So, You Want to be a Partner at Sidley & Austin?

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ARTICLE

SO, YOU WANT TO BE A PARTNER AT SIDLEY & AUSTIN?

Leonard Bierman* & Rafael Gely**

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I. INTRODUCTION

Law firms and other professional organizations (e.g., accounting firms, medical practice groups) had until recently remained somewhat immune to the economic cycles affecting the rest of the U.S. economy.\(^1\) It was extremely uncommon to hear about downsizing, mergers, and layoffs in any of these organizations.\(^2\) Law firms and their counterparts in other professions appeared to have been fairly isolated somehow from the ebbs and flows of the economy.\(^3\)

That pleasant isolation has dissipated. Starting in the early 1990s\(^4\) and certainly in the first couple of years of the new millennium, the harsh realities of the business cycle have touched even these organizations.\(^5\) Closing of operations,\(^6\) mergers,\(^7\) and downsizing\(^8\) have become common occurrences among professional organizations.\(^9\) More broadly, concerns about cost-cutting measures have become a common part of the operations of many professional organizations.\(^10\)

One of the effects of the “industrialization” of professional

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3. See Elizabeth H. Gorman, Moving Away from “Up or Out”: Determinants of Permanent Employment in Law Firms, 33 LAW & SOC’Y REV. 637, 637–42 (describing the environment in which law firms operated for much of the last century).

4. See GALANTER & PALAY, supra note 1, at 37–76 (noting that by the early 1990s promotion practices of the “big firm” had changed, with significantly fewer associates achieving partnerships, and those who achieve partnership facing pressure and risk once partnership is attained).


7. See Neil Caesar, The Age of Mergers Is Here: Decide Now How to Decide, Managed Care, Legal Forum, at http://www.managedcaremag.com/archives/9701/9701.legal.shtml (Jan. 1997) (describing the recent experience with mergers in the health care industry); Hechler, supra note 5 (pointing out that the growth of eight of the ten fastest-growing firms was by means of mergers and acquisitions).

8. See Hechler, supra note 5 (describing recent layoffs experienced at major law firms).

9. See Galanter & Palay, supra note 2, at 965–66 (noting several law firm strategies for maintaining profitable growth).

organizations has been a shift in the business forms that these organizations adopt. Some organizations have shifted from partnership associations into professional corporations. Other organizations have remained partnerships in form, but have significantly restructured the roles of partners.

These changes have exposed a group of individuals who traditionally have been somewhat isolated from the possibility of discriminatory practices to the realities faced by millions of other workers. Professional firm partners who have been stripped of the authority and power they once enjoyed find themselves in quite vulnerable positions where they do not have the ability to protect themselves against discriminatory and strategic behavior by their employers. To add insult to injury, these individuals may also lack any remedy for the discriminatory treatment they suffer.

It is this predicament that Judge Richard A. Posner addresses in the recent decision by the U.S. Court of Appeals for the Seventh Circuit in EEOC v. Sidley, Austin, Brown & Wood. The case involved an age discrimination complaint against the Chicago-based law firm for the demotion of thirty-two partners.

11. See Kristin Nicole Johnson, Note, Resolving the Title VII Partner-Employee Debate, 101 Mich. L. Rev. 1067, 1076 (2003) (describing the modern legal services market as an "industry" in which firms may take advantage of state law permitting "firms to select from a variety of business forms").


13. See David B. Wilkins, Partners Without Power? A Preliminary Look at Black Partners in Corporate Law Firms, 2 J. Inst. for Study Legal Ethics 15 (1999) (noting that in the contemporary economic environment "partnership is no longer the equivalent of tenure"); see also Galanter & Palay, supra note 1, at 121-38 (describing various employment arrangements recently implemented by law firms); Gorman, supra note 3, at 637-38 (describing the increasing use of permanent nonpartners employment arrangements in large law firms).

14. See, e.g., Wilkins, supra note 13, at 16 ("[R]etention now is almost as important an issue for partners as it is for associates. This is particularly true... for minority partners who have recently been exiting their prestigious partnerships at alarming rates.").

15. See Johnson, supra note 11, at 1069 (observing that "[d]iscrimination against partners in law firms presents a unique legal issue... [because] the circuits are split on the issue of whether Title VII covers partners alleging to be victims of discrimination").

16. Id. at 1070. The author explained the following:

   [P]laintiffs seeking protection under Title VII must fall within the purview of the statute. Title VII covers "employers" and "employees." Courts... decline to exercise jurisdiction if the party alleging discrimination does not qualify as employee or the party accused of discriminating is not an employer as defined by the statute.

Id. (footnotes omitted).

17. 315 F.3d 696 (7th Cir. 2002).
and for the reduction of the firm's mandatory retirement age as part of a firm restructuring. The law firm argued that the investigation should have been halted because the partners involved in the demotion were not "employees," and thus were not covered under the Age Discrimination in Employment Act (ADEA).

Similar disputes involving the definition of the term "employee" under various antidiscrimination statutes have been percolating through the federal judiciary, even recently reaching the U.S. Supreme Court. In a number of recent cases involving medical practices, accounting firms, and law firms, courts have been faced with the task of figuring out the proper contours of the term "employee" under these statutes. Courts have proven to be very divided on this issue, both in terms of outcome and in terms of the doctrinal analysis they have used in deciding these cases.

As Judge Posner's opinion in the Sidley case suggests, however, this recent debate has taken place without any direct discussion by reviewing courts about underlying changes occurring in employment relationships in these organizations. In this Article, we advance a theoretical framework that we submit provides some theoretical guidance with respect to the resolution of the issues raised in cases like Sidley and the matter currently before the U.S. Supreme Court.

In the next Part of the Article, we briefly summarize Judge Posner's opinion in the Sidley case. In his characteristic "academic" style, Judge Posner provides significant insights into the dynamics surrounding this type of case. In Part III, we

18. Id. at 698–99.
19. Id. at 699.
23. Sidley, 315 F.3d at 698.
24. Id. at 702.
25. Id. at 701. Judge Posner first notes that it was "remarkable" that "neither party has addressed the question why some or all members of partnerships should for purposes of the federal antidiscrimination laws be deemed employers and so placed outside the protection of these laws." Id. After discussing a number of cases from a variety of related areas, Judge Posner concludes, "[a]ll that is clear amidst this welter of cases is that the coverage issue in the present case remains murky despite Sidley's partial compliance with the subpoena." Id. at 707.
26. Refer to Part II infra.
discuss the theory of Internal Labor Markets (ILMs). Over the past decade, various scholars have utilized ILMs theory to address a number of difficult employment law issues. Relying on the recent work of Professor Christine Jolls and others, we argue that ILMs theory provides helpful insights into the discussion at hand. In Part IV, we discuss the implications of ILMs theory for the Sidley case and related important cases. Part V of the Article concludes our work.

II. EEOC v. SIDLEY, AUSTIN, BROWN & WOOD

A. Majority Opinion

In 1999 the law firm of Sidley & Austin (S&A) demoted thirty-two of its equity partners to the rank of "counsel" or "senior counsel." The EEOC then began an investigation to determine whether these partner demotions might have violated the Age Discrimination in Employment Act (ADEA). As part of its investigation, the EEOC sought considerable information from S&A. S&A contended it provided enough information to prove that the demoted equity partners were "real partners" and thus "employers" under federal antidiscrimination law. Because federal antidiscrimination laws apply only to "employees" and not "employers," S&A asserted that the EEOC had no jurisdiction over the case.

