TIES THAT BIND AND RESTRICTIONS ON LAWYER COMPETITION: RESTRICTIVE COVENANTS AS CONDITIONS TO THE PAYMENTS OF RETIREMENT BENEFITS*

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INTRODUCTION

Client loyalties often run stronger to lawyers than the firms in which their lawyers practice, with the consequence that within a given firm there likely exists a number of lawyers with the ability to leave the firm and take with them revenue streams of some consequence.1 One of the more dynamic and litigated issues within the growing law of lawyer mobility concerns efforts to restrict contractually future competition by present members of a law firm.2 For the most part, contractual restraints on competition fall under the clearly articulated ethics codes’ bans on bargained practice restrictions following departure from a firm, the raison d’être being that clients should have the right to choose the lawyers who will represent them.3

There exists one important, but largely undeveloped, exception to the ethics codes’ ban on restrictive covenants. Both the Model Code of Professional Responsibility4 and the more recent Model Rules of Professional Conduct exempt from their anticompetition bans an agreement tying noncompetition to benefits paid on account of retirement.5 The retirement benefits exception is important because the departure of a partner from a law firm typically will prompt some

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2. See generally ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY § 2.3.5 (Supp. 2005).
3. See id. § 2.3.3.
4. See MODEL CODE OF PROF’L RESPONSIBILITY DR 2-108(A) (1980) (“A lawyer shall not be a party to or participate in [a covenant not to compete], except as a condition to payment of retirement benefits.”).
5. See MODEL RULES OF PROF’L CONDUCT R. 5.6 (2005) (“A lawyer shall not participate in offering or making [a covenant not to compete], except an agreement concerning benefits upon retirement.”).
type of payout in satisfaction of the lawyer’s interest in the firm. To the extent that firms are able to categorize the payouts as retirement benefits, they have an effective means of protecting their client base by preventing competition from lawyers to whom client loyalties may run deeply.

The ethics codes are bereft of anything resembling legislative history, and the policy justification for linking retirement payments with a noncompetition commitment is not entirely clear. The lack of a definition for “retirement” heightens the interpretive challenges posed by the retirement benefit exception. The nearly blank tablet offered by the codes has left courts with the task of articulating a framework for identifying the range of contractual restraints on competition that may fall within the retirement benefits exception. This Article considers the developing law on the point and offers a framework for distinguishing impermissible restraints on competition from allowable retirement benefits conditioned on noncompetition.

I. A PRELIMINARY NOTE ON PARTNERSHIP PAYOUTS

Law firm partners are equity participants in an economic enterprise. Often, but not always, partners purchase their interests upon becoming partners or through subsequent capital contributions. The value of a given partner’s interest may be more or less than any amount the partner paid for the interest and may fluctuate with each accounting cycle. When a partner’s association with a firm ends, either by death, withdrawal, or discharge, the partnership agreement typically will provide a method and formula for settling the account of the former

6. The ethics codes’ ban on restrictive covenants dates to the Model Code’s appearance in 1969. From the beginning the prohibition has included an exception for the payment of retirement benefits. In the decade preceding the appearance of the Model Code, ethics opinions signaled uneasiness with contractual restraints on competition. See, e.g., ABA Comm. on Ethics and Prof’l Responsibility, Informal Op. 1072 (1968) (finding that law partners cannot enter into restrictive covenants); ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 300 (1961) (declaring improper an anticompetitive covenant in an associate’s employment contract).


8. This statement assumes that the label “partner” is employed correctly. For a discussion of nonequity partners in law firms, see Robert W. Hillman, Law, Culture and the Lore of Partnership: Of Entrepreneurs, Accountability and the Evolving Status of Partners, 40 WAKE FOREST L. REV. 793 (2005).

9. In this Article, “partner” is used in the broadest sense to include any equity stakeholder in a firm, whether the firm is a partnership, a professional corporation, a limited liability company, or some other form of association.
partner. The payment may be a single lump sum or installments over a period of time and may consist of both a return of the capital invested by the former partner in the firm as well as some element of profit or enhanced value on this sum.

