AMERICAN BAR ASSOCIATION
STANDING COMMITTEE ON ETHICS AND PROFESSIONAL RESPONSIBILITY

Formal Opinion 06-444 **September 13, 2006**

Permissibility Of Restrictive Covenants In Lawyer Agreements Concerning Benefits Upon Retirement

Under ABA Model Rule of Professional Conduct 5.6(a), a lawyer may participate in offering or making a partnership, shareholder, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship only if the agreement concerns benefits upon retirement. To be considered an agreement concerning retirement benefits under the Rule, however, the provision must affect benefits that are available only to a lawyer who is in fact retiring from the practice of law, and cannot impose a forfeiture of income already earned by the lawyer. Beyond that, law firms and employers have significant latitude in shaping the nature and scope of the restrictions on practice and the penalties for noncompliance.[1]

Rule 5.6(a) broadly prohibits agreements that restrict the rights of lawyers to engage in the practice of law after they terminate relationships with a law firm or an employer. As Comment [1] to Rule 5.6 explains, "[a]n agreement restricting the right of lawyers to practice after leaving a firm not only limits their professional autonomy but also limits the freedom of clients to choose a lawyer." Thus, for example, it is impermissible for a law firm partnership agreement to include a restrictive covenant that prohibits departing partners from practicing law after their withdrawal, even if the restriction is limited in temporal and geographic scope. Likewise, law firm partnership agreements generally may not include provisions that require partners who leave the firm and engage in a competing practice of law to forfeit financial benefits that are otherwise payable to partners who withdraw from the firm and do not thereafter compete.

A limited exception to Rule 5.6(a) allows "restrictions incident to provisions concerning retirement benefits for service with the firm."[2] If a benefit is

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1. This opinion is based on the Model Rules of Professional Conduct as amended by the ABA House of Delegates through August 2003. The laws, court rules, regulations, rules of professional conduct, and opinions promulgated in the individual jurisdictions are controlling.

2. *See* Rule 5.6 cmt. 1.

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a "retirement benefit" within the meaning of Rule 5.6(a), its payment may be conditioned on adherence to the terms of a restrictive covenant. However, neither the rule nor the comment provides any further indication of the kinds of benefits that may properly be subject to restrictive covenants, or any guidance as to the permissible scope of such restrictions. These questions are addressed below.

The fact that a particular benefit may be denominated a "retirement benefit" in an agreement governing lawyers is, of course, not dispositive. Were that the case, through the mere expedient of labeling, a law firm or an employer could create significant financial disincentives for lawyers who might otherwise leave the firm to practice elsewhere. It would not be proper under Rule 5.6(a), for example, for a law firm to place a "retirement benefit" label on a partner's capital account or on income already earned by the partner, and thereby seek to divest lawyers of such sums if they compete with the firm.[3]

To be considered a "retirement benefit" capable of restriction under Rule 5.6(a), the benefit must be one that is available only to lawyers who are in

