

**COMPILATION OF CASES INVOLVING RESTRICTIVE COVENANTS
AMONG LAW PARTNERS (MR 5.6/DR 2-108)**

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The ethical rules prohibiting lawyers from entering into restrictive covenants – Model Rule 5.6 and its predecessor, DR 2-108 of the Code of Professional Responsibility – are not as simple as they appear. For those lawyers, schooled under *Cohen v. Lord Day & Lord*,¹ the prohibition appears absolute: lawyers may not enter into agreements with their law partners that require those who leave the firm to forfeit earned compensation or other benefits if they compete with the firm. Some courts take an equally simplistic view. But other courts, commentators and Bar Committees are more nuanced, recognizing that the supposed purpose behind the absolute rule (to enhance lawyer availability to potential clients) may not be as protective of clients as first appears, and that competing interests, such as the law firm’s desire to ensure its continuing economic health, need protection as well.

During the past two decades, state courts have roughly divided into two groups: the majority, which follow *Cohen* and flatly prohibit “forfeiture for competition” clauses, and the minority, which follow cases like *Howard v. Babcock*,² and recognize that reasonable restrictions on competition for departing partners may be sensible and necessary. Even in States that follow the majority view, debates have developed as to the extent law firms can circumvent the restrictions of MR 5.6 by characterizing pay-outs to withdrawing partners as “retirement benefits” exempt from the Rule, by making pre-arrangements to divide contingency fees ultimately earned on matters taken to the new firm, by reflecting the economic impact of the lawyer’s departure through a reduced valuation of his or her shares in the firm, or by having the economic penalty linked to a specific financial burden the firm had recently undertaken (*e.g.*, a lease extension, the build-out of new space).

In this article, we have compiled cases and ethics opinions from around the country to show the range of views in this area. We have provided a brief synopsis of the portion of each case that concerns restrictive covenants. Although we do not claim this compilation is comprehensive, it reveals that the majority rule still holds firm sway, even in recent cases, but a few jurisdictions continue to rule otherwise. As a helpful guide, we have indicated minority view cases, and cases from majority view jurisdictions that take an unusually flexible view, with a double asterisk (**).

Ethics Opinions

ABA Formal Op. 06-444 (2006):

- 1. Question:** The prohibition on restrictive covenants in MR 5.6(a) makes an exception for “retirement benefits.” What kinds of benefits may properly be subject to restrictive covenants, and what is the permissible scope of those restrictions?

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¹ *Cohen v. Lord Day & Lord*, 75 N.Y.2d 95 (1989).

² *Howard v. Babcock*, 6 Cal. 4th 409, 863 P.2d 150 (1993).

2. **Answer:** To be considered a “retirement benefit” under MR 5.6(a), “the benefit must be one that is available only to lawyers who are in fact retiring and thereby terminating or winding down their legal careers.” Indicia of bona-fide “retirement benefits” include: significant and meaningful age and years-of-service requirements, the presence of benefit calculation formulas, benefits that increase as years of service in the firm increase, benefits payable over the life of the retired partner, an interrelationship between firm retirement benefits and other retirement benefits (Social Security, pensions, etc.), the presence of a separate “retirement” benefit in the partnership agreement, and a difference between the payouts given retiring partners and those given other withdrawing partners. Assuming the partners have agreed on a bona-fide “retirement benefit,” they may condition the scope of the restriction on competition in any way they see fit, either geographically, temporally, or substantively (*i.e.*, limiting the retiring partner to non-competitive legal work such as judging or teaching).

ABA Formal Op. 94-381 (1994):

1. **Question:** May a corporation’s in-house lawyer make employment of outside counsel on a specific matter contingent on the outside counsel agreeing never to represent any party against the corporation in the future?
2. **Answer:** Such a restriction is prohibited by MR 5.6(a). That Rule has two purposes: to protect the lawyer’s “professional autonomy,” and to prohibit covenants that would limit “the freedom of clients to choose a lawyer.” The restriction here would “restrain a lawyer from engaging in his profession,” and would restrict the public “from access to lawyers who, by virtue of their background and experience, might be the best available lawyers to represent them.” While the interests of a former client (which the corporate client would be once the lawyer is discharged) are to be protected, the scope of that protection is found in MR 1.9 (the former client conflict rule). “A lawyer may not ethically ask for nor may a lawyer agree to any further restriction unnecessarily compromising the strong policy in favor of providing the public with a free choice of counsel.”

D.C. Bar Op. 325 (2004):

1. **Question:** May law firm partners who have decided to merge their firm agree that only those partners who join the post-merger firm receive a share of profits earned by the pre-merger firm?
2. **Answer:** No. This agreement violates MR 5.6(a) because it creates a financial disincentive for those partners wanting to leave the merged firm and practice with another firm. The “retirement benefits” exception cannot be invoked here, because it applies only to the type of retirement typical at the end of a career and not to all departures from a firm.

Indiana St. Bar Assoc. Legal Ethics Comm. Op. 3 of 1994 (1994):

A partnership agreement provision stating that a withdrawing partner had to forfeit 25% of the buyout figure for his interest in firm if he continued to practice in the county where the firm was located or in any adjoining county violates Rule 5.6.

South Carolina Bar Eth. Adv. Comm. Op. 91-20 (1991):

A law firm could not condition payment of a departing partner's interest in accounts receivable already earned on the partner's complete cessation of the practice of law.

