So You Are Thinking About Moving—A Primer on Ethical Obligations of Departing Lawyers and Their Firms (Part II)

Ethics Watch

By Nathan M. Crystal

Part I of this column, published in March, discussed four issues: (1) When should departing lawyers inform their firms of their plans to leave? (2) If a lawyer is joining a new firm, may the lawyer reveal information to the new firm to do a conflicts check without violating the lawyer's duty of confidentiality? (3) When does a conflict exist, and what can be done about it? (4) How should the lawyer and the old firm handle notification to existing clients of the lawyer's departure?

5. *When clients of the old firm decide to retain the departing lawyer's new firm, how are fees from these clients' matters allocated between the new and old firms?*

Traditionally, the withdrawal of a partner constituted a dissolution of the partnership. Further, during the period in which a partnership's affairs were being wound up following a partner's withdrawal, the "no-additional-compensation rule" applied. This rule of partnership law meant that withdrawing partners were not entitled to additional compensation for services rendered in winding up partnership business. The seminal case on this rule is *Jewel v. Boxer,* 203 Cal. Rptr. 13 (Ct. App. 1984); see *Huber v. Etkin*, 2012 Pa. Super. Lexis 4076 (2012) (extensive discussion of rule and leading cases). The rule appears to apply to partnerships, but it is unclear whether it applies to other forms of entities in which lawyers practice. See id. (applying the rule to LLP) and *Fox v. Abrams*, 210 Cal. Rptr. 260 (Ct. App. 1985) (rule applies to corporations). But see S.C. Code §33-44-403(d) ("A member is not entitled to remuneration for services performed for a limited liability company, except for reasonable compensation for services rendered in winding up the business of the company.") In addition, the rule may not apply if the entity continues rather than being dissolved. The economic crisis of recent years has resulted in a number of law firm bankruptcies in which trustees have sought to obtain fees received by departing lawyers and their new firms in both contingency fee and hourly representation cases. See, e.g. *Development Specialists, Inc. v. Aiken Gump Strauss Hauer & Feld, LLP,* 477 B.R. 318, 2012 U.S. Dist. Lexis 73994 (S.D.N.Y. 2012).

Thus, under the no-additional-compensation rule, if a lawyer leaves a firm and a client that the lawyer was representing while a member of the firm elects to have the lawyer complete the client's case, the lawyer is not entitled to the full fee from that matter. The fee would be paid to the old firm, and the lawyer would receive the lawyer's share pursuant to the partnership agreement or pro rata based on the lawyer's interest in the partnership in the absence of an agreement. Note that departing partners also receive benefits from the no-additional-compensation rule because they are paid their partnership percentage in any cases that remain with the firm, even though they will not be performing any services on those cases.

Lawyers practicing in partnerships, LLCs, or LLPs are free to modify the no-additional-compensation rule by agreement; so long as the agreement is reasonable and does not amount to an indirect attempt to restrict the departing lawyer's ability to practice law (see section 6 below), the agreement should be enforceable. See *Kelly v. Smith*, 611 N.E.2d 118 (Ind. 1993) (recognizing no-additional-compensation rule but interpreting partnership agreement to provide that firm would be paid on *quantum meruit* basis for work done before clients elected to retain departing lawyer). For an example of a "*Jewel* waiver" clause in a partnership agreement, see *Geron v. Robinson & Cole, LLP,* 476 B.R. 732, 2012 U.S. Dist. Lexis 128678 (S.D.N.Y. 2012).

If the partnership agreement does not include a provision on fee allocation with departing lawyers, the departing lawyers and the firm may be able to reach an agreement at the time of the departure. For example, the parties might agree that a 50-50 division between the old firm and the departing lawyer of all cases regardless of their stage of completion is fair recognition of the contributions of the old firm before departure and of the moving lawyer in completing the case. The comments to the rules of professional conduct provide that an agreement between an old firm and a departing lawyer about division of fees in a case is not a fee splitting agreement under Rule 1.5(e) and therefore does not require client consent. See SCRPC 1.5, comment 8.

In the absence of an agreement between the old firm and the departing lawyers, either in the partnership agreement or at the time of departure, a court could apply the no-additional-compensation rule, or it could allocate the fees between the departing lawyer and the old firm on a *quantum meruit* basis. Compare *Hurwitz v. Padden*, 581 N.W.2d 359 (Minn. Ct. App. 1998) (in absence of agreement applying no-additional-compensation rule to LLC) with *Miller v. Jacobs & Goodman*, 820 So.2d 438 (Fla. Dist. Ct. App. 2002) (upholding trial court's allocation of 46 percent of fees in cases taken by departing associates under *quantum meruit* principles).

6. *To what extent may a firm impose restrictions on practice*

by a departing lawyer?

In the business world covenants not to compete are quite common and are legally enforceable provided the covenant protects a legitimate interest of the covenantee and provided the covenant is reasonable in its restrictions. Thus, a covenant by a seller of a business not to compete with the purchaser, or by an employee not to compete with his employer, is valid if it is reasonable in scope, geography, and duration. By contrast to the "rule of reason" that governs covenants in general, covenants by lawyers not to compete are *per se* invalid. See SCRPC 5.6(a). The rationale for this prohibition rests on the interests of clients. The client-lawyer relationship is personal and fiduciary in character. It is against public policy to deprive a client of the right to employ the lawyer of the client's choosing. The rule also protects young lawyers from bargaining away their future employment prospects. See SCRPC 5.6, cmt. 1. The rule applies not only to direct restrictions on a lawyer's right to practice law but also to indirect restrictions as well. Partnership agreements typically provide for payments to a departing partner of that partner's share of the capital of the partnership and of any earned but uncollected fees. If a partnership agreement provides that a departing lawyer forfeits that partner's share of termination payments when the partner continues practice in competition with the partner's former firm, courts are likely to find such a provision invalid as an indirect restriction on the departing lawyer's right to practice law.