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3. *See* Pierce v. Hand, Arendall, Bedsole, Greaves & Johnston, 678 So. 2d 765, 770 (Ala. 1996) (partnership agreement stating that if retired partner discontinued practice of law he would be entitled to deferred compensation in amount equal to what he would have received had he died at time of retirement did not truly concern "retirement benefits"); Schoonmaker v. Cummings & Lockwood of Connecticut, P.C., 747 A.2d 1017, 1032-34 (Conn. 2000) (forfeiture of benefits provision that required absolute cessation of practice did not qualify under the "retirement benefits" exception); Donnelly v. Brown, Winick, Graves, Gross, Baskerville, Schoenebaum & Walker, P.L.C., 599 N.W.2d 677, 681-82 (Iowa 1999) (significant monetary penalty that partnership agreement exacted if withdrawing partner practiced competitively with former firm was an impermissible restriction on practice of law); Anderson v. Aspelmeier, Fisch, Power, Warner & Engberg, 461 N.W.2d 598, 601-02 (Iowa 1990) (same); Pettingell v. Morrison, Mahoney & Miller, 687 N.E.2d 1237, 1240 (Mass. 1997) (amounts to be paid not "retirement benefits," but rather are amounts payable to partners who voluntarily withdraw from firm); McDonough v. Bower & Gardner, 641 N.Y.S.2d 391, 392-93 (N.Y. App. Div.), *leave to appeal denied by* 672 N.E.2d 605 (N.Y. 1996) (provision of partnership agreement conditioning payment of amount remaining in account on partner's death or permanent retirement from practice not "retirement benefit"); Spiegel v. Thomas, Mann & Smith, P.C., 811 S.W.2d 528, 531 (Tenn. 1991) (provision of partnership agreement conditioning payment of deferred compensation upon withdrawing shareholder's discontinuation of practice did not involve payment of "retirement benefits"); Indiana State Bar Ass'n Legal Eth. Committee Op. 3 of 1994 (Oct. 1994) (partnership agreement that provided that withdrawing partner had to forfeit 25% of buyout figure for his interest in firm if he continued to practice in county where firm located or in any adjoining county violated Rule 5.6); South Carolina Bar Eth. Adv. Committee Op. 91-20 (Sept. 1991) (firm could not condition payment of interest in accounts receivable already earned on complete cessation of practice of law).

fact retiring and thereby terminating or winding down their legal careers.[4] Thus, the benefits should be payable only upon the satisfaction of minimum age and years-of-service requirements that are consistent with the concept of retirement. At a minimum, a benefit that is payable to a lawyer who has attained an age at which it is common for employers to offer early retirement and who has worked for the firm or employer for a substantial period of time would constitute a bona fide retirement benefit under generally accepted definitions of that phrase.[5] In contrast, restrictions on the receipt of benefits payable during the prime of a lawyer's career and after only a relatively modest period of service with the firm would clearly be targeting, in most cases, lawyers who are withdrawing for competitive reasons, not to "wind down"

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4. *See* Borteck v. Riker, Danzig, Scherer, Hyland & Perretti LLP, 844 A.2d 521, 527 (N.J. 2004) (agreement included normal indicia one would expect to see in legitimate retirement plan); Cohen v. Lord, Day & Lord, 551 N.Y.S.2d 157, 158-59 (N.Y. 1989) (although provision did not expressly or completely prohibit withdrawing partner from engaging in practice of law, significant monetary penalty it exacted if withdrawing partner practiced competitively with former firm constituted impermissible restriction on practice of law); Gray v. Martin, 663 P.2d 1285, 1290 (Or. Ct. App.), *review denied*, 668 P.2d 384 (Or. 1983) (agreement precluding withdrawing partner from receiving certain partnership benefits if he resumed active practice of law in designated counties violated disciplinary rule prohibiting the restriction of right of lawyer to practice law after termination of partnership relationship); Connecticut Bar Ass'n Prof'l Ethics Committee Op. 89-26 (Oct. 25, 1989) (partnership agreement imposing financial disincentives not related to benefits upon retirement upon departing partner who subsequently competes with former firm violates Rule 5.6); District of Columbia Bar Legal Eth. Committee Op. 325 (Oct. 2004) (agreement to distribute profits already earned by former firm that would be paid in future only to partners who continue to practice with post-merger firm did not come within retirement exception of Rule 5.6(a); agreement created financial disincentive to partners who wished to leave merged firm and practice with another firm).