The EEOC disagreed and sought a federal district court order enforcing its subpoena against S&A for more information. The district court ordered the law firm to "comply in full," and S&A immediately appealed this decision to the U.S. Court of Appeals for the Seventh Circuit. A three judge panel comprised

27. Refer to Part III infra.
28. Refer to Part IV infra.
29. Refer to note 245 infra and accompanying text.
30. Sidley, 315 F.3d at 698.
31. Id.
32. Id.
33. Id. at 698-99.
34. Id. at 699. Sidley & Austin's argument was that the Commission has no jurisdiction... because a partner is an employer within the meaning of the federal antidiscrimination laws if (a) his income included a share of the firm's profits, (b) he made a contribution to the capital of the firm, (c) he was liable for the firm's debts, and (d) he had some administrative or managerial responsibilities.
35. Id.
36. Id.
of Judges Richard Posner, Frank Easterbrook, and Diane Wood—interestingly, all former University of Chicago Law School Professors—heard the case and issued an opinion on October 24, 2002.\(^\text{37}\)

The court’s opinion, authored by Judge Posner, enforced the district court’s ruling in part and remanded the case back to the lower court with directions.\(^\text{38}\) Judge Posner ruled that there was enough “doubt” regarding whether the thirty-two demoted partners were truly “employers” under federal antidiscrimination law to entitle the EEOC to full compliance with the “coverage portion of the subpoena”—the part of the subpoena requesting documents relating to whether the thirty-two former partners are covered as “employees” under the ADEA.\(^\text{39}\) The Seventh Circuit further ordered the federal district court to evaluate all of these documents once submitted and make a determination regarding whether or not the thirty-two demoted partners were covered by federal antidiscrimination law.\(^\text{40}\) The appeals court held that S&A’s compliance with the part of the EEOC’s subpoena calling for “voluminous and sensitive documentation” relating to the merits of whether the former partners had been subjected to age discrimination would only be triggered by an initial district court determination that said employees were “employees” for ADEA purposes.\(^\text{41}\)

Before getting to this “bottom line,” however, Judge Posner engaged in a highly illuminating discussion of how large law firms—and indeed other professional services firms—really work. Judge Posner took pains to point out that S&A “complied with all the formalities required by Illinois law to establish and maintain a partnership,” and that the thirty-two aggrieved individuals were clearly “partners” within the “meaning of applicable partnership law.”\(^\text{42}\) The key question to Judge Posner, though, was whether “when a firm employs the latitude allowed to it by state law to reconfigure a partnership in the direction of making it a de facto corporation, a federal agency enforcing antidiscrimination law is compelled to treat all ‘partners’ as employers.”\(^\text{43}\)

In developing his argument, Judge Posner cited to the U.S.
Supreme Court case of *Hishon v. King & Spalding,* 44 which held that law firm decisions regarding whether to promote lawyers to firm partnerships are subject to federal antidiscrimination law. 45 In his important concurring opinion in that case, Justice Lewis Powell noted that the relationship among law partners traditionally differs markedly from that of employer and employee in that the "essence of the law [of] partnership is the common conduct of a shared enterprise." 46 Moreover, Justice Powell wrote that the "relationship among law partners contemplates that decisions important to the partnership normally will be made by common agreement or consent among the partners." 47

Judge Posner observed that in contrast to Justice Powell's "traditional law partnership," 48 S&A operated in a much more hierarchical "corporate" manner. 49 All power in the firm essentially resided, and continues to reside, in a thirty-six member executive committee. 50 The partnership at S&A does not elect the executive committee. 51 Instead, the executive committee elects its own members "like the self-perpetuating board of trustees of a private university or other charitable foundation." 52 While partners at S&A do have some limited powers, "so far as their own status is concerned they are at the [executive] committee's mercy." 53 The firm's executive committee can fire partners, demote partners (as it did with the thirty-two aggrieved parties), raise or lower their pay, and so forth. 54 Virtually all important decisions of the firm are made by the executive committee, with partnership-wide votes on matters occurring roughly once every twenty-five years. 55

The most "partneresque feature" of the thirty-two partners' relation to the firm, Judge Posner conceded, was their "personal liability for the firm's debts." 56 Judge Posner, though, citing and

45. Id. at 77–78 (declaring that "nothing in the statute or legislative history . . . would support such a per se exemption" of partnership decisions from Title VII coverage).
46. Id. at 79–80 (Powell, J., concurring).
47. Id. at 80 (Powell, J., concurring) (citation omitted).
48. Sidley, 315 F.3d at 706.
49. Id. at 702–03.
50. Id.
51. Id. at 703.
52. Id.
53. Id. at 699.
54. Id.
55. Id.
56. Id. at 703.
discussing a "broadly similar" case involving the large accounting firm partnership of Ernst & Young,\(^{57}\) questioned whether this was enough to pin the proverbial "tail on the donkey."\(^{58}\) He noted that, if "implicit in the ADEA's exemption for employers is recognition that partners ordinarily have adequate remedies under partnership law to protect themselves against oppression (including age or other forms of invidious discrimination)," the issue of partner "exposure to liability can hardly be decisive."\(^{59}\) Judge Posner averred that the thirty-two demoted partners were "defenseless" and "had no power over their fate."\(^{60}\) He also pointed out that if other partners "shirked" and as a result imposed liability on the thirty-two, these thirty-two partners could not, unlike partners in a "conventional partnership," vote to expel them because they had no real "voting power."\(^{61}\)

In sum, Judge Posner cautioned against the "tyranny of labels," making clear that being titled a major law firm equity "partner" does not necessarily mean the individual is an "employer" for federal antidiscrimination law purposes.\(^{62}\) He left it up to the district court, however, to ultimately make this determination with respect to the thirty-two demoted equity partners at S&A.\(^{63}\)

B. **Judge Easterbrook's Concurrence**

Judge Frank Easterbrook concurred in part with the court's decision and concurred in its judgment. Somewhat ironically, though, given the context of the case, such "concurring" labels can be fairly deceiving, given that he fundamentally disagreed with the court's decision. Judge Easterbrook sharply questioned why the court decided to "punt" the critical legal question in the case to the district court.\(^{64}\) He asserted that "Sidley and other large partnerships need to plan their affairs," and that the members of these firms "need to know their legal status."\(^{65}\)

In Judge Easterbrook's reading of the law, the thirty-two demoted equity partners at S&A were "bona fide . . . real

\(^{57}\) See Simpson v. Ernst & Young, 100 F.3d 436 (6th Cir. 1996).
\(^{58}\) Sidley, 315 F.3d at 703.
\(^{59}\) Id. at 704.
\(^{60}\) Id.
\(^{61}\) Id.
\(^{62}\) Id. at 705–06.
\(^{63}\) Id. at 707.
\(^{64}\) Id. at 708 (Easterbrook, J., concurring in part and concurring in the judgment).
\(^{65}\) Id. (Easterbrook, J., concurring in part and concurring in the judgment).
partners and consequently not employees. These thirty-two individuals were not "income" partners of the firm; they shared firm profits and were liable for firm losses, and Judge Easterbrook chastised his colleagues for not pointing to any clear authority for the proposition that "concentration of decision-making authority within an entity alters the legal status of those who share profits and bear all residual risk of loss."

Moreover, Judge Easterbrook questioned whether a concentration of decision-making power at S&A truly left all of the firm's 450-plus nonexecutive committee member partners powerless. He noted that in universities and other organizations the fact that a "board of trustees holds all the legal authority" does not mean that committees throughout the organization lack "real influence and responsibility." Consequently, he asserted that his colleagues "ought not to sneeze at Sidley's observation" that all thirty-two of the demoted partners served on various and sundry law firm committees. In short, Judge Easterbrook had no real question about S&A's assertion that the thirty-two demoted equity partners were legally "employers" and thus not covered by the protections of the ADEA.

The reason for the nature of his concurring opinion, though, was the fact that he had some "uncertainty" regarding whether all partners at S&A are "employers" for age discrimination law purposes. More specifically, Judge Easterbrook noted that S&A has a mandatory "retirement age for everyone it dubs a partner" and that there might be possible ADEA violations if some other partners at the firm are indeed subject to ADEA coverage. In this context, Judge Easterbrook concurred in the court's decision to permit the EEOC to gather further information regarding possible partnership "coverage" under the ADEA at S&A.

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66. Id. at 709 (Easterbrook, J., concurring in part and concurring in the judgment).
67. Id. at 709–10 (Easterbrook, J., concurring in part and concurring in the judgment).
68. Id. at 710 (Easterbrook, J., concurring in part and concurring in the judgment).
69. Id. (Easterbrook, J., concurring in part and concurring in the judgment).
70. Id. (Easterbrook, J., concurring in part and concurring in the judgment).
71. Id. at 711 (Easterbrook, J., concurring in part and concurring in the judgment).
72. Id. (Easterbrook, J., concurring in part and concurring in the judgment).
73. Id. at 710–12 (Easterbrook, J., concurring in part and concurring in the judgment).
74. Id. at 711–12 (Easterbrook, J., concurring in part and concurring in the judgment).
III. INTERNAL LABOR MARKETS AND THE MARKET FOR LAWYERS

The employment relationship can take a variety of forms. Employers and employees can enter discrete contracts of fairly short duration and with no expectation of continuing employment. These types of arrangements have been described as encompassing what economists call the External Labor Market (ELM). ELMs are characterized by large numbers of workers and large numbers of employers. In general, ELMs are considered relatively competitive due to the mobility of workers and the competition among firms for these new workers.

ELMs operate on two basic assumptions. First, the tasks performed by employees are of a general kind in the sense that very little of the task is specific to the particular organization. "General skills" are learned by the employee at his or her expense and thus require no training from the particular firm. "General skills" are equally valuable to any other firm in the search for the same type of knowledge. Second, within the ELM context there is no expectation of a long-term employment relationship. Both parties to employment contracts within the ELM can terminate the contractual relationship without incurring any substantial loss.

