Noncompete Agreements for Attorneys *Are We Now Fair Game?*

By Daniel D. Quick

Fast Facts

Attorney noncompetes are historically prohibited by ethics rules and concerns about client choice.

California and Arizona have endorsed reasonable agreements that impose liquidated damages in the event of post-employment competition by an attorney.

Michigan has not ruled on the issue, but the trend suggests at least limited recognition of attorney noncompetes.

Introduction

Despite judicial acceptance of noncompetes in numerous industries, including the medical profession,[1] attorneys have historically been treated differently. Relying on portions of the Rules of Professional Conduct, attorneys often consider their personal relationships with clients and the concept of client choice as superseding any basis for a noncompete agreement. In the vast majority of jurisdictions, courts have steadfastly refused to countenance attorney noncompetes.

Beginning with a 1993 decision in California,[2] and now followed by a recent opinion in Arizona,[3] not all courts have seen the necessity of giving attorneys special standing. Is an attorney's client's interest in selecting the attorney of his choice really sacrosanct? Is it really different from, say, the right of a patient to select her own physician, which many courts have held an inadequate basis on which to strike down physician noncompetes? In short, are the reasons supporting the ban on attorney noncompetes outdated and unsupportable?

Because the Michigan Supreme Court has not definitively decided whether noncompetes are enforceable in the legal profession, Michigan caselaw is somewhat unclear on this issue. But Michigan appears to be tentatively joining the group of states permitting noncompetes in areas that were previously taboo, such as, for example, physicians. Are attorneys next?

This article does not answer the complex set of issues inherent in the question of whether attorney noncompetes should be enforceable and under what circumstances. But the topic raises hard questions and challenges long-cherished notions about our profession, which may soon have to be decided by Michigan courts.

The Traditional Stance against Attorney Noncompetes

Before 1985, all noncompetes were unlawful in Michigan.[4] As applied to attorneys, additional complications were presented by legal ethics rules. Michigan Rule of Professional Conduct (MRPC) 5.6 states:

> A lawyer shall not participate in an offering or making of: (a) an employment or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement or as permitted in Rule 1.17; or (b) an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a controversy between private parties.[5]

This provision of the MRPC was adopted in 1988, and a similar rule previously existed as Michigan Code of Professional Responsibility DR 2-108. The justification for the rule is stated plainly in the Comment to the Rule: "An agreement restricting the right of a lawyer to practice after leaving a firm not only limits the lawyer's professional autonomy but also limits the freedom of clients to choose a lawyer."[6]

The American Bar Association has, since the early 1960s, taken a strong stand against attorney noncompetes, even though they were upheld by some courts earlier in the century. From the 1960s forward, a nearly unbroken string of cases upheld the per se rule against attorney noncompetes.[7] A recent, yet representative, case is *Karas v Katten Muchin Zavis Rosenman*[8] from New York. The plaintiff, a former employee of the defendant, claimed that the defendant breached its employment severance contract, which provided that the plaintiff "will be entitled to…$200,000 per year… so long as he does not and has not worked for another law firm."[9] The plaintiff claimed that he built goodwill for the firm and that the annual payments were installment payments for that goodwill.[10] The defendant maintained that the payments were intended as consideration for the plaintiff's refraining from competition with his former firm.[11]

The *Karas* court analyzed the noncompete agreement under New York's Code of Professional Responsibility, which is generally similar to the MRPC.[12] The court held that the agreement was unenforceable, explaining that "restrictions on the practice of law that include 'financial disincentives' against competition…are objectionable primarily because they interfere with the client's choice of counsel."[13] Furthermore, the court stated that even restrictions on competition of limited duration are unenforceable "where the effect of the agreement is to 'exact a penalty upon a withdrawing partner who competes with [the firm] by servicing its former clients[.]'"[14]

Courts Begin to Enforce Attorney Noncompetes

As in so many other things, California has taken a different view. In *Howard v Babcock,*[15] the California Supreme Court upheld a law firm provision that required complete or partial forfeiture of accrued capital if a departing attorney competed with the law firm. The Court was careful to draw a distinction between an indirect noncompete—a liquidated damages clause triggered by competition (sometimes called a "pay to play" provision)—and a direct noncompete containing an outright ban on competition:

> We consider it obvious that an absolute ban on competition with the partnership would be per se unreasonable, and inconsistent with the legitimate concerns of assuring client choice of counsel and assuring attorneys of the right to practice their profession. We agree with the court in *Haight*, [*Brown, & Bonesteel v Superior Court*], 234 Cal.App.3d 963; 285 Cal.Rptr. 845 [1991], however, that to the extent the agreement merely assesses a toll on competition within a specified geographical area, comparable to a liquidated damage clause, it may be reasonable.[16]

