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Do Associates Still Care About Making Partner?

Eric Seeger

By Eric Seeger

Whether the frequent gripe is true that "associates today don't want to work hard and pay their dues like we did," what is certainly true is that a number of forces have conspired to make equity partnership less attainable and less desirable in many firms than it used to be. As the typical law firm career path becomes more fluid, less traditional and less predictable, law firm leaders and associates alike are struggling to come to terms with what the changes mean for recruiting, retention, professional development, promotion, capitalization, individual contribution and compensation, just to name a few of the many question marks. It seems that the ultimate prize of equity partnership is not sufficiently motivating for associates in many firms. What does that mean for law firm leaders?

When Is a Partner Not a Partner? Defections and NEPs

The first challenge is to make sure we are all talking about the same thing. "Partner" used to mean "equity partner"—those who shared directly in the profits, risk and capitalization of the firm and had full or limited voting rights concerning firm matters. Traditionally equity partners joined the firm while young and inexperienced and then rose through the ranks, ultimately becoming "one of us." The partners held all the cards. Good citizenship was important—in some firms, most important.

Times have changed. The growth imperative has become more urgent for many firms. The drive toward bigness has been driven in large part by globalization (the need for competent, connected lawyers in more places), corporate consolidation (larger clients needing or wanting larger law firms to handle the breadth and depth of their legal needs), convergence (law firms shrinking their preferred outside counsel lists from hundreds of firms to a more manageable few) and specialization (requisite level of sophisticated technical expertise in a variety of disciplines). Firms' voracious appetite for partners in order to staff, build and grow big-time practices led to the now-familiar "lateral hire" (so called by the hiring firm), also known as "partner defections" depending on your point of view. The notion of defection implies the breaking of a fundamental bond. It speaks to the quaint old notion

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(again, depending on your point of view) that partners are in it together, for the long term, through thick and thin. In view of lateral mobility, associates may conclude that the wiser strategy is to hitch their wagon to a key partner than to a firm.

"Large classes of non-equity partners can send the message inside and outside the firm that mediocrity is tolerated in your firm."

When partner meant equity partner, it was pretty simple. You were either a partner or you weren't. Or maybe you were "of counsel," which had its own clear meaning: part-time or experienced but with limited clientele. Now we have fuzzy, in-between, something-else categories, and a lack of shared definitions between firms. Large law firms created non-equity partnership tiers in earnest in the 1990s for lawyers who were talented and productive but not quite equity partner material, or to accommodate demotions. By 2006, nearly 80 percent of *AmLaw* 200 firms had a non-equity tier. Frequently these are lawyers who would be tough to replace but are not contributing significant value to the firm in excess of their own billable hours. Sometimes called "contract partners" or "income partners," NEPs arrive at that status on an upward trajectory (often as a lengthening of the partnership track), a downward trajectory (de-equitization) or as a probationary status (say, for two years after lateral hire).

It is important for firms to clearly determine what their NEP tier is for. Is it a holding tank, a proving ground, a safe haven, or something else? Can NEP status be permanent, or is it up or out? If the latter, how long does one have to prove their merit? What contributions are expected annually and longer term? Do NEPs attend partnership meetings? Do they have any voting rights?

We recommend that firms avoid these classes becoming too large, for a couple of reasons. First, if these lawyers are not likely to ever become equity partners, then they are blocking opportunities for your talented associates by doing work that could and should be pushed down. Second, NEPs frequently contribute to morale problems in the firm. They complain about not being valued for their "other" contributions, and their positions can be seen as sinecures by others in the firm. Large classes of non-equity partners can send the message inside and outside the firm that mediocrity is tolerated in your firm. That's not good for business.

Salary Increases and Compression

Not only are fewer equity partnership slots available for associates to attain, but the financial disparity between senior associate and new partner has closed in many firms as well. This removes an important incentive for making partner, as well as the urgency to do so.

Associate salaries have migrated higher and higher as the largest, most prosperous firms took starting salaries into six figures, to $145,000 and then $160,000. Expect an even bigger jump with the next round of increases, as a select group of firms tries to make the climb too steep for other firms to follow.

Salaries have gone higher and farther afield. Since 1985, the New York-based firms in the *AmLaw* 200 have more than doubled their number of US offices (to 140 non-New York offices) and more than doubled the number of lawyers in those offices (from 15 to 35). In the old days, if salaries went up in New York, the increase was largely confined to New York. Now when salaries go up in New York, they also go up in those firms' other offices to avoid associate unrest and to convey to clients that the firms' practices are national in scope. That sets the new compensation benchmark in cities across the US.

Because demand for new law school graduates has exceeded and will continue to surpass supply, intense competition for talent forces smaller-market firms to keep up with escalating associate salaries as best they can. In a seller's market, now the associates hold the cards. Why care about making partner if you're already making upwards of $200,000 in total compensation with none of the commitments and responsibilities of ownership? High levels of law school debt increase the focus on short term compensation from the associate's perspective.

With all the money being thrown around and the high level of mobility, the problem for the profession is that, for associates and partners alike, people who will come for money will leave for money, fueling a free agent market that diminishes even the expectation that a firm will hang together for the long term. Firms of all sizes need to worry about their viability and stability should they lose their key rainmakers. "Do I want partnership? In what? This firm won't exist in fifteen years!"

Profit Per Partner

Some blame the *AmLaw* 200 and its kin for causing firms to obsess about their published profit per partner (PPP) figures as a recruiting and marketing tool, and indeed, algebra confirms that profit per equity partner goes up when the number of equity partners goes down. It follows, then, that firms can appear more profitable by de-equitizing marginally contributing partners and raising the bar for entry from the associate ranks. But published rankings did not cause the split of large law firms into haves and have-nots — differences in financial performance always existed, the rankings just made the comparisons easier to make. It is true, however, that profit per partner has become a number that people use (fairly or unfairly) to compare firms and that firms have incentive to keep their PPP number high and growing.

Hard Working Partners

In the new reality, partners have to keep earning their keep. It's like NFL training camp, where even the veterans have to keep proving themselves each summer because there are only so many roster spots available. Last year's *Survey of Law Firm Economics* showed partners billing an average of 1,710 hours compared to the associate average of 1,802. Among high performing (ninth decile) firms, however, partners outbilled associates by a count of 2,193 hours to 2,159. Across all firms in the *Survey*, the average number of annual charged hours decreased for associates by 40 hours from 2002 to 2006.

The billable hour is fully entrenched in the profession as the measure of a lawyer's worth if not their value. Because most associates have limited business development capability due to their relative youth and inexperience, their way to stand out among their peers is to bill more hours than the rest of their class. To excel in that contest means little time for anything else. Meanwhile, in many firms, partners are billing more hours than associates, so the reward for all that effort as an associate is to produce all the more effort as a partner. Small wonder if that prize is less sought after than it used to be.

Generational Differences

On top of all this, there are profound differences in how Gen X and Gen Y lawyers view work, life and relationships. They don't expect to work their whole career with one firm, or even necessarily to practice law forever. Most expect to leave the firm that hired them within five years. They are more short term and opportunistic in their thinking, more open to change and to pursuing new opportunities as they arise. They value independence and autonomy more than collegiality and competition. They are willing to work hard and they also want a life outside of work. They want early, hands-on experience with sophisticated work and client interaction. They expect frequent feedback from partners who matter. They want to be heard.

Despite the fact that 88 percent of them do not expect to become equity partners in their firms according to one survey, they nonetheless require a great deal of care and feeding. Is all that attention really necessary? Only if you want them to stay. Associates with options (which means all the good ones) will not tolerate being treated as fungible units of production rather than as individuals with unique motivations and needs, and they don't really care about the proud traditions of the firm and how things used to work around here. They're not wired to care and they don't have to care.

What's a Law Firm to Do?

From the associate's perspective, the result of all these changes is a narrower door into equity partnership, a higher contribution threshold for getting and staying there, generous compensation whether they get there or not, and less long-term security if they do. For some good, talented keepers, the motivation just won't be there. The "brass ring" of equity partnership has already lost its luster in their eyes. To keep all your keepers, then, you need to reward and satisfy them in other ways.

When it comes down to it, the situation isn't all that different than it ever was. Successful equity partners who are now surrounded by other successful people inside and outside the firm may forget that a small percentage of any population goes on to become that successful. Most of their classmates didn't become highly successful equity partners in law firms. Every generation has its high achievers at the narrow tail of its bell curve who accomplish more than others, and in the end Generation X and Gen Y will be no different. The challenge remains, however, to make your firm a place where high achievers will stay and achieve.

Conclusion: Acceptance, Clarity, Communication and Flexibility

The next generations see the world differently than you do. You can rail against their different perspective or accept it as a fact of life. (Hint: facts of life are not affected by your unwillingness to accept them.)

Gen Y is a new breed and you can't wish them away. They are your current associates and the future owners of your firm. You can't make them care about what you cared about, or what you think they *should* care about. Get over it. You can try to give them what they want — and let them know what is expected in return.

Do associates still care about making partner? Ask them. But be

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fair — define what partnership means in your firm, what non-equity partnership and other employment categories mean, how to get into and out of each, and the consequences of nonperformance at each level. Make the effort to understand your associates both generally (by studying generational characteristics) and specifically (by engaging in regular direct dialogue and feedback). Speak to their immediate needs and their longer term interests. Despite their strong desire to control their own destinies, they do recognize and desire strong leadership and will follow leaders who serve their own interests. Give them clearly defined goals and a work structure that gives them frequent opportunities to succeed. Recognize their small successes like their highly involved parents did. Provide the technology they say they need to be productive. Find ways to give them some authority. Answer their many questions and encourage them to keep asking. But don't let them get too comfortable. One study concluded that "the more secure or content an associate feels in his or her job, the less profitable it is for the firm, after controlling for market segment, leverage, firm prestige, and hours billed." (Henderson, 2006)

There is still value in partnership status, both tangible and intangible. Be clear what the benefits and obligations of partnership are in your firm and what alternatives your lawyers may have as they mature. Explain why ownership in your firm is different and better than in other firms. Allow for the fact that some care about equity status more than others. Also allow room for them to change their minds as they move down the path. Discern which among your associates are your future partners and invest heavily in them.

Defining the terms will make for a more constructive dialogue, and while having this dialogue, do your best to put aside your own preconceptions of what your younger lawyers ought to want and listen to what they really do want. Those things may be easier and cheaper to provide than you think. ◆

Eric Seeger *is a law firm strategy consultant with Altman Weil, Inc., working out of the firm's offices in Newtown Square, Pennsylvania. He can be reached at (610) 886-2000 or eseeger@altmanweil.com.*

LAW PRACTICE
THE BUSINESS OF PRACTICING LAW

In Up or Over
Making Partner

It's Up or Out No More as Alternatives Shake up the Traditional Partnership Model

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Making Partner - Or Not
Is It In, Up or Over in the 21st Century?
By Janet Ellen Raasch

There is no doubt that the partnership model is continuing to change in firms of all sizes-with multiple consequences. Among them is a trend toward fewer homegrown associates achieving equity partnership. But the changes are also leading to an unprecedented range of alternatives to traditional partnership.

In the 1920s Cravath, Swaine & Moore became the first law firm on record to openly recruit from law schools with the express understanding that many of the young lawyers it hired would not make partner. Those associates who did not make partner with the rest of their class were expected to leave the firm.

However, those deemed best among the associates, who did the necessary work and stayed on track for the requisite number of years, could expect to become stakeholders, earn lockstep increases in compensation, and enjoy lifetime employment in the firm.

This "up or out" model offered obvious benefits, giving associates a defined career track to partnership (usually six to eight years) while providing profitability for partners based on leveraging the time of succeeding classes of associates (the pyramid structure).

"On the downside, many firms ended up making the 'wrong' lawyers partners simply on the basis of longevity," says Gerry Riskin, a firm management consultant and principal of Edge International.

Until about 20 years ago, the Cravath model reigned supreme. But the tide has since shifted against longevity and other historical factors involved in partnership, mainly because increased competition has pressured firms to make changes to the traditional model.

"Some see these changes as positive and leading to a stronger business model for law firms," says Thomas Grella, chair of the ABA Law Practice Management Section and managing partner of McGuire, Wood & Bissette. "Others see them as negative and driving away valuable talent."

Whatever one's perspective on the issues, there is no doubt that the partnership model is continuing to change in firms of all sizes—with multiple consequences. Among them is a trend toward fewer homegrown associates achieving equity partnership. But the changes are also leading to an unprecedented range of alternatives to traditional partnership. The following hits the highlights.

Where Profits per Equity Partner Are Making Their Mark

One concern centers on how far to split the profit pie—and who you choose to split it with. "Many modern law firms are operating more like businesses and less like traditional partnerships—with partnership decisions made for more strictly business reasons," according to Richard Gary, principal of Gary Advisors and a former chair of Thelen Reid & Priest. "As a result," he says, "it is not only harder to make partner, it is harder to stay partner."

A highly publicized case in point is Chicago-based Mayer, Brown, Rowe & Maw, which in early March of this year shocked the legal community by announcing that it would eliminate more than 10 percent of the firm's 427 equity partners. About half were demoted and half fired.

Incoming chair James Holzhauer actually referred to this move in terms of protecting the high price of the firm's "stock." Law firms are not public companies, of course, but Holzhauer's use of this term says a lot about law firms' perspective in the 21st century. What he was referring to was profits per equity partner (PPP), a ratio used to calculate AmLaw rankings. Despite the fact that neither the numerator (net operating income) nor the denominator (number of equity partners) of this ratio is strictly defined, law firms that want to be competitive consider PPP important—both to attract and retain high-value talent and to impress prospective and existing clients.

So what happens when the slices of the pie look too thin? "When professional services firms get too 'happy' with their promotions to partner, leverage and partner compensation suffers," wrote one anonymous individual in a comment to the *Wall Street Journal* legal blog post on the Mayer Brown story. "Under these circumstances, the firm has three choices: Keep doing the same thing and watch its top performers move on to other firms in search of higher compensation; stop promoting new partners and lose its most promising senior associates; or cut or demote the weak performers."

"The choice is a no-brainer," said the commenter, "and fulfills the fiduciary duty to the firm as an institution."

Mayer Brown is not alone in decreasing the ranks of nonproductive partners, although most other firms are taking a more incremental approach. Moreover, while this trend is most obvious at large firms, it is moving steadily through the industry to affect small and midsize firms as well. After all, the smaller a firm is, the more its profitability is put at risk by less-productive partners.

The upshot for associates reaching for the brass ring? "Law firms of all sizes are being much more selective about who makes partner in the first place," says **John Sapp**, senior partner at Michael Best & Friedrich. "In the past, 'good work' and the requisite number of years were enough at most firms. Today, candidates for equity partner almost always need to be rainmakers with a good book of business—so that they can contribute their share to the firm's PPP."

How More Laterals and Leverage Add to the Mix

Another issue is the expansive firm growth being fueled by the addition of high-value lateral lawyers, practice groups and even entire firms—and their ready-made books of business.

"This kind of lateral movement was almost unheard of 20 years ago," says Susan Manch of consulting firm Shannon & Manch, who specializes in law firm recruitment, retention and career development. "Many lateral lawyers today are wooed with the promise that they will soon join the acquiring firm's partnership ranks—which further decreases the partnership chances for 'homegrown' senior associates."

At the same time, there is an increasing demand for entry-level associates to fill the bottom ranks of the pyramid. According to a *National Law Journal* study, the number of associates hired by the 250 largest law firms increased 76 percent from 1996 to 2006. Simultaneously, the number of law school graduates increased only 7 percent.

Although the hiring numbers at small and midsize firms are not as dramatic, competition at large firms certainly affects the new talent that is available to them. Consider that to compete, large law firms have had to steadily increase associate salaries—$160,000 for first-years in New York and $145,000 for competitive firms in other parts of the country.

Although these salaries have not "trickled down" to most small and midsize firms, they are starting to appear in specialty firms—such as intellectual property or litigation boutiques—that compete with larger firms for bet-the-company business.

To earn these salaries, associates are expected to work even more billable hours than their predecessors. In addition, thanks to the advances of the information age, they are expected to produce far more work in the same amount of time, as partners pile on the assignments in a never-ending effort to boost PPP. And this often happens, according to associates at firms of all sizes, without the partners providing direction, feedback or guidance on their development. When leverage was one-to-one, mentoring was part of the process. At higher levels, it becomes less likely.

"At most firms, associates spend much more time interacting with their computers and other electronic devices than they do interacting with clients and mentors," says Gary. "Most associates do not find this a very satisfying way to work."

Associates at highly leveraged firms face another impact: While higher leverage tends to make a firm more profitable, it also means less opportunity to become a partner. In a firm with three associates for each partner—which is considered the "sweet spot"—two of every three associates (regardless of their talent) will not make partner. Many highly profitable firms have four or five associates per partner; some consultants are predicting eventual levels of 10 to 1. At smaller firms, the ratio is closer to 2 to 1.