State Courts

a. Alabama

- i. ****Pierce v. Hand, Arendell, Bedsole, Greaves, & Johnston, P.C., 678 So.2d 765 (1996)**
 1. **Facts:** In Paragraph 13 of their Partnership Agreement, the Hand, Arendell partners agreed that partners over the age of 60 could withdraw and receive so-called "retirement benefits" only if they ceased to practice law in the geographic area contiguous to the firm's offices. Pierce retired from the firm, but continued to practice. The firm denied him \$250,000 in deferred compensation benefits, and he sued to have the restrictive covenant declared void.
 2. **Holding:** To the extent Paragraph 13 contains a prohibition on competition, it violates an Alabama statute that prohibits such restrictions in employment agreements, and does not fall within the "retirement benefits" exception to the Alabama equivalent of DR 2-108. The firm must pay Pierce his deferred compensation benefits.
 3. **Reasoning:** Although the trial court had ruled that Paragraph 13 was void in its entirety, because it violated the Alabama statute prohibiting contracts which restrain employees from practicing their professions, the appellate court took a more nuanced approach. It found the portion of Paragraph 13 that prohibited competition void, but upheld the remainder of the provision. The court rejected the application of the "retirement benefits" exception, noting that Paragraph 13 did not "truly concern retirement benefits," apparently because it addressed all withdrawals by partners over the age of 60, no matter what the reason. Citing *Cohen*, the court held that "to treat departure compensation as a retirement benefit would invert the exception into the general rule."

b. Arizona

- i. **Fearnow v. Ridenour, Swenson, Cleere & Evans, P.C., 138 P.3d 723 (Ariz 2005)**
 1. **Facts:** Plaintiff had paid \$33,674.22 for his partnership interest in an earlier law firm. When he and several other partners left to form the Defendant Ridenour firm, they did not put in new capital, but simply "deemed" their capital contribution to be the same as what it was at the other firm. Their shareholder agreement created two classes of departing partner: partners who left because of disability, retirement or compulsory withdrawal receive the "deemed" monetary value of their shares, while those who left voluntarily received nothing. Fearnow voluntarily left the firm, then sued for the value of his shares, claiming the partnership agreement violated Rule 5.6.
 2. **Holding:** The agreement does not violate Rule 5.6. The court applies a "rule of reason" approach similar to that used in *Howard (infra)* and in Arizona cases addressing restrictive covenants entered into by non-lawyers.
 3. **Reasoning:** While certain types of restrictive covenants are absolutely prohibited, such as those involving temporal or geographical restrictions,

restrictions involving financial disincentives are not. The court declined to create a special prohibition for lawyers, but chose instead to apply the same rule for lawyers as it applies to restrictive covenants for doctors and other professionals – that is, “a rule of reasonableness.” The case was remanded for the parties to present facts on the reasonableness of the restriction in the Shareholder Agreement.

c. California

i. ****Howard v. Babcock**, 6 Cal. 4th 409 (1993)

1. **Facts:** Plaintiff was a partner at defendant firm. The partners in the firm agreed to a provision in their partnership agreement that if a partner left the firm before the age of 65 and engaged in the practice of insurance defense in the limited geographic area near the firm’s offices, the withdrawing partner would forfeit all rights to withdrawal benefits. Plaintiffs asserted that this provision was unenforceable.

2. **Holding:** The court held that an agreement among law partners imposing a reasonable restriction (including a reasonable financial penalty) on departing partners who competed with the firm is enforceable.

3. **Reasoning:** The court noted that California has a strong policy in favor of competition but that it had long been the law of the state that a partnership agreement may prohibit competition in a limited geographic area. Such agreements do not actually prevent competition, but simply put a price on it and are evaluated under a “rule of reason” standard – a standard that treats the restriction as valid to the extent it is reasonably necessary for the protection of the firm. The court stated that it was adopting the “rule of reason” test to “achieve a balance between the interest of clients in having their attorney of choice, and the interest of law firms in having a stable business environment.” It also did so because it saw no difference between the legal profession and other professions, as to which the Court had long applied the “rule of reason” in this context. Finally, the court noted that allowing some financial disincentives to departure might serve clients better, since “the culture of mistrust that results from systemic grabbing [of clients] is very likely to damage, if not destroy, the law firm’s stability,” making firms less willing to invest in the resources necessary to serve clients properly. **[Note: The majority decision contains the most comprehensive case-law analysis of the “rule of reason” approach, and the dissent gives an equally spirited rejoinder.]**

ii. ****Haight, Brown & Bonesteel v. Superior Court of Los Angeles County**, 234 Cal. App. 3d 963 (Ct. of Appeal, 1991)

1. **Facts:** The law firm’s partnership agreement contained a clause requiring a partner who left the firm, joined a competing firm located within any one of five nearby counties, and represented a client of the former firm to forfeit both his capital and his share of the accounts receivable. Plaintiffs commenced an action against some former partners who left the firm and then competed.

2. **Holding:** The contractual provision was not contrary to law or public policy, and the case was remanded so the trial court could determine whether the restriction worked a forfeiture or “on its face amounts to a [valid] agreement for liquidated damages.”

