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Case No. S232946

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP,

Plaintiff and Respondent,

v.

J-M MANUFACTURING CO., INC.,

Defendant and Appellant.

Court of Appeal of the State of California, Civil No. B256314
Superior Court of the State of California, Los Angeles County
Civil Case No. YC067332

APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF; AMICI CURIAE BRIEF OF PROFESSIONAL LIABILITY INSURERS AF BEAZLEY SYNDICATE 623/2623 AT LLOYD'S, CNA FINANCIAL CORPORATION, ENDURANCE US HOLDINGS CORP., AND W. R. BERKLEY IN SUPPORT OF PLAINTIFF AND RESPONDENT SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

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APPLICATION TO FILE AMICI CURIAE BRIEF

Pursuant to Rule 8.520(f) of the California Rules of Court, AF Beazley Syndicate 623/2623 at Lloyd's, CNA Financial Corporation, Endurance US Holdings Corp., and W. R. Berkley respectfully request leave to file the accompanying *amici curiae* brief in support of Plaintiff and Respondent Sheppard, Mullin, Richter & Hampton LLP ("Sheppard Mullin").

Amici are four of the nation's leading providers of professional liability insurance for attorneys. Collectively, they provide professional liability insurance for hundreds of law firms and thousands of attorneys throughout California. Amici also work closely with attorneys to prevent potential claims by consulting with law firms on best practices and risk management.

Amici and their insureds have a substantial interest in professional conduct rules that are practical and fair, and that reflect the modern practice of law. Rules that are ill-adapted to developments in the legal industry limit the ability to obtain representation of one's choice, promote gamesmanship, and contribute to the unnecessary rise in the cost of professional liability insurance – all of which undermines the integrity of the judicial system and harms the very clients whom the rules are supposed to protect.

Amici thus request leave to file the attached brief in support of Plaintiff and Respondent Sheppard Mullin on the second issue presented.[1] Amici agree with Sheppard Mullin that under the applicable rules of professional responsibility, a sophisticated consumer of legal services

[1] Pursuant to rule 8.520(f)(4) of the California Rules of Court, Amici represent that no party other than those identified in this application and their counsel have authored the proposed amicus brief, in whole or in part, or financially contributed to the brief's preparation or submission.

represented by independent counsel can give informed consent to a general or open-ended waiver of conflicts of interest.

Amici believe that their proposed brief will aid the Court by discussing, in greater detail than the merits briefs, the current legal market and relevant developments in the legal industry. These include the dramatic changes driven by the rise of sophisticated corporate counsel and how those trends implicate the policies and assumptions underlying the rules of professional conduct. The brief addresses the necessary and appropriate role general conflict waivers play in modern practice. It also highlights how an unduly stringent, absolutist approach will only encourage tactical disqualification motions or malpractice claims, to the detriment of clients, law firms, and the courts.

Accordingly, Amici respectfully request that the Court grant this application and accept for filing the included Amici Curiae Brief.

AMICI CURIAE BRIEF

INTRODUCTION AND SUMMARY OF ARGUMENT

The relationship between corporate clients and their outside counsel is evolving dramatically. Heightened competition between law firms, economic pressures on the businesses themselves, and the rise of in-house counsel have driven companies to become increasingly sophisticated consumers of legal services. These sophisticated clients now exercise great bargaining power in selecting counsel and controlling the terms of the relationship. As a result, the concerns that have justified absolutist approaches to the standards of professional conduct – such as whether the client can understand the terms of an engagement agreement, is being taken advantage of, or can effectively monitor the quality of representation – are mitigated. Instead, the public interest lies in rules that are practical and promote client autonomy.

These new dynamics are at play in the question presented regarding the enforceability of a general waiver of conflicts of interest agreed to by a sophisticated client represented by in-house counsel.[2] The Court of Appeal held that a conflict waiver can never be effective unless it identifies the specific client and conflict at issue, regardless of the client's sophistication, and even if the conflict arises only after the engagement began. (*See* Opn. 18-19.) Defendant-Appellant J-M Manufacturing Co., Inc. ("J-M") supports this absolutist approach, contending that California law should be interpreted more stringently than the American Bar Association ("ABA") Model Rules and approaches adopted in other jurisdictions. While the merits briefs review the relevant rules and case law, Amici seek to place the

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[2] This brief focuses on the role of in-house counsel, but the same considerations apply when a company uses an outside firm in a corporate counsel role – *i.e.*, where the outside firm acts a liaison in engaging more specialized counsel for a particular matter.

question presented in the context of the modern legal industry and to demonstrate why the Court of Appeal's approach is impractical and unsound on both professional responsibility and public policy grounds.