When Free Agents Seek Better Pay and Work-Life Balance

Many associates are seeing the writing on the wall and taking their career prospects into their own hands. The National Association for Law Placement Foundation reports that the rate of associate attrition is the highest it has ever been—37 percent of associates leaving within the first three years and 77 percent leaving within five years. And the senior associates are leaving when they are most valuable to their firms—when they have enough experience to know what they are doing and when their rates are profitable. It can cost $300,000 or more for a firm to replace each one.

Some, of course, truly want to be law firm partners and are doing whatever it takes, or going wherever it takes, to achieve the goal. Others, however, simply want to pay off their school loans and add the name of a reputable firm to their resumes so they can decamp to a less stressful environment. This "free agent" attitude is part and parcel of the Generation X mentality.

Most associates today are members of Generation X, which as many commentators have observed, are known to be "dual-centric." They are hard workers, but they also seek a life outside of work—for family, community and personal development. They are focused on balancing both sides of their lives, and are not willing to sacrifice one for the other. Working at a law firm is less of a lifetime commitment, they believe, and more of a current economic arrangement. When their work or life goals are thwarted, they are very comfortable marketing their skills elsewhere.

"Even some talented senior associates on track to make partner do not want to assume the financial and time obligations that this title currently requires," says Manch.

So, absent options within their current firm environment, senior associates will leave for friendlier pastures, which in many instances presents opportunities for small and midsize firms that promise better work-life balance and the chance to develop skills. "Many of my current partners previously worked at big firms in big cities," says Grella. "They made the move to our firm not for money, but for values."
In other cases, senior associates go in-house with clients, into public service, to work for investment banks, into academia, to start a solo practice, or take any of countless other options where they can use their law degrees—or they simply leave the law for another career.

Law firms across the country are considering how to turn the tide—and, again, in ways that are altering the meaning of partnership as well as the terms "associate" and "partner."

It's Up or Out No More Under a Range of Alternatives

In recent years, law firms of all sizes have developed a number of new alternatives designed to retain talented senior associates who are either not ready to become partners or not interested in making partner.

One approach has been to lengthen the partnership track to 10 years or even 12 years. "With this option, the firm gets more time to evaluate each attorney," says Manch. "Associates get more time to prove themselves and also more time to determine whether partnership is the right goal for them."

Some firms are adding a new category like "senior associate" toward the end of the track. Once named to this group, the associates are considered to be potential partners and given additional training to prepare them for the business development and management responsibilities of equity partnership.

Other firms have created a permanent associate track for those who wish to stay with the firm, especially those who offer a particular technical expertise. Keeping them on as contract lawyers is another option. At Denver-based Holland & Hart, for example, 70 of the firm's 355 lawyers are contract lawyers. "This approach has worked very well for us," says managing partner Lawrence Wolfe.

In addition, titles like counsel, of counsel, special counsel or staff attorney can be used for lawyers whose status is in transition with a firm. The titles seem to vary from firm to firm, and from lawyer to lawyer, depending on negotiated preferences.

To help keep talent in the fold, more firms have adopted "alternative scheduling" approaches to address the work-life issue as well. At some firms, use of these options can take a lawyer off the partnership track, at least temporarily. At other firms, though, alternative schedules are available to those on the partnership track, and to the partners, too.

At 400-lawyer Dickstein Shapiro, for example, attorneys who work a 50 percent or greater schedule may remain candidates for partner, usually after the equivalent of eight years of legal experience. "Anyone interested in this option can consult—confidentially—with an adviser who is herself a partner working a 75 percent schedule," says firm chair Michael Nannes. "Since we started this program in the 1990s, about 40 lawyers have taken advantage of this opportunity," he adds, "which enables us to tap into an exceptionally capable, committed and grateful talent pool."

Among the most notable trends is the increasingly common use of nonequity partnership—also called salaried, tier or income partnership. This can be a temporary or transitional title for someone whose status is uncertain, or it can be a permanent career position. Nonequity partners are not included when calculating a firm's PPP, allowing a firm to reserve equity status for only its strongest performers.

Today, 80 percent of the firms in the AmLaw 200 follow this two-tier model, and more than half of firms in the 20-to-100-lawyer range report using this approach. Others are exploring it as an option. At Holland & Hart, says Wolfe, "We are currently a single-tier system that uses a lot of contract lawyers, but...it can be very time-consuming to manage 70 individualized lawyer contracts each year. To study our alternatives going forward, we have created a task force on partnership structure."

On the negative side, two-tier systems can lead to the perception that the nonequity partners are "second-class citizens" within the firm. Managed properly, however, the structure can help firms to retain talent and provides lawyers with a healthy base salary and benefits without the demands of full equity partnership. Importantly, too, they can use the title "partner" instead of "associate" in the world outside the firm, for business development, network building or even job-hunting purposes.

"Second-tier status provides a convenient transition for partners either new to the firm or newly elevated from the associate ranks, or for former equity partners whose performance no longer justifies equity participation," says Gary. "It is also a permanent resting place for lawyers who don't meet equity-partner performance standards but are important firm resources nonetheless—often because of a unique technical proficiency."

Some firms pay nonequity partners a straight salary; others follow a formula (often with a fixed base amount); and still others pay a fixed amount plus a share of firm profits and responsibilities. Because he feels that it promotes teamwork and firm unity, Gary recommends the third alternative.

Keeping Longevity in the Equation

Clearly the past 20 years have brought many changes to the traditional partnership track and to associates' perceptions of partnership. Whether it's for better or worse is, in many instances, a matter of opinion. But some level of balance does seem to be resulting.

"Law firms can make partnership decisions that consider their business needs," says Manch. "Associates who want to stay within a law firm environment can explore an increasing range of internal options as an alternative to the traditional 'up or out' model."
Of course, many profitable law firms are still committed to the traditional partnership track. These firms feel that the possibility to make full partner is an important part of their culture—a part they are not willing to leave behind.

"Some of the strongest law firms of all sizes are single-tier firms," says Gary. "They have found a way to make the hard choices up front—hiring the right associates and then investing in their development for the long term."

Although to ensure a strong, long-term fit between law firm and lawyer, it is equally important that each new recruit conduct in-depth due diligence on a firm and its partnership culture prior to accepting a position.

"From day one—and even sooner—even the youngest associate at a law firm should have a specific individual career plan in mind," says Manch. "If you wake up at year six and start to think about your career in the law, you have waited far, far too long."

The Partnership Paradigm and Law Firm Non-equity Partners

Douglas R. Richmond[*]

I. INTRODUCTION

Law firms have traditionally been organized as general partnerships.[1] Although many firms have now registered as limited liability partnerships to shield partners against vicarious liability in whole or part,[2] the general partnership has been the predominant law firm organizational form.[3] For years, lawyers have proudly announced their elevation to partner as evidence of significant personal and professional achievement.[4] "Making partner" or being "made a partner" has long been an important career milestone for lawyers in private practice. As a matter of professional prestige, referring to oneself and one's colleagues as "partners" is appealing. Despite well-publicized generational differences, most law firm associates aspire to partnership.[5]

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[*] Senior Vice President, Global Professions Practice, Aon Risk Services, Chicago, Illinois. J.D., University of Kansas; M.Ed., University of Nebraska; B.S., Fort Hays State University. Opinions expressed here are the author's alone.

1. LESLIE D. CORWIN & ARTHUR J. CIAMPI, LAW FIRM PARTNERSHIP AGREEMENTS § 1.01 (2009).

2. Registering a general partnership as a limited liability partnership (LLP) does not result in the formation of a new partnership entity. Hart v. Theus, Grisham, Davis & Leigh, L.L.P., 877 So. 2d 1157, 1163 (La. Ct. App. 2004). A general partnership's registration as a LLP affects only the partners' potential liability exposure; a general partnership that registers as a LLP is otherwise governed by the state's partnership laws. *Id.* at 1162.

3. Law firms are also organized as professional corporations and, less commonly, as limited liability companies (LLCs). Occasionally, a law firm name may end with the word "Chartered" or the abbreviation "Chtd." This is not yet another organizational form. Rather, states may require law firms organized as professional corporations to so identify themselves by ending their firm names with "Chartered," "Professional Corporation," "Professional Association," or the respective abbreviation. *See, e.g.*, KAN. STAT. ANN. § 17-2711 (2008) (requiring the use of "Chartered," "Professional Association," or their abbreviations at the end of professional corporations' names).

4. Robert W. Hillman, *Law, Culture, and the Lore of Partnership: Of Entrepreneurs, Accountability, and the Evolving Status of Partners*, 40 WAKE FOREST L. REV. 793, 794 (2005) [hereinafter Hillman, *Evolving Status of Partners*].

5. Ian J. Silverbrand, Note, *Modified Partnership Structures and Their Effects on Associate Satisfaction*, 21 GEO. J. LEGAL ETHICS 165, 169 (2008).

The essence of partnership is equality.[6] The law generally treats the relationship among or between partners as one of equals.[7] Unfortunately, equality—for all its virtues—has a downside in professional partnerships. Some partners are simply more productive than others, regardless of whether productivity is measured by new business generation, the management and expansion of existing client relationships, or fees produced as working attorneys. In some firms, productive partners effectively subsidize their unproductive or under-productive peers.[8] The disparity among partners' relative contributions to their firms' profitability is most acutely observed in terms of new business dollars. Good law firms value all their partners, but because clients are the lifeblood of all law firms, they tend to especially value rainmakers. Moreover, once admitted to partnership, there is a risk that some lawyers will shirk their responsibilities as partners by not attempting to develop new business or expand existing client relationships, by not billing as many hours or otherwise generating fee revenue as they should, or by failing to participate in the full panoply of non-billable activities typically expected of partners—such as serving on firm committees, leading practice groups, training junior lawyers, and so on. Although most firms adjust or structure partners' compensation on individual bases to reward performance, relatively unproductive or unmotivated partners may still earn handsome livings at the expense of their more capable or ambitious colleagues.[9]

Equality poses other potential problems. For example, some associates who become eligible for partnership based on years of service at a firm may not be prepared to assume the mantle of partnership and the professional obligations and responsibilities that come with it, or their particular practices may not justify promotion to partnership. Under a traditional up-or-out model, firms risk losing valuable lawyers for the mere reason that they are not ready to graduate to partnership according to an arbitrary schedule.[10] Even if a law firm does not adhere to an up-or-out philosophy, junior lawyers passed over for partnership may become disappointed or disillusioned and, accordingly, leave the firm to pursue other opportunities.[11]

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6. Hillman, *Evolving Status of Partners*, *supra* note 4, at 796.

7. *Id.*

8. William D. Henderson, *An Empirical Study of Single-Tier Versus Two-Tier Partnerships in the Am Law 200*, 84 N.C. L. REV. 1691, 1694 (2006).

9. *See id.* (citing ALTMAN & WEIL, INC., AM. BAR ASS'N, COMPENSATION PLANS FOR LAWYERS AND THEIR STAFFS: SALARIES, BONUSES AND PROFIT-SHARING 16 (1986)).

10. CORWIN & CIAMPI, *supra* note 1, § 3.02[2].

11. *See id.*

The perceived deficiencies or inefficiencies of traditional partnerships have not been lost on law firm leaders and those who advise them, and, in response, the 1970s saw the advent of two-tier partnerships.[12] Two-tier partnerships are characterized by a top tier of partners who hold equity in the firm and a lower tier of partners who do not. Generally speaking, equity partnership is now seen as being reserved for rainmakers and other lawyers of special stature, although many law firms have numerous equity partners who were effectively grandfathered into that status when their firms converted from single-tier to two-tier partnerships. Law firms widely adopted two-tier partnership structures throughout the 1980s and 1990s,[13] and their popularity continues today. Most large law firms are now either two-tier or multi-tier partnerships,[14] although two-tier partnerships are also found in small law firms.[15] Many more lawyers are becoming non-equity partners rather than achieving equity partner status, with the proportion of non-equity partners in law firms growing at three times the rate of equity partners.[16] In summary, "the prize of equity partnership, which includes the traditional prerogatives of ownership, is increasingly rare."[17]

Non-equity partners are not uniformly described or identified; some law firms refer to them as "income partners," while others describe them as "non-share partners," "salary partners," or "contract partners." Unlike equity partners, who share in a firm's profits, non-equity partners typically receive guaranteed payments out of firm profits that resemble a salary.[18] Non-equity partners may further receive bonuses depending on their achievements or the firm's profitability.[19] They have whatever rights and privileges a firm's partnership agreement affords them.[20] They generally have no interests or rights in the firm's assets, profits, or property beyond the right to be compensated as agreed.[21]

12. *See* Silverbrand, *supra* note 5, at 171 (reporting that two-tier partnerships were first adopted in Chicago in the 1970s).

13. Henderson, *supra* note 8, at 1694–95.

14. *Id.* at 1695 (using the Am Law 200 as a measure); Silverbrand, *supra* note 5, at 172 (describing a 2004 report that an estimated seventy percent of firms with seventy-five lawyers or more were two-tier partnerships).

15. Hillman, *Evolving Status of Partners*, *supra* note 4, at 818.

16. Henderson, *supra* note 8, at 1695.

17. Marc Galanter & William Henderson, *The Elastic Tournament: A Second Transformation of the Big Law Firm*, 60 STAN. L. REV. 1867, 1892 (2008).

18. CORWIN & CIAMPI, *supra* note 1, at § 3.02[2].

19. *Id.*

20. *Id.*

21. *Id.*

There are three paths to non-equity partnership. The first is an ascending one for associates in law firms. Some firms first promote all associates worthy of partnership to non-equity partner status with the expectation that they will pass through the non-equity tier and become equity partners after an established period of time.[22] Other firms promote associates to a non-equity tier and reserve judgment on whether equity partnership will follow, with some lawyers becoming equity partners as their careers progress and others remaining non-equity partners for the duration of their time at the firm.[23] Still other firms promote especially promising junior lawyers directly to equity partnership, while raising others to non-equity partnership.[24] Regardless of the particular approach employed, the ascending path has at least four perceived benefits for law firms: (1) it improves client service by reducing lawyer attrition, (2) it minimizes errors in promotion decisions by extending the evaluation period for equity partnership, (3) it aligns partners' voting power with their economic contributions to the firm, lessening the likelihood of defections by rainmaking partners, and (4) it favorably influences market dynamics by increasing the firm's profits per partner—which are calculated solely on the basis of equity partners—allowing the firm to more easily lure lateral lawyers and attract high-caliber firms for potential mergers.[25]

Analyzing two-tier partnership from below, junior lawyers may derive value from non-equity partnership in the form of increased job stability, and the opportunity to achieve greater work-life balance and career flexibility than equity partnership is thought to afford.[26] They also benefit from the stature and prestige that comes with being described as a

22. *See* Hillman, *Evolving Status of Partners*, *supra* note 4, at 819 (Non-equity partnership "may represent a transition phase between status as an associate and admission to the partnership. The status may be used as a means of lengthening the 'partnership track' that defines progression from associate to partner.").

23. *See* CORWIN & CIAMPI, *supra* note 1, § 6.02[3] (stating that non-equity status "allows the partners to observe how newly promoted associates handle these responsibilities and integrate themselves into the partnership"). Occasionally, economic conditions force alterations to these plans, as when firms convert non-equity partners to equity partners as a means of raising capital. *See, e.g.*, Ashby Jones, *Some Top Law Firms Tap Partners for Cash*, WALL ST. J., Jan. 29, 2009, at B1 (reporting that DLA Piper planned to convert 200 non-equity partners into equity partners, requiring each lawyer to contribute more than $100,000 in capital to the firm); Ameet Sachdev, *Law Firms' Woes Likely to Last*, CHI. TRIB., Jan. 1, 2009, § 1, at 28 (reporting that DLA Piper asked 300 non-equity partners to become equity partners by paying $100,000 or more because the firm wanted to reduce its debt and increase lawyers' financial incentives).

24. CORWIN & CIAMPI, *supra* note 1, § 6.02[3].

25. Henderson, *supra* note 8, at 1711–12.

26. Silverbrand, *supra* note 5, at 174–75.

partner.[27] Financially, non-equity partners potentially benefit by receiving a guaranteed income, as compared to equity partners, who may see their income decrease in years in which the firm performs poorly.[28] Some associates may favor non-equity partnership as a financial matter because it does not require them to invest capital in the firm.[29]

The second path to non-equity partnership is horizontal in the sense that some firms require all lateral partners to join as non-equity partners. This approach allows the lawyer moving laterally to decide whether her decision was a wise one before cementing it through a capital contribution.[30] Equally important, it allows the firm to evaluate the migrating lawyer in some depth—to see whether, for example, the lawyer will actually deliver a predicted or promised book of business—before committing to equity participation.[31]

The third path is a descending one, euphemistically referred to as "de-equitization." De-equitization refers to the demotion of partners from equity status to non-equity status.[32] Law firms commonly de-equitize partners in times of economic stagnation or as a result of slowing practices,[33] but they also do so as a means of pruning unproductive partners.[34] De-equitization can be a contentious, upsetting,

27. Hillman, *Evolving Status of Partners*, *supra* note 4, at 820.

28. *See* William C. Cobb, *Changing Equity Partners to Non-Equity Status*, OF COUNS., Mar. 2002, at 10, 11 (asserting that non-equity partnership "[p]rotects lawyers from the risks associated with being an equity owner, including . . . the risk of lower incomes in poor performance years").