5. *See* Schoonmaker v. Cummings & Lockwood of Connecticut, P.C., 747 A.2d at 1033 (early retirement provisions in law firm partnership agreement requiring retirees to permanently retire from practice of law except for public service activities related to law contained sufficient indicia of bona fide retirement arrangement); Neuman v. Akman, 715 A.2d 127, 136-37 (D.C. 1998) (partnership agreement providing that partners who leave firm to engage in private law practice will receive capital contribution and share of net partnership profits, but are not entitled to "additional amount" linked to productivity of partner over period of years preceding withdrawal fell within rule's "benefits upon retirement" exception); Hoff v. Mayer, Brown & Platt, 772 N.E.2d 263, 268-69 (Ill. App. Ct.), *appeal denied*, 786 N.E.2d 183 (2002) (firm's benefit plan was bona fide retirement plan that could deny benefits to lawyer who took early retirement to practice law); Donnelly v. Brown, Winick, Graves, Gross, Baskerville, Schoenebaum & Walker, P.L.C., 599 N.W.2d at 682 (firm's retirement plan, requiring 10 years of service and 60 years of age or 25 years of service, qualified as retirement plan and thus benefits under plan could be conditioned on lawyer's remaining out of private practice of law in state); Miller v. Foulston, Siefkin, Powers & Eberhardt, 790

their legal careers, and could not be considered restrictions on "retirement benefits" under Rule 5.6(a).[6]

Other indicia of a legitimate retirement benefit – none of which are mandatory or dispositive of the issue, but each of which could provide additional support for a conclusion that a benefit falls within the Rule 5.6(a) exception – include (i) the presence of benefit calculation formulas, (ii) benefits that increase as the years of service to a firm increase, and (iii) benefits that are payable over the lifetime of a retired partner.[7] Similarly, if there is an interrelationship between the benefits and payments from other retirement funds, such as Social Security and defined contribution retirement plans (that is, the payments from the firm decrease as other sources of retirement income phase

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P.2d 404, 410 (Kan. 1990) (agreement under which only partners expelled from firm who could receive additional compensation were those who met requirements for retiring and who did in fact retire); Apfel v. Budd Larner Gross Rosenbaum Greenberg & Sade, 734 A.2d 808, 813 (N.J. Super.), *cert. denied*, 744 A.2d 1208 (1999) (agreement that reduced departing lawyer's retirement benefits if lawyer left firm to work for another law firm in same state was anticompetitive and thus violated Rule 5.6); W. HILLMAN, HILLMAN ON LAWYER MOBILITY § 2.3.5, at 2:90-91 (2d ed. 1998) (describing criteria useful for defining retirement plan, including existence of minimum age and service requirements).

6. Although some authorities addressing Rule 5.6(a) have referred to the benchmark of the so-called "Rule of 75," that is, a combination of age and years of service that total 75, as a minimum requirement for retirement benefit status, *see*, *e.g.*, Neuman v. Akman, 715 A.2d at 136-37, we do not believe that level is mandated by Rule 5.6(a). Nor, for that matter, would satisfaction of the Rule of 75 necessarily compel the conclusion that a payment is a retirement benefit within the meaning of Rule 5.6(a).

7. *See* Schoonmaker v. Cummings & Lockwood of Connecticut, P.C., 747 A.2d at 1020 (agreement provided that benefit was payable only after retiring lawyer reached 60, or became physically or mentally incapable of continuing to practice law and took into account length of lawyer's service and average annual income over five-year period); Newman v. Akman, 715 A.2d at 129-30 (benefit generally payable beginning at age 65 to withdrawing partners who satisfy certain age and longevity requirements or leave firm by reason of death or permanent disability); Borteck v. Riker, Danzig, Scherer, Hyland & Perretti LLP, *infra* note 8; Gray v. Martin, 663 P.2d at 1290 (for 24 months following effective date of withdrawal, partner would receive one-fourth of share of profits based upon average percentage of participation that lawyer and firm held during preceding 36 months); South Carolina Bar Ethics Advisory Committee Op. 91-20 (agreement eliminated requirement that new partners purchase interest in firm's accounts receivable and either partially or completely eliminated partner's interest in accounts receivable at the time of departure); W. HILLMAN, HILLMAN ON LAWYER MOBILITY, § 2.3.5, at 2:89-90 (criteria helpful to inquiry include presence of minimum age and service requirements; existence of provisions dealing independently with withdrawal for purposes of retirement and withdrawal for other reasons; and period over which payments are to be made).