In the current legal market, general or "open-ended" conflict waivers play a legitimate role in the ability to obtain counsel of one's choice. Sophisticated clients with independent counsel have the capacity to understand the scope, nature, and implications of such waivers, and they have the bargaining power to negotiate their terms if they choose. While an attorney's duty of loyalty is important, it is premised on client expectations. It does not undermine attorney professionalism or the integrity of the judicial process for sophisticated clients to define their own expectations and to waive the kind of remote, imputed conflict presented here – where a different attorney, in a different office, is representing an adversary in an unrelated matter. If the waiver is clear and limited to unrelated matters, and confidentiality and the quality of representation are not impaired, the waiver should be enforced according to its terms, like any provision in an agreement between sophisticated parties represented by counsel.

Moreover, the approach followed by the Court of Appeal and advocated by J-M would merely encourage gamesmanship – harming clients and law firms alike. Courts recognize that disqualification motions often are brought for purely strategic reasons, rather than any sincere concern with the quality of representation or the integrity of the judicial process. That appears to be the case here. Encouraging such tactics leads to increased disputes and malpractice claims, needlessly inflating the costs of professional liability insurance, harming client choice, and burdening the courts. Public policy weighs in favor of crafting rules in a practical way to avoid such results.

Amici thus support Sheppard Mullin's position that the Court of Appeal's decision should be reversed.

ARGUMENT

I. THE RISE OF SOPHISTICATED CLIENTS HAS CREATED A PARADIGM SHIFT IN THE LEGAL INDUSTRY

The traditional paradigm of the attorney-client relationship was one in which a layperson was totally dependent on the attorney for legal advice. This was true even in the context of corporate clients: the historical model was one in which a company relied almost exclusively on a single firm as its "trusted advisor" for all of the company's legal needs. (*See, e.g.*, Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney/Client Relationship*, 78 Fordham L. Rev. 2067, 2067-2068, 2077 (Apr. 2010) [hereinafter Wilkins].) Under this model, the client lacked both the bargaining power and the substantive legal knowledge to monitor its attorney effectively. (*See id.* at pp. 2077-2078; Wendel, *Pushing the Boundaries of Informed Consent: Ethics in the Representation of Legally Sophisticated Clients*, 47 U. Tol. L. Rev. 39, 41-42 (Fall 2015) [hereinafter Wendel].) The rules of professional responsibility have been developed, in significant part, to protect vulnerable clients from unscrupulous behavior or situations that compromise the attorney's ability to provide effective representation.

The rise of sophisticated in-house counsel – what some have called the in-house counsel "movement" – has dramatically changed the model for the attorney-client relationship with corporate clients. (Wilkins, 78 Fordham L. Rev. at pp. 2080-2084; Wendel, 47 U. Tol. L. Rev. at pp. 48-49.) As a result of this movement, corporate clients have increasingly relied on in-house counsel to take over the "trusted advisor" role and assume greater responsibility for the company's strategic utilization of legal services. (*Ibid.*) Sophisticated in-house counsel enable their companies to be less dependent on particular outside firms and drive outside firms to compete more aggressively for the client's business. (*Ibid.*) Indeed, "the

dominant theme over the last thirty years has been corporate clients' ability to reduce dramatically the information asymmetries that used to characterize their relationship with outside counsel." (Wilkins, 78 Fordham L. Rev. at p. 2105.)

These developments have caused "a paradigm shift in the relationship—and the balance of power—between lawyers and their clients." (Davis & Fielder, *Indemnity Provisions in Outside Counsel Guidelines: A Tale of Unintended Consequences*, 23 The Professional Lawyer No. 4 (ABA Center for Professional Responsibility 2016) [Davis & Fielder]; *see also* Wendel, 47 U. Tol. L. Rev. at p. 59 [observing "sea change in the attorney-client relationship" that has involved a "dramatic shift of power from law firms to clients"]; Wilkins, 78 Fordham L. Rev. at 2077-2084.) The global recession has only exacerbated the economic conditions driving this trend, as it has increased the pressure on outside firms to compete for business while also increasing the pressure on in-house counsel to control outside counsel costs and activities. These developments manifest in various ways relevant to understanding how the practice of law no longer conforms to the traditional model and why general conflict waivers with sophisticated clients should be enforceable.

<u>Sophisticated clients and their in-house counsel exercise increased power in defining the terms of the engagement</u>. As explained by the Association of Corporate Counsel ("ACC"), a bar association for in-house attorneys: "With many law firms struggling to attract or retain corporate clients, companies now often have the upper hand in negotiating new engagements." (Thomas & Bulacan, *Outside Counsel Retention Agreements* (ACC Sept. 16, 2011), http://www.acc.com/legalresources/quickcounsel/ocra.cfm.) This "increased bargaining power" is now part of the "New Normal." *Ibid.* Nor is this bargaining power limited to requiring alternative fee arrangements or

other cost-cutting measures. Whether through "Outside Counsel Guidelines" or other measures, sophisticated in-house counsel are capable of defining a broad range of parameters, such as staffing controls, diversity requirements, and media policies. (*Ibid.*) Sophisticated clients may, and often do, insert their own conflicts provisions; in some cases clients may even seek to impose terms beyond what are required by any ethical rules, including for competitive purposes. (*Ibid*; *see also* Practical Law, *Working Effectively with Outside Counsel Checklist* (Thompson Reuters 2016), http://us.practicallaw.com/7-617-8668.)