29. Hillman, *Evolving Status of Partners*, *supra* note 4, at 819.

30. Steven T. Taylor, *The Rising Tier: Many Firms Increase Their Non-Equity Partner Ranks*, OF COUNS., Nov. 2008, at 1, 15.

31. *See id.* (quoting a law-firm-managing partner who says non-equity partnership "allows us to be more flexible with someone we're willing to bet on").

32. *See* Hillman, *Evolving Status of Partners*, *supra* note 4, at 816–17 (using the term "de-equitized" to describe partner demotions).

33. *See, e.g.*, Leigh Jones, *Downsizing: Who's Next?*, NAT'L L.J., Mar. 12, 2007, at 1, 1 (discussing de-equitization at large law firms in response to stagnant profits and as a means of becoming more competitive); Richard Lloyd, *Heavy Lies the Crown*, AM. LAW., Feb. 2009, at 20, 20 (discussing firms de-equitizing partners in response to economic crisis).

34. *See, e.g.*, Elizabeth Goldberg, *The Departed*, AM. LAW., May 2007, at 144, 145 (identifying several large law firms orchestrating exits of allegedly under-performing partners); Jones, *supra* note 33 (discussing firms downsizing equity partner ranks); Nathan Koppel, *'Partnership Is No Longer a Tenured Position'—More Law Firms Thin Ranks of Partners to Boost Profits, Attract, Keep High Earners*, WALL ST. J., July 6, 2007, at B1 (describing increasingly frequent partner de-equitization, expulsion, and "the partner purge" as firms attempt to increase profitability); Lynne Marek, *Jenner & Block Takes Some Partners Off Equity Level*, NAT'L L.J., June 11, 2007, at 10, 10 (reporting on a law firm de-equitizing some partners and asking others to leave); Aric Press & John O'Connor, *Lessons of the Am Law 100*, AM. LAW., May 2008, at 131, 131 (reporting that thirty-seven large law firms shrunk their equity partner ranks in 2007); Ameet Sachdev, *Jenner & Block Law Firm Cuts Several Partners*, CHI. TRIB., Mar. 6, 2008, § 3, at 1, 6 (reporting on second round of partner de-equitizations and expulsions at firm).

and stigmatizing process.[35] For many lawyers, being de-equitized is "'almost like getting fired.'"[36] In other instances, lawyers grudgingly accept de-equitization as a condition of law firm acquisitions or mergers.[37]

The widespread acceptance of non-equity partnerships does not, however, connote agreement among lawyers or courts on what it means to be a non-equity partner, or even whether non-equity partners are in fact partners.[38] As one respected scholar has observed, non-equity partnership "is an oxymoron" because partnership is defined by "co-ownership and shared personal responsibility," and non-equity partners have neither of these things.[39] Other commentators state that non-equity partners "are far from genuine partners" in their firms,[40] that non-equity partners "are not considered partners under partnership or employment law,"[41] that non-equity partners "are not true partners,"[42] and that non-equity partners are "'actually . . . highly paid associates.'"[43] If these bold opinions are accurate, what are courts and the legal profession to make of non-equity partners, and what are non-equity partners to conclude about their own status? For example, if non-equity partners are not partners, they do not owe one another or the equity partners in their firms a duty of good faith and fair dealing, nor are they owed this important duty.[44] If non-equity partners are not partners, they do not owe their colleagues or firms other fiduciary duties imposed on partners.[45] If non-equity partners are not partners, they do not owe the special ethical duties imposed on partners under Model Rules of Professional Conduct 5.1 and 5.3.[46] If

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35. *See* Jeff Blumenthal, *The Distasteful Medicine of De-Equitization*, LEGAL INTELLIGENCER, Dec. 5, 2002, http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=900005533420.

36. *Id.* (quoting legal consultant Joel Rose).

37. *See, e.g.*, Heather Cole, *Shughart to Thin Equity Partner Ranks*, MO. LAW. WKLY., Dec. 15, 2008, at 2 (describing drastic de-equitizations required to accomplish merger of two large Kansas City law firms).

38. *See* CORWIN & CIAMPI, *supra* note 1, § 1.09[2] ("The definition of a non-equity partner can vary from partnership to partnership.").

39. Hillman, *Evolving Status of Partners*, *supra* note 4, at 820.

40. Silverbrand, *supra* note 5, at 171.

41. *Id.* at 175.

42. Mark Curriden, *No Tears for Two Tiers . . . More and More Firms Are Sure Non-Equity Partner Slots Benefit Everyone*, OF COUNS., Apr. 2001, at 18, 19.

43. Henderson, *supra* note 8, at 1723 (quoting Susan S. Samuelson & L.J. Jaffe, *Success and Failure*, *in* LAW FIRM MANAGEMENT: A BUSINESS APPROACH § 7 (Susan S. Samuelson ed., 1994)).

44. *See* Eisenstein v. David G. Conlin, P.C., 827 N.E.2d 686, 693 (Mass. 2005) (stating that equity partners in a firm "owe each other a fiduciary duty of the utmost good faith and loyalty").

45. Non-equity partners still owe their firms fiduciary duties as agents, however. *See* Friedman Siegelbaum, LLP v. Pribish, No. A-3027-07T1, 2009 WL 910326, at **7–8 (N.J. Super. Ct. App. Div. Apr. 7, 2009) (per curriam) (holding that a "contract partner" had a fiduciary duty to the firm).

46. *See* MODEL RULES OF PROF'L CONDUCT R. 5.1 (2009) (establishing partners' supervisory

non-equity partners are not partners but are instead employees, are they accordingly protected against adverse employment actions under federal and state anti-discrimination laws? These issues and doubtless others spawned by non-equity partners' awkward legal status are important.

Part II of this Article analyzes whether non-equity partners truly are partners in their law firms as a matter of partnership law. The resolution of this critical issue necessarily determines the answers to most other questions concerning non-equity partners' rights and responsibilities under partnership law and settles other material issues, such as whether non-equity partners owe the ethical duties imposed on partners under Model Rules 5.1 and 5.3. Applying the factors that courts traditionally weigh when attempting to determine the existence of a partnership, this part rejects the conventional view that non-equity partners are not in fact partners. It thoroughly explains why non-equity partners generally are true partners as a matter of partnership and other law despite the differences between them and equity partners.

Part III explores the descending path to non-equity partnership, i.e., de-equitization. More particularly, it navigates partners' duty of good faith and fair dealing in connection with de-equitizations. Consistent with the law of partnership expulsions, this part explains that firms may de-equitize partners without incurring related liability so long as they do not do so for predatory purposes.

Finally, Part IV examines employment law constraints on law firms' treatment of non-equity partners. It concludes that, contrary to the views held by many lawyers and scholars, whether law firm partners are protected under anti-discrimination laws depends not on whether they are equity partners or non-equity partners, but on their workplace control as measured by the six factors identified by the United States Supreme Court in *Clackamas Gastroenterology Associates, P.C. v. Wells*.[47] Equity versus non-equity partner status, without more, is simply not a meaningful employment law divide.

II. NON-EQUITY PARTNERS AS TRUE PARTNERS

The Uniform Partnership Act (UPA) defines a partnership as "an association of two or more persons to carry on as co-owners a business for profit."[48] The newer Revised Uniform Partnership Act (RUPA)

responsibilities with respect to other lawyers in their firms); R. 5.3 (governing partners' supervisory responsibilities for non-lawyer assistants).

47. 538 U.S. 440, 449–50 (2003).

48. UNIF. P'SHIP ACT § 6 (1914).

defines it the same way,[49] further establishing that "the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership."[50] Regardless of the definition selected, the existence of a partnership is generally treated as a question of fact,[51] although not all courts agree on this point. Some courts see the existence of a partnership as a mixed question of law and fact, with the ultimate determination being a question of law;[52] still others consider the existence of a partnership to be a legal question.[53] It is perhaps most accurate to say that the existence of a partnership is a question of law that depends heavily on the facts. In any event, courts typically search for several factors when attempting to determine the existence of a partnership,[54] including (1) a common enterprise, (2) risk-sharing, (3) expense-sharing, (4) the sharing of profits and losses, (5) a joint right of control over the business, and (6) the joint ownership of capital.[55] Whether the parties hold themselves out to the public as partners is another factor to be weighed.[56] Not all courts consider all factors. Not every element must be satisfied for there to be a partnership,[57] and no single factor is conclusive.[58] The parties' intent is the primary factor for determining whether a partnership exists.[59] As an Ohio court explained, "[t]he relevant inquiry is 'not whether the parties

49. REV. UNIF. P'SHIP ACT § 101(6) (1997).

50. § 202(a).

51. *See, e.g.*, Persson v. Smart Inventions, Inc., 23 Cal. Rptr. 3d 335, 347 (Cal. Ct. App. 2005); Beckman v. Farmer, 579 A.2d 618, 628 (D.C. 1990); *In re* Marriage of Hassiepen, 646 N.E.2d 1348, 1353 (Ill. App. Ct. 1995); Gates v. Houston, 897 N.E.2d 532, 535 (Ind. Ct. App. 2008); Willson v. King, 744 N.W.2d 425, 438 (Neb. 2008).

52. Harker v. Peterson, 72 P.3d 949, 952 (Mont. 2003); Sandvick v. LaCrosse, 747 N.W.2d 519, 521 (N.D. 2008) (quoting Tarnavsky v. Tarnavsky, 666 N.W.2d 444, 446 (N.D. 2003)).

53. Filippi v. Filippi, 818 A.2d 608, 618 (R.I. 2003).

54. *See* Harrell Oil Co. of Mt. Airy v. Case, 543 S.E.2d 522, 525 (N.C. Ct. App. 2001) (determining whether a partnership exists "involves examining all the circumstances").

55. Aaron Rents, Inc. v. Fourteenth Street Venture, L.P., 533 S.E.2d 759, 761 (Ga. Ct. App. 2000).

56. *See, e.g.*, Compton v. Kirby, 577 S.E.2d 905, 913 (N.C. Ct. App. 2003) (explaining that defendant was aware that plaintiffs were "holding themselves out as 'principals'" of the partnership by signing agreements and approving business cards).

57. Willson v. King, 744 N.W.2d 425, 441 (Neb. 2008) (stating partnership factors slightly differently).

58. Beckman v. Farmer, 579 A.2d 618, 627 (D.C. 1990); John Nagle Co. v. Gokey, 799 A.2d 1225, 1227 (Me. 2002) (quoting Dalton v. Austin, 432 A.2d 774, 777 (Me. 1981)); Kyle v. Brenton, 584 N.Y.S.2d 698, 699 (N.Y. App. Div. 1992); *In re* Estate of Ivanchak, 862 N.E.2d 151, 155 (Ohio Ct. App. 2006) (quoting *In re* Estate of Nuss, 646 N.E.2d 504, 507 (Ohio 1994)); Martin v. Coleman, 19 S.W.3d 757, 761 (Tenn. 2000).

59. *In re* Marriage of Geraci, 51 Cal. Rptr. 3d 234, 245 (Cal. Ct. App. 2006) (quoting Constans v. Ross, 235 P.2d 113, 116 (Cal. 1951)); *In re* Marriage of Hassiepen, 646 N.E.2d 1348, 1353 (Ill. App. Ct. 1995); Price v. Vattes, 161 S.W.3d 397, 401 (Mo. Ct. App. 2005).

intend that the law describe their relationship as a partnership, but whether they intend a relationship that includes the essential elements of a partnership.'"[60]

A partnership agreement is important evidence of the parties' intent. Indeed, it is generally unnecessary for courts to examine the various factors indicating or refuting a partnership relation where a written partnership agreement can be found,[61] although a partnership agreement must be clear and the parties must conduct themselves consistently with its terms to preempt a court's analysis of other factors.[62]

A. Non-equity Partners in the Courts

The question of whether non-equity law firm partners are partners as a matter of law is a recurring one.[63] In *D'Esposito v. Gusrae, Kaplan & Bruno PLLC*, for example, James D'Esposito was forced from his position as a non-equity member of Gusrae, Kaplan & Bruno PLLC ("Gusrae").[64] Although Gusrae was organized as a professional limited liability company rather than as a partnership, the firm apparently identified and treated its members as partners.[65]

The reasons for D'Esposito's termination are not apparent from the opinion, but he sued Gusrae on a variety of theories and sought a range of remedies.[66] The trial court rejected his claims on the basis that he was

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60. Mellino v. Charles Kampinski Co., 837 N.E.2d 385, 390 (Ohio Ct. App. 2005) (quoting Allen v. Niehaus, Nos. C-000213, C-000235, 2001 WL 1589169, at *6 (Ohio Ct. App. Dec. 14, 2001)); *see also* Byker v. Mannes, 641 N.W.2d 210, 218 (Mich. 2002) (stating the partnership inquiry should focus on "whether the parties intentionally *acted* as co-owners of a business for profit, and not on whether they consciously intended to create the legal relationship of 'partnership'").

61. *See* Cmty. Capital Bank v. Fischer & Yanowitz, 850 N.Y.S.2d 508, 510 (N.Y. App. Div. 2008) (stating that whether a partnership exists depends on the parties' conduct, intention, and relationship when there is no written partnership agreement); Joachim v. Flanzig, 773 N.Y.S.2d 267, 273 (N.Y. Sup. Ct. 2004) (noting that general indicia of partnership were not relevant where parties had a written partnership agreement).

62. *See In re* Brokers, Inc., 363 B.R. 458, 470 (Bankr. M.D.N.C. 2007) (noting that "[a] general statement that parties are partners cannot outweigh the conduct of the parties" and referring to the absence of "a clear partnership agreement" as justification for examining the various factors that indicate the existence of a partnership).

63. *See, e.g.*, Morson v. Kreindler & Kreindler, LLP, 616 F. Supp. 2d 171, 172–73 (D. Mass. 2009) (examining law firm's residency for purposes of diversity jurisdiction and, since the firm's registered agent in Massachusetts was a "contract partner," discussing how the law firm's contract partners were essentially senior associates—they were paid a fixed salary, had no voice in firm governance or affairs, were not allowed to bind the firm, could not see the firm's books, etc.).

64. 844 N.Y.S.2d 214, 215 (N.Y. App. Div. 2007).

65. *See id.* (describing D'Esposito's position and the law firm's identification and treatment of him).

