No. S232946

IN THE SUPREME COURT OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP,

Plaintiff and Respondent,

v.

J-M MANUFACTURING CO., INC.,

Defendant and Appellant.

After a Decision of the Court of Appeal of the State of California,
Second Appellate District, Division Four, Case No. B256314

The Superior Court of Los Angeles County, Case No. YC067332
The Honorable Stuart M. Rice, Presiding

OPENING BRIEF ON THE MERITS

*KEVIN S. ROSEN (SBN 133304)
THEANE EVANGELIS (SBN 243570)
BRADLEY J. HAMBURGER (SBN 266916)
ANDREW G. PAPPAS (SBN 266409)
GIBSON, DUNN & CRUTCHER LLP
333 South Grand Ave.
Los Angeles, CA 90071
Tel: (213) 229-7000
Fax: (213) 229-7520
krosen@gibsondunn.com

Attorneys for Plaintiff and Respondent
Sheppard, Mullin, Richter & Hampton LLP

No. S232946

IN THE SUPREME COURT OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP,

Plaintiff and Respondent,

v.

J-M MANUFACTURING CO., INC.,

Defendant and Appellant.

After a Decision of the Court of Appeal of the State of California,
Second Appellate District, Division Four, Case No. B256314

The Superior Court of Los Angeles County, Case No. YC067332
The Honorable Stuart M. Rice, Presiding

OPENING BRIEF ON THE MERITS

---

*KEVIN S. ROSEN (SBN 133304)
THEANE EVANGELIS (SBN 243570)
BRADLEY J. HAMBURGER (SBN 266916)
ANDREW G. PAPPAS (SBN 266409)
GIBSON, DUNN & CRUTCHER LLP
333 South Grand Ave.
Los Angeles, CA 90071
Tel: (213) 229-7000
Fax: (213) 229-7520
krosen@gibsondunn.com

Attorneys for Plaintiff and Respondent
Sheppard, Mullin, Richter & Hampton LLP

TABLE OF CONTENTS

Page

ISSUES PRESENTED FOR REVIEW 1

INTRODUCTION 1

STATEMENT OF THE CASE 5

I. Sheppard Mullin's Representation of J-M 5

II. The Engagement Agreement Between J-M and Sheppard Mullin 5

III. Sheppard Mullin's Representation of South Tahoe 7

IV. South Tahoe's Disqualification Motion 8

V. The Arbitration Panel Rules in Sheppard Mullin's Favor, and the Trial Court Confirms the Panel's Award 10

VI. The Court of Appeal's Decision 12

ARGUMENT 12

I. Courts Cannot Vacate Arbitration Awards Based on Non-Legislative Expressions of Public Policy 12

A. Vacating an Arbitration Award on Illegality Grounds Requires a Legislative Expression of Public Policy 13

B. The Rules of Professional Conduct Cannot Be Used to Vacate an Arbitration Award on Illegality Grounds 18

C. The Court of Appeal's Expansive View of the Illegality Exception Cannot Be Salvaged Based on the Contention That the Engagement Agreement Was "Entirely" Illegal 23

II. For Sophisticated Clients Represented by Independent Counsel, "Informed Written Consent" Means Understanding the Scope of the Waiver and the Nature of the Conflicts It Covers 26

A. Under Rule 3-310(C)(3), a Sophisticated Client Represented by Independent Counsel Can Give Informed Consent to a Comprehensive Waiver of Conflicts 27

B. J-M Gave Informed Written Consent to the Waiver of the Conflict Regarding South Tahoe 31

TABLE OF CONTENTS
(continued)

Page

C. The Modern Legal Marketplace Calls for an Informed Consent Standard Tailored to Sophisticated Clients Represented by Independent Counsel 37

III. Even If the Conflict Waiver Is Deemed Invalid, Sheppard Mullin Was Entitled to Retain and Recover Its Attorneys' Fees Under the Circumstances Here 40

A. J-M Cannot Obtain Disgorgement of Past Fees Because It Stipulated That It Suffered No Damages 41

B. A Conflict of Interest Does Not Automatically Require Forfeiture of All Legal Fees 44

CONCLUSION 50

TABLE OF AUTHORITIES

Page(s)

Cases

Aguilar v. Lerner
(2004) 32 Cal.4th 974 ..... 16, 20

Ahdout v. Hekmatjah
(2013) 213 Cal.App.4th 21 ..... 13, 19, 25, 26

All Points Traders, Inc. v. Barrington Associates
(1989) 211 Cal.App.3d 723 ..... 15, 23

Anderson v. Eaton
(1930) 211 Cal. 113 28

In re Attorney Discipline Sys.
(1998) 19 Cal.4th 582 22

Board of Education v. Round Valley Teachers Assn.
(1996) 13 Cal.4th 269 16

Burrow v. Arce
(Tex. 1999) 997 S.W.2d 229 47

Cable Connection, Inc. v. DirecTV, Inc.
(2008) 44 Cal.4th 1334 18

Cel-Tech Communications, Inc. v. L.A. Cellular Telephone Co.
(1999) 20 Cal.4th 163 18

Christensen v. Dewor Developments
(1983) 33 Cal.3d 778 17

City & Cnty. of San Francisco v. Cobra Solutions, Inc.
(2006) 38 Cal.4th 839 28

Clark v. Millsap
(1926) 197 Cal. 765 ..... 45, 46, 47, 48

Cotchett, Pitre & McCarthy v. Universal Paragon Corp.
(2010) 187 Cal.App.4th 1405 ..... 19, 24

Epic Medical Management, LLC v. Paquette
(2015) 244 Cal.App.4th 504 26

TABLE OF AUTHORITIES
(continued)

Page(s)

Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street
(1983) 35 Cal.3d 312 ..... 14, 17, 20

Frye v. Tenderloin Housing Clinic, Inc.
(2006) 38 Cal.4th 23 42

Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC
(N.D.Tex. 2013) 927 F.Supp.2d 390 ..... 31, 36