Thus, it simply is not true that sophisticated clients are compelled to accept law firms' conflict waivers as if they were part of a take-it-or-leave contract of adhesion. Rather, in the modern legal industry, "the relationship between a legally sophisticated client and outside counsel is as close to an ordinary arms-length negotiation as any professional relationship can be." (Wendel, *supra*, at p.49.)

Sophisticated clients use a range of providers. A related feature of the modern legal industry is that "[c]lients that once utilized the legal services of a single law firm for all their needs, especially large multinational corporations, now frequently engage numerous firms to handle discrete and highly specialized legal problems." (Lerner, *Honoring Choice by Consenting Adults: Prospective Conflict Waivers As a Mature Solution to Ethical Gamesmanship -- a Response to Mr. Fox*, 29 Hofstra L. Rev. 971, 973 (2001) [hereinafter Lerner].) In the current market, "[i]ncumbency is no longer a guarantee," as the "steady trends" in the corporate legal world include "increased sophisticated law firm selection" and a willingness "to entertain moving work" to different kinds of legal service providers to increase value. (Satkunas, *6 Consistent Corporate Legal Trends in Data, Staffing and Spend*, LexisNexis Business of Law

Blog (Apr. 28, 2015), http://businessoflawblog.com/2015/04/corporate-legal-trends-2/.)

This trend reflects that, in the modern legal industry, relationships between law firms and sophisticated clients are more transactional in nature, or at best more closely resemble strategic business relationships, than what was envisioned by the traditional model. Even when clients adopt "preferred provider" programs, they typically still use a number of firms – thus preserving the ability to shift work from one firm to another as necessary – and they have adopted such programs specifically to increase their ability to shape the relationship and governing policies with those firms. (Wilkins, 78 Fordham L. Rev. at pp. 2085-2088; Levine et al., 1 Successful Partnering Between Inside and Outside Counsel (rev. Apr. 2016) § 7:4 ; *cf.* Fong, *Doing More With Less*, 27 No. 2 ACC Docket 4 (2009) [describing "Preferred Provider Network of 47 firms"].)

Sophisticated clients focus on hiring the individual lawyer. Another trend driven by sophisticated in-house counsel is that they are more focused on hiring a particular attorney or practice team with specialized expertise, rather than hiring the "firm." As the Chief Counsel for Litigation at AON explained: "[L]et's just stop asking whether clients hire lawyers or firms. If clients have any sense at all, they hire lawyers." (Herrmann, *Inside Straight: Hiring Law Firms or Lawyers?*, Above the Law (Apr. 21, 2011), at http://abovethelaw.com/2011/04/inside-straight-hiring-law-firms-or-lawyers/.) Another "sophisticated buyer" explains: "I hire individual lawyers—the firm is incidental." (Cohen, *Lawyers, Law Firms, and a Sophisticated Buyer*, Bloomberg Law, Big Law Business Blog (Oct. 14, 2015), https://bol.bna.com/lawyers-law-firms-and-a-sophisticated-buyer/.)

ACC-sponsored programs provide the same advice, explaining that, "[h]istorically, corporations typically selected a law firm," but the better practice is that "corporations should select the lawyer and not the law firm."

(Best Practices in Hiring Outside Counsel 6, 10 (2003), http://www.acc.com/vl/public/ProgramMaterial/loader.cfm?csModule=security/getfile&pageid=20527&recorded=1.) That is the case even as law firms have expanded in size to offer "one stop shopping" experience:

> At a time when over a dozen law firms have 1000+ lawyers in the United States, and 200 lawyers will not even place a law firm among the 200 largest, retention decisions cannot be based solely on firm versus firm assessments.... [S]uccess will be driven primarily by the skill, efficiency and strategic choices of the individual lawyer(s) responsible for the matter.

Robinson, et al., 1 Successful Partnering Between Inside and Outside Counsel (rev. Apr. 2016) § 4:10.

Developing deep and sustained relationships still matters a great deal in the practice of law, and the relationships between particular firms and clients of course will vary in their depth and breadth. But this trend shows that to a sophisticated consumer of legal services, the "heart of the attorney-client relationship" often lies with *particular attorneys or teams*, more so than with other attorneys who just happen to work at the same firm.