66. *Id.* (listing D'Esposito's theories of recovery).

not a partner in the firm.[67] D'Esposito appealed, and the appellate court affirmed the trial court, explaining:

> Indeed, notwithstanding that plaintiff was called a partner and listed as such in Martindale-Hubble [sic], on the firm's letterhead and tax return, and he received distributions of net profits from the firm at a fixed rate, he was not responsible for the firm's rent or losses, was not a signatory of the partnership and/or operating agreement, made no capital investment and had no ownership interest in the firm.[68]

Furthermore, the court noted, D'Esposito "had no control at all" over Gusrae's affairs.[69]

In a similar case, *Zito v. Fischbein Badillo Wagner Harding*, plaintiff Robert Zito had been a "contract partner" at Fischbein Badillo Wagner Harding (FBWH).[70] He sued FBWH and several of its former lawyers, alleging that FBWH failed to compensate him for fees that he generated while with the firm.[71] The defendants countered that Zito was not entitled to a share of the fees he produced because he was simply a salaried, at-will employee of the firm despite his contract-partner designation.[72] They asserted that Zito was not a party to the FBWH partnership agreement, never guaranteed or agreed to be responsible for firm debts, did not share in the firm's losses, was not issued an IRS Schedule K-1 for tax purposes as a partner would be, and contributed no capital to the firm.[73] Those same facts were pleaded by several former contract partners that Zito also sued as evidence that they were not truly partners in FBWH and therefore could not be held liable for FBWH's potential obligations to Zito.[74] Under the New York Partnership Law, "[p]artners are liable for wrongful acts committed by any of them, in connection with the partnership."[75] An employee, on the other hand, is not.[76]

One of the contract partners Zito sued, Menachem Kastner, moved to dismiss the action on these grounds.[77] Kastner offered two documents as

67. *See id.* (referring to his lack of an equity interest in the firm).
68. *Id.*
69. *Id.*
70. 809 N.Y.S.2d 444, 445 (N.Y. Sup. Ct. 2006).
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.* at 446.
75. *Id.*
76. *Id.*
77. *Id.*

evidence that he was an employee of FBWH, not a partner, and therefore could not be liable to Zito.[78] The first document was his employment agreement with the firm, which offered him a choice of being called a "contract partner" or a "senior attorney."[79] The agreement, which fixed Kastner's annual compensation and created his position for a one-year term, made clear that he would "not be entitled to any equity, accounts receivable or assets of the Firm," and described his relationship with FBWH as an "affiliation."[80] The agreement contained no provision with respect to Kastner sharing in FBWH's losses.[81] The second document that Kastner offered was a Form W-2 issued to him by the firm.[82]

The *Zito* court began its analysis by observing that under New York law, the indicia of partnership are joint control over the enterprise, profit-splitting, and loss-sharing.[83] Even where there is joint control and an agreement to split profits, the absence of an agreement to share losses may defeat a partnership claim because loss-sharing is an essential element of partnership.[84] The court quickly concluded that Kastner's employment arrangement with FBWH satisfied none of the three factors.[85] Furthermore, the fact that the firm issued him a Form W-2 for tax purposes rather than a Schedule K-1 plainly indicated that he was an FBWH employee rather than a partner.[86]

In an effort to establish that contract partners shared losses, Zito argued that, based on the firm's method of calculating his bonuses, the firm factored overhead costs into contract partners' compensation.[87] The court disagreed, finding that FBWH's allocation of overhead costs across its payroll did not constitute loss-sharing and did not otherwise prove a required partnership element.[88] The fact that lawyers such as Kastner elected contract partner status rather than being called senior attorneys did not change the analysis.[89] The court, therefore, granted Kastner's motion to dismiss.[90]

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78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.* at 447.
82. *Id.*
83. *Id.* at 446–47 (citing Prince v. O'Brien, 683 N.Y.S.2d 504 (N.Y. App. Div. 1998)).
84. *Id.* at 447 (citing *Prince,* 683 N.Y.S.2d at 507).
85. *Id.*
86. *Id.*
87. *Id.*
88. *Id.*
89. *Id.*
90. *Id.*

In another case, *Davis v. Loftus*, disgruntled clients sued their lawyers, Michael Loftus and David Engel, and the partners in the law firm of Gottlieb & Schwartz for alleged malpractice in a real estate transaction.[91] One defendant, Anthony Frink, moved for summary judgment on the basis that he did not qualify as a partner for purposes of vicarious liability.[92] Frink was an "income partner."[93] Under the firm's partnership agreement, income partners received a fixed compensation set annually by the executive committee, plus a bonus.[94] The agreement further provided that income partners would not share in the firm's profits or losses.[95] Each income partner made a $10,000 capital contribution to the firm to be repaid upon withdrawal or dissolution, without any adjustment for firm growth or profits since the time it was made.[96] Income partners had no rights to vote on firm affairs or decisions, and were not eligible to sit on the firm's executive committee.[97]

Several other income partners joined Frink's summary judgment motion.[98] The trial court granted the motion, holding that the income partners did not qualify as partners, and therefore did not share liability for the acts of the firm's other partners or employees.[99] The plaintiffs appealed.[100]

The appellate court first noted that the "substance and not the form of a business relationship determines whether the relationship qualifies as a partnership."[101] Here, the income partners received a fixed salary plus bonus and did not share in the firm's profits or losses.[102] While the income partners made capital contributions, the firm agreed to repay those contributions in full upon the income partners' withdrawal from the firm or the firm's dissolution, regardless of the firm's intervening profit or loss.[103] The firm's executive committee set income partners' compensation, and the income partners had no right to vote on the

91. Davis v. Loftus, 778 N.E.2d 1144, 1146 (Ill. App. Ct. 2002).
92. *Id.* at 1148.
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* at 1146, 1153.
100. *Id.* at 1153.
101. *Id.* at 1151 (citing Koestner v. Wease & Koestner Jewelers, Inc., 63 Ill. App. 3d 1047, 1050–51 (1978)).
102. *Id.* at 1152.
103. *Id.*

management of the firm or the conduct of its business.[104] These factors culminated in the court's finding that the income partners at Gottlieb & Schwartz lacked "the essential characteristics of 'partners'" under the Illinois Partnership Act, and therefore they could not be held liable for Loftus's and Engel's alleged malpractice.[105] The court affirmed summary judgment for Frink and the other two defendants identified as income partners in the partnership agreement that Frink submitted as an exhibit to his motion.[106] The other income partners not similarly identified had their summary judgments reversed and their cases remanded for presentation of evidence concerning their partnership status.[107]

B. Analysis

It would be easy to conclude from the cases decided to date that non-equity partners are not partners as a matter of partnership law, but are instead employees of the law firms in which they practice.[108] That is not the conclusion that should be drawn, however, because the relationships described in those cases are variously inconsistent with typical non-equity partnerships. In *D'Esposito*, for example, the plaintiff, who was judged not to be a partner, did not sign the firm's partnership agreement.[109] As a rule, two-tier firms require non-equity partners to sign their partnership agreements, and law firm advisors often recommend this approach.[110] In *Zito*, the would-be partners were not elected as "contract partners," but selected that designation by circling it as an option on their employment agreements.[111] In true two-tier partnerships, lawyers are elected to non-equity partnership, either by a vote of the equity partners or by a vote of all partners; they do not get to simply choose their own status or rank. In *Davis*, the non-equity partners had no right to vote on the management of the firm or the conduct of its

104. *Id.*
105. *Id.* at 1153.
106. *Id.*
107. *Id.* at 1152–53.
108. There are, of course, some law firms in which non-equity partners are indeed mere employees. *See, e.g.*, Morson v. Kreindler & Kreindler, LLP, 616 F. Supp. 2d 171, 172 (D. Mass. 2009) (describing employee status of so-called "contract partners"). Such firms are the exception, however, rather than the rule.
109. D'Esposito v. Gusrae, Kaplan & Bruno PLLC, 844 N.Y.S.2d 214, 215 (N.Y. App. Div. 2007).
110. *See, e.g.*, CORWIN & CIAMPI, *supra* note 1, § 3.02[2].
111. Zito v. Fischbein Badillo Wagner Harding, 809 N.Y.S.2d 444, 446 (N.Y. Sup. Ct. 2006).

business.[112] In many two-tier firms, non-equity partners vote on all issues that come before the partnership except the election of lawyers to equity partnership.[113] In other two-tier firms, non-equity partners are allowed to vote on at least some issues.[114] The *Davis* court was also influenced by the fact that the income partners who were repaid their capital upon withdrawal or dissolution received no capital increase based on intervening firm profitability,[115] yet many firms do not repay capital beyond that which a terminated or withdrawing partner actually contributed. In summary, lawyers and courts should not form assumptions about the legal ramifications of non-equity partnership based on cases that confuse general practices.

To determine whether non-equity partners are partners in their firms for purposes of partnership law and professional responsibility, it is helpful to compare current law firm practices against factors that courts regularly examine when attempting to determine the existence of a partnership. It is also important to consider law firms' tax treatment of non-equity partners and the ramifications of law firms holding out non-equity partners to the public and profession as partners. When all of these factors are analyzed, it will become clear that the majority rule should hold law firm non-equity partners to be partners rather than employees, and courts should treat them accordingly.

1. Partnership Agreements and Parties' Intent

Most law firms structured as two-tier partnerships require non-equity partners to sign their partnership agreements, just as they require equity partners to sign. Partnership agreements typically do not distinguish between equity and non-equity partners except in sections addressing compensation, the contribution and return of capital, voting rights, and service on select firm committees—for example, executive, management, or compensation committees. These facts reveal the parties' intent that non-equity partners be considered partners in their firms to the extent that status has legal ramifications. Were non-equity partners mere employees, on the other hand, there would be no need for them to sign a firm's partnership agreement or to be mentioned therein.

112. Davis v. Loftus, 778 N.E.2d 1144, 1152 (Ill. App. Ct. 2002).

113. Kimberly Kirkland, *Ethics in Large Law Firms: The Principle of Pragmatism*, 35 U. MEM. L. REV. 631, 663 (2005).

114. CORWIN & CIAMPI, *supra* note 1, § 1.09[1].

115. *Davis*, 778 N.E.2d at 1152.

2. Sharing Profits

The UPA and RUPA, which form the bases for state partnership statutes, define a partnership as "an association of two or more persons to carry on as co-owners a business for profit."[116] Seizing on that definition, courts evaluating the relationship between parties generally consider an agreement to share in the profits of their common enterprise to be an essential element of a partnership.[117] Courts follow the same approach when determining whether lawyers are partners.[118] If one person is employed by another and receives a salary or wages, on the other hand, the two are not partners.[119] The widely-held belief that non-equity partners are always compensated by way of salary has fueled the common perception that they are law firm employees rather than partners.

In fact, profit-sharing is only evidence of a partnership, "rather than a required element of the definition of a partnership."[120] Even if it were a required element, law firms typically compensate non-equity partners through guaranteed payments out of firm profits.[121] Although these monthly payments resemble a salary and some lawyers describe them that way for simplicity's sake, they are not a salary—they are a share of firm profits.[122] Indeed, most law firms issue non-equity partners a Schedule K-1 for tax purposes, just as they do their equity partners.[123] That would not be the situation if they were paying non-equity partners a

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116. UNIF. P'SHIP ACT § 6 (1914); REV. UNIF. P'SHIP ACT § 101(6) (1997).

117. *See, e.g.*, Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549, 557 (5th Cir. 2007) (applying Mississippi law); Argianas v. Chestler, 631 N.E.2d 1359, 1368 (Ill. App. Ct. 1994) (observing that "a sharing of profits is an essential test in determining the existence of a partnership"); Playboy Enters., Inc. v. Editorial Caballero, S.A. de C.V., 202 S.W.3d 250, 267 (Tex. App. 2006) ("A partnership requires an agreement to share profits.").

118. *See, e.g.*, Cmty. Capital Bank v. Fischer & Yanowitz, 850 N.Y.S.2d 508, 510 (N.Y. App. Div. 2008) (finding that law firm was not a partnership because the lawyers did not agree to share profits or losses).

119. *In re* Brokers, Inc., 363 B.R. 458, 469 (Bankr. M.D.N.C. 2007) (citing Williams v. Biscuitville, Inc., 253 S.E.2d 18, 19–20 (N.C. Ct. App. 1979)).

120. Holmes v. Lerner, 88 Cal. Rptr. 2d 130, 138 (Cal. Ct. App. 1999); *see also* Southex Exhibitions, Inc. v. R.I. Builders Ass'n, 279 F.3d 94, 101 (1st Cir. 2002) (stating that evidence of profit sharing does not compel the conclusion that a partnership exists).

121. Douglas R. Richmond, *Expelling Law Firm Partners*, 57 CLEV. ST. L. REV. 93, 128 (2009).

122. The fact that these payments are made monthly in fixed amounts does not alter the analysis. Equity partners often receive set monthly draws paid out of firm profits, with the remainder of their compensation coming in quarterly or year-end distributions.

123. A Schedule K-1 is an Internal Revenue Service form which a law firm provides to its partners to reflect their shares of income, credits, deductions, etc., for the partnership's tax year. A K-1 provides a partner with information to report on her individual income tax return. *See* Joachim v. Flanzig, 773 N.Y.S.2d 267, 271 (N.Y. Sup. Ct. 2004).

salary.[124] Firms use a Form W-2 to report wages, including salaries, paid to employees and taxes withheld from them. Furthermore, most non-equity partners bear the full cost of any self-employment taxes rather than having their firms pay any portion of them or having income taxes withheld from their monthly compensation. Again, these factors are consistent with receiving a share of firm profits rather than being paid a salary. Finally, non-equity partners are often paid bonuses from firm profits.

3. Law Firms' Tax Treatment of Non-equity Partners

As noted above, the fact that law firms typically issue non-equity partners Schedule K-1's and require them to pay their own self-employment taxes is consistent with non-equity partners sharing in firm profits. These facts are also independently relevant, inasmuch as courts have long considered the good faith filing of partnership tax returns to evidence the existence of a partnership.[125] It is reasonable to assume that a law firm would not issue its non-equity partners Schedule K-1's unless it considered them to be partners.[126]

4. Sharing Losses

As important to the existence of a partnership that profit-sharing clearly is, the burden of spreading a firm's losses is equally essential.[127] Partners in general partnerships are jointly and severally liable in tort for the wrongs of their fellow partners committed in the course and scope of partnership business, and jointly liable for all other partnership debts and obligations.[128] Any suggestion that non-equity partners are not truly partners because they are not liable for a firm's losses in the same fashion as equity partners, however, misses the mark for at least two reasons. First, the partnership liability landscape has radically shifted

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124. *See* Zito v. Fischbein Badillo Wagner Harding, 809 N.Y.S.2d 444, 447 (N.Y. Sup. Ct. 2006) (rejecting lawyer's claim of partnership where firm issued him a Form W-2 and stating that if he was a partner, the firm would have issued him a Schedule K-1); Mellino v. Charles Kampinski Co., 837 N.E.2d 385, 391 (Ohio Ct. App. 2005) (observing that lawyer's failure to file a K-1 suggested that he was an employee rather than a partner).

125. WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP § 175 (3d ed. 2001) (discussing the UPA definition of partnership).

126. *Cf. id.* at 267–68 (discussing partnership tax returns).

127. *See, e.g.*, Cmty. Capital Bank v. Fischer & Yanowitz, 850 N.Y.S.2d 508, 510 (N.Y. App. Div. 2008) (finding that a firm was not a partnership because lawyers never "submitted to the burden of making good the losses" of the firm).

128. CORWIN & CIAMPI, *supra* note 1, § 1.09[3].

with the proliferation of limited liability partnerships (LLPs). The vast majority of law firms organized as general partnerships have now registered as LLPs. This was to be expected, since all states permit general partnerships to do so.[129] Most LLP statutes effectively eliminate partners' vicarious liability for all partnership debts and obligations, thus providing "full shield" protection. For example, the Minnesota LLP statute provides in pertinent part:

> An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner.[130]

Illinois has an identical "full shield" statute.[131]

Other statutes provide varying degrees of so-called "partial shield" protection. For example, the Texas LLP statute provides:

> A partner in a registered limited liability partnership is not individually liable, directly or indirectly, by contribution, indemnity, or otherwise, for debts and obligations of the partnership arising from errors, omissions, negligence, incompetence, or malfeasance committed while the partnership is a registered limited liability partnership and in the course of partnership business by another partner or a representative of the partnership not working under the supervision or direction of the first partner unless the first partner:
>
> (A) was directly involved in the specific activity in which the errors, omissions, negligence, incompetence, or malfeasance were committed by the other partner or representative; or
>
> (B) had notice or knowledge of the errors, omissions, negligence, incompetence, or malfeasance by the other partner or representative at the time of occurrence and then failed to take reasonable steps to prevent or cure the errors, omissions, negligence, incompetence, or malfeasance.[132]

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129. Susan Saab Fortney, *High Drama and Hindsight: The LLP Shield, Post-Andersen*, BUS. L. TODAY, Jan./Feb. 2003, at 46, 47.

130. MINN. STAT. ANN. § 323A.0306(c) (West Supp. 2008).

131. 805 ILL. COMP. STAT. ANN. 206/306(c) (West 2004).

132. TEX. REV. CIV. STAT. ANN. art. 6132b, § 3.08(a)(2) (Vernon 2009).

Under both full and partial shield statutes, law firm partners remain liable for their own errors,[133] and partners in direct supervisory roles may be liable for related failures.[134] Individual partners' potential vicarious liability, however, has been eliminated or at least seriously constrained.

In short, equity partners in law firms registered as LLPs are generally shielded from liability for firm losses not caused by their own negligence or supervisory lapses. Partial shield statutes afford equity partners less protection than do full shield statutes, of course, but even a partial shield affords substantial protection against personal liability. It therefore makes little sense to argue that non-equity partners in LLPs are not true partners on the basis that they do not share in firm losses.[135]

Second, non-equity partners *are* potentially bound to share in their firm's losses, but the firm simply indemnifies them against this risk. The firm indemnifies equity partners in the same fashion. For example, a law firm partnership agreement might provide:[136]

> The Firm shall, subject to the other provisions of this Section, indemnify each partner and former partner who was a partner on or after [date] (an "Indemnified Partner"), with respect to any debt, obligation, expense or liability of, or chargeable to, the Firm or such Indemnified Partner (a "Liability" or "Liabilities"), whether arising in tort, contract, or otherwise, if and to the extent such Liabilities are incurred or are assumed by such Indemnified Partner in the course of (1) engaging in the practice of law on behalf of the Firm or (2) engaging in or serving in the management of the Firm and its activities except, in each case, to the extent such Indemnified Partner has been reimbursed under a policy of insurance. No Indemnified Partner shall be entitled to indemnification for any Liability to the extent it results from such Indemnified Partner's:
>
> (a) failure to act in good faith and in a manner in which such Indemnified Partner reasonably believed to be in, or not opposed to, the Firm's best interests;
>
> (b) reckless conduct, intentional misconduct, or knowing material violation of the law;

133. *In re* Reitz, 694 N.W.2d 894, 901–02 (Wis. 2005).

