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The Underlying Causes of Withdrawal and Expulsion of Partners from Law Firms

Geoffrey C. Hazard, Jr.*

The law governing the withdrawal and expulsion of partners from law firms is undergoing rapid change as demonstrated in the papers presented in this symposium.[1] Under the older, traditional conception of lawyer affiliation, withdrawal or expulsion was unthinkable: Once a lawyer became a partner it was assumed that he – in the old days it was almost always "he" – stayed with the firm until death or retirement. The firm cleaved to the lawyer over the same course, or so we were led to believe.

In the good old days, decisions about membership in partnerships involved organizations that were actually partnerships and participants who were actually partners. The decision about partnership was thus crucial in a professional lifetime, a decision of perhaps the same solemnity as marriage and indeed possibly more solemn. The traditional conception was largely myth, transforming an ideal into an assumption about reality. Be that as it may, in today's world we accept marital divorce on demand, recognizing that basic social forces have required the law to permit no-fault divorce, and we similarly accept that corporate takeovers and dissolutions are inevitable. Social forces similar to those that have radically changed family life and corporate life have also changed life in law firms. Thus, in considering the evolution of the law governing law firm withdrawal and expulsion, it may be beneficial to consider the underlying social forces that drive the law to respond. What follows is a sketch of those forces rather than a detailed inventory.

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1. Leslie D. Corwin, *Response to* Loyalty in the Firm: A Statement of General Principles on the Duties of Partners Withdrawing from Law Firms, 55 WASH. & LEE L. REV. 1055 (1998); Deborah A. DeMott, *The Faces of Loyalty: A Comment on Hillman,* Loyalty in the Firm: A Statement of General Principles on the Duties of Partners Withdrawing from Law Firms, 55 WASH. & LEE L. REV. 1041 (1998); Robert W. Hillman, *Loyalty in the Firm: A Statement of General Principles on the Duties of Partners Withdrawing from Law Firms*, 55 WASH. & LEE L. REV. 997 (1998); Allan W. Vestal, *Law Partner Expulsions*, 55 WASH. & LEE L. REV. 1083 (1998).

First, these external social forces manifest themselves in changes in the character of law practice itself. Among these social forces are the manifold changes in the work performed by law firms. The following litany of changes is familiar: the specialization and hyper-specialization in lawyer functions; the increasingly rapid rate of obsolescence in legal knowledge acquired in law school as compared to relevant legal knowledge needed at later stages in a professional career; the increasing competition in law practice; the transformation of law from a local vocation practiced in the county courthouse and law offices on the town square into a national and increasingly globalized vocation; and the need to assemble large teams on short notice to deal with heavy transactions or heavy litigation. The cumulative effects of these changed conditions on law firms are similar to the cumulative effects of modern social pressures on marriage, on the family, on neighborhoods, and on business organizations. That is, the vectors of social force are strongly centrifugal.

Second, and relatedly, are changes occurring in the structure of legal service organizations. In this context, I am using the term "legal service organization" advisedly. A law firm is an organization created to perform professional services. As such, it must adapt its structural form to perform the specific work it undertakes. What constituted effective organization a century ago is not necessarily effective organization today. This change is partly due to the fact that much law practice today, although not most, is carried out in settings that are not law firms. I refer here to the law departments of corporations and of nonprofit institutions such as hospitals and universities; to prosecutorial and defender offices; to civil law departments of local, state, and federal governments; and, last and unfortunately least, to offices providing legal services for the poor.

Third, law practice within independent law firms has radically changed. Law practice in towns and smaller cities remains much as it was a half century ago, but that is not where most visible change is occurring. This change is occurring on the now familiar grounds of the large law firms. There are now more than a dozen or so law firms of five hundred lawyers or more, firms of one hundred lawyers exist all over the country, and firms of no fewer than fifty lawyers exist in virtually all cities with a population greater than 250,000.[2] Increasingly, these organizations are formed as limited liability entities partly out of concern for malpractice liability and partly because this form of organization affords greater stability and managerial control. Most larger law firms are now managed not by the partners as a whole but by a small group constituted as an executive committee. In many law firms,

2. For general statistical data concerning all aspects of law firms, see generally ALTMAN WEIL PENSA, INC., THE 1997 SURVEY OF LAW FIRM ECONOMICS (1997).

management delegates to others, often nonlawyers, such tasks as administration, hiring procedures, and internal continuing legal education. Many law firms have a corps of paralegals in numbers approximating the number of lawyers. Outside the United States, and less visibly within this country as well, the large accounting firms are employing more and more lawyers and are thought by many to be engaged in the practice of law as well as accounting. The old pathway to partnership is no longer assured. In many firms, that pathway is a nearly abandoned old trace for many young lawyers.

In reviewing these changed conditions, it is important not to overlook the fact that a majority of lawyers, including myself, are still in solo practice or in small firms.[3] Most solo practitioners and small firm lawyers have always had potentially unstable professional relationships. In the classic pattern, a young lawyer fresh out of law school or the district attorney's office joined a senior lawyer or a firm. This environment provided the young lawyer with office space, use of the library, and informal colleagueship. In return, the apprentice provided help as needed on menial and support tasks in the senior attorney's cases and was afforded the time and a base to try to build his own practice. Some young lawyers succeeded in this effort and joined the firm or left for solo practice or practice with another firm. Meanwhile, the members of the old firm might stick together, as in an old marriage, or they might not. Withdrawal and expulsion were not unknown in small firms, but the separation was called simply dissolution.

The composition of small law firms has always been in continual flux. We could call their pattern that of dissolution and recombination or of mutation. It remains that way. The law governing mutation of small law firms has been fairly simple. In economic terms, the simplicity of the law concerning withdrawal and dissolution is largely explained by the marketing position and internal finances of the typical small law firm.

The marketing position of a small law firm, yesterday and today, almost always depends on the personal reputation of each of its constituent lawyers. The senior lawyers have a following in a community consisting of either the local community or of a more remote circle of potential clients who know the lawyer or have reliable information regarding the lawyer's ability and integrity. Reputation for the solo practitioner or small firm is individual, not institutional. A solo practitioner or small firm lawyer without personal visibility to potential clients has no claim to revenue except his salary, and his salary ends when his tenure ends. If a salaried associate's work becomes unremunerative, the firm dismisses the associate. The remaining lawyers continue their practice.

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3. *Id.*

The law of employment at will governs the mutation of small law firms.[4] That legal rule ordinarily has simple application, presenting only the questions of whether the firm paid the departing lawyer until the date of termination and whether the firm made payments for taxes, social security, and benefits. In fact, senior lawyers in a typical small firm usually practice as solo practitioners operating under a common roof, engaging their partners only occasionally and marginally. Upon a dissolution, therefore, the partners can separately identify their respective clienteles for the purposes of financial accounting. Equally important, the clients have personal attachments to the lawyers who provide them service. The risk that one lawyer may "grab" the client of another lawyer in the firm is correspondingly negligible or nonexistent.[5]

Dissolution of the firm can be peaceful, resulting from a senior partner's death, retirement, or, perhaps, appointment to the judiciary. Dissolution may also result from a crisis, often a personality conflict that becomes unbearable to one or more of the parties, just like in a failed marriage. But, unlike some failed marriages, the financial relationships in a small traditional law firm are usually clear because returns from the practice have been based on personal linkage between lawyers and clients. A partnership agreement, therefore, need only take account of "flow," that is, fees earned but not collected. Calculation of these amounts is usually simple.

Even the question of firm name is simple. The departing lawyer either is no longer in practice at all or wants to use his own name in his new practice. The remaining lawyers continue to practice under their own names. What had been Jones, Smith & Schwartz becomes Jones & Schwartz.

The instances in which small firms fall into legal controversy usually appear to involve intergenerational conflict. The classic example occurs when one or more maturing, younger partners believe that they are carrying a workload that their compensation does not reflect. They cannot remedy this discrepancy because they are harnessed to senior partners who want to taper off their workloads without reducing their take.[6] The situation often is com-

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4. *See* Rodney M. Confer & Cheryl R. Zwart, *"Disintegrating Erosion" of Fiduciary Duty in the Dissolution of a Partnership at Will*, 70 NEB. L. REV. 107, 108-09 (1991).

5. *See generally* Robert W. Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving*, 67 TEX. L. REV. 1 (1988) (discussing legal implication of attorneys leaving firm and taking clients with them); Vincent R. Johnson, *Solicitation of Law Firm Clients by Departing Partners and Associates: Tort, Fiduciary, and Disciplinary Liability*, 50 U. PITT. L. REV. 1 (1988) (discussing extent to which attorney leaving firm may solicit firm's clients).

6. *See, e.g.*, Sonkin & Melena Co. v. Zaransky, 614 N.E.2d 807, 810 (Ohio Ct. App. 1992) (concerning dispute over right to clients between partnership and former associate); Adler, Barisch, Daniels, Levin & Creskoff v. Epstein, 393 A.2d 1175, 1177 (Pa. 1978) (involving partnership's suit to prevent former associates from contacting partnership's clients).

plicated by erstwhile bonds of affection between junior and senior partners. Indeed, these bonds of affection may have inhibited the juniors from pressing the issues of revenue reallocation until the financial imbalance has become serious. At this point, the conflict can be more intense because confrontation of the subject has been postponed and repressed. The parties are now at risk of a disputatious dissolution that may result in lost professional visibility and clientele, reduced revenue for all concerned, and, indeed, impairment of their sense of professional identity.

The underlying impetus for dissolution is typically economic, at least in a substantial part. The economic problem is, to put it bluntly, the allocation of firm revenues. The same dynamics can occur in larger firms. The economics of a larger law firm's practice, however, are different. This difference may well be the impetus for changes in the law governing the withdrawal and expulsion from the law firm.

The essence of the economic problem is that there is no "principled" way in which to allocate profits or losses from a joint undertaking, that is, an undertaking in which two or more people cooperate to produce a marketable product or service. In theory, an allocation can provide equal shares to each person. Such an allocation, however, will be unacceptable to a senior partner who contributes clientele and experience to the venture in which the neophyte lawyer contributes only enthusiasm and the capability of sitting in a second chair. In theory, an allocation can be made on the basis of the original unequal sharing between the senior and junior partners. This allocation, however, will be increasingly unacceptable to the junior partner as the value of his contribution increases with the enhancement of his technical and interpersonal skills. If the senior and junior partners are able to make periodic, mutually agreeable adjustments to the value of their shares, the conflicting interests are accommodated by contract, the only way that such a conflict can rationally be accommodated. If the senior and junior partners are unable to make adjustments at a mutually agreeable rate, a conflict results, and eventually, the firm dissolves.

The fundamental obstacle to mutual agreement is, of course, the difference in perception between senior and junior partners as to the relative value of their contributions as time goes by. The senior partner can be oblivious to his fading professional powers and his increasing appetite for leisure. The junior partner can have an exaggerated sense of his worth. Also, their spouses or other members of the firm may have come to detest one another.

Conflict over the withdrawal and expulsion from larger law firms and the evolution of the law governing such conflicts can be considered as more or less complicated variations of the breakup of a small senior-junior partnership. A primary problem involves determining an agreeable allocation of revenues.