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In reaching this opinion, the Court met its critics head on. In response to the "lofty assertions about the uniqueness of the legal profession" and the primacy of client choice, the Court countered with the "reality" that clients are already sometimes limited as to whom they retain as counsel (for example, if a conflict exists).[17] Moreover, the Court branded the bemoaning of the dissenting judge that law is a "profession" not a "business" as "rhetoric that appears to obscure, rather than clarify, the problem," and as "unpersuasive and unreflective of reality."[18]

Recently, Arizona sided with California. In *Fearnow v Ridenour, Swenson, Cleere & Evans, PC,*[19] a former law partner sued his law firm seeking to invalidate a provision of his shareholder agreement that required him to relinquish stock for no compensation upon leaving the firm and competing. Notwithstanding Rule 5.6, the Court instead stated that noncompete agreements "should be evaluated under the well-established law governing similar restrictive covenants in agreements between non-lawyers."[20]

> We are unable to conclude that the interests of a lawyer's clients are so superior to those of a doctor's patients (whose choice of a physician may literally be a life-or-death decision) as to require a unique rule applicable only to attorneys. The language of [Rule] 5.6 does not support such a sweeping special treatment of lawyers, nor does protection of clients mandate such a result.[21]

Accordingly, the Court adopted a reasonableness standard similar to that applied in the Michigan Antitrust Reform Act, and held that reasonableness "depends on the whole subject matter of the contract, the kind and character of the business, its location, the purpose to be accomplished by the restriction, and all the circumstances which show the intention of the parties."[22] Like the Court in *Howard,* the Court in *Fearnow* only sanctioned reasonable liquidated damages provisions, and expressly stated that it would hold as unenforceable "agreements that forbid a lawyer to represent certain clients or engage in practice in certain areas or at certain times."[23]

The Status in Michigan

The Michigan Supreme Court has not definitively ruled on the issue of noncompete agreements in the legal profession. In *Evans & Luptak, PLC v Lizza,*[24] the Michigan Court of Appeals held that contracts that violate ethical rules for attorneys violate public policy and are therefore unenforceable. The question thus becomes what the intent is behind MRPC 5.6 and whether a noncompete agreement conflicts with the rule.

The Court of Appeals somewhat addressed the issue in *McCroskey, Feldman, Cochrane & Brock, PC v Waters.*[25] There, a partner at a law firm signed an agreement which provided that, if he left the firm and represented clients of the firm, he would pay, depending on the status of the case, up to 75 percent of his fee back to the firm. In holding that the agreement did not violate Rule 5.6, the Court relied on testimony that the purpose of the provision was not to limit competition but to provide a mechanism for calculating the split of attorneys fees between the firm and the departing attorney when the client decided to move an active file from the firm to the departing partner.[26]

McCroskey was followed under similar facts in an unpublished opinion.[27] But, in two ethics opinions, *McCroskey* has been construed as limited to the circumstance of resolving a contingency fee-splitting issue.[28] In both opinions, issued in 1995 and 1998, the ethics panel took pains to reinforce the point that attorney noncompetes remain prohibited by MRPC 5.6. As stated in RI-305:

> The instant language does not constitute a penalty or create unfair competition between the withdrawing or expelled partner and the continuing partnership, since the language acknowledges the departing lawyer's right to continue to practice and represent former clients of the partnership. While the language may impose a financial burden on the departing lawyer, the burden does not *per se* amount to an actual restriction on the departing lawyer's right to practice law. The partnership agreement is an attempt to fix the fee the continuing partnership is entitled to in light of the amount of work done on a given file before the file leaves the continuing partnership, a practice specifically approved of by the Michigan Court of Appeals.[29]

This same rationale might support a liquidated damages attorney noncompete similar to that at issue in *Howard* and *Fearnow.*

A final case of note regarding noncompetes is *St Clair Medical PC v Borgiel.*[30] *Borgiel* involved a liquated damages noncompete provision in the medical profession. The Michigan Court of Appeals discussed at length the appropriate standard under which noncompetes are to be analyzed, stating that "[t]his Court recently concluded that [MCL 445.761, et seq.] represents a codification of the common-law rule 'that enforceability of noncompetition agreements depends on their *reasonableness.*'"[31] The *Borgiel* court applied this standard to the physician's agreement despite "Principles of Medical Ethics" issued by the American Medical Association, which had been construed (like the ABA position) as contrary to noncompete agreements.[32]

Conclusion

It is difficult to say whether Michigan courts will enforce some version of an attorney noncompete. *Borgiel* suggests that a liquidated damages provision might find favor. The topic raises a host of interesting questions, of which I will briefly note two.

