Supreme Court 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, Second Appellate District, Division Four
Case No. YC067332

San Bernardino County Superior Court/Central Justice Center
Case No. CIVDS 1108273
Honorable Stuart Rice, Judge

J-M MANUFACTURING COMPANY, INC.'S CONSOLIDATED ANSWER TO AMICUS BRIEFS

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INTRODUCTION

The amicus briefs supporting the two parties here depict two starkly different versions of the reality confronting clients when they hire lawyers.

The amici supporting Sheppard—large law firms, their insurance companies, a group of law professors and an association representing discipline defense counsel—insist that their thirst for generalized, open-ended conflict waivers is motivated by nothing more than a desire to protect their clients. They insist that sophisticated clients or those with in-house counsel have more than sufficient bargaining power to negotiate out of such waiver provisions. (E.g., Liability Insurers' Brief, pp. 5-15; Law Firms' Brief, p. 11; Discipline Defense Counsel Brief, pp. 4-9.) In fact, the large law firms go so far as to claim that the "only reasonable inference" that can be drawn from some clients agreeing to such waivers is that clients don't mind conflicts: They claim that clients are "indifferent to who is adverse" to them, do not want the "disrupti[on]" of having to read and consider disclosures, or actually want to hire firms with conflicted interests. (Law Firms' Brief, pp. 17, 19.) Amici thus implore that courts must "[a]llow clients to opt out of" receiving pesky disclosures of the relevant facts and to treat the waiver of an attorney's duty of loyalty as a simple arm's-length business deal. (*Id.* at p. 10.)

By contrast, amici supporting J-M—institutional clients consisting of business entities and the Association of Corporate Counsel—share their actual experience. They explain that they care deeply about having the

opportunity to consider factual disclosures that bear on their attorneys' conflicts of interests, but they often have no real choice but to agree to general, open-ended waivers. The expressed desires and experience of the clients themselves belie the claims of Sheppard's amici that their desire for this Court's approval of broad, non-specific, open-ended conflict waivers is rooted in their concern for client welfare and suggests a harsher, if far more plausible, reality:

First, the large law firms have such a hefty appetite for general, open-ended conflict waivers because it allows them to grow their profits without the mess of obtaining conflict waivers as conflicts arise, and the ever-present risk that they will lose business because the existing client will not agree to waive the conflict once apprised of the relevant facts. It is no small surprise that it has historically been the large law firms that have sought to modify ethics rules to allow general, open-ended advance conflict waivers. (E.g., Buckner, *Addressing the Intricacies of Future Conflict Waivers* (2008) 50-NOV Orange County Law. 46, 47["intensive lobbying efforts by large law firms" drove the California Bar's initial examination of advance conflict waivers].) And the sheer numbers of large law firms appearing as amici on behalf of Sheppard only confirms the significance of the issue to them.

Second, while there may be some clients that have the bargaining strength to negotiate out of such waivers, most are not so fortunate. That a client has in-house counsel does not make it a "bargaining heavyweight[]," as amici put it. (See Law Firms' Brief, p. 11.) Most

clients are not that large. Most are not that powerful. And most do not carry the promise of so great a volume of potential work that they can tempt law firms to abandon their desire for general, open-ended conflict waivers. As some of the amici supporting J-M explain, they have personally been forced to sign such waivers because the law firms demanded they do so, and they needed the law firm because of its particular expertise in the type of case they were confronting. (E.g., Exponential Interactive, et al. Brief, pp. 2-8, 11, 15-16; Assn. Corporate Counsel Brief, pp. 4, 12.)

Indeed, the Law Firm amici expose the extremes to which they want to push California's rules of ethics—far beyond anything resembling even the ABA Model Rules. For instance:

- They see nothing wrong with a prospective attorney telling a prospective client there are "no conflicts" even though the attorney's conflict check revealed one. (Law Firms' Brief, p. 7, fn. 1.) The Law Firms say this is permissible because it is supposedly "accepted usage for lawyers, and courts, to use the words 'no conflicts' when they mean 'no unwaived conflicts.'" (*Ibid.*) That can't possibly be right. When a *prospective* client inquires about the existence of any undisclosed conflicts *before* the prospective client waives conflicts, the undisclosed conflicts are by definition "unwaived conflicts." Besides, under every ethical regime, the attorney is obligated to disclose the known conflict, whether or not the client asks.

- The Law Firms apparently envision a world in which even unsophisticated clients can be made to sign generalized, open-ended advance conflict waivers. The ABA Model Rules absolutely prohibit this. (ABA Model Rules, rule 1.7, com. 22.) But the law firm amici are only willing to say that "truly unsophisticated clients who do not have the benefit of independent counsel *may* need more disclosure" than what Sheppard Mullin provided here, which is *no* disclosure at all. (Law Firms' Brief, p. 5, italics added.)

In this brief, we explain that, contrary to the assumption of Sheppard's amici, the only issue presented here is the validity of a general, open-ended conflict waiver where the attorney *knows* of a present or imminent conflict but fails to tell the prospective client of the facts relevant to that conflict—a practice permitted in no jurisdiction. We then explain why Sheppard's amici's policy reasons seeking to justify that practice have no validity whatsoever.

This argument, however, is bookended by a brief discussion of two other issues touched upon by two of Sheppard's amici. First, we address whether California law requires a court or an arbitrator to determine the issue of whether an entire contract is unlawful. As we explain, for decades this Court and the lower appellate courts have clearly held that the issue of entire contract illegality *must* be decided by the courts—principally because that's the system the Legislature designed. Thus, even if amici's policy arguments had merit (as we show, they do not), it is the Legislature, not this Court, that is the proper forum for any change. Second, we address

whether California law requires the client to prove harm arising from such an undisclosed conflict of interest and whether any disgorgement or forfeiture of fees must be proportionate to that proven harm. As we explain, there is no justification for such a rule, which would operate solely to allow attorneys to take advantage of what authorities uniformly recognize is a circumstance in which the extent of damages is, for all practical purposes, impossible to prove, but in which the client unquestionably did not receive what it bargained for.

ARGUMENT

I. UNDER WELL-ESTABLISHED CALIFORNIA LAW, COURTS—NOT ARBITRATORS—MUST DETERMINE ENTIRE-ILLEGALITY CHALLENGES TO A CONTRACT THAT CONTAINS AN ARBITRATION PROVISION.

As J-M's Answer Brief demonstrated, a long line of decisions of this Court and the intermediate appellate courts firmly establishes the rule in California that where, as here, a party challenges the entire illegality of a contract containing an arbitration provision, that challenge must be decided by a court—not an arbitrator. (J-M Answer Brief, § I.) The Amici Law Firms contrary arguments are wholly without merit.

First, the Law Firms rely on *Gueyffier v. Ann Summers, Ltd.* (2008) 43 Cal.4th 1179, 1182, for the proposition that "'[a]bsent an express and unambiguous limitation in the contract,'" arbitrators have broad authority to grant any relief "rationally related" to their factual findings and contractual interpretation, and they assert the arbitrators therefore had the authority to find that Sheppard Mullin acted in good faith and was entitled to compensation. (Law Firms' Brief, pp. 7, 9.) But *Gueyffier* was concerned with the scope of arbitral powers of contract interpretation and had nothing to do with the question of the appropriate forum for determining the issue of whether a case should go to arbitration in the first place—much less whether the contract containing the arbitration provision is entirely illegal. "'It is axiomatic, of course, that a decision does not stand for a proposition

not considered by the court.'" (*Agnew v. State Bd. of Equalization* (1999) 21 Cal.4th 310, 332.)

Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1 and its progeny are clear that an arbitrator has no power to decide any issue if the arbitration provision is contained in an entirely illegal contract—a determination that courts must make de novo before compelling arbitration. (J-M Answer Brief, § I.) Where, as here, the entire contract is illegal as against public policy, no court could enforce it by compelling arbitration, the dispute was not arbitrable, and the arbitrators' factual findings and award therefore lacked any force. Similarly, the Law Firms' contention that parties are entitled to rely on the benefits of an arbitration agreement (Law Firms' Brief, p. 6) makes no sense when the arbitration provision is in a contract that is *entirely* illegal; no party has the right to rely on any part of a contract that is so violative of public policy that it is entirely unenforceable.

Second, the Law Firms worry that "[i]f J-M's position were to be accepted, a client could conceivably await the result of an arbitration and then, if the result is unpalatable, seek to relitigate *de novo* what the arbitrators had already decided by claiming 'illegality.'" (Law Firms' Brief, p. 9.) Not so. *Moncharsh* itself guarantees that such fear is baseless: Parties cannot contest entire-illegality unless they "raise the illegality question prior to participating in the arbitration process." (*Moncharsh*, *supra*, 3 Cal.4th at pp. 30-31 [discussing "'procedural gamesmanship'"]; see J-M Answer Brief, p. 16.) And J-M did exactly that here. (Opinion, pp. 8-9 [trial court argument and writ petition].)

Third, amici note that a contract is only entirely illegal if it has a "'single object, and such object is unlawful.'" (Law Firms' Brief, p. 6, quoting Civ. Code, § 1598.) They argue that engagement agreements have many lawful objects—the various terms and conditions under which the attorney will provide legal services—regardless of the legality of the conflict waiver provision. (*Id.* at pp. 6-7.) This argument seems deliberately obtuse. Every contract has terms and conditions. But it is undeniable that the single, overarching object of an engagement agreement is the creation of an attorney-client relationship. Sheppard Mullin's acceptance of the representation under the engagement agreement here—the document that created the attorney-client relationship—itself violated law and public policy because Sheppard Mullin withheld the information necessary to obtain J-M's informed consent. (Rules of Professional Conduct, rule 3-310(C).) That illegality permeated everything, including the various terms of the engagement agreement that defined the minutiae of the illegal relationship. Those other terms served no independent object. In short, the type of violation of the duty of loyalty committed by Sheppard Mullin struck at "the very foundation of an attorney-client relationship" and thus vitiated the entire agreement that purported to create that relationship. (See Opinion, pp. 11, 22-26.)

Fourth, the Law Firms urge this Court not to create a rule that lawyer-client arbitration clauses are unenforceable whenever a violation of an ethical rule is alleged. (Law Firms' Brief, p. 6.) No one has ever suggested such a thing. While the Law Firms assert that unconscionable

fees or an incident of lawyer "fraud" during a representation can implicate the duty of loyalty, such violations generally are not enough to render the *entire contractual relationship* illegal. If a fee is unconscionably high, the relationship itself remains lawful and the attorney is entitled to only reasonable compensation for his services. If a lawyer commits some types of "fraud" during a representation, the relationship itself remains lawful and the attorney must pay damages caused by the single unlawful act. None of these are comparable to the fundamental ethical violation that rendered the entire relationship invalid here.[1]

What's more, no one has ever suggested that an arbitration provision within an engagement agreement is unenforceable whenever a conflict rule has been "alleged" to have been violated. (*Ibid.*) The trial court must *determine* whether the contract is entirely illegal before denying a petition to compel arbitration. (Code Civ. Proc., §§ 1281, 1281.2; J-M Answer Brief, pp. 12-13 [trial court must deny arbitration when "grounds exist for the revocation" of the agreement].)

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[1] The Court of Appeal remanded so that the trial court could determine whether the conflict already existed or came into existence three weeks later because that is relevant to the scope of disgorgement. The United States District Court has already examined the evidence and held that South Tahoe was an existing Sheppard client at the time Sheppard undertook the J-M representation, finding Sheppard's contrary argument "unpersuasive" and not supported by "any evidence." (2AA347-348, 405.) But either way, the public policy problem existed from the beginning because Sheppard Mullin accepted the representation without obtaining J-M's informed consent to an existing or imminent conflict.

Fifth, the Law Firms express various concerns about the expense that will be generated in cases like J-M's:

- The Law Firms argue that in "many instances," courts will conclude that some issues are arbitrable, resulting in multiple litigations in different forums. (Law Firms' Brief, p. 8.) Not true. If the entire agreement containing the arbitration provision is illegal, then there is no enforceable arbitration agreement on which to premise an arbitration. In any event, the Law Firms are wrong to suggest that it would strike "at the core of the State's public policy" to sever arbitrable and non-arbitrable claims. (*Ibid.*) The Legislature provided for precisely such circumstances. (Code Civ. Proc., §§ 1281.2, subd. (c) [establishing procedure if "court determines that there are other issues between the petitioner and the respondent which are not subject to arbitration"], 1281.4 [stays involving arbitrable and non-arbitrable claims].)

- It is not clear if the Law Firms are concerned that a trial court must undertake a full trial, with discovery, to determine whether a claim is arbitrable. If that is what they mean by "delay and increased expense" (Law Firms' Brief, p. 8), the burden is not nearly so great. Just like any other opposition to a petition to compel arbitration, the trial court resolves the issue in a summary proceeding. If the court denies arbitration, that determination is immediately appealable. (Code Civ. Proc., § 1294, subd. (a).) If the court compels arbitration, that determination is reviewable by discretionary writ or after confirmation of the award. (*State Farm Fire & Casualty v. Hardin* (1989) 211 Cal.App.3d 501, 506.)

- The Law Firms argue that "[w]hen a dispute is removed from arbitration to a court, the court needs to allow discovery, request briefs, hold a hearing and issue a reasoned decision." (Law Firms' Brief, p. 8.) That is true if they mean that this is the result if the trial court refuses to compel arbitration and the Court of Appeal affirms that determination. But that is the normal cost of litigation of any non-arbitrable claim. And of course, arbitration involves discovery, briefing and hearings as well.

And despite all of the Law Firms' attempted criticisms, they fail to wrestle with the fundamental fact that it is *the Legislature* that has devised the scheme by which courts must determine entire illegality while deciding whether to compel arbitration. (J-M Answer Brief, pp. 12-14.) As this Court and the lower appellate courts have recognized for decades, the approach is mandated by statute. (*Id.* at pp. 12-15.) If the Law Firms want to change the law, they should take up the matter with the Legislature. They can then address their policy arguments—which, as shown above, are of dubious value at best—to a body in a position to do something about it.

II. CONTRARY TO THE ARGUMENTS OF SHEPPARD'S AMICI, NEITHER CALIFORNIA LAW NOR THE LAW OF ANY JURISDICTION PERMITS THE TYPE OF UNINFORMED CONFLICT WAIVER SHEPPARD USED HERE.

A. Contrary To Sheppard's Amici's Claims, No Jurisdiction Permits General Waivers For Existing Or Imminent Conflicts.

The amici supporting Sheppard operate on the assumption that the ABA and other jurisdictions consider general, open-ended conflict waivers appropriate not just when the attorney has no knowledge about a possible future conflict, but even when a particular conflict already exists or the attorney is aware that a particular conflict is imminent. For instance, the Professional Liability Insurer Amici argue that non-specific, open-ended waivers are enforceable against "sophisticated" clients who sign an "advance *or* general waiver of conflict of interest." (Liability Insurer Brief, p. 11, italics added; see also *id.* at pp. 16-18.) That is not and cannot be the law. Not in California. Not anywhere.