Not all employment transactions, however, are of this form. Some jobs require the learning of skills that are somewhat specific to the particular contracting firm. These "specific skills"
are valuable only to the particular firm; thus, there are no incentives to acquire them within the ELM context. Employees will be reluctant to invest in skills that are only valuable to a particular employer in the absence of some expectation of a long-term employment relationship. Employers will be equally reluctant to train employees in these more specific skills, because there is no guarantee that these employees will either stay with the firm or perform in a way that allows the employer to recover the costs associated with such training. Thus, the need arises to devise a mechanism that will create the right kind of incentives for the acquisition of firm-specific skills.

Internal Labor Markets provide such a mechanism and constitute an alternative to exclusive reliance on the use of ELMs. "ILMs arise because of ELMs' inability to deal with employment transactions when there is a need for skills that are specific to a firm." Implementation of an ILM requires the employer and employee to agree to an understanding of a long-term employment relationship.

"By internalizing parts of the employment relationship, firms potentially can encourage workers to make long-term investments with them, which in turn produce technological and cost efficiencies for the firm." Such "internalizing" involves undertaking certain types of investments in human capital. Employees make firm-specific investments early in their careers by learning skills required to perform firm jobs and agreeing to a wage rate lower than what they could potentially get elsewhere—


86. See Wachter & Cohen, Collective Bargaining, supra note 77, at 1358.
87. See id. at 1363 (observing that employees are willing to accept lower wages while they are learning firm-specific skills because they expect to receive higher wages later in their careers); see also Ramona L. Paetzold & Rafael Gely, Through the Looking Glass: Can Title VII Help Women and Minorities Shatter the Glass Ceiling?, 31 HOUS. L. REV. 1517, 1522–23 (1995) (discussing the reluctance of an employee to leave her job until she has recovered her investment in firm-specific skills).
88. Paetzold & Gely, supra note 87, at 1522–23; see also Wachter & Cohen, Collective Bargaining, supra note 77, at 1364 (illustrating an employee's ability to behave strategically by shirking or threatening to quit).
89. See Paetzold & Gely, supra note 87, at 1522–24 (discussing the development of ILMs and their application to employment discrimination problems).
90. See Wachter & Cohen, Collective Bargaining, supra note 77, at 1358 (asserting that ILMs arise because of the costs of job- or company-specific skills); see also Wachter, Reform, supra note 77, at 385–86 (contrasting ILMs and ELMs).
91. Paetzold & Gely, supra note 87, at 1522.
92. Id. at 1522–23.
93. See id. at 1522 (citing Wachter & Cohen, Collective Bargaining, supra note 77, at 1360–61).
94. See Wachter, Reform, supra note 77, at 385.
the employee’s opportunity wage. Employees then recover their return on this investment at a later point in their careers when their actual or inside wages are higher than their opportunity or outside wages. Employers, on the other hand, invest at an earlier stage of the employee’s career by paying a wage that is higher than that employee’s marginal productivity. The employer recovers its investment during the employee’s mid-career years. At that stage, the employee’s marginal productivity is believed to exceed the wage paid by the employer.

In the ILM, both employers and employees expect that the employment relationship will be long-term and that they will be adequately compensated for their investments in the case of a breach. For example, once an employee “invests” in learning firm-specific skills—skills that are not easily transferable to another firm—she will be disinclined to leave her employer voluntarily until she has recovered this investment. Conversely, because the employer would lose productivity during

95. See Stewart J. Schwab, *Life-Cycle Justice: Accommodating Just Cause and Employment at Will*, 92 Mich. L. Rev. 8, 12–19 (1993). Professor Schwab provides an excellent analysis of the ILM concept from two different perspectives: the “specific human capital” story and the “efficiency wage” story. *Id.* at 13–19. Under the “specific human capital” story, investments in firm-specific skills occur under an incentive system in which both parties share the cost and benefits associated with learning firm-specific skills throughout the employee’s work life. *Id.* at 14–15. Professor Schwab points out that a critical aspect of the “specific human capital story is the self-enforcing” nature of the employment relationship. *Id.* at 15. Because the “specific human capital” story assumes that later stages in the employment relationship that the employee’s productivity is higher than the employee’s inside wage, and at the same time that the employee’s inside wage is higher than the employee’s opportunity wage, there is no incentive for either party to terminate the employment relationship. *Id.* Employees have no incentive to leave the firm because they are being paid more than they could make in the outside market, and employers have no incentive to fire the employees because their productivity exceeds their wages. *Id.* Under the “efficiency-wage” story, while employees’ productivity later in their careers is higher than their outside or opportunity wage, their inside wage at that stage is even higher. *Id.* at 16–17. Consequently, an incentive exists on the part of the employer to terminate late-career employees because their wages exceed their productivity. *Id.* at 19.

96. *Id.* at 18; see also Wachter & Cohen, *Collective Bargaining*, supra note 77, at 1363 (proposing that employees are willing to take lower wages early in their careers because they have an expectation that their inside wages will exceed their opportunity wages later).


98. *Id.*

99. *Id.* at 1363–64.

100. See Paetzold & Gely, supra note 87, at 1522.

101. Wachter & Cohen, *Collective Bargaining*, supra note 77, at 1363. Employees “invest” in learning firm-specific skills by accepting a lower wage than they could get elsewhere in their career, with the expectation that this investment will pay off by receiving correspondingly higher wages later in their career. *Id.; see also* Paetzold & Gely, *supra note 87*, at 1522–23 (observing that an employee with firm-specific skills will be reluctant to leave her employer before recovering her investment).
the training period for a replacement, the employer has “invested” in the employee with firm-specific skills and would not want to lose her to another firm. Thus, to the extent that the parties to the ILM arrangement continue their relationship, their agreement will be fully realized.

Opportunistic or strategic behavior, however, becomes a problem within ILMs. Opportunistic behavior appears when either party attempts to breach implicit or explicit contracts. In such situations one party can be seen as trying to expropriate the returns or “rents” that the other party expects out of her investments. As noted above, workers generally make firm-specific investments early in their careers and then recoup such investments as they age. The employee invests—perhaps by agreeing to a below-market wage early in her career—with the expectation that later on she will receive above-market compensation. For example, an employee may, early in her career, engage in learning a skill that is specific to a particular employer. While doing this, she will likely agree to receive a below-market wage with the expectation that later on she will be permitted to stay in the firm and recover her investment in the form of above-market compensation. However, if the employer terminates the employment relationship after the employee has learned the skill and the employer’s investment has been recovered but before the employee is able to recover her investment, the employee’s investment will be lost.

Similarly, an employer may invest in an employee’s career by paying her more than her marginal productivity at an early or later stage in her career, with the expectation that the employer will recover its investment during the employee’s mid-career.

102. Watchter & Cohen, Collective Bargaining, supra note 57, at 1361; see also Paetzold & Gely, supra note 87, at 1522 (discussing the employer’s potential decreased productivity due to the loss of employees with firm-specific skills).

103. See Paetzold & Gely, supra note 87, at 1523 (“As long as the expectation of a long-term employment relationship exists, both parties are likely to perform their obligations under these implicit agreements.”); Wachter, Reform, supra note 77, at 385–86 (discussing how benefits to both an employer and an employee accrue in the ILM); see also George M. Cohen & Michael L. Wachter, Replacing Striking Workers: The Law and Economics Approach, in PROCEEDINGS OF NEW YORK UNIVERSITY 43RD ANNUAL NATIONAL CONFERENCE ON LABOR 109, 118 (Bruno Stein ed., 1990) (applying the internal labor model to the issue of strikers’ replacements under the NLRA).

104. See Watchter & Cohen, Collective Bargaining, supra note 77, at 1360–64.

105. Id. at 1360.

106. Id. In particular, Wachter & Cohen argue that “workers make sunk investments in their jobs by agreeing to long-term implicit contracts that provide for ‘deferred compensation,’ that is, below-market wages at early stages of employment and above-market wages at later stages.” Id.

107. Id. at 1360–64.
years. During this middle period, the employee could behave opportunistically and make it difficult for her employer to recover its investment.\textsuperscript{108}

For example, let's say a given university has a special football tradition and a law school dean wants a certain law faculty member (perhaps a former football player) to serve on a special university committee meeting two hours per week for the academic year to study the merits of retaining this tradition. This service can be viewed as a "firm-specific" investment by the professor, or alternatively as an investment in the "internal labor market" of the given university. The roughly sixty hours the professor spends on this endeavor may win the faculty member some "good citizen" points at this school, but it will likely be of roughly zero interest to other universities should the professor apply to them for a job some time in the future. Indeed, from the perspective of other universities—the "external labor market"—the professor would be much better off spending the sixty hours working on an article for publication in a prestigious law journal.