General Dynamics Corp. v. Superior Court
(1994) 7 Cal.4th 1164 21

Gilchrist v. Perl
(Minn. 1986) 387 N.W.2d 412 48

Goldstein v. Lees
(1975) 46 Cal.App.3d 614 ..... 45, 46, 48

Green v. Ralee Engineering Co.
(1998) 19 Cal.4th 66 ..... 22, 23

Huskinson & Brown, LLP v. Wolf
(2004) 32 Cal.4th 453 ..... 45, 46

Internat. Materials Corp. v. Sun Corp.
(Mo. 1992) 824 S.W.2d 890 47

Jeffry v. Pounds
(1977) 67 Cal.App.3d 6 ..... 45, 46, 48

Johnson v. Ford Motor Co.
(2005) 35 Cal.4th 1191 49

Lindenstadt v. Staff Builders, Inc.
(1997) 55 Cal.App.4th 882 15

Loving & Evans v. Blick
(1949) 33 Cal.2d 603 ..... 14, 15, 23, 24, 26

Macy's, Inc. v. J.C. Penn[e]y Corp.
(App. Div. 2013) 968 N.Y.S.2d 64 31

Mardirossian & Associates, Inc. v. Ersoff
(2007) 153 Cal.App.4th 257 ..... 46, 48

TABLE OF AUTHORITIES
(continued)

Page(s)

In re Marriage of Pagano
(Ill. 1992) 607 N.E.2d 1242 48

Maxwell v. Superior Court
(1982) 30 Cal.3d 606 28

Moncharsh v. Heily & Blase
(1992) 3 Cal.4th 1 ..... 13, 14, 15, 16, 17, 18, 19, 21, 23, 24, 25

Oasis W. Realty, LLC v. Goldman
(2011) 51 Cal.4th 811 41

Olson v. Cohen
(2003) 106 Cal.App.4th 1209 42

Pringle v. La Chapelle
(1999) 73 Cal.App.4th 1000 ..... 46, 47, 48

Richey v. AutoNation, Inc.
(2015) 60 Cal.4th 909 ..... 13, 16

Singerlewak LLP v. Gantman
(2015) 241 Cal.App.4th 610 16

Slovensky v. Friedman
(2006) 142 Cal.App.4th 1518 ..... 42, 43

Sullivan v. Dorsa
(2005) 128 Cal.App.4th 947 ..... 47, 48

Visa U.S.A. Inc. v. First Data Corp.
(N.D. Cal. 2003) 241 F.Supp.2d 1100 ..... 34, 35

Zador Corp. v. Kwan
(1995) 31 Cal.App.4th 1285 34

Statutes

Bus. & Prof. Code, § 650 26

Bus. & Prof. Code, § 6068 42

Bus. & Prof. Code, § 6076 22

Bus. & Prof. Code, § 6077 22

TABLE OF AUTHORITIES
(continued)

Page(s)

Code Civ. Proc., § 1280 et seq. 3, 13, 21, 22, 24

Code Civ. Proc., § 1286.2, subd. (a) 14

Code Civ. Proc., § 1286.2, subd. (a)(4) 14

Corp. Code, § 13406, subd. (b) 42

Lab. Code, § 1102.5, subd. (b) 23

Rules

ABA Model Rules of Prof. Conduct, rule 1.7 ..... 29, 34, 36

Rules Prof. Conduct, rule 1-100(A) 18, 19, 28

Rules Prof. Conduct, rule 2-200 45

Rules Prof. Conduct, rule 3-110(C) 20

Rules Prof. Conduct, rule 3-310 ..... 14, 19, 30, 35, 42, 43, 46, 47

Rules Prof. Conduct, rule 3-310(A)(1) 28

Rules Prof. Conduct, rule 3-310(A)(2) 28

Rules Prof. Conduct, rule 3-310(B)(1) 20

Rules Prof. Conduct, rule 3-310(C)(3) 12, 20, 26, 27, 29, 31, 40, 48

Rules Prof. Conduct, rule 3-400(A) 20

Rules Prof. Conduct, rule 4-200(A) 19, 20

Other Authorities

ABA Com. on Prof. Ethics, Opn. No. 05-436 (2005) 29, 30, 34

ABA Com. on Prof. Ethics, Opn. No. 95-390 (1995) 50

D.C. Bar Assn., Ethics Opn. 309 (2001) 30, 37

Kobak, *Dealing with Conflicts and Disqualification Risks Professionally* (2015) 44 Hofstra L.Rev. 497 39

TABLE OF AUTHORITIES
(continued)

Page(s)

Lerner, *Honoring Choice by Consenting Adults: Prospective Conflict Waivers As a Mature Solution to Ethical Gamesmanship—A Response to Mr. Fox* (2001) 29 Hofstra L.Rev. 971 ..... 37, 38

Lipson et al., *Foreword: Who's in the House? The Changing Nature and Role of In-House and General Counsel* (2012) 2012 Wis. L.Rev. 237 39

Mallen et al., *Legal Malpractice* (2016) 50

Morgan, *Finding Their Niche: Advance Conflicts Waivers Facilitate Industry-Based Lawyering* (2008) 21 Geo. J. Legal Ethics 963 38

N.Y.C. Bar Assn. Com. on Prof. & Jud. Ethics, Formal Opn. 2006-1 (2006) 30, 34, 37

Painter, *Advance Waiver of Conflicts* (2000) 13 Geo. J. Legal Ethics 289 34

Rest.3d Law Governing Lawyers (2000) § 37 47

Rest.3d Law Governing Lawyers (2000) § 122 ..... 31, 34, 36

State Bar Standing Com. on Prof. Responsibility & Conduct, Formal Opn. No. 1989-115 30

Wendel, *Pushing the Boundaries of Informed Consent: Ethics in the Representation of Legally Sophisticated Clients* (2015) 47 U.Tol. L.Rev. 39 ..... 38, 39

Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship* (2010) 78 Fordham L.Rev. 2067 38

ISSUES PRESENTED FOR REVIEW

1. May a court rely on non-legislative expressions of public policy to overturn an arbitration award on "illegality" grounds?

2. Can a sophisticated consumer of legal services, represented by independent counsel, give its informed consent to an advance waiver of conflicts of interest?