As J-M's Answer Brief on the Merits demonstrated, the only type of "general" conflict waiver permitted anywhere is a general *advance* conflict waiver. (J-M Answer Brief, § II.A.) Thus, these authorities address the permissibility of general waivers only with respect to *advance* waivers and explicitly state that a general waiver *cannot* be used as a substitute for disclosure of existing or impending conflicts about which the attorney is

aware. (*Id.* at pp. 22-25.) Likewise, the authorities describe the policy reasons *unique to advance waivers* that they believe justify the use of general advance waivers for hypothetical future conflicts. (*Id.* at pp. 28-31.)

None of the amicus briefs actually attempts to *demonstrate* that the ABA, the Restatement or any authority anywhere permits general, open-ended waivers for existing or imminent conflicts known by the attorney. And the very notion clearly and directly conflicts with California Rule of Professional Conduct 3-310. (See § II.B.1., *post.*)

As demonstrated in J-M's Answer Brief on the Merits, in light of the facts of this case, this Court need decide nothing beyond the disclosure rules applicable to existing conflicts and imminent conflicts, because under either party's interpretation of the facts, this case fits into one of those two categories:

- J-M contends that South Tahoe was an existing client of Sheppard Mullin: South Tahoe's engagement agreement with Sheppard Mullin was not restricted to a particular matter or time. (2AA277.) Rather, it contemplated a continuous, uninterrupted lawyer-client relationship involving periodically recurring employment advice from Sheppard on an "as-needed" basis. (2AA278-279, 288-289; Opinion, p. 4.) Neither South Tahoe nor Sheppard Mullin acted to terminate the relationship (as the engagement agreement permitted only by following an express procedure), and both lawyer and client acted consistently with J-M's interpretation of

the engagement agreement as providing for a continuing attorney-client relationship permitting South Tahoe to ask, whenever it saw fit, for legal advice. (2AA290; Opinion, p. 4; see J-M Answer Brief, pp. 4-6.) Indeed, Sheppard stated that its conflict check identified South Tahoe as an "existing client" and confirmed the "'long-standing relationship between [South Tahoe] and our Firm'" for nearly a decade. (Opinion, pp. 4, 7; 2AA317, ¶ 5; see J-M Answer Brief, p. 6 & fn. 1.) Not surprisingly, the district court rejected Sheppard's "argument that South Tahoe was not its client at the time it took on representation of J-M" as "unpersuasive," not based on "any evidence" and contrary to Sheppard and South Tahoe's pattern of conduct. (2AA347-348, 405.)

- Sheppard Mullin contends that the conflict did not arise until a few weeks after J-M signed the engagement agreement and conflict waiver. (See J-M Answer Brief, pp. 24-25.) But under the undisputed facts, Sheppard's relationship with South Tahoe constituted at least an imminent conflict that Sheppard Mullin was required to disclose. After all, Sheppard Mullin *knew* that South Tahoe was a long-time client to which it gave periodic, as-needed legal advice under an engagement agreement that purported to create an attorney-client relationship. (See J-M Answer Brief, pp. 4-6 & fn. 1.) And Sheppard Mullin *knew* that South Tahoe returned every few months for another round of legal advice. (*Ibid.*) While Sheppard Mullin did not know precisely when South Tahoe would next return, the firm had every reason to believe that it would shortly resume active work for South Tahoe. This was not speculation about some

hypothetical unknown party adverse to J-M that might some day retain Sheppard Mullin.

As this Court is well aware, the State Bar is nearing completion of its new rule regarding advance waivers of hypothetical conflicts that might later arise. (See § II.B.5.a., *post.*) As explained above, this case indisputably does not involve that situation. Consequently, there is absolutely no reason for this Court to decide that issue now.

As we next explain, amici's various arguments do not justify a change in California law regarding the requirements of informed consent in the circumstances that *are* present here—where there is a known conflict that either presently exists or is imminent.

B. Amici's Arguments Do Not Justify The Enforcement Of Broad, Open-Ended, General Waivers For Existing Conflicts, Imminent Conflicts, Or True Advance Conflicts.

1. Rule 3-310 does not permit general waivers of all undisclosed conflicts.

Rule 3-310 is clear. It requires "informed written consent" following "written disclosure" that informs the client of both "the *relevant circumstances* and of the actual and reasonably *foreseeable adverse consequences*" of any conflict of interest. (Italics added.) The rule ensures that the client receives vital information so that the client can evaluate the likelihood, nature, and degree of a conflict and decide whether it is in its

best interests to retain the attorney. Without such disclosure, the prospective client lacks the necessary information to make an informed decision—information known to the prospective attorney. Thus, the rule alleviates the fundamental information asymmetries facing the prospective client.

It is beyond question that an attorney fails to disclose the "relevant circumstances" of an existing or impending conflict if an attorney—knowing of an existing or imminent conflict—says only that he "*may*" have a conflict now or in the future, as Sheppard did here. (1AA201, italics added.) Such a general "disclosure" in reality discloses *no* "relevant circumstances" whatsoever.

Amicus Association of Discipline Defense Counsel takes a different view, but it can do so only by refusing to confront Rule 3-310's actual language. It contends the rule is only concerned with whether the client is aware of "what the client is actually agreeing to" and that sophisticated clients can easily understand "what the language of the waiver plainly says . . . ." (Discipline Defense Counsel Brief, pp. 11, 13-14.) Not so. Informed consent requires "written disclosure" of the "relevant circumstances" of a conflict and reasonably foreseeable risks—not just a client who is capable of intelligently reading a waiver that makes no disclosures whatsoever.

Likewise, contrary to what the Association of Discipline Defense Counsel argues, requiring the identification of an existing or highly likely

conflict known by the attorney does not improperly "elevate[] one factor" over other factors such as the client's sophistication. (*Id.* at p. 12.) Rule 3-310 requires disclosure of the "relevant circumstances" of a conflict, which at the very least requires the identification of the existence or likelihood of a particular conflict. It may be true that sophisticated clients with in-house counsel require *less detailed* disclosures in order to understand a disclosed conflict's scope and foreseeable adverse consequences. For instance, unlike a lay client, a sophisticated client's in-house counsel can better understand legal terminology that another attorney uses to describe a conflicting representation and can better appreciate the magnitude of such a representation. And once a particular conflict has been disclosed, in-house counsel might be in a better position to appreciate the significance of that conflict and its potential risks without as detailed a disclosure about foreseeable adverse consequences. But nothing in Rule 3-310—or the law of any jurisdiction—permits the attorney to withhold information about the *fact* of an existing or impending likely conflict.

Indeed, a Sheppard-style waiver in a firm's form engagement agreement is tailor-made to confuse clients, particularly in-house counsel. In-house counsel are well aware that the law requires attorneys to disclose conflicts. Naturally, when no conflicts are disclosed, in-house counsel will assume that a form waiver provision in a form engagement letter that says a conflict "may" exist is merely a form that has not been tailored to the circumstances of the representation, and therefore would reasonably infer that no present or impending conflict exists at all. And that is all the more

true when the in-house counsel asks and the attorney confirms that there are "no conflicts." (1AA191.)

2. Contrary to Sheppard's amici's arguments, confidentiality concerns do not justify general waivers of existing conflicts.