The payout methodology is important to both the firm and the recipient’s former partners. Firms commonly pay departing partners a “return of capital,” with payments ranging from a few thousand dollars to several hundred thousand dollars made in installments over periods ranging from three to sixty months. Goodwill often is not included in payout amounts. Payouts are a function of bargaining, however, and some partnership agreements provide for payments to departing partners well in excess of the balances in their capital accounts. Such contractual provisions may serve to encourage lateral departures and subsidize competition by former firm members. When this occurs, the contracts have the operative effect of destabilizing firms.

Beyond the normal withdrawal payments, partners, like employees, may enjoy payouts grounded in funded and qualified retirement plans offering significant tax benefits conditioned on broad-based participation. Qualified plans, however, cannot discriminate in favor of highly compensated employees (i.e., partners). Nonqualified plans may discriminate and are a popular means of structuring deferred compensation for partners of professional services firms. Altman Weil surveys reveal that a substantial but declining minority of law firms have nonqualified plans providing payouts to partners upon their withdrawals from the firms; the larger the firm, the more likely it is that some form of such a plan exists.

The historical law firm retirement “plan” had been an income stream for life for retired partners. The modern traditional non-qualified plan consisted of a return of capital and an interest in unbilled time and accounts receivable (essentially an accrual basis buy-out as opposed to an income stream for retirement). Today, firms with unfunded plans often use a percentage of past earnings as the primary determinant of entitlement, in addition to a return of cash basis capital.

10. Payment in settlement of a departing partner’s account distinguishes the partner from an employee. Although the employee may have helped build value in the firm, her claim on firm assets normally is limited to salary paid for services rendered.

11. In the case of a professional corporation, the capital repurchase would be accomplished through a stock buyback, with the capital return comprising all or a portion of the purchase price.


13. Id. The assumption here is that firm goodwill is minimal or nonexistent because clients have greater loyalties to individual attorneys than to the firms in which the attorneys practice. For a discussion of efforts to enhance firm goodwill, see Hillman, supra note 2, § 2.5.2.

These plans are represented by unsecured promises.\textsuperscript{15} The nonqualified plans typically are not pre-funded, which means that payments are dependent upon future income streams of the firm.\textsuperscript{16} Significantly, about one-third of firms surveyed pay benefits only to individuals who retire from the practice of law.\textsuperscript{17} For present purposes, the important characteristic of a nonqualified plan is its similarity to more generalized arrangements for payouts to departing partners. In fact, it may be difficult, if not impossible in some cases, to distinguish clearly the retirement payout from the payout in settlement of a partner's interest. To the extent that the label controls the analysis, firms have an incentive to denominate a large portion of payouts as retirement benefits in order to subject such payments to possible forfeiture in the event of competition by the former partner.

II. PAYOUTS AS COMPETITION SUBSIDIES

Although economic disincentives to competition by former law partners generally are not enforced, courts often acknowledge the difficulty of striking a proper balance between the interest of clients in enjoying unfettered choice among lawyers and the interest of firms in limiting payments to individuals who depart, compete, and potentially undermine the very income stream used to fund the payments. One of the more candid discussions of the point is found in a New Jersey Supreme Court opinion that voided a partnership agreement's clause requiring a forfeiture of payouts in the event of competition:

[W]e recognize 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.\textsuperscript{18}

Accordingly, while forfeiture of the capital account for the reason of competition may never be permitted, other components of a payout reflecting the former partner's interest in the firm's future income stream may be offset by the

\textsuperscript{15} Altman Weil 2005 Survey, supra note 12, at 12.

\textsuperscript{16} Id. at 114. However, the percentage of firms prefunding their plans has increased to thirty-five percent from the thirteen percent reported in 2002. See Altman Weil 2002 Survey, supra note 14, at 56.

