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The Law Firm as Jurassic Park: Comments on *Howard v. Babcock**

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* © 1994 by Robert W. Hillman. The title was inspired by the reaction of an attorney to *Howard v. Babcock:* "A Jurassic Park effort to save the dinosaurs." *See* Victoria Slind-Flor, *Non-Compete Clauses Approved: California Goes Own Way*, NAT'L L.J., Dec. 20, 1993, at 3, col. 1 (quoting comment on *Howard v. Babcock* by author of amicus brief filed in case for California State Bar).

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INTRODUCTION

In recent years, many law firms have suffered sudden defections of their partners, or sometimes entire departments, with clients in tow.[1] Few firms are immune to this activity, which is often referred to as "grabbing and leaving."[2] In the words of the Chief Justice, "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."[3]

The causes of grabbing and leaving are many, but perhaps the most common is dissatisfaction with the allocation of income within a firm. In the past, "lockstep" compensation keyed to seniority in the firm was the dominant method of dividing a firm's income among its partners.[4] Although some partners chafed at a system rewarding seniority over productivity, their options were limited because lateral movement of partners between firms was rare. More recently, barriers to lateral movement have fallen, which has given options to lawyers dissatisfied with the methods by which their firms allocate income. Lawyers who have achieved the status of "rainmakers" are thus able to auction their "portfolios" of clients to

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[1] *See generally* MARC GALANTER & THOMAS PALAY, TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM 54-55 (1991); ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY: THE LAW AND ETHICS OF PARTNER WITHDRAWALS AND LAW FIRM BREAKUPS § 1.1 (1994); ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 277-81 (1993).

[2] *See, e.g.*, Hillman, *supra* note 1, § 1.1. (1990); Robert W. Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving*, 67 TEX. L. REV. 1 (1988). Professors Gilson and Mnookin used "grabbing" to describe a partner's renegotiation of income under a threat to leave and "leaving" as the actual taking of clients from a firm. *See* Ronald J. Gilson & Robert H. Mnookin, *Sharing Among the Human Capitalists: An Economic Inquiry into the Corporate Law Firm and How Partners Split Profits*, 37 STAN. L. REV. 313, 321 (1985).

[3] William H. Rehnquist, *The Legal Profession Today*, 62 IND. L.J. 151, 152 (1987). One commentator has suggested that the "breakdown" in the relationship between firms and their members is partly a function of the size of the firms. *See* KRONMAN, *supra* note 1, at 278. It is important to recognize, however, that much of the reported litigation on law firm breakups involves small and medium size firms. For example, the subject of this Commentary, *Howard v. Babcock*, involved a firm that had, prior to the withdrawals, fourteen partners.

[4] Gilson & Mnookin, *supra* note 2, at 315-16; HILLMAN, *supra* note 1, § 1.1.

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the highest bidders or use the threat of departure as a means of securing larger allocations of their firms' incomes.[5]

Ideally, lawyers are well equipped to address and shift risk through the private ordering reflected in law firm partnership agreements. If the bargaining among members of a firm were free of external regulation, partnership agreements would make it difficult, or at least expensive, to withdraw and compete with firms. Either covenants not to compete or significant financial disincentives for competition would become standard features of partnership agreements.[6] Such anti-competition clauses would rarely require enforcement because their mere existence would serve to dissuade many lawyers from grabbing and leaving.[7]

The reality is that private ordering addressing competition among lawyers is not free of external regulation. Every state legal ethics code prohibits the use of covenants not to compete as anti-grabbing devices.[8] With regularity, ethics committees and courts have declared attempts to "barter clients" through the use of the

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5 Indeed, lawyers with large "books of clients" are the targets of advertisements and legal recruiters. *See, e.g.*, N.Y.L.J., Feb. 8, 1988, at 12, col. 1 (advertisement reading: "Senior Partner — Any Art with Portfolio for Major Firm."); LEGAL TIMES, Dec. 13, 1993, at 44, col. 3 (advertisement reading: "DC law firm seeks attorney with portable law practice preferably with general corporate trade association, international, tax or litigation practice."). *See also* James W. Jones, *The Challenge of Change: The Practice of Law in the Year 2000*, 41 VAND. L. REV. 683, 688 (1988) (commenting that "[t]he concept of the 'portable practice' and the increasing willingness of lawyers to leave their current firms to work for the highest bidding competitors have created a whole new growth industry in legal recruitment services.").

6 *But cf.* Howard v. Babcock, 863 P.2d 150, 157 (Cal. 1993) ("[M]any firms have inserted noncompetition clauses into their partnership agreements."); Steven Brill, *The Partner Breakup Follies*, AM. LAW., Mar. 1988, at 3 (reporting that one half of firms surveyed had restrictive covenants even though most lawyers seem unaware of problems concerning their enforceability).

7 This conclusion seems obvious, but there is some reason for doubt. Illinois did not ban lawyer restrictive covenants until 1990. *See* ILL. SUP. CT. RULES OF PROFESSIONAL CONDUCT Rule 5.6 (1993). It would be interesting to gather additional data on the effect of the absence of a restriction on lateral movement by lawyers.

8 The ban on restrictive covenants dates to 1961, when the American Bar Association's Committee on Professional Ethics declared improper an anti-competition clause in a firm's employment agreement with an associate. *See generally* HILLMAN, supra note 1, § 2.3.3.

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clauses unenforceable.[9] Two reasons support the antagonism toward contracts among lawyers that restrain competition. First, clients must be free to choose their lawyers, and anti-competition agreements in partnership agreements impede client choice.[10] Second, lawyers themselves have a justifiable and unwaivable interest in freedom of movement among firms.[11] Of the two policy justifications, the principle of client choice is mentioned far more frequently as the reason for the ethics ban on covenants not to compete.