134. Fortney, *supra* note 129, at 47–48.

135. *See* Hillman, *Evolving Status of Partners*, *supra* note 4, at 822 ("With the sharp contraction of liability for claims against partners [attributable to LLP status], the substantive distinctions that may otherwise exist between the liability of true partners and the liability of other participants in the firm diminishes.").

136. Confidentiality obligations prevent me from identifying the law firms from whose partnership agreements the following indemnification provisions are adapted.

(c) failure to comply with written Firm policies which the Executive Committee has notified the partners must, in advance of the conduct in question, be complied with as a condition of indemnification hereunder; or

(d) involvement in a proceeding in which the Firm is adverse to such Indemnified Partner (except in the case of any successful proceeding brought by the Indemnified Partner to enforce a right to indemnification or expense advancement hereunder).

Alternatively, an indemnification provision in a law firm partnership agreement might state:

The partnership shall indemnify and hold harmless each partner and former partner who is or was a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or proceeding, whether administrative, civil, or criminal (other than an action by or in the right of the partnership) by reason of the fact that such person is or was a partner, or is or was serving at the request of the partnership as a trustee or administrator of any employee benefit or welfare plan established or maintained by the partnership for the benefit of partners or employees of the partnership, against expenses (including attorneys' fees), judgments, fines (including excise taxes assessed in connection with an employee benefit plan) and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit, or proceeding. Indemnification shall survive a partner's death, retirement, or withdrawal from the partnership. Notwithstanding the foregoing, the partnership shall not be obligated:

(a) To indemnify a partner or former partner against any liability (i) caused in whole or part by the partner's gross negligence or willful misconduct, or (ii) to the extent such indemnification would be prohibited by applicable law;

(b) To indemnify a partner or former partner against liability arising from any conduct that constituted a breach of the partner's duty of loyalty to the partnership or for any transactions from which a partner or anyone affiliated with him or her derived an improper personal benefit;

(c) To indemnify any partner or former partner with respect to any claim or proceeding initiated by such person against the partnership or its partners, agents or employees, unless the claim or proceeding (i) was authorized by the managing partner or (ii) is for the sole purpose of determining whether such person is entitled to indemnification hereunder;

(d) To indemnify any partner or former partner for expenses or liabilities of any type whatsoever that have been paid directly to such

> person by an insurance carrier under a policy of insurance maintained by the partnership; or
>
> (e) To indemnify a former partner in respect to obligations of the partnership or in respect of any other partner for debts owed to the partnership.

If a law firm indemnifies both equity and non-equity partners, as most do, then loss-sharing is not a substantial factor in determining whether a non-equity partner is truly a partner. Even if that were not the case, and only non-equity partners were indemnified, it would remain true that a firm's promise of indemnification is only as good as its ability to fulfill it, and if the firm is unable to do so—as perhaps in a bankruptcy or dissolution—then non-equity partners may be forced to share the firm's losses. This threat is unfortunately very real, given the many high-profile law firms that have failed in the recent past.

Finally, to the extent loss-sharing is understood to mean that true partners earn less—or nothing—in years in which the partnership business declines or is unprofitable, such that non-equity partners who receive fixed compensation cannot be "partners" as a result, loss-sharing is still not determinative. There are two reasons for this. First, some equity partners negotiate fixed or guaranteed compensation with their firms. It is especially common for lateral equity partners to have their compensation guaranteed for their first few years at their new firms. Second, law firms often do reduce non-equity partner compensation during lean periods, such that non-equity partners in fact share in firm losses so measured.[137]

5. Sharing Risk

If a court were to consider risk-sharing in evaluating whether a partnership exists, it would find nothing there to distinguish between equity and non-equity partners. First, the LLP structure that now predominates among law firm partnerships has mooted many questions of partner liability and, thus, of risk-sharing. Quite simply, many risks that partners in general partnerships once shared have been statutorily

137. *See, e.g.*, Heather Cole, *Partners, Associates Learn of Pay Cuts*, MO. LAW. WKLY., June 12, 2009, at 1, 17 (reporting that a large Kansas City law firm running well behind budget withheld income from non-equity partners as well as equity partners because non-equity partners were also "owners of [the] firm"); Alana Roberts, *Ruden McClosky Cuts Pay by 9 Percent*, DAILY BUS. REV., June 30, 2009, http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202431873641 (reporting that a large Florida law firm struggling financially reduced non-equity partner compensation by nine percent while equity partners were likely to see an eighteen percent reduction).

eliminated or severely restricted under the LLP regime. As a result, "risk" in the sense of the unlimited personal liability that once characterized general partners and which separated them from employees,[138] ought not be a material consideration when attempting to distinguish equity and non-equity partners in law firms. Second, law firms generally indemnify both equity and non-equity partners against most firm- or practice-related risks. The possibility that a firm might be unable to satisfy its indemnity obligations is potentially as consequential for non-equity partners as it is for equity partners. Third, law firms today insure against almost all foreseeable risks at levels sufficient to protect partners against personal liability for even calamitous errors or occurrences. Even if a risk were for some reason uninsured, or a loss or series of losses exceeded the limits of the firm's applicable insurance, in the great majority of cases equity partners would still be insulated against personal liability by virtue of the firm's status as an LLP.[139]

6. Joint Control of the Firm

One factor courts may consider in determining if a partnership exists is whether the parties exercise or participate in joint control over the enterprise,[140] or at least have the right to do so.[141] The rationale long offered for this rule is that control of a business enterprise "is so crucial that it is rarely entrusted to mere employees or independent contractors."[142] Applying this rationale to typical two-tier law firm partnerships leads to the conclusion that non-equity partners are generally bona fide partners. In typical two-tier firms, for example, non-equity partners vote on a variety of partnership matters,[143] and often vote on all matters except the election of equity partners.[144] Non-equity partners generally attend partnership meetings, participate in various aspects of firm management, and sit on firm committees.[145] They

138. *See* Wheeler v. Hurdman, 825 F.2d 257, 274 (10th Cir. 1987) (discussing risk borne by general partners before the advent of the LLP structure).

139. This position, of course, assumes that a law firm is registered as an LLP rather than simply remaining a general partnership.

140. Peoples Bank v. Bryan Bros. Cattle Co., 504 F.3d 549, 557 (5th Cir. 2007) (discussing Mississippi law); Wood v. Phillips, 823 So. 2d 648, 653 (Ala. 2001) (citing Vance v. Huff, 568 So. 2d 745, 748 (Ala. 1990)); Ziegler v. Dahl, 691 N.W.2d 271, 277 (N.D. 2005).

141. *Ziegler*, 691 N.W.2d at 277.

142. GREGORY, *supra* note 125.

143. CORWIN & CIAMPI, *supra* note 1, § 1.09[1].

144. Kirkland, *supra* note 113.

145. CORWIN & CIAMPI, *supra* note 1, § 1.09[1].

generally have the right to view the law firm's financial records.[146] The fact that non-equity partners do not enjoy as much control over firm affairs as do equity partners does not force a different conclusion as to their status.[147]

It is also important when analyzing the issue of joint control to consider the effect of centralized management on law firms, which "is a departure from the basic partnership norm of equal participation in [firm] management."[148] The traditional partnership structure in which the partners decide matters through common agreement and consensus no longer exists in many law firms.[149] In typical large and mid-sized firms, most managerial decisions are entrusted to a managing partner, or executive or management committee.[150] The few partnership decisions that these lawyers do not make are often delegated to select partners functioning as practice-group leaders. Other operational decisions are left to non-partner managers holding titles such as "chief operating officer," "executive director," or "firm administrator." Partner compensation decisions are entrusted to a compensation or policy committee. New lawyers are selected by hiring committees. Firms' futures are plotted by strategic planning committees. In many large and mid-sized law firms, equity partners' "joint control" is limited to electing colleagues to serve on the committees that manage all aspects of firm affairs. Those elections are controlled by nominating committees and other groups selected or influenced by firm management, further reducing equity partners' actual control over management of the enterprise. Even small law firms delegate most operational decisions to a managing partner. In summary, traditional conceptions of joint control of partnership affairs are clearly outdated in the large and mid-sized law firm context, where firms have essentially "outgrown the law under which they operate,"[151] and are not necessarily valid even among smaller firms.

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146. § 6.02[3].

147. *See* GREGORY, *supra* note 125, § 187 (discussing partnership's ability to weight equity partners' voting rights or to create classes of partners with differing rights).

148. Robert W. Hillman, *The Bargain in the Firm: Partnership Law, Corporate Law, and Private Ordering Within Closely-Held Business Associations*, 2005 U. ILL. L. REV. 171, 180–81 (2005) [hereinafter Hillman, *The Bargain in the Firm*].

149. Lauren Winters, *Partners Without Power: Protecting Law Firm Partners from Discrimination*, 39 U.S.F. L. REV. 413, 436 (2005).

150. *See* Richard L. Marcus, *The Impact of Computers on the Legal Profession: Evolution or Revolution?*, 102 NW. U. L. REV. 1827, 1852 (2008) (referring to executive committees); Winters, *supra* note 149, at 437 (referring to managing partner and executive committee).

151. Hillman, *The Bargain in the Firm*, *supra* note 148, at 183.

7. Capital Contributions

Courts sometimes reason that the contribution of capital by members of an alleged partnership weighs favorably in finding that a partnership exists.[152] It is certainly true that a person's capital contribution to an enterprise may indicate the existence of a partnership. There is, however, no requirement that partners contribute capital in order to create a partnership, or that a person must contribute capital to become a partner.[153] The fact that non-equity partners do not contribute capital to their firms is therefore irrelevant to their status as a matter of partnership law. Curiously, some firms require non-equity partners to contribute capital—albeit less than that required of equity partners—with the non-equity partners then receiving fixed incomes rather than variable, and generally greater, incomes tied to the firm's profitability.[154] To the extent that a partner who contributes capital to a firm can be fairly described as "non-equity," which seems like quite a reach, non-equity partners in these firms obviously are more likely to be characterized or treated as bona fide partners for all purposes.

8. Holding Out as Partners

Law firms hold out non-equity partners to the public as partners just as they do their equity partners. Firms do not distinguish between equity and non-equity partners on their websites, on their letterhead, on lawyers' business cards, in legal directories, in their hourly billing rates, in their public announcements of lateral hires, or in their marketing materials. As an annual rite, law firms announce the election of new partners without distinguishing between equity and non-equity partners. Law firms permit non-equity partners to describe themselves as partners to courts, lawyers at other firms, existing clients, prospective clients, CLE program audiences, and the like. The public generally cannot distinguish between equity and non-equity partners, and has no idea if a law firm has two partnership tiers.[155] The same is often true of law firm

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152. *In re* Brokers, Inc., 363 B.R. 458, 469 (Bankr. M.D.N.C. 2007).

153. CORWIN & CIAMPI, *supra* note 1, § 2.02[3].

154. *See, e.g.*, Zach Lowe, *Reed Smith to Ask Nonequity Partners to Pay Chunk of Salary to Firm*, http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=120243547 2073 (reporting that one large law firm is now requiring non-equity partners to contribute capital and thereafter become "fixed-share partners"); *Capital and Voting Rights*, MO. LAW. WKLY., May 18, 2009, at 2 (discussing a large St. Louis law firm in which non-equity partners contribute approximately one-third of the capital that equity partners are required to contribute).

155. CORWIN & CIAMPI, *supra* note 1, § 1.09[2].

clients. If a firm publicly represents that a lawyer is a partner and a third-party reasonably relies on that representation, that lawyer has apparent authority to perform all acts that a partner in the firm ordinarily would.[156] In some cases, this kind of holding out may result in partnership by estoppel vis-à-vis third-parties.[157]

It is true that even where the rights and duties of partnership exist in relation to third parties, the relation between partners themselves remains consensual.[158] A good argument can therefore be made that "partnership" has a different meaning within a firm as compared to without. Nonetheless, the fact that firms allow non-equity partners to hold themselves out as partners is compelling evidence that the equity partners in those firms intend a true partnership with their non-equity colleagues. If they did not, they would require that non-equity partners identify themselves as "counsel," "senior counsel," "special counsel," or "senior attorney," rather than using the title "partner."

It is difficult for law firms to convincingly argue that non-equity partners are not partners for agency law or vicarious-liability purposes given the fashion in which they hold them out to the world as partners.[159] It is similarly disingenuous for non-equity partners to hold themselves out as partners when it is beneficial to do so but then deny or disclaim partner status when it has negative ramifications. To deny partnership in either instance is to arguably engage in multiple ethical violations.

For example, for a firm's equity partners to claim that a non-equity partner who has been held out as a partner is not one is to potentially acknowledge deceit, dishonesty, and misrepresentation in those activities, and thus to admit violations of Model Rule 8.4(c).[160] Such a claim might also be alleged to violate Model Rule 7.1, which prohibits lawyers from making false or misleading communications about their services;[161] Model Rule 7.5(a), which forbids lawyers from using a professional designation that violates Rule 7.1;[162] and Model Rule 7.5(d), which provides that lawyers may state or imply that they practice in a

156. Dow v. Jones, 311 F. Supp. 2d 461, 468 (D. Md. 2004).

157. *See* Andrews v. Elwell, 367 F. Supp. 2d 35, 41–43 (D. Mass. 2005) (discussing partnership by estoppel but declining to decide the issue).

158. Beckman v. Farmer, 579 A.2d 618, 627 (D.C. 1990).

159. *See, e.g.*, PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, L.L.P., 58 Cal. Rptr. 3d 516, 521–24 (Cal. Ct. App. 2007) (finding a triable issue of fact concerning the law firm's vicarious liability for a non-equity partner's actions).

160. MODEL RULES OF PROF'L CONDUCT R. 8.4(c) (2009) (prohibiting conduct involving "dishonesty, fraud, deceit or misrepresentation").

161. R. 7.1.

162. R. 7.5(a).

partnership only when that is the fact.[163] At least one bar's ethics committee has reached some similar conclusions.[164] On the law firm side, all equity partners will end up being liable under Model Rule 5.1(a) for allowing those violations to occur.[165] From the individual lawyer's perspective, the fact that the firm allowed or encouraged her to hold herself out as a partner is no defense to alleged violations of Rules 7.1, 7.5, and 8.4(c), because lawyers are bound by ethics rules even when they are acting at the direction of another person.[166]

C. Summary and Synthesis

"Partnership" is an imprecise term.[167] It refers to a contractual relationship that may vary widely in form and substance.[168] Partners do not even have to appreciate that they are partners for a partnership to exist.[169] Viewing partnership in this light, and considering the factors discussed previously, it is apparent that non-equity law firm partners are generally "partners" in the full legal meaning and context of the term. On the factors most critical to courts charged with evaluating alleged partnership relations—profit-sharing, loss-sharing, and joint control or equal participation in management—equity and non-equity partners are closely aligned. Also important to courts evaluating whether partnerships exist is whether law firms clearly hold out their non-equity partners as partners. This they generally do. The differences between equity and non-equity partners—e.g., equity partners receive a greater share of firm profits because their income is not fixed, equity partners vote on admitting lawyers to equity partnership while non-equity

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163. R. 7.5(d).

164. N.Y. County Lawyers Ass'n Comm. on Prof'l Ethics, Op. No. 740 (2008) (analyzing then-New York DR 2-102(C), which, much like Model Rule 7.5(d), prohibited lawyers from holding themselves out as having a partnership with other lawyers unless they were in fact partners; applying that rule to law firms holding out non-equity partners as "partners;" and concluding that DR 2-102(C) required "that attorneys holding themselves out to the public as partners, and the law firms in which they practice, be in fact partners under New York partnership law and their individual partnership agreements").

165. R. 5.1(a) (providing that "[a] partner in a law firm . . . shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct").

166. R. 5.2(a).

167. Southex Exhibitions, Inc. v. R.I. Builders Ass'n, 279 F.3d 94, 100 (1st Cir. 2002).

168. Boeckmann v. Mitchell, 909 S.W.2d 308, 311 (Ark. 1995) (quoting Zajac v. Harris, 410 S.W.2d 593 (Ark. 1967)).

169. *In re* Lona, 393 B.R. 1, 14 (Bankr. N.D. Cal. 2008) (discussing California law); Dealers Supply Co. v. Cheil Indus., Inc., 348 F. Supp. 2d 579, 588 (M.D.N.C. 2004) (interpreting North Carolina law).

partners do not vote—do not foreclose the conclusion that non-equity partners are partners for purposes of partnership law.