3. **Reasoning:** The court reasoned that the applicable rule only prevented agreements to refrain altogether from the practice of law, and did allow partners to be penalized for competing with the firm. The court viewed this as a balancing of the competing interests: on the one hand, it enables departing partners to withdraw from a partnership and continue to practice anywhere and to accept employment from any client who wants them; on the other, it allows law firms to maintain the stability of their practices. Further, the court found no basis for treating lawyers differently than any other profession.

d. **Connecticut**

- i. *Schoonmaker v. Cummings and Lockwood*, 252 Conn. 416 (2000)

1. **Facts:** Plaintiff was a partner at defendant firm which had a non-competition provision in the partnership agreement. When concerns about the validity of the non-compete were raised, plaintiff was instrumental in the addition of a “savings provision” to the agreement that allowed an arbitrator to construe or revise the non-competition clause as needed to preserve it under current professional responsibility rules. The non-compete provided two benefit levels: one to partners/attorneys withdrawing after four years (“1x”) and one to partners/attorneys leaving after twenty years, reaching the age of 60 or having become incapable of the practice of law (“2x”). These benefits (which include payments from income to be generated in the future, not past payments) would be forfeited if the partner retired prior to age 70 and competed with the firm within a limited geographic area within three years. Plaintiff left the firm after age 60 and started his own firm and the defendant firm refused to make the payments, citing the agreement. Per the agreement, the parties went to arbitration, and the arbitrator determined that Rule 5.6 allowed firms to condition retirement benefits on non-competition, and as such the 2x benefits (which the arbitrator classified as retirement benefits) were enforceable. The arbiter invoked the savings clause to make the 1x benefits available on the same terms as the 2x benefits. Plaintiff filed suit to vacate the arbitrator’s award.
2. **Holding:** The court held that the arbitrator’s decision would be reviewed de novo, that the complete cessation of the practice of law was not required as a condition of “retirement” under the Rule 5.6 retirement exception, that the 2x benefits could thus be construed as “retirement benefits” under Rule 5.6 and properly subject to a restrictive covenant, and that the arbitrator did not violate public policy by invoking the savings clause to preserve the 1x benefits.
3. **Reasoning:** The court noted that a Connecticut court had yet to pass on a Rule 5.6 case and so looked to the law of neighboring states. The court then noted that Rule 5.6 does not say what “retirement” means and only states that an attorney need be “retired” for a forfeiture provision to not offend public policy. The court then concluded that absent a clear policy statement from either the legislature or the courts, “the public policy embodied in Rule 5.6 does not require that eligibility for retirement benefits [be conditioned] on the absolute cessation of practice.” Instead, whether benefits would constitute “retirement benefits” under Rule 5.6 would depend on several factors, including whether (a) the source of the funding comes from future firm revenues; (b) the funding involves a lengthy disbursement period, so as to assist lawyers in retirement; and (c) the provision

contains significant age and length of service restrictions. Since the 2x benefit level met these requirements, the 2x payment constituted a “retirement benefit” properly subject to a restrictive covenant. The 1x payment level did not meet these criteria, and could be preserved only by making the eligibility criteria the same as for the 2x benefit.

e. District of Columbia

i. *Neuman v. Akman*, 715 A.2d 127 (D.C. Ct. App. 1998)

1. **Facts:** The Arent Fox partnership agreement provided for a lifetime payment to retiring partners who satisfied certain age and longevity requirements, provided those partners did not “engage in the private practice of law in the U.S.” Neuman, a retired partner who otherwise met the criteria for the payments but continued to practice, challenged this under Rule 5.6.
2. **Holding:** The Court held that this provision involved “retirement benefits,” and thus fell within the exception to Rule 5.6.
3. **Reasoning:** The Court noted that Rule 5.6 served two purposes: to protect lawyers, particularly young lawyers, from bargaining away their right to open their own law offices after they end an association with a firm, and to protect clients from having a restricted pool of lawyers to choose from. Nevertheless, the “retirement benefits” exception to the prohibition against “forfeiture for competition” clauses in Rule 5.6 applies. The Court applied the same criteria for “retirement benefits” as the court in *Schoonmaker*, and concluded that the payments here satisfied that test.

f. Illinois

i. *Hoffman v. Levstik*, 860 N.E.2d 551 (Ill. 2006)

1. **Facts:** Plaintiff brought an action against his former firm (defendant) seeking a declaration that sections of the partnership agreement violated Rule 5.6. The agreement required partners to contribute capital to the firm and, in the circumstances of voluntary withdrawal, provided that the firm may reduce payments of this “paid-in-capital” by the greater of one-half the balance or \$50K. Further, partners would forfeit their retirement capital if they withdrew from the firm for any reason other than retirement. Plaintiff contended that any financial disincentive violated Rule 5.6.
2. **Holding:** The court held that the provisions of the partnership agreement did not violate Rule 5.6 as they did not unduly limit plaintiff’s mobility or the ability of a client to choose counsel.
3. **Reasoning:** In an earlier case, *Stevens, infra*, the court noted that Illinois has a strong policy favoring the freedom to contract and that there had been no blanket prohibition against financial disincentives to leaving a firm; here, the agreement did not contain a significant economic disincentive, since the partner left the firm despite the provision. Further, in the instant case, the withdrawal provisions made no mention of refraining from competition.

ii. *Dowd & Dowd, Ltd. v. Gleason*, 181 Ill. 2d 460 (1998)

1. **Facts:** Plaintiff firm, a professional corporation, sued two former employees. The trial court refused to enforce plaintiff’s non-compete agreement which provided that former employees could not solicit clients of the corporation for up to two years. The agreement was made prior to the adoption of Rule 5.6.