Lawyers excel at circumventing limitations, and the ethics prohibition on restrictive covenants has provided ample opportunity for the display of creative lawyering. The most interesting efforts have been in the form of forfeiture-for-competition clauses. Most forfeiture clauses reduce, or eliminate, the firm's obligations to make payments in settlement of the withdrawing partner's accounts. Although the clauses allow competition, at a cost, and therefore are distinguishable from restrictive covenants, *Cohen v. Lord, Day & Lord*,[12] a landmark 1989 New York opinion, reasoned that forfeiture for competition agreements may "functionally and realistically discourage" attorneys from representing clients and, therefore, are the

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[9] *See, e.g.*, ABA Comm. on Professional Ethics, Informal Op. 1072 (1968) (attorneys should not "barter in clients" through agreements restricting competition). *See generally* HILLMAN, *supra* note 1, §§ 2.3.3-.4.

[10] The freedom of clients to discharge their lawyers at any time, with or without cause, greatly facilitates competition among lawyers. Because the lawyer-client relationship is personal in nature, both the Model Code of Professional Responsibility and the Model Rules of Professional Conduct mandate lawyer withdrawal upon discharge by a client. See MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-110(B)(4) (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.16(a)(3) (1989). *See also* RESTATEMENT OF THE LAW GOVERNING LAWYERS § 44(1) (Tentative Draft No. 5, 1992) ("A client may discharge a lawyer at any time."). Accordingly, neither the firm nor any of its members may claim a possessory interest in clients. As one court stated, "Although the firm may refer to clients of the firm as 'the firm's clients,' clients are not the 'possession' of anyone, but, to the contrary, control who will represent them." Kelly v. Smith, 611 N.E.2d 118, 122 (Ind. 1993).

[11] *See, e.g.*, Howard v. Babcock, 863 P.2d 150, 160 (Cal. 1993) (indicating one purpose of ban on restrictive covenants is to assure attorneys of right to practice their profession); ABA Comm. on Professional Ethics, Informal Op. 1072 (1968) ("The attorney must remain free to practice when and where he will and to be available to prospective clients who might desire to engage his services.").

[12] 550 N.E.2d 410 (N.Y. 1989).

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equivalent of restrictive covenants.[13] Most courts have followed *Cohen*'s lead and apply ethics standards to virtually eliminate contractual responses to grabbing and leaving.[14] The opinions distinguish law practice from ordinary commercial endeavors and elevate clients' rights to choose their lawyers above the economic interests of lawyers and firms affected. Each of the opinions affirms, explicitly or implicitly, the long-standing ethical norm that lawyers may not trade in clients.

Moving against this growing body of judicial and ethics committee decisions, a recent California Supreme Court decision approved a role for anti-competition agreements as a means of protecting firms' interests in their clients. In *Howard v. Babcock*,[15] four partners withdrew from the firm of Parker, Stanbury, McGee, Babcock & Combs, which specialized in insurance defense litigation. Prior to the withdrawal, the firm had fourteen partners, nine of whom were equity partners.[16] Under the partnership agreement, a partner that withdrew and engaged in insurance defense work forfeited the withdrawal benefits (other than a return of capital) to which the partner would have otherwise been entitled. Although courts of other states have without difficulty equated clauses of this type with restrictive covenants, the California Supreme Court recognized that a "revolution in the practice of law has occurred requiring economic interests of the law firm to be protected as they are in other business enterprises"[17] and concluded that forfeiture for competition agreements reasonably intended to compensate a firm for the loss of its clients are acceptable and perhaps necessary devices for enhancing the stability of law firms.[18]

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[13] *Id.* at 411. *See also* Denburg v. Parker, Chapin, Flattau & Klimpl, 624 N.E.2d 995 (N.Y. 1993) (decided at about same time as *Howard* and reaffirming court's earlier holding in *Cohen*).

[14] *See, e.g.*, Anderson v. Aspelmeier, Fisch, Power, Warner & Engberg, 461 N.W.2d 598 (Iowa 1990); Jacob v. Norris, McLaughlin & Marcus, 607 A.2d 142 (N.J. 1992); Spiegel v. Thomas, Mann & Smith, P.C., 811 S.W.2d 528 (Tenn. 1991).

[15] 863 P.2d 150 (Cal. 1993).

[16] One of the withdrawing partners was not an equity partner. For a discussion of the distinction between equity and nonequity partners, see *infra* text accompanying notes 28-35.

[17] 863 P.2d at 156.

[18] *Howard* was decided against the backdrop of conflicting intermediate appellate court opinions. *See* Haight, Brown & Bonesteel v. Superior Court, 285 Cal. Rptr. 845 (Ct. App. 1991) (refusing to hold forfeiture for competition clause void on its face); Howard v. Babcock, 7 Cal. Rptr. 2d 687 (Ct. App.

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Howard is itself a revolution in judicial thinking. In recognizing a firm's "financial interest in the continued patronage of its clientele"[19] and signaling a willingness to enforce contractual provisions that are designed to protect that interest, *Howard* attempts to offer a new framework for addressing the competing interests of firms, withdrawing lawyers, and clients. The opinion offers a rich base for considering both the law and the ethics frameworks for regulating the activities of lawyers withdrawing from firms and, more generally, the nature of a law firm and its relationship with its members.

I. The Regulatory Framework

A. *Statutory Regulation of Restraints on Competition*

California disfavors agreements that restrain the pursuit of business or professional activities. By statute, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[20] The statute includes an important exception applicable to partnership dissolutions:

> Any *partner* may, upon or in anticipation of a *dissolution of the partnership*, agree that he will not carry on a similar business within [specified counties or cities], where the partnership business has been transacted, so long as any other member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein.[21]

In *Howard*'s view, the statutory scheme is unambiguous and applies to contractual arrangements between law firms and their members.[22]

On its face, the conclusion that lawyers are subject to statutory regulation is unexceptional. *Howard* failed to note, however, limiting aspects of the exception that may *expand* the breadth of the general statutory prohibition on contracts in restraint of competition. The exception is applicable only to agreements by partners "upon or in anticipation of a dissolution." In most jurisdictions, a

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1992), *rev'd*, 863 P.2d 150 (1993) (describing *Haight* as "wrong" and voiding forfeiture for competition clause).

