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Restrictive Covenants and the Curious Case of National Law Firm Breakups

Post-employment restrictions may prove unenforceable if decided by the wrong court.

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There is a provocative line in a largely forgotten 1980s movie: "[E]verything ends badly, otherwise it wouldn't end." While perhaps not the inescapable truth of every relationship, it appears to be an unfortunate reality for law firm breakups.

While there are many reasons that law firm partnerships tend to end badly, an underappreciated one is the uncertainty over whether and how restrictive covenants can bind lawyers. The law varies from state to state, but most have adopted one of two diametrically opposed approaches. This divergence creates difficulties for firms with offices in multiple states, as there is no straightforward way to evaluate the risks and benefits of adopting and enforcing restrictive covenants. To make matters worse, there is a dearth of guidance on how to resolve the complex choice of law problems that arise.

A recent example is the dispute between Quinn Emanuel Urquhart & Sullivan, LLP, a California partnership with multiple national and international offices, and a group of partners who left to form Selendy & Gay PLLC in New York.

Suffice to say things ended badly between them. When Selendy launched, Quinn filed an arbitration in California to enforce a clause in its partnership agreement requiring departing partners to forfeit a portion of their future income if they compete with the firm within 18

months after they leave. Then, just as quickly, the Selendy partners brought a New York action to permanently stay the arbitration on the basis that the forfeiture provision was void and any relief granted by the arbitrator would violate the state's public policy.

At the center of this dispute was the issue of whether New York or California law should govern the enforceability of the forfeiture provision. In an April 2019 decision, the New York trial court declined to rule on the issue, reasoning that it was one for the arbitrator to decide. Whether that ruling was correct is largely irrelevant; what matters is that there was no public resolution of the choice of law problem. It remains an unanswered, and thorny, legal issue.

New York Prohibits Attempts to Limit Competition

Simply put, jurisdiction matters. While New York's well-trodden law of restrictive covenants is considered employer-friendly in general, lawyers are an exception. New York has determined that unique policy considerations justify special treatment for lawyers.

Rule 5.6(a)(1) of the New York Rules of Professional Responsibility, which tracks the parallel ABA Model Rule, provides that "[a] lawyer shall not participate in offering or making a partnership…agreement that restricts the right of a lawyer to practice after termination of the relationship[.]" According to a Rule comment, the basis for it is that "[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." In other words, it is unethical for a firm to restrict a lawyer from competing because it negatively impacts both the lawyer and his or her clients.

Embracing those policy rationales, New York courts have voided as contrary to public policy economic penalties that would discourage lawyers from representing their clients after leaving a firm. In *Cohen v. Lord, Day & Lord*, 550 N.E.2d 410 (1989), the Court of Appeals voided a partnership provision that required withdrawing partners to relinquish their share of earned-but-uncollected revenue if the partners competed. It concluded that the "significant monetary penalty

[the provision] exacts, if the withdrawing partner practices competitively with the former firm, constitutes an impermissible restriction on the practice of law." *Id.*, at, 411. While the Court recognized that a law firm has a "legitimate interest in its own survival and economic well-being and in maintaining its clients," it found those considerations must give way to public policy in this instance. *Id.* at 413.

The Court of Appeals revisited this issue four years later in *Denburg v. Parker Chapin Flattau & Klimpl*, 624 N.E.2d 995 (1993). In that case, it cautioned against reading *Cohen* as prohibiting all restrictions on departing partners. Nevertheless, it found that a provision monetarily penalizing a former partner that moved to a new firm was invalid because "its effect is to improperly deter competition and thus impinge upon clients' choice of counsel." *Id.*, at 999.

Two years later, however, the Court of Appeals appeared to find *Cohen's* outer limits. In *Hackett v. Milbank, Tweed, Hadley & McCloy*, 654 N.E.2d 95 (1995), it considered a provision that limited supplemental payments made to departing partners irrespective of whether they were retiring or withdrawing. After evaluating evidence on the lack of a significant anticompetitive effect, an arbitrator upheld the enforceability of the provision. The Court of Appeals refused to second-guess the arbitrator's conclusion. Because the provision was not "inevitably anticompetitive on its face," the Court found that arbitrator's decision was entitled to deference. *Id.*, at 101.

While these authorities leave open the possibility that an economic penalty could be sufficiently tied to a firm's survival as to be justified, there are no reported decisions reaching that conclusion.

California Permits Penalties on Competition

California, joined by a handful of other jurisdictions, has adopted a very different approach. "[U]nlike New York courts, California courts are more likely to enforce restrictive covenants in

law firm agreements, despite the same prohibition in that state's lawyer code." *Selendy v. Quinn Emanuel Urquhart & Sullivan, LLP*, 98 N.Y.S.3d 814, 819 (Sup. Ct. N.Y. Cty. 2019).

In *Howard v. Babcock*, 863 P.2d 150 (1993), the Supreme Court of California considered a provision that forfeited a withdrawing partner's right to withdrawal benefits if the partner competed with the firm within a limited geographic area for a year. In its decision, the Court expressly rejected *Cohen*'s view of the legal profession's unique status: "[W]e have determined that these courts' steadfast concern to assure the theoretical freedom of each lawyer to choose whom to represent…and the theoretical freedom of any client to select his or her attorney of choice is inconsistent with the reality that both freedoms are actually circumscribed." *Id.*, at 151. Reasoning that law firms have economic interests that are as deserving of protection as other partnerships, the court held that "an agreement among partners imposing a reasonable cost on departing partners who compete with the law firm in a limited geographical area is not inconsistent with [the lawyer-code] and is not void on its face as against public policy." *Id.*

As is evident from the *Howard* court's analysis, the two dominant approaches afford different weight to the interests of lawyers and their clients, and arise from fundamentally different views of the role of the legal profession and the nature of the attorney-client relationship. A jurist applying California law would likely uphold the Quinn forfeiture provision, even though a New York jurist likely would not.

Drafting Around the Choice of Law Issue

The Selendy partners and Quinn agreed to the application of California law, and in most circumstances that decision would be respected. However, that is not necessarily true here. This is one of the rare choice of law problems that cannot be directly contracted around, as judges seem comfortable setting unambiguous contractual language aside if it conflicts with the forum state's public policy. For example, in what appears to be the lone case directly on-point, a Northern District of Illinois court found that it had to apply Illinois law to a forfeiture provision despite the existence of a Texas choice of law clause in the partnership agreement. *See Cummins*

v. Bickel & Brewer, 2001 WL 204797, at *4 (N.D. Ill. Mar. 1, 2001) ("[B]ecause applying Texas law could violate fundamental Illinois public policy, we must apply Illinois law.").

National law firms that safeguard their economic interests by imposing restrictive covenants on departing partners should consider two issues to increase the likelihood that any such covenants will be enforced.

First, forum is going to play an outsized role in enforceability. Courts in California or in jurisdictions that follow that state are going to be more likely to uphold such provisions than arbitrators, and arbitrators are going to be more likely to do the same than courts in jurisdictions like New York. Law firms should consider, assuming there is an appropriate nexus, a favorable jurisdiction for lawsuits between the firm and its partners or for enforcing an arbitral award.

Second, a one-size-fits-all approach may be inappropriate given the differences in state law. Rather than including a uniform forfeiture provision in a partnership agreement, firms could consider separate riders for lawyers in jurisdictions that permit reasonable restrictions on competition. While the disparate treatment of partners based on geographic region may be neither practical nor desirable, it is an option for firms that have large clients in particular regions that they wish to protect. Alternatively, firms could offer key rainmakers "golden handcuffs," as these are going to appear less like penalties that are designed to thwart competition.

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