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Golden Handcuffs: Restrictive Covenants in Law Firm Employment Agreements

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In some industries, employment agreements include so-called "golden handcuffs": provisions that effectively restrict employees from going to work for competitors through direct prohibitions or financial penalties. RPC 5.6(a), which is based on its ABA Model Rule counterpart, generally prohibits them in law firm employment agreements:

> "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[.]"

The principal exceptions are narrowly tailored to retirement agreements under RPC 5.6(a) and sales of law practices under RPC 1.17(h). Comment 1 to ABA Model Rule 5.6 explains the rationale for the rule:

> "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."

At the same time, law firms sometimes include pre-departure notice or related financial provisions in their employment agreements that walk up to—and occasionally cross—the line between permissible and prohibited restrictions. Although in theory impermissible restrictions could expose the participants to

regulatory discipline, the larger practical risk in most instances is that such provisions will be held unenforceable by courts.

In this column, we'll look at both pre-departure notice provisions and related financial disincentives. With each, precise line-drawing is generally impossible in light of their inherently fact-driven contexts. Nonetheless, we'll survey the factors that courts have used in determining on which side of the line these kinds of provisions fall.

Pre-Departure Notice

This past December, the ABA issued an ethics opinion—Formal Opinion 489—that focused on pre-departure notice. In doing so, the opinion built on an earlier ABA opinion—Formal Opinion 99-414 (1999)—that addressed lawyer mobility issues generally and that, in turn, significantly influenced the primary state opinions on that topic in the Northwest, OSB Formal Opinion 2005-70 (rev 2015) and WSBA Advisory Opinion 201801 (2018).

The new ABA opinion emphasized that pre-departure notice provisions are not inherently suspect because both a departing lawyer and the lawyer's firm have a duty to inform the clients for which the lawyer was principally responsible of the lawyer's planned departure and to protect the clients' interests in the

transition. At the same time, the ABA opinion—quoting an Oregon State Bar *Bulletin* article—cautioned:

> "'Although "reasonable" notice provisions may be justified to ensure clients are protected when firm lawyers depart, what is "reasonable" in any given circumstances can turn on whether it is truly the client's interest that is being protected or simply a thinly disguised restriction on the right to practice in violation of RPC 5.6(a).'"

In striking a balance, ABA Formal Opinion 489 synthesized case law nationally and concluded:

> "Firms have an ethical obligation to assure that client matters transition smoothly and therefore, firm partnership/shareholder/member/employment agreements may request a reasonable notification period, necessary to assure that files are organized or updated, and staffing is adjusted to meet client needs. In practice, these notification periods cannot be fixed or rigidly applied without regard to client direction, or used to coerce or punish a lawyer for electing to leave the firm, nor may they serve to unreasonably delay the diligent representation of a client. If they would affect a client's choice of counsel or serve as a financial disincentive to a competitive departure, the notification period may violate Rule 5.6."

Financial Disincentives

ABA Formal Opinion 489 noted that there is no practical distinction under ABA Model Rule 5.6(a) between pre-departure notice provisions that impermissibly interfere with client choice and financial disincentives imposed on a client's preferred lawyer that do the same:

> "There is no meaningful distinction for purposes of Rule 5.6 between an agreement provision that imposes a financial disincentive to a competitive departure irrespective of the pre-departure notice requirements and a provision that imposes a financial disincentive for the failure to comply with a fixed, pre-established notice period that extends beyond the time necessary, generally or in a particular case, to ensure an appropriate transition[.]"

The Oregon Court of Appeals in *Gray v. Martin*, 63 Or App 173, 663 P2d 1285 (1983), and *Hagen v. O'Connell, Goyak & Ball, P.C.*, 68 Or App 700, 683 P2d 563 (1984), took the same approach with other financial penalties for leaving. In *Gray*, for example, a law firm partnership agreement included a provision forfeiting future income rights if a departing lawyer continued to practice in a three-county area surrounding the firm's office. In *Hagen*, a law firm shareholder agreement included a provision reducing the valuation of a departing shareholder's stock unless the lawyer executed a noncompete. The Court of Appeals found that both provisions were unenforceable under RPC 5.6(a)'s analogous predecessor in the former Oregon Code of Professional Responsibility. Similarly, WSBA Advisory Opinion 2118 (2006) concluded that an outright liquidated damages provision tied to breach of a non-compete in a law firm employment agreement was also prohibited under Washington's version of RPC 5.6(a).

By contrast, the simple fact that a lawyer who leaves before a firm's scheduled year-end compensation process and effectively foregoes the opportunity to be considered for year-end bonus should not ordinarily raise the same issues under RPC 5.6(a)—as long as it is not a direct penalty for leaving.

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