Reconsideration of Ethics Opinion 09-01

Introduction

ER 5.6(a) prohibits a lawyer from offering or making "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 Arizona Supreme Court addressed the meaning of this rule in a 2006 opinion, *Fearnow v. Ridenour, Swenson, Cleer & Evans*, 213 Ariz. 24 (2006). The *Fearnow* opinion was not issued in a disciplinary proceeding. The case arose from a dispute between a law firm and a lawyer who had left the firm to join another firm. Under the terms of the first firm's shareholder agreement, the firm would repurchase the capital interest of a lawyer who chose to retire or was involuntarily expelled from the firm. But a lawyer who chose to leave the firm and continue practicing in the firm's geographic area forfeited this right to repayment. When the firm refused to repurchase a voluntarily departing shareholder's shares, the lawyer sued, arguing that the forfeiture provision violated ER 5.6 and was therefore unenforceable as against public policy.

The trial court agreed with the plaintiff, and the Court of Appeals affirmed, though with a slightly different analysis. The Supreme Court then took review and reversed, concluding that:

> Although the rule prohibits—and we will hold unenforceable—agreements that forbid a lawyer to represent certain clients or engage in practice in certain areas or at certain times, its language should not be stretched to condemn categorically all agreements imposing any disincentive upon lawyers from leaving law firm employment. Such agreements, as is the case with restrictive covenants between other professionals, should be examined under the reasonableness standard.

213 Ariz. at 30, ¶ 21. The Court remanded the case to the trial court to make a reasonableness determination. *Id*. at 30-31, ¶ 24.

Three years later, the State Bar of Arizona issued Ethics Opinion 09-01, which addressed the following question: "May Firm require, as a condition of employment, that in the event Associate departs from Firm, Associate must pay a $3,500 fee for each former Firm client that Associate continues to represent after departing?"

The opinion concluded that such an agreement would violate ER 5.6 because it would, for four reasons, "improperly constrain a client's freedom to choose to continue representation by the departing associate": (1) it would discourage the departing lawyer from representing a client that might want to continue with the lawyer; (2) the set amount of the fee would have a disproportionate impact on continuing to represent clients in lower-value cases; (3) it would give the departing lawyer an incentive to charge the client more, in violation of the policy behind ER 1.17(d), which prohibits increasing a client's fees when a practice is sold; and (4) it would create a conflict of interest in violation of ER 1.7(a)(2).

The Arizona Supreme Court's Attorney Ethics Advisory Committee elected to reconsider Opinion 09-01 in order to address the impact of the Supreme Court's earlier decision in

Fearnow. The Committee finds that the per-client fee that was the subject of Opinion 09-01 goes beyond discouraging a lawyer from leaving the law firm, like the shareholder agreement in *Fearnow*, and instead directly impinges on client choice. It is therefore prohibited by ER 5.6.

Discussion

Public Policy and ER 5.6

Some commentators have argued that it is problematic to use ER 5.6 to define public policy for purposes of determining the enforceability of a contract. When that approach is taken, and the Rule is interpreted broadly, it allows a lawyer to violate ER 5.6 and then use the Rule to avoid their contractual obligations—a clearly inequitable result.

> A rule that a contract or action that violates an ethical rule violates public policy creates a bright line rule that courts would apply regardless of the equities. Under traditional contract law analysis, when contracts are held to violate public policy, courts do not look behind the contract to see if it would be unfair *not* to enforce it. If a contract violates public policy it is void *ab initio*. Such a proposition is problematic in the context of the ethical rules for two reasons. First, invalidating certain contracts could be used by a lawyer to advance their own personal interests, contrary to the purpose of the rules, which is not to protect the interests of the lawyer.
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> Second, and more significant, unethical agreements may have been fairly negotiated and, as a matter of substantive contract law, are not problematic

Donald E. Campbell, *The Paragraph 20 Paradox: An Evaluation of the Enforcement of Ethical Rules As Substantive Law*, 8 St. Mary's J. Legal Mal. & Ethics 252, 303 (2018). *See also Feldman v. Minars*, 230 A.D.2d 356, 361, 658 N.Y.S.2d 614, 617 (1997) (concluding that it would be “unseemly” to allow an attorney to “us[e] their *own* ethical violations as a basis for avoiding obligations undertaken by them” and noting that a violation of the ethical rule regarding restrictions on the right to practice could be “addressed by the appropriate disciplinary authorities”); *Lee v. Florida Dept. of Ins. & Treasurer*, 586 So. 2d 1185, 1188 (Fla. Dist. Ct. App. 1991) (“We first would note that the application of rule 4-5.6 to invalidate or render void a provision in a private contract between two parties is beyond the scope and purpose of the Rules and constitutes error.”); *Potter v. Peirce*, 688 A.2d 894, 895 (Del. 1997) (concluding that a lawyer could not enter into an agreement in violation of the ethics rules and then “use those Rules as a shield to avoid a contractual duty”).

The Supreme Court in *Fearnow* adopted ER 5.6 as a statement of public policy without any discussion. Perhaps concerned about creating the inequities discussed above by reading ER 5.6 broadly, the Court—though acknowledging that ER 5.6 is grounded in concerns about preserving “lawyer autonomy and client choice” (213 Ariz. at 27, ¶ 12)— was unwilling to “condemn categorically all agreements imposing any disincentive upon lawyers from leaving law firm employment” (*id*. at 31, ¶ 21). Instead, “[s]uch agreements, as is the case with restrictive

covenants between other professionals, should be examined under the reasonableness standard." *Id*.