19 863 P.2d at 157.

20 Cal. Bus. & Prof. Code § 16600 (West 1987).

21 *Id.* § 16602 (emphasis added).

22 *See* 863 P.2d at 155 ("Accordingly, finding no ambiguity in the terms of the statute, and finding no demonstrated legislative intent to create a silent exception for lawyers, we may apply the statute 'according to its terms without further judicial construction.'") (citation omitted).

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dissolution occurs whenever a partner withdraws from a firm.[23] The California partnership act, on the other hand, allows partnership agreements to provide that withdrawal of a partner does *not* dissolve the partnership.[24] Evidence suggests that a large number of partnership agreements include anti-dissolution provisions.[25] When such agreements exist, the statutory exception presumably is inapplicable because the mere withdrawal of a partner does not prompt a dissolution of the partnership.

The exception is further limited by its applicability to "partners."[26] Associates, as employees, fall outside of the exception, a consequence of some importance because associates do engage in grabbing and leaving.[27] Because the exception allowing contractual restraints on competition is limited to agreements among partners, associates would seem to be free of covenants barring competition that may form part of their employment agreements.

A further question is whether the statutory exception applies to "nonpartner partners," for want of a better term. Increasingly, law firm partnerships have multiple levels of partners that include one or more layers of "nonequity," or "salaried," partners.[28] Nonequity partners are presented to clients as partners, but within the firm they do not have partner status in several material respects.[29] They

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23 *See* UNIF. PARTNERSHIP ACT § 31, (1992) (partner may dissolve partnership at any time through expression of will, even if dissolution is in contravention of agreement).

24 *See* CAL. CORP. CODE § 15031(7) (West 1977). *See generally* HILLMAN, *supra* note 1, § 4.3.

25 On the enforceability of such provisions, see HILLMAN, *supra* note 1, § 4.3.2.3.

26 In discussing the statute, *Howard* noted "[w]e are not called upon to discuss noncompetition agreements affecting employees, as opposed to partners." 863 P.2d at 155 n.4.

27 *See, e.g.*, Pratt, P.C. v. Blunt, 488 N.E.2d 1062 (Ill. App. Ct. 1986); Brown & Bins v. Lehman, 1993 WESTLAW 377101 (Minn. Ct. App.); Adler, Barish, Daniels, Levin & Creskoff v. Epstein, 393 A.2d 1175 (Pa. 1978), *cert. denied*, 442 U.S. 907 (1979); Bray v. Squires, 702 S.W.2d 266 (Tex. Ct. App. 1985).

28 *See, e.g.*, T. Weidlich, *No-Share Partners on Rise: Nearly Half of Big Firms Have a Non-Equity Track*, NAT'L L.J., Oct. 25, 1993, at 36, col. 1. *See generally* HILLMAN, *supra* note 1, § 4.2; KRONMAN, *supra* note 1, at 278-79 (discussing changes in partnership hierarchy).

29 Individuals may be treated as partners for purposes of their dealings with third parties but not be partners *inter se.* Section 7(1) of the Uniform Partnership Act provides that "persons who are not partners as to each other are not partners as to third persons," but this is subject to Section 16, Partner by Estoppel. UNIF. PARTNERSHIP ACT § 7(1).

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may, or may not, participate in profit sharing[30] but typically do not have an equity interest in the firm's assets and do not vote as partners.[31] Because co-ownership is the essence of a partnership,[32] nonequity partners are not partners at all.

A more difficult question concerns law partnerships that do not formally distinguish equity from nonequity partners but nevertheless have one or more partners that more closely resemble employees than partners. This situation is common in smaller firms dominated by a single partner. In *Beckman v. Farmer*,[33] for example, the Beckman, Farmer & Kirstein firm consisted of only three partners. Although they dealt with third parties as a partnership and filed K-1 partnership tax returns, Beckman dominated the firm's management and practice. Farmer and Kirstein received a draw, guaranteed by Beckman, and shared in profits only after certain levels of net firm profits were reached. Beckman provided not only clients but financing for the firm. Notes were co-signed by Farmer, but the loans were adequately secured by Beckman's assets.

Farmer left the firm and a dispute arose over his interest as a partner in fees later received by Beckman. Beckman contested Farmer's status as a partner. The appellate court reversed a grant of summary judgment for Farmer on the point because of material issues of fact concerning control rights and risk of loss. It was not entirely clear, in other words, that Farmer was a partner rather than an employee.

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30 *See* UNIF. PARTNERSHIP ACT §§ 7(3) (sharing of gross returns does not of itself establish partnership, whether or not persons sharing them have common right or interest in property from which profits are derived), 7(4) (receipt by person of share of profits of business is evidence of partnership unless such profits were received as wages of employee). *See also* ALAN R. BROMBERG & LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP § 2.09(c) at 2:89 (1988) ("Profit sharing as wages is inconsistent with partnership because a profit share without control or other incidents of partnership is commonly given to a worker as a way of aligning his or her incentives with the best interests of the business.").

31 The intermediate appellate court opinion in *Howard* reveals that the Parker, Stanbury firm had a class of nonequity ("participating" as opposed to "general") partners who participated in profit sharing but did not have an equity interest in the firm. One member of the group that withdrew was a nonparticipating partner. The trial court found that this "partner" was not bound by the agreement, and did not benefit by it. *See Howard*, 863 P.2d at 153 n.2.

32 *See* UNIF. PARTNERSHIP ACT § 6 (defining partnership as "association of two or more persons to carry on as co-owners a business for profit").

