* at 17. The defendant claimed that it did not have the required number of employees because its president and vice president were directors and major shareholders of the company. *Id.* at 18. The plaintiff sought limited discovery on the threshold employee issue. *Id.* at 19. The company's payroll records listed the president and vice-president as employees for every week in the relevant period, but the court held that fact, by itself, not dispositive. *Id.* at 19, 22. The court then held that the *Clackamas* approach applies to close corporations as well as to professional corporations. *Id.* at 24. It rejected the defendant's contention that the director/shareholder status of the president and vice president defeated coverage because the defendant had merely averred that those two officers were directors and shareholders and had failed to offer any evidence permitting the trial court to analyze the defense based upon the six *Clackamas* factors. *Id.* at 24. Hence, it remanded the case, inferentially authorizing the plaintiff's demand for limited discovery into the coverage facts. *Id.* at 24.

Kirleis v. Dickie, 2007 U.S. Dist. LEXIS 53542 (W.D. Pa. July 24, 2007).

Kirleis is a very recent case, and a law firm case, and it illustrates the difficulties the present unsettled state of the law creates when a partner or shareholder sues his or her employer under the discrimination laws. The plaintiff was a Class A shareholder in this professional corporation, who was claiming sex discrimination, a hostile work environment and retaliation under Title VII and the Equal Pay Act. *Id.* at **2-3. The issue, which arose on a motion to dismiss, was whether the plaintiff was an employee and so entitled to bring an action under the statutes invoked. *Id.* at *5. The firm had 63

shareholders. *Id.* at *16. The court analyzed the case by discussing the six *Clackamas* factors *seriatim*:

As for the first factor, whether the defendant could hire and fire the plaintiff or set rules for her work, the court found that the facts before it weighed in favor of the plaintiff. It noted that, as a shareholder, she could only be fired by an official vote of three-fourths of the shareholders, that she could speak and vote on the question of her own ouster, that she was allowed to delegate work and supervise lawyers, and that she could set her own hours. *Id.* at *7. The plaintiff claimed, however, that the power of the shareholders was illusory, and that the Executive Committee had the real control over terminations, demotions and promotions through its power to set compensation and determine work assignments. *Id.* at *7. Specifically, she claimed that, when the Executive Committee wished to terminate a shareholder, they reduced the amount of work given to that lawyer, which resulted in lower billing hours and compensation. *Id.* at **7-8. The court found that the firm did not address the contention that the Executive Committee could force a shareholder from his or her position by controlling work assignments and compensation. *Id.* at **8-9.

As for the question of whether the defendant supervised the plaintiff's work, the defendant argued that the majority of her work was for one major client, and that all of the work for that client was directed by the Executive Committee. *Id.* at 9-10. The court was not persuaded by the fact that, if the plaintiff brought in her own clients, she would have greater freedom in her work and found this factor also to favor employee status. *Id.* at **9-10.

On the question of whether the plaintiff reported to someone higher or acted independently, the court found that her work was controlled by the Executive Committee and that she did not act independently. *Id.* at **10-11. It reached this conclusion even though it found that the plaintiff as a shareholder could be nominated and elected to the Executive Committee and be involved in firm management. *Id.* at *11.

As to whether the plaintiff was able to influence the organization, the court was impressed by the facts that important matters had been presented for a vote to the shareholders only after the transactions were completed and that shareholders who were not members of the Executive Committee did not know how compensation was set. *Id.* at **12-13. The court was not persuaded by the facts that plaintiff was able to attend, speak and vote at board meetings and the annual meeting, that she had exercised these rights, including voting for members of the Executive Committee, and that she was eligible herself to become a member of the Executive Committee if elected by her peers. *Id.* at **11-12. The plaintiff had contended that the shareholder meetings functioned only as a rubber stamp for decisions already made by the Executive Committee. *Id.* at **12-13.

On the question of whether the parties intended the plaintiff to be an employee as reflected in written documents, the defendant contended that the firm By-Laws made this clear. *Id.* at **13-14. However, the court found that this factor weighed in favor of employee status because the plaintiff had never received a copy of the By-Laws, and that

the only "contract" available for review was the By-Laws she had never received. *Id.* at **13-14.

Finally, on the sixth *Clackamas* factor, whether the plaintiff shared in the profits, losses and liabilities of the organization, the court also found in the plaintiff's favor. Despite a modest capital contribution by the plaintiff, the plaintiff contended that shareholder salaries were set secretly by the Executive Committee and that there was a system of secret bonuses to a number of shareholders, such that the real compensation structure was not consistent with true profit-sharing. *Id.* at **14-15.