The essential question is what it means to acknowledge that non-equity partners are true partners. Certainly, accepting this conclusion has external implications for law firms and non-equity partners in terms of agency and vicarious liability. It is less clear that non-equity partners' status as true partners for partnership-law purposes is meaningful within law firm confines. Partnership is a contractual relation as well as a fiduciary one, and partners are generally free to fix their rights by agreement.[170] Thus, when it comes to their relations with their colleagues and firms, non-equity partners generally enjoy only those privileges and rights granted them in their firms' partnership agreements. Their status as partners rather than employees does not, for example, entitle them to share in firm profits or assets contrary to the language in a partnership agreement, or allow them voting rights other than those contractually conferred.

Non-equity partners' status as partners may be consequential, however, where a law firm attempts to sever its relationship with them. The termination of a partner is referred to as expulsion, and expelling partners can be a difficult and potentially perilous exercise.[171] A law firm that wishes to expel a partner must carefully adhere to the expulsion provision in its partnership agreement.[172] The failure to do so exposes a firm to liability for breach of contract.[173] In addition, the partner relation "is a fiduciary one, a relation of trust" that "carries with it the requirement of utmost good faith and loyalty."[174] Thus, a law firm that wishes to expel a partner must satisfy itself that its decision will withstand allegations of bad faith and breach of fiduciary duty by the expelled partner. Although it is true that partners' fiduciary duties to one another are substantially shaped by the terms of their partnership agreement,[175] good faith and bad faith remain imprecise concepts. In contrast, a law firm that wishes to terminate an associate's or of-counsel-

170. Bailey v. Fish & Neave, 868 N.E.2d 956, 959 (N.Y. 2007); Booth v. Attorneys' Title Guar. Fund, Inc., 20 P.3d 319, 326 (Utah 2001).

171. Robert W. Hillman, *The Impact of Partnership Law on the Legal Profession,* 67 FORDHAM L. REV. 393, 396 (1998).

172. *See, e.g.*, Ehrlich v. Howe, 848 F. Supp. 482, 490–92 (S.D.N.Y. 1994) (construing partnership agreement strictly and finding that defendants breached the agreement in expelling partner because not all partners were notified of expulsion vote as required).

173. *Id.* at 492.

174. Della Ratta v. Larkin, 856 A.2d 643, 658 (Md. 2004).

175. Coffman v. Provost * Umphrey Law Firm, 161 F. Supp. 2d 720, 731–32 (E.D. Tex. 2001) (applying Texas law).

lawyer's employment must only concern itself with much clearer anti-discrimination laws.

Recognizing non-equity partners as bona fide partners also has major professional responsibility implications. Unlike associates and other employed lawyers, partners have broad supervisory responsibility for the conduct of other lawyers in their firm. Partners must make reasonable efforts to ensure that all lawyers in the firm conform to rules of professional conduct.[176] A partner who breaches this duty may be sanctioned apart and independent from any discipline imposed on the lawyers to whom her failure relates.[177] Under Model Rule 5.1(c)(2), a partner is responsible for another lawyer's violation of ethics rules if she knows of the other lawyer's conduct "at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action."[178] Partners have nearly identical professional responsibilities with respect to non-lawyer assistants.[179]

III. DE-EQUITIZATION

As explained previously, one of the paths that lawyers take to non-equity status is a descending one. Firms commonly de-equitize partners whom they perceive to be under-productive or unproductive. For example, equity partnership is generally considered to require as essential qualifications the ability and willingness to attract new clients to a firm, the ability to retain existing clients, the capability to meet practice goals with a high degree of knowledge and skill, and the ability and willingness to accept independent responsibility for significant client matters. These are not the only attributes required of equity partners, but they are critical ones. Two-tier firms understandably operate on the basis that partners who do not satisfy all of these criteria should not enjoy equity status. Firms may also de-equitize partners as punishment for disruptive internal behavior or major transgressions, such as conduct that materially impairs a key client relationship, or that is unprofessional or exposes the firm to liability.

176. MODEL RULES OF PROF'L CONDUCT R. 5.1(a) (2009).

177. *In re* Anonymous Member of S.C. Bar, 552 S.E.2d 10, 12 (S.C. 2001).

178. R. 5.1(c)(2).

179. *See* R. 5.3(a) (providing that partners must make reasonable efforts to ensure that non-lawyer assistants' conduct is compatible with lawyers' professional obligations); R. 5.3(c)(2) (making partners responsible for non-lawyer assistants' misconduct where they know of it at a time that it can be avoided or mitigated but fail to take remedial action).

In recent years, law firms have de-equitized partners as a means of increasing profitability.[180] This trend began in the 1990s and continues unabated.[181] De-equitization is a superficially simple means of ratcheting up profitability, because the key measure of law firm profitability is profits per partner, and profits per partner are calculated solely based on a firm's equity partners. Among some groups, a firm's willingness to de-equitize partners is regarded as a sign of financial health.[182] In other instances, de-equitization is perceived to have sinister overtones,[183] as this tip in a blog post about partner de-equitizations at a large Chicago law firm reflects:

> Management just voted themselves massive raises while cutting the points of partners who are not politically connected. . . . [O]ver the last few days, management is going office to office de-equitizing and partially de-equitizing tons of partners in an effort to raise the profits per partner number. Those partners who are being de-equitized are no different than those who are permitted to keep their equity except those whose status remained intact have friends on management.[184]

When it comes to firms' ability to de-equitize partners, partnership statutes are silent. The drafters of the UPA and RUPA never contemplated de-equitization. Of course, partnership is a contractual relation.[185] Partners may generally fix their rights by agreement.[186] It follows that a law firm's right to de-equitize partners arises, if at all, from its partnership agreement. Attempting to de-equitize a partner absent a provision permitting that measure breaches the partnership agreement and potentially entitles the partner to damages. The interpretation of a partnership agreement is a question of law.[187]

An as-yet unanswered question is whether an expulsion provision in a partnership agreement is sufficient to authorize the lesser action of de-

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180. Koppel, *supra* note 34, at B1 (reporting on the practice of de-equitizing to increase profits).

181. David B. Wilkins, *Partner, Shmartner! EEOC v. Sidley Austin Brown & Wood*, 120 HARV. L. REV. 1264, 1265 (2007) (stating that de-equitization took hold among law firms in the 1990s).

182. Marcus, *supra* note 150, at 1851–52.

183. *See, e.g.*, D'Amour v. Ohrenstein & Brown, LLP, No. 601418/2006, 2007 WL 4126386, at *3 (N.Y. Sup. Ct. Aug. 13, 2007) (alleging a "de-equitization scheme" to deprive partners of their partnership rights).

184. Posting of Elie Mystal to Above the Law, *Jenner & Block: Problems Per Partner?*, http://abovethelaw.com/2009/05/jenner_block_problems_per_part_php. (May 7, 2009, 11:05 EST).

185. Clancy v. King, 954 A.2d 1092, 1100 (Md. 2008) (quoting Klein v. Weiss, 395 A.2d 126, 141 (Md. 1978)).

186. Bailey v. Fish & Neave, 868 N.E.2d 956, 959 (N.Y. 2007).

187. Nationwide Mortgage Servs., Inc. v. Troy Langley Constr. Co., 634 S.E.2d 502, 507 (Ga. Ct. App. 2006); Shoemaker v. Shoemaker, 745 N.W.2d 299, 308 (Neb. 2008); *In re* Dissolution of Midnight Star Enters., L.P., 724 N.W.2d 334, 336 (S.D. 2006).

equitization. Logic suggests that it should be, even though the actions are different. There is no compelling argument to the contrary. Partnership being a voluntary relation, a law firm's right to completely sever a partner's relationship with it impliedly encompasses the right to distance or reduce that relationship. A partner who is unwilling to accept de-equitization is free to withdraw from the firm. It would make no sense for a partner in a law firm with a partnership agreement that provided only for expulsion to contest her de-equitization on the ground that it was not contractually permitted when the probable consequence of her resistance would be expulsion. Furthermore, law firm compensation processes provided for in partnership agreements typically allow firms to reduce partner compensation to levels so low that equity status is valueless, or nearly so.[188] That being so, permitting de-equitization in the absence of express authority in a partnership agreement seems unremarkable. As a practical matter, firms often present de-equitization as an alternative to expulsion, and with most partnership agreements clearly permitting the latter and courts routinely upholding law firms' expulsion decisions,[189] most lawyers have little incentive to contest the issue.

In addition to the rights conferred under a partnership agreement, partners owe one another a duty of good faith and fair dealing that obliges them to consider their co-partners' welfare in addition to their own.[190] Partners cannot use the partnership agreement to contract away their duty of good faith and fair dealing.[191] The duty of good faith and fair dealing either arises from the partnership agreement or is among partners' fiduciary duties to one another. Some courts and partnership scholars consider partners' duty of good faith and fair dealing to be a creature of contract, which is logical considering that partnership agreements are contracts and the law implies a duty of good faith and fair dealing in all contracts.[192] Traditionally, however, courts have framed

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188. *See, e.g.*, Julie Triedman, *Tough Year at Dewey*, AM. LAW., Apr. 2009, at 16 (reporting that a large law firm slashed sixty-six partners' compensation by as much as eighty percent, in some cases lowering their compensation below that of first-year associates).

189. *See, e.g.*, Heller v. Pillsbury Madison & Sutro, 58 Cal. Rptr. 2d 336, 346–48 (Cal. Ct. App. 1996) (rejecting partner's expulsion challenge); Lawlis v. Kightligner & Gray, 562 N.E.2d 435, 440–43 (Ind. Ct. App. 1990) (upholding partner's expulsion); Bohatch v. Butler & Binion, 977 S.W.2d 543, 546–47 (Tex. 1998) (upholding partner's expulsion despite serious professional responsibility implications).

190. Eisenstein v. David G. Conlin, P.C., 827 N.E.2d 686, 693 (Mass. 2005) (quoting Meehan v. Shaughnessy, 535 N.E.2d 1255, 1263 (Mass. 1989)).

191. Winston & Strawn v. Nosal, 664 N.E.2d 239, 246 (Ill. App. Ct. 1996); Alloy v. Wills Family Trust, 944 A.2d 1234, 1249–50 (Md. Ct. Spec. App. 2008).

192. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981); *see, e.g.*, Wilensky v. Blalock, 414

the duty of good faith in intra-partner affairs as an aspect or extension of the fiduciary duty of loyalty.[193]

Regardless of the duty's source, it clearly applies to firms' decisions to de-equitize partners. It is therefore critical to determine what constitutes good faith, or perhaps more appropriately, what conduct evidences bad faith. Partnership statutes offer little guidance here. For example, RUPA leaves to courts the task of defining good faith and fair dealing "based on the experience of real cases."[194] RUPA presumes that courts will treat the good faith requirement as an exclusionary test, such that the phrase "good faith and fair dealing" has no general meaning of its own, but instead "'functions to rule out many different forms of bad faith.'"[195] In addition to the exclusionary test, courts evaluating allegations of bad faith may employ a cost-of-contracting analysis.[196] Cost-of-contracting analysis asks whether discretion in performing the contract, here a partnership agreement, is exercised in a fashion consistent with the parties' reasonable expectations.[197] The party vested with discretion in a matter breaches its duty of good faith and fair dealing if it exercises its discretion in order to recapture its cost of contracting or to deprive the other party of the benefit of the bargain.[198]

Unfortunately, it is difficult to evaluate whether either the exclusionary approach or cost-of-contracting analysis is preferable when analyzing the duty of good faith and fair dealing in the de-equitization context. Despite firms' widespread use of de-equitization as a management tool, there is a dearth of case law on the subject. There are several reasons for this. First, firms often present de-equitization as an alternative to expulsion or force it upon partners who lack professional alternatives; it is thus the lesser of two evils in each case. Firms routinely offer to return de-equitized partners' capital to them sooner than required under the partnership agreement and provide other

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S.E.2d 1, 4 (Ga. 1992) (finding implied duty of good faith in oral partnership agreement); Phelps v. Frampton, 170 P.3d 474, 483 (Mont. 2007) (implying duty of good faith and fair dealing in partnership agreement).

193. *See, e.g.*, *Winston & Strawn*, 664 N.E.2d at 245–46; *Alloy*, 944 A.2d at 1250; *Phelps*, 170 P.3d at 482; Leigh v. Crescent Square, Ltd., 608 N.E.2d 1166, 1169–71 (Ohio Ct. App. 1992); Moore v. Moore, 599 S.E.2d 467, 472 (S.C. Ct. App. 2004).

194. ROBERT W. HILLMAN ET AL., THE REVISED UNIFORM PARTNERSHIP ACT § 404 cmt. 4 (2007 ed.).

195. *Id.* (quoting Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 262 (1968)).

196. Paula J. Dalley, *The Law of Partner Expulsions: Fiduciary Duty and Good Faith*, 21 CARDOZO L. REV. 181, 198 (1999).

197. *Id.* at 199.

198. *Id.* at 200.

sweeteners as incentives to acquiesce in their demotions. In any event, de-equitization is presented in such a way or at such a time that contesting it is not a viable option. Second, partners who consider de-equitization intolerable may negotiate separation agreements with their firms and thereby avoid disputes. Third, many law firm partnership agreements include arbitration provisions, meaning that de-equitization disputes are contested privately. Fourth, when partners do challenge their de-equitization, and those challenges reasonably appear to be legitimate, firms are inclined to confidentially settle with the partner rather than risk any reputational injury that may attend litigation. Fifth, many de-equitized partners likely view suing their law firms as career suicide. Litigation will materially disrupt their current environment, may diminish their ability to move to another firm, and may ruin key relationships. Sixth, for insecure partners who have been worried about their futures, de-equitization may be a relief from the pressures they feel, and thus be an acceptable step, especially if the compensation offered with the change is palatable.

Kehoe v. Wildman, Harrold, Allen & Dixon is a rare case in which a partner's de-equitization was fully litigated.[199] The plaintiff, Robert Kehoe, was elected to equity partnership with Wildman, Harrold, Allen & Dixon ("Wildman") in 1979.[200] In 1994, the firm's management committee reviewed the productivity of all partners and negotiated separation packages with ten of them.[201] Those partners resigned from the firm and received benefits normally paid to partners upon involuntary withdrawal.[202] The management committee discussed Kehoe's productivity but took no action against him.[203]

In November 1995, the partnership approved a loan agreement with American National Bank (ANB) that required each equity partner to execute a guaranty in a form acceptable to ANB. By February 1996, every equity partner except Kehoe had executed a personal guaranty; Kehoe refused to do so on the basis that he found some provisions in ANB's proposed guaranty to be unacceptable.[204] He said he would be willing to execute a personal guaranty if his concerns about the guaranty were satisfied.[205] The ANB loan closed without Kehoe executing a

199. 899 N.E.2d 1177, 1183–84 (Ill. App. Ct. 2008).
200. *Id.* at 1181.
201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*
205. *Id.*

guaranty.[206] ANB allowed Wildman to draw on its line of credit even though Kehoe never executed a guaranty.[207]

In July 1996, the firm negotiated with ANB to modify some of the guaranty provisions to which Kehoe had objected.[208] In Kehoe's mind, these amendments eliminated the need for him to provide a personal guaranty.[209] Although John Eisel, who chaired the management committee, told Kehoe that ANB still wanted a personal guaranty from every partner, Eisel never pressed the issue.[210] ANB never approached Kehoe about his failure to execute a guaranty.[211]

In a November 1996 partnership meeting, the management committee proposed a resolution that would allow the firm to de-equitize any partner who failed to personally guarantee the ANB loan.[212] At the time, the firm's partnership agreement provided that a partner could be de-equitized by an affirmative vote of at least sixty-seven percent of the partnership interests.[213] Eisel presented the resolution to the partnership. Kehoe was present and was given the opportunity to speak, and he explained his objections.[214] The resolution was put to a vote, and fifty-five of the firm's sixty-one equity partners voted for it.[215] Afterwards, several partners implored Kehoe to sign a guaranty in order to preserve his status as an equity partner, but he declined to do so.[216]

The resolution took effect on January 1, 1997, and Wildman then considered Kehoe a non-equity partner.[217] On January 2, Kehoe requested that Wildman pay him his capital.[218] The firm refused.[219] Kehoe then sued Wildman and six partners—including Eisel and the other members of the management committee—for breach of contract and breach of fiduciary duty.[220] Kehoe alleged that he should receive his capital as separation payments provided for in the partnership agreement as though he had involuntarily withdrawn from the firm, which would

206. *Id.*
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.*
211. *Id.*
212. *Id.* at 1181–82.
213. *Id.* at 1182.
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.*
219. *Id.* at 1182.
220. *Id.* at 1180.

entitle him to a payout of $405,116.[221] The firm countered that Kehoe's change in status from equity to non-equity partner was merely that—a change in status.[222] He was still allowed to practice law at Wildman. When he later chose to leave the firm, he did so voluntarily, and thus was not entitled to separation payments as though he had involuntarily withdrawn.[223]

The trial court determined that the Wildman partnership agreement was ambiguous and instructed the jury to determine whether Kehoe's de-equitization amounted to an involuntary withdrawal from the firm.[224] The jury found for Kehoe on both his breach of contract and breach of fiduciary duty claims and awarded damages of $405,116.[225] After the trial court denied their motions for judgment notwithstanding the verdict, the defendants appealed.[226]

The *Kehoe* court first took up the issue of whether Wildman's partnership agreement was ambiguous, that is, whether it was "'capable of being understood in more sense than one.'"[227] In doing so, it noted that the defendants focused on the agreement's separation payments provision, which stated:

> If an equity partner's separation results from his or her involuntary withdrawal, the firm shall pay to the withdrawn partner . . . a sum equal to twice his or her Base Amount. Payment shall be made in one hundred twenty (120) equal monthly installments, commencing on the last day of the month following the month in which separation occurred.[228]

The plaintiff, on the other hand, honed in on the agreement's definition of involuntary withdrawal, which provided:

> The term "involuntary withdrawal" . . . shall mean the withdrawal of a partner from the firm as a result of (i) action taken by the other partners, which action shall be by not less than sixty-seven percent of the share interest held by the partners; (ii) compelling reasons of health, which shall be defined as any condition preventing said individual from

221. *Id.* at 1183.
222. *Id.* at 1184.
223. *Id.*
224. *Id.* at 1183.
225. *Id.*
226. *Id.* at 1184.
227. *Id.* at 1185 (quoting Farm Credit Bank of St. Louis v. Whitlock, 581 N.E.2d 664, 667 (Ill. 1991)).
228. *Id.* at 1183.