Amici Scholars contend that giving "due weight to the confidentiality of a client's identity" requires the allowance of general waivers of existing conflicts. (Legal Scholars' Brief, p. 7; see generally *id.* at pp. 6-10.) They explain that an existing client may not want its identity disclosed to its attorneys' other prospective clients, thus interfering with the attorneys' ability to obtain the prospective client's informed consent to an existing conflict. (*Id.* at pp. 6-8.) True, but this possibility does no damage to confidentiality rights and does not justify the use of a general conflict waiver.

The law is clear that under these circumstances, the attorney must respect the existing client's right to confidentiality and *cannot* undertake the new representation. For instance, the same D.C. Bar Ethics Opinion that recognizes general advance conflict waivers stresses that as to existing conflicts, a lawyer "cannot seek a waiver and hence may not accept the second representation" if full disclosures cannot be made due to first client's confidentiality concerns. (D.C. Ethics Opn., 309; see D.C. Rules Prof. Conduct, rule 1.7, com. 27 ["if a lawyer's obligation to one or another client or to others or some other consideration precludes making such full

disclosure to all affected parties, that fact alone precludes undertaking the representation at issue"].) The Restatement recognizes the same result: If confidentiality precludes full disclosure, it "might be possible for the lawyer to explain the nature of undisclosed information in a manner that nonetheless provides an adequate basis for informed consent. If means of adequate disclosure are unavailable, consent to the conflict may not be obtained." (Rest.3d Law Governing Lawyers, § 122, com. c(i).) Simply withholding the fact of a conflict by using a general waiver is not an option. The values of protecting confidentiality and of avoiding conflicts demands this result.[2]

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[2] The ABA Model Rules and the statutes of at least forty-three states likewise recognize the interplay between confidentiality and informed consent, agreeing that "[u]nder some circumstances it may be impossible to make the disclosure necessary to obtain consent." (ABA Model Rules, rule 1.7, com. 19; see Ala. Rules Prof. Conduct, rule 1.7, com. *Consultation and Consent*; Alaska Rules Prof. Conduct, rule 1.7, com. *Informed Consent*; Ariz. Rules Prof. Conduct, rule 1.7, com. 19; Ark. Rules Prof. Conduct, rule 1.7, com. 19; Colo. Rules Prof. Conduct, rule 1.7, com. 19; Conn. Rules Prof. Conduct, rule 1.7, com. 4; D.C. Rules Prof. Conduct, rule 1.7, com. 27; Del. Rules Prof. Conduct, rule 1.7, com. 19; Fla. Rules Prof. Conduct, rule 4-1.7, com. *Consultation and Consent*; Ga. Rules Prof. Conduct, rule 1.7, com. 5; Hawaii Rules Prof. Conduct, rule 1.7, com. 19; Idaho Rules Prof. Conduct, rule 1.7, com. 19; Ill. Rule Prof Conduct, rule 1.7, com. 19; Ind. Rules Prof. Conduct, rule 1.7, com. 19; Iowa Rules Prof. Conduct, rule 32:1.7, com. 19; Kan. Rules Prof. Conduct, rule 226:1.7, com. 19; Ky. SCR 3.130(1.7), com. 19; La. Rules Prof. Conduct, rule 1.7, com. 19; Me. Rules Prof. Conduct, rule 1.7, com. 19; Md. Rules Prof. Conduct, rule 1.7, com. 19; Mass. Rules Prof. Conduct, rule 1.7, com. 19; Mich. Rules Prof. Conduct, rule 1.7, com. *Consultation and Consent*; Minn. Rules Prof. Conduct, rule 1.7, com. 19; Miss. Rules Prof. Conduct, rule 1.7, com. *Consultation and Consent*; Mo. Rules Prof. Conduct, rule 4-1.7, com. 19; N.C. Rules Prof. Conduct, rule 1.7, com. 19; N.D. Rules Prof. Conduct, rule 1.7, com. 24; Neb. Rules Prof. Conduct, § 3-501.7, com. 19; N.H. Rules Prof. Conduct, rule 1.7, com. 19; N.M. Rules Prof. Conduct, rule 1.7, com. *Consultation and Consent*; Ohio Rules Prof. Conduct, rule 1.7, com. 30; Okla. Rules Prof. Conduct, rule 1.7, com. 19; Pa. Rules Prof. Conduct,

(continued. . .)

Sheppard's amici cite nothing suggesting or even arguing that a general conflict waiver is or should be an appropriate means of addressing these confidentiality problems. Not one statute. Not one ethics opinion. Not one scholarly article.

Instead, they argue that the rule that exists everywhere will harm clients, particularly "clients of more modest means and pro bono clients." (Legal Scholars' Brief, pp. 9-11.) They argue that if a client asks a firm to keep its identity confidential, the "firm may be inclined to charge that client a premium to compensate for the inability to obtain a general waiver" from other clients. (*Id.* at p. 11.) Sheppard's Scholars say that (1) this will increase the cost of legal services for those who do not want to "give up their right" to confidentiality, and (2) clients who need confidentiality but are unable to pay these premiums will have to "forego representation." (*Ibid.*) Nonsense. For one thing, it is highly doubtful that an attorney could ethically extort a waiver of a client's confidentiality rights so that the attorney could profit by disclosing the information to obtain other clients. Attorneys are fiduciaries and cannot force their clients to pay extra to hold on to the fundamental right to confidentiality. In fact, amici seem to concede this on a different page of their own brief. (*Id.* at p. 9 ["In light of

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(. . . continued)

rule 1.7, com. 19; R.I. Rules Prof. Conduct, rule 1.7, com. 18; S.C. Rules Prof. Conduct, rule 1.7, com. 17; Tenn. Rules Prof. Conduct, rule 1.7, com. 17; Tex. Rules Prof. Conduct, rule 1.7, com. 7; Utah Rules Prof. Conduct, rule 1.7, com. 19; Vt. Rules Prof. Conduct, rule 1.7, com. 19; Va. Rules Prof. Conduct, rule 1.7, com. 19; Wash. Rules Prof. Conduct, rule 1.7, com. 19; W.Va. Rules Prof. Conduct, rule 1.7, com. 19; Wis. Rules Prof. Conduct, Rule 1.7, com. 19; Wyo. Rules Prof. Conduct, rule 1.7, com. 19.

ethical obligations, a lawyer or law firm cannot properly insist that all clients waive confidentiality . . . simply to secure the lawyer's or law firm's own ability to negotiate conflict waivers"].) Moreover, the Scholars' theory is empirically untrue: We have not uncovered any instance—and the Scholars cite none—of a lawyer demanding a client pay a premium for confidentiality. Nor is there any indication in the real world that attorneys refuse to perform pro bono work for fear that the pro bono client will insist on confidentiality and block the firm's ability to accept more lucrative clients in the future.

Besides, even if there were some basis in reality for Sheppard's Scholars' concerns, it does not support acceptance of general waivers for known existing or imminent conflicts, as occurred here. Indeed, here Sheppard never even attempted to determine whether South Tahoe would object to disclosure on confidentiality grounds. It didn't even speak to the Sheppard partner in charge of South Tahoe's representation about whether South Tahoe might have such a concern. (See J-M Answer Brief, p. 6 [Sheppard concealed the conflict even from partner working with South Tahoe].) And rather than at least disclosing that a present or imminent conflict existed so as to give J-M minimal non-confidential information, when J-M asked whether there were any conflicts, Sheppard Mullin replied "no" and then it presented J-M with a form waiver provision stating that the firm "*may* currently or in the future" have a conflict. (1AA201, italics added.)