3. Does a conflict of interest that undisputedly caused no damage to the client and did not affect the value or quality of an attorney's work automatically (i) require the attorney to disgorge all previously paid fees, and (ii) preclude the attorney from recovering the reasonable value of his unpaid work?

INTRODUCTION

This case is about whether a sophisticated and powerful corporate client, represented by independent counsel, can engage the outside law firm of its choice, heavily negotiate an engagement agreement, provide informed consent to a conflict waiver, agree to arbitrate any claims, and then—after the firm provides millions of dollars in valuable legal services, the client admittedly suffers no damages, and the matter is fully and fairly vetted before a distinguished panel of arbitrators—renege on the conflict waiver, nullify the arbitration agreement, refuse to pay any legal fees, and obtain a $4 million windfall. Because precedent and public policy preclude such a result, the Court should reverse the Court of Appeal's decision to the contrary.

When J-M Manufacturing Co., Inc.—the world's largest PVC pipe manufacturer—faced potentially ruinous liability in a $1 billion federal qui tam action, it turned to Sheppard Mullin. J-M valued Sheppard Mullin's

expertise and relationships with some of the governmental entities with potential claims against J-M in the qui tam action. After extensive negotiation, review, and editing by J-M's General Counsel, Sheppard Mullin and J-M signed a written engagement agreement governing not only the qui tam action, but also any future matters. That agreement included an arbitration provision. As part of the engagement agreement, J-M waived any conflicts of interest arising from Sheppard Mullin's representation of current, former, and future clients in unrelated matters, so long as Sheppard Mullin had not obtained any of J-M's confidential information relevant to those matters.

Over the next 16 months, Sheppard Mullin performed 10,000 hours of legal work for J-M in the qui tam action. But then another Sheppard Mullin client (the South Tahoe Public Utility District)—which held 0.0004% of the potential qui tam claims against J-M and itself previously had provided two advance conflict waivers to Sheppard Mullin—successfully moved to disqualify the firm based on Sheppard Mullin's provision of 12 hours of entirely unrelated labor consultation beginning shortly after J-M engaged Sheppard Mullin. J-M initially encouraged Sheppard Mullin to fight disqualification, and the federal district court proposed a solution to avoid disqualification. But J-M rejected that proposal shortly after being advised by two other law firms that it could seek disgorgement of the $2.7 million in fees it already had paid and avoid paying the $1.1 million in outstanding fees it owed if Sheppard Mullin was disqualified.

Even though J-M stipulated both that it suffered no damages from either the conflict or the disqualification and that it was not challenging the quality of Sheppard Mullin's work, it nonetheless asserted in this action that the conflict with South Tahoe meant that Sheppard Mullin was not

permitted to retain or recover any fees for its work in the qui tam action. The parties arbitrated this dispute, and the arbitration panel ruled in Sheppard Mullin's favor after finding that Sheppard Mullin had acted in complete good faith in its dealings with J-M.

J-M seeks to escape this arbitration award. J-M contends that the conflict with South Tahoe rendered the engagement agreement "illegal" because J-M supposedly did not give informed consent to the conflict waiver it signed, even though it is a sophisticated business and was represented by independent counsel who negotiated that agreement. J-M also asserts that *any* actual conflict of interest requires attorneys to forfeit *all* fees they earned after the conflict arose—even where they acted in good faith, no confidential information was disclosed, and the client suffered no injury. The Court of Appeal agreed with J-M on each of these issues, vacated the arbitration award, and held that Sheppard Mullin was not entitled to any compensation for its legal work for J-M. This Court should reverse.

First, the Court should deny J-M's attempt to obtain judicial review of the arbitration award because it is premised on an alleged violation of the Rules of Professional Conduct—a non-legislative expression of public policy. In enacting the California Arbitration Act, the Legislature strictly limited judicial review of final arbitration awards. Therefore, as this Court has emphasized, only *legislative* expressions of public policy may serve as a basis to vacate an arbitration award under the Act's narrow exceptions. Any contrary rule would have profound practical consequences and would lead to frequent challenges to the finality of arbitration awards, especially in attorney-client disputes given the broad scope of the Rules of Professional Conduct. The Court should reject this significant expansion of judicial review of arbitration awards, hold that the trial court properly

confirmed the award in favor of Sheppard Mullin, and decline to reach any other issue.

Second, J-M—a powerful and savvy client advised by independent counsel—gave informed written consent to waive the conflict at issue. Sheppard Mullin disclosed in writing that it had many lawyers and multiple offices and that it may currently or in the future represent clients with interests adverse to J-M in unrelated matters where J-M's confidential information was irrelevant. Yet J-M now contends that its informed consent required specification in the first instance of each client falling within the scope of the waiver—even though the plain language of the waiver made clear to J-M exactly what it covered, and J-M never expressed interest in specification of client names. The Court should reject this opportunistic argument and recognize, like the American Bar Association, the Restatement, prominent scholars, and many courts, that sophisticated clients represented by independent counsel need far less specific disclosures to make their consent to waive conflicts sufficiently informed.

Third, the Court should reject J-M's contention that any conflict of interest automatically requires complete fee forfeiture. J-M should not be awarded a $4 million windfall based on such a per se rule that fails to account for either J-M's lack of injury or Sheppard Mullin's good faith effort to comply with the Rules. Such an arbitrary, inflexible, and punitive standard, wholly disproportionate to both the client's injuries and the firm's culpability, is unfair and should not be adopted. Rather, the propriety and extent of any fee forfeiture should account for the egregiousness of the conduct, the harm to the client, and the attorney's good faith.

STATEMENT OF THE CASE

I. Sheppard Mullin's Representation of J-M

Sheppard Mullin represented J-M in a federal qui tam action alleging that J-M misrepresented the strength of its plastic pipe and sold defective pipe to nearly 200 governmental entities. (Opn. at p. 3; 1AA53B; 2AA490-491.) J-M reached out to Sheppard Mullin after firing its previous law firm, which it later sued for alleged malpractice. (2AA473-474; 2AA494-495.)