\textsuperscript{17} See Altman Weil 2005 Survey, supra note 12, at 94. Interestingly, an earlier survey revealed that nearly two-thirds of firms limit benefits by noncompetition clauses. See Altman Weil 2002 Survey, supra note 14, at 35. The question was removed from the 2005 Survey because of a poor response rate in the earlier survey, which calls into question the reliability of the 2002 data on these noncompetition clauses.

diminution of the income stream attributable to the partner’s departure.\textsuperscript{19} Although the logic of the reasoning cannot be disputed, the difficulty lies in crafting a buyout adjustment that reflects or even approximates the effect of the partner’s departure. At least to date, only a handful of forfeiture clauses have survived challenges.\textsuperscript{20}

### III. Why Distinguish Retirement?

One obstacle to interpreting the retirement payment exception to the ban on restrictive covenants is the absence of an articulated policy supporting the exception.

The principal justification for allowing restraints on competition by retiring partners lies in the concern over the use of a firm’s income streams to support competition with the firm. To discourage departures and to avoid subsidizing competition that may itself affect income streams, a rational firm will seek to minimize payouts to departing partners, perhaps limiting such amounts to the return of capital the partners previously invested in their firm. Such a limited payout applied across-the-board to all departing partners would be unobjectionable under ethics norms.\textsuperscript{21}

The ethics problem arises not from limited payouts but from differential payouts that are reduced because of competition. By altogether limiting or prohibiting forfeitures for competition, the ethics norms promote a more vibrant market for legal services that operates to the benefit of the consumers of those services. Under these circumstances, it is to be expected that firms will tend to provide lower rather than higher payouts to all partners, applied without regard to anticipated or actual competitive activities.

This, of course, ignores the special circumstance of retirement. An attorney’s retirement may serve the interests of the firm as well as the individual. This is especially true when the individual claims an amount of the firm’s present income that exceeds the revenues associated with the lawyer’s practice. In the past era of lockstep compensation,\textsuperscript{22} the period in which the present restrictions on forfeiture for competition were framed, the retirement of senior lawyers (or more

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\textsuperscript{19} See id.

\textsuperscript{20} See generally HILLMAN, supra note 2, § 2.3.4.

\textsuperscript{21} However, if a distinction is drawn between ordinary withdrawals that trigger forfeitures and retirements that do not, the effect may be to discourage competition, and enforcement of the agreement becomes problematic. For example, in Fearnlow v. Ridenour, Swenson, Cleere & Evans, P.C., 110 P.3d 357, 358 (Ariz. Ct. App. 2005), a law firm’s stockholder agreement provided that a lawyer who withdrew from the firm for reasons other than retirement “shall tender his or her [s]hare to the Corporation for no compensation.” This was an especially harsh provision in that the forfeiture it triggered included a partner’s capital investment in the firm. Not surprisingly, the court had little trouble voiding the clause. Id. at 360.

\textsuperscript{22} Lockstep compensation plans generally allocate profits on the basis of seniority, so that a lawyer who remains with a firm may expect a progressively greater share of profits with each passing year.
bluntly, “pushing out the old”) was a critical step in moderating the distortions inherent in seniority-based compensation schemes. For this reason, it is no surprise that an allowance for contractual restraints on competition in the case of retirement benefits became an important exception to the general prohibition on competition restraints.

Over the last several decades, trends in lawyer mobility have correlated with widespread abandonment of lockstep compensation systems. The demise of compensation systems skewed in favor of those with seniority diminishes the need for a firm to have a rational exit plan (i.e., a retirement plan) for more highly compensated senior partners. Through reductions in compensation, demotions, and even expulsions, firms have adopted alternatives to retirement for addressing the declining productivity of aging partners.

Moreover, the growth of lateral movement by lawyers among firms means that many lawyers do not remain with firms for large portions of their professional lives. In an environment of lawyer mobility, one would expect firms to limit their financial commitments to former partners. This may explain the apparent decline in nonqualified deferred compensation plans, and even when such plans are continued, it is common to see changes reducing benefits and imposing longer vesting schedules. From a longer term perspective, the trend would suggest the need for greater portability in retirement benefits, although it is doubtful that the argument for such a change is any stronger for lawyers than it is for other participants in the workforce.