3. Amici's "impossibility" arguments are meritless.

Two of Sheppard's amici bemoan the supposedly "impossible" circumstances imposed on attorneys unable to ask sophisticated clients to agree to general, open-ended waivers of all existing, imminent and hypothetical conflicts. There is no such impossibility or impracticability—attorneys comply with this rule every day without a problem.

First, the Law Firms rely on *Maxwell v. Superior Court* (1982) 30 Cal.3d 606, 622 and a treatise for the proposition that conflict rules do not require attorneys to undertake the "impossible burden of explaining separately every conceivable ramification" or "consequence" of a conflict. (Law Firms' Brief, pp. 11-12.) They say that attorneys should not be put to an "unrealistic burden." (*Id.* at p. 12.)

That's not what's at issue here. This case concerns whether California ethics rules require an attorney to disclose the relevant circumstances concerning the *fact* of a conflict—not a laundry list of every conceivable "ramification" of waiving that conflict. It was not an "impossible" or "unrealistic" burden to expect Sheppard to disclose its existing or imminent conflict as a result of its representation of South Tahoe. Attorneys do that all the time. As to hypothetical future conflicts—which are not involved here—it is not "impossible" or "unrealistic" to expect an attorney to provide a client with an advance waiver that is more descriptive than a general, open-ended advance waiver. Indeed, the ABA Model Rules foreclose anything but this more descriptive form when

dealing with unsophisticated clients, so it is obviously not "impossible" or unrealistically burdensome for an attorney or large law firm to do the same for sophisticated clients. (ABA Model Rules, rule 1.7, com. 22.)

Second, the Scholars describe a hypothetical in which an attorney cannot obtain a willing client's consent to conflicts "no matter how much" the client wishes to consent and "no matter how much [it] understand[s] what [it is] doing." (Legal Scholars' Brief, p. 6.) Wrong:

- As to existing or impending conflicts, the client could give consent if the attorney makes the necessary disclosures. As the Scholars put it, that is the information that would allow the client to "understand what [it is] doing" and to give informed consent. (*Ibid.*)

- The Scholars are also wrong in asserting that without a general, open-ended advance waiver, a willing, sophisticated client somehow would be barred from waiving purely hypothetical future conflicts. (*Ibid.*) It could easily waive such conflicts using the more-descriptive type of advance waiver contemplated by the ABA rules, just as non-sophisticated clients do.

4. In addition to conflicting with Rule 3-310, Sheppard's amici's arguments improperly treat the attorney-client relationship as an ordinary business relationship rather than a fiduciary relationship guided by fundamental ethical principles.

Three of Sheppard's amici argue that sophisticated clients should be entitled to no disclosures about existing, impending or hypothetical future conflicts because, according to them, the relationship between an attorney and sophisticated client is akin to a standard "arm's length" business relationship. (E.g., Discipline Defense Counsel Brief, pp. 5-9; Law Firms' Brief, p. 11; Liability Insurers' Brief, pp. 4-13.) The argument not only conflicts with the disclosure requirements of Rule 3-310 (§ II.B.1., *ante*), it also does serious damage to the fundamentally fiduciary nature of the attorney-client relationship and the reasons for conflict disclosures.

First, the Law Firms quote *Howard v. Babcock* (1993) 6 Cal.4th 409, 422-423 as recognizing that the "assertion that the practice of law is not comparable to a business" is "unreflective of reality" and that "lofty assertions about the uniqueness of the legal profession" should be put aside. (Law Firms' Brief, p. 11.) *Howard* says that, but context matters. *Howard* addressed the relationship between *partners in a law firm*, holding that ordinary rules regarding non-compete agreements apply to law partners. (6 Cal.4th at pp. 412, 421.) *Howard* in no way suggests that the attorney-client relationship is just a garden-variety business relationship rather than a fiduciary relationship, defined first and foremost by the duty of loyalty. By

contrast, unadulterated freedom of contract is *not* a defining aspect of the attorney-client relationship. In fact, *Howard* observed that 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" by conflict rules. (*Id.* at pp. 422-423.)

Second, Sheppard's amici misplace reliance on *Ferguson v. Yaspan* (2014) 233 Cal.App.4th 676. (Cited at Discipline Defense Counsel Brief, pp. 8-9.) *Ferguson* considered a rule that prohibited an attorney from going into business with his client unless the terms of the business contract were fully disclosed to the client. (233 Cal.App.4th at pp. 687-688.) The Court of Appeal held that this did not require the attorney to *personally* make the disclosures to the client, and that it was sufficient that the client took the attorney's advice to discuss the contract terms with independent counsel. (*Id.* at p. 688.) The court, however, explained that this was true because "the attorney does not have any information bearing on the advisability of the transaction that is unavailable to independent counsel." (*Ibid.*) In other words, in *Ferguson*, independent counsel was sufficient because independent counsel could make the very same disclosures about the written contract's express terms and consequences that the attorney could make.

The opposite is true for Rule 3-310 disclosures of conflicts with other clients. Here (and in most circumstances), a sophisticated client's independent counsel has no way of knowing that a firm like Sheppard

represents an adverse party in another matter. The relevant information is uniquely in Sheppard's hands and only Sheppard can disclose it. In other words, the presence of independent counsel does nothing to alleviate the information asymmetry.

Third, neither *Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405 nor *Desert Outdoor Advertising v. Superior Court* (2011) 196 Cal.App.4th 866 support amici's view of the attorney-client duty of loyalty. (Cited at Discipline Defense Counsel Brief, pp. 5-8; Liability Insurers' Brief, p. 13.)

In *Cotchett*, a sophisticated client and attorney negotiated a contingency fee formula. (187 Cal.App.4th at pp. 1409-1410.) In that case, it was the *client* who "wanted to avoid up-front attorney fees and allocate some of the risk of litigation to [the attorney] through a contingency fee agreement." (*Id.* at pp. 1409-1410.) The attorney agreed to the client's proposed formula. (*Id.* at p. 1410.) The Court of Appeal held that the agreement was not procedurally unconscionable because the client "wielded equal bargaining power during those negotiations" so that the fee arrangement was a "private business transaction between equally matched parties, pure and simple." (*Id.* at pp. 1420-1421.) But *Cotchett*'s consideration of the client's sophistication in determining the procedural unconscionability of the amount of a particular fee formula does not somehow mean that the duty of loyalty to a sophisticated client can be satisfied without any of the disclosures required by Rule 3-310. The fiduciary relationship and the client's need for and right to information

known only by the attorney do not change simply because the client is sophisticated.

The same is true of *Desert Outdoor*, which held that an attorney's fiduciary duty did not require him to separately alert the client to and explain the retainer agreement's arbitration provision. (*Desert Outdoor*, *supra*, 196 Cal.App.4th at pp. 873-874.) True, the court observed that the attorney's fiduciary duty did not require this since the client was sophisticated and clearly read the agreement in detail. (*Id.* at p. 874) But that does not mean that all aspects of the relationship are similar to an arm's-length business transaction, free from fiduciary duties and the requirements of the duty of loyalty.