II. THE COURT SHOULD CONFIRM THE ENFORCEABILITY OF GENERAL CONFLICT WAIVERS AGREED TO BY SOPHISTICATED CLIENTS REPRESENTED BY COUNSEL

A. General Conflict Waivers Between Law Firms and Sophisticated Clients Represented by Counsel Play an Appropriate Role in the Modern Legal Industry

Rule 3-310(C) of the California Rules of Professional Conduct requires "informed written consent" before a law firm represents a client in a matter adverse to another client, even if its work for the other client is unrelated. Under the rule of imputed conflicts, the client of one attorney at a law firm is considered a client of the entire firm. Thus, a conflict can arise when one attorney seeks to represent a new client in a matter that incidentally involves a party that a different attorney in the firm, in a

different office, represents for a completely unrelated matter. That kind of imputed conflict is at issue in this case: Sheppard Mullin's white-collar defense attorneys were representing J-M in the qui tam action at the same time that an employment attorney in another office had provided sporadic employment advice to South Tahoe Public Utility District ("South Tahoe"), which joined the qui tam action after it began as an intervenor with a fractional stake.

The dynamics of the modern legal industry, including those discussed above, have dramatically increased the potential for these kinds of technical, imputed conflicts. (*See* Jones & Davis, *In Defense of a Reasoned Dialogue About Law Firms and Their Sophisticated Clients*, 121 Yale L.J. Online 589, 592-593 (2012); Lerner, 29 Hofstra L. Rev. at p. 973.) Commercial enterprises have become more complex, and they face a broadening range of legal issues, including regulatory, litigation, corporate governance, transactional, employment matters, and more. These sophisticated clients have shown a preference for using a range of providers and shopping for individual attorneys with specialized expertise to handle particularized matters. At the same time – and in response to the demands of their clients – law firms are growing in size, including through mergers, lateral acquisitions, and other expansions into new geographic or practice areas. These firms may have hundreds or thousands of current clients for which they have done or are doing varying amounts work in different practice areas.

Thus, "changes on both sides of the equation in the practice of law have resulted in a proliferation of potential lawyer-client conflicts." (Matusky & Suglia, *Nostradamus, Esquire?*, New Jersey Lawyer, the Magazine (Dec. 2011), at pp. 60, 61 [hereinafter Matusky].) But frequently these conflicts are arising "in situations where the core values of loyalty and confidentiality are *not* threatened in the same direct and serious way

they were when the canons and rules were adopted and the predominant business model was very different." (*Ibid.* [emphasis added].)

Faced with this reality, and the increased potential that even small matters could prevent a law firm from working on unrelated matters for different clients in the future, law firms frequently include in their engagement agreements a provision for the advance or general waiver of conflicts of interest for unrelated matters. (*See* Lerner, 29 Hofstra L. Rev. at p. 973; DiLernia, *Advance Waivers of Conflicts of Interest in Large Law Firm Practice* (2009) 22 Geo. J. Legal Ethics 97, 97; *see also* Matusky, *supra*, at pp. 61-62.) Such waivers serve a fundamental purpose of promoting the ability of sophisticated clients to "exercis[e] their important right to select counsel of choice." (Lerner, *supra*, at p. 974; *see also* Matusky, *supra*, at p. 62.) Without the ability to obtain such waivers, firms would be less willing to accept smaller clients or matters, to avoid being disqualified from taking on a more lucrative client or matter at a later time. That concern also, and especially, applies to pro bono work and work for government entities. Moreover, without enforceable open-ended waivers, legacy clients would be able to exercise a "veto" over new engagements for purely strategic reasons, simply to deny an adverse party the attorney of its choice.

B. Sophisticated Clients Represented by Counsel Have the Capacity to Provide Informed Consent to a General Conflict Waiver

In the decision on review, the Court of Appeal held that a general conflict waiver is never enforceable. Part of the dispute in this case involves whether an actual – as opposed to a prospective – conflict with South Tahoe existed at the time that the engagement with J-M began. But the Court of Appeal did not rely on that point, holding that "[e]ven assuming Sheppard Mullin was not representing South Tahoe at the time it

entered into the agreement with J–M," Sheppard Mullin was required to obtain a "second waiver" from each party once the conflict arose. (Opn. at 18-19.) Thus, according to the Court of Appeal, consent cannot be "informed" unless the party involved in the "potential or actual conflict" is specifically identified. *Id.* Requiring a "second waiver," of course, would eviscerate the utility of having an open-ended or prospective waiver in the first place, especially given that, in most cases, it would be infeasible or even impossible to enumerate all of the potential conflicts that could arise.

The Court of Appeal's approach reflects an impractical and unnecessarily paternalistic approach to "informed consent" when dealing with sophisticated clients represented by independent counsel.[3] As reflected in the discussion in Part I, sophisticated corporate in-house counsel are fully capable of understanding the nature, purpose, and impact of an open-ended conflict waiver. They understand the dynamics of the modern legal industry and the potential for technical, imputed conflicts to arise. Some clients may balk at providing a prospective or open-ended waiver. Others may not have an issue with it, especially when – as here – the client is hiring particular lawyers for a specific matter rather than hiring the "firm" for ongoing work across practice areas. In any event, sophisticated clients represented by counsel have the ability to negotiate the terms of an engagement agreement and revise, limit, or reject the conflict waiver if they so choose.

