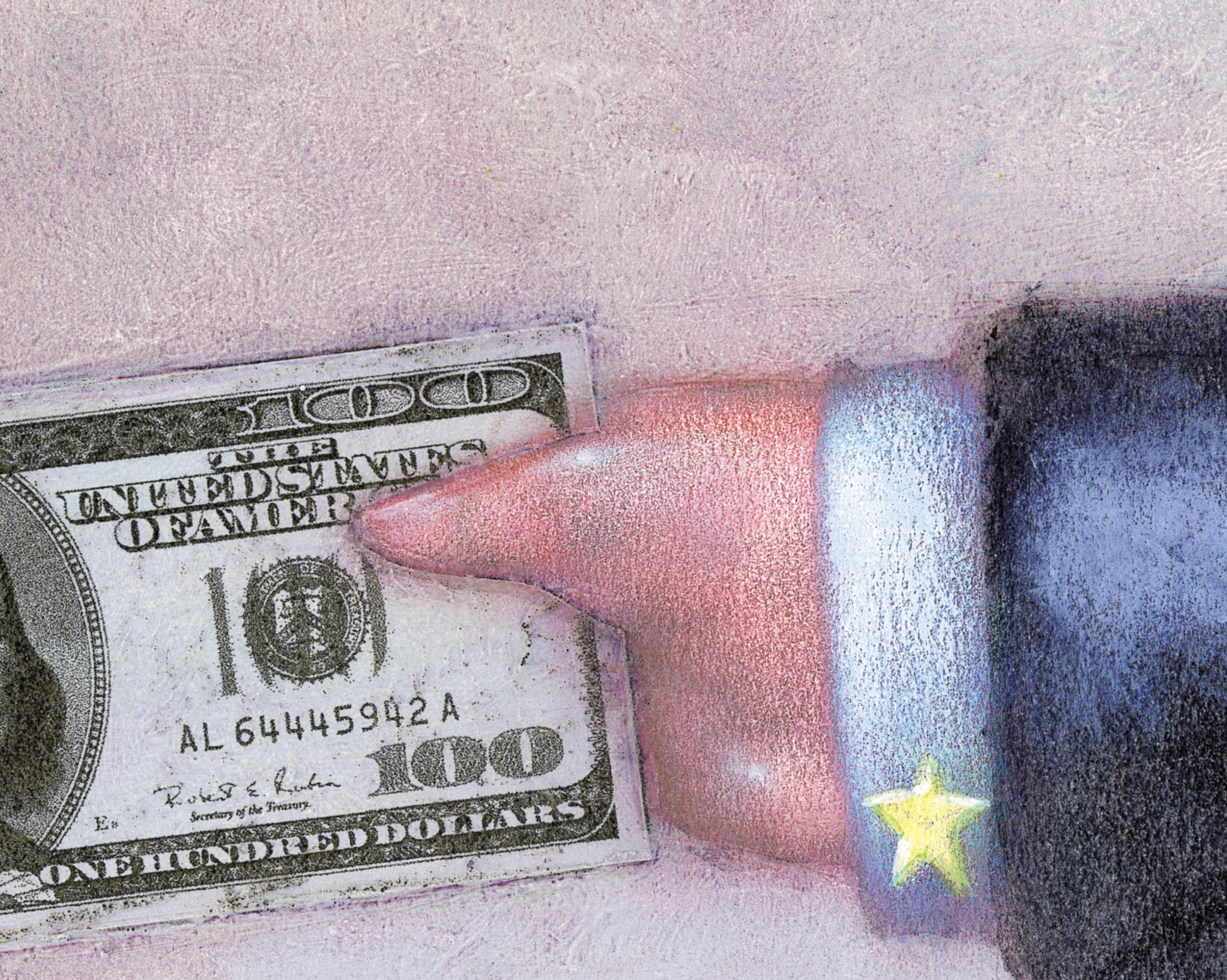
Fast Facts:

- Existing MRPC 5.6(a) bans agreements restricting the lawyer's right to practice law except in connection with retirement benefits or the sale of a law practice.
- Financial disincentives place financial penalties on the withdrawing lawyer, which have the effect of discouraging the lawyer from leaving the firm to go with a competitor and/or representing clients of the former firm in the future.