2. **Holding:** The agreement was against public policy and the court refused to enforce it.
 3. **Reasoning:** The court decided that Rule 5.6 did indeed have retroactive effect as it was not worded in the future tense nor did it expressly apply only to agreements made after its adoption. The rule was designed to “afford clients greater freedom in choosing counsel and to protect lawyers from onerous conditions that would unduly limit their mobility.” In order to carry out both the plain terms and the policy behind Rule 5.6, the court held the restrictive covenant here void.
- iii. *Stevens v. Rooks Pitts and Proust*, 682 N.E.2d 1125 (Ill. App. Ct. 1997)
1. **Facts:** Plaintiff was a general partner at defendant firm until he voluntarily withdrew. The partnership agreement contained a provision that provided payment would be limited in the case of a voluntary withdrawal if the partner practiced law with another firm in the same geographic area during the year following withdrawal. The distribution to the partner would be reduced by 20% in this case. Plaintiff filed a declaratory judgment seeking to have this provision declared void under MR 5.6.
 2. **Holding:** The clause violated MR 5.6 and was void as against public policy.
 3. **Reasoning:** The court noted that Illinois law provided little basis for applying a “rule of reason” with respect to lawyer restrictive covenants. Applying MR 5.6 strictly, the court held that the clause in question hindered plaintiff’s mobility as well as the client’s ability to select him as counsel.
- g. **Iowa**
- i. *Donnelly v. Brown, Winick, Graves, Gross, Baskerville, Schoenbaum & Walker, P.L.C.*, 599 N.W.2d 677 (Iowa 1999)
 1. **Facts:** The Brown, Winick partnership agreement provided that any partner who either was 60 years old and had worked at the firm for 10 years, or who had worked for the firm for 25 years regardless of age, and who “retired” (*i.e.*, “elects to terminate the practice of law within the State of Iowa”), would receive a defined payout over a ten year period. Donnelly worked at the firm for 25 years, then left to join another firm. He demanded the payments, and the firm claimed they were “retirement benefits” and thus subject to the exception contained in DR 2-108(A).
 2. **Holding:** The benefits in question are “retirement benefits,” and thus the firm can restrict payment to those who cease practicing law in Iowa.
 3. **Reasoning:** Donnelly argued that these were not “retirement benefits” because they would be paid even if the lawyer did not actually retire – *e.g.*, if the lawyer went into government service, became a judge, or practiced in another state. The “retirement benefits” exception does not require “true” retirement, the court reasoned, because otherwise it would be “surplusage,” since there would be no need for a restrictive covenant if only the complete cessation of the practice of law were contemplated. The court concluded that “retirement benefits” must involve payments pursuant to a bona-fide retirement plan, which the court defined as “a systematic arrangement established by an employer for guaranteeing an income to employees upon retirement according to definitely established rules with or without employee contributions.” The Brown, Winick plan, with its strict

age and length of service criteria, easily qualified. A concurring opinion agreed, citing the *Schoonmaker* factors.

ii. *Anderson v. Aspelmeier*, 461 N.W.2d 598 (Iowa 1990)

1. **Facts:** This case involved the valuation of a withdrawing partner's interest in a firm. Plaintiff withdrew from defendant firm after building up a very successful tax practice. The partnership agreement provided for a two tier payment system upon withdrawal: the first was for share repurchase, and the second was for future payments over eight years to cover the value of the withdrawing partner's interest above the net purchase price – this tier could be reduced or eliminated if the withdrawing partner “committed an act which is detrimental to the partnership which affects the value of the remaining partners' interest in the partnership.” When plaintiff left, 325 of 329 notified clients went with him. The firm invoked the “detrimental act” clause in the agreement and plaintiff sued.
2. **Holding:** The “detrimental act” provision of the partnership agreement was a restrictive covenant in violation of DR 2-108(A) and was therefore void.
3. **Reasoning:** While defendant firm maintained that the agreement was made only to protect the financial integrity of the firm and did not restrict plaintiff's right to represent former firm clients, the court noted that the provision served only to penalize plaintiff for exercising his right to unrestricted practice under DR 2-108(A). The reason was that the provision, no matter the intent, would functionally penalize a withdrawing partner for serving clients who wish to be served by him. Effectively, plaintiff was being punished for his client's decision to exercise their choice to have him as their counsel – not just for his withdrawal – and that contravened the aims of DR 2-108.

h. Massachusetts

i. *Eisenstein v. Conlin*, 444 Mass. 258 (2005).

1. **Facts:** Plaintiff and another attorney resigned from defendant firm to become partners at another firm. The partnership agreement with defendant firm required that voluntarily withdrawing partners had to remit to the firm 15% of all fees received at their new firm for work performed for current or former clients of the former firm during the next four years.
2. **Holding:** The provision violated MR 5.6 and was therefore void.
3. **Reasoning:** The court reiterated that MR 5.6 exists to allow clients free choice of counsel and that this supersedes any benefits other law firm members might derive from restrictions placed on the withdrawing lawyer's right to practice law. Further, the court stated that MR 5.6 is not limited to agreements that “directly penalize a withdrawing attorney for competing by denying that attorney compensation already earned while at the firm” – the situation in *Cohen* -- but also “requires close judicial scrutiny of any partnership provision that imposes financial disincentives on attorneys who leave a firm and then compete with it.” The court ruled that the limited exception set forth in *Pettingell* did not apply, because the disincentives could not “reasonably be justified by any legitimate interest [defendant firm] had in its own survival.” The court was especially troubled by the facts that the financial penalty applied no matter why the client chose the new firm, no matter what the work the new firm did for the client (*i.e.*, even if the work was unrelated to the specialized IP work performed by the

former firm), and no matter whether the client had left the former firm because its lawyer there had ceased practicing. Because of all this, enforcing the provision would have given the defendant firm a windfall of fees it otherwise might never have received.