> practicing law or engaging in any other gainful employment anywhere, or (iii) death.[229]

The court focused on the portion of the involuntary withdrawal definition that spoke of "action taken by the other partners."[230] The defendants argued that there could be no involuntary withdrawal without a partner being required to withdraw from the firm, but the court found no such requirement in the definition of involuntary withdrawal.[231] Because Kehoe withdrew from the firm as a result of the sufficient partnership vote to de-equitize him, his withdrawal was arguably involuntary and the jury was free to so decide.[232] The fact that Kehoe might have chosen to remain with Wildman as a non-equity partner instead of withdrawing did not cure the ambiguity. As the court explained:

> The "involuntary withdrawal" provision was capable of being understood as applying to withdrawal of a partner when his withdrawal is required by the requisite vote of the other partners or where the action taken by the requisite vote of the other partners forced, but did not compel, the withdrawal of a partner. Contrary to the Firm's implied argument, the express provisions of the agreement do not, as a matter of law, require that at least 67% of the partners "vote to terminate" the plaintiff as a partner . . . before separation benefits are owed. . . . That the plaintiff was "welcome to, and indeed expected to, practice law at the firm after January 1, 1997" as a nonequity partner did not preclude the jury from deciding that the plaintiff was entitled to separation benefits because he was forced to withdraw by the passage of the resolution . . . .[233]

While the court affirmed the judgment against Wildman for breach of contract, it reversed the judgment against the individual defendants on the same theory.[234] This was an easy decision because the partnership agreement stated that the firm was obligated to pay all separation benefits from its net income.[235] The court rejected Kehoe's claim that the individual defendants were liable as a matter of partnership law on the basis that he had not alleged a violation of the Illinois partnership

229. *Id.* at 1182.
230. *Id.* at 1185.
231. *Id.*
232. *Id.* at 1185–86.
233. *Id.* at 1186–87.
234. *Id.* at 1189.
235. *Id.* at 1187.

law—he had alleged a breach of contract, and the contract made clear that separation benefits were a firm obligation.[236]

The court next turned to Kehoe's breach of fiduciary duty claim. Kehoe alleged that the individual defendants had breached fiduciary duties to him by (a) failing to advise the other partners of the July 1996 amendments to the guaranty requirement, (b) advising the other partners that he was unwilling to execute a guaranty, (c) not advising him that not all partners supplied personal financial statements, (d) implying that his refusal to execute a guaranty jeopardized the firm's financing, (e) not telling the other partners that his concerns might be satisfactorily resolved, (f) recommending the de-equitization resolution so as to terminate his partnership, and (g) providing a pretextual rationale for the resolution.[237]

Kehoe's breach of fiduciary duty claim quickly floundered in light of Illinois precedent focusing on partners' fiduciary obligations not to make secret profits at their co-partners' expense and to fully disclose to other partners all information that may be of value to the partnership.[238] Kehoe's allegations did not remotely approach a claim that the individual defendants' actions constituted secret dealings contrary to the partnership's interests, that their actions somehow deprived Wildman of profits it otherwise would have earned, or that by voting to de-equitize him, the defendants somehow enriched or enhanced themselves at the firm's expense.[239] Furthermore:

> The requisite number of partners might well have voted in favor of the resolution even if they had been provided with the information the plaintiff contends was either concealed or misstated for the most obvious reason: to remain an equity partner, one had to agree to share the same risks with the other partners. . . .
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> . . . .
>
> [A]s the partner defendants point out, the plaintiff was provided an opportunity to argue his position against the adoption of the resolution at the [partnership] meeting. The plaintiff either failed to present his case completely, or if he did, he failed to persuade. Having made his

236. *Id.* at 1188–89.
237. *Id.* at 1189.
238. *Id.* at 1190 (citing Day v. Sidley & Austin, 394 F. Supp. 986, 993 (D.D.C. 1975)).
239. *Id.*

> case to the other partners and lost, we question his right to carry on his fight . . . .[240]

Finally, Kehoe's breach of fiduciary duty claims against the individual defendants were inextricably linked to his contract claim against the firm. The damages sought for the alleged fiduciary breaches were based solely on the firm's failure to pay Kehoe separation benefits he was due.[241] Had the firm read the partnership agreement the way the jury did and paid Kehoe separation benefits, the partners' vote for the resolution permitting his de-equitization would have been irrelevant.[242] Accordingly, Kehoe's breach of fiduciary duty claims against his former partners failed for a lack of proximate cause.[243] While the *Kehoe* court ultimately affirmed the plaintiff's judgment against Wildman for breach of contract, it reversed the trial court in all other respects.[244]

Kehoe is unremarkable from a contract law perspective. Wildman's partnership agreement was vague and the firm paid for that imprecision. As for Kehoe's breach of fiduciary duty claim, it is settled that a law firm may expel a partner for conduct that produces a partnership schism without the partners who vote for expulsion breaching their duties of good faith and fair dealing to the partner voted out.[245] By analogy, partners should be able to vote to de-equitize a co-partner who creates a schism in their firm without being guilty of a fiduciary breach.

Partners breach their duty of good faith and fair dealing if they expel a co-partner for economically predatory purposes or for exercising rights conferred under their partnership agreement.[246] The same principles necessarily apply to partner de-equitizations. Thus, Kehoe might have been able to sustain a tort claim if he could have demonstrated that the partners he sued acted predatorily in supporting the resolution that allowed his demotion. That appears to have been what he was getting at when he alleged that those partners provided a "pretextual rationale" for the resolution.[247] The problem for Kehoe was that no evidence showed that he was de-equitized for economically predatory purposes. The resolution that imperiled his equity interest was well known to him;

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240. *Id.* at 1190–91.
241. *Id.* at 1191.
242. *Id.*
243. *Id.*
244. *Id.* at 1193.
245. *See* Richmond, *supra* note 121, at 113–14 (discussing partner expulsion and its corresponding duties with regard to partnership agreements).
246. *Id.* at 123.
247. *Kehoe*, 899 N.E.2d at 1189.

indeed, Kehoe was allowed to speak in opposition to it at the partnership meeting at which the resolution was called to a vote.[248] Although Kehoe's de-equitization might seem petty given that his unwillingness to execute a personal guaranty was apparently inconsequential to ANB, the record indicates that he was demoted for his disharmonious behavior rather than as a pretext to steal his clients or unfairly re-distribute his share of firm profits. Colleagues implored him to change his position to avoid de-equitization, yet he stubbornly refused to do so.[249] There was nothing to suggest that their efforts were insincere, or that the lawyers who urged Kehoe to reconsider his position were unaware of a management plot against him. The fact that a more charitable law firm might not have de-equitized Kehoe for his intransigence does not mean that the Wildman partners breached their duties of good faith and fair dealing by proceeding as they did. Kehoe had ample opportunities to avoid being de-equitized and squandered them all.

From a practical perspective, two-tier partnerships must be able to demote equity partners for legitimate reasons if they are to function efficiently. If, for example, a law firm is unable or unwilling to de-equitize undeserving or unproductive equity partners, or equity partners who no longer satisfy the criteria for equity status, then valued non-equity partners and aspiring associates will quickly come to see the two-tier system as artificial and unfair. There is substantial risk that they will eventually become dissatisfied with the partnership structure and their related prospects to the point that they leave the firm, thereby undoing all the benefits that two-tier partnership was intended to achieve.

If either courts or lawyers are tempted to downplay this functional need, there are at least four reasons they ought not to. First, most law firms have equity partners who achieved that status before the firms converted to two-tier partnerships. Were some of those same partners up for partnership today, they would be considered only for non-equity positions. It is unfair to their colleagues, and unhealthy for their firms, for these partners to escape the accountability or productivity that they require of those aspiring to their partner status. Firms must be able to de-equitize partners fitting this description if their performance warrants it. Second, lawyers' practices commonly change over time. If changes to equity partners' practices are negative from a profitability standpoint or otherwise, firms must be able to address those changes. De-equitization may be an appropriate adjustment in some instances. Third, some equity

248. *Id.* at 1182.
249. *Id.*

partnership decisions may prove to be mistakes. A firm that errs in making a lawyer an equity partner ought to have a remedial option short of expulsion. Finally, lateral movement among lawyers is now routine.[250] Lawyers may change firms several times over their careers. For gifted non-equity partners and associates who are dissatisfied with their firms' partnership structures, relocation to other firms is often a viable option.

IV. PARTNERSHIP AND EMPLOYMENT LAW

Non-equity partnership has perhaps drawn the most attention for its employment law aspects.[251] During recessions and times of economic stress for individual law firms, non-equity partners are thought to be vulnerable to layoffs.[252] This perceived vulnerability is principally attributable to the perception that non-equity partners are employees rather than partners.[253] The belief that non-equity partners are employees has employment law implications in that anti-discrimination statutes, such as Title VII of the Civil Rights Act of 1964 ("Title VII"), the Age Discrimination in Employment Act (ADEA), and the Americans With Disabilities Act (ADA) protect "employees" against unlawful discrimination.[254] As a rule, partners are considered to be employers, not employees, and, therefore, are not protected against adverse employment

250. Joan C. Rogers, *Analysis & Perspective: Private Firm Withdrawal and Termination*, 24 LAW. MANUAL ON PROF'L CONDUCT 330, 330 (2008).

251. There is potential for confusion here because law firms organized as professional corporations sometimes refer to shareholders or members as "partners," even though that term is obviously a misnomer. Furthermore, incorporated firms may have different classes or categories of shareholders. For a case involving a lawyer in a professional corporation who was described as a non-equity partner, and who the court concluded was an employee for purposes of federal anti-discrimination law, see Rosenblatt v. Bivona & Cohen, P.C., 969 F. Supp. 207, 214–15 (S.D.N.Y. 1997).

252. *See, e.g.*, Cliff Collins, *Pulling Together During a Tough Time*, 69 OR. ST. B. BULL. 26, 27 (2009) (reporting that twenty-four percent of law firms surveyed had terminated non-equity partners in the previous six months, and twenty percent were considering such cuts in the future); Leigh Jones, *Nonequity Partners May Be Casualties*, NAT'L L.J., Dec. 15, 2008, at 1 ("Forget associate layoffs. The most precarious position for attorneys in big law firms right now may well be among the nonequity partner ranks."); Lynne Marek, *Sonnenschein Cuts 30, Including Partners,* NAT'L L.J., Sept. 14, 2009, at 8 (describing non-equity partner layoffs at national law firm); Ameet Sachdev, *Law Firms Cutting Staff, Pay*, CHI. TRIB., Mar. 20, 2009, at 32 (reporting that a large Chicago law firm terminated seven non-equity partners because of the recession).

253. Kim Koratsky, *Lawyers Are Employers Too*, FED. LAW., Nov./Dec. 2004, at 6 (asserting that "[m]any, if not most, nonequity partners are actually employees").

254. *See* Clackamas Gastroenterology Assocs., P.C. v. Wells, 538 U.S. 440, 444–51 (2003) (discussing the ADA); Devine v. Stone, Leyton & Gershman, P.C., 100 F.3d 78, 80–81 (8th Cir. 1996) (discussing Title VII and the ADEA).

action under federal anti-discrimination laws.[255] This is particularly true in the law firm context.[256] Courts have historically been reluctant to extend employment law principles "to the management of a law firm by its partners" given that the relationships among law partners "differ markedly" from employer-employee relationships.[257]

Courts' traditional differentiation between partners and employees when enforcing anti-discrimination laws has been viewed by some as being one of the chief benefits of non-equity partner status. As one scholar observed, "[t]he biggest advantage that non-equity partners have over equity partners . . . is access to the remedial provisions of federal laws prohibiting workplace discrimination."[258] Or, as a commentator recently noted when discussing associates' partnership aspirations: "[A]ssociates may appreciate that non-equity partners, who are not considered partners under . . . employment law, can avoid . . . the loss of significant workplace rights. These additional legal rights may be valued by associates who worry . . . about potential adverse employment-related actions against them."[259]

It is highly doubtful that any lawyer would favor non-equity over equity partnership based on potential employment law protections, and it is only minimally more likely that lawyers who have achieved any partnership status give the employment law ramifications of their positions a moment's thought until professional disaster looms. For that matter, it is seldom easy for a plaintiff to prove a claim under federal anti-discrimination statutes, and the mere right to sue under such laws probably affords savvy lawyers little comfort. Even if state anti-discrimination laws are more favorable to plaintiffs than their federal analogs, it is still doubtful that they offer lawyers meaningful assurance. Regardless, the distinction between equity and non-equity partnership is simply not the momentous employment law consideration that lawyers and scholars may believe. Courts have recognized for a while now that the centralized management common among large professional partnerships has so blurred the line between partners and employees that partners may sometimes enjoy the protection of anti-discrimination

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255. *See, e.g.*, Burke v. Friedman, 556 F.2d 867, 869 (7th Cir. 1977) ("[W]e do not see how partners can be regarded as employees rather than as employers who own and manage the operation of the business.").

256. *See, e.g.*, Serapion v. Martinez, 119 F.3d 982, 991–92 (1st Cir. 1997) (concluding that an equity partner in a law firm was not eligible for Title VII protection).

257. Hishon v. King & Spalding, 467 U.S. 69, 79 (1984) (Powell, J., concurring).

258. Winters, *supra* note 149, at 439.

259. Silverbrand, *supra* note 5, at 175 (footnotes omitted).

laws.[260] The title "partner" is not itself determinative in employment disputes.[261]

For law firms, the partner versus employee paradigm materially shifted in 2002 with the Seventh Circuit's decision in *EEOC v. Sidley Austin Brown & Wood*.[262] The *Sidley* case arose out of a 1999 decision by the leaders of Sidley & Austin ("Sidley"), as the firm was then known, to demote thirty-two equity partners to "counsel" or "senior counsel" status.[263] None of the demoted partners filed a charge of discrimination against the firm.[264] Even so, the EEOC launched an investigation into the firm's possible violation of the ADEA and subpoenaed a variety of information from the firm. To prove an ADEA violation, the EEOC had to show that the partners were in fact employees before their demotions.[265] When Sidley resisted the subpoena the district court ordered the firm to comply fully and Sidley appealed.[266]

Sidley challenged the EEOC's jurisdiction to investigate the demotions on the basis that a partner is an employer within the meaning of the federal anti-discrimination laws if (a) her income included a share of the firm's profits, (b) she contributed capital to the firm, (c) she is liable for firm debts, and (d) she has some administrative or managerial duties.[267] The court's focus, however, quickly shifted to the firm's centralized management structure: the firm was controlled by an executive committee that held the other partners at its "mercy" by controlling their income and status within the firm.[268]

Sidley had met Illinois's requirements for forming and maintaining a partnership, and the demoted partners certainly were partners for state law purposes.[269] The EEOC, however, argued that partner status was not

260. *See, e.g.*, Simpson v. Ernst & Young, 100 F.3d 436, 443–44 (6th Cir. 1996) (affirming age discrimination verdict for accounting firm partner); Strother v. S. Cal. Permanente Med. Group, 79 F.3d 859, 867–68 (9th Cir. 1996) (finding that doctor's status as a partner rather than an employee of a large medical group required further factual inquiry).

261. *See, e.g.*, *Simpson*, 100 F.3d at 441 (agreeing with district court that "'partner' was a title that carried no legal significance"); *Strother*, 79 F.3d at 867–68 (rejecting district court's conclusion that doctor's label as partner precluded a finding that she was an employee within the meaning of a California anti-discrimination statute); Rhoads v. Jones Fin. Cos., 957 F. Supp. 1102, 1106 (E.D. Mo. 1997) (explaining that courts must look beyond labels such as "partner" when evaluating liability for discrimination).