The dilemma thus becomes clear. The organization wants the employee to make the firm-specific investment, but the employee may resist. The faculty member, especially if untenured, wants to keep his options open; the way to do this is to develop a general skill set which is readily marketable in the external labor market. Given this situation, it is far better for the faculty member to spend sixty hours on a major research publication than attend meetings for a special university committee.

For ILMs to work, it is necessary to adopt some mechanisms to minimize the ability of employers and employees to engage in opportunistic behavior.\textsuperscript{109} Arguably, individuals can always enter contracts to protect against possible opportunistic behavior.\textsuperscript{110} These contracts can provide guarantees of long-term employment, thus allowing the employee sufficient time to recover the value of her investment in firm-specific skills.\textsuperscript{111} In theory, contractual arrangements requiring employers to commit to high pay at the end of the life cycle could "make it possible for employers and employees to rely on age-based wages."\textsuperscript{112}

\begin{itemize}
\item \textsuperscript{108} Id. at 1361.
\item \textsuperscript{110} Id. at 1830–35.
\item \textsuperscript{111} See id. at 1830 (arguing that contracts might deter employers from firing "older employees whose wages exceed their marginal revenue product").
\item \textsuperscript{112} Id. at 1830–31.
\end{itemize}
Several scholars, however, have noted that the contract option to guard opportunistic behavior is often unsatisfactory. Transaction costs, incomplete information, information processing limitations, and market factors make it difficult for contracts to be negotiated and adopted in the employment relationship context.

In addition to contract mechanisms, other nonlegal mechanisms exist that can serve to enforce ILM-type contracts, or for that matter any kind of contract. First, the party who feels that the other party is misbehaving can terminate the relationship. In the context of ILMs, employees who feel employers are trying to violate their understanding regarding wages can leave their jobs. Obviously, this alternative is useless to the employee who has made firm-specific investments and is now seeking to recover those investments. Terminating the employment relationship will, in effect, reward the employer’s misbehavior.

A potentially more powerful sanction relates to the possible reputational losses that the party in breach will suffer as the result of repeated violations. Arguably, an employer who repeatedly violates ILM contracts will develop a reputation for being “untrustworthy.” This reputation will make it harder for that employer to convince future employees to make the kind of firm-specific investments the employer expects, creating difficulties for the employer’s operations.

The extent to which reputation serves as a constraint on opportunistic behavior is highly questionable, particularly in the employment context. For example, interfirm transfer of

113. Id. at 1831; see also Schwab, supra note 95, at 21–24 (“To the degree that clear contracts . . . are difficult to write, monitor, and enforce, opportunistic behavior by employees will remain a threat.”).
114. See Jolls, supra note 109, at 1831–35.
115. Id. at 1835.
116. Id.; see also Richard A. Epstein, In Defense of the Contract at Will, 51 U. CHI. L. REV. 947, 958–62 (1984) (arguing that in an at-will employment relationship, one of the only controls against abuse is each party’s ability to opt out of the relationship).
117. Id., supra note 109, at 1835.
118. Id. Professor Jolls distinguishes between losses of future business and individual or social condemnation. Id. Future business losses refer to the gains that the party in breach relinquishes from future business interactions with the injured party. Id. Social condemnation refers to the negative reputation the breaching party acquires within the relevant business community. Id. Various other scholars have discussed the effect of reputational losses on curbing opportunistic behavior. See, e.g., Schwab, supra note 95, at 26–27 (contending that one “check” on an employer’s opportunistic firing of older workers is that employer’s concern for its reputation).
119. Schwab, supra note 95, at 26–27.
120. See Jolls, supra note 109, at 1835.
reputational information, such as employees who have been fired telling new employees about the employer's reputation, is likely to be incomplete and consequently not likely to serve as a substantial constraint against opportunistic firings. The case for a reputational constraint is somewhat stronger in the context of intrafirm reputation transfer—employees in the firm telling other employees in the same firm about their experiences with the employer’s reputation. Still, reputational constraints are likely to be minor. Employers possess an extraordinary ability to misinform employees and reconstruct past events in the light most favorable to the organization. Employees new to the organization can be made to believe that they will be better off in the same situation and that prior problems were not caused by the employer, but instead by a "disgruntled" group of employees.

Finally, mutual deterrence could be a very effective way of enforcing some types of contracts—particularly contracts in which both parties have similar bargaining leverage. Individuals can retaliate or threaten to retaliate against contracting partners who attempt to change the terms of the contract not only by leaving the contractual relationship, which might not be either a credible or damaging option, but instead by staying and fighting under the existing relationship. In a sense this is the basis of collective bargaining agreements. By

121. See Schwab, supra note 95, at 26–27.
122. Clearly the "power" in the relationship lies with the employer, and employees may be reluctant to question what their employer is telling them. See generally James Atleson, Value and Assumptions in American Labor Law (1983) (arguing that the hierarchical nature of the employer/employee relationship has not been equalized through such devices as unionization and collective bargaining). Moreover, employers may place, or try to place, restrictions on employee communication about events at the workplace. See David Yamada, Voices from the Cubicle: Protecting and Encouraging Private Employee Speech in the Post-Industrial Workplace, 19 Berkeley J. Emp. & Lab. L. 1, 5–21 (1998) ("[T]oday's American workplace is evolving into an institution in which the expression of an individual employee is severely devalued.").
123. See generally Guillermo J. Grenier, Inhuman Relations: Quality Circles and Anti-Unionism in American Industry 116–25 (1988) (describing how a social psychologist at a plant that was undergoing unionization attempted to manipulate employees into changing positions they had publicly taken supporting the union).
124. See Epstein, supra note 116, at 963–67 (analyzing how an employment-at-will contract, which empowers both sides to terminate the relationship at any time, discourages opportunistic behavior by either party).
125. Refer to notes 121–23 supra and accompanying text (discussing the limited effectiveness of an employee's attempt to spread negative reputational information).
127. See id. at 600 n.97 (noting that Congress clearly intended the National Labor Relations Act of 1935 to "provide a collective employee check on management demands at
allowing employees to organize collectively, we place employers
and employees on a similar footing, at least in the sense that
they can both make credible threats and commit to those
threats. The ability to make and carry out threats such as
strikes and lockouts provides the necessary incentives for both
parties to "stick" to the terms of the collective bargaining
agreement, avoiding other more disruptive enforcing
mechanisms.

Partnership agreements can be conceptualized in the same
way. Partners, particularly in smaller partnerships, have the
ability to easily monitor each other's behavior. Partners also
can pressure misbehaving partners through the use of other
rights conferred to all partners under partnership agreements.
If, for example, in a two-person partnership all major business
decisions must be made by unanimity, an aggrieved partner can
oppose any decisions until the partner in breach rectifies prior
wrongs. In larger partnerships, aggrieved partners may be able
to form coalitions with other partners and collectively exercise
t heir voting rights in a manner that ensures their complaints are
addressed.

While none of the enforcing mechanisms described are
perfect, there is a role for the law to play. Various scholars have
demonstrated in several different areas that recognizing and
enforcing ILM contracts can enhance efficiency. Particularly,

the bargaining table").

128. See Stewart J. Schwab, Collective Bargaining and the Coase Theorem, 72
CORNELL L. REV. 245, 255 (1987) (summarizing the arguments of others that unions can
promote efficiency by acting as "countervailing powers against employers' monopsony
power").

129. Id. at 254 ("[C]ollective bargaining is intended to prevent fundamental, perhaps
violent, up-heaval in our industrial system. Undoubtedly strikes will occur because they
are a necessary element of private collective bargaining." (footnote omitted)).

130. See Epstein, supra note 116, at 960 (commenting that monitoring activities may
include tracking who spends the most time in the office working on firm business and
whose services are demanded by the customers).

131. See Fortney, supra note 12, at 340 (finding that a law firm's cultural and
organizational structure may give partners the right to review their peers).

132. See Epstein, supra note 116, at 962 (noting that in extreme cases one partner
may threaten to withdraw from the partnership).

133. See Wilkins, supra note 13, at 47 (describing allegiances with powerful partners
inside a big law firm as one way minority partners can "break out of the circle of
powerlessness").

134. See Jolls, supra note 109, at 1829 (suggesting that legal rules can help satisfy
an employer and employee's preference for age-based wages when the unregulated
market fails to do so).

135. See, e.g., Leonard Bierman & Rafael Gely, Striker Replacements: A Law,
theory to argue that permitting employers to hire permanent replacements for striking
workers is economically inefficient); Rafael Gely, Whose Team Are You On? My Team or
the ADEA has been described as a "hands-tying" mechanism.\(^{136}\)
By prohibiting dismissals based on age, the ADEA makes it credible for the employer to commit to an ILM contract in which wages increase with seniority.\(^{137}\) This allows ILMs to be created, motivating employees to make firm-specific investments with particular employers.\(^{138}\)

IV. IMPLICATIONS

A. Implications for Sidley & Austin's Litigation

The ILM model provides significant insights into the kind of legal dispute addressed in the Sidley case. The question of whether an individual plaintiff is a partner and thus outside the protection of the ADEA must be understood in the context of the dynamics that in part motivate partnership agreements and in the context of the role that partnership agreements play as a sanction in the enforcement of ILM contracts.