J-M chose Sheppard Mullin in part because it valued the expertise of the two former Assistant U.S. Attorneys who would lead the Sheppard Mullin team. (2AA471, 474-475; 2AA488, 490-492.) J-M's General Counsel said that the firm's relationships with some of J-M's potential adversaries in the qui tam action, including its former client the Los Angeles Department of Water and Power, would be useful in attempting to resolve the qui tam action. (2AA474-475; 2AA490-492.) One of the Sheppard Mullin attorneys even told J-M's General Counsel that he "hoped to represent the LADWP again in the future," and she did not "express[] any concern whatsoever" about that prospect. (Motion for Judicial Notice and Supporting Declaration ("MJN Decl."), Ex. E at p. 2.)

II. The Engagement Agreement Between J-M and Sheppard Mullin

Before agreeing to represent J-M in the qui tam action, Sheppard Mullin provided a draft engagement agreement to J-M. (Opn. at p. 5; 1AA191.) The lead Sheppard Mullin partner discussed the agreement—which included an arbitration clause and a conflict waiver—at a two-hour meeting with J-M's General Counsel. (Opn. at p. 5.) During this meeting about the draft agreement, J-M's General Counsel negotiated a 15% discount off Sheppard Mullin's fees and an additional 7% prompt-pay

discount for payments within 30 days. (2AA477.) J-M's General Counsel then took several days to consider and edit the agreement with J-M's CEO. (Opn. at pp. 5-6; 2AA475-478.)

The agreement informed J-M that Sheppard Mullin "may *currently or in the future* represent one or more other clients (including *current*, former, and future clients) in matters involving [J-M]." (1AA201, italics added.) The conflict waiver limited the permitted adversity to *unrelated* matters and to instances in which Sheppard Mullin had "not obtained confidential information" from J-M that would be "material to representation of the other client." (1AA201.) With those limitations, J-M agreed that Sheppard Mullin could represent other clients, "even if the interests of the other client are *adverse* to [J-M] (including appearance on behalf of another client *adverse* to [J-M] *in litigation or arbitration*)." (1AA201, italics added.) J-M represented that it had "read and underst[ood] this engagement letter and agree[d] that it ... waived any conflict of interest on the part of [Sheppard Mullin] arising out of the representation described above." (1AA204.)

J-M's General Counsel "made a number of handwritten edits related to the fee provisions" in the engagement agreement, and "also edited the paragraph preceding the conflict waiver provision," but "she did not edit the conflict waiver provision." (Opn. at pp. 5-6.) In so doing, J-M was acutely aware of the significance of conflict waivers. According to J-M's General Counsel, J-M "had never waived any conflict for any of its other (past or present) attorneys," and on the same day it agreed to the conflict waiver with Sheppard Mullin, J-M "refused to grant a conflict waiver to Morgan Lewis." (1AA192.)

Sheppard Mullin performed over 10,000 hours of work for J-M in the qui tam action. (Opn. at p. 4; 2AA493.) J-M stipulated below that it "waive[d] any argument challenging[] the value or quality of Sheppard Mullin's work," including "any challenge to the nature or amount of Sheppard Mullin's bills or the substantive work performed by any of its lawyers or other personnel." (3AA580.) J-M also "waive[d] any claims for ... any costs or expenses associated with the replacement of Sheppard Mullin" as counsel in the qui tam action. (3AA581; see also Opn. at p. 9.)

III. Sheppard Mullin's Representation of South Tahoe

Before agreeing to represent J-M, Sheppard Mullin conducted a conflict check regarding each of the approximately 200 governmental entities identified in the qui tam complaint. (2AA475.) One of those entities was South Tahoe, which held 0.0004% of the potential claims at issue ($97,000 of more than $1 billion). (2AA480; 2AA498-499; 1AA53B-53C.) The conflict check revealed that a lawyer in a different Sheppard Mullin office had finished a labor arbitration for South Tahoe five months earlier, but Sheppard Mullin had done no work for South Tahoe since. (2AA512-514; 2AA538-540.) Sheppard Mullin's work for South Tahoe was unrelated to J-M or the qui tam action and was not adverse to J-M.

The conflict check further revealed that South Tahoe had consented twice to conflict waivers with Sheppard Mullin that allowed Sheppard Mullin to represent parties adverse to South Tahoe in unrelated matters. (2AA516-526.) Accordingly, Sheppard Mullin saw no need to inform South Tahoe of the potential representation of J-M in the unrelated qui tam matter, or J-M of Sheppard Mullin's work for South Tahoe. (2AA475-476; 2AA538-540; see also MJN Decl., Ex. H at pp. 4-6 [supp. expert report of Prof. Marshall].)

On March 29, 2010—three weeks after J-M signed the engagement agreement—Sheppard Mullin "began actively working for South Tahoe again" on a matter wholly unrelated to J-M. (Opn. at p. 6.) During the ensuing 16 months that it represented J-M, Sheppard Mullin billed approximately 12 hours of unrelated labor advice to South Tahoe. (2AA512-514.) No confidential information concerning J-M was ever disclosed to South Tahoe, and nothing about the qui tam action had any relevance to Sheppard Mullin's work for South Tahoe. (3AA677-678; 2AA513-514.)

IV. South Tahoe's Disqualification Motion

About a year later, in March 2011, in a letter to Sheppard Mullin, one of the lawyers who represented many of the governmental entities in the qui tam action, including South Tahoe, noted that Sheppard Mullin had "represented South Tahoe in other matters," and asked how it was "permissible" for Sheppard Mullin to be "adverse to South Tahoe." (2AA303-304.) The Sheppard Mullin lawyers believed this lawyer was unaware South Tahoe had agreed to a conflict waiver squarely covering the situation. (MJN Decl., Ex. E at p. 4; MJN Decl., Ex. G at pp. 2-3.) They therefore responded that South Tahoe had agreed to a conflict waiver. (2AA306.) The same lawyer then requested additional information about the conflict waiver. (2AA308-309.) Sheppard Mullin reiterated that South Tahoe had waived the conflict and noted that South Tahoe had been aware of Sheppard Mullin's representation of J-M for almost a year. (2AA311.)