24. The 1980s marked the transition to a period of lawyer mobility. In 1987, Chief Justice Rehnquist noted the change: “Institutional loyalty appears to be in decline. Partners in law firms have become increasingly 'mobile,' feeling much freer than they formerly did and having much greater opportunity than they formerly did, to shift from one firm to another and take revenue-producing clients with them.” William H. Rehnquist, The Legal Profession Today, 62 Ind. L.J. 151, 152 (1987). By the mid-1990s, the trend of enhanced lawyer mobility was sufficiently established that the New York Court of Appeals noted that the “revolving door” is a “modern-day law firm fixture.” Graubard Mollen Dannett & Horowitz v. Moskovitz, 653 N.E.2d 1179, 1180 (N.Y. 1995). And with the turn of the century came a website, www.lateralattorneys.com, that openly solicited “partners with portables” and offered to “assist entire practice groups in relocating to new firms.” Law Firm Mergers/Partners with Portables, http://www.lateralattorneys.com/attorneyjobs/partners.asp (last visited Nov. 17, 2005). The present site is somewhat more subdued in emphasizing individual lawyer and paralegal mobility rather than the movement of practice groups.


IV. RETIREMENT TRENDS

For nearly a century, society has assumed an individual with a normal lifespan will reach a point at which he or she will withdraw from the workforce (i.e., retire). Earlier conceptions of retirement assumed the withdrawal would be complete, while more contemporary assumptions may depart from this linear model and involve somewhat greater professional and work activity during the retirement period. In either event, retirement for a lawyer marks withdrawal from practice, a substantial change in the nature of practice, or a meaningful reduction in the amount of time committed to practice.

Studies have demonstrated that within the labor force leisure is an increasingly important motivation for retirement. There seems little reason to suggest that lawyers have a different view of what it means to retire. Viewed in this light, allowing contractual restraints on competition when payments are keyed to retirement is consistent with the larger assumption that individuals often retire because they choose leisure over work. The inference to be drawn from this assumption is that retirement does not occur when a lawyer simply transports a practice from one firm to another.

Although the desire for increased leisure may motivate retirement, one of the most significant trends in retirement is the continuation by retired individuals of some work or professional activities. Although fifty percent of U.S. workers officially retire by age sixty, only eleven percent fully retire by that time. The reasons for work activities after retirement range from the economic (especially lifestyle considerations and a reluctance to lower the previous standard of living) to the desire to remain active in a work-related environment. Whatever the motivation, past assumptions that equate retirement with idleness may no longer hold. The change is of some importance when applying a standard premised on a simple and aged model of retirement as a cessation of work.

Portability is more readily achieved with funded defined contribution plans, which are based on individual account balances rather than a formula that defines the payout.

28. See generally COSTA, supra note 23, at 133-54 (discussing trends in leisure consumption).

29. Cf. D.C. Bar Legal Ethics Comm. Op. 325 (2004) ("The exception in Rule 5.6(a) for an agreement relating to benefits upon retirement applies only to the type of retirement typical at the end of a career and not to all departures from a firm.").

30. See Seongsu Kim & Daniel C. Feldman, Working in Retirement: The Antecedents of Bridge Employment and Its Consequences for the Quality of Life in Retirement, 43 ACAD. MGMT. J. 1195 (2000). Moreover, retirees with a high degree of career identification are more likely than others to engage in work or professional activities subsequent to retirement. Id.

31. Gender differences are noteworthy. Older women on average seek to work fewer hours than men of comparable ages, but more educated women tend to work until older ages. See Elizabeth T. Hill, The Labor Force Participation of Older Women: Retired? Working? Both?, 125 MONTHLY LAB. REV. 39 (2002). Men tend to have more orderly career paths than women, and this has been found to contribute to the earlier retirement of men. See Shin-Kap Han & Phyllis Moen, Clocking Out: Temporal Patterning of Retirement, 105 AM. J. SOC. 91 (1999).
V. THE PARAMETERS OF RETIREMENT

Because the ethics codes explicitly exempt retirement benefit payments from the general ban on restrictive covenants, considerable importance attaches to the rather straightforward inquiry of what, exactly, does "retirement" mean?