[3] As explained in Sheppard Mullin's merits briefs, the Court of Appeal's approach also runs contrary to the recognition in the ABA Model Rules and by other courts and bar associations that a sophisticated client represented by counsel can provide a "general [and] open-ended waiver," without requiring identification of "a particular party, class of parties, or the nature of the potentially conflicting future matter." (*Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC* (N.D.Tex. 2013) 927 F.Supp.2d 390, 401; *see also* Opening Br. at 27-31.)

In this case, for example, there is no dispute that the language of the waiver was clear and specifically alerted J-M that it was intended to cover imputed conflicts arising from the fact that Sheppard Mullin "has many attorneys and multiple offices." (*See* Opn. 5.) Discussions with J-M about Sheppard Mullin's representation of another intervenor – the Los Angeles Department of Water and Power – also alerted J-M to that kind of conflict. J-M obviously understood that, under the terms of the waiver, Sheppard Mullin was allowed to represent an adverse intervenor, as long as it was in an unrelated matter and confidences were preserved. J-M apparently was not concerned that doing so would endanger the quality of Sheppard Mullin's defense and agreed to the waiver after its general counsel had the opportunity to review and negotiate the terms of the engagement agreement.

As one court has explained in a related context, when a "sophisticated corporate client" is represented by counsel and has the opportunity to negotiate the terms of the engagement agreement with the law firm, the result is "a private business transaction between equally matched parties, pure and simple." (*Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405, 1420-1421 [rejecting challenge to contingency fee agreement as unconscionable and in violation of California ethics rules].) Enforcing such agreements validates and promotes client autonomy both because it facilitates clients' ability to hire counsel of their choosing and because it respects clients' contracting decisions. A sophisticated client who agrees to a general conflict waiver should not be able to get the benefit of that agreement (*i.e.*, securing counsel of its choice) without satisfying the consideration it promised in returned (*i.e.*, permitting the firm to represent other clients in unrelated matters). Allowing sophisticated clients to manipulate the system in this manner harms both the law firm and its other clients.

J-M argues that "in-house counsel are sometimes unsophisticated, young, and inexperienced" and hire outside firms "*because* those firms are more sophisticated." (Answer Br. 30.) The argument that in-house counsel are too inexperienced and too outmatched by firm attorneys to effectively represent their client is condescending and baseless. Contrary to the past perception that in-house departments were merely "less prestigious destinations for young lawyers," there has been "significant increase in the educational credentials and prior work experience" of in-house counsel, many of whom are recruited from major law firms. (Wilkins, *The In-House Counsel Movement: Metrics of Change*, The Practice (Harvard Law School Center on the Legal Profession May 2016); *see also* Wendel, 47 U. Tol. Rev. at p. 48.) Moreover, while in-house counsel may hire outside firms for their expertise or resources in handling a particular matter, it is the essence of an in-house counsel's job to be an expert *on the process and conditions for retaining outside counsel.* (*See* Wendel, 47 U. Tol. Rev. at p. 59 ["What good is an in-house lawyer who does not understand the effect of language in a contract he is signing for the client?"].)

J-M further argues that clients have no effective bargaining power because (a) a "long-time client" of a firm would face expense and hardship in moving work to a new firm, while (b) a new client lacks the clout to force a change in a firm's standard terms. (Answer Br. 30.) Neither argument matches reality, as explained in Part I. Given the fierce competition among law firms, "long-time clients" – *i.e.*, those that maintain a volume of business for the firm – exercise substantial power over the relationship, and most sophisticated clients use a range of service providers, so they would not face undue hardship in shifting work from one firm to another. Fierce competition among law firms also means that even "new clients" have bargaining power in a new engagement, and those "new

clients" are the very ones that would struggle in finding representation from "top notch firms" if general waivers were deemed unenforceable.

C. Allowing General Conflict Waivers With Sophisticated Clients for Imputed Conflicts Does Not Undermine Professionalism or the Quality of Representation

No one disputes that, regardless of developments in the legal industry, attorneys must still conduct themselves as professionals and adhere to ethical standards, which exist for the benefit of clients. But allowing sophisticated clients represented by counsel to enter into a general conflict waiver does not undermine those professional values, especially as applied to the kind of imputed conflict presented here.

The rule against concurrent conflicts is premised on the attorney's duty of loyalty. (*See Flatt v. Superior Court* (1994) 9 Cal.4th 275, 285-289.) That duty reflects the concern that, if an attorney has a relationship with both parties to a dispute, the attorney could be placed in a "practical dilemma" that can compromise "the quality of attorney's services." (*Flatt*, 9 Cal.4th at pp. 282, 287 (internal quotation omitted); *id.* at p. 289 [duty of loyalty precludes "the honest practitioner from putting himself in a position where he may be required to choose between conflicting duties, or be led to attempt to reconcile conflicting interests, rather than to enforce to their full extent the rights of the interest which he alone should represent"]; *cf.* Restatement (Third) of Law Governing Lawyers § 121 [defining a conflict as one that presents "a substantial risk that the lawyer's representation of the client would be *materially and adversely affected* ... by the lawyer's duties to another current client, a former client, or a third person"] [emphasis added].)