Nearly three weeks later, on April 11, 2011, a different lawyer representing South Tahoe in the qui tam action sent an email stating for the first time that South Tahoe was "contemplating" a disqualification motion, and seeking to schedule a meeting to discuss the matter. (2AA342.) The

Sheppard Mullin lawyers believed this lawyer "either didn't know about or didn't understand South Tahoe's advance waiver." (MJN Decl., Ex. G at p. 4; see also MJN Decl., Ex. E at pp. 4-5.) But when they discussed the matter with South Tahoe's qui tam counsel, it "became clear" for the first time that they "simply did not intend to honor South Tahoe's conflict waiver." (MJN Decl., Ex. E at p. 5; see also MJN Decl., Ex. G at pp. 4-5.) The next day, Sheppard Mullin informed J-M's General Counsel about the threatened disqualification motion. (1AA214; MJN Decl., Ex. G at p. 5.)

On May 9, 2011, roughly 14 months after Sheppard Mullin began representing J-M, South Tahoe moved to disqualify Sheppard Mullin in the qui tam action. (2AA319-339.) The federal court issued a tentative ruling finding a conflict from the perspective of South Tahoe, but asked for supplemental briefing regarding possible solutions that might avoid disqualification. (2AA351-352.) J-M then encouraged Sheppard Mullin to continue working aggressively on the case and to fight disqualification. (2AA482-483; 2AA501-506.) Indeed, J-M's CEO called Sheppard Mullin and J-M "a 'team' and a 'family'" and stated that "he viewed the disqualification motion as a distraction and disruption." (2AA482; 2AA502.) J-M also authorized Sheppard Mullin to offer compensation, in the "form of cash" and "some free labor law advice," to South Tahoe to resolve the disqualification issue. (MJN Decl., Ex. D; 2AA483-484, 2AA502-504.) South Tahoe rejected Sheppard Mullin's $250,000 offer, even though it was more than double its $97,000 damages claim. (2AA483-484; 2AA504-505.)

The federal court subsequently proposed that, under certain modest conditions, including bifurcation of South Tahoe's claim and the appointment of separate counsel for J-M with respect to that claim (at Sheppard Mullin's expense), it would permit Sheppard Mullin to continue

representing J-M as to the remainder of the claims (99.9996%) in the qui tam action. (2AA400; 2AA484-485; 2AA506-507; 1AA234-237.) The district court gave J-M one week to consider this proposal. (1AA234; 1AA196.) During that week, J-M's General Counsel was advised by other outside counsel that J-M could seek disgorgement of its previously paid fees and avoid paying its outstanding invoices if Sheppard Mullin were disqualified. (1AA196-197; 1AA242-267.) J-M then rejected the federal court's proposal; the court consequently disqualified Sheppard Mullin. (1AA196-197; 1AA269; 2AA405.)

V. The Arbitration Panel Rules in Sheppard Mullin's Favor, and the Trial Court Confirms the Panel's Award

After the disqualification, J-M refused to pay its outstanding legal fees and "demanded that Sheppard Mullin pay back to J-M all fees J-M had paid to Sheppard Mullin pertaining to the Qui Tam Action and related litigation." (2AA486.) In response, Sheppard Mullin filed suit and moved to compel arbitration. (1AA1-7; 1AA41-53.) J-M opposed, arguing that the engagement agreement was unconscionable and fraudulently induced because Sheppard Mullin had not disclosed its relationship with South Tahoe. (1RA20-37.) After Sheppard Mullin demonstrated that fraud in the inducement and unconscionability are not grounds to avoid arbitration (1RA42-44), J-M repackaged the same arguments and evidence into a claim that the agreement was "illegal." (1AA54-58.) The trial court rejected J-M's arguments and compelled arbitration. (Opn. at pp. 8-9; 1AA59-65.)

Before the arbitration panel—which included a retired California Court of Appeal justice and a retired federal judge—Sheppard Mullin sought recovery of its unpaid fees, while J-M asserted tort cross-claims seeking disgorgement of all paid fees as a remedy. (3AA670-672.) The panel ruled in Sheppard Mullin's favor. (3AA670-679.)

The arbitration panel found that Sheppard Mullin at all times had acted "honestly and in good faith believed that no conflict existed when it undertook the Qui Tam defense." (3AA674; see also MJN Decl., Ex. C at pp. 32, 34-35, 37, 46-48 [expert report of Professor Lawrence C. Marshall].) It further found that any ethical violation "was not so serious or egregious as to make appropriate a disgorgement or forfeiture of fees." (3AA677.) The unrefuted evidence demonstrated that Sheppard Mullin's work for South Tahoe had ended five months earlier, and South Tahoe twice had consented to a conflict waiver. (2AA476; 2AA521, 547-548; MJN Decl., Ex. E at pp. 1-2.) Sheppard Mullin also disclosed to J-M in the engagement agreement that it "may currently" represent clients that "are adverse" to J-M in unrelated matters. (1AA201.) In response to Sheppard Mullin's evidence of good faith, J-M's General Counsel told the panel that Sheppard Mullin "assured" her orally "that there were no conflicts" before signing the engagement agreement (1AA191)—an assertion that Sheppard Mullin denied. (2AA477; 2AA493; MJN Decl., Ex. E at p. 2; MJN Decl., Ex. I at pp. 1-2.)

The panel assumed (without deciding) that there was a conflict of interest, but concluded there is no "automatic" fee forfeiture rule; instead, an "equitable weighing test" applies. (3AA674-676.) The panel then found that neither the conflict nor the resulting disqualification: (1) caused J-M any damage; (2) resulted in disclosure of J-M's confidences; (3) rendered Sheppard Mullin's representation less effective; (4) adversely affected the value of its services; (5) prejudiced J-M's defense in the qui tam action; or (6) "pervade[d] [Sheppard Mullin's] whole relationship" with J-M. (3AA677-678.) The panel awarded Sheppard Mullin its unpaid fees and denied J-M's disgorgement request. (3AA679.)