As noted above, neither the Model Code nor the Model Rules attempts to define the term, which creates an ambiguity that those desiring to employ contractual restraints on competition may choose to exploit. Viewed most broadly, retirement may be synonymous with withdrawal, such that any partner leaving a firm may be said to be retiring from the firm. Such a reading was rejected in one of the earlier cases on the retirement benefits exception, where the court quite properly remarked that if withdrawal is the same as retirement "then the disciplinary rule has no meaning."\(^32\) That perceptive point made, the court failed to give additional guidance on defining retirement benefits.

An early and significant judicial analysis of retirement benefits is Cohen v. Lord, Day & Lord,\(^33\) a landmark case on lawyer mobility. Cohen's principal significance is its conclusion that the ethics prohibition on restrictive covenants extends to contractual provisions imposing a monetary penalty on withdrawing partners who subsequently compete with their former firms.\(^34\) Importantly, it rejected the law firm’s attempt to bring the contractual forfeiture within the retirement benefits exception, offering three distinct reasons in support of this result: (1) a different and mutually exclusive section of the partnership agreement specifically provided for retirement benefits; (2) retirement benefits typically extend to the death of the retiring partner, while the departure compensation at issue in the case was paid only over a three year period; and (3) treating "departure compensation as a retirement benefit would invert the exception into the general rule, thus significantly undermining the prohibition against restraints on lawyers practicing law."\(^35\)

Although the existence of distinct, mutually exclusive provisions concerning departure compensation and retirement benefits is a reason not to treat departure compensation as a retirement benefit, placing undue emphasis on such provisions may prompt an adroit draftsman to merge the provisions into an integrated provision of the partnership agreement. Cohen was correct in observing that to treat all departure compensation as retirement benefits would undermine severely the ban on restrictive covenants,\(^36\) but that point does little to develop a framework for distinguishing payments triggered by withdrawal that qualify as retirement benefits from those that do not.

The most meaningful and specific guidance offered in the opinion for defining "retirement" benefits that may be subject to forfeiture for competition

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34. Id. at 412. See generally HILLMAN, supra note 2, § 2.3.
36. Id.
is the temporal notion that retirement benefits "extend to the death of the retiring partner and then may even continue to the partner's surviving spouse,"37 while the departure payments under the agreement at issue ended after three years. Some retirement plans do indeed provide for payments over the life of the recipient, but many do not. A large number of retirement plans provide for lump-sum or installment payments, and it is unclear what policy consideration is advanced by concluding that a short pay-out period for benefits removes the payments from the retirement exception.

VI. A SUGGESTED FRAMEWORK FOR APPLYING THE RETIREMENT BENEFITS EXCEPTION

Inasmuch as restrictive covenants are permissible when tied to the payment of retirement benefits, it is important to focus on the purpose of an agreement establishing the right to departure payments as a first step in determining whether a forfeiture-for-competition provision unduly impedes the ability of clients to choose their lawyers.

An agreement may provide for post-withdrawal payments for any one of a number of reasons. Some agreements merely reiterate the partnership law's winding-up provisions and set forth the method by which a withdrawing partner will share in income generated from work in process at the time of withdrawal.38 Other agreements, such as the one at issue in Cohen, attempt to modify the default provisions of partnership law by setting forth an alternative mechanism for the sharing of post-withdrawal income. And still other agreements seek to terminate the right of any withdrawing partner to share in post-withdrawal income and provide only for departure payments calculated with reference to the partner's capital account.

Each of the types of agreements described above provides a method of terminating a partner's interest in unfinished business or settling the account of a withdrawing partner. Account-settlement agreements are to be distinguished from agreements recognizing that some partners, upon reaching a certain age, will cease practicing law and as a result suffer a substantial drop in income. Only this latter type of agreement pertains to "retirement" as that term is customarily used. Furthermore, it is only the benefits that are payable pursuant to such agreements that fit comfortably within the retirement exception to the ban on restrictive covenants. When a partner "retires" and then proceeds to compete with the firm, the premise upon which retirement benefits have been based is undermined.