Our argument is that the traditional career progression in law firms—the promotion-to-partner system—can be understood as the way for law firms to implement ILM arrangements. Law practice, particularly in large law firms, involves a significant amount of firm-specific training.\(^{139}\) Providing legal advice to clients requires learning information about clients, and the relevant environment in which lawyers operate is very specific to the given client and very valuable to the particular employer.\(^{140}\) This firm-specific information could also be very valuable to competitor law firms.\(^{141}\) Thus, we have a kind of knowledge that

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\(^{136}\) See Jolls, supra note 109, at 1841.

\(^{137}\) Id. at 1846 (concluding that the ADEA is, in part, a device that allows employers to commit to age-based wages).

\(^{138}\) Id. at 1837–38 (reasoning that legal rules limiting the cost-based discharge of older workers frees employees to participate in an ILM relationship with an employer even though the employee may change jobs in the future).

\(^{139}\) See GALANTER & PALAY, supra note 1, at 93–98 (describing the complex relationship that develops between partner and associate due to the extensive firm-specific training). "[T]o assure partners that they will receive the proper return on the investments they make—whether those investments are in client relationships, reputation, or the skills they impart to associates—the firm must induce associates not to grab or leave prematurely." Id. at 99.

\(^{140}\) Id. at 95 (observing that investing in an associate exposes the law firm to the risk that the associate may develop relationships with the firm's clients that allow the associate to take them and leave).

\(^{141}\) See id.
the employer needs to share with the employee requiring some investment on the part of the employee, but which the employer also wants to protect from competitors. To motivate employees to make this kind of investment, the employer needs to provide a set of incentives that potentially guarantees a long-term employment relationship.\(^\text{142}\)

The promotion-to-partner arrangement provides the necessary incentives.\(^\text{143}\) The employee is given the opportunity to prove herself over the course of roughly seven years.\(^\text{144}\) During this time the employee is making the firm-specific investments the employer needs.\(^\text{145}\) The employee makes these investments with the hopeful expectation of reaching partner status.\(^\text{146}\) With the promotion to partner comes an expectation of long-term employment.\(^\text{147}\)

Notice that the partnership structure serves as an enforcement mechanism for the ILM type of contract. Once an associate becomes a partner, arguably she has rights similar to those of other partners, and thus a voice in partnership decisions, access to meetings, and, in short, the ability to enforce the expectations of the bargain reached with the law firm.\(^\text{148}\)

The ILM contract in law firms, however, will not be self-
enforcing if, as in the S&A situation, partners do not all enjoy roughly similar rights.\textsuperscript{149} If the promotion to partner does not carry with it at least some ability to influence decisions and have access to forming alliances, there will be nothing in the employment relationship that will prevent employers from reneging on their agreements with associates.\textsuperscript{150}

When employers renege on their ILM contracts, employees may have access to a myriad of statutory protections that could protect their investments in firm-specific skills.\textsuperscript{151} In particular, as Professor Jolls has noted, the ADEA can be conceptualized as a hands-tying mechanism allowing employers to commit to a long-term, age-based wage strategy.\textsuperscript{152} The problem for law firm partners is, as was argued by S&A, that they might not be “employees” under the various antidiscrimination statutes.\textsuperscript{153} Thus, they may not have available to them the statutory protections available to “employees” under the various antidiscrimination laws.\textsuperscript{154} At the same time, because of the manner in which their employers have structured the partnership relationship, they do not have the same mechanisms to enforce the understandings reached under the ILM arrangement as individuals in “traditional partnerships.”\textsuperscript{155}

Under these conditions, law firms have the opportunity to behave strategically. By promoting an associate to partner, the law firm removes the particular individual from the coverage of statutory protections like the ADEA, which could serve to ameliorate the ability of employers to cheat on their ILM agreements.\textsuperscript{156} By structuring the partnership relationship in a

\begin{footnotes}
\item[149] See Wilkins, supra note 13, at 16 (discussing how a law firm partnership agreement that does not provide partners with similar rights creates a group of partners that are substantially weaker than the elite partners that manage the firm).
\item[150] See Sidley, 315 F.3d at 699 (outlining how S&A’s partnership structure placed the majority of its partners at the mercy of the firm’s executive committee).
\item[151] See id. at 708 (Easterbrook, J., concurring in part and concurring in the judgment) (listing Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, and the Family and Medical Leave Act as statutes that protect “employees”).
\item[152] Refer to notes 134–38 supra and accompanying text (explaining how ADEA lends credibility to the employer’s commitment to the employee, which encourages the employee to reciprocate).
\item[153] Sidley, 315 F.3d at 699.
\item[154] Id. (“It is the law that the EEOC cannot protect employers . . . .”).
\item[155] Id. at 702–03 (analyzing how Sidley’s partnership structure turned most of its partners into the functional equivalent of employee shareholders).
\item[156] See Hishon v. King & Spalding, 467 U.S. 69, 79–80 (1984) (Powell, J., concurring) (clarifying that Title VII does not extend to the relationship between partners when important decisions are made by common agreement or consent). Of course, we do not mean to imply that the only reason a law firm promotes an associate to partner is to limit the ability of that individual to use the protections of the various antidiscrimination
\end{footnotes}
way that minimizes the ability of the partner to take self-remedial action within the partnership, the employer takes away the remaining enforcing mechanism, leaving the individual vulnerable to the law firm's opportunistic actions.\(^{157}\)

This appears to have been S&A's strategy. Generally, as both Judge Posner and the late Justice Powell have noted, the "essence of the law partnership is the common conduct of a shared enterprise," and "[t]he relationship among law partners contemplates that decisions important to the partnership normally will be made by common agreement or consent among the partners."\(^{158}\) Contrary to that situation, however, Judge Posner noted that little of the traditional law partnership model was left within S&A's hierarchical "corporate" model.\(^{159}\) He noted the existence of the self-perpetuating thirty-six member executive committee and the power wielded by this committee.\(^{160}\) Particularly, Judge Posner noted the executive committee's unfettered discretion regarding firing, demotions, and compensation of other partners, and the sparing use of partnership-wide votes, which Posner noted had occurred once in the past twenty-five years.\(^{161}\) According to Judge Posner, this state of affairs at S&A left the plaintiff partners "defenseless" with "no power over their fate."\(^{162}\) The plaintiffs did not have any means to respond to decisions with which they disagreed, because they had no real "voting power."\(^{163}\)

Judge Posner's discussion is entirely consistent with the ILM model. When hiring an associate, a law firm expects the individual to make the type of firm-specific investments necessary in law practice.\(^{164}\) Associates make these investments with the expectation that should they successfully jump through all the "hoops" and become a firm partner they are, if not guaranteed, at least implicitly provided some measure of job and

\(^{157}\) See, e.g., Sidley, 315 F.3d at 699 (finding that an executive committee of partners had the power to fire, demote, or lower the pay of other partners).

\(^{158}\) \textit{Id.} at 706 (quoting \textit{Hishon}, 467 U.S. at 79–80 (Powell, J., concurring)).

\(^{159}\) \textit{Id.} at 705 (describing S&A's as a firm that "employ[ed] the latitude allowed to it by state law to reconfigure a partnership in the direction of making it a de facto corporation").

\(^{160}\) \textit{Id.} at 702–03.

\(^{161}\) \textit{Id.} at 699.

\(^{162}\) \textit{Id.} at 704.