The trial court subsequently rejected J-M's petition to vacate, and granted Sheppard Mullin's petition to confirm, the arbitration award. (3AA824-829.)

VI. The Court of Appeal's Decision

On January 29, 2016, the Court of Appeal reversed. It refused to defer to the panel's award because it concluded that J-M had "challenged the legality of the contract as a whole." (Opn. at pp. 13-15.) Without deciding whether South Tahoe was a current client when the representation of J-M began, the Court of Appeal held that a conflict of interest arose "three weeks after J-M signed the Agreement." (*Id.* at pp. 17-18.) It also held that the engagement agreement was entirely "illegal" because J-M did not give "informed written consent" to the conflict waiver it had signed, and thus Rule 3-310(C)(3) of the Rules of Professional Conduct had been violated because of the South Tahoe conflict. (*Id.* at p. 18.) The Court of Appeal further held that J-M was automatically entitled to disgorgement of all fees incurred after the conflict with South Tahoe arose and that Sheppard Mullin was not entitled to any quantum meruit recovery of its unpaid fees as a matter of law. (*Id.* at pp. 26-30.)

Sheppard Mullin asked the Court of Appeal to correct multiple factual misstatements and omissions. (See Rehg. Petn. at pp. 16-21.) The Court of Appeal declined.

ARGUMENT

I. Courts Cannot Vacate Arbitration Awards Based on Non-Legislative Expressions of Public Policy

Because the strict limitations on judicial review of final arbitration awards derive from an enactment of the Legislature, any deviations from them must also come from the Legislature. Accordingly, this Court

repeatedly has linked the availability of judicial review to situations where a *statutory* right would be violated or an explicit *legislative* expression of public policy would be frustrated. (See, e.g., *Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909, 916 (*Richey*); *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 32 (*Moncharsh*).)

Here, the Court of Appeal broadly authorized judicial review of arbitration awards based on anything "perceived to be contrary to the public welfare"—including public policies the Legislature has neither considered nor endorsed. (Opn. at p. 25, quotation marks and citation omitted.) It concluded that the engagement agreement between Sheppard Mullin and J-M was entirely "illegal" because it supposedly violated "the public policies embodied in the California Rules of Professional Conduct." (*Id.* at p. 23.)

While the public policies reflected in the Rules of Professional Conduct have enormous significance in the areas they govern, they "are approved by the Supreme Court, not the Legislature." (*Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21, 39 (*Ahdout*).) The Rules thus do not reflect a legislative expression of public policy and cannot override the Legislature's clear intent to narrowly limit judicial review of arbitration awards. To hold otherwise would violate the separation of powers between the legislative and judicial branches, mire trial courts in satellite litigation over the underlying merits of disputes just to determine arbitrability, and effectively preclude arbitration in large numbers of attorney-client disputes.

A. Vacating an Arbitration Award on Illegality Grounds Requires a Legislative Expression of Public Policy

In adopting the California Arbitration Act, Code Civ. Proc., § 1280 et seq. ("CAA"), "the Legislature has expressed a 'strong public policy in

favor of arbitration as a speedy and relatively inexpensive means of dispute resolution.'" (*Moncharsh*, *supra*, 3 Cal.4th at p. 9, quoting *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 312, 322 (*Ericksen*).) The "arbitrator's decision should be the end, not the beginning, of the dispute," and therefore "judicial review of private arbitration awards" is limited to "those cases in which there exists a statutory ground to vacate or correct the award." (*Id.* at pp. 10, 28.) Code of Civil Procedure section 1286.2, subdivision (a), provides six exclusive grounds for vacating an arbitration award, including that "[t]he arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted." (Code Civ. Proc., § 1286.2, subd. (a)(4).)

Relying on *Loving & Evans v. Blick* (1949) 33 Cal.2d 603 (*Loving*), J-M asked the trial court to vacate the arbitration award because the engagement agreement supposedly violated "a well-defined public policy" expressed in Rule 3-310 of the Rules of Professional Conduct. (3AA732-733.) But *Loving*, which held for the first time that arbitrators exceed their powers when acting under an illegal contract, does not support J-M's position. Rather, *Loving* involved a construction contract found to be illegal because the contractor had violated statutory licensing requirements. (33 Cal.2d at p. 604.) The Court held that in light of the "clear violation of the *statutes* regulating the contracting business," the arbitrator exceeded his powers because he was acting under a contract that could not "be reconciled with the settled public policy of this state as expressed in our *statutory* law." (*Id.* at pp. 604, 607, italics added.) Therefore, confirming the arbitration award "would be tantamount to giving judicial approval to acts which are declared unlawful by *statute*." (*Id.* at p. 612, italics added.)

As its repeated statutory references demonstrate, *Loving*'s recognition of an illegality exception to the finality of arbitration awards was premised on the existence of a legislative expression of public policy. If the Legislature itself has forbidden certain behavior by statute, insulating that conduct from judicial review through the arbitration process would defy the Legislature's intent. But when expressions of public policy flow from an extra-legislative source, reviewing arbitration awards for "illegality" threatens to undermine the Legislature's intent to strictly limit challenges to arbitration awards.

Until now, every decision applying *Loving* and vacating arbitration awards on illegality grounds has involved legislative expressions of public policy. For example, in *Lindenstadt v. Staff Builders, Inc.* (1997) 55 Cal.App.4th 882, the Court of Appeal held that, under *Loving*, a trial court must decide whether an arbitration award should be vacated on illegality grounds where a person acting as a real estate broker allegedly failed to comply with a statutory licensing requirement. (*Id.* at pp. 886, 891-893.) Likewise, *All Points Traders, Inc. v. Barrington Associates* (1989) 211 Cal.App.3d 723 (*All Points Traders*)—which also involved a contract with an allegedly unlicensed real estate broker—held that, under *Loving*, judicial review was necessary because "[e]nforcement of the contract ... would be in direct contravention of the *statute* and against public policy." (*Id.* at pp. 737-738, italics added.)