A Time for Ch



Lawyer Financial Disincentives

By Angus G. Goetz, Jr.

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There is an ethical prohibition against agreements restricting a lawyer's right to practice law in the association documents of an existing attorney relationship. There are two basic forms known as competitive restrictions and financial disincentives. The perception is that the restrictions will either curtail a departing lawyer's right to practice law on leaving one law firm to join a competing law firm or limit the client's right of free choice of counsel, or perhaps both. Each kind of restriction has been held against public policy and therefore unenforceable. This article will deal primarily with the latter, "financial disincentives."

The Michigan Rules of Professional Conduct (MRPC) 5.6 provides:

> *RULE 5.6 RESTRICTIONS ON RIGHT TO PRACTICE*
>
> *A lawyer shall not participate in offering or making:*
>
> *(a) a partnership or employment 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.*

Thus, existing MRPC 5.6(a) bans agreements restricting the lawyer's right to practice law except in connection with retirement benefits or the sale of a law practice. These exceptions to the rule are supported by the lawyer's intent to retire from practice and therefore do not seem to interfere with the client's ability to freely choose counsel.

The American Bar Association's (ABA) counterpart to MRPC 5.6 is essentially the same and substantially similar to MCPR DR2-108, effective October 4, 1971.[1]

Competitive Restrictions

Contractual provisions in law firm documents that forbid a departing lawyer from competing with the former can take the form of geographical limitations, time and association prohibitions, advertisement and communication restraints, limitations on the type of permitted practice, or a combination thereof. For example, the ABA held in Formal Opinion 300 (1961) that a covenant restricting an employed departing lawyer from practicing law in an identified community for a specific period of time was unethical because the agreement restricted the lawyer's right to practice and therefore was against public policy. In ABA Formal Opinion 1417 (1978), the ethics committee opined that an agreement among firm lawyers obligating a withdrawing partner to refrain from hiring or otherwise associating with the firm's lawyers on withdrawal was an unethical restriction on the lawyer's right to practice law even though the prohibition was for a limited period of time.

The State Bar of Michigan Committee on Professional and Judicial Ethics has said that partnership, shareholder, and employment contracts may not restrict a lawyer's right to practice law following termination of a lawyer relationship. Michigan Informal Opinions RI-86 (1991) and RI-245 (1995). As stated in RI-86:

> *"The rule (MRPC 5.6) protects future clients against having a restricted pool of lawyers from which to chose and protects lawyers from bargaining away the right to open their own offices."*[2]

Financial Disincentives

Financial disincentives generally do not forbid a departing lawyer from competing with the lawyer's former firm. Rather, they place financial penalties on the withdrawing lawyer, which have the effect of discouraging the lawyer from leaving the firm to go with a competitor and/or representing clients of the former firm in the future. The financial penalties may force the departing lawyer to forgo deferred income earned while at the firm, forfeit some of the lawyer's equity in the former firm, or obligate the departing lawyer to pay a portion of the fees earned by the lawyer from clients who elect to leave the former firm with the departing lawyer. Agreements by which a departing lawyer must forgo otherwise accrued financial benefits have been upheld unless the denial applies to all departing lawyers whether or not going into a competitive practice.

While courts in many jurisdictions have held that financial disincentives have the same effect as restrictive covenants because the financial penalty imposes on the departing lawyer an obligation to turn away potential clients, a reasonable compromise to the economic situation seems appropriate.