\(^{163}\) \textit{Id.}

\(^{164}\) \textit{GALANTER & PALAY}, supra note 1, at 97 (identifying the location of new clients for the firm and learning a firm client's business as investments typically made by an associate).
income security.\textsuperscript{165} The security is channeled in the form of the partnership.\textsuperscript{166} This ILM type of contract is self-enforcing in the sense that as a partner each individual has a similar opportunity to protect herself against possible abuses by other partners.\textsuperscript{167} Under this model, general parity in the treatment of partners' rights in law firms is essential to the enforcement of the implicit ILM understandings.\textsuperscript{168}

The existence of this general parity likely was at least in part a consideration in Congress's treatment of partners under the various antidiscrimination statutes.\textsuperscript{169} According to Judge Posner, it appears reasonable that "implicit in the ADEA's exemption for employers is recognition that partners ordinarily have adequate remedies under partnership law to protect themselves against oppression . . . by the partnership."\textsuperscript{170} If so, failure by courts to treat individuals in the position of the plaintiffs in this type of case as "protected" would leave them with no remedy to enforce their ILMs contracts, and thus at the mercy of the law firm, or more specifically the powerful executive committee.\textsuperscript{171} In short, the demoted partners will both not be covered by the ADEA and not have any of the powers normally accruing to partners in a "traditional law partnership."\textsuperscript{172}

Our discussion of the ILM model also suggests what the proper legal response should be. If the problem is with the failure of the self-enforcing aspects of the promotion-to-partner model, the law can play a constructive role by finding alternative means to enforce the ILM contract.\textsuperscript{173} The ADEA in particular provides

\begin{enumerate}
\item[165.] Id. at 96 (explaining that part of an associate's compensation involves the potential opportunity to own a portion of the partnership).
\item[166.] Id. at 101 (describing how the prize of admittance to the partnership, which goes to the winners of the promotion-to-partner tournament, provides the assurances and incentives required by the associates).
\item[167.] See Hishon v. King & Spalding, 476 U.S. 69, 79–80 (1984) (Powell, J., concurring) (noting that, unlike the partner-associate relationship, the relationship between law partners is one of equals and that decisions are made by common agreement).
\item[168.] Refer to notes 143–48 supra and accompanying text (discussing how a law firm's promotion-to-partner arrangement creates ILM understandings and how, once partner status is attained, it serves to enforce them).
\item[169.] See Burke v. Friedman, 556 F.2d 867, 869 (7th Cir. 1977) (concluding that partners in a small partnership were not employees because the common law in existence prior to the passage of Title VII of the Civil Rights Act of 1964 recognized that partners are co-owners who "manage and control the business and share in the profits and losses").
\item[170.] EEOC v. Sidley, Austin, Brown & Wood, 315 F.3d 696, 704 (7th Cir. 2002)
\item[171.] See id. at 699 (detailing the plight of the nonexecutive committee partners absent a legal remedy under ADEA).
\item[172.] See Hishon, 467 U.S. at 79–80 (Powell, J., concurring).
\item[173.] See Jolls, supra note 109, at 1837–38 (illustrating how legal rules can help to ensure the employee will receive the age-based wages that typically result in ILM
\end{enumerate}
such a mechanism by limiting the ability of employers to make employment decisions based on age, thus making it possible to commit to an age-based wage system.\footnote{\textsuperscript{174}}

Providing individuals who are found in the predicament faced by the plaintiffs in the S&A case with access to the ADEA is necessary in order to effectuate the implicit understandings embedded in the ILM contract.\footnote{\textsuperscript{175}} The ultimate legal issue, as noted by Judge Posner, is whether this large law firm—which in recognition that conventional partnership is designed for much smaller and simpler firms has contractually altered the structure of the firm in the direction of the corporate form—should for purposes of antidiscrimination law be deemed the employer of some at least of the individuals whom it designates as partners.\footnote{\textsuperscript{176}}

In addressing this critical issue, ILM theory suggests that courts should adopt a very narrow interpretation of the definition of who is a partner under the various antidiscrimination laws. Only where the partner label carries with it real authority that allows the named partner to take effective action against others in the firm should the court find the individual to be an “employer,” and thus outside statutory coverage.\footnote{\textsuperscript{177}} This is because only in these situations can named partners enforce ILM contracts via nonstatutory means and thus avoid strategic behavior by the firm.\footnote{\textsuperscript{178}}

Two tests have been considered by the courts in the various cases dealing with this issue: the literal or mechanical test, and the right of control or common law approach.\footnote{\textsuperscript{179}} The literal or mechanical test approach, as the name implies, looks at the

arrangements by complementing or replacing contractual relationships).

\textsuperscript{174} Refer to notes \textsuperscript{134–38} supra and accompanying text (explaining how the ADEA ties the hands of the employer, preventing it from opportunistically dismissing its senior employees before they receive the full benefit of the age-based wage system).

\textsuperscript{175} Refer to notes \textsuperscript{92–99} supra and accompanying text (summarizing an employee’s firm-specific investment, expectation for return on that investment, and need for assurance of adequate compensation if the ILM contract is breached).

\textsuperscript{176} \textit{Sidley}, 315 F.3d at 707.

\textsuperscript{177} See \textit{Hishon}, 467 U.S. at 79–80 (Powell, J., concurring) (relying on the normal partnership requirement that partners participate in all important decisions to conclude that the “reasoning of the Court’s opinion does not require that the relationship among partners be characterized as an ‘employment’ relationship to which Title VII would apply”).

\textsuperscript{178} See \textit{Jolls}, supra note \textsuperscript{109}, at 1830–31 (explaining how legally enforceable contractual relationships, such as partnership arrangements, can be used to protect the parties from opportunistic behavior).

\textsuperscript{179} Simpson v. Ernst & Young, 100 F.3d 436, 442–43 (6th Cir. 1996) (discussing the development of both tests).
business form the employer has adopted. The choice of corporate form is determinative to the extent that it “precludes any examination designed to determine whether the entity” is anything other than what its corporate form indicates. Once this determination is made, the classification of individuals as employees is mechanical because in a professional corporation all individuals employed by the corporation qualify as employees under the various antidiscrimination statutes.

On the other hand, the “economic realities” or “right of control” test disregards form and focuses on substance. While several definitions of this test have been advanced by various agencies and courts, the basic import of this test involves a consideration of “the actual role played by the claimant in the operations of the involved entity and the extent to which that role dealt with traditional concepts of management, control, and ownership.” Courts applying the “economic realities” test have looked at factors such as the method of compensation, the claimant’s responsibility for the organization’s liability, the management structure of the organization, and the claimant’s role in the management of the organization.

The insights derived from the ILM framework lead us to conclude that in the Sidley type of case, courts should clearly adopt the “economic realities” or functional test. The rationale is twofold. First, in this type of situation where the plaintiff is a named partner but possesses only relatively minimal authority, the major concern should be providing the plaintiff with a mechanism to enforce the ILM agreement. By deciding to adopt a partnership form of business, and by then adopting an internal structure much different from the “traditional partnership,” as

182. See, e.g., 42 U.S.C. §§ 12101–12117 (2000) (applying the Americans with Disabilities Act to corporations with more than twenty-five employees who work more than twenty weeks in a calendar year).
186. See Johnson, supra note 11, at 1095–96 (arguing that properly applied, the economic realities test improves on the deficiencies associated with the literal test).
187. See EEOC v. Sidley, Austin, Brown & Wood, 315 F.3d 696, 699 (7th Cir. 2002) (observing that the employer had a small but powerful executive committee that made firm-wide decisions).
described by Justice Powell in Hishon, the law firm has de facto taken away the nonlegal sanctions available to the plaintiffs to enforce their ILM agreements. We submit that courts should address this situation by providing plaintiffs in this type of case with coverage under the appropriate antidiscrimination statute.

Second, because the dispute arises after the plaintiff has invested in firm-specific skills, reliance on labels could leave the plaintiff vulnerable to opportunistic behavior by the employer. Courts should make the determination of whether the plaintiff is covered under the statute by looking at the various factors identified under the “economies realities” test. As Judge Posner suggested in Sidley, this decision might entail thinking of three possible categories under the ADEA: “partner/employer,” “partner/employee,” and “employee,” with protection afforded to the last two.

B. Broader Implications

The Sidley case involved a situation where the plaintiffs were the individuals whose characterization as partners, employers, or employees was in direct dispute. A different type of factual scenario has also troubled the courts recently, including the U.S. Supreme Court. In this second type of case, the question is whether the employer meets the minimum number of employees threshold under the various antidiscrimination laws. The question regarding the classification of an individual as an employee or as a partner arises because the employer argues that one or more of the individuals that appears to be an “employee” is in fact a “partner,” and thus should not be counted in deciding whether

188. Refer to notes 44–55 supra and accompanying text (discussing Justice Powell’s view of the traditional partnership).
189. See Hishon v. King & Spalding, 467 U.S. 69, 79–80 (1984) (noting that a plaintiff’s ability to enforce an ILM agreement can be stifled by internal employer decisions); Sidley, 315 F.2d at 706.
190. Refer to notes 104–08 supra and accompanying text (discussing opportunistic behavior).
191. Refer to note 183–85 supra and accompanying text.
192. See Sidley, 315 F.3d at 704–07 (explaining that the general applicability of ADEA’s exceptions creates three possible categories of claimants).
193. Id. at 698–99.
195. Id.; see also Hyland v. New Haven Radiology Assocs., 794 F.2d 793, 794–98 (2d Cir. 1986) (explaining that plaintiff’s status as either a “partner” or a “shareholder” will be determinative of ADEA applicability), abrogated by Clackamas, 123 S. Ct. 1673; EEOC v. Dowd & Dowd, Ltd., 736 F.2d 1177, 1178 (2d Cir. 1984) (arguing that determinations of includable employees rests on plaintiff-shareholder status), abrogated by Clackamas, 123 S. Ct. 1673.
the employer is covered under the particular antidiscrimination statute.\footnote{196}