Moncharsh expressly recognized the link between legislative expressions of public policy and judicial review. The issue there was whether "the fee-splitting provision of [a] contract that was interpreted and enforced by [an] arbitrator was 'illegal' and violative of 'public policy' as reflected in several provisions of the Rules of Professional Conduct." (*Moncharsh, supra*, 3 Cal.4th at p. 31.) The Court rejected judicial review,

emphasizing that "the normal rule of limited judicial review may not be avoided by a claim that a provision of the contract, construed or applied by the arbitrator, is 'illegal,' except in rare cases when according finality to the arbitrator's decision would be incompatible with the protection of a *statutory* right." (*Id.* at p. 33, italics added.)

The Court repeatedly has reaffirmed this principle. For example, in *Board of Education v. Round Valley Teachers Assn.* (1996) 13 Cal.4th 269 the Court "adhere[d] to [its] holding in *Moncharsh* that arbitrator finality is the rule rather than the exception," and emphasized that judicial review was appropriate there only because there was "an 'explicit legislative expression of public policy'" that "conflict[ed] with the expressed legislative intent to limit private arbitration awards to statutory grounds for judicial review." (*Id.* at pp. 276-277.) There, "granting finality ... would be inconsistent with a party's *statutory rights*." (*Ibid.*, original italics.) In *Aguilar v. Lerner* (2004) 32 Cal.4th 974 (*Aguilar*), the Court held that judicial review was warranted because the arbitration agreement "contravened both plaintiff's *statutory rights* ... and the public policy underlying the *statute*." (*Id.* at pp. 982-983, italics added.) The Court recently reiterated in *Richey* that "[a]rbitrators may exceed their powers by issuing an award that violates a party's *unwaivable statutory rights* or that contravenes an *explicit legislative* expression of public policy." (*Richey, supra*, 60 Cal.4th at p. 916, italics added.)

Post-*Moncharsh* Court of Appeal decisions similarly have limited judicial review of arbitration awards on illegality grounds to situations where the Legislature itself has spoken. (See, e.g., *Singerlewak LLP v. Gantman* (2015) 241 Cal.App.4th 610, 622 [holding judicial review not "appropriate" because arbitration award was not challenged as

"contraven[ing] an explicit legislative expression of public policy that undermines the strong presumption in favor of private arbitration"].)

Despite this wall of authority, the Court of Appeal in this case held that arbitration awards can be overturned based on "public policy" found in "a variety of sources," including anything "perceived to be contrary to the public welfare," because "a determination of relevant public policy is not limited to an explicit expression of public policy by the Legislature." (Opn. at p. 25, quotation marks and citation omitted.) This significant expansion of the illegality exception contradicts this Court's instruction that legislative expressions of public policy are necessary to expand the CAA's narrow exceptions to the finality of arbitration awards.

Broad judicial review of arbitration awards portends an exponential increase in "'procedural gamesmanship' aimed at undermining the advantages of arbitration." (*Ericksen, supra*, 35 Cal.3d at p. 323, quoting *Christensen v. Dewor Developments* (1983) 33 Cal.3d 778, 784.) Litigants disappointed by arbitration results would challenge awards in court by invoking "public polic[ies]" expressed in "a variety of sources" the Legislature has never considered or endorsed (Opn. at p. 25), which impermissibly would make an "arbitrator's decision ... the beginning[] of the dispute" rather than the end. (*Moncharsh, supra*, 3 Cal.4th at p. 10.) Trial courts would also frequently need to hold mini-trials on the underlying merits to determine arbitrability. And the inevitable uncertainty would upset the expectations and agreements of sophisticated parties—like J-M and Sheppard Mullin here—who voluntarily, knowingly, and

undisputedly agreed to arbitrate any disputes with the "expectation of finality." (*Ibid.*)[1]

Because "'[p]ublic policy' as a concept is notoriously resistant to precise definition," this Court has warned in other contexts that "courts should venture into this area, if at all, with great care and due deference to the judgment of the *legislative* branch." (*Cel-Tech Communications, Inc. v. L.A. Cellular Telephone Co.* (1999) 20 Cal.4th 163, 185, quotation marks and citation omitted; italics added.) Given the Legislature's enactment of "a comprehensive statutory scheme regulating private arbitration," through which it has "expressed its strong support for private arbitration and the finality of arbitral awards" by strictly limiting judicial review (*Moncharsh, supra*, 3 Cal.4th at pp. 9, 32), this warning applies with even more force in the arbitration context.

B. The Rules of Professional Conduct Cannot Be Used to Vacate an Arbitration Award on Illegality Grounds

While the Rules of Professional Conduct are essential regulations of attorney conduct, they are not enactments adopted and approved by the Legislature. Nor, on their own terms, are they "intended to create new civil causes of action" or "create, augment, diminish, or eliminate any substantive legal duty of lawyers," much less third parties. (Rules Prof. Conduct, rule 1-100(A).) Rather, the Rules are "adopted by the Board of Governors of the State Bar of California and approved by the Supreme

---

[1] If J-M had wanted judicial review of the arbitration award beyond the limited statutory grounds, it could have bargained for that. (See *Cable Connection, Inc. v. DirecTV, Inc.* (2008) 44 Cal.4th 1334, 1340, 1361 ["The California rule is that the parties may obtain judicial review of the merits by express agreement"].)

Court of California," and are "intended to regulate professional conduct of members of the State Bar through discipline." (*Ibid.*)

Because the Rules of Professional Conduct "are approved by the Supreme Court, not the Legislature," they do not "reflect[] an explicit expression by the *Legislature* of its public policy objectives." (*Ahdout, supra,* 213 Cal.App.4th at p. 39, original italics.) "To permit judicial review of [an] arbitrator's award" based on a violation of one of the Rules of Professional Conduct "would be contrary to the strong policy favoring the finality of arbitration awards" that the Legislature has adopted. (*Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405, 1418 (*Cotchett*).) Therefore, judicial review was unavailable for a claim that an "arbitrator exceeded her powers by issuing an award that violated the public policy expressed in rule 4-200(A) of the Rules of Professional Conduct." (*Id.* at pp. 1417-1418.)