The Scope of the Fearnow Decision

Justice Bales, in his dissent, says the majority interpreted ER 5.6 narrowly, as applicable *only* to outright prohibitions on a lawyer's right to practice in a particular area, for a particular period of time, or for certain clients. *Id*. at 32 and 35, ¶¶ 35 and 46. Others appear to have interpreted the case similarly. S*ee* Karen E. Komrada, *Fearnow v. Ridenour, Swenson, Cleere & Evans, P.C.: Encouraging Firms to Punish Departing Attorneys?,* 48 Ariz. L. Rev. 677, 677 (2006); Betsy Lamm, *Ethics and the Arizona Bar: A Discussion of the Arizona Supreme Court's 2005-06 Decisions*, 39 Ariz. St. L.J. 613, 624 (2007).

As Justice Bales's dissent points out, such a narrow reading of the rule means that an agreement can comply with the Rule—be ethically permissible—while, as a practical matter, achieving the same result as an outright prohibition by imposing significant financial disincentives. Because that ethical conclusion is as counterintuitive as the legal conundrums that result from a broad reading of the Rule, it invites a closer reading of exactly what the Court in *Fearnow* said.

In that regard, it is worth noting two things the Court did *not* say. First, although the Court explicitly rejected a categorical interpretation of ER 5.6 that would *prohibit* all financial disincentives, it did *not* explicitly adopt a categorical interpretation that would *permit* all such disincentives. In fact, by saying that ER 5.6 shouldn't be read to "categorically" condemn "all" agreements imposing "disincentives" on a departing lawyer—instead of simply saying that the Rule doesn't apply to such disincentives—the majority opinion implies that the rule *does*—or at least *might*—condemn *some* disincentives.

Second, the Court did *not* say that only unreasonable agreements violate ER 5.6. Although the Court in *Fearnow* ultimately held that the shareholder agreement at issue in that case did *not* violate ER 5.6 (213 Ariz. at 25, ¶ 1), it *also* remanded the case to the trial court for an analysis of the agreement's reasonableness, which necessarily means that the agreement could comply with ER 5.6 but still be unreasonable and therefore legally unenforceable. In other words, despite the Court's insistence that it was interpreting ER 5.6, it did not adopt "reasonableness," the legal standard, as the ethical standard.

Application of Fearnow to the Question Addressed in Opinion 09-01

So, if ER 5.6 does not categorically permit all financial disincentives, and does not prohibit only unreasonable disincentives, what distinguishes unethical financial disincentives from those that are ethically permissible?

Under the agreement at issue in *Fearnow*, the firm agreed to repurchase a departing shareholder's stock in the event of disability, retirement, withdrawal or expulsion from the firm. But a lawyer voluntarily leaving the firm and continuing to practice law in the firm's geographic area for more than 10 hours per week forfeited this benefit. Similarly, the agreement at issue in *Howard*, a California case heavily relied upon by the *Fearnow* majority, provided that a departing lawyer would be paid for their capital interest in the firm plus a share in the firm's net

profits for a year after departure. Those benefits were forfeit, however, if the lawyer thereafter competed with the firm. Another California case cited by the *Fearnow* majority, *Haight, Brown & Bonesteel v. Superior Court*, 234 Cal. App. 3d 963 (Ct. App. 1991), also involved forfeiture of a departing partner's interest in the firm's capital and accounts receivable. In both cases, the California Court of Appeal found that the agreements did not violate California's version of ER 5.6.

Thus, *Fearnow* and the California cases on which it relied each involved the forfeiture of capital interests and accounts-receivable for which a departing partner or shareholder would otherwise be compensated under the terms of the partnership or shareholder agreement, based on the lawyer's competition with the firm. Such agreements have certain characteristics in common. They typically are entered into by lawyers with more or less equal bargaining authority; each lawyer who is a party to the agreement could potentially be benefitted *or* penalized by the financial disincentives, depending on who ultimately leaves and who stays; they involve the forfeiture of rights that would not exist but for the partnership or shareholder relationship defined in the contract, rather than imposition of a fee or penalty; and they are related to the capital structure of the firm, and the firm's legitimate concern with maintaining the stability of that structure, rather than to continued representation of *particular clients*. Such an agreement could, depending on the circumstances, be unreasonable, and hence legally unenforceable, but it does not raise the type of concerns that would trigger ER 5.6.

In contrast, the agreement examined by Opinion 09-01 imposed on a departing associate a flat $3,500 penalty for each firm client the lawyer continued to represent. It was not a shareholder or partnership agreement, and an associate being newly hired by a firm is obviously not in the same bargaining position as a partner or shareholder; the agreement was one-sided in that it protected the firm but would never benefit the associate; it involved an affirmative obligation to pay the firm, rather than the forfeiture of benefits to which the associate would otherwise be contractually or legally entitled; and it was directly tied to continued representation of particular clients.

In the opinion of the Committee, these are material differences. Such a penalty does not just discourage the lawyer from leaving the firm. As Opinion 09-01 explains, such a penalty acts as a substantial disincentive for the departing lawyer to agree to continue representing a client who wants to continue working with that lawyer. That is particularly true for clients with lower-value cases. It also incentivizes charging those clients higher fees and creates a potential conflict between the lawyer's interests and the interests of a particular client. More than the agreements at issue in *Fearnow* and the California cases on which *Fearnow* relied, the agreement appears on its face to be an attempt to prevent the associate from representing specific clients. As such, the Committee has concluded that such a per-client fee is distinguishable from *Fearnow* and falls within the scope of ER 5.6's prohibition.