First, it remains an open question for some as to whether attorneys actually deserve special treatment. Those who oppose restrictions on attorneys often invoke our status as "professionals" and bemoan the commercialization of the practice. Whether this is grasping at outdated and idealized notions or whether there indeed is something worthy that unnecessarily is being lost is a discussion that goes to the heart of some of the core tenets of our profession and our legal system.

Second, it may well turn out that decisions like *Fearnow* are simply way stations on the path toward doing away altogether with per se impediments to attorney noncompetes. *Fearnow* and *Howard* were only willing to go so far—endorsing reasonable liquidated damages provisions but expressly objecting to straightforward noncompetes. Whether there is a difference between these two sorts of agreements is not entirely clear; in practice, both can inhibit competition. In Michigan, the Supreme Court in *Follmer, Rudzewicz & Co v Kosco*[33] presaged the demise of the ban on direct noncompetes by sanctioning liquidated damages noncompete provisions as outside the scope of the statute banning noncompetes. The policy reasons endorsed in *Follmer* later were recognized as the very principles that militate toward enforcement of direct noncompetes as long as they are reasonable; indeed, in *Borgiel,* a liquidated damages noncompete was analyzed under the same reasonableness rubric as a direct noncompete.

For now, California and Arizona have drawn a distinction between liquidated damages noncompetes and direct noncompetes, but Michigan law teaches that this may be a distinction without a difference. Just as *Follmer*'s line drawing between these two types of noncompetes later gave way to a recognition that they should all be analyzed under the same standard, so too may *Howard* and *Fearnow* give rise to judicial recognition of direct attorney noncompetes as long as they are reasonable. *Borgiel* may represent the first step in this direction for enforcement of attorney noncompetes in Michigan. ■

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FOOTNOTES

1. See Quick, *Physician, meet thy covenant: Noncompete agreements in the medical profession,* 86 Mich B J 22 (May 2007).
2. *Howard v Babcock,* 863 P2d 150; 25 Cal Rptr 2d 80 (Cal, 1993).
3. *Fearnow v Ridenour, Swenson, Cleere & Evans, PC,* 138 P3d 723 (Ariz, 2006).
4. MCL 445.761, *et seq.*
5. MRPC 5.6.
6. Comment to MRPC 5.6 (Oct. 1, 1991).
7. For a more in-depth discussion of attorney noncompetes and the policy reasons behind MRPC 5.6, see 6 Williston, Contracts (4th ed), § 13.7 (online update through May 2008); *Enforceability of Agreement Restricting Right of Attorney to Compete with Former Law Firm,* 28 ALR 5th 420 (1995 and supp); American Bar Association, Annotated Model Rules of Professional Conduct 491–498 (5th ed, 2004); Ewald, *Agreements restricting the practice of law: A new look at an old paradox,* 26 J Legal Prof 1 (2002); Hamilton, *Are we a profession or merely a business? The erosion of Rule 5.6 and the bar against restrictions on the right to practice,* 22 Wm Mitchell L R 1409 (1996).
8. *Karas v Katten Muchin Zavis Rosenman, a partnership,* 2006 WL 20507 (SD NY, June 03, 2006).
9. *Id.* at 7.
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.* at 7.
14. *Id.*
15. *Howard v Babcock, supra.*
16. *Id.* at 160.
17. *Id.* at 158.
18. *Id.* at 161.
19. *Fearnow v Ridenour, Swenson, Cleere & Evans, PC, supra.*
20. *Id.* at 724.
21. *Id.* at 729.
22. *Id.* at 725.
23. *Id.* at 729.
24. *Evans & Luptak, PLC v Lizza,* 251 Mich App 187, 196; 650 NW2d 364 (2002).
25. *McCroskey, Feldman, Cochrane & Brock, PC v Waters,* 197 Mich App 282; 494 NW2d 826 (1992).
26. *Id.* at 287.
27. *Torpey v Secrest, Wardle, Lynch, Hampton, Truex, Morley, PC,* unpublished opinion per curiam of the Court of Appeals, issued August 14, 2003 (Docket No. 234956, 234973).
28. Michigan Ethics Opinions RI-245 and RI-305.
29. Michigan Ethics Opinion RI-305.
30. *St Clair Medical PC v Borgiel,* 270 Mich App 260; 715 NW2d 914 (2006).
31. *Id.* at 265–266.
32. *Id.* at 269–270.
33. *Follmer, Rudzewicz & Co, PC v Kosco,* 420 Mich 394; 362 NW2d 676 (1984).

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