Fourth, although sophisticated clients with in-house counsel may have become more capable of negotiating certain terms of an engagement (see Liability Insurers' Brief, pp. 4-13), that does not mean that they are entitled to any less of their attorney's duty of loyalty or that the entire attorney-client relationship should be viewed as an arm's-length business transaction. It does not mean that their attorneys can withhold information identifying existing and impending conflicts that are essential to the client's consideration of its best interests. It does not mean that all or even most clients with in-house counsel have the bargaining strength to negotiate out of general waivers. (See pp. 9-11, *ante.*) And it certainly does not mean, as the Liability Insurers contend, that the relevant "'information asymmetries'" between attorney and sophisticated client are "'dramatically'" reduced. (Liability Insurers' Brief, pp. 5-6, quoting

Wilkins, *Team of Rivals? Toward A New Model Of The Corporate Attorney-Client Relationship* (2010) 78 Fordham L.Rev. 2067, 2105.) The cited article does not discuss the information asymmetry between a client and the attorney who is in sole possession of information about the attorney's conflicts. Rather, the article explains that historically, even sophisticated businesses lacked "any significant internal expertise to help them" understand complex business regulations that were imposed beginning with the New Deal. (78 Fordham L.Rev. at p. 2077.) It was this sort of "pervasive information asymmetries" that historically made companies reliant on forming long-term relationships with law firms. (*Ibid.*) And it is this sort of "information asymmetry" that the article says have been closed as companies have hired in-house counsel to "meet their diagnostic and referral needs." (*Id.* at pp. 2080-2081.) But in-house counsel has no magical ability to know about a law firm's conflicts with other clients. That is the information asymmetry that has always required that attorneys disclose their conflicts of interests.

5. Amici's other arguments in favor of general, open-ended waivers are likewise meritless.

Sheppard's amici offer a number of other arguments in favor of general waivers. All are meritless. And in any event, none can overcome Rule 3-310's requirements.

a. The Bar's efforts to craft a new rule.

The Law Firms quote ABA Model Rule 1.7 comment 22 as saying that, "'if [a] client is an experienced user of the legal services and is reasonably informed regarding the risk that a conflict may arise,' an advance conflict waiver 'is more likely to be effective, particularly if, *e.g.*, the client is independently represented by other counsel in giving consent and the consent is limited to future conflicts unrelated to the subject of the representation.'" (Law Firms' Brief, p. 14.) They say "[t]his is the critical wording now contained in draft Comment [22] proposed for our State." (*Ibid.*, citing nothing.) The argument has no force in the context presented here.

First, ABA Model Rule 1.7 comment 22 and the proposed California counterpart that is currently being developed address the advance waiver of hypothetical conflicts that might arise—not existing or impending conflicts of the sort here, which Sheppard Mullin was fully capable of identifying with specificity. (See J-M Answer Brief, § II.)

Second, J-M takes no position regarding the "comprehensive[ness of] the explanation of the types of" hypothetical representations that might arise that would be enough to allow clients of various levels of sophistication to provide informed consent. (ABA Model Rules, rule 1.7, com. 22.) The issue here is whether it is sufficient to provide *no disclosure* at all and instead to rely on a general, open-ended waiver of all conflicts.

Third, comment 22 of the ABA Model Rule does say that a "general and open-ended" waiver is "more likely to be effective" as client sophistication increases. But this is the "critical wording" that the California State Bar *removed* from the proposed California Rule, going so far as to highlight the removal in a redline of the draft adopted by the State Bar's Rules Revision Commission 2014 and circulated for public comment. (See J-M Answer Brief, p. 34 & fn. 7.) Subsequently, the Rules Revision Commission added a sentence saying that the client's sophistication and the presence of independent counsel will be relevant in determining whether an advance waiver of hypothetical conflicts is sufficient. But that version too excludes the ABA Model Rule's suggestion that a "general and open-ended" waiver is ever permissible. (10/26/16 Version of Proposed Rule 1.7, com. 10, available at http://ethics.calbar.ca.gov/Portals/9/documents/2d_RRC/Public%20Comment%20Y/PC%20Rules/RRC2%20-%201.7%20[3-310]%20-%20Rule%20-%20XDFT1%20(10-26-16)%20-%20ALL.pdf [now open for public comment].)[3]

[3] In its reply brief, Sheppard Mullin faulted J-M as "erroneously" failing to cite this most recent draft proposal. (Sheppard Mullin's Reply, p. 20.) Of course, this October 26, 2016 draft had not been written when J-M filed its Answer Brief in mid-September.

b. Large law firms' desires to take new clients without making disclosures does not justify Amici's proposed rule.

The Association of Discipline Defense Counsel expresses concern that "for large law firms," existing and potential conflicts "would effectively limit the diversity of clients they represent unless each of those clients consents to the conflicts that exist and may exist." (Discipline Defense Counsel Brief, p. 10.) Well, sure. But it is difficult to conceive why this justifies stripping clients of their right to disclosures necessary to their evaluation of whether they are comfortable that the representation is in their best interests.

c. Amici's suggestions that clients want or will benefit from general waivers do not justify Amici's proposed rule.

Sheppard's amici—none of whom are actual clients—offer a number of reasons why clients should be grateful for a rule that permits law firms to withhold information about existing, impending and hypothetical conflicts. None has any substance. For instance:

- According to the Law Firms, many clients do not "want nor accept extended conflict waivers that exhaustively catalog all potentially relevant details." (Law Firms' Brief, p. 11.) They say that clients are often "indifferent" to conflicts and prefer to grant blanket, uninformed consent because that is "less disruptive to their internal operations." (*Id.* at p. 19.)

It is difficult to understand why a client would think it is disruptive to have a choice. But if particular clients really do prefer not to read or think about their lawyer's written disclosures, nothing compels them to do so. Besides, this case has nothing to do with "exhaustively catalog[ing]" all details concerning conflicts. It is about whether an attorney is obligated to identify an existing or impending conflict revealed by the attorney's conflict check.

- Sheppard's Scholars contend that if general waivers are not permitted, attorneys will have no incentive to suggest that their clients receive the advice of independent counsel. (Legal Scholars' Brief, pp. 5-6.) Not so. When an attorney discloses an actual or imminent conflict or provides an explanation of the types of hypothetical advance conflicts that might arise, a client's independent counsel can assist the client to understand the foreseeable adverse consequences of the disclosed conflict. That is one of the key ingredients of informed consent, so attorneys have ample incentive to recommend that clients receive such advice. (Rules Prof. Conduct, rule 3-310(A)(1).)

- The Liability Insurers contend that without general waivers, firms would be less willing to accept smaller clients or pro bono matters to avoid being disqualified from working for more lucrative clients at a later time. (Liability Insurers' Brief, p. 11.) Similarly, the Scholars argue that attorneys are likely to charge small and pro bono clients higher rates because of disqualification risk. But none of this requires general, open-ended advance waivers. Rather, that purported problem can be easily avoided by obtaining the smaller or pro bono client's consent to the more

descriptive form of an advance waiver. In fact, the small and pro bono clients might well not be sophisticated enough to permit a general, open-ended waiver even under the ABA's rule.

- Sheppard's amici urge that general, open-ended waivers are necessary to foster "the goal of promoting greater certainty and reliability" of conflict waivers. (Discipline Defense Counsel Brief, p. 10; see also *id.* at p. 12.) But it is Sheppard's amici's approach that creates uncertainty and post-hoc litigation. That approach leaves open debates about whether the client is sufficiently sophisticated and had sufficient bargaining power to make an open-ended disclosure enforceable. A simple rule—the rule that exists everywhere—that attorneys must disclose existing and imminent conflicts leaves no doubt about the reliability of the waiver. So too does a rule recognizing that consent to advance waivers of hypothetical future conflicts can be obtained if they are descriptive of the types of conflicting clients and matters that are likely to arise.

d. Amici's concerns about gamesmanship and encouraging malpractice claims do not justify Amici's proposed rule.

