# ISBA Professional Conduct Advisory Opinion

ILLINOIS STATE BAR ASSOCIATION

**Opinion 23 – 02**

**March 2023**

SUBJECT: Division of Fees; Law Firm Partnership and Employment Agreements; Restrictions on Lawyer's Practice.

DIGEST: Under Rule 1.5(e), a law firm may agree to share fees with a retired partner as part of a retirement agreement. However, Rules 1.5(e) and 5.6 bar the firm from requiring that a lawyer or the lawyer's new firm continue to share fees with the retired partner after the lawyer has left the firm.

REFERENCES: Illinois Rules of Professional Conduct 1.5(e) and 5.6(a)
*Dowd & Dowd v. Gleason*, 181 Ill. 2d 460, 481 (1998)
*Hoffman v. Levstik*, 369 Ill. App. 3d 144 (1st Dist. 2006)
ABA Formal Opinion 06-444
Massachusetts Bar Ethics Op. 2014-4
DC Bar Ethics Opinion 65
DC Bar Ethics Opinion 325

## FACTS

A law firm practices as a professional corporation with 10 shareholders. The shareholders' compensation is based on several factors, including collections generated by clients the shareholder brought to the firm even though other lawyers worked on the matter ("origination client"). The law firm is considering amending the shareholder agreement to provide that, upon retirement from the practice of law, a "retired shareholder" will receive from the firm 15 percent of the new collections received from the retiring shareholder's origination clients ("retired shareholder payments"). To be entitled to "retired shareholder payments," the retired shareholder must either (i) become a judge; (ii) become general counsel with a corporation or similar entity, or (iii) retire from the practice of law. There would be no agreement with the shareholder's origination clients for the payment of the retiring shareholder's payments.

The law firm ("Old Firm") is also considering adding a provision to the shareholder agreement that would require a shareholder who leaves the firm ("departed shareholder") to practice solo or with another firm ("New Firm") to pay directly or through the New Firm the retired shareholder payments for fees generated by the retired shareholder's origination clients at the New Firm. (For purposes of the discussion, we refer to "shareholders" and "shareholder agreement." However, the same analysis and conclusions apply equally to partners and partnership agreements or other similar law firm structures and agreements.)

## QUESTION

May a shareholder agreement require that a departed shareholder or the shareholder's New Firm share with a retired shareholder 15% of the fees generated at the New Firm by the retired shareholder's origination client(s) that left with the departed shareholder?

## OPINION

At the heart of the Inquiry is the issue of fee-sharing with lawyers who are no longer in the same firm: Whether a lawyer who is no longer associated with a former firm may share fees with a retired partner of that law firm pursuant to a retirement plan. Rule 1.5 governs the division of fees between lawyers who are not in the same law firm. That Rule provides, in relevant part, as follows:

> (e) A division of a fee between lawyers who are not in the same firm may be made only if:
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> (1) the division is in proportion to the services performed by each lawyer, or if the primary service performed by one lawyer is the referral of the client to another lawyer and each lawyer assumes joint financial responsibility for the representation;
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> (2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and
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> (3) the total fee is reasonable.

Notably, the restrictions on sharing fees under Rule 1.5(e) do not "prohibit or regulate … payments made pursuant to a separation or retirement agreement." Rule 1.5, Comment [8]. Thus, payments made to a shareholder *by the Old Firm* pursuant to retirement or separation provisions of the shareholder agreement (or partnership or other similar agreement) should not be prohibited, even if the payments were based on a division of fees, as proposed here. *Cf.* Mass. Bar Ethics Op. 2014-4 (purchase price of practice of retiring lawyer may include fees earned in the future from representation of retiring lawyer's current and former clients, but not new clients referred by the lawyer.) Although the proposed "retirement" provision applies to lawyers who may not actually be retiring from the practice of law (*e.g.*, those who leave to become in-house counsel), Comment 8 to Rule 1.5 makes clear that Rule 1.5 does not apply to payments made pursuant either to retirement provisions and, more broadly, to separation provisions.

However, the fee-sharing obligation of the Old Firm may not be imposed on a departed lawyer (or New Firm) for fees generated at the New Firm *after* the departed shareholder has left the Old Firm (setting aside fees that may be owed to the Old Firm for work performed by the lawyer at that law firm or quantum meruit claims).