1. Clackamas Gastroenterology Associates v. Wells.\footnote{197} In \textit{Clackamas Gastroenterology Associates v. Wells}, the plaintiff was terminated from her job with the defendant, a medical clinic organized as a professional corporation under state law.\footnote{198} Plaintiff Wells brought suit alleging unlawful discrimination on the basis of disability under the Americans with Disabilities Act (\text{ADA}).\footnote{199} The defendant moved for summary judgment, arguing that it was not an “employer” and thus not a “covered entity” within the meaning of the \text{ADA} because it did not have the requisite “fifteen or more employees for the twenty weeks required by the statute.”\footnote{200} The basis for this argument, according to the defendant, was that its four physician-shareholders should not be counted as employees for purposes of determining whether the defendant was a covered entity.\footnote{201} Relying on the “economic realities” test, the defendant successfully argued before the federal district court that its four physician-shareholders should be regarded as “partners” and not as “employees” within the meaning of the \text{ADA}.\footnote{202}

The U.S. Court of Appeals for the Ninth Circuit found in favor of the plaintiff, adopting the literal test to determine statute coverage.\footnote{203} The court was troubled by the possibility of permitting professional corporations to secure “‘the best of both possible worlds’ by allowing [a professional corporation] 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.”\footnote{204} The court emphasized the voluntary nature of the defendant’s decision to form as a professional corporation.\footnote{205}

\footnote{196} Hyland, 794 F.2d at 794–95 (reversing the district court’s finding that Hyland was a partner and therefore could not be included as an employee in the office).
\footnote{197} 123 S. Ct. 1673.
\footnote{198} Id. at 1676.
\footnote{200} Clackamas, 123 S. Ct. at 1676. “[A]n employer means a person engaged in an industry affecting commerce who has 25 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding year, and any agent of such person.” 42 U.S.C. § 12111(5)(a) (2000).
\footnote{201} Clackamas, 123 S. Ct. at 1676.
\footnote{202} Id.
\footnote{203} Wells v. Clackamas Gastroenterology Assocs., 271 F.3d 903, 905–06 (9th Cir. 2001), rev’d, 123 S. Ct. 1673 (2003).
\footnote{204} Id. at 905.
\footnote{205} Id.
The court noted that it might be appropriate “to apply an ‘economic realities’ test to determine that a nominal partner should . . . be considered an ‘employee’ in order to prevent a firm from labeling the bulk of its employees as partners simply to insulate itself from liability for discrimination” — the Sidley type of dispute. 206 However, the court noted that the type of dispute involved in Clackamas was substantively different. 207 According to the court, it was inappropriate to apply the “economic realities” test to the question of whether shareholder-employees of a corporate enterprise were partners. 208 The court said that “[w]hile the shareholders of a corporation may or may not be ‘employees,’ they can never be partners in that corporation because the roles are ‘mutually exclusive.’” 209

The Supreme Court reversed and remanded, rejecting the Ninth Circuit’s adoption of the literal test. 210 In an opinion authored by Justice Stevens and joined by six other Justices, the Court found the literal test inconsistent with Congress’s decision to exempt small firms — firms with fewer than twenty-five employees — from the ADA and with Congress’s expectation that courts would fill in the gaps left as the result of congressional silence by referring to common law rules on the specific subject matter. 211

Having rejected the literal test, the Court adopted the EEOC’s guidelines on the issue of who is an employee and when partners qualify as employees. 212 The EEOC guidelines, which as the Court noted properly focus on the “touchstone” issue of control, identify the following six factors:

[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

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206. Id.
207. Id.
208. Id.
209. Id.
211. Id. at 1679.
212. Id. at 1680–81.
an employee, as expressed in written agreements or contracts

[6] "Whether the individual shares in the profits, losses, and liabilities of the organization."\textsuperscript{213}

In adopting the EEOC's approach, the Court noted that neither individual job titles nor the existence of an "employment agreement" will be determinative; instead, "all the incidents of the relationship" ought to be considered.\textsuperscript{214} The Court remanded the case to the Ninth Circuit, noting that while several of the factors considered under the EEOC guidelines supported the finding that the four physician-shareholders were not employees for ADA purposes, contrary evidence existed on the record.\textsuperscript{215}

Justice Ginsburg, joined by Justice Breyer, dissented, accusing the majority of unnecessarily shrinking the inquiry as to who is an employee under the ADA by unduly focusing on the issue of control in the employment relationship.\textsuperscript{216} Justice Ginsburg would have found the physician-shareholders to be employees under the ADA, and thus the defendant to be covered under the Act.\textsuperscript{217} The reasoning of her opinion is, however, somewhat unclear. At first, it appears that Justice Ginsburg agrees with the majority's decision to use the common law test.\textsuperscript{218} While criticizing the manner in which the common law functional test was applied, Justice Ginsburg argues that a broader application—an application that does not narrowly focus on control—would have resulted in a different outcome.\textsuperscript{219}

Justice Ginsburg, though, appears to change directions by arguing that in deciding who is an employee under the ADA—and arguably in other cases involving antidiscrimination laws—the courts should look at the corporate form chosen by the employer.\textsuperscript{220} In a discussion more consistent with the "literal test," Justice Ginsburg noted that the effect of selecting to organize the medical practice as a corporation established a "separate and distinct" entity in order to reap the advantages of

\textsuperscript{213} Id. at 1680 (quoting EEOC Compliance Manual § 605:0009 (2000)).
\textsuperscript{214} Id. at 1680–81 (quoting Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 324 (1992)).
\textsuperscript{215} Id. at 1681.
\textsuperscript{216} Id. (Ginsburg, J., dissenting).
\textsuperscript{217} Id. at 1681–83 (Ginsburg, J., dissenting) (expressing her determination that the purpose of the ADA's applicability was to cover employees in offices such as Clackamas).
\textsuperscript{218} Id. at 1682 (Ginsburg, J., dissenting) (commenting that the doctors on Clackamas's premises engaged in daily services as employees).
\textsuperscript{219} Id. at 1681–82 (Ginsburg, J., dissenting).
\textsuperscript{220} Id. at 1682 (Ginsburg, J., dissenting) (positing that shareholders of an organization who obtain benefits under both federal and state laws as employees should be prevented from denying their status as employees to prevent ADA applicability).
limited liability. Accordingly, Justice Ginsburg pointed out that there is "no reason to allow the doctors to escape from their choice of corporate form when the question becomes whether they are employees for purposes of federal antidiscrimination statutes."222

In closing, Justice Ginsburg reminded the Court of the real issue in this case. While the Court had exclusively focused on whether the physician-shareholders were employees under the ADA, the plaintiff in this case was not a physician-shareholder, but a clerical employee, who for every other purpose clearly falls under the Act's definition of an employee.223 Thus, concluded Justice Ginsburg, "the character of the relationship between [the employer] and the doctors supplies no justification for withholding from clerical worker Wells [(the plaintiff)] federal protection against discrimination in the workplace."224

2. Clackamas and Internal Labor Markets. Cases like Clackamas are significantly different from the Sidley type of case in several respects. First, unlike in Sidley, the plaintiffs are not the individuals whose status is under dispute.225 The plaintiffs in this second type of case are clearly employees.226 The employer is casting doubts over the status of some other person in the organization.227 Second, in these cases, employers have usually decided to organize themselves as professional corporations in order to take advantage of various tax laws.228 In professional corporations, the distinction between owners and employees is supposed to be very clear.229 The employer, however, argues that

221. Id. (Ginsburg, J., dissenting).
222. Id. (Ginsburg, J., dissenting).
223. Id. at 1683 (Ginsburg, J., dissenting) (emphasizing her opinion that clerical employees should not have their ability to enforce their ILM agreements stripped away by employer classification).
224. Id. (Ginsburg, J., dissenting).
225. United States Supreme Court Transcript at 19, Clackamas Gastroenterology Assoc.s v. Wells, 123 S. Ct. 1673 (2003) (No. 01-1435), available at 2003 WL 840129 (Oral Argument of Irving L. Gornstein for Amicus Curiae United States). In oral argument in the Clackamas case, the Supreme Court appeared to recognize this distinction. In an exchange during the oral argument, one of the Justices commented, "Well, I thought we were looking to see if some other, lower employee was covered, not these directors, and that turns on whether you count them as employees or not." Id.
226. Clackamas, 123 S. Ct. at 1676 (noting that the dispute centered on whether the defendants were employees).
227. Id.
228. Id. at 1682 (stating that Clackamas shareholders organized their practice as a professional corporation to limit tax liability).
229. See Wells v. Clackamas Gastroenterology Assoc.s., 271 F.3d 903, 905, 907 (9th Cir. 2001) (contending that a decision as to corporate form selection is voluntary and is calculated to minimize corporate liabilities), rev'd, 123 S. Ct. 1673 (2003).
some of the alleged professional corporation employees are in fact shareholder-directors, and thus, should not be counted as employees regarding the decision as to whether the employer meets the jurisdictional minimum employee requirement. 230

