

January 2017 *Multnomah Lawyer Ethics Focus*

## **Golden Handcuffs: Non-Competes and Penalty Provisions**

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When preparing employment agreements for business clients in a wide variety of industries, lawyers sometimes include “non-compete” provisions that bar employees from working for competitors for a stated period or geographic area after the person leaves the client. When managing their own practices, however, lawyers are generally prohibited from including non-competes or similar financial penalties in partnership, shareholder or employment agreements. By contrast, provisions that recognize the financial impact of the lawyer’s departure on the firm present a more nuanced question of whether they are an impermissible penalty on lawyer movement or a practical recognition of the economic effect of a lawyer’s departure.

### ***Non-Competes***

RPC 5.6(a) generally prohibits both “offering or making” a non-compete:

“A lawyer shall not participate in offering or making:

“(a) a partnership, shareholders, operating, employment, or other similar type of agreement that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement[.]”

This limitation is neither new or unusual. Oregon’s predecessor professional rules contained a similar limitation in former DR 2-108(A). Oregon’s current rule is patterned largely on the corresponding provision of the ABA Model

Rules of Professional Conduct, Model Rule 5.6(a). Around the Northwest, Washington, Alaska and Idaho all have similar rules.

As the text of the rule makes plain, it applies to both lawyer-owners (whether partners or shareholders) and lawyer-employees (whether traditional associates or firm lawyers holding other titles). The justification for the prohibition is summarized in Comment 1 to ABA Model Rule 5.6: “An 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.”

RPC 5.6(a) exempts non-competes entered into in conjunction with retirement benefits and RPC 1.17(h) also exempts similar provisions associated with law practice sales. As ABA Formal Ethics Opinion 06-444 puts it (at 2-3): “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 fact retiring and thereby terminating or winding down their legal careers.” ABA Formal Ethics Opinion 468 (2014) makes the same point about the exemption for law practice sales.

RPC 5.6(a) can be enforced in the disciplinary context (*see generally* OSB Formal Ethics Op 2005-29). But, in many instances, the more practical effect is that non-competes have been held to be unenforceable (*see, e.g., Gray v.*

*Martin*, 63 Or App 173, 181-82, 663 P2d 1285 (1983) (partnership agreement); *Hagen v. O’Connell, Goyak & Ball, P.C.*, 68 Or App 700, 703-04, 683 P2d 563 (1984) (shareholder agreement)). The rationale for a court refusing to enforce a prohibited non-compete is that it is void as against public policy. In *Gray*, for example, the Court of Appeals concluded (at 63 Or App at 182 n. 1): “[W]e believe that courts other than the Supreme Court may apply the disciplinary rules in determining whether the contract provisions are enforceable.”

### ***Financial Penalties***

Provisions that penalize a lawyer financially for leaving to compete with the “old” firm are generally treated as the functional equivalent of non-competes and are also generally prohibited by RPC 5.6(a). In *Hagen*, for example, the Oregon Court of Appeals refused to enforce a provision that imposed a financial penalty on a withdrawing shareholder if the shareholder did not agree to a non-compete. The Court of Appeals used the same approach on the penalty as with a non-compete (at 704): “The 40 percent penalty provision . . . [in valuing the departing shareholder’s interest in the professional corporation on withdrawal] . . . is unenforceable, because it is contrary to the public policy of making legal counsel available, insofar as possible, according to the wishes of a client.” Similarly, the Court of Appeals in *Gray* refused to enforce a provision that

effectively forced a withdrawing partner to forfeit the partner's unpaid draw and capital account unless the lawyer agreed to a non-compete. Again, Oregon is not unique in this regard, with ABA Formal Ethics Opinion 06-444 noting (at 1) that "law firm partnership agreements generally may not include provisions that require partners who leave the firm and engage in a competing practice to forfeit financial benefits that are otherwise payable to partners who withdraw from the firm and do not thereafter compete."

At the same time, the Court of Appeals in *Hagen* found (at 704) that the law firm could adjust the withdrawing shareholder's stock value to reflect the economic impact of the lawyer's departure on the firm as long as the adjustment "would result in a valuation that bears a reasonable relationship to the probable loss to the firm." Citing *Hagen*, OSB Formal Ethics Opinion 2005-29 agrees that (at 67) "partnership agreements may provide for reimbursement to the partnership for harm actually caused to the partnership by the withdrawal or for a diminution in value caused by the withdrawal." Opinion 2005-29 does not draw a bright line between a prohibited penalty and a permissible provision recognizing the economic impact of a withdrawal. But, as in *Hagen*, the closer a provision comes to a non-compete—either directly or implicitly—the more likely it will be held unenforceable under RPC 5.6(a).

## ABOUT THE AUTHOR

Mark J. Fucile of Fucile & Reising LLP handles professional responsibility, regulatory and attorney-client privilege issues for lawyers, law firms and corporate and governmental legal departments throughout the Northwest. Mark has chaired both the WSBA Committee on Professional Ethics and its predecessor, the WSBA Rules of Professional Conduct Committee. Mark is also a former member of the Oregon State Bar Legal Ethics Committee and is a current member of the Idaho State Bar Section on Professionalism & Ethics. Mark writes the monthly Ethics Focus column for the Multnomah (Portland) Bar's *Multnomah Lawyer*, the quarterly Ethics & the Law column for the WSBA *NWLawyer* and is a regular contributor on legal ethics to the WSBA *NWSidebar* blog. Mark is a contributing author/editor for the current editions of the OSB *Ethical Oregon Lawyer*, the WSBA *Legal Ethics Deskbook* and the WSBA *Law of Lawyering in Washington*. Before co-founding Fucile & Reising LLP in 2005, Mark was a partner and in-house ethics counsel for a large Northwest regional firm. He also teaches legal ethics as an adjunct for the University of Oregon School of Law at its Portland campus. Mark is admitted in Oregon, Washington, Idaho, Alaska and the District of Columbia. He is a graduate of the UCLA School of Law. Mark's telephone and email are 503.224.4895 and Mark@frllp.com.