A Time for Change

Modern-day law practice can be capital intensive, involving an enormous cash flow—especially in the larger firms. Law firms can accumulate a significant number of unbilled hours or time billed and unpaid. The matter may be on a contingency with substantial costs advanced and time spent in production of the matter. Firms are committed to pay for rent on space, equipment contracts, personnel training, and other expenses while the firm's income may fluctuate depending on the general state of the economy and the comings and goings of substantial clients and experienced lawyers. Should not the legitimate business interests of the law firm be accommodated? Can the law firm's economic dilemma be recognized by reaching some sensible solution that will harmonize clients' interest in freedom of choice of counsel with the economic interests of lawyers? After all, the profession is a business much like other service industries. The legitimate business

concerns of lawyers should not go uncompensated just because some practices were once held unethical, so long as the total fee charged the client is not excessive under MRPC 1.5. Agreements among lawyers parceling out fees should not be the concern of clients so long as the total fee is reasonable and the client is not unduly restricted in a choice of counsel.

Michigan recognizes that not all reductions in the size of departure compensation due a withdrawing attorney are unethical. In *McCroskey, Feldman, Cochrane & Beck, PC v Waters,*[3] the court held that an employment agreement between a law firm and its individual members that provides for a vision of an already existing fee in the event of a lawyer's departure did not violate the rule against restrictions on the right to practice law. The court said, "...We conclude that the agreement (50-50 share of post departure fees earned on work in progress at the time of departure) does not violate MRPC 5.6(a)," because the provisions are not so over-reaching that they amount to an actual restriction on the departing lawyer's right to practice law. In sum; paragraph 17 of the contract reasonably assigns to the plaintiff a ratable proportion of a given fee on the basis of the stage of the litigation at the time of departure. "The agreement is simply a mechanism for dividing an already existing fee.... We agree...that such arrangements, as long as they are reasonable, should be encouraged." Instead, the contract simply seeks to obviate time-consuming squabbles that formerly arose when a plaintiff's entitlement to his/her fair share of any fee generated by a departing client's file was determined on a quantum merit basis.[4] A similar result was reached in the New York decision of *Hackett v Milbank, Tweed, Hadley & McCoy.*[5]

Suggested Solution

A sensible solution to the financial disincentive restriction on the right to practice law problem would be to allow law firm agreements reducing the amount of departure compensation to the extent a law firm can demonstrate that the lawyer's departure reduced the firm's financial integrity and the financial penalty does not impair the ability of the departing lawyer to service clients.[6] The question is whether or not the legitimate business concerns of the law firm can be accommodated. MRPC 5.6 does not focus on the financial interests of law firms. It seems necessary and desirable to have a rule that is not inconsistent with the language and purpose of the rule and also makes good economic sense. Thus, the key is to have a rule that will harmonize the competing economic interests of the law firm while insuring that the client interests are not sacrificed.

One way to accomplish this suggested result would be to apply the MRPC 5.6 prohibition to income or benefits accrued after the lawyer's departure from the firm—not the income or benefits earned before departure. So long as the economics are reasonable, the firm should be recompensed for its loss. ✦

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Footnotes

1. DR 2-108, Agreements Restricting the Practice of a Lawyer.
   (A) A lawyer shall not be a party to or participate in a partnership or employment agreement with another lawyer that restricts the right of a lawyer to practice law after the termination of a relationship created by the agreement, except as a condition to payment of retirement benefits.
   (B) In connection with the settlement of a controversy or suit, a lawyer shall not enter into an agreement that restricts his right to practice law.
2. For a more detailed discussion of competitive restrictions see Annotated MRPC 461, et seq. (4th Ed. 1999); ABA/BNA Lawyer's Manual on Professional Conduct § 51:201 et seq. (1995); 2 Hazard & Hodges, The Law of Lawyering § 5.6:100 et seq. (2nd Edition).
3. 197 Mich App 282; 494 NW2d 826 (1992).
4. Ibid at 287.
5. 654 NE2d 95 (1995).
6. See Pettingell v Morrison, Mahoney & Miller, 687 NE2d 1237 (Mass 1997).