There remains the problem of distinguishing forfeiture-for-competition clauses relating to true retirement benefits from those relating to other types of departure payments, principally account settlement arrangements. Because those who desire to draft enforceable restrictive covenants have every incentive to cast payments forfeited by virtue of competition as retirement benefits, the task of

37. Id.

38. The default provisions of partnership law provide for sharing of income from work in process at the time of a withdrawal. See generally Hillman, supra note 2, § 4.6.
making the distinction is difficult. Nevertheless, a number of criteria may be useful in evaluating whether the retirement exception is available. These include: (1) the presence of minimum age and service conditions; (2) the existence of distinct withdrawal provisions governing non-retirement payouts; (3) the payment of benefits over an extended period of time; and (4) the payment or availability of ancillary benefits (primarily insurance and staff support). The criteria are discussed below, as is the issue of whether the nature of payments as “retirement” benefits should be dependent upon the sources from which they are derived.

A. The Factors

1. Minimum Age and Service Conditions.—Perhaps the most important distinguishing characteristics of retirement benefits are minimum age and service requirements. Payments made without regard to a partner’s age and length of association can hardly be denominated payments for that partner’s “retirement.”39 Moreover, a relatively modest service condition without a minimum age requirement should be viewed as suspect because of the unlikelihood that substantially all partners who leave the firm after satisfying the service condition will indeed be withdrawing for the purpose of retirement (that is, cessation of the practice of law).

2. The Existence of Separate Withdrawal Provisions.—Another factor relevant in evaluating whether departure payments are retirement benefits is the existence of provisions dealing independently with withdrawal for purposes of retirement and withdrawal for other reasons. Cohen treated the existence of “mutually exclusive” provisions dealing with withdrawal for purposes of retirement and withdrawal for other purposes as evidence that the latter is distinct from the former.40 As noted, this represents an invitation to the clever drafter of partnership agreements to expand the range of withdrawals for retirement and to attempt to restrict (or even eliminate) the range of withdrawals for other purposes. The existence of independent and substantial provisions covering retirement and nonretirement withdrawals, on the other hand, does give credence to the argument that the provisions dealing with retirement may indeed have been designed for the purpose suggested by their label.

3. Period Over Which Payments Are Made.—The period over which the payments are to be made is relevant, although not dispositive. As noted, the Cohen court’s assumption that retirement payments generally extend over the life of the recipient is incorrect; many retirement plans permit lump-sum or installment payments. Although the fact that payments are made over a relatively short period of time should not defeat their classification as retirement benefits, payment over an extended period supports the conclusion that they are for

39. Cf. Miller v. Foulston, Siefkin, Powers & Eberhardt, 790 P.2d 404, 413 (Kan. 1990) (upholding a partnership agreement provision precluding the withdrawing attorney who received retirement benefits from practicing law because of the requirement that eligibility for retirement was conditioned on a minimum age (sixty) or period of service (thirty years)).

funding a retirement.

4. Availability of Ancillary Benefits.—Firms commonly provide ancillary benefits to retired partners. These benefits may include life insurance, health insurance, and office and staff support. The presence of one or more of such benefits would support the conclusion that a partner has “retired” and payouts may be conditioned on noncompetition. The absence of all ancillary benefits does not necessarily dictate a contrary result, but it is contrary to the norm for retired partners. Therefore, it may create a presumption that payouts are not made for the purpose of funding retirement (and so may not be tied to noncompetition).

