Where Mandatory Retirement Meets the ADEA

By Laura B. Friedel and Russell I. Shapiro

Planning for your firm's future without violating age discrimination laws.

Developing new leaders—and giving them the roles and responsibility necessary to keep them happy and help the firm move forward—is critical to every accounting firm. However, the flip side of giving opportunities to the next generation is that such opportunities have to be either created anew or taken from older members. (For ease of reference, we use the terms "partner" and "member" interchangeably in this article to refer to partners, members, shareholders, and other, similar classifications, and we use the term "partnership agreement" to refer to the operating agreement of your business, regardless of whether it is a partnership, an LLC, or other structure.) Age-based mandatory retirement programs have long been used as a clear-cut way to move older partners on and give younger ones greater opportunities, but these policies can open the door to age discrimination claims. If your firm wants to transition responsibility from one generation to the next, it's critical that you do so in a way that doesn't violate age discrimination laws.

The federal Age Discrimination in Employment Act (ADEA) protects individuals aged 40 and over from adverse action relating to their employment; there are similar provisions in state and local law, although the rules may differ. Many assume that partners of professional services firms aren't protected by age discrimination laws, but unfortunately it's not that simple. There are some partners who would be deemed to be "employers" and fall outside the ADEA's protection (we will refer to these partners as "owners"), but there are others—including some who have equity in the firm—who could be considered "employees" covered by the ADEA. The key is understanding not only which partners qualify as owners, but also how to build a viable succession plan that doesn't run afoul of the ADEA.

Determining whether your firm's partners are protected by age discrimination laws

Contrary to popular understanding, the ADEA does not have a "partner exception." The ADEA has just two classifications—employers (who we are referring to as "owners") and employees. If a partner is to be considered outside the ADEA's protections, the firm will have to establish that he or she is an owner, rather than an employee.

The Supreme Court has found that the key issue in determining whether an individual member is an owner is whether he or she is able to assert control. As the Court explained in 2003:

> an [owner] is the person, or group of persons, who owns and manages the enterprise. The [owner] can hire and fire employees, can assign tasks to employees and supervise their performance, and can decide how the profits and losses of the business are to be distributed. The mere fact that a person has a particular title—such as partner . . . should not necessarily be used to determine whether he or she is an employee of a proprietor.

So, how is an accounting firm to determine whether its partners have enough control to classify them as owners? The U.S. Equal Employment Opportunity Commission (EEOC) has established six factors to consider in making this determination:

1. Can the firm hire or fire the individual or set the rules and regulations relating to his or her work?
2. Does the firm supervise the individual's work, and to what extent?
3. Does the individual report to someone higher in the organization?
4. Is the individual able to influence the firm, and to what extent?
5. Was the intent that the individual be an employee (as expressed in written agreements and contracts)?
6. Does the individual share in the profits, losses, and liabilities of the organization?

Recent cases have also looked to the structure of the firm and the role individual partners have in running

the firm. The more control that is vested in the individual members—as opposed to an executive or management committee—the more likely that the partners will be considered owners rather than employees.

What the factors and standards described above make clear is that there is no bright-line test to determine whether a partner is an owner outside the protections of the ADEA. Nonetheless, applying these tests and factors, a spectrum begins to take form:

- **Nonequity partners/members.** At one end of the spectrum are nonequity partners, who generally will qualify as "employees" and be protected by age discrimination requirements. Generally, it is difficult to argue that individuals who do not share in the firm's profits, losses, and liabilities are owners. This is compounded by the fact that nonequity partners usually report to equity partners and have limited (if any) voting rights. In these circumstances, it is likely that the individual will be deemed to be an "employee" and would be able to bring a claim if he or she was required to retire from the partnership or discriminated against based on his or her age.
- **Managing partners/executive committee members.** At the other end of the spectrum are the members who run the business on a day-to-day basis. These individuals are the most likely to be deemed to be owners because they exert the most control over the firm and have the most control over their own destiny. As a result, these partners are the most likely to be considered outside the scope of age discrimination laws.
- **General equity partners.** In the middle are partners who have equity in the firm but aren't key players in the firm's management. While the size of your partnership can be an indicator of the partners' classification (it being assumed that partners in a five-member firm retain more control than those in a 500-member firm), the number of partners in your firm is not determinative. Whether these members will be considered employees or owners depends on how your firm is structured and on how much control they have over the firm and their own practice. In evaluating these individuals' status, consider the following questions:
  - *How autonomous is the member?* How much authority and discretion does the partner have in client matters (including accepting clients and billing arrangements)? Does he or she have to report to someone "higher up" in the organization? Is he or she required to meet certain production goals? Must he or she obtain approval for specific marketing expenses?
  - *How much control does the partner have over his or her own career?* Can the partner be fired or demoted without following a set expulsion process set forth in the partnership agreement, such as a vote of all partners?
  - *How much control does the partner have over the firm?* Does the member have voting rights on decisions important to the firm, or are such issues determined by a subset of partners? When he or she does vote, is it merely a ratification of a management committee recommendation? Does he or she participate in the admission or discharge of partners or other personnel?
  - *Does the member have a financial stake in the firm?* Is the partner paid a percentage of profits or a salary? Is his or her draw, if any, calculated as a percentage of expected revenues, or is it more like a salary? Is he or she personally liable for or a guarantor of firm debt? If the firm takes a loss, does he or she take a loss?