- ii. ****Pettingell v. Morrison, Mahoney & Miller, 426 Mass. 253 (1997)**
 - 1. **Facts:** Plaintiffs withdrew from defendant firm and began their own firm. The defendant firm's partnership agreement provided that when a partner voluntarily withdraws and engages in competition with the firm, that partner forfeits all the benefits he would have received had he not competed. The benefits had two parts: cash profits attributable to the partner and annual partnership interest credits.
 - 2. **Holding:** The court held that in this instance the provision was void as against public policy and DR 2-108(A), but did note a significant exception to the absolute prohibition against "forfeiture for competition" clauses: when the forfeiture is necessary to protect the firm's interest in its own survival.
 - 3. **Reasoning:** While the court refused to adopt a per se rule against forfeiture provisions, it found this one against public policy because in this case "the firm has not presented evidence in the [record] that the plaintiffs' departures have caused, or have seriously threatened to cause, any harm to the firm or its continuing partners that should be recognized as a reasonable offset against some or all of the amounts due to plaintiffs." The court did note that "[a] law firm's legitimate interest in its survival and well-being" might justify a limitation on payments to a withdrawing partner in circumstances such as when the firm has been left with "onerous partnership debts" which threaten the financial integrity of the firm.

i. New Jersey

- i. **Bortek v. Riker, Danzig, Scherer, Hyland, & Perretti, 179 N.J. 246, 844 A.2d 521 (2004)**
 - 1. **Facts:** The Riker, Danzig partnership agreement contained a provision for early retirement, after a lawyer had worked in the firm for 10 years. This involved a five-year payout of a percentage of prior years' earnings, based on the retiring partner's contributions to the firm. "Retirement" was defined to include "permanent retirement as a capital partner of the firm from the private practice of law" subject to some qualifications, including remaining as 'of counsel' to the firm and engaging in public service work. Any right to receive these benefits would end if the withdrawing partner's retirement ends. Bortek left the firm after 11 years to work for another firm, and claimed entitlement to the early retirement benefits.
 - 2. **Holding:** The benefits here were bona-fide "retirement benefits," and Bortek was not entitled to them.
 - 3. **Reasoning:** The court analyzed whether the Riker, Danzig agreement set forth a "bona fide retirement arrangement" as opposed to a disguised restrictive covenant. The court focused on the usual factors: (i) minimum age and length of service requirements; (ii) the existence of benefit computation formulas; (iii) a lengthy, definite payout; (iv) the fact that benefits increase as years of service to the firm increase; (v) the fact that payments are made to the retiring partner's

estate; (vi) a distinction between the payout for retiring partners and those who are just withdrawing; and (vii) benefits funded with post-withdrawal monies. The retirement benefits are no less legitimate because of the exception for public service, which the court clearly wants to encourage. The court asked its Professional Responsibility Rules Committee to consider more carefully defining “retirement benefits” in MR 5.6. The court also asked the Committee to evaluate another aspect of the Riker, Danzig agreement: the 90-day notice of withdrawal provision. **[Note: this case provides a good summary of other N.J. cases disallowing forfeiture for compensation provisions that are disguised as retirement plans, and distinguishes those provisions from the ones at issue here.]**

- ii. *Groen, Laveson, Goldberg & Rubenstone v. Kancher*, 362 N.J. Super. 350, 827 A.2d 1163 (App. Div.), *certif. den.*, 178 N.J. 35 (2003)
 1. **Facts:** Kancher left Groen to join another law firm (“Schaffer”). The Groen partnership agreement requires all partners who leave the firm to pay the firm 50% of all fees earned on contingency fee cases that had started at Groen and were taken to the new firm. Kancher refused to pay the percentage of the fees, claiming this provision violated Rule 5.6.
 2. **Holding:** This provision does not violate Rule 5.6, because (a) the financial disincentive for Kancher continuing to represent the former Groen clients at his new firm was not substantial enough to run afoul of the Rule, and (b) Groen was entitled to obtain a portion of the fees ultimately earned on cases it had worked on and invested in.
 3. **Reasoning:** Although noting that the 50% payment created some financial disincentive for Kancher taking on former Groen clients, the court nevertheless distinguished this case from *Jacob*, which involved non-contingent fee cases, and *Leonard & Butler, P.C. v. Harris*, 279 N.J. Super. 659, 653 A.2d 1193 (App. Div.), *certif. den.*, 141 N.J. 98 (1995), where the departing lawyer had to give the former firm 100% of contingency fees ultimately earned on matters he took to the new firm. It held that the partnership agreement here was not as restrictive as in those cases, and that the record failed to demonstrate “that the agreement prevented, as a matter of fact or economic reality, Kancher’s ability to continue his practice or to handle cases that clients wanted him to take from the plaintiff firm.” Moreover, to permit Kancher to keep the entire contingent fee, or even to limit Groen to a lodestar amount, would give Kancher a windfall, since Groen is entitled to be compensated both for the work it did on the case and the risk it took. **[Note: The court’s decision features an extensive, nation-wide review of cases involving provisions in which partners agree as to the split of future contingent fees if departing partners take cases with them, and how those provisions impact Rule 5.6.]**
- iii. *Jacob v. Norris, McLaughlin & Marcus*, 128 N.J. 10 (1992)
 1. **Facts:** Plaintiffs left defendant firm which had a “service termination agreement” in the shareholder agreement that barred plaintiffs from collecting termination compensation if they continued to represent defendant firm clients or solicit defendant firm employees within one year of withdrawal. When plaintiffs left they took some associates and a paralegal with them along with some clients. The

shareholder agreement drew a sharp distinction between competitive and non-competitive departures - it provided that with a competitive departure the partner had no right to receive any termination compensation.