In *Cohen v. Lord, Day & Lord*, 550 N.E.2d 410 (N.Y. 1989), the New York Court of Appeals ruled that a partnership agreement that conditioned payment of a departing partner's share of earned but uncollected revenues on noncompetition by the departing partner was unenforceable because of the ethical prohibition on restriction of practice by lawyers; other courts have agreed with this approach. In cases like *Cohen* the departing lawyers forfeited all payments from their former firms if they continued to practice law. Less restrictive provisions may be upheld. For example, clauses may be valid if they reasonably reduce the amount that a departing lawyer receives to reflect the financial impact on the firm of the lawyer's departure, or if they attempt to measure compensation due the firm for its *quantum meruit* contribution to cases in which clients elect to retain the departing lawyer rather than continue to have the firm represent them.

In *Howard v. Babcock*, 863 P.2d 150 (Cal. 1993), the California Supreme Court rejected decisions from other states and held that a contractual provision imposing a reasonable cost on departing partners to compensate their former firm for their loss was enforceable. The court noted the change in economic climate in which law firms now operate. It expressed the view that such provisions could benefit clients by reducing the "culture of mistrust" among partners that can damage law firm stability.

Rule of Professional Conduct 5.6 contains an exception to the general prohibition against covenants not to compete among lawyers: Covenants not to compete are permissible when the lawyer is receiving "benefits upon retirement." The exception is not limited to full retirement by a lawyer because it would be unnecessary in such a situation. However, the exception applies only to bona fide retirement plans, not to disguised attempts to restrict competition on departure from a firm.

7. May departing lawyers seek to employ other lawyers or staff members of the old firm?

Prior to announcing their departure, lawyers cannot attempt to hire staff members or associates in the firm. To do so would amount to a breach of fiduciary duty, much like attempting to solicit clients. After announcing their departure, the departing lawyers could certainly respond to overtures from staff members or associates seeking possible employment. Whether departing lawyers can attempt to hire associates or staff members depends on the contractual relationship between such employees and the old firm. If they are employed under a contract of a definite duration, then the departing lawyers should not seek to negotiate or hire an employee of the firm without the permission of the firm. To do so could amount to tortious interference with a contractual relationship. If the staff member or associate is employed under an at-will contract, attempts to hire such a person would not amount to tortious interference with a contractual relationship but might be considered to be tortious interference with prospective economic advantage. This tort is difficult to establish and generally requires some wrongful conduct, such as an intentional tort in connection with the solicitation or an intention to harm the employer of the at-will employee. See Ronald C. Minkoff, *Poaching Lawyers: The Legal Risks,* http://fkks.com/article.asp?articleID=188.

8. *What equipment, furniture, and electronic or physical records from the departing firm may a moving lawyer take?*

Ownership of equipment and furniture should be straightforward. If the old firm purchased the equipment or furniture, it is the property of the firm. Equipment, furniture, or art work purchased by departing lawyers is their property. The moving lawyer and the firm may, of course, agree to sell property that belongs to the other.

If a client has informed the old firm that the client wishes to retain a moving lawyer, the client and thereby the moving lawyer will be entitled to the client's file, which should include any accounting and trust account records related to the file. The firm may have a retaining lien on the file for any unpaid fees or expenses, but in South Carolina such a lien could not be exercised if it would prejudice the client. See Wilcox & Crystal, ANNOTATED SOUTH CAROLINA RULES OF PROFESSIONAL CONDUCT 132 (2010 ed.)

Work done by a lawyer for clients of the firm, like physical property, belongs to the firm, absent an agreement between the lawyer and the firm. Many lawyers will retain personal files of work product that they produced while employed by the firm and will take such files with them when they leave. Perhaps such action can be justified on the ground that a firm's claim to such material would effectively cripple many lawyers from leaving the firm and would therefore amount to an indirect restriction on the practice of law in violation of Rule 5.6(a). The better way to deal with this issue, of course, is by agreement either in advance or at the time of departure.

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As these columns have shown, there are a number of issues involved when lawyers leave a firm. Because of the breadth of issues and the fact that substantial amounts of money may be involved, the potential for disputes and ill-will is significant. Well-drafted partnership agreements (or similar documents for other organizational forms) can reduce the possibilities of disputes. What should be included in such agreements? In my opinion, a well-drafted agreement should have a section on the fiduciary duties of partners to the firm. This section should include provisions on (a) when notification of departure must be made, (b) procedures for conflict checking when a lawyer is considering departure, (c) procedures for notification of clients when a lawyer is departing, along with prohibitions against solicitation of clients other than through this procedure, (d) allocation of fees and expenses between the old firm and the departing lawyer, (e) amount and method of payment of the departing lawyer's equity interest in the firm, (f) procedures for contacting other lawyers and staff members in the firm about possible employment, and (g) statement of the relative rights of the firm and the departing lawyers to furniture, equipment, and electronic and physical records. ■