262. 315 F.3d 696 (7th Cir. 2002) (Posner, J.).

263. *Id.* at 698.

264. *Id.* at 701.

265. *Id.*

266. *Id.* at 698–99.

267. *Id.*

268. *Id.*

269. *Id.* at 702.

the same for purposes of state and federal law.[270] The court's concern was whether the partners were employers under the ADEA, and the court was not satisfied that partner status established employer status. As the court explained in comparing the firm to a corporation:

> This case . . . . involves a partnership of more than 500 partners in which all power resides in a small, unelected committee (it has 36 members). The partnership does not elect the members of the executive committee; the committee elects them, like the self-perpetuating board of trustees of a private university or other charitable foundation. It is true that the partners can commit the firm, for example by writing opinion letters; but employees of a corporation, when acting within the scope of their employment, regularly commit the corporation to contractual undertakings, not to mention tort liability. Partners who are not members of the executive committee share in the profits of the firm; but many corporations base their employees' compensation in part anyway, but sometimes in very large part, on the corporation's profits, without anyone supposing them employers. The participation of the 32 demoted partners in committees that have . . . merely administrative functions does not distinguish them from executive employees in corporations. Corporations have committees and the members of the committees are employees; this does not make them employers. Nor are the members of the committees on which the 32 serve elected; they are appointed by the executive committee. The 32 owned some of the firm's capital, but executive-level employees often own stock in their corporations. . . . [T]here is authority that employee shareholders of professional corporations are still employees, not employers, for purposes of federal antidiscrimination law.[271]

The court found the demoted partners' personal liability for the firm's debts significant, but this factor did not outweigh the other considerations.[272] The fact that the demoted partners were bona fide partners did not determine whether they were employers, and their personal liability was relevant only to the former.[273] It was conceivable that the two classes at issue—partners under state law and employers under federal law—did not overlap.[274] The *Sidley* case ultimately settled for the collective sum of $27.5 million.[275] For purposes of the settlement, Sidley also admitted that the demoted partners were

270. *Id.*
271. *Id.* at 702–03.
272. *Id.* at 703.
273. *Id.* at 704.
274. *Id.*
275. Michael Bologna, *EEOC Reaches $27.5 Million Settlement in Age-Bias Action Against Sidley Austin*, 23 LAW. MANUAL ON PROF'L CONDUCT 533, 533 (2007); Ameet Sachdev, *Age Suit Could Raise Bar*, CHI. TRIB., Oct. 6, 2007, § 2, at 1.

employees within the meaning of the ADEA.[276] Of course, the firm did not admit that it violated the ADEA in demoting them.[277]

The *Sidley* court did not hold that the demoted partners were employees, or that they were entitled to ADEA protection. The decision should not be interpreted to mean that law firms cannot de-equitize or expel partners who are not performing the functions expected of partners, or who are not doing so satisfactorily. The case is of lasting significance, however, because equity partners are increasingly vulnerable to dramatic compensation adjustments and involuntary separation from their firms as part of firms' continuing quest to enhance, or at least maintain, their profitability.[278] As a result of the *Sidley* decision, law firms making such decisions now consider the employment law aspects of them more carefully than they perhaps previously appreciated or understood.

Shortly after *Sidley* was decided, the Supreme Court, in *Clackamas Gastroenterology Associates, P.C. v. Wells*, was called upon to determine whether four physicians who were shareholder-directors in a professional corporation were employees within the meaning of the ADA.[279] Focusing on the element of control, the Court identified six factors that are relevant to the determination of whether a shareholder-director is an employee: (1) whether the organization can hire or fire the individual, or set the rules and regulations governing her work, (2) whether and to what extent the firm organization supervises the individual's work, (3) whether the individual reports to someone higher in the organization, (4) whether and to what extent the individual is able to influence the organization, (5) whether the parties intended the individual be an employee as expressed in written agreements or contracts, and (6) whether the individual shares in the organization's liabilities, losses, and profits.[280] These factors are not exhaustive,[281] and no one of them alone is decisive.[282]

276. Bologna, *supra* note 275, at 533.

277. Sachdev, *supra* note 275, at 2.

278. *See, e.g.*, Mike Delikat & John D. Giansello, *A "Partner" May Not Be a Partner*, NAT'L L.J., Apr. 27, 2009, at S1 (stating that in the latest recession, "law firm 'right-sizing' has led to numerous partner departures"); Nate Raymond & Claire Duffett, *One Side of Midnight*, AM. LAW., Oct. 2008, at 22 (reporting that "some firms are thinking about firing equity partners to boost take-home profits per partner"); Triedman, *supra* note 188, at 16 (discussing a large, New York-based law firm's dramatic reduction of sixty-six partners' compensation in an effort to maintain profitability during a lean period).

279. 538 U.S. 440, 442 (2003).

280. *Id.* at 449–50.

281. *Id.* at 450 n.10.

282. *Id.* at 451.

The Court in *Clackamas* focused on whether a professional corporation was an employer under the ADA; it did not address whether a director-shareholder could sue such an organization for unlawful discrimination.[283] It is clear, however, that courts may employ the *Clackamas* factors to determine whether law firm partners are employees for employment law purposes.[284]

Solon v. Kaplan illustrates the application of the *Clackamas* factors in the law firm context.[285] James Solon was one of four equity partners in a Chicago law firm organized as a general partnership.[286] He served as the firm's managing partner for approximately two years and, after relinquishing that post, remained involved in the firm's administration.[287] Unfortunately, the firm's three name partners lost confidence in Solon's administrative, legal, and rainmaking skills, and decided to remove him as a partner.[288] They offered him the option of remaining with the firm as an administrator or independent contractor, but he refused.[289] Solon left the firm and then sued it and the name partners for allegedly violating Title VII and the ADEA in connection with his departure.[290] The district court granted summary judgment for the defendants and Solon appealed to the Seventh Circuit.

On appeal, the Seventh Circuit applied the *Clackamas* factors and concluded that "no reasonable juror could find that Solon was an employee of the firm."[291] Without delving into all the details, Solon was one of four equity partners and could be removed only by a unanimous vote of the other three partners; he exercised substantial control over the allocation of the firm's profits; because new equity partners could be added only by a unanimous vote of the existing equity partners, he possessed veto power over new partner admissions; and, unlike the

283. *See id.* at 442.

284. *See, e.g.*, Kirleis v. Dickie, McCamey & Chicolte, P.C., No. 06-1495, 2007 WL 2142397, at *6 (W.D. Pa. July 24, 2007) (applying *Clackamas* factors and finding that equity shareholder was law firm employee); Simons v. Harrison Waldrop & Uhereck, L.L.P., No. Civ.A. V-05-71, 2006 WL 1698273, at **6–8 (S.D. Tex. June 14, 2006) (finding that three equity partners who held small stakes in partnership and were thus subject to the control of more senior partners were not employees for ADEA purposes); Panepucci v. Honigman Miller Schwartz & Cohn, L.L.P., 408 F. Supp. 2d 374, 376–78 (E.D. Mich. 2005) (applying *Clackamas* factors and concluding that plaintiff's employment status could not be determined on motion to dismiss), *aff'd*, 281 F. App'x 482 (6th Cir. 2008).

285. 398 F.3d 629 (7th Cir. 2005).

286. *Id.* at 630.

287. *Id.* at 630–31.

288. *Id.* at 631.

289. *Id.*

290. *Id.*

291. *Id.* at 633.

firm's "special partners," he shared in the firm's profits, had access to the firm's financial information, and attended partnership meetings.[292] The fact that the firm forced him out without affording him notice and an opportunity to be heard did not reveal a lack of control supporting his characterization as an employee, nor did the fact that he consulted with his fellow partners before making major decisions in his role as managing partner. The firm's partnership agreement did not require notice or a hearing as a condition of removing a partner,[293] and Solon's collaborative leadership style suggested only that he was "passive"—not "powerless."[294] The *Solon* court thus affirmed the district court's grant of summary judgment.[295]

At the end of the day, whether law firm partners are entitled to the protection of anti-discrimination laws pivots not on their status as equity partners or non-equity partners, but on their workplace control as measured by the *Clackamas* factors. The greater the level of partners' control over their professional environments, the less likely they are to be considered employees for anti-discrimination law purposes. That said, not all partners must be equal. For example, a firm's differentiation between partners based on the size of their equity interests does not automatically transform partners with relatively small equity interests into employees.[296] As a Texas federal court has explained:

> The *Clackamas* inquiry is designed to identify situations in which an employee is given a title traditionally reserved for someone in an ownership position without any of the attendant rights, privileges, and responsibilities of control. In such an instance, a shareholder, director, or partner may in fact be an employee. However, the *Clackamas* inquiry does not suggest that a partner in a partnership may be designated as an "employee" merely because some other partner has

292. *Id.*
293. *Id.*
294. *Id.* at 634.
295. *Id.*
296. Simons v. Harrison Waldrop & Uhereck, L.L.P., No. Civ.A. V-05-71, 2006 WL 1698273, at *8 (S.D. Tex. June 14, 2006).

> been granted more of the rights, privileges, and responsibilities traditionally attendant to partnership.[297]

Control may similarly be an issue under state employment law.[298]

The outcome of any case decided by application of the *Clackamas* factors will turn on its facts. Partnerships are not all alike. Depending on the characteristics of the law firm, equity partners may be able to establish that they are employees within the meaning of anti-discrimination laws, just as non-equity partners might.[299] On the other hand, equity partners who hold nominal stakes in their firms and are vulnerable to domination by more senior partners with greater interests may still be deemed bona fide partners and not employees for purposes of anti-discrimination laws.[300] Equity versus non-equity partner status, without more, is simply not the meaningful employment law divide that many lawyers and observers seem to believe.

V. CONCLUSION

Two-tier partnerships are now standard in large and mid-sized law firms. Non-equity partner ranks are growing far faster and larger than equity partner numbers. It is therefore important to understand what it means to be a non-equity partner. Contrary to the many claims by lawyers and scholars that non-equity partners are not true partners, in most cases that is exactly what they are as a matter of partnership law. There are differences between equity and non-equity partners to be sure, but none relegate non-equity partners to some lesser category of association. As with equity partners, non-equity partners' rights and obligations are principally determined by their firms' partnership agreements. Equity and non-equity partners have equal supervisory responsibilities under ethics rules. Both equity and non-equity partners may be entitled to protection against unlawful employment actions under federal and state anti-discrimination laws depending on the facts of the particular case. Courts, lawyers, and scholars must understand that the proper emphasis in the term "non-equity partner" is not on "non-equity," but on "partner."

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297. *Id.*

298. *See, e.g.*, *In re* Mintzer, 722 N.Y.S.2d 93, 94 (N.Y. App. Div. 2001) (finding that non-equity partner who had no control over her workplace activities was an employee to whom law firm owed unemployment compensation benefits).

299. Kirleis v. Dickie, McCamey & Chicolte, P.C., No. 06-1495, 2007 WL 2142397, at *6 (W.D. Pa. July 24, 2007).

300. *See, e.g.*, *Simons*, 2006 WL 1698273, at *8.

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ATTORNEY SEARCH

By Carey Bertolet

Two-Tier or Not Two-Tier? The Equity Partnership Dichotomy

One of the most pronounced trends among the nation's top law firms in the past 10 years is that most firms — the overwhelming majority of firms — are two-tiered partnerships. A decade ago, 80 percent of the 100 largest law firms in the United States were single tier equity partnerships. Now 80 percent are two-tiered partnerships (see, e.g., "'De-equity' Stirring Big-Firm Partner Ranks" by Dick Dahl for Lawyers USA, August 27, 2007). Although the importance of retaining a single-tiered partnership may seem diminished given the groundswell in favor of promoting non-equity partners, there are still important considerations in choosing between a one- or two-tiered partnership.

The first major distinction to be made is how the way the partnership is structured affects the bottom line. The conventional wisdom is that a two-tiered partnership allows the rainmaking equity partners to keep more of the "pie" to themselves. In other words, non-equity partners exist so that the profits of the firm can be split among a smaller pool of partners — typically those who are the "major players" in the firm. Presumably, a partner is more likely to promote only those lawyers who are contributing to the profitability of the firm, and the non-equity category exists so that there is no need to share profits with valuable, but less profitable, partners.

The evidence doesn't support the proposition that equity partners make more money in a two-tiered partnership. It appears that the firms that choose to have single-tier partnerships (though they find themselves in the ever-shrinking minority of firms) *are the most profitable*. In his blog, *Adam Smith, Esq.,* Bruce MacEwen makes the convincing case that the most recent AmLaw statistics prove that profits per partner are inversely proportional to the percentage of non-equity partners a firm allows. In other words, firms with single-tier partnerships (i.e., no non-equity partners) generally have the highest average revenue per lawyer.

A quick review of the 2008 AmLaw 100 reveals that the list of firms that remain single-tier partnerships is populated with many of the New York powerhouse "white shoe" firms (Cravath, Wachtell, and Sullivan & Cromwell to name three). These are the types of firms that we expect to see at the top of the revenue and profit statistics in any event. Despite the undeniable popularity of multiple tiers of partnership, it is those firms that are often viewed as the best in the business that are decidedly off-trend.

Why is it so trendy, then, to create non-equity partnership roles in firms? What are the considerations a lateral partner candidate should make in evaluating a single-tier system versus multiple-layer partnerships?

We'll start by evaluating the single-tier system. If you are considering joining a firm with a single-tier partnership that is in the AmLaw 100, then the caliber of firm on your dance card likely speaks for itself. If you are being courted as a partner, then you are considering membership in an exclusive club. This in and of itself may compel you to join a single-tier partnership. Your partnership status is projecting that they have set the bar at the same height for all partners, giving the same gold seal to each. I recently asked the managing partner of a firm why they hadn't changed to two-tiers, and he answered, quite surprised, because all of the partners at the firm had achieved at a remarkably high level in their careers. The partnership, he added, would settle for nothing less, and wouldn't consider any lawyer who couldn't pass muster under the more stringent standards for equity partnership.

In other words, there is no question how well you measure up as a partner in a single-tier partnership system. You have more than passed muster.

Take this ''single-tier'' view of the world — that a law firm should accept only the absolute best into its partnership, leaving no need for further classification. Combine it with the evidence that the remaining 20% of AmLaw 100 firms are indeed the most impressive profit centers. A conclusion, then, is that by staying as single-tier partnerships a certain ''elite'' category of firms is setting itself apart from the rest of the large law firm community.

The issue is, of course, more nuanced. There are elite firms that have decided to create two-tier partnership structures, so it is simply too facile to say that the nation's very top firms choose single partnership, while the rest bring in non-equity partners. Latham & Watkins and White & Case are two examples of premier firms with two-tiered partnerships. It can't, then, only be about prestige.

There are multiple advantages to the two-tier system.

Although some of the biggest money-making firms are single-tier partnerships, there are immensely profitable firms with two tiers of partnership. Indeed, the equity partners of those firms are able to promote associates to partner more freely without necessarily having to create another seat for an equity partner at the table. This may mean that two-tiered partnerships have more flexibility in rewarding (or not rewarding) partners based on whether they generate revenue for the firm. There are reasons for firms to keep partners in the firm based on their expertise, their management skills, or their potential for business development in the future — but those reasons may not justify an equity partnership.

Additionally, two levels of partnership allow some flexibility to move partners in and out of the equity category. While admittedly an unpopular tool, de-equitizing partners does allow a firm to directly reward revenue generators and remove those partners who can't justify their portion of the firm's profits. It allows a firm to give potential business developers the gravitas of the title to fuel their efforts in attracting business to the firm.

Sometimes lawyers prefer to be non-equity partners, and like having the flexibility of earning the title of partner without taking on the strain of producing revenue for the firm in the way equity partners are expected to do. I have heard a great deal about how younger lawyers in law firms are statistically less interested in partnership than previous generations. Multi-tiered partnerships may be the first substantial step in defining the infrastructure of a more flexible law firm that can imagine lawyers serving in a variety of roles in the organization.

Although we now have far more partner-titled attorneys at AmLaw 100 firms, the path to equity partner seems that much more elusive. Instead of being promoted from associate to partner, the trend seems to be moving an associate to non-equity partner, with equity partnership consideration down the road. We're gravitated from a seven- to eight-year track to something longer and less defined. Some non-equity partners fear being left in purgatory — they are satisfied with their title but uncertain of how or when they will make the next step.

Increasingly I am talking to partners looking for a new position because the two tiers in their own partnership lack transparency — and they want to move away from a partnership too bloated on the non-equity side. Thus, those firms going on-trend with multiple tiers of partners should do so with a concrete plan of why and when to use the partnership title for a non-equity role. Lawyers in the lateral market evaluating a two-tiered partnership should identify those firms that have not let the use of several tiers obscure the path to partnership and continue to define benchmarks for both the non-equity and equity roles.recession!