2. **Holding:** The provision violated MR 5.6.
3. **Reasoning:** The court noted that any provision that operates to restrict a lawyer's post-termination practice is in contravention of MR 5.6. Not only does the rule prohibit outright limits on the practice of law but also reaches indirect restrictions such as financial disincentives to compete. Such restrictions, the court reasoned, violate both "the language and the spirit" of the Rule: they encourage lawyers to drop certain clients, which in turn would interfere with the client's right to choose counsel. The court articulated why a special rule should be applied to lawyers that does not apply to other businesses: "clients are not merchandise, lawyers are not tradesmen," and "restrictive covenants inappropriately barter in clients." (The court did not explain why lawyers get a different rule than doctors, other than by suggesting that the attorney-client relationship is unique because it is "consensual and highly fiduciary on the part of counsel.") The court further stated that it did not matter if the denied compensation was "earned" or "additional"; all that mattered was that payment was being denied in violation of the Rule. The question "is not what income the departing partner has a 'right' to receive, it is the effect of the terms of payment on the lawyer's decision to decline or accept those clients who wish to choose him or her as counsel." The court eagerly took the majority view on restrictive covenants, noting that "although law firms are understandably concerned about their financial well-being in view of the increasing fluidity of law-firm membership, that fluidity only justifies a heightened vigilance against any form of restrictive covenant." Nevertheless, the court was willing to make one concession: "[i]n computing a withdrawing partner's equity interest in the former firm, accounting for the effect of the partner's departure on the firm's value is not unreasonable." A partner's departure may affect the value of the firm's good will, since it may affect the willingness of clients to return to the firm, so good will can be taken into account in valuation of the partner's interest in the firm.. Lastly, the "practice of law" entailed the lawyer's right to solicit personnel equipped to service his clients, so the restriction on solicitation of employees was also void.

j. New York

- i. *Hackett v Milbank, Tweed, Hadley and McCloy*, 86 N.Y.2d 146 (1995).
 1. **Facts:** Defendant law firm's partnership agreement stated that supplemental payments would be available to all withdrawing partners, whether competing or not, but those payments would be reduced dollar for dollar to the extent that the withdrawing partner's income, from any source, exceeded \$100K. Plaintiff claimed that defendant firm owed him sums he earned while a partner at the firm. The defendant denied him this money and the matter was turned over to an arbitrator who concluded that the provision denying plaintiff the sums was enforceable. The arbitrator determined that the terms and conditions on the withdrawal payments were "inconsistent with an intention to approximate a share of undistributed earned income," and thus more resembled a "safety net for partners withdrawing for lower paying jobs" than a forfeiture-for-competition

- clause barred by DR 2-108. Moreover, because the provision applied to all withdrawing partners, it was “competition neutral.”
2. **Holding:** The clause was held to be enforceable because the arbitrator’s award did not on its face contravene public policy, and thus there was no ground for vacatur under N.Y. Civ. Pract. Law & Rules, §7511 (grounds for vacating arbitration award).
 3. **Reasoning:** The court agreed with the arbitrator that the clause was not anti-competitive on its face as the reduction applies no matter the source of the withdrawing partner’s income, and does not penalize partners who withdraw to compete more than other withdrawing partners. Thus, deferring to the arbitrator’s finding that the clause was a “safety net,” the court did not find that the award, on its face, violated New York public policy as embodied in DR 2-108(A).
- ii. *Denburg v. Parker Chapin Flattau & Klimpl*, 82 N.Y.2d 375 (1993)
1. **Facts:** Parker, Chapin had a partnership agreement requiring withdrawing partners who practiced law in the private sector during a five year period to pay either a percentage of the departing partners’ share of net profits (as calculated under the agreement) or a percentage of billings for former Parker Chapin clients who had moved to the departing partner’s new firm. The agreement made exceptions for departing partners who had earned less than \$85K in the previous year, but only if that partner’s new firm did no work for former or current Parker Chapin clients for a period of two years. Plaintiff left the firm and defendant firm demanded sums under the agreement.
 2. **Holding:** The provision was invalidated because it violated DR 2-108, as interpreted by *Cohen*.
 3. **Reasoning:** The court reiterated that financial disincentives to compete are objectionable as well as outright prohibitions as they affect a client’s right to counsel. However, *the court acknowledged that a firm has a legitimate interest in protecting its own economic well-being*. Parker Chapin argued that the clause in question had been made effective only for five years because it was intended to protect the firm, which had just undertaken large loans. Yet the court focused on the effect, not the intent, of such financial disincentive provisions and noted in this case that the provision applied only to lawyers continuing in private practice, and not to other lawyers leaving for equally lucrative in-house positions; even the exception for low paying lawyers applied only if there was no competition. Finally, in contrast to the *Hoffman* decision in Illinois, the fact that partners left despite the clause was not considered sufficient to save it, as the amounts forfeited, about \$25K, were substantial and did provide some financial disincentive to competing with the firm.
- iii. *Cohen v. Lord, Day & Lord*, 75 N.Y.2d 95 (1989)
1. **Facts:** Plaintiff left defendant firm and demanded a departure payment due under the terms of the partnership agreement that was calculated based on the firm’s profits while the partner was working there. The defendant firm denied him this payment as the partnership agreement contained a clause which provided that the departure payment would be forfeited if the withdrawing partner continued to practice law anywhere defendant firm had an office or in a contiguous jurisdiction.