This Court in *Moncharsh* likewise held that "judicial review of [an] arbitrator's decision [was] unavailable" where a contractual provision allegedly was "illegal" and "violate[d] public policy" because it contravened the Rules of Professional Conduct prohibiting "unconscionable fees," "certain types of fee splitting arrangements," and "agreements restricting an attorney's right to practice." (*Moncharsh, supra,* 3 Cal.4th at pp. 32-33.) This Court "perceive[d] ... nothing in the Rules of Professional Conduct at issue in [the] case that suggest[ed] resolution by an arbitrator of what is essentially an ordinary fee dispute would be inappropriate or would improperly protect the public interest." (*Id.* at p. 33.) To be sure, *Moncharsh* did not specifically address an alleged violation of Rule 3-310, but its reasoning—like that of *Ahdout* and *Cotchett*—applies with equal force to Rule 3-310 and all of the other Rules of Professional Conduct.

The Court of Appeal's contrary conclusion—that arbitration awards could be challenged on the ground that they violated "the public policies embodied in the California Rules of Professional Conduct" (Opn. at p. 23)—is profoundly problematic, particularly given the increasingly widespread use of arbitration clauses in agreements between clients and lawyers (see *Aguilar*, *supra*, 32 Cal.4th at p. 985), and the myriad aspects of the attorney-client relationship encompassed by the Rules. J-M's arguments easily could be used to challenge arbitrability or arbitration awards in a range of attorney-client disputes—including, to name just a few examples, suits alleging that a lawyer entered an agreement to charge an unconscionable fee (Rule 4-200(A)), accepted a matter without having sufficient learning and skill in the area (Rule 3-110(C)), sought to limit her liability to her client (Rule 3-400(A)), or failed to disclose a legal, business, financial, professional, or personal relationship with a party or witness (Rule 3-310(B)(1)). That would require trial courts to resolve highly factual disputes on the merits to determine if arbitration agreements are enforceable, thereby eliminating the advantages of arbitration. (See *Ericksen*, *supra*, 35 Cal.3d at p. 323 ["If participants in the arbitral process begin to assert all possible legal or procedural defenses in court proceedings before the arbitration itself can go forward, the arbitral wheels would very soon grind to a halt"], quotation marks and citation omitted.)

These problems cannot be solved by deeming some of the Rules of the Professional Conduct more important than others; that would necessarily require courts to make arbitrary and problematic distinctions. For example, courts would need to decide whether Rule 4-200(A)'s *absolute* prohibition of agreements charging illegal and unconscionable fees is on equal footing with Rule 3-310(C)(3)'s *waivable* prohibition of conflicts. These difficult questions would lead to significant litigation and

uncertainty. And even if the illegality exception were somehow extended only to cases involving alleged conflicts of interest, judicial review of arbitration awards still would be significantly expanded. Arbitration would be pointless whenever a client alleges a conflict even potentially existed, and thus such allegations would become standard in any malpractice complaint.

J-M attempted below to justify expanding the illegality exception to cover the Rules of Professional Conduct by pointing to cases *outside* the arbitration context. For example, J-M relied on this Court's expansion of wrongful discharge claims to cover situations where an in-house attorney is "discharged for following a mandatory ethical obligation prescribed by professional rule or statute." (*General Dynamics Corp. v. Superior Court* (1994) 7 Cal.4th 1164, 1188-1189 (*General Dynamics*).) But the arbitration context makes all the difference because "the Legislature has already expressed its strong support for private arbitration and the finality of arbitral awards" in enacting the CAA. (*Moncharsh, supra*, 3 Cal.4th at p. 32.)

Given this strong legislative intent, allowing challenges to arbitration awards based on the Rules of Professional Conduct is worlds away from permitting claims by in-house attorneys who are discharged because they complied with the Rules. Indeed, in the arbitration context, the issue is merely *where* a claim will be adjudicated, while cases like *General Dynamics* concern *whether* a claim even exists at all. That the law would endorse a broader view of the relevant sources of public policy for purposes of permitting a wrongful discharge claim is thus unsurprising, particularly given the alternative of depriving employees of any remedy whatsoever for an employer's retaliatory conduct. (See *General Dynamics, supra*, 7 Cal.4th at p. 1186 ["By providing the employee with a remedy in tort

damages for resisting socially damaging organizational conduct, the courts mitigate the otherwise considerable economic and cultural pressures on the individual employee to silently conform"].)

J-M also cited another case addressing wrongful discharge claims—*Green v. Ralee Engineering Co.* (1998) 19 Cal.4th 66 (*Green*)—in which this Court noted the Rules of Professional Conduct are "adopted pursuant to statute by the California State Bar with the approval of this court and [are] binding on all attorneys in the state." (*Id.* at p. 78, citing Bus. & Prof. Code, §§ 6076, 6077.) But the Legislature's authorization of the State Bar having a role in crafting and enforcing a set of Rules of Professional Conduct does not mean that the Legislature approved their content, let alone endorsed construing the CAA to permit vacating arbitration awards based on violations of those Rules. Rather, recognizing this Court's "inherent authority over the practice of law," the Legislature "condition[ed] the State Bar's formulation and enforcement of rules of professional conduct upon the approval of this court." (*In re Attorney Discipline Sys.* (1998) 19 Cal.4th 582, 599.) Nor do Business and Professions Code sections 6076 and 6077 require (or even suggest) that this Court adopt any particular rule governing the practice of law. Those statutes at most show that the Legislature approved of the State Bar having a role in formulating and enforcing rules governing attorney behavior; but they do not establish that the Rules of Professional Conduct themselves reflect legislative, rather than judicial, expressions of public policy.

As this Court noted in *Green*, "the Legislature, and not the courts, is vested with the responsibility to declare the public policy of the state." (*Green*, *supra*, 19 Cal. 4th at p. 71.) Thus, in concluding that the "source[s] of fundamental public policy that limit[] an employer's right to discharge an at-will employee" can include regulations, this Court specifically relied

on the enactment of a "whistle-blower" statute as demonstrating the "Legislature believe[d] that fundamental public policies embodied in regulