Washington Law Review

Volume 69
Number 1 *Dedicated to Marjorie Dick Rombauer*

1-1-1994

Enforcing Lawyers' Covenants Not to Compete

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ENFORCING LAWYERS' COVENANTS NOT TO COMPETE

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Abstract: Courts uphold most post-employment covenants not to compete if they meet a three part reasonableness test that balances the interests of the employer, the employee, and the public. Lawyers' covenants not to compete, however, are treated differently. Courts hold lawyers' agreements that prohibit competition with their former firms per se invalid, in order to preserve clients' unrestricted freedom to choose their attorneys. Courts have split on whether to apply the per se rule to invalidate lawyers' agreements that discourage rather than prohibit post-employment competition. The California Supreme Court's recent decision in *Howard v. Babcock,* applying the familiar reasonableness test to a lawyer's agreement discouraging post-employment competition, is sure to add to the controversy. This Comment critically analyzes the application of the per se rule to covenants that discourage rather than prohibit attorneys from competing with their former firms. The Comment concludes that the reasonableness test applied to restrictive covenants in other professions adequately protects client choice while giving consideration to firm interests and should apply to lawyers' covenants not to compete.

Richard Cohen headed the tax department at the venerable firm of Lord, Day & Lord.[1] After 20 years, Cohen crossed Wall Street to join the equally venerable Winthrop, Stimson, Putnam & Roberts, taking several clients with him. Understandably perturbed, Cohen's former partners declined to pay certain sums due him under the partnership agreement, citing a clause that limited payments to withdrawing partners who compete with their former firm. Cohen sued, claiming the clause in question violated ethical rules governing attorneys.[2] Ironically, the partnership agreement at Cohen's new firm contained a similar restrictive covenant. Furthermore, Cohen had previously benefited from application of the restrictive covenant to other Lord, Day & Lord partners upon their withdrawal. Apparently, Cohen even had participated in drafting the very clause he now sought to invalidate. Nevertheless, Cohen won his suit, illustrating an unusual quirk in the ethical rules governing attorneys: Sometimes lawyers' ethics compel them not to keep agreements they sign.[3]

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1. The facts in the introduction are from Cohen v. Lord, Day & Lord, 550 N.E.2d 410 (N.Y. 1989), as stated in Steven Brill, *The Partnership Breakup Follies,* Am. Law., Mar. 1988, at 3.

2. *See* Model Rules Of Professional Conduct Rule 5.6 (1992); Model Code of Professional Responsibility DR 2-108(A) (1969).

3. Gail Diane Cox, *Defect at Your Own Risk,* Nat'l L.J., Oct. 14, 1991, at 13 (paraphrasing Don Howarth, attorney for Haight, Brown & Bonesteel in Haight, Brown & Bonesteel v. Superior Court, 285 Cal. Rptr. 845 (Cal. Ct. App. 1991)).

Model Rule of Professional Conduct 5.6 and Disciplinary Rule 2-108(A) prohibit restrictive covenants between attorneys. Unlike such agreements made by professionals in other fields, courts hold attorneys' restrictive covenants per se invalid. Part I of this Comment looks at the applicability of these rules to contract actions and then examines the related question of the enforceability of agreements that merely discourage rather than prohibit competition. Part II analyzes the per se rule and its effect on law firms and attorneys. Part III concludes that the rule of reasonableness applicable to restrictive covenants in other professions should apply to lawyers.

I. COURTS EMPLOY THE PER SE RULE TO INVALIDATE LAWYERS' COVENANTS NOT TO COMPETE

A. Most Restrictive Covenants Are Subject to the Reasonableness Test

Restrictive covenants may be appurtenant to contracts involving the sale of a business or to employment or partnership agreements.[4] When businesses are sold, the sellers may promise to refrain from competition in order to protect the value of the goodwill acquired by the purchasers.[5] In the context of employment or partnership agreements, anti-competitive clauses protect employers' customer relationships and confidential information.[6] Restrictive covenants have negative effects as well. Covenants not to compete can prevent individuals from supporting themselves and their families.[7] Furthermore, post-employment restraints may harm the public if they operate to create a monopoly.[8]

Courts analyze most post-employment covenants not to compete under a reasonableness test, balancing the interests of employers, employees, and the public. A restrictive covenant will be found unreasonable if it (1) is broader than necessary to protect a legitimate interest of the employer,[9] (2) imposes an undue burden on the

4. Restatement (Second) of Contracts § 188(2) (1981).

5. *Id.* cmt. f.

6. Harlan M. Blake, *Employee Agreements Not To Compete,* 73 Harv. L. Rev. 625, 654 (1960).

7. *Id.* at 685–86.

8. *Id.* at 687. Surprisingly, enforcement of these covenants is uniformly governed by common law rather than federal antitrust law. Harvey J. Goldschmid, *Antitrust's Neglected Stepchild: A Proposal for Dealing with Restrictive Covenants Under Federal Law,* 73 Colum. L. Rev. 1193 (1973). This may be because federal antitrust law has been interpreted to prohibit only those restrictive covenants already invalid under state law. *Id.* at 1204–06.

9. *See* Mantek Div. of NCH Corp. v. Share Corp., 780 F.2d 702, 711 (7th Cir. 1986) (holding that a provision prohibiting salesmen from selling competing products in their former territories is

employee,[10] or (3) tends to create a monopoly or restrict production.[11] Courts apply the reasonableness test to covenants restricting the practice of doctors,[12] dentists,[13] veterinarians,[14] and other professionals.[15]

B. Lawyers' Restrictive Covenants Are Per Se Invalid

Lawyers, however, are treated differently. Both Model Rule of Professional Conduct (MRPC) 5.6[16] and Disciplinary Rule (DR) 2-108(A) of the Model Code of Professional Responsibility (MCPR)[17] prohibit lawyers from entering into agreements that restrict their right to practice after termination of a relationship with a firm.[18] These rules were adopted primarily to prevent lawyers from signing agreements that restrict clients' freedom to select their attorneys.[19]

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unnecessary to protect employer's interests; only a prohibition on calling former customers is reasonable).

10. *See* Ferrofluidics Corp. v. Advanced Vacuum Components, Inc., 789 F. Supp. 1201, 1210 (D.N.H. 1991) (holding that a covenant not to compete that prohibited employees from working for competing magnetic fluid manufacturers for five years is an undue burden on employees), *aff'd*, 968 F.2d 1463 (1st Cir. 1992).

11. *See* Dow v. Gotch, 201 N.W. 655, 657 (Neb. 1924) (upholding beautician's covenant not to compete as not tending to create a monopoly when city "ha[s] beauty parlors a plenty, a number of them").

12. Karlin v. Weinberg, 390 A.2d 1161 (N.J. 1978).

13. Olson v. Hillside Dental, Ltd., 371 N.W.2d 429 (Wis. Ct. App. 1985).

14. *See* Kaeser v. Adamson, No. CA-800 (Ohio Ct. App. Mar. 6, 1984) (LEXIS, States Library, Ohio file).

15. *See, e.g.*, Mailman, Ross, Toyes, & Shapiro v. Edelson, 444 A.2d 75 (N.J. Super. Ct. Ch. Div. 1982). *See generally* Samuel Williston, *Williston on Contracts* § 1639 (3d ed. 1972).

16. MRPC 5.6, in relevant portion, reads:

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 . . . .

Model Rules of Professional Conduct Rule 5.6 (1992).

17. DR 2-108(A) reads: "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 . . . ." Model Code of Professional Responsibility DR 2-108(A) (1969).

18. Every state except California has adopted ethical rules based on the MRPC or the MCPR. *See* Charles W. Wolfram, *Modern Legal Ethics* 56, 62 (1986). California is governed by the California Rules of Professional Ethics. *Id.* at 64. The provisions regarding lawyers' restrictive covenants are nearly identical in each state and it is unimportant for the purposes of this Comment which system a state has adopted.

19. 2 Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* 824 (2d. ed. Supp. 1992). The ABA Committee on Professional Ethics originally opposed lawyers' covenants not to

Ethical codes, however, are not law.[20] Both the MCPR and the MRPC disclaim any attempt to govern civil actions.[21] Violations of these rules may give rise to professional discipline, but are not by themselves a basis for civil liability.[22] Thus, in an action by a law firm or an attorney to enforce a covenant not to compete, the ethical codes are not directly controlling.

Nevertheless, courts may look to the codes for guidance, and to provide a remedy if appropriate to the nature of the violation.[23] Most courts have concluded that the public policy embodied in MRPC 5.6 and DR 2-108(A), the right of clients to unrestricted choice of counsel, is furthered by invalidating partnership or employment agreements that conflict with the rules.[24] These courts have developed the per se rule of invalidity: Unlike restrictive covenants in other professions, which are

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compete because they smacked of commercialism. ABA Comm. on Professional Ethics, Formal Op. 300 (1961). To the committee, agreeing to restrictive covenants was akin to bartering in clients, and was inconsistent with a lawyer's professional status. *Id.* Furthermore, the committee believed lawyers' restrictive covenants were unnecessary because attorneys were already prohibited from soliciting the clients of their former firms. *Id.* Lawyers today have much more freedom to pursue clients than in 1961. *See, e.g.*, Model Rules of Professional Conduct Rule 7.3 (1983) (allowing attorneys to solicit clients with whom they have a prior professional relationship). By the time the ABA adopted DR 2-108(A) in 1969, the rationale for prohibiting attorneys' covenants not to compete had changed from preventing "bartering" of clients to preserving clients' freedom to choose their attorneys. ABA Comm. on Ethics & Professional Responsibility, Informal Op. 1072 (1968) (reasoning that an attorney must "be available to prospective clients who might desire to engage his services").

20. Courts and legislatures adopted the codes to "authoritatively measur[e] a lawyer's liability to professional discipline." *See* Wolfram, *supra* note 18, at 51.

21. The Model Code does not "undertake to define standards for civil liability of lawyers for professional conduct." Model Code of Professional Responsibility, Preliminary Statement (1969). The Model Rules provide in part:

> Violation of a Rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The Rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability. Furthermore, the purpose of the Rules can be subverted when they are invoked by opposing parties as procedural weapons. The fact that a Rule is a just basis for a lawyer's self assessment, or for sanctioning a lawyer under the administration of a disciplinary authority, does not imply that an antagonist in a collateral proceeding or transaction has standing to seek enforcement of the Rule.

Model Rules of Professional Conduct, Scope (1983).

22. Wolfram, *supra* note 18, at 51.

23. *Id.* at 52.

24. Cohen v. Lord, Day & Lord, 550 N.E.2d 410, 413 (N.Y. 1989); *accord* Jacob v. Norris, McLaughlin & Marcus, 607 A.2d 142, 155 (N.J. 1992); Hagan v. O'Connell, Goyak & Ball, P.C., 683 P.2d 563, 565 (Or. Ct. App. 1984); Spiegel v. Thomas, Mann & Smith, P.C., 811 S.W.2d 528, 531 (Tenn. 1991).

upheld if reasonable, lawyers' covenants not to compete are per se invalid as contrary to public policy.[25] No attempt is made to balance the interests of concerned parties.[26]

Dwyer v. Jung,[27] a New Jersey case decided in 1975, relied on DR 2-108(A) to find that lawyers' restrictive covenants were per se illegal and against the public interest. The court refused to enforce a provision in a partnership agreement that prohibited partners from representing a client designated as that of another partner for five years after the dissolution of the firm.[28] The court excluded restrictive covenants between lawyers from the general category of agreements restricting post-employment competition.[29] Instead of the reasonableness test, the court adopted the per se rule because of the special nature of the attorney-client relationship.[30] The court believed that "[t]he attorney-client relationship is consensual, highly fiduciary on the part of counsel, and he may do nothing which restricts the right of a client to repose confidence in any counsel of his choice."[31] Quoting DR 2-108(A), the court held that an agreement effectively restricting the right of clients to counsel of their choice was per se invalid as against public policy.[32]

Karlin v. Weinberg,[33] another New Jersey case decided shortly after *Dwyer,* limited the application of the per se rule to attorneys' restrictive covenants. The trial court, relying on *Dwyer,* held that restrictive

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25. Older sources do not distinguish attorneys from other professionals. *See* Blake, *supra* note 6, at 662 ("Restraints upon professional employees, such as associates or technical assistants of *lawyers,* doctors, architects, accountants and dentists are also generally upheld . . . ." (citations omitted) (emphasis added)). The Restatement (First) of Contracts contains the following illustration, applying the usual reasonableness test to a restrictive covenant between attorneys:

> *A,* a lawyer, employs *B,* a young lawyer, as his clerk, who, as part of the bargain covenants not to engage in the practice of law within the State after the termination of the employment. Although *A's* practice extends throughout the State, the covenant is illegal, since it imposes undue hardship upon *B.*

Restatement (First) of Contracts, § 515 Illus. 5 (1932).

26. *See, e.g.,* Denburg v. Parker Chapin Flattau & Klimpl, 586 N.Y.S.2d 107 (App. Div. 1992) (invalidating a restrictive covenant intended to assure repayment of a $4.5 million loan to the partnership).

27. 336 A.2d 498 (N.J. Super. Ct. Ch. Div. 1975).

28. *Id.* at 499.

29. *Id.*

30. *See id.* at 500; *see also* Robert L. Schonfeld, Note, *Attorneys Must Not Enter Into Partnership Agreements Prohibiting Themselves from Representing Former Clients Upon Termination of the Partnership,* 4 Fordham Urb. L.J. 195, 202 (1975).

31. *Dwyer,* 336 A.2d at 500.

32. *Id.* at 501.

33. 372 A.2d 616 (Super. Ct. App. Div. 1977), *aff'd,* 390 A.2d 1161 (N.J. 1978).

covenants between doctors were per se invalid because they infringed on a patient's choice of physicians.[34] The appellate court reversed, citing the *Principals of Medical Ethics* published by the American Medical Association (AMA).[35] The court refused to apply *Dwyer* to doctors because, unlike the ABA, the AMA had no ethical restrictions on enforcing restrictive covenants.[36] The court applied the reasonableness test, and upheld the agreement.[37]

C. *Courts May Permit Agreements Discouraging Competition Under the Per Se Rule*

Although some scholars have criticized the prohibition on attorneys' restrictive covenants,[38] no court has upheld enforcement of an absolute prohibition on competition since the MCPR was adopted.[39] Some firms' partnership or employment agreements, however, use burdensome financial conditions to discourage rather than prohibit competition from attorneys who leave the firm.[40] There are two types of agreements discouraging competition. Each withholds some benefit from the departing attorney if the attorney competes with the firm or continues to serve firm clients. Courts have split on whether agreements discouraging competition are per se invalid.

1. *Forfeiture-For-Competition Restrictions*

The first type of agreement discouraging competition is a forfeiture-for-competition clause. When an attorney leaves a firm, the partnership or employment agreement usually provides terms for reimbursement of

34. *Id.* at 618–19.

35. *Id.*

36. *Id.*

37. *Id.* at 619.

38. For an excellent and thorough discussion of some of the problems inherent in the prohibition, see Kirstan Penasack, *Abandoning the Per Se Rule Against Law Firm Agreements Anticipating Competition: Comment on* Haight, Brown & Bonesteel v. Superior Court of Los Angeles County, 5 Geo. J. Legal Ethics 889 (1992). *See generally* Stephen E. Kalish, *Covenants Not To Compete and the Legal Profession*, 29 St. Louis U. L.J. 423 (1985); Schonfeld, *supra* note 30.

39. Laurel S. Terry, *Ethical Pitfalls and Malpractice Consequences of Law Firm Breakups*, 61 Temp. L. Rev. 1055, 1073–74 (1988).

40. Robert W. Hillman points out that language like "departing" or "leaving" contains significant value judgments about the rights of attorneys and firms competing for clients. "The idea that a partner 'leaves' while others 'stay' tips the analysis towards a view that the partner 'taking' clients is, in effect, looting the firm." Robert W. Hillman, *Law Firm Breakups* 6–7 (1990).

the attorney's capital contribution and payment of uncollected salary or other earnings.[41] Frequently these agreements also provide compensation for accounts receivable (hours billed but not yet paid by clients) and work in progress (hours worked but not yet billed).[42] A forfeiture-for-competition clause, like that in the partnership agreement between Richard Cohen and Lord, Day & Lord, reduces this departure compensation when an attorney leaves but continues to practice in competition with the firm.[43] A majority of courts invalidate these agreements as per se against public policy because, like restrictive covenants that prohibit competition, forfeiture-for-competition clauses may operate to restrict a client's choice of attorney.

Gray v. Martin[44] is the leading case holding a forfeiture-for-competition clause unenforceable. In *Gray,* the partnership agreement provided that a withdrawing partner would receive the balance due on any unpaid draws, reimbursement for the partner's capital contribution, and continuing compensation in an amount equal to one half the partner's annual draw, to be paid over two years.[45] The agreement further provided that the withdrawing partner would relinquish any right to the continuing compensation if he or she continued to practice in the geographic vicinity of the firm.[46] The court found that DR 2-108(A) prohibited this provision, even though the provision did not technically prevent the departing attorney from practicing in the area.[47] Any agreement that requires an attorney to relinquish benefits that are otherwise due, the court reasoned, may dissuade the attorney from representing former clients.[48] Such an agreement necessarily affects the right of a lawyer to practice, violating the public interest protected by DR 2-108(A).[49]

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41. Chuck Santangelo & Gerry Malone, *Partnership Agreements: Don't Dance Around the Issues,* Trial, Apr. 1988, at 58.

42. *Id.*

43. Cohen v. Lord, Day & Lord, 550 N.E.2d 410, 410–11 (N.Y. 1989).

44. 663 P.2d 1285 (Or. Ct. App. 1983).

45. *Id.* at 1290.

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* Although phrased in terms of protecting the right of an attorney to practice, the court indicated that "[t]he purpose of the rule is to govern the relationships between attorneys for the protection of the public." *Id.* The court explained in a later case that agreements discouraging competition are "contrary to the public policy of making legal counsel available, insofar as possible, according to the wishes of a client." Hagan v. O'Connell, Goyak & Ball, P.C., 683 P.2d 563, 565 (Or. Ct. App. 1984).

Not all courts agree, however, that forfeiture-for-competition clauses are necessarily contrary to the public interest. In *Howard v. Babcock*,[50] for example, the California Supreme Court recently refused to invalidate a forfeiture-for-competition clause that deprived departing partners of all withdrawal benefits other than return of their capital contributions.[51] The Court first noted that the California Business and Professional Code section 16602, which authorizes non-compete clauses in partnership agreements, did not contain an exception for lawyers.[52] The Court explained that, while it had the authority to impose a higher standard of conduct on lawyers, it would not do so in this context, concluding that an agreement among law partners imposing a reasonable cost on departing partners who compete with the firm was not inconsistent with the California Rules of Professional Conduct nor contrary to public policy.[53] The Court held that "a partner's agreement to pay former partners, or to forego payments otherwise due under the contract, in an amount that at the time of the agreement is reasonably calculated to compensate the firm for losses that may be caused by the with drawing [sic] partner's competition with the firm, may be permitted."[54]

2. *Client-Based Restrictions*

Some law firms also use client-based restrictions to discourage departing attorneys from competing with their former firms. These agreements reduce the attorney's departure compensation by some amount for each client who elects to follow the departing attorney, or provide that fees received from specific clients must be shared with the attorney's former partners.[55] In *In Re Silverberg*,[56] the New York

50. 1993 Cal. LEXIS 6006 (Dec. 6, 1993); *accord* Haight, Brown & Bonesteel v. Superior Court, 285 Cal. Rptr. 845 (Cal. Ct. App. 1991).

51. *Howard*, 1993 Cal. LEXIS at *2.

52. *Id.* at *13–14. The Court's conclusion on this issue was buttressed by its recognition that "a revolution in the practice of law has occurred requiring economic interests of the law firm to be protected as they are in other business enterprises." *Id.* at *19. The Court was referring to the flourishing practice of lateral hiring, where increasingly mobile lawyers change firms bringing revenue-producing clients with them. *Id.* at *21–22; *see generally* Hillman, *supra* note 40, at 1–7. The Court went on to explain that "we are confident that our recognition of a new reality in the practice of law will have no deleterious effect on the current ability of clients to retain loyal, competent counsel of their choice." *Id.* at *19–20.

53. *Id.* at *16, *32. California Rule of Professional Conduct 1-500 is substantially similar to MRPC 5.6 and DR 2-108(A). *Id.* at *16, n. 5. *See supra* note 18.

54. *Id.* at *33.

55. Terry, *supra* note 39, at 1076.

56. 427 N.Y.S.2d 480 (App. Div. 1980).

Supreme Court, Appellate Division rejected client-based restrictions. In that case, the partnership agreement provided that, upon dissolution, a party who represented a client brought to the firm by his partner would turn over 80 percent of the fees generated by that client for a period of eighteen months.[57] Citing DR 2-108(A) and ABA opinion 300, the court determined that the clause amounted to a restrictive covenant, and was void as a violation of the public policy against trafficking in clients.[58]

D. Attempts To Accommodate Firm Interests Under the Per Se Rule

Although courts have generally refused to enforce contracts containing financial disincentives to competition, lawyers continue to sign and attempt to enforce these agreements.[59] Firms and attorneys, after all, have significant financial interests at stake.[60] Courts are aware of those interests, and some have suggested ways to accommodate them under the per se rule.

The court in *Cohen,* for instance, while invalidating a forfeiture-for-competition clause in the Lord, Day & Lord partnership agreement, expressly declined to decide whether an agreement that called for forfeiture of unearned income would be similarly invalid.[61] The court reasoned that "[w]hile a law firm has a legitimate interest in its own survival and economic well being and in maintaining its clients, it cannot protect those interests by contracting for the forfeiture of [a departing partner's] earned revenues."[62] The court left open the possibility that a firm might provide additional, unearned compensation to partners who leave for academia or to accept government positions, but deny that compensation to partners who join competing firms.

Other courts have also recognized firm interests while applying the per se rule. In *Jacob v. Norris, McLaughlin & Marcus,*[63] the New Jersey Supreme Court rejected the *Cohen* distinction. The important question, according to the New Jersey court, is not the nature of the departure

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57. *Id.* at 481–82.

58. *Id.*

59. An unscientific survey of the partnership agreements at twenty New York firms found that about half contained restrictive covenants. Brill, *supra* note 1, at 3; *see also* Santangelo & Malone, *supra* note 41, at 58 (recommending that lawyers' partnership agreements contain non-compete clauses and penalties for violating them).

60. *See* Hazard & Hodes, *supra* note 19, at 824.1.

61. Cohen v. Lord, Day & Lord, 550 N.E.2d 410, 413 (N.Y. 1989).

62. *Id.*

63. 607 A.2d 142 (N.J. 1992).

compensation but instead the agreement's effect on clients.[64] The *Jacob* court said any provision that may dissuade an attorney from representing a specific client violates MRPC 5.6 and is invalid under the per se rule.[65] The court also concluded that, although both parties were guilty of violating New Jersey Rule of Professional Conduct 5.6, equitable considerations did not bar the departing partners from receiving their departure compensation.[66] The court admitted that awarding the departing attorneys their departure compensation would give them an unbargained-for windfall, but believed that such an outcome best served the public interest.[67]

The court recognized the detrimental effect that a lawyer's competitive departure might have on his or her firm, however. The court indicated it would approve a provision that deducted a firm's actual loss of goodwill from the lawyer's departure compensation, explaining that:

> if a partner's departure will result in a decrease in the probability of a client's return and a consequent decrease in prospective earnings, that departure may decrease the value of the firm's goodwill. It would not be inappropriate therefore for law partners to take that specific effect into account in determining the shares due a departing partner.[68]

Similarly, the Oregon Court of Appeals in *Hagan v. O'Connell, Goyak & Ball, P.C.*[69] approved a provision that tied a reduction in departure compensation to the actual losses suffered by the firm.[70] The shareholders' agreement in *Hagan* contained a client-based restriction that reduced the price of the departing attorney's shares by one half the annual gross billings of any client who elected to follow the attorney.[71] The court refused to invalidate this clause because it believed the price reduction based on client billings bore a rational relationship to the loss suffered by the firm.[72] The shareholders' agreement also contained a

64. *Id.* at 150.

65. *Id.* at 147–48 (rejecting an agreement that deprived departing partners "of additional compensation unrelated to their vested interest" because they compete with the firm after their departure).

66. *Id.* at 155.

67. *Id.*

68. *Id.*

69. 683 P.2d 563 (Or. Ct. App. 1984).

70. *Id.* at 565.

71. *Id.*

72. *Id.*

forfeiture-for-competition clause that reduced the buy-out price of a departing lawyer by 40 percent if the lawyer continued to compete with the firm after his or her departure.[73] As in *Gray* and *Cohen,* the court held this provision of the shareholders' agreement invalid as contrary to public policy because it impinged on client choice.[74] Unlike the reduction in departure compensation based on client billings, the 40 percent reduction for competition was not based on the firm's actual losses.

II. COURTS SHOULD ABANDON THE PER SE RULE

Most courts hold that attorneys' employment or partnership agreements that bar post-employment competition are per se void as against public policy. The courts' reasoning is flawed in three respects. First, such covenants do not injure the public. Second, the per se rule inadequately protects the interests of firms and violates principles of contract law. Finally, courts seem to apply the per se rule in name only, approving agreements that are indistinguishable from reasonable covenants not to compete. Firms have also found ways to circumvent the rule. Rather than continue to apply the per se rule, courts should analyze lawyers' covenants not to compete under the reasonableness test applicable to anti-competitive covenants in all other professions.

A. Attorneys' Restrictive Covenants Are Not Unduly Injurious to the Public

When a court strikes down a restrictive covenant between attorneys, it is stating that the covenant in some way injures the public.[75] Courts have found lawyers' restrictive covenants injurious to the public because the agreements limit competition among attorneys, and restrict clients' free choice of counsel. Courts have failed, however, to distinguish lawyering from other professions in which covenants not to compete are routinely upheld.

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73. *Id.*

74. *Id.*

75. *See supra* note 24 and accompanying text.

1. *Courts Have Failed To Distinguish Lawyering from Other Professions*

Some courts have justified the per se rule as necessary to protect the "consensual, highly fiduciary" nature of the attorney-client relationship.[76] Courts routinely uphold restrictive covenants in other professions with similar client-provider relationships, however. The doctor-patient relationship, for example, is similarly "confidential and intimate."[77] Accountants, likewise, receive personal and confidential information from clients during the course of their professional relations.[78] In comparing accountants to lawyers, a New Jersey court concluded that "[l]ike the lawyer-client relationship characterized in *Dwyer*, the accountant-client relationship is also consensual and fiduciary, and the right of the client to repose confidence in the accountant of his or her choice should not readily be circumscribed."[79] Yet, this court found the reasonableness test perfectly adequate to protect the public interest in being able to choose among accountants.[80] Lawyers, doctors, and accountants all provide services that are highly personal in nature.[81] Courts have concluded that covenants not to compete between doctors or accountants are not unduly injurious to the public, and have permitted them if reasonable.[82] Lawyers' covenants not to compete should likewise be allowed.

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76. *See supra* note 31 and accompanying text.

77. Howard v. Babcock, 1993 Cal. LEXIS 6006, at *31 (Dec. 6, 1993); Ladd v. Hikes, 639 P.2d 1307, 1311 (Or. Ct. App. 1982) (Butler, J., dissenting) (arguing for application of the per se rule to doctors); Karlin v. Weinberg, 390 A.2d 1161, 1171 (N.J. 1978) (Sullivan, J., dissenting) ("Both [the doctor-patient and lawyer-client] relationships are consensual, highly fiduciary and dependent on the patient's or client's trust and confidence in the physician consulted or attorney retained.").

78. Mailman, Ross, Toyes & Shapiro v. Edelson, 444 A.2d 75, 80 (N.J. Super. Ct. Ch. Div. 1982); Racine v. Bender, 141 Wash. 606, 252 P. 115, 116 (1927).

79. *Mailman, Ross, Toyes & Shapiro,* 444 A.2d at 80.

80. *Id.*

81. Hillman, *supra* note 40, at 29 ("The reasons for distinguishing lawyering from other professions in this context are vague, and it is questionable whether the availability of choice for the client is any less critical when the professional engaged is a physician, for example, rather than a lawyer.").

82. *Id.*

2. *Promoting Competition Among Attorneys Is an Insufficient Justification for the Per Se Rule*

Some commentators support the per se rule because it promotes competition among attorneys.[83] When an attorney leaves a firm, he or she may engage in a bidding war for certain valued clients.[84] Consequently, the client may benefit from lower fees.[85] There are several reasons, however, why promoting competition proves an inadequate justification for the per se rule. First, the reason a departing attorney is able to compete effectively for former clients is that the attorney was exposed to confidential client information during the employment relationship.[86] The benefit from this confidential information, however, belongs to the firm and not the individual attorney.[87] Second, there are over 700,000 attorneys in the United States.[88] The fact that a particular attorney is unable to compete for a client's business will have very little effect on that client's ability to find suitable representation.[89] Finally, although reasonable restrictive covenants are anti-competitive, courts tolerate them in every other profession.[90] Promoting competition among attorneys cannot justify the per se rule because it does not explain why lawyers should be treated as sui generis.

3. *Promoting Client Choice Is an Insufficient Justification for the Per Se Rule*

A final rationale for the per se rule is that enforcing attorneys' covenants not to compete restricts clients' choice of attorneys.[91] The relationship between attorney and client is a highly personal one.[92] The client's confidence in the attorney is a vital factor in the attorney's ability

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83. Hazard & Hodes, *supra* note 19, at 824.4–824.5.

84. *Id.*

85. *Id.*

86. *See infra* note 94 and accompanying text.

87. Kalish, *supra* note 38, at 444.

88. Robert C. Clark, *Why So Many Lawyers? Are They Good or Bad?*, 61 Fordham L. Rev. 275 (1988).

89. *See* Kalish, *supra* note 38, at 452.

90. Hillman, *supra* note 40, at 29.

91. *See supra* notes 31–32 and accompanying text.

92. *See* Mark H. Epstein & Brandon Wisoff, Comment, *Winding Up Dissolved Partnerships: The No-Compensation Rule and Client Choice*, 73 Cal. L. Rev. 1597 (1985).

to provide effective legal services. Protecting client choice is an important value served by the ethical rules governing attorneys.

Client choice is not paramount, however. The principle of client choice gives way to other interests in a variety of situations. Ethical rules, for instance, do not obligate lawyers to accept every client who wishes to employ them.[93] Conflict of interest rules may also restrict a client's right to counsel of his or her choice.[94] MRPC 1.16 permits an attorney to withdraw from representing a client for non-payment of fees or when the representation creates an unreasonable financial burden, even if the withdrawal materially adversely affects the client.[95]

Finally, the ethical codes at times actually require a client's choice of attorney to be restricted. MRPC 1.17 prohibits the seller of a law practice from competing with the purchaser, implying in the sale of every law firm a promise by the seller not to practice in the same geographic vicinity as the firm.[96] Although clients are, of course, free to terminate the relationship with the purchaser of the firm at any time, MRPC 1.17 mandates that their former attorney be unavailable to them. The harm to the client in that instance is indistinguishable from the harm caused by a similar covenant contained in an employment or partnership agreement.[97] Yet, courts forbid a client's choice of attorney to be bargained away in the latter situation, but the ethical codes require it in the former. The Model Rules explain that the purchaser of a practice must receive the goodwill he or she bargains for.[98] The Model Rules therefore elevate the need to preserve the value of a firm's goodwill over the client's right to choose. Rule 1.17 illustrates that while client choice is an important value, it is not necessarily superior to other interests.

The public interest in unfettered competition among attorneys is no greater than the public interest in unfettered competition in many professions. The public interest in freedom to choose one's attorney, for

93. The Ethical Considerations of the CPR, however, suggest that "in furtherance of the objective of the bar to make legal services fully available, a lawyer should not lightly decline proffered employment." Model Code of Professional Responsibility EC 2-26 (1969).

94. Center For Professional Responsibility, *Annotated Model Rules of Professional Conduct* 177 (2d ed. 1992) ("Courts have recognized that the ethical considerations underlying imputed disqualification must be balanced with the right to one's free choice of counsel.").

95. Model Rules of Professional Conduct Rule 1.16(b)(1992). Subsection (d) requires a withdrawing attorney to take steps to minimize the effect of the withdrawal on the client. *Id.*

96. Model Rules of Professional Conduct Rule 1.17 (1992).

97. When a partner leaves a firm, the remaining partners repurchase his or her share of the firm's equity. MRPC 1.17, however, applies only when the entire practice is sold. Model Rules of Professional Conduct Rule 1.17(b) (1992).

98. Hazard & Hodes, *supra* note 19, at 824 n.1.

example, is surely no more significant than the public interest in choosing one's doctor. Attorneys' covenants not to compete are no more injurious to the public than those between other professionals. Therefore, courts should abandon the per se rule which applies solely to attorneys' covenants not to compete in favor of the reasonableness rule applicable to all other professions.

B. Application of the Per Se Rule Fails To Adequately Protect Firms' Interests

In contrast to the minimal public interest in the enforcement of the per se rule, the harm to law firms from enforcement of the rule is significant. First, application of the per se rule results in the forfeiture of law firms' property interest in goodwill. Second, the per se rule contravenes the principle of in pari delicto by penalizing law firms while affording a windfall to departing attorneys, even though both are guilty of violating DR 2-108(A) and MRPC 5.6. Finally, allowing attorneys to use the ethical codes for private gain by escaping their obligations under agreements they enter into consensually violates the maxim of unclean hands.

1. Application of the Per Se Rule Results in a Forfeiture of Law Firms' Property

Courts recognize the probability of clients' future patronage as a definable property interest called goodwill.[99] Goodwill has been defined as "nothing more than the probability that old customers will resort to the old place."[100] The value of goodwill inures to the firm because often the attorney's opportunity to serve the client came about only because of the attorney's firm affiliation.[101] Furthermore, the attorney may have undertaken client development at significant cost to the firm.[102] The rule

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99. Jacob v. Norris, McLaughlin & Marcus, 607 A.2d 142, 152 (N.J. 1992) ("The probability of future patronage can be translated into prospective earnings.").

100. *Id.* (quoting Cruttwell v. Lye, 34 Eng. Rep. 129, 134 (1810)).

101. *See* Kalish, *supra* note 38, at 423.

102. The plaintiff in *Cohen,* for instance,

> was allowed to spend a considerable amount of his professional time writing tax articles and serving on committees of the New York State Bar Association Tax Section and the American Law Institute. . . . As a result, he gradually established a reputation as an expert in certain areas of practice . . . essentially at the firm's expense.

Affidavit of Henry Baldwin, Lord, Day & Lord executive committee chairman, *quoted in* Brill, *supra* note 1, at 102.

is that, unless otherwise specified, clients retain law firms and not particular attorneys.[103]

Application of the per se rule results in the forfeiture of a law firm's property interest in goodwill. A forfeiture is the taking away of a pre-existing valid right without compensation.[104] Forfeitures are disfavored both in law and equity, particularly when they are not compelled by the express requirements of a contract.[105] When an attorney leaves a firm, the firm loses anticipated income generated by clients who choose to follow the departing attorney. In order to protect that property interest, firms bargain for a restrictive covenant, either offsetting the loss with a reduction in the attorney's departure compensation,[106] or preventing it with a client-based restriction.[107] When courts invalidate covenants not to compete under the per se rule, the firm's property interest is forfeited.

As Arthur Corbin has stated with respect to a covenant not to compete appurtenant to the sale of a business:

> The reason that the buyer should be able to enforce the lawful promises of the seller is not that he is more nearly innocent than the seller but that the harm to the public is mostly prevented by eliminating the illegal excess restraint, and the forfeiture resulting from total non-enforcement would be unjust punishment.[108]

Similar logic applies to a covenant not to compete appurtenant to a lawyer's partnership or employment agreement.

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103. Note, *The Death of a Lawyer,* 56 Colum. L. Rev. 606, 616 (1956); *see also* Anthony L. Marks, *Barefoot Shoemakers: An Uncompromising Approach to Policing the Morals of the Marketplace When Law Firms Split Up,* 19 Ariz. St. L.J. 509, 529 (1987). The Model Rules and the Model Code recognize the general rule by allowing attorneys to disclose client confidences to other attorneys in the firm. Model Rules of Professional Conduct Rule 1.6 (1983); *see also* Model Code of Professional Responsibility EC 4-2 (1969).

104. *Black's Law Dictionary* 650 (6th ed. 1990).

105. *In re* Erie L. Ry., 548 F.2d 621, 627 (6th Cir. 1977) (holding that a railroad's cancellation of an employee's retirement benefits is an invalid forfeiture absent sufficient cause occasioned by the acts of the employee).

106. *See supra* note 41 and accompanying text.

107. *See supra* note 55 and accompanying text.

108. 6A Arthur Linton Corbin, *Corbin on Contracts* § 1524 (1962).

2. *The Per Se Rule Violates the Principle of In Pari Delicto*

When firms and attorneys enter into contracts containing restrictive covenants, both violate DR 2-108(A) and MRPC 5.6.[109] Typically, suits over attorneys' covenants not to compete arise when a departing attorney sues a firm to obtain departure compensation that the firm has withheld.[110] Under the per se rule, courts enforce the firm's obligations, while relieving attorneys of their responsibilities under the contract. This is contrary to the principle of in pari delicto, which suggests that when two parties are equally in the wrong, the defendant, typically the firm, holds the stronger position.[111] The per se rule, therefore, incorrectly favors attorneys over their firms even though the misconduct by each party is exactly the same.[112]

Moreover, where the restriction is in the form of an agreement discouraging competition, courts have uniformly voided the anti-competitive portion of the agreement while allowing the departure compensation to stand.[113] A contract, however, is severable only when the performances can be divided into equivalent pairs of part performances.[114] When courts hold the anti-competitive portion of the agreement invalid so that the attorney may compete but enforce the firm's obligation to pay departure compensation, the remaining pairs of part performances are nowhere near equal.[115] The per se rule therefore violates the rule of severability.

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109. Jacob v. Norris, Mclaughlin & Marcus, 607 A.2d 142, 155 (N.J. 1992); *see supra* notes 66–67 and accompanying text.

110. *See, e.g.*, Jacob v. Norris, McLaughlin & Marcus, 607 A.2d 142 (N.J. 1992); Cohen v. Lord, Day & Lord, 550 N.E.2d 410 (N.Y. 1989).

111. Pinter v. Dahl, 486 U.S. 622, 632–33 (1988) (applying the principle of in pari delicto to a violation of federal securities law).

112. *Cohen,* 550 N.E.2d at 419 (Hancock, J., dissenting) (noting that striking the restrictive covenant imposes a sanction on defendant law firm while plaintiff, who also violated the rule, reaps a substantial reward).

113. *Cohen,* 550 N.E.2d at 413; *accord Jacob,* 607 A.2d at 154; Hagan v. O'Connell, Goyak & Ball, P.C., 683 P.2d 563, 565 (Or. Ct. App. 1984); Spiegel v. Thomas, Mann & Smith, P.C., 811 S.W.2d 528, 531 (Tenn. 1991).

114. E. Allen Farnsworth, *Contracts* § 5.8 (2d ed. 1990); Restatement (Second) of Contracts, *supra* note 4, § 183.

115. Voiding the entire agreement, Farnsworth concludes, is preferable to depriving one party of the expected performance with no concession in return, where the performance sought is a material part of the contract. Farnsworth, *supra* note 114, § 5.8.

3. *Application of the Per Se Rule Violates the Maxim of Unclean Hands*

The maxim of unclean hands requires that a party seeking to enforce a contract be willing to abide by its terms.[116] When attorneys sue firms to collect departure compensation, this principle suggests that the attorneys should be willing to perform their obligations to refrain from competition before the court comes to their aid. Public policy, after all, requires that competent parties be capable of arranging their obligations as they see fit.[117] The per se rule compromises this principle by relieving attorneys of their obligations to refrain from competition with their former partners while the firms' obligations are enforced.

Cohen illustrates the inequitable consequences of enforcing the per se rule. Cohen and Lord Day & Lord entered into a partnership agreement whereby Lord Day & Lord promised to pay Cohen a significant sum in return for his promise not to compete with the firm if he left.[118] Cohen reneged on the deal. The court came to Cohen's aid, however, even though both parties violated DR 2-108(A) when they signed the agreement. According to the principle of in pari delicto, the court should have refused to interfere. Cohen sought to enforce the firm's promise to pay departure compensation, even though he was unwilling to keep his side of the agreement. This violated the principle of unclean hands. Finally, the court allowed Cohen to serve several of the clients he had developed while at Lord, Day & Lord. This worked a forfeiture of the firm's goodwill – the probability that those clients would return to the firm for additional work. All this to comply with a rule of legal *ethics*. It is a curious result: Sometimes lawyers' ethics force them not to keep agreements they sign.

C. *Courts Apply the Per Se Rule in Name Only*

Courts have proposed solutions to address the negative effects of the per se rule. Yet the alternatives they have offered would impact clients in the same way that the invalid covenants not to compete did. Furthermore, newer partnership agreements frequently work around the

116. Gibson v. Kansas City Refining Co., 32 F.2d 658, 665 (8th Cir. 1929).

117. Williston, *supra* note 15, § 1630 ("If there is one thing more than any other which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that contracts, when entered into freely and voluntarily, shall be held good and shall be enforced . . . ." (citation omitted)).

118. *See supra* note 1 and accompanying text.

per se rule by leaving departure compensation to the discretion of the remaining partners. In practice, the per se rule merely muddies the waters while achieving none of its intended positive effects.

For instance, the *Jacob* court indicated it would approve a provision that reduced a departing partner's share of firm capital by the amount of prospective firm billings lost if a client elected to follow the departing attorney.[119] The deduction would remove the departing attorney's economic incentive to continue to serve the client. This is exactly the effect the *Jacob* court sought to avoid.[120] The relationship of the departure compensation deduction to the amount of goodwill lost by the firm goes to the reasonableness of the provision, not to the type of incentive it creates for the attorney to accept representation of former clients.

Similarly, newer partnership agreements avoid formulas and geographic restrictions in computing a departing partner's share in the firm, and leave the departing partner's share to be paid out over an unspecified period to be determined by the remaining partners.[121] If the departing partner takes firm clients, the remaining partners pay the departure compensation more slowly. If, on the other hand, the departing partner does not compete with the firm, the remaining partners accelerate payment of the departure compensation. But the word "compete" never appears in the agreement.[122] And while it seems possible that these agreements may be applied in a way that restricts a client's choice of attorney, determining whether this has happened requires a court to do the sort of balancing that the per se rule forbids.

A law firm could use either the restriction outlined by the *Jacob* court or the unspecific agreement described above to avoid the strictures of the per se rule. To evaluate whether a provision impermissibly discourages an attorney from representing clients of his or her former firm, a court must compare the reduction in departure compensation to the firm's lost goodwill. This is exactly the type of balancing courts do when they review the reasonableness of covenants not to compete covering other professions.

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119. *See supra* note 68 and accompanying text.

120. *See supra* note 65 and accompanying text.

121. *See* Cox, *supra* note 3, at 13.

122. *Id.*

III. COURTS SHOULD APPLY THE REASONABLENESS TEST TO ATTORNEYS' COVENANTS NOT TO COMPETE

The per se rule's failing is apparent on its face: It does not consider the relative weight of all the interests affected by a restrictive covenant. The reasonableness rule, on the other hand, affords an ad hoc balancing of the interests of all concerned. Courts should adopt the reasonableness rule because it avoids the failings of the per se rule and is compatible with the public policy encouraging clients' freedom to choose counsel.

The rule is flexible enough to take into account the special importance of client choice while still offering a minimum of protection to both restricted attorneys and their former firms. Firms should be able to take reasonable measures to protect their interests, as long as those measures do not unduly burden the restricted attorneys or limit the public's access to legal services. And, allowing reasonable restrictive covenants avoids the inequitable results of applying the per se rule. The reasonableness rule enforces the parties' expectations, rather than allowing one party to shift the costs of complying with public policy to another party.

The essence of the reasonableness rule is an individualized inquiry into the circumstances of the parties to the restrictive covenant. Thus it is impossible to say in the abstract what types of restrictive covenants are reasonable: a restraint reasonable in one set of circumstances may be unreasonable in the next. Nonetheless, it is possible to speculate how a court might apply the reasonableness test to specific types of restraints.

For instance, a general prohibition on practicing in a given community seems plainly unreasonable. The restriction is too broad to be related to a legitimate firm interest.[123] For instance, it would apply whether or not the departing attorney served any clients belonging to his or her former firm. The restriction would apply even if the attorney practiced in a specialized field in which his or her former firm did not. Furthermore, the restriction would impose an undue burden by requiring the restricted attorney to relocate in order to continue the practice of law.[124] Finally, a general prohibition would harm the interest of the public by making an attorney unavailable to all potential clients in the restricted area, not just those clients who dealt with the attorney at the attorney's former firm.[125]

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123. *See supra* note 9; *see also* Howard v. Babcock, 1993 Cal. LEXIS 6006, at *32 (Dec. 6, 1993).

124. *See supra* note 10 and accompanying text.

125. *See* Terry, *supra* note 39, at 1078 n.124.

Financial disincentives are more flexible than general prohibitions. A forfeiture-for-competition clause, for example, reduces the attorney's departure compensation if the attorney competes with his former firm.[126] These clauses allow the restricted attorney to decide whether competing with his or her former firm makes economic sense.[127] Forfeiture-for-competition clauses may also be less harmful to the public.[128] Unlike a client-specific restriction, a forfeiture-for-competition clause will not give a departing attorney an incentive not to serve a particular client.[129] Forfeiture-for-competition clauses, however, are not ideal because they are not narrowly tailored to protect firm interests. As with the general prohibition, they apply whether or not the firm suffers any actual loss of goodwill from clients who choose to follow the departing attorney.

A client-based restriction is the solution most narrowly tailored to protect firm interests. This type of restriction reduces an attorney's departure compensation for each client who elects to follow the departing attorney.[130] As with a forfeiture-for-competition clause, courts could invalidate as unreasonable a client-based restriction if the impact on the attorney was grossly disproportionate to the loss suffered by the firm. But a client-based restriction that reduced the attorney's departure compensation by an amount equal to the firm's loss of goodwill may be upheld as reasonable. Such a restriction would be no greater than necessary to protect firm interests. It would burden the restricted attorney only to the extent the departure caused a loss to the firm. Finally, a client-based restriction would minimize the impact on the public because it would potentially affect only those clients served by the departing attorney.

IV. CONCLUSION

Courts review attorneys' covenants not to compete under differing standards. Most courts mistakenly apply DR 2-108(A) and MRPC 5.6 to find the agreements per se invalid. There is little reason, however, to view attorneys' covenants not to compete as any more detrimental to the public interest than anti-competitive covenants covering other professions. Moreover, the per se rule creates inequities between firms

126. *See supra* note 43 and accompanying text.

127. *See* Howard v. Babcock, Cal. LEXIS 6006, at *18 (Dec. 6, 1993).

128. *See* Terry, *supra* note 39, at 1078 n.124.

129. *Id.*

130. *See supra* note 55 and accompanying text.

and attorneys because courts employing the rule ignore legitimate firm interests. Furthermore, courts apply the per se rule in name only, allowing agreements that are indistinguishable from reasonable covenants not to compete. A better approach would be to view attorneys' covenants not to compete under the reasonableness test applicable to restrictive covenants in all other fields. The reasonableness test would preserve clients' freedom to choose their counsel, while protecting legitimate firm interests. Towards this end, MRPC 5.6 and DR 2-108 (A) of the MCPR should be amended to allow attorneys to enter into reasonable covenants not to compete.