33 579 A.2d 618 (D.C. 1990).

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The firm involved in *Beckman* is typical of many law firms organized today along hierarchical rather than egalitarian lines. Increasingly, the label "partner" does not accurately depict the true status of the lawyer in the firm. Indeed, even a "managing partner" may, on closer examination, prove to be something less than a partner in the firm.[34] The increasing variations in the uses of the term "partner" illustrate that law partnerships have outgrown the statutes that regulate their internal affairs. In the context of regulation of contractual restraints on competition by "partners," the California statute's failure to recognize the many types of relationships that fall within and without the partner classification guarantees difficult interpretive questions in the future.[35]

B. *Legal Ethics and Restraints on Competition*

Lawyers are subject to a unique process of dual regulation. At the first level are the various laws, such as the California statutory provisions on restraints of competition, that apply to anyone engaged in a commercial or professional endeavor. Lawyers face an additional level of control arising from the "inherent power" of courts to regulate the legal profession.[36] In sometimes surprising ways, judicial regulation may operate to change sharply the groundrules under which lawyers and law firms operate.[37] It is therefore not surprising that the statute provided merely the starting point for *Howard*'s evaluation of the forfeiture agreement.

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[34] *See* Connors, Fiscina, Swartz & Zimmerly v. Rees, 599 A.2d 47 (D.C. 1991) ("managing partner" without equity interest in firm).

[35] At first glance, *Howard* would seem to have relevance only to equity partners because other members of firms normally do not have claims to payments that may be forfeited because of competition. The opinion, however, emphasizes the recovery of "reasonable costs" and appears to allow contractual commitments to pay such costs upon withdrawal. *See, e.g., Howard*, 863 P.2d at 160 (referencing "partner's agreement *to pay* former partners, *or to forego benefits* otherwise due under the contract") (emphasis added).

[36] *See generally* HILLMAN, *supra* note 1, § 6.4.

[37] *See, e.g.*, First Bank & Trust Co. v. Zagoria, 302 S.E.2d 674 (Ga. 1983) (professional corporation statute limiting liability of shareholders cannot extend to law corporations because of inherent power of courts to establish responsibilities of lawyers); SUP. CT. RULES FOR THE GOV. OF THE BAR OF OHIO Rule III(4) (West 1992) ("The participation of an individual as a shareholder of a legal professional association shall be on condition that such individual shall . . . guarantee the financial responsibility of the association for its breach of any duty, whether or not arising from the attorney-client relationship."). *See generally* HILLMAN, *supra* note 1, § 6.4.1.

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To date, the enforceability of anti-competition agreements among lawyers has been assessed under ethics standards that are limited, of course, to the legal profession. Every state ethics code bans agreements among lawyers associated in practice that restrict the right of a lawyer to practice after termination of the relationship.[38] The breadth of the prohibition against restrictions on the practice of law is the point at which *Howard* parts company with most other courts addressing forfeiture for competition agreements:

> We are not persuaded that this rule was intended to or should prohibit the type of agreement that is at issue here. An agreement that assesses a reasonable cost against a partner who chooses to compete with his or her former partners does not restrict the practice of law. Rather, it attaches an economic consequence to a departing partner's unrestricted choice to pursue a particular kind of practice.[39]

The conclusion is important because it varies from the conclusions of other courts that have considered agreements similar to the one contested in *Howard*.[40] It is all the more interesting for two additional reasons: (1) the court's attempt to support enforcement of the agreement by equating law practice with commercial activity, and (2) the court's use of a standard of reasonableness that emphasizes compensation to the firm for the loss of its clients rather than the effect of the agreement on the clients themselves. Each of these bears further exploration.

1. Law Firms as Commercial Enterprises

Howard made much of the fact that law firms are commercial enterprises and should be regarded by the judiciary as such: "Recognizing these sweeping changes in the practice of law, we can see no legal justification for treating partners in law firms differently in this respect from partners in other businesses and professions."[41]

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38 *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR2-108(A) (1980); MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.6 (1989). The California Rules add an exception for a covenant that "[i]s a part of an employment, shareholders', or partnership agreement among members provided the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship." CALIFORNIA RULES OF PROFESSIONAL CONDUCT Rule 1-500(B)(1) (1989).

39 863 P.2d 150, 156 (Cal. 1993).

40 *See supra* text accompanying notes 12, 14.

41 *Howard*, 863 P.2d at 157. *But cf. A Statistical Analysis of Noncompetition Clauses in Employment Contracts*, 15 J. CORP. L. 483, 521 (1990) ("When

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In one sense, *Howard*'s recognition of the commercial character of law practice is refreshing. Law firms operate in a competitive environment in which cash flow, debt service, and cost controls determine survival or failure. Courts often are reluctant to openly recognize the commercial culture of law practice and the fact that lawyers who ignore the economic culture in which they operate will not long be around to assist clients. Along this line, the dissent in *Howard* expressed a dangerously simplistic and strident view by implying the incompatibility of "profit-centered" and "client-centered" objectives and by suggesting that ethics rules serve a useful check on "amassing fees."[42]

Unfortunately, the opinion does not clarify the implications of treating law practice as a commercial activity. If, as *Howard* emphasized, law practice is indistinguishable from other commercial and professional endeavors, then what is the justification for regulating competition agreements among lawyers through legal ethics standards rather than the more general statutory scheme?

Perhaps one reason for *Howard*'s focus on ethics rather than statutory standards is the court's desire to deliver a message regarding the "revolution" it sees in the practice of law. The court was obviously sympathetic to the plight of law firms savaged (it might say) by grabbing and leaving. By endorsing a view of law practice as a commercial activity, *Howard* could introduce *to the ethics analysis* considerations other than the protection of client interests. Indeed, the opinion is extraordinary in the limited importance it assigned to clients' interests, a point developed more fully below.