The Liability Insurers raise a number of purported red flags about encouraging malpractice and gamesmanship. None rings true.

First, they contend that unless this Court authorizes general, open-ended conflict waivers, it will "encourage[] the filing of malpractice claims." (Liability Insurers' Brief, p. 21.) But it is unfathomable why

malpractice claims would be "encouraged" by requiring attorneys to disclose existing and imminent conflicts to sophisticated clients. This has always been the law. In fact, amici acknowledge that attorneys will certainly need to make such disclosures to clients without in-house counsel, but amici seem unconcerned that this will "encourage" malpractice claims in that setting. Similarly, it is difficult to comprehend why amici think malpractice claims would be "encouraged" by requiring attorneys to give sophisticated clients the same type of descriptive advance waivers of hypothetical conflicts that attorneys must give to other clients. Perhaps amici mean that if the Court eliminates a duty, it will eliminate all malpractice claims arising from that duty. That's true, but hardly seems a legitimate reason to eliminate a legal duty.

In fact, it is the ABA Model Rule—the rule that the Liability Insurers champion—that will encourage malpractice claims. The Model Rule provides that general, open-ended advance waivers are "*more likely* to be effective" if the client is experienced and has the assistance of independent counsel. (ABA Model Rules, rule 1.7, com. 22, italics added.) The result is that attorneys and clients will need to litigate whether the client's particular circumstances permit the general waiver.

Second, Sheppard's amici argue that unless the Court blesses general conflict waivers, it will be "promot[ing] gamesmanship" as parties use "disqualification motions for purely strategic purposes." (Liability Insurers' Brief, pp. 11, 19-20.) Not true. A rule requiring attorneys to disclose existing and imminent conflicts to a prospective client does not

permit gamesmanship or strategic disqualifications. It merely allows the prospective client to immediately consider the conflict and to decide whether to retain the attorney. And as to advance waivers of hypothetical conflicts, the more informative type of advance waiver—not the open-ended variant—is all that is necessary to prevent the client from using tactical disqualification motions down the line.

Third, amici say that it is not always clear to an attorney whether a client is a former or current client. (Liability Insurers' Brief, pp. 18-19.) They say that a general waiver resolves this issue and avoids disruptive and time-consuming disputes and disqualification motions. So does disclosure. If an attorney is uncertain of a client's status and wants to avoid a dispute, she can easily disclose the conflict and obtain consent. The attorney can also ask the client whether it considers itself a current or former client since amici acknowledge that the client's reasonable understanding controls. (*Id.* at p. 18.) Depriving clients of information is not the solution to a law firm's preference to hedge its bets.

III. CONTRARY TO THE ARGUMENTS OF TWO OF SHEPPARD'S AMICI, DISGORGEMENT AND FORFEITURE DO NOT—AND SHOULD NOT—REQUIRE A SHOWING OF HARM OR SUBJECTIVE BAD MOTIVE.

Amici Law Firms and Discipline Defense Counsel both argue that whether Sheppard should forfeit fees and the extent of such forfeiture must be subject to a multi-factor balancing test that predominantly considers the

extent of J-M's proven harm and Sheppard's subjective bad faith in withholding any information about the results of its conflict check. (Law Firms' Brief, pp. 20-26; Discipline Defense Counsel Brief, pp. 15-32.) Their arguments are meritless and, if adopted, would have no salutary effect while at the same time would permit attorneys to enjoy the proceeds of an illegal representation.

A. Sheppard's Amici's Due Process Arguments Are Meritless.

Amici contend that requiring attorneys to disgorge or forfeit their fees where they have provided conflicted representation without the client's knowledgeable waiver is, like punitive damages, "a form of punishment" and thus subject to "California and federal due process" requirements. (Law Firms' Brief, pp. 24-25; see Discipline Defense Counsel Brief, p. 31.) They contend that what they characterize as the fundamentally punitive nature of disgorgement and forfeiture constitutionally requires courts to place heavy reliance on the reprehensibility of the attorney's conduct and to limit any disgorgement to an amount proportionate to the client's proven harm. (*Ibid.*) This argument is without substance.

Amici say that it "cannot be denied" that fee forfeitures constitute punishment because the Restatement and *Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000 use the term "forfeiture" to describe an attorney's loss of the right to receive or retain compensation for services following an ethical violation. (Law Firms' Brief, p. 24.) But they do not explain

how the use of the word "forfeiture" magically transforms the remedy into a constitutionally-protected punishment or punitive damages.

It is well established that forfeiture or disgorgement of ill-gotten gains is an equitable remedy that does not trigger constitutional protections applicable to "punishments." (E.g., *S.E.C. v. Bilzerian* (D.C. Cir. 1994) 29 F.3d 689, 696 [double jeopardy clause does not apply because requiring the return of unlawfully received funds is not "punishment"]; *S.E.C. v. Teo* (3d Cir. 2014) 746 F.3d 90, 109 [disgorgement is not punishment]; *United States v. Phillip Morris USA* (D.D.C. 2004) 310 F.Supp.2d 58, 62-64 [Eighth Amendment Excessive Fines Clause does not apply to requirement that wrongly received funds be returned because such a requirement is not "punishment"].) So it is no surprise that this Court has expressly held that Business and Professions Code section 7031 *automatically* prohibits an unlicensed general contractor from seeking compensation and to return any compensation it obtained regardless of whether the client knew the contractor was unlicensed and "[r]egardless of the equities." (*MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works Co., Inc.* (2005) 36 Cal.4th 412, 423; *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 Cal.3d 988, 994-1002.)

Just so, when an attorney is required to forego recovering compensation and to disgorge any ill-gotten compensation from providing services that are prohibited because of an undisclosed conflict of interest. That is not "punishment" within the constitutional sense. Instead, the remedy avoids unjust enrichment from the prohibited relationship. And it

recognizes that the client did not receive precisely what it bargained for—a relationship characterized by undivided loyalty and free from doubt that the attorney may not be advocating for the client to the fullest extent possible. As this Court explained in *Flatt v. Superior Court* (1994) 9 Cal.4th 275, 285, a "client who learns that his or her lawyer is also representing a litigation adversary, even with respect to a matter *wholly unrelated* to the one for which counsel was retained, cannot long be expected to sustain the level of confidence and trust in counsel that is one of the foundations of the professional relationship."

There is little doubt why amici suggest that fee forfeiture should be limited to the harm the client is able to prove: Courts and respected commentators recognize that, in most instances, it is extraordinarily difficult, if not impossible, for the client to prove damages in this context. (E.g., Rest.3d Law Governing Lawyers, § 37, com. b; *Burrow v. Arce* (Tex. 1999) 997 S.W.2d 229, 238.) Proving that the attorney pulled punches as a result of the conflict is practically impossible. For instance, the Law Firms assert that Sheppard "plainly did a great deal of wholly ethical work and believed in good faith that it did not have an unconsented conflict." (Law Firms' Brief, p. 21.) But just saying that doesn't make it true, and more important, no client has a way of knowing whether or not it is true.[4]

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[4] If Sheppard's amici divine this from the arbitrators' findings (see Law Firms' Brief, p. 20), they can do so only by forgetting that those findings are irrelevant since the arbitrators had no power to decide any issue. (§ I., *ante*.)

Disgorgement is designed to redress that problem; not to punish the attorney.

B. Sheppard's Amici's Other Arguments Are Likewise Meritless.

Sheppard's amici assert a number of other arguments in favor of applying a multi-factored balancing test that focuses on client harm and reprehensibility. None has merit or application here.