Where a particular individual or group falls on the spectrum is thus a very fact-specific inquiry, and between the ends of the spectrum there is room for disagreement. Don't be surprised if you have trouble determining where your partners fall on the spectrum; the combination of somewhat vague legal standards and personal involvement often makes these determinations a daunting task. Many firms find it helpful to rely on an outside advisor to provide an independent and unbiased evaluation.

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Developing policies that plan for the future without violating the law

As noted above, whether your firm can legally rely on a mandatory age-based retirement policy or other age-based transition policies depends on whether the partners being impacted by the policy are protected by age discrimination laws. If they are not, then there isn't a

legal impediment to these policies. On the other hand, if the members you wish to cover with such policies aren't clearly classified as owners under age discrimination laws, there is a legal risk in having—and applying—such policies. This legal risk includes damages, punitive damages, costs and attorneys fees, lost time in defending against the claim, and the reputational damage that publicity of such a claim often brings.

Deciding whether to change existing policies requires a cost-benefit analysis, weighing your firm's business needs against the likelihood that one or more partners (or attorneys or government agencies proceeding on their behalf) would be able to put forth a supportable age discrimination claim. Assuming that at least a portion of your firm's members don't have the control and involvement necessary to be clearly classified as owners, it makes sense to consider what business needs your firm's age-based policies are filling and whether those needs can be met through alternative, less legally risky means. Following are some alternatives that can be written into a partnership agreement to meet many of the same goals of a mandatory retirement policy, with less risk:

- **Only apply age-based policies to certain partners.** The fact that some of your partners or members may not meet the requirements for an "owner" doesn't mean that you can't apply age-based policies to the ones who do. Consider whether there is a way to categorize your partners based on nonage criteria (such as position within the firm), and only apply mandatory retirement policies and other policies tied to age to those categories of partners who are not protected by age discrimination laws.
- **Tie policies to facts and circumstances rather than age.** Age discrimination laws prohibit policies that are based on age or have an undue impact on older employees. They do not prohibit policies that tie retirement and succession to nonspecific age triggers, such as an individual's reducing his or her work hours or limiting the scope of his or her work, both of which often occur when a partner is approaching retirement. Consider changing your policy so that it is triggered by an individual's decision to cut back on work time or reduce time dedicated to the firm's operations rather than age. An additional benefit of such a policy is that it avoids the need to carve out exceptions for partners who hit a particular birthday but who the firm wants to keep on in the same capacity.
- **Link age-based policies to eligibility to participate in retirement programs.** Another option is to tie retirement benefits to the partner's decision to retire from the partnership at a particular age. In this case, the partner or member would not be required to retire at a set age, but if he or she does so, he or she would be eligible for an attractive retirement plan. Such a retirement plan could include both monetary compensation and the opportunity to continue on with the firm in a different capacity. If a partner doesn't retire at the stated age, he or she forfeits these benefits. In this way, the partner is incentivized to make the retirement decision for him- or herself.
- **Institute long-term service requirements or term limits for leadership roles.** To the extent that your firm's age-based policies are intended to create leadership opportunities for newer members, an alternative is to amend the provisions of your partnership or operating agreement regarding how long an individual must or may serve in a leadership position. One approach would be to require a long (*e.g.,* seven years)

Avoid Post-Retirement Work Arrangements that Suggest Age Discrimination

Be careful because it's necessary to consider whether arrangements with retired partners run afoul of age discrimination laws. Many firms require that their members retire at a given age and then place those individuals in "senior" or "retired" status. The fact that an individual once qualified as an "owner" for age discrimination purposes doesn't exempt him or her from age discrimination protections when he or she moves on to a post-retirement position. As a case filed by the EEOC in 2010 demonstrates, firms need to be careful that the way senior and retired partners are treated—in particular with respect to compensation—isn't considered to be age discrimination. Think carefully about how you are compensating and otherwise treating those who stay on with the firm after retiring as a member. If you are paying them on a less-favorable pay scale or limiting their opportunities, make sure that there is a legitimate, non-discriminatory reason for doing so.

commitment to a position, which is likely to discourage the older generation's participation. Another approach is to institute term limits, providing that an individual is only permitted to serve a set number of terms in a management or executive position.

So, can an accounting firm require that its partners retire at a given age? The answer is that it depends on how your partnership operates. Age-based mandatory retirement policies are not always the answer. Firms need to balance the business need for succession planning against the risk of age discrimination claims and consider alternative approaches that could meet the same business goals with less business risk. There is no one-size-fits-all answer, but by considering both the risk and the need, and developing policies that strike a balance between the two, your firm can find the right approach.

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