2. Reasonable to Whom?

Howard's allowance of reasonable costs for competition introduces an important element lacking in most decisions on competition disincentives. Most courts have simply assumed the equivalency of restrictive covenants and forfeiture clauses without exploring whether the two types of agreements may have different operative effects on clients.[43] *Howard* recognizes that forfeitures

examined over time, then, the data do reveal a growing trend in favor of the physician who is attempting to practice medicine in violation of a noncompetition clause. Thus, in spite of the overall enforcement rate of fifty percent, recent data do provide some support to the commonly held belief that physicians may be more immune from noncompetition clauses than members of other occupations.").

[42] *Howard*, 863 P.2d at 161-62 (Kennard, J., dissenting).

[43] *See supra* text accompanying note 13.

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limited in amount may shift income from lawyers to their former firm without undermining the lawyers' willingness to take clients from the firm.[44] A forfeiture relatively small in amount may have no effect on a lawyer's willingness to represent clients, a point not addressed in opinions that have summarily equated forfeitures with restrictive covenants.

Howard directs a reasonableness inquiry, but it *may* be one based upon considerations other than the effects of forfeitures on clients:

> Under this standard, a partner's agreement to pay former partners, or to forego benefits otherwise due under the contract, in an amount that at the time of the agreement is reasonably calculated to compensate the firm for losses that may be caused by the withdrawing partner's competition with the firm, would be permitted.[45]

Reasonableness viewed from the perspective of adequate compensation for a firm's losses may be radically different from reasonableness viewed from the perspective of effects on clients. Adequate compensation to the firm may justify a forfeiture sufficiently large to affect a lawyer's ability to represent clients, while a smaller forfeiture that does not serve as a disincentive to competition may provide only negligible compensation for the firm.

Although *Howard*'s reasonableness inquiry focuses on the adequacy of compensation to the firm, portions of the opinion suggest, albeit faintly, that a forfeiture's effects on clients are not to be ignored. In particular,

> [W]e question the premise that an agreement such as is at issue here would necessarily discourage withdrawing partners from continuing to represent clients who choose to employ them. Unless the penalty were unreasonable, it is more likely that the agreement would operate in the nature of a tax on taking the former firm's clients — a tax that is not unreasonable, considering the financial burden the partners' competitive departure may impose on the former firm.[46]

As so stated, *Howard*'s standard of reasonableness is stretched to a point at which it loses all shape. If the court did intend to consider

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[44] "[W]e question the premise that an agreement such as is at issue here would necessarily discourage withdrawing partners from continuing to represent clients who choose to employ them." *Howard*, 863 P.2d at 159.

[45] *Howard*, 863 P.2d at 160. *See also* Haight, Brown & Bonesteel v. Superior Court, 285 Cal. Rptr. 845 (Ct. App. 1991) (balancing interests of firms and withdrawing partners without according equal weight to interests of clients in choosing their lawyers).

[46] 863 P.2d at 159.

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the effects of the forfeiture on clients, it should have clearly stated that a forfeiture is reasonable if it performs the compensatory function *and* is not sufficiently large that withdrawing lawyers will decline to represent clients of their former firm.

Howard's assumption that the agreement at issue would probably not discourage the withdrawing partners from representing clients is curious. The operative effects of enforcing the forfeiture clause were addressed in the intermediate appellate court's opinion[47] but not the supreme court's majority opinion.[48] The obligation to share post-withdrawal income may run both from the firm to withdrawing partners and from withdrawing partners to the firm.[49] The post-withdrawal billings for clients taken from the Parker Stanbury firm totaled nearly 16,000 hours, yielding the withdrawing partners a profit of $463,862. The trial court judgment required the payment of $382,686, or 82.5 percent, of this sum to the firm, leaving the lawyers who took the clients and completed the work with only $81,175, or $5.10 an hour for their services. *If* Parker Stanbury had a reciprocal obligation to share income from unfinished business with the partners who had withdrawn, such a payment would not *necessarily* have operated as a penalty for taking clients from the firm. Enforcing the forfeiture for competition clause, however, eliminates the requirement that Parker Stanbury share fees with its former partners, thereby creating one-sided fee sharing running in favor of the firm.

Because *Howard* addressed only the enforceability of the forfeiture for competition portion of the agreement and did not review the obligation of the former partner to share fees from the completion of pending cases taken from the firm, the opinion did not consider the potential harshness of one-sided fee sharing running to the benefit of the firm and at the expense of withdrawing partners.[50] This makes all the more important the factors underlying

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47 *See Howard v. Babcock*, 7 Cal. Rptr. 2d 687 (Ct. App. 1992), *rev'd*, 863 P.2d 150 (1993).

48 The dissent, however, did consider the disincentive effects of the agreement. *See Howard*, 863 P.2d at 163 (Kennard, J., dissenting).

49 The mutual income sharing obligations, which may be modified in the partnership agreement, are based on the idea that the original partnership continues until all work in process at the time of a withdrawal is completed. *See generally* HILLMAN, *supra* note 1, § 4.3.

50 A recent decision of the Indiana Supreme Court recognized the "inequitable result" of one-sided fee sharing and interpreted a partnership agreement in a way that avoided such a result. *See* Kelly v. Smith, 611 N.E.2d 118, 121 (Ind. 1993). *But cf. Meehan* v. Shaughnessy, 535 N.E.2d 1255, 1269-71

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the reasonableness inquiry directed by the court. If the reasonableness of the forfeiture is measured by the adequacy of compensation for the losses of the firm rather than its effects on the withdrawing lawyers' ability or willingness to represent clients, enforcing a forfeiture that results in one-sided fee sharing may provide a fair level of compensation but also an overpowering disincentive to representing clients of firms from which lawyers withdraw. *Howard*'s emphasis on the compensatory aspects of forfeitures leaves unclear whether, if at all, the clients' interests are relevant to the reasonableness inquiry.