B. The Funding Question

A small but growing body of authority distinguishes benefits funded by the recipient partner from benefits funded by the firm in assessing whether forfeitures for competition by retired partners are permissible. A Virginia ethics opinion draws this distinction in concluding that only benefits funded by the firm or a third party (as opposed to deferred compensation previously earned by a partner) qualify as retirement benefits forfeitable because of competition. The letter from the chair of the ethics committee to the firm requesting the opinion explained:

It is our opinion that a plan containing a clause which would prohibit a lawyer from withdrawing compensation already earned in the event that attorney engaged in the practice of law in a geographically competitive radius to his old firm, would be in violation of the Disciplinary Rule, but only to the extent that the plan involved deferred compensation . . . . To the extent that the benefits from such a plan came from funding by the employer corporation or partnership or third parties, then the exception to the basic rule should prevail and the restriction on the right to practice within a “reasonable radius” should be acceptable.

The Virginia ethics opinion was noted by the District of Columbia Court of Appeals in Neuman v. Akman, which distinguished a “deferred payout of a current asset” from a retirement benefit:

Under the partnership agreement, Neuman will recover his capital account and his “share of net profits of the partnership for the portion of the fiscal year of retirement ending on the date of retirement” regardless

41. See Altman Weil 2005 Survey, supra note 12, at 46-47. Among firms of all sizes, a majority provide retired partners with health insurance (sixty percent) and office and staff support (seventy-nine percent), while a minority provide retired partners with life insurance (thirty-one percent). Id. at 46.


43. Id.


45. Id. at 132 n.6.
of his choice to continue practicing law in competition with the firm. It is only future firm revenues that Neuman will be deprived of, and only because he is at least potentially competing with the firm and effecting a depression of those revenues.46

The court buttressed its conclusion regarding the source of the forfeited payments by observing that “[t]here is no language in the partnership agreement to suggest that the [forfeited payout] is funded in any traceable manner by the partner receiving the benefit.”47 Along this line, the firm’s obligation to make payments was subject to the cash flow limitations set forth in the partnership agreement.48

Other courts have indicated or suggested that payouts forfeitable under the retirement benefits exceptions must be sourced in future firm revenues rather than contributions previously made by the retired partner. The Connecticut Supreme Court, for example, has defined retirement payments as benefits “payable from future firm revenues.”49 More recently, the New Jersey Supreme Court emphasized that a forfeiture it was sustaining was a “benefit funded at least in part from revenues” generated subsequent to the departure of the partner.50 The court also directed the state’s Professional Responsibility Rules Committee to consider whether a definition of retirement should be included in the ethics rules.51

Because of the law’s reticence to impose forfeitures of interests in partnerships, it is understandable that some courts consider the source of the benefit in considering whether a retirement payment may be conditioned on noncompetition with the firm. The challenge lies in tracing the source of a payment. In a law firm, partners “fund” their own postwithdrawal benefits by accepting less in the way of present compensation (i.e., allocation of current profits) in exchange for payments in the future. Any benefit paid to a withdrawing partner is a form of deferred compensation. This is true even of those plans that base benefits to a former firm member on a percentage of the firm’s current profits. The profits allocable to the remaining partners are reduced, a consequence the partners accept in the hope they will enjoy similar benefits when they leave the firm.

In Neuman, the court recognized the difficulty of tracing the source of a payment and pointed to the partnership agreement’s limitation on the obligation to make retirement payments in excess of defined cash flow thresholds as

46. Id. at 136.
47. Id. at 136 n.12 (emphasis added).
48. Id.
51. Borteck, 844 A.2d at 530.
evidence that payments were sourced in post-departure firm revenues. This is not a complete answer to the tracing concern, however, because the firm’s revenues are sourced in the efforts of the present set of partners, who accept less in the way of current income in the expectation that they will later receive retirement benefits funded at least in part by the future efforts of partners in the firm.

Given the complexity of tracing the source of a payment to a departed partner and the need to develop a standard with some predictive value, it may be desirable to define and protect from forfeiture a limited but easily determined type of retirement benefit payment that represents a return of quantifiable contributions previously made by the partner. For example, if future payments are funded by defined annual contributions (or withheld distributions), then the amount so contributed bears some similarity to a capital contribution and should not be subject to forfeiture for future competition.