The other concern underlying the duty of loyalty is based more generally on the "client's legitimate expectation" and "sense of trust and security." (*Flatt*, 9 Cal.4th at pp. 278, 282.) The concern is with how the

client will "feel" if an attorney "upon whom he looks as his advocate and his champion" is adverse to him in a separate matter. (*Id.* at pp. 284-286 [internal quotation omitted].). As explained in *Flatt*, "[a] *lay client* is likely to doubt the loyalty of a lawyer who undertakes to oppose him in an unrelated matter." (*Id.* at p. 287 [emphasis added] [internal quotation omitted].)

As *Flatt* makes clear, the core ethical concerns underlying the duty of loyalty are premised on the traditional model of the attorney as a "trusted advisor" to an unsophisticated client. When a sophisticated client represented by counsel agrees to a general conflict waiver, the agreement articulates what the "client's legitimate expectation" is: the client is acknowledging that its "sense of trust and security" will *not* be destroyed merely because the firm happens to represent an "adversary" in an unrelated matter. (*Flatt*, 9 Cal.4th at pp. 278, 282.) That makes sense because sophisticated clients understand the legal industry and take a more business-orientated view to their engagements with outside law firms. "Loyalty to clients is undeniably a core principle of legal ethics, but loyalty requires respecting the client's actual interests, not a hypothetical construct of reasonable-client interests." (Wendel, *supra*, 47 U. Tol. Rev. at p. 49.)

Moreover, general conflict waivers are intended to cover precisely the kind of remote, imputed conflicts that have no material impact on the quality of representation by the particular attorney hired for the matter. Here, for example, J-M hired Sheppard Mullin to take advantage of the expertise of two particular attorneys (Daly and Kriendler) who would lead the team. South Tahoe, meanwhile, had a relationship with a different Sheppard Mullin attorney (Dinkin) who provided sporadic advice on unrelated employment matters. There is no suggestion that Daly and Kriendler compromised the aggressiveness of their defense of J-M in the qui tam action, simply because South Tahoe was among the plaintiff-

intervenors. Likewise, there is no suggestion that, by defending the qui tam action, Sheppard Mullin caused South Tahoe to lose its "sense of trust and security" in the employment advice that Dinkin provided to it. It divorces ethics from reality for J-M to argue that the kind of technical conflict in this case goes to the "heart of the attorney-client relationship."

While the rule against imputed conflicts is not in dispute in this case,[4] it is merely a *default* rule, and public policy does not require an overly stringent approach to a sophisticated client's ability to alter the default. Allowing such a waiver does not diminish the attorneys' professionalism or services, because the attorney remains subject to numerous other duties, including the immutable duty to provide effective representation and the duty to maintain client confidentiality. Sophisticated clients with in-house counsel also have a far greater capacity than a lay client to monitor the attorney's performance on an ongoing basis and even dictate legal strategy in a case, thus providing a check against any potential diminution the effectiveness of its service.

Moreover, nothing compels a client to continue using an attorney if it later becomes uncomfortable or annoyed that the firm took on a new engagement. But sophisticated clients have far greater power to resolve such issues for themselves, whether by switching counsel or entering into a dialogue with the law firm to take steps to assuage its concerns. A general conflict waiver simply allocates to the sophisticated client the responsibility to handle such a concern *as a business or relationship issue*, rather than using the conflict rules to defeat another client's choice of counsel. Sophisticated corporate counsel understand and are able to evaluate this

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[4] Commentators have noted that, in other jurisdictions, the kind of conflict presented in this case would not qualify as a conflict at all. (*See, e.g.*, Jones & Davis, 121 Yale L.J. Online at 592-593.)

risk, and they have the market power and legal expertise to deal with potential conflicts in this way, rather than relying on protectionist rules.

For all of these reasons, the policy interests in promoting client autonomy and respecting the terms of a bargained-for agreement far outweigh any competing concerns that would justify the prohibitionist approach adopted by the Court of Appeal.

D. The Court of Appeal's Absolutist Approach Promotes Gamesmanship, Hurting Clients, Inflating the Cost of Professional Liability Insurance, and Undermining the Integrity of the Judicial System

As professional liability insurers, Amici would always encourage firms to be thorough and proactive with their conflicts management. Indeed, firms have ample business-based incentives to avoid misunderstandings, confusion, or any kind of act or omission that might impact the firm's reputation or relationship with a client, regardless of whether it risks an ethical violation. In this regard, J-M argues that because an actual or imminent conflict with South Tahoe allegedly was known at the time of the engagement with J-M, it should have been specifically disclosed. With the benefit of hindsight, it is easy for J-M to ask why Sheppard Mullin simply did not disclose South Tahoe specifically, even if the conflict were only a potential one.