In a fashion, *Howard* indirectly responded to a criticism of determining reasonableness by reference to the adequacy of compensation rather than effects on clients: "We are confident that our opinion will leave the lawyer's professional duties to his or her clients undisturbed, and that clients will enjoy the same degree of choice in retaining attorneys as they have always possessed."[51] The key words are "as they have always possessed," for *Howard* has a more limited view of the principle of client choice than that expressed by most courts:

> Upon reflection, we have determined that these courts' steadfast concern to assure the theoretical freedom of each lawyer to choose whom to represent and what kind of work to undertake, 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. Putting aside lofty assertions about the uniqueness of the legal profession, the reality is that the attorney, like any other professional, has no right to enter into employment or partnership in any particular firm, and sometimes may be discharged or forced out by his or her partners even if the client wishes otherwise. Nor does the attorney have the duty to take any client who proffers employment, and there are many grounds justifying an attorney's decision to terminate the attorney-client relationship over the client's objection. Further, an attorney may be required to decline a potential client's offer of employment despite the client's desire to employ the attorney. For example, the attorney may have a technical conflict of interest. . . . Finally, the client in the civil context, of course, ordinarily has no "right" to any attorney's services, and only receives those services he or she can afford.[52]

(Mass. 1989) (requiring significant one-sided fee sharing on cases taken *unfairly* from a firm).

51 *Howard*, 863 P.2d at 161.

52 *Id.* at 158-59 (citations omitted).

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Howard's point concerning the practical restrictions on the clients' ability to choose their lawyers is something of a paper tiger.[53] No one had suggested that the right of clients to the lawyers of their choice extends to the narrow circumstances the court described. The issue is not whether the principle of client choice knows no limitations but, instead, how the interests of clients should be balanced against the firms' interests in retaining their clients. Although *Howard* declared it had achieved "a balance between the interests of clients in having the attorney of choice, and the interest of law firms in a stable business environment,"[54] its adoption of a standard of compensation for losses of firms leaves unclear how clients' interests are to be accommodated in the balancing.[55]

To reiterate, *Howard* correctly challenges the assumption of other courts that forfeiture for competition agreements necessarily are the economic equivalent of restrictive covenants. Limited forfeitures should not dissuade withdrawing partners from representing their former firm's clients. If clients are not affected, there is no reason to deny enforcement of the bargain between the law firm and its members. If *Howard* had so stated its standard of reasonableness, the opinion would have properly accommodated the interests of firms, withdrawing lawyers, and clients and significantly advanced existing case law. Perhaps *Howard* was attempting to do just this, but the murkiness surrounding its discussion of reasonableness invites interpretation of the opinion as a radical and ill-advised departure from established ethics norms.

II. THE CLIENTS' INTEREST IN STABLE LAW FIRMS

Although the interests of clients play a vague role, at best, in *Howard*'s reasonableness inquiry, the opinion did emphasize that law firm stability enhances client interests. The point is important

[53] *Cf. id.* at 165 (Kennard, J., dissenting) ("The majority's list reflects rationalization, not reasoning.").

[54] 863 P.2d at 160.

[55] At one point, *Howard* often failed to distinguish restrictive covenants from forfeitures and even suggested both should be enforceable: "[I]t has been argued that a noncompetition agreement, or a penalty for competition, may actually serve clients as well as the financial well-being of the law firms." *Id.* at 159. At another point, however, *Howard* left no doubt it was not approving restrictive covenants: "We consider it obvious that an absolute ban on competition with the partnership would be per se unreasonable, and inconsistent with the legitimate concerns of assuring client choice of counsel and assuring attorneys of the right to practice their profession." *Id.* at 160.

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because a connection between law firm stability and clients' interests is a reason to regulate lawyers' activities under the standards of legal ethics.

To support its contention that clients have an interest in law firm stability, *Howard* quoted with apparent approval the following argument set forth in a published student note:

> The culture of mistrust that results from systematic grabbing is very likely to damage, if not destroy, the law firm's stability. It is clear that when law firms dissolve, work on behalf of clients is undeniably disrupted. But even where a law firm does not self-destruct, it is easy to comprehend the *disastrous impact on clients.* Law firms have an affirmative obligation to the client to provide an atmosphere most conducive to the development of the attorney-client relationship and to the efficient, diligent completion of work. In an environment of pervasive lateral hiring, partners may be loath to financially or otherwise support the development of a colleague's relations with particular clients because the colleague may later exclusively usurp the benefits of that relationship. In addition, partnerships may be less willing to invest monies necessary to provide the equipment, library and other resources necessary to serve a client well if a partner could both leave a firm free of the mutually incurred liability, and also take the future income of the firm.[56]

The argument merely *assumes* that the fortunes of clients are tied to their firms' stability. Experience suggests, however, that law firm instability is far more a concern of lawyers than their clients. Neither *Howard* nor the student note on which it relies provides *any* evidence for the claim that the instability of law firms has had a "disastrous impact" on clients.[57] Indeed, the very existence of grabbing and leaving is predicated on the willingness of large numbers of clients to follow their lawyers from firm to firm.[58] Moreover, clients that remain with firms damaged by grabbing and leaving are

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56 863 P.2d at 159-60 (emphasis added) (quoting Kirstan Penasack, Note, *Abandoning the Per Se Rule Against Law Firm Agreements Anticipating Competition: Comment on* Haight, Brown & Bonesteel v. Superior Court of Los Angeles County, 5 GEO. J. LEGAL ETHICS 889, 890-91 (1992)). The point that a partner may leave a firm "free of the mutually incurred liability" is inaccurate. *See generally* HILLMAN, *supra* note 1, § 4.10.

57 In fact, firm instability evidenced by the lateral movement of partners may well be evidence of inefficiencies in both the structure and the compensation systems of law firms. *See infra* text accompanying notes 58-64.