Having thus reviewed all of the *Clackamas* factors, the court held, on the record before it, that the plaintiff was an employee and was permitted to proceed with her suit. *Id.* at *16. It should be noted that these issues arose and were decided on a motion to dismiss, and, as the court itself noted, the standard of proof at that point was lower than that for summary judgment. *Id.* at *16. What is also noteworthy about the case is the element of secrecy in concentrated, centralized control of the major decision-making of a not small law firm, and the implication that the voting power of shareholders was illusory because they were, at best, asked only to ratify decisions already made. The immediate result of the decision, of course, is that the plaintiff would be permitted to pursue discovery on the coverage issues.

Panepucci v. Honigman Miller Schwartz and Cohn, LLP, 408 F. Supp. 2d 374 (E.D. Mich. 2005).

Panepucci is an earlier post-*Clackamas* case that is similar to *Kirleis*. The plaintiff was a partner in a law firm, claiming sex discrimination and retaliation as a result of her attempts to exercise influence over the organization concerning equal rights for female attorneys. *Id.* at 375, 377. The court gave a somewhat less detailed analysis on the *Clackamas* factors than did the court in *Kirleis*, but it found disputed issues of fact regarding whether the plaintiff could set the rules of her own work, whether she was supervised, whether she reported to someone higher in the organization, and whether she was able to influence the organization. *Id.* at 376-77. It also believed that, as to the sixth *Clackamas* factor, whether the plaintiff's compensation was tied to the financial risks of the business, there was an issue as to whether her compensation was determined by a subjective evaluation of her performance, which it said was more in line with compensation of an employee than a partner. *Id.* at 377. At the heart of the court's inability to resolve these issues on the record before it was the evidence proffered by the plaintiff that she had been constructively cut off from her client base by the actions of the firm vice chair and head of the Attorney Compensation Committee, with whom she had had a falling out, and that she could thereafter no longer secure work assignments from him or other senior lawyers. *Id.* at 375-76. Notably, the issue arose here, as in *Kirleis*, on a motion to dismiss, not on a full factual record. *Id.* at 376-77. Ordinarily, the sequel would have been authorization to the plaintiff to proceed with discovery in the litigation, but that eventuality was foreclosed by the court's holding that the plaintiff's controversy with the firm was required to be submitted to arbitration. *Id.* at 378-79.

VI. Summary And conclusions.

The law in this area remains unsettled. Whether a member of a professional corporation or partnership is an "employee" or an "employer" for the purposes of the antidiscrimination statutes requires a fact-based inquiry. As *Clackamas* itself, *Sidley Austin, Kirleis* and *Panepucci* demonstrate, the question is difficult to resolve at the threshold or motion to dismiss stage of litigation. That means that many, if not most, of these cases will require discovery, sometimes intrusive and expensive, before the issue of coverage under the antidiscrimination statutes can be determined. In particular, such claim may force a level of transparency for some firm decisions, particularly regarding compensation, to which some traditional partnerships are unaccustomed and may find uncomfortable.

The recent cases have resolved some issues. First of all, the form of organization of a professional business (or even a non-professional close corporation) is not determinative. The facts of right-to-control analysis under the six-factor *Clackamas* test are what matter. That the business may be organized as a partnership in full compliance with state partnership law is not dispositive. Second (see *Castaways*), it appears that real ownership interest in the organization is required for qualification as an employer. *De facto* control by itself is not enough. Third, a form of organization that is nominally open, democratic and participatory, with all partners or shareholders having a right by reason of ownership to participate according to their ownership interest in authorizing the important decisions concerning the firm, will not confer employer status if the facts demonstrate that the form of organization is a sham, that shareholders either are not consulted or that their votes are treated as a rubber stamp for important decisions already made, or that all meaningful power and authority is concentrated in a small, elite group (see *Sidley Austin* and *Kirleis*). Fourth, secrecy by a controlling elite concerning matters, notably including compensation and how it is set, that are nominally the prerogative of the shareholder or partner population as a body will generally tend to be fatal to employer status (see *Sidley Austin* and *Kirleis*). In particular, the failure to disclose documents upon which the partner/shareholder's claimed right to control is based will not be helpful (see *Kirleis*). Finally, it does appear that the mere fact that a shareholder/partner who has a substantive right to control firm decisions according to his ownership interest in the firm does not secure the majority opinion of his fellow shareholders or partners does not by itself defeat the reality of his right to control. See *Solon, supra*, 398 F.3d at 633-34; *Schmidt, supra*, 322 F.3d at 467; *Simons, supra*, 2006 U.S. Dist. LEXIS at **26-27.

Undoubtedly, the facts in *Sidley Austin*, where a small, self-perpetuating elite committee exercised exclusive and secret control over all of the important management, financial and compensation decisions of a huge professional firm, revealed an extreme, if perhaps not unusual, case. But, as the litigation history in this area demonstrates, that is not the only factual pattern under which a firm, even one that is modest in size, that conceives of itself as a traditional partnership can be vulnerable to litigation under the antidiscrimination laws. The developments in this area mandate that professional firms, if they are concerned about their exposure to antidiscrimination litigation and liability, examine their organizational structures and the reality of their operations.