2. **Holding:** The clause was void as against public policy and violated DR 2-108(A).
 3. **Reasoning:** The court noted that the provision was not an outright prohibition on practice, but that it exacted significant monetary penalties and therefore (a) constituted an impermissible restriction on the practice of that lawyer; and (b) discouraged a withdrawing partner from servicing clients who may want to continue with him as counsel. Further, the court noted that the plain language of DR 2-108(A) indicated that financial penalties could constitute “restrictions on the practice of law” or there would be no need to specifically exempt those dealing with retirement. The court noted that while the firm does have an interest in protecting its economic well being, it cannot do so by contracting for the forfeiture of *earned* revenues. The firm’s effort to have the withdrawal payment characterized as a “retirement benefit” failed: retirement benefits were dealt with in a separate section of the partnership agreement. As the court stated: “to treat departure compensation as a retirement benefit would invert the exception into the general rule, thus significantly undermining the prohibition against restraints on lawyers practicing law.”
- iv. *Judge v. Bartlett, Pontiff, Stewart & Rhodes, P.C.*, 197 A.D.2d 148 (3d Dept. 1994)
1. **Facts:** Plaintiff left defendant firm which had a forfeiture for competition clause in its employment agreement. The clause provided that if a partner left the firm and practiced law within a 30 mile radius then the contractually-provided termination pay would be reduced by 75%. The defendant firm maintained that this pay was not “earned but uncollected fees” under *Cohen* as the firm was not a partnership but a corporation in which employees were governed by the employment contract and had no right to a share of client fees.
 2. **Holding:** The provision of the employment agreement was void under DR 2-108.
 3. **Reasoning:** The court refused to differentiate the effect of forfeiture for competition clauses where the entity in question was a professional corporation and not a partnership, and where the payment forfeited involved monies earned *after* the departing partner left the firm. Further, the court noted that DR 2-108(A) specifically addresses employment agreements. Lastly, the court, citing *Denburg*, focused on the effect rather than the supposed intent of the agreement and found the effect was to restrict competition with the firm.
- k. **Oregon**
- i. ***Hagen v. O’Connell, Goyak & Bali, P.C.*, 68 Ore. App. 700 (Ct. App. 1984)
 1. **Facts:** Plaintiff was an attorney and shareholder in the defendant, a legal professional corporation. A buy-sell agreement existed between the corporation and its shareholders that provided upon voluntary termination that the departing attorney’s shares would be bought back at a penalty. The penalty was (a) a 40% reduction if the departing partner refused to sign a binding non-competition agreement with the firm; and (b) an additional reduction based on the amount of fees generated by clients the departing partner took with him. Defendant said this was not a restriction on competition, but simply a reflection of the loss of value in the corporation once the attorney left with clients.

2. **Holding:** The portion of the provision involving the 40% penalty was in violation of DR 2-108(A), but the provision reducing the stock value based on the amount of fees generated by departing clients was not.
 3. **Reasoning:** The court noted that an attorney was punished for leaving regardless of whether clients went with him, so the provision went beyond anti-raiding. Indeed, it provided a financial incentive to induce the lawyer to sign a binding anti-competition provision, and thus clearly ran afoul of DR 2-108(A). The court did note, however, that a corporation does have the right to adjust the value of its stock according to the financial impact caused by a withdrawing shareholder. The adjustment may be determined by a formula determined by the firm so long as it bears a “reasonable relationship to the probable loss to the firm.”
- ii. *Gray v. Martin*, 63 Ore. App. 173 (1983)
1. **Facts:** Plaintiff and defendant were partners, and their partnership agreement contained a provision for voluntary withdrawal. The provision mandated that if a client left the firm with the partner then any monies for unbilled time on completed and uncompleted matters would be the property of the firm. Further, if a partner withdrew and competed within a limited geographic area the firm did not have to pay the partner a share of the earned profits.
 2. **Holding:** The part of the agreement terminating payments to withdrawing partners who compete was void as against DR 2-108(A).
 3. **Reasoning:** The court reasoned that the provision was facially invalid as it prohibited an attorney from practicing in certain geographic areas lest he lose his benefits.

I. Pennsylvania

- i. ***Capozzi v Latsha & Capossi, P.C.*, 2002 P.A. Super. 102 (2002)
 1. **Facts:** Plaintiff and defendant formed their own law firm (a professional corporation). Soon thereafter plaintiff experienced prolonged problems with alcohol and began overbilling clients. The firm found out and returned the money to the clients. Plaintiff later left the defendant firm with many of the firm’s clients who had not been aware of the overbilling. When the defendant firm had been incorporated there had been an oral agreement among the partners that if any shareholder left the firm or competed with the firm, that shareholder would receive only the amount of capital he contributed for his stock. There was never a written agreement. Plaintiff asserted this was a restriction on his ability to practice and was unenforceable under MR 5.6.
 2. **Holding:** The valuation clause is enforceable in Pennsylvania, since a “rule of reason” should apply to restrictive covenants among lawyers, just as it does to restrictive covenants in other employment contracts.
 3. **Reasoning:** The court adopted *Howard, supra*, and reasoned that a “forfeiture for competition clause serves as a sufficient tool to allow attorneys to leave a practice with one firm to start another,” while “afford[ing] protection for the existing firm” and “not directly hinder[ing] the practice of law.” The court distinguished “financial disincentive clauses” (acceptable) from “direct restrictive covenants” which place a “blanket or geographic” ban on a lawyer’s ability to practice (unacceptable). Notwithstanding, “the clause [here] affords protection to the original firm, and does not directly hinder the practice of law.” However, such a

clause must still meet the tests for acceptable restrictive covenants: (1) ancillary to the main propose of a lawful transaction, (2) reasonably necessary, (3) supported by consideration and (4) limited in application.