58 In rare cases, clients may prompt the change of firms by lawyers. *See* Daniel Wise, *Mudge Partners Jump at Client's Request,* NAT'L L.J., Jan. 31, 1994, at 2 col. 2 (discussing client's request that lawyers change firms so that client's environmental defense litigation could be consolidated).

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free to discharge their firms if they become dissatisfied with the quality of legal services they are receiving.[59]

The student note and *Howard* raise a more subtle point. The possibility of future grabbing and leaving may affect a firm's management decisions. In various ways, concern over possible lawyer defections may prompt defensive management policies. For example, a firm may hire fewer associates, lease less space, and not expand its library if its management perceives the risk of sudden departures of lawyers or even departments within the firm. *If* that is the case, and *if* clients are harmed as a consequence of the policies, then legal ethics may properly be employed to restrict grabbing and leaving.

The key to the argument, however, lies in the "ifs." It is not at all clear that firms are being managed in ways detrimental to clients' interests because of concerns over future lawyer defections from the firm. Associates not hired, space not leased, and books not bought may be attributable to a variety of concerns other than, or in addition to, the possibility of future grabbing and leaving by members of the firm.[60] Moreover, a firm managed in ways that disable it from meeting its clients' needs will be at a competitive disadvantage in attracting new clients and retaining its current clients.

Grabbing and leaving conceivably may actually serve clients' interests. For example, movement of lawyers among firms may facilitate competition among lawyers and increase choices available to clients.[61] In addition, lawyers may leave a firm because of management policies that they believe are inconsistent with the clients' interests because of conflict-of-interest considerations and attend-

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[59] On standards for compensating a discharged firm, see HILLMAN, *supra* note 1, §§ 2.3.1.2-.4.

[60] Concern over general economic conditions, firm specialization in areas in which demand for services is likely to decline, and a desire to increase the profitability of the firm by reducing expenses are among the reasons why firms may decline to make significant, and arguably necessary, capital or personnel expenditures.

[61] The departure of a lawyer from a firm *may* give clients of the firm, or the lawyer, choices concerning who will represent them. Empirical work would be useful however, in evaluating both the extent to which the activities of withdrawing lawyers, or their firms, tend to undermine any real competition for clients and the degree to which clients are in a position to exercise informed choice.

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ant incompatibilities of clients within the firm[62] or because of personality differences that have led to discord and undermined the ability of firm members to respond to the needs of their clients. In each of these cases, the movement of lawyers and clients to a new firm may serve the needs of the clients affected.[63]

If clients perceive their interests to be adversely affected by law firm instability, they would move to firms with a record of stability. A market would develop for stable law firms. The absence of evidence that such a market either exists or is emerging negates the claim that lateral movement of partners has had a "disastrous impact" on clients.[64]

III. THE FIRMS' INTEREST IN STABLE CLIENTS

Howard recognizes that "[t]he firm has a *financial interest* in the continued patronage of its clientele."[65] The statement, which even the dissent accepted,[66] is undoubtedly correct if "financial interest" simply means a dependency on clients as a source of future income. As used in *Howard*, however, the term seems to mean an expectancy deserving of protection against competing claims from lawyers who withdraw from law firms. Apart from the difficulties of recognizing anyone's financial interest in clients, the opinion assumes that the firm's interest in its clients is superior to the partners' interest in the same clients. The important question not addressed in *Howard*

[62] *See, e.g.*, MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.7 (a "lawyer shall not represent a client if the representation of that client will be directly adverse to another client" unless each client consents to the representation and the lawyer believes the representation will not directly affect the relationship with the other client.). Conflicts considerations also may impede lateral movement of lawyers. *See, e.g.*, MODEL RULES OF PROFESSIONAL CONDUCT Rules 1.9 and 1.10 (addressing situation where lawyer changes firms and represents client with interests materially adverse to those of client of lawyer's former firm). *See generally* HILLMAN, *supra* note 1, § 2.7.

[63] Most of the discussions of law firm instability focus on problems created by lawyer mobility and ignore the fact that many firms have grown substantially through the lateral hiring of partners.

[64] *Cf. Howard*, 863 P.2d at 166 n.2 (Kennard, J., dissenting) ("The majority has made no effort to show that because of the economic 'revolution' in the practice of law it asserts has taken place, law firms in jurisdictions that do not allow restrictive covenants have suffered greatly. I am doubtful such evidence exists.").

[65] 863 P.2d at 157 (emphasis added).

[66] 863 P.2d at 165 (Kennard, J., dissenting).

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is the extent to which a firm is an economic entity with interests that are independent of those of its members.

An evaluation of the nature of the law firm, and the relationships among members of a firm, is complicated greatly by words commonly used to describe firms. There is a "firm"—an entity—even though the law under which it is organized might deny the existence of the entity.[67] A lawyer "departs," "withdraws," or "leaves" the firm. Other lawyers "stay," and the firm "continues" after the lawyer's withdrawal. If the departing lawyer "takes" a client, the client's file is "transferred" from the firm to the lawyer. The words imply that it is withdrawing lawyers, not the firms they leave, that engage in "grabbing." And the idea that a partner "leaves" while others "stay" tips the analysis toward a view that the partner "taking" clients is, in effect, looting the firm. Quite different conclusions might be drawn if we referred to the dissociating lawyers (a more neutral term) as "keeping" their clients.