Whereas in a small firm there can be recurrent tensions concerning revenue allocation, a large firm requires a systematic procedure for the adjustment of revenues over time. One such system is the "lockstep," in which lawyers are classified by seniority and all lawyers in each cohort are paid equal amounts.[7] Another option is systematic attribution in which allocations are made according to rules prescribing various credits for obtaining a client, for managing the matter, for meeting the hourly requirements, and for other contributions.[8] Both systems require auxiliary rules concerning the share of revenue to be allocated to nonpartners and to the annual bonus pool. Obviously, setting these rules can generate conflict.

Allocation systems must also address the fact that some fields of practice do not generate as high a level of revenue as others. Traditionally, for example, estate planning and probate generate a relatively low amount of revenue in comparison to commercial litigation, even when the necessary technical and interpersonal skills are comparable. Many firms want to maintain a broad array of practice areas, thus avoiding the risk of disappointing clients whose needs shift from field to field. Hence, they maintain practice in fields where the returns are unequal. Addressing this inequality may also cause conflicts. Branch offices generate a somewhat related problem, particularly when the branches are in locations where the cost of living is excessive or the living conditions are burdensome. For example, Paris is nice, but expensive; Middle East locations are expensive and not so nice; and locations within the United States offer comparable variations.

Further financial problems can arise on the expense side. For example, the firm must decide whether to adjust the compensation level for associates to be competitive with that of New York attorneys. The firm must also make decisions concerning the quality and the cost of the firm's offices. Remaining in an old building, even as that becomes "B" space, is cheaper than entering into a long-term lease in a new, prestigious high-rise building. Additionally, the firm must determine how and at what level to fund pensions.

The problem of competent management adds another dimension. All large law firms require management with a high order of skill. In a small firm, the most critical management problems may be the assignment of secretaries and parking places. In a large firm, the organization itself, including systems of authority and consultation, is continuously problematic. Lawyers are not trained in management, although some lawyers are excellent managers. Thus,

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7. *See* Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 341-42 (1985) (discussing systems of lockstep compensation for attorneys).

8. *See, e.g., id.* at 346-51 (describing method to determine partners' contributions based on productivity).

finding the best people to manage the firm and persuading them to assume that responsibility is often a process of trial and error. An arrangement that works for one period of a firm's history will not work forever, posing problems parallel to those of the maturation of junior lawyers in a small firm.

Then there is the matter of "marketing strategy," that is, the concept of how the firm defines itself and the kinds of practice it hopes to develop. Every law firm necessarily has such a concept, if only one that is tacitly shared. Yet, no group of lawyers can be of one mind as to what that concept should be. For example, is the firm to engage in a bankruptcy practice while continuing to represent banks, to represent plaintiffs in commercial litigation while representing business and financial corporations, or to establish a criminal law practice, but confine its scope to "white collar crime?" Once the firm decides upon a marketing strategy, it must decide whether to execute it with strong self-publicity or with a traditional, low-key approach.

Of course, lifestyle and aspirations concerning lifestyle cause other problems. Many lawyers enter into a law practice rather than another business because they envision an autonomy in life that seems impossible to obtain in the typical business corporation.[9] Accordingly, lawyers may envision themselves as practicing under the proverbial shingle even though, in fact, they are part of a large professional combine. Today, an additional lifestyle problem concerns marriage and family, an issue often salient with women lawyers but also present, if not as often articulated, with male lawyers. Some lawyers crave the lifestyle of a small city, but find themselves in a field of practice that requires a big city market. In a sense, these problems are variations of those posed by the wishes of traditional older lawyers to taper down their practice without tapering down their income.

Finally, there is the problem of the firm name of an established law firm. Here, withdrawing lawyers will have to abandon the name under which they have traded during the period in which they established their competence. The result can be a substantial loss. Recognition of this risk of loss may lead dissident lawyers to engage in an internal struggle for control, possibly expelling other lawyers rather than making a peaceful exit.

All these factors can be subsumed under the proposition that withdrawal and expulsion can be the result of interpersonal conflict. They also can be subsumed under the proposition in economics that there is no a priori fair way to allocate revenues and losses in a team undertaking. Accordingly, all these factors can put stress on the cohesion of a law firm's organization and thus become causes of withdrawal or expulsion.