We believe that the ILM theory is also relevant in understanding this second type of case. As in the S&A situation, the issue of the status of individuals as partners, owners, or employees relates to the ability of individuals to enforce their ILM agreements. 231 In choosing an organizational form, the "employers" or owners have the ability to structure the employment relationship in a way that facilitates or impedes the enforcement of these understandings. 232 One important component of that choice is whether an individual will have access to either internal (nonlegal) or external (legal) enforcement mechanisms. As discussed above, the partnership status provides individuals with one such mechanism, and access to various antidiscrimination statutes provides another. 233

When an organization such as a law firm or a medical practice decides what organizational form to adopt, the organization is making a choice with implications for the enforcement of ILM agreements. In the S&A type of case, the problem from an ILMs perspective is that the employer is seeking to alter the organizational form midway through the employment relationship, altering the tradeoffs that individuals have made earlier. 234 Thus, in that context, it is important for courts overseeing disputes regarding the actions of the employer to carefully construe the terms of the original agreement, such as the definition of being a partner, to prevent employers from reneging on their original bargain. This attempt to alter the basis of the ILM's bargain after the initial understanding has been entered leaves employees vulnerable to opportunistic behavior on the part of the employer and should be carefully monitored by the courts. 235 As we argued above, the doctrinal implication of this

230. Clackamas, 123 S. Ct. at 1678.
231. See id. at 1683 (Ginsburg, J., dissenting) (critiquing the majority's decision by exposing that determinations of status as partners or shareholders has a major effect on "employees'" ability to recover under the statute; not only do these decisions impact the owner's status as a partner, employer, or employee, but individual employees' ability to enforce their ILM agreement requires a determination that the employer has a certain number of employees for statute applicability).
232. See Wells, 271 F.3d at 905 (noting that when incorporators of a business adopt a corporate form, they have the ability to avail themselves of tax and liability advantages).
233. Refer to notes 134–38 supra and accompanying text.
234. Refer to notes 85–99 supra and accompanying text (discussing the employee's investment in firm-specific skills).
235. See EEOC v. Sidley, Austin, Brown & Wood, 315 F.3d 696, 699 (7th Cir. 2002)
argument is that courts should look beyond the labels—avoiding what Judge Posner calls the “tyranny of labels”—and apply the functional test when deciding if a particular individual qualifies as an employee under the various antidiscrimination statutes.\(^\text{236}\)

Unlike the Sidley type of dispute, in the Clackamas type of case the decision regarding organizational structure is made *before* the beginning of the employment relationship.\(^\text{237}\) That is, the employer decision regarding organizational form precedes the ILM bargain between the employer and the new hire.\(^\text{238}\) At that time, both parties make an assessment of the sanctions available to them to enforce any ILM understanding called for by the nature of the employment relationship. For example, employees agreeing to work for a professional corporation employing the threshold number of employees will know in advance that as employees they are covered by the various antidiscrimination laws.\(^\text{239}\) To the extent that their jobs require potential new hires to make ILM types of investments, they can assess at that time whether such a sanction is sufficient to safeguard their investments, whether they should seek to negotiate other enforcement mechanisms, or instead seek other job opportunities.

We believe that in order to validate the initial ILM understanding that the contracting parties appear to be making in the Clackamas type of situation, courts need to take an approach different from that suggested above regarding the Sidley type of case.\(^\text{240}\) We argue that courts in this type of case should adopt a literal or mechanical approach to the issue of interpreting the definition of the term “employee” under the various statutes.\(^\text{241}\) Thus, if the employer has adopted a professional corporation form, individuals like the four doctors in Clackamas will be considered employees, even if those individuals perform functions similar to those performed by partners in firms of similar size. Both Justice Ginsburg and the

\(\text{\footnotesize (questioning the legal ramifications of employees' status when their partnership reconfigures as a "de facto corporation" and seeks for its partners to be treated as employers under statute).}\)

\(\text{\footnotesize 236. See id. at 699, 702, 705 (reasoning that the "tyranny of labels" problem arises when legal consequences hinge upon whether one is classified as a partner or an employee).}\)

\(\text{\footnotesize 237. Clackamas Gastroenterology Assocs. v. Wells, 123 S. Ct. 1673, 1676 (2003) (chronicling the organization of Clackamas Gastroenterology Associates as a professional corporation and finding the plaintiff as an employed bookkeeper).}\)

\(\text{\footnotesize 238. Id.}\)

\(\text{\footnotesize 239. See generally 42 U.S.C. § 12111(5)(A) (2000) (clarifying the definition of "employer" for the purposes of statute applicability).}\)

\(\text{\footnotesize 240. Refer to note 236 supra and accompanying text.}\)

\(\text{\footnotesize 241. But see Johnson, supra note 11, at 1098 (arguing that the literal test should not be applied to the Clackamas type of case).}\)
Ninth Circuit appear to have adopted this argument. In applying the mechanical test in Clackamas, the Ninth Circuit noted, "Having freely made the choice to adopt this form of business organization [(a professional corporation), the defendants] 'should not now be heard' to say that their firm is 'essentially a medical partnership,' and not a corporation."

Our reasoning is as follows. The decision regarding what corporate form to adopt is made before a particular dispute occurs. That decision is then factored by the contracting parties into their assessment of whether they should invest in firm-specific skills during the course of their employment relationship. If potential employees feel that having access to the various antidiscrimination statutes is important in their decision of whether to make firm-specific investments with a particular employer, they might not take a job with a firm formed as a partnership that does not come under these statutes' coverage. If on the other hand the new employees decide to make specific investments knowing that legal sanction will not be available in case of employer breach, we see little reason why to provide judicial relief in such situations. In applying the literal or mechanical test, the courts will be validating the exchange of information that takes place at the time an individual decides to seek employment with a particular employer.

We argue that the Supreme Court's application of the functional test to the Clackamas-type situation is misguided. In cases like Clackamas, courts should adopt a literal or mechanical approach to the interpretation of the definition of an "employee" under the various antidiscrimination statutes. Such an approach is consistent with the underlying dynamics of ILMs and necessary to protect employees in their ILM agreements.

V. CONCLUSION

Judge Posner's October 24, 2002 opinion in the Sidley case is arguably one of the most important in terms of affecting the nature of the practice of law in many years. Traditionally, becoming a partner in a firm like S&A was a really big deal.

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242. See Clackamas, 123 S. Ct. at 1682-83 (Ginsburg, J., dissenting) (reasoning that Clackamas should be prevented from escaping its selected corporate form in order to avoid federal antidiscrimination provisions).


244. See Clackamas, 123 S. Ct. at 1682–83 (observing that by restricting Clackamas Gastroenterology Associates' ability to reconfigure its corporate form, the determination on whether employees such as Wells can sue under the ADA becomes clearer).

245. Refer to notes 143–47 supra and accompanying text (discussing the incentives of
Law firm associates toiled arduously for years, making all kinds of firm-specific investments, in the hope they would reach the "brass ring" of partnership, and more or less be "tenured" and "set for life." But, as Bob Dylan has put it, "the times they are a-changin'."\textsuperscript{247} S&A recently demoted thirty-two of its older equity partners to the rank of "counsel" and "senior counsel," and when these individuals sued the firm for age discrimination, it argued that employment actions taken against partners in the firm are not covered by the ADEA.\textsuperscript{248}

In this Article, we disagree with S&A's argument and assert that an "economic realities" legal test should be applied to the situation. "Real" partners are able to protect their ILM investments through the partnership process, but the sad reality is that the thirty-two demoted equity partners at S&A were not "real" partners. S&A reneged on its ILM "deal" with these individuals, and the plaintiffs should be entitled to statutory redress. We differentiate this situation from that in the Clackamas case recently decided by the U.S. Supreme Court where a "literal" or "mechanical" test—as opposed to an "economic realities" test—for determining employment status appears more appropriate.

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\textsuperscript{246} See generally EEOC v. Sidley, Austin, Brown & Wood, 315 F.3d 696, 699, 709 (7th Cir. 2002) (illustrating that each plaintiff had a capital account with the firm, each was responsible for the liabilities of the firm, and each derived an income based on a percentage of the overall firm profits).
\textsuperscript{247} BOB DYLAN, The Times They Are A-Changin', on THE TIMES THEY ARE A-CHANGIN' (Columbia 1964).
\textsuperscript{248} Sidley, 315 F.3d at 699, 702.
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