Consider the plight of the hypothetical *AB&C* firm, composed of three name partners and seven additional partners. The seven junior partners "leave" the partnership, taking clients, and form a new firm located on another floor of the building. Where is the successor to the original firm, and which group of lawyers, if either, should the law favor in the competition for *AB&C*'s clients? Which group of lawyers, the three or the seven, actually withdrew from the firm? Is continuity of the name, location, and telephone number dispositive? In fact, assigning "original firm" status to either group of partners is problematic when done for the purpose of evaluating which group has the superior claim to the clients.[68]

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[67] For most purposes, the Uniform Partnership Act treats a partnership as an aggregate of its members rather than a distinct legal entity. *See, e.g.*, UNIF. PARTNERSHIP ACT §§ 6(1) (1992) (defining partnership as association of persons), 15 (providing for joint and several liability of partners), 25 (providing that partnership property is owned by partners as tenants in partnership). The Revised Uniform Partnership Act, accords entity status to partnerships. *See, e.g.*, REV. UNIF. PARTNERSHIP ACT § 201 (1993) ("A partnership is an entity.").

[68] *Cf.* Fox v. Abrams, 210 Cal. Rptr. 260, 265 (Ct. App. 1985) ("[the] law should simply recognize that the lawyers once practiced together and are now practicing separately on the same cases as before, and no good purpose is served by characterizing one entity as the members who left and the other entity as the members who remained.").

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A law firm is the organizational means for lawyers to associate in practice,[69] and its product is the services of its members. When *Howard* asserts the existence of a firm's economic interest in the "continued patronage of *its* clientele,"[70] it is describing the interests of lawyers within the firm rather than the interests of an economic entity distinct from its membership. To protect the firm's interests is simply to favor the interests of one group of lawyers (those who "stay") over the interests of another group of lawyers (those who "leave").

Howard does not discuss the reasons that lawyers leave firms, but those reasons are relevant in deciding whether to favor the interests of lawyers that stay with firms. As noted earlier,[71] disagreements over income allocation are a major reason for the instability of law firms. One response is for firms to reallocate income in a way favorable to lawyers for whom there is a market demand, at the expense of other lawyers within the firm. Not surprisingly, this response sometimes encounters considerable resistance, not necessarily rational, from lawyers on the uncomfortable side of the income reallocation. Arguing the need to protect interests of firms, they would prefer to erect barriers to departure that narrow the market for lawyers that control clients. They seek, in short, to capture the value that the market accords to the lawyer with a loyal following of clients.[72]

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69 When compared with looser associations such as office-sharing or independent contractor relationships, the firm offers some distinct advantages. For example, the firm allows lawyers to specialize and, at the same time, diversify the investment each member has made in her human capital. *See* Gilson & Mnookin, *supra* note 2, at 321-29. It also provides a structure for monitoring the quality of services provided and self-interested behavior that may harm the interests of the group. *Id.* at 332-39.

70 *Howard*, 863 P.2d at 157 (emphasis added).

71 *See supra* text accompanying note 4.

72 Between the extremes of reallocating income to rainmakers and barring departures from firms are additional possible responses. The most intriguing is for the firm to convince clients that their ties are to the firm rather than to particular lawyers by, for example, encouraging the exposure of clients to many members of the firm. *See generally* Gilson & Mnookin, *supra* note 2, at 353-80. This faces, however, a number of obstacles. Clients may resist, for reasons of costs and otherwise, efforts to have additional lawyers work on their matters. Moreover, sophisticated clients are increasingly retaining lawyers for limited purposes (rather than general representation), which makes it more difficult for firms to involve additional lawyers in the work of the clients. Perhaps most importantly, lawyers are often unwilling to "share" their clients with other lawyers in their firms.

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Of course, lawyers leave firms for reasons other than income maximization. Dissatisfaction with firm management policies, personal animosities, conflicts among clients, or a simple desire for change are among the many reasons why lawyers may choose to change firms. Whatever the reasons for discontent may be, to the extent barriers to departure are erected, the incentive to respond to the needs of dissatisfied members of the firm is lessened. *Howard* fails to recognize that its effort to bolster the stability of law firms simply favors one group of lawyers over another.

IV. CONCLUSION

That *Howard* is attempting to give a weapon to firms in their battle with defecting partners is clear. Whether that goal is appropriate is another matter. Critics decry the decline of "institutional loyalty"[73] but rarely consider why the conditions they lament have developed. In favoring lawyers who stay over lawyers who leave, *Howard* treats the symptoms rather than the causes of law firm instability.

This does not mean that grabbing and leaving should be free of the restraints of law and ethics. One largely overlooked aspect of partner withdrawals is the extent to which the status of members of a firm as fiduciaries for each other may limit clandestine activities in preparation for withdrawal. For example, may members of a firm secretly negotiate their moves to other firms, revealing in such negotiations information concerning the clients that are likely to follow them? May members of a firm secretly make logistical arrangements (leasing office space, arranging bank financing, and so forth) in anticipation of leaving their firm? Do members of a firm have a duty "to tell the truth" if rumors concerning their departure develop?

Very few cases have considered the application of fiduciary standards to these and related activities common to grabbing and leaving.[74] Much activity occurs, however, in preparation for leaving a firm, and perhaps the freshly stated standards of the duties of partners set forth in the new Revised Uniform Partnership Act will

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[73] Rehnquist, *supra* note 3, at 152.

[74] The leading case addressing fiduciary standards is Meehan v. Shaughnessy, 535 N.E.2d 1255 (Mass. 1989). *See generally* HILLMAN, *supra* note 1, § 4.8.

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prompt closer attention to the *manner* in which lawyers take clients from their firms.[75]

[75] *See, e.g.*, REV. UNIF. PARTNERSHIP ACT § 403(c) (1993) (requiring partners to disclose, "*on demand*, . . . to the extent just and reasonable, complete and accurate information concerning the partnership") (emphasis added); *id.* § 404(b)(2) (partner has duty of loyalty to refrain from dealing with partnership in conduct of its business, as or on behalf of partner with adverse interest); *id.* § 404(b)(3) (partner has duty of loyalty to refrain from competing with partnership before its dissolution); *id.* § 404(d) (obligation of "good faith and fair dealing"). *But cf. id.* § 404(e) ("A partner does not violate a duty or obligation under this [Act] or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.").

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