Yet there are a number of reasons why firms acting ethically and in good faith may fail to identify a particular potential conflict. For example, the rules provide that disclosure is not required for potential conflicts with a *former* client if the matters are unrelated and do not risk confidentiality. (*See* Rule 3-310(E); *Flatt*, 9 Cal.4th at p. 283.) But it is not always clear in practice whether a client is a former or current one: the test for whether an attorney-client relationship has terminated generally is whether "*the client* actually and reasonably believes that the representation is continuing," and this issue is frequently characterized as predominantly a question of fact, on

which reasonable minds can differ. (*See Gonzalez v. Kalu* (2006) 140 Cal.App.4th 21, 31-32 [emphasis added].) As another example, a firm may find itself adverse to a subsidiary, affiliate, or officer of a corporate client (often without even realizing the affiliation when running its conflicts check), in situations where it is later disputed whether representation of the corporation extends to its entire corporate family. In either of these cases, attorneys may believe that there is no current-client conflict to disclose, only to have the status of the relationship later disputed.

While Amici advise firms to adopt best practices to try to avoid these situations, they inevitably arise. General conflict waivers help mitigate against issues that would turn the Rules of Professional Conduct into a trap, guarding against the risk of disruptive and time-consuming disqualification motions or other disputes in situations that involve technical conflicts on unrelated matters but do not materially limit or impair the quality of the attorney's services. The terms of the waiver that J-M agreed to were clear, and J-M understood that it covered the situation in which Sheppard Mullin represented an intervenor in an unrelated matter. When, as here, a sophisticated client is represented by counsel and has the capacity to understand and negotiate a conflict waiver provision, there is no policy basis to deny its enforcement, absent situations such as a showing of bad faith or that the conflict would materially impair the attorney's representation in a given case.[5]

Moreover, a contrary rule would do more to promote gamesmanship than ethics. As courts and commentators have recognized, parties "now

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[5] To the extent the Court is concerned with any specific factual disputes over the circumstances of this particular case, it should adopt a general rule in favor of the enforceability of advance or general conflict waivers and remand to the proper factfinder for further proceedings. The Court may also avoid the second issue altogether by ruling in favor of Sheppard Mullin on the first issue presented.

commonly use disqualification motions for purely strategic purposes," including as a "litigation tactic" to create delay, harass the opposing party, or deprive it of its counsel of choice. (*Zador Corp. v. Kwan* (1995) 31 Cal.App.4th 1285, 1302-1303 [internal quotation omitted].) Courts are often "skeptical of the impetus and purpose" of a party asserting a conflict, because the tactical assertion of conflicts "poses the very threat to the integrity of the judicial process that it purports to prevent." (*Sharp v. Next Entmt., Inc.* (2008) 163 Cal.App.4th 410, 434.) General conflict waivers enable courts to dispose of disqualification motions in cases where the purported conflict does not actually taint the trial, without having to wade into technical but intensely factual disputes that might require automatic disqualification.

Based on the facts presented in the briefs, the pattern of asserting a conflict purely for strategic gain appears in this case. Sheppard Mullin was representing J-M for over a year before South Tahoe filed a motion to disqualify. (*See* Opening Br. 9.) J-M initially did *not* view the issue as a disqualifying conflict from its perspective and only changed its mind when it believed that it could leverage the situation to avoid paying its legal fees. (*Id.*) The ethics rules should be a shield to protect vulnerable clients, not a sword that sophisticated commercial entities wield for financial or strategic gain.

A purported conflict of interest can also supply the basis for an attorney malpractice claim. Just as motions to disqualify are often asserted purely for tactical gain, malpractice claims too can be asserted without significant merit and simply as a way of negotiating down the fees owed to the attorney. Thus, in addition to encouraging strategic disqualification motions, the Court of Appeal's approach would also tend to encourage malpractice claims.

That is bad policy, as it ends up harming the very clients that the rules are supposed to protect. The frequency of legal malpractice claims – including claims based on conflicts-of-interest – has risen since the recession, and there has been a surge in claim exposure level, as well as the cost to defend claims. (*See* American Bar Association, *Profile of Legal Malpractice Claims 2012-2015*, at p. 26 (Sept. 2016); Ames & Gough, *Lawyers' Professional Liability Claims Trends: 2015*, http://www.law.uh.edu/faculty/adjunct/dstevenson/007a%20Legal%20Malpractice%20Claims%20Survey%202015%20Final.pdf (last visited Nov. 18, 2016); Sebold, *Post-Recession, Legal Malpractice Claims on the Rise*, Daily Journal (July 29, 2013).) A legal rule that encourages the filing of malpractice claims has the tendency to inflate professional liability insurance rates *for all attorneys*. That, in turn, tends to drive attorneys out of the profession or causes them to raise their billing rates, both of which negatively impact clients – especially less affluent ones who end up with diminished access to affordable counsel. (*See* Schnidman & Salzler, *The Legal Malpractice Dilemma: Will New Standards of Care Place Professional Liability Insurance Beyond the Reach of the Specialist?* (1976) 45 U. CIN. L. REV. 541, 560 [discussing relationship between increasing stringent professional liability rules and increased malpractice rates, and its impact on clients].)