First, Sheppard's amici argue that "J-M's approach lacks any internal logic, consistency or practicality." (Law Firms' Brief, pp. 22-23.) They wonder aloud why an attorney should automatically be required to disgorge in the case of an actual conflict if additional evidence to establish seriousness would be required in the event of a mere technical violation of conflict laws. (*Ibid.*; see J-M Answer Brief, pp. 38-41.)

But as explained above, a client does not get what it bargained for—undivided loyalty and the assurance that it has such loyalty—when the attorney operates under an actual conflict. (See *Flatt*, 9 Cal.4th at p. 285.) On the other hand, a client is far less likely to suffer such a loss of confidence where the disclosure violation is merely "technical" or where the conflict is merely potential and thus the attorney's loyalties cannot actually divided. (See J-M Answer Brief, pp. 40-41.) For instance, in *Pringle*, *supra*, 73 Cal.App.4th at p. 1002, the court refused to allow a corporate officer to avoid fees when that client provided informed consent to a potential conflict with the corporation, an aligned co-defendant. The

corporate officer could not conceivably lose confidence in his counsel's loyalty merely because the attorney obtained the corporation's informed consent through a writing that was not technically compliant because it was signed by the corporate officer who was the subject of the potential conflict. (*Ibid.*; see J-M Answer Brief, p. 41.) Moreover, damages are inevitable when an actual conflict results in disqualification—something that is not true for technical or potential conflicts: Before its disqualification, Sheppard even prepared and filed a declaration for J-M attesting to such damages here. (1AA195, 225-227.)

Second, Sheppard's amici cite *Latipac, Inc. v. Superior Court* (1966) 64 Cal.2d 278, 279-280, arguing that it holds in circumstances analogous to those here, "fundamental fairness" requires a fact-specific balancing test. (Law Firms' Brief, pp. 23-24.) But *Latipac* bears no reasonable resemblance to this case. In *Latipac*, the Court excused a technically unlicensed contractor from the statutory prohibition against the recovery of compensation because the "facts clearly indicate that the contract has 'substantially' complied with" the licensure requirements. (64 Cal.2d at pp. 280-281.) As the Court explained, the contractor possessed a valid license at the time the parties executed the construction contract for the first fifteen months of the job, but failed to promptly renew the license because the employee tasked with renewing the license suffered an emotional breakdown so severe that he was ultimately committed to a mental institution. (*Ibid.*) Here, there is no suggestion that Sheppard "substantially complied" with its duty to obtain informed consent:

It withheld information and did not disclose any relevant circumstances that would alert its clients to an actual or imminent conflict.

What's more, a rule that subjects all actual conflicts to the suggested factual balancing test is not necessary to permit an attorney to recover fees when he *does* substantially comply with conflict rules. The courts already treat representations plagued by the failure to disclose an actual conflict differently than those in which conflict rules were only "'technically'" violated. (See J-M Answer Brief, pp. 39, 41.)

Similarly, Sheppard's amici urge that it is imperative that courts consider factors such as "[w]hether the lawyer proceeded without any waiver at all, or whether there was an attempt to obtain a waiver," whether and the extent to which the lawyer "alerted the client to the risk of what might happen if the lawyer subsequently had to withdraw," and whether the "client seeking forfeiture or disgorgement may be responsible for any harm that it may have suffered." (Law Firms' Brief, pp. 21-22.) Again, these types of inquiries may indeed be relevant where the lawyer's violation is merely technical. But they make no sense in a situation such as that presented here, where (1) the attorney concealed known facts about the *existence* of an actual or impending conflict, (2) proceeded with the representation without obtaining a knowledgeable waiver of any conflict, (3) was then removed from the representation more than a year down the line when the conflict was discovered (4) but still advised the client to continue the attorney's retention in a bifurcated trial although the attorney had previously advised that this was not in the client's best interests,

leaving the client to wonder the extent to which the representation was compromised and its interests harmed. (J-M Answer Brief, pp. 4-7.)

What would in fact be fundamentally unfair is amici's proposed requirement that limits forfeiture to the "proven" damages—something that authorities consistently recognize is practically impossible to prove. (See p. 46, *ante*.) Likewise, it would be fundamentally unfair to compel a client to pay for services that the client cannot absolutely trust were untouched by an actual conflict simply because the attorney claims that she acted in subjective good faith. And to permit an attorney to be rewarded for such representation in any measure would send precisely the wrong message to the legal community—that it's worth proceeding without a knowledgeable waiver since, even in the unlikely event you are caught, any harm to your bottom line will be minimized by requiring the client to make the near-impossible showing of the extent of actual damage.

Third, Sheppard's amici contend that attorneys will be unwilling to represent multiple clients in an action if they know that an undisclosed actual conflict will result in fee forfeiture. (Discipline Defense Counsel Brief, p. 29.) But California courts have clearly, and without dissent, hewed to this rule for decades. (See J-M Answer Brief, pp. 38-41.) This Court itself has cited those cases. (See *Huskinson & Brown, LLP v. Wolf* (2004) 32 Cal.4th 453, 463.) Yet as far as we are aware, there has been no decline in attorneys lawfully representing multiple clients—and certainly none of Sheppard's amici point to any data suggesting such a decline. Presumably, the rule has worked, and the vast majority of attorneys have

scrupulously informed their potential clients of actual conflicts—as the ethical rules of every jurisdiction require.

CONCLUSION

Sheppard violated its duty of loyalty by withholding *all* information about the relevant circumstances of an actual or impending conflict of interest identified in the firm's initial conflict check. Contrary to what amici argue, a general, open-ended waiver of all conflicts that Sheppard "may" have now or in the future is not sufficient to permit informed consent—not under California's current law, California's proposed rule change or the law of any other jurisdiction. That fundamental violation renders the entire agreement illegal and the dispute non-arbitrable, and it compels forfeiture of Sheppard's compensation for the illegal representation. Sheppard's amici have presented no cogent reason, in practice or in policy, why that fundamental and long-settled ethical stricture should be changed.

Dated: January 17, 2017

Respectfully submitted,

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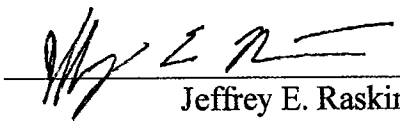
By 
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J-M MANUFACTURING COMPANY, INC., dba
J-M EAGLE

CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.204(c)(1), I certify that the attached **J-M MANUFACTURING COMPANY, INC.'S CONSOLIDATED ANSWER TO AMICUS BRIEFS** is proportionately spaced and has a typeface of 13 points or more. Excluding the caption page, tables of contents and authorities, signature block and this certificate, it contains 13,378 words.

DATED: January 17, 2017

Jeffrey E. Raskin

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss
COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 5900 Wilshire Boulevard, 12th Floor, Los Angeles, California 90036.

On January 17, 2017January 17, 2017, I served the foregoing document described as **J-M MANUFACTURING COMPANY, INC.'S CONSOLIDATED ANSWER TO AMICUS BRIEFS** on the interested parties in this action by placing a true copy thereof enclosed in sealed envelopes as stated below.

SEE ATTACHED SERVICE LIST

BY MAIL

I mailed a copy of the document identified above as follows:

I placed the envelope(s) for collection and mailing on the date stated above, at Los Angeles, California, following our ordinary business practices. I am readily familiar with this business's practice of collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the U.S. Postal Service, in a sealed envelope(s) with postage fully prepaid.

Executed on January 17, 2017January 17, 2017, at Los Angeles, California.

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

Charice L. Lawrie

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