Although earnings on amounts contributed should be entitled to similar protection in theory, the difficulties associated with determining these amounts and properly allocating them to the accounts of partners may be substantial; for this reason it may be prudent to limit the protection against forfeitures to the amounts contributed with no adjustment for earnings on these amounts. The result may seem harsh, but it offers the advantage of simplicity, spares judicial resources, and implements the bargained contract under which retirement payments are to be made.

VII. A POSTSCRIPT ON RETIREMENT: THE LOOK-BACK ISSUE

Assuming payments come within the retirement exception and therefore may be conditioned on noncompetition with the firm, what is to be done if a partner retires, receives some or all of the payments designated as retirement benefits, and then competes with the firm in contravention of the restrictive covenant? To put the question more directly, must the retirement that prompts the payouts be a permanent status, or need retirement only be coterminous with the period over which payments are made? What are the consequences of abandoning retirement?

In Graubard Mollen Horowitz Pomeranz & Shapiro v. Moskovitz, a 1990 New York lower court decision, the court correctly concluded that “if the partner abandons his right to these benefits, the restriction ceases to be proper.” The

52. Neuman, 715 A.2d at 136 n.12.
54. Id. at 676; see also Geoffrey C. Hazard & W. William Hodes, The Law of Lawyer § 47.4, at 47-5 (3d ed. 2001).

The purpose and meaning of the exception for “benefits upon retirement” contained in the last clause of Rule 5.6(a) is not crystal clear. It appears to mean that when a lawyer is retiring or winding up his affairs with a firm, he may be required to agree to ‘stay retired’ as a condition of obtaining payouts from future earnings of the firm. Such a condition is innocuous if limited to the situation given, for in that context it resembles
statement is unremarkable, but it prompts the interesting issue of the
recoverability of retirement payments made before the restrictive covenant was
breached. As to this question, the court offered noteworthy comments
inexplicably excluded from the published opinion:

This reading will result in some anomalies . . . . If an attorney were to be
paid benefits in a lump sum, would he be allowed a year later to change
his mind and return to practice although part of the quid pro quo for the
lump sum was that he not practice at any time thereafter? If that attorney
simply gave up future benefits, he would be giving up nothing. The
attorney who wished to return to practice might be made to return the
entire lump sum (or at least a proportionate share of it). In the case of
permanent periodic benefits, the more likely situation, the attorney may
merely forgo future benefits. In the case before me, had Moskovitz left
at the end of the five years, he would have received all of the benefits due
him, yet, in the Firm’s intention, would still be obliged to do nothing to
impair the Firm’s relationship with its clients . . . . Nevertheless, I
conclude that the attorney should be free to change his mind. A firm
intent on protecting its client base to the greatest possible extent should
tie the constraints the firm seeks directly to the period of the payment. 55

The court’s comment that an attorney who has received all retirement benefits
payable “would be giving up nothing” by returning to the practice seems
inconsistent with its observation that some or all payments previously made
might be recoverable by the firm. In any event, as a practical matter it is far
easier to suspend future payments than reclaim past benefits, which is yet another
reason for firms to extend the payout period for retirement payments to the
maximum extent possible. Changing retirement status may be addressed through
the private ordering that underlies partnership agreements.

CONCLUSION

The exclusion of retirement benefits conditioned on noncompetition from the
general ban on contractual restraints on competition was of little importance when
competition between firms and their former partners was itself a departure from
established norms. As lawyer mobility has become a dominant trend within the
profession, more firms seek to use the retirement benefits exception as a check
on competition.

The difficulty lies in articulating a concept of retirement that is consistent

pension provisions that reduce benefits for retirees who engage in significant
remunerative employment.

Id.

55. Graubard Mollen Horowitz Pomeranz & Shapiro v. Moskovitz, N.Y.L.J., May 7, 1990,
with the larger changes occurring within the profession, and within society for that matter. This Article has offered a framework that would allow a measure of certainty as to the enforceability of payouts contingent on noncompetition. But this solution is in the nature of a stopgap for an ethics rule in need of reformulation for an era in which competition is encouraged, and mobility, rather than loyalty, is the norm.