in), the benefits are more likely to be considered "retirement benefits" under Rule 5.6(a).[8]

The overall structure of the agreement in which the provision appears may itself provide evidence supporting a determination that the benefits in question are truly retirement benefits. For example, the existence of separate provisions in a law firm partnership agreement for withdrawal from the firm and for retirement, or the establishment of an extended period of time for paying out retirement benefits beyond that required for payments due on withdrawal, would suggest that the benefits were intended to be available only to lawyers who had attained retirement status, not to lawyers who were leaving the firm to engage in the practice of law elsewhere.[9]

Under Rule 5.6(a), a law firm may properly require that a lawyer receiving bona fide "retirement benefits" cease the practice of law permanently. Alternatively, the firm may tailor the restriction by limiting it temporally, geographically, or to certain types of practice.[10] Likewise, a provision restricting the receipt of retirement benefits would not run afoul of Rule 5.6(a) if it permitted the departing lawyer to engage in public or other non-competitive employment, such as service as a judge, a law professor, an elected or appointed government official, a public defender, a legal services lawyer, or an in-house counsel for a charitable or other non-profit organization, activities that a law firm may not wish to discourage. In short, if the restrictive covenant applies only to the receipt of retirement benefits within the meaning of Rule 5.6(a), the contracting parties are free to determine the scope of the restriction on the future practice of law.

Of course, the restrictive covenants contemplated by Rule 5.6(a) are not outright and absolute prohibitions on the practice of law after termination of the lawyer's relationship with the firm, but are only preconditions to the receipt of certain benefits from the firm. Thus, a lawyer may choose to continue the practice of law notwithstanding a restrictive covenant authorized by Rule 5.6(a), provided the lawyer is also prepared to forfeit whatever retirement benefits are subject to the restriction.[11] Likewise, a lawyer who has

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8. *See* Borteck v. Riker, Danzig, Scherer, Hyland & Perretti LLP, 844 A.2d at 523-24 (agreement included minimum age requirements, benefit calculation formulas, and defined term for benefit payouts, with benefits payable over five-year or ten-year period and increasing as years of service to firm increased, and benefits payable to deceased retiree's estate).

9. *Id*. at 528-29 (2004); W. HILLMAN, HILLMAN ON LAWYER MOBILITY, § 2.3.5, at 2:89-90 (distinguishing retirement benefits from other types of departure payments).

10. *Cf*. Model Rule 1.17(a) (regarding the sale of a law practice by a retiring lawyer).

11. *See* Graubard Mollen Horowitz Pomeranz & Shapiro v. Moskowitz, 565 N.Y.S.2d 672, 675-76 (N.Y. Sup. Ct. 1990) (disciplinary rule outlawing agreements among counsel that restrict lawyer's right to practice law did not foreclose restrictions in partner's retirement agreement but also did not prevent him from foregoing retirement benefits and going to work for new firm).

received retirement benefits under an agreement including a restrictive covenant would be free to resume the private practice of law, subject to any penalties set forth in the agreement, which could conceivably include the forfeiture of all future benefits as well as the disgorgement of benefits received prior to the violation of the restriction.[12]

Rule 5.6(a) and the associated comments express a strong disapproval of restrictive covenants in lawyer agreements. The exception for restrictions concerning the receipt of retirement benefits must therefore be construed strictly and narrowly. Accordingly, to be considered an agreement concerning retirement benefits under Rule 5.6(a), the provision in question must affect benefits that are available only to a lawyer who is in fact retiring from the practice of law, and cannot work a forfeiture of income already earned by the lawyer. Beyond that, however, law firms and employers have significant latitude in shaping the nature and scope of the restriction on practice and the penalties for noncompliance.

12. *See* Miller v. Foulston, Siefkin, Powers & Eberhardt, 790 P.2d at 411-12 (lawyer had choice of retiring, including stopping practice of law and receiving over $190,000 in retirement benefits, or continuing practice of law, in which case he lost retirement benefits).