First, the New Firm itself could not share fees with the retired partner under the exception to Rule 1.5(e). Any "sharing" of fees would not be made pursuant to a "retirement agreement" between the New Firm and the retired shareholder. That agreement would be between the Old Firm and the retired partner. Accordingly, fees could be shared only if all the conditions of Rule 1.5(e) were met. They are not. Under the proposed shareholder agreement, to be entitled to any retirement payment, the retired shareholder must no longer be providing any legal services to clients (other than as in-house counsel). Thus, a retired shareholder cannot meet the very first requirement of Rule 1.5(e)—that the division of fees be in proportion to legal services performed because, as a condition of the retirement payment, the retired shareholder could not provide any legal services to the client under the shareholder agreement. The second principal condition—the client's agreement—is also not met because, as noted in the facts summarized above, there will be no agreement with the origination clients. (Under Rule 1.5(e), fees may also be shared with the agreement of the client where the lawyer's primary service is the referral of the client. That does not apply here because the retired shareholder is not the referral source and, again, there will be no client agreement.)

Second, although the departed shareholder would be a party to the shareholder agreement that contains the retirement payment obligation, a requirement that the departed shareholder continue to share fees generated by clients after departure would appear to run afoul of Rule 5.6. That Rule provides, in relevant part as follows:

> A lawyer shall not participate in offering or making:
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> (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; . . . .[1]

Rule 5.6 "is designed both to afford clients greater freedom in choosing counsel and to protect lawyers from onerous conditions that would unduly limit their mobility." *Dowd & Dowd v. Gleason*, 181 Ill. 2d 460, 481 (1998). *See also* Rule 5.6, Comment [1] (an agreement that "restricts the right to practice law after leaving a firm not only limits their professional autonomy but also the freedom of clients to choose a lawyer.")

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[1] The exception to Rule 5.6(a) – "an agreement concerning benefits upon retirement" – does not apply here. That exception permits a firm to restrict the *retired* lawyer's practice of law in exchange for receiving benefits upon retirement. *See* ABA Formal Op. 06-444. It does not permit restrictions on other lawyers' practice.

The reach of Rule 5.6 is not limited to agreements that expressly restrict lawyer's practices but also includes "agreements that … create financial disincentives to taking these actions." DC Bar Ethics Op. 325 (concluding that merger agreement that created financial disincentives for lawyers to leave firm violated Rule 5.6(a)). But not all financial disincentives constitute an improper restriction under Illinois law in the absence of an explicit restriction on competition. Rather, the courts take into consideration the "strong[]" public policy interest in Illinois in favor of the freedom to contract in determining whether a contractual provision "unduly limit[s]" a lawyer's "mobility or hamper his clients from choosing counsel." *Hoffman v. Levstik*, 369 Ill. App. 3d 144 (1st Dist. 2006) (holding that forfeiture of paid in capital did not violate Rule 5.6 where lawyer testified that no client had issue moving to new firm and contract provision did not interfere with clients' free choice of counsel).

The proposed provision here appears to violate Rule 5.6. Although the proposed provision does not expressly restrict the ability of a departing lawyer to compete with the Old Firm, the requirement of perpetual fee sharing would clearly inhibit the ability of a lawyer to leave the Old Firm and practice elsewhere. As the DC Bar concluded, agreements that require a departing lawyer to continue to share with the former firm fees received from a client of the former firm after departure "impose a barrier" that effectively interferes with the clients' choice of attorney because "[t]he departing attorney would find work for clients of the former firm economically less attractive than work at similar rates received from other clients, and might be deterred from accepting employment from such clients." DC Bar Ethics Op. 65 (addressing predecessor rule).

The same is true of the proposed shareholder provision here. Even if permitted (and it is not for reasons discussed above), prospective firms may not (and likely would not) be willing to agree to share fees with the retired shareholder of the Old Firm (or at least not without reducing the departed lawyer's financial arrangements accordingly), both restricting options available to the lawyer who wishes to leave the Old Firm and imposingthe financial burden of the fee sharing obligation entirely on that lawyer. The departing lawyer (or New Firm) could offset the financial burden "only by charging excessively high rates in order to compensate for the payments which would be due under the terms of the employment contract," creating a disincentive for the origination clients to choose the departing lawyer. DC Bar Op. 65. The effect would be to financially and substantially penalize the departing lawyer and diminish the ability of the lawyer to leave the Old Firm, limiting both the lawyer's "professional autonomy [and] the freedom of clients to choose a lawyer," in violation of Rule 5.6. Rule 5.6 Comment [1].

## **CONCLUSION**

A shareholder agreement (or partnership or similar agreement) may not include retirement benefits that would require lawyers who later choose to leave the firm (or their new firms) to continue to share fees with retired partners of the Old Firm. Such a requirement would violate both Rule 1.5(e) and Rule 5.6(a).

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