m. Tennessee

- i. *Arena v Schulman, LeRoy & Bennett*, 2006 Tenn. App. LEXIS 696 (Tenn Ct. App. October 27, 2006)
 1. **Facts:** Plaintiff voluntarily withdrew from defendant firm. Defendant firm had a shareholder agreement that provided that if a shareholder left and competed then the departing shareholder had to forfeit 50% of all fees in matters that the shareholder took with him if the shareholder remained in the county, and had to pay 100% of his share of the costs on matters that he left with the firm.
 2. **Holding:** The provision was a significant disincentive to practice law in a specific geographic area and therefore invalid under MR 5.6.
 3. **Reasoning:** The financial disincentive was tied to practicing law in competition with defendant firm and that connection constitutes an impermissible restraint on the practice of law whether intended or not. While an agreement requiring a departing partner to pay a blanket percentage of fees earned on matters taken from the firm would have been acceptable, this agreement attached an economic value to files only if the departing lawyer remained in a limited geographic area and competed with the firm. If plaintiff had left the area (as he apparently thought about doing, but did not because the clients wanted him to stay in the restricted area), then there would have been no problem.
- ii. *Spiegel v. Thomas, Mann & Smith, P.C.*, 811 S.W.2d 528 (Tenn. 1991)
 1. **Facts:** Shareholder agreement provided that deferred compensation was payable only to those shareholders who left but did not “continue in the practice of law.” If a shareholder left but went into another field, then compensation would be paid. Plaintiff left the firm to become in-house counsel and demanded payment, maintaining that he was no longer “in the practice of law.”
 2. **Holding:** The agreement was unenforceable under DR 2-108(A).
 3. **Reasoning:** By taking an in-house legal position, the plaintiff continued in “the practice of law,” and thus fell under the penalty provisions of the shareholders agreement. Nevertheless, that provision runs afoul of DR 2-108(A), which prohibits “bartering in clients by the use of restrictive covenants.” The court applied *Cohen*, and noted that the agreement provided a financial disincentive for the continued practice of law. The provision was not a “retirement benefit,” because it applied to all partners leaving the firm, no matter what the reason.

n. Texas

- i. *Whiteside v Griffis & Griffis, P.C.*, 902 S.W.2d 739 (Tex. App. 1995)
 1. **Facts:** Plaintiff became a partner and then shareholder in defendant firm which executed a restrictive stock agreement. Under the agreement, if a shareholder left the firm, he had to sell his stock back to the firm at book value. Goodwill would be included to enhance the value only if the shareholder did not compete within a certain radius for a period for five years. Plaintiff asserted that the agreement violated DR 2-108(A).
 2. **Holding:** The agreement was in violation of DR 2-108(A) and unenforceable.

3. **Reasoning:** The court had to decide whether this indirect restriction via a financial disincentive to practice law violated the DR. The court rejected *Howard, supra*, and the minority view, and reasoned that even an indirect financial disincentive such as the one at issue violated the DR. The court focused on the strong public policy concerns voiced in the courts that had adopted the majority view. This was the first time the courts of the state of Texas had passed on the issue. The court declared: “While an indirect financial disincentive against competition or a reasonable covenant not to compete may have vitality in a commercial setting, we believe the strong public-policy concerns surrounding client choice warrant prohibition of lawyer restrictions.” Plaintiff’s victory, however, was pyrrhic, because the court refused to sever the good will provision from the rest of the void provision, and did not award plaintiff the good will payment he sought.

o. Virginia

- i. ***Shuttleworth, Ruloff & Giordano v. Nutter, 254 Va. 494 (1997)*

1. **Facts:** When the Shuttleworth firm was entering into an eleven year lease extension, Nutter, an employee and shareholder of the firm, executed an addendum to his employment agreement in order to address his personal guaranty on the lease. Under the relevant portion of the addendum, Nutter agreed that if he left the firm “voluntarily or involuntarily,” he would remain liable on a monthly basis for his proportionate share of the lease payments. The exceptions: if Nutter died, became disabled, was appointed to the judiciary, was terminated involuntarily by less than majority vote and, most importantly, if he stopped practicing law after the first five years. Nutter challenged the agreement as violating the Virginia equivalent of DR 2-108(A).
2. **Holding:** The addendum did not violate the Disciplinary Rule because its purpose was not to restrict competition.
3. **Reasoning:** The court contrasted the addendum with “forfeiture for competition” clauses in other cases, which punished lawyers for competing in the same geographic area, for practicing a particular kind of law, or for taking the firm’s clients. Here, the purpose was to “insure that Shuttlesworth had the financial means with which to make the lease payments.” The relevant portion of the addendum did not make the payment provision contingent on Nutter’s practice of law as to geographic area, subject matter or clientele. Moreover, Nutter’s obligation to pay was absolute during the first five years, not contingent on his continued practice of law.