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9. *See generally* ANTHONY T. KRONMAN, THE LOST LAWYER 128-34 (1995) (arguing that lawyers should exercise independent judgment and assess their clients' decisions).

The legal problems arising from lawyer-law firm breakups are simply a special case of the legal problems arising from the breakup of any multi-person enterprise, with one very important qualification – the intensity of the public interest in limiting the constraints on freedom of lawyers to compete for clientele in the situation after the breakup. Otherwise, the legal problems arising upon a lawyer's withdrawal or expulsion from a law firm are much the same as those arising from the breakup of any personal services enterprise. These problems include the determination and allocation of capital accounts; the determination and allocation of profits from continuing operations; the rights and restrictions regarding use of firm trade secrets, including legal forms, lists of clients, and knowledge about client needs; the rights and restrictions regarding solicitation of firm clientele; the rights and restrictions on recruitment of fellow employees for service in a new venture; and the rights and restrictions on the use of firm time and facilities in the stage of preparation before exiting.[10]

A common "procedural" problem in all dissolutions, whether of law firms or of other organizations, regards notice by the party taking initiative to the party who will be more or less surprised by the announcement. Giving reasonable notice is a matter of decency and fairness from which it would follow that the greater the lead time, the better. Yet, giving notice itself radically changes the relationship among the parties, from which it would follow that the less lead time, the better. The legal concept of "reasonable notice" represents an uneasy accommodation of these two incompatible considerations.

Under the general law, that is, the law governing co-venturers other than lawyers, the parties are governed by property law and fiduciary rules concerning their interests in the pending enterprise and by tort law concerning trade secrets, solicitation of clientele, and competition after the breakup. The rights and obligations established by these bodies of law can be modified by contract subject to vague but important rules concerning bad faith, unconscionability, and unreasonable restraints. The legal rules governing the breakup of law firms, however, are different than those covering the breakup of other kinds of personal service enterprises.

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10. *See* HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP §§ 227-242, at 342-74 (2d ed. 1990) (discussing legal issues involved in breakup of partnerships); J. William Callison, *Partnership Law Issues in the Break-Up and Dissolution of Law Firms*, 21 COLO. LAW. 409, 409 (1992) (listing issues related to partnership withdrawals and dissolutions). These economic components are captured in part by the concept of law firm goodwill. *See* Gary S. Rosin, *The Hard Heart of the Enterprise: Goodwill and the Role of the Law Firm*, 39 S. TEX. L. REV. 315, 323-31 (1998) (discussing concept of law firm goodwill). Perhaps, needless to say, there is no a priori fair way apart from contract to take account of law firm goodwill.

The legal system has a special interest in maintaining the client's freedom to choose legal counsel. This interest evolved in common-law decisions and is now reflected in Rule 5.6(a) of the Model Rules of Professional Conduct which, in turn, was drawn from DR 2-108 of the Model Code of Professional Responsibility. Rule 5.6(a) provides: "A lawyer shall not participate in offering or making . . . 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."[11] There is substantial question whether Rule 5.6(a) adequately addresses the problems of withdrawal and expulsion now that these problems occur in contexts other than the classic small firm. The developing decisional law reflects these uncertainties.[12] These issues may be addressed in the future during the course of the deliberations of the Committee on Ethics 2000 and perhaps during the American Bar Association's reexamination of the Model Rules of Professional Conduct.

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11. MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.6(a) (1983).

12. *See* Howard v. Babcock, 863 P.2d 150, 160 (Cal. 1993) (discussing developing instability of law firms and holding that partnership agreement "that assesses a reasonable cost against a partner who chooses to compete with his or her former partners does not restrict the practice of law" despite state rule based on Model Rule 5.6); Neil W. 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. REV. 1409, 1421-23 (1996) (discussing state court decisions interpreting Rule 5.6).