In various contexts, the legislature and courts have recognized the strong public policy against unnecessarily encouraging malpractice suits. (*See, e.g.*, *Lee v. Hanley* (2015) 61 Cal.4th 1225, 1233–1236 [explaining how statute of limitations in Code of Civil of Procedure section 340.6 was enacted to curb rise in attorney malpractice premiums]; *Goodley v. Wank & Wank Inc.* (1976) 62 Cal.App.3d 389, 397–398 [holding that attorney malpractice claims were not assignable because, among other things, it would "encourage unjustified lawsuits against members of the legal

profession," creating "an undue burden on not only the legal profession but the already overburdened judicial system" as well]; Mallen, *Panacea or Pandora's Box? A Statute of Limitations for Lawyers* (1977) 52 State Bar. J. 22 [noting how rising premiums concern the profession generally].)

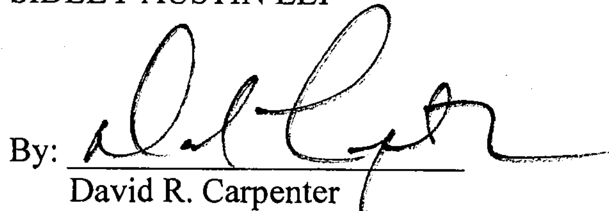
At bottom, sophisticated clients represented by their own counsel do not need to be protected from the terms of their own agreements. In addition to having the capacity to understand and negotiate the terms of an engagement, sophisticated corporate counsel have both the market power and substantive ability to control and regulate their counsel without unduly protectionist rules, and they can benefit from a system that gives attorneys flexibility in taking on new engagements. By encouraging unnecessary disqualification motions and malpractice claims, the Court of Appeal's unduly stringent, absolutist approach would ultimately frustrate clients' legitimate interests far more than it would protect them from harm.

CONCLUSION

Accordingly, for the reasons set forth above, the Court should rule in Sheppard Mullin's favor and reverse the decision below.

Dated: December 1, 2016

Respectfully submitted,
SIDLEY AUSTIN LLP



By: ______________________
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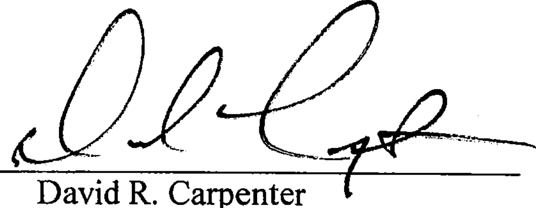

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CERTIFICATE OF SERVICE

STATE OF CALIFORNIA)
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I am employed in the County of Los Angeles, State of California. I am over the age of 18 years and not a party to the within action. My business address is 555 West Fifth Street, Suite 4000, Los Angeles, California 90013-1010, mbrown@sidley.com.

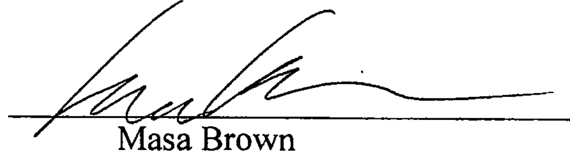
On December 1, 2016, I served the foregoing document described as: **APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF; AMICI CURIAE BRIEF OF PROFESSIONAL LIABILITY INSURERS AF BEAZLEY SYNDICATE 623/2623 AT LLOYD'S, CNA FINANCIAL CORPORATION, ENDURANCE US HOLDINGS CORP., AND W. R. BERKLEY IN SUPPORT OF PLAINTIFF AND RESPONDENT SHEPPARD, MULLIN, RICHTER & HAMPTON LLP** on all interested parties in this action as follows (or as on the attached service list):

See Attached Service List

☒ (BY U.S. MAIL) I served the foregoing document by U.S. Mail, as follows: I placed a true copy of the document in a sealed envelope addressed to each interested party as shown on the attached service list. I placed each such envelope, with postage thereon fully prepaid, for collection and mailing at Sidley Austin LLP, Los Angeles, California. I am readily familiar with Sidley Austin LLP's practice for collection and processing of correspondence for mailing with the United States Postal Service. Under that practice, the correspondence would be deposited in the United States Postal Service on that same day in the ordinary course of business.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed on December 1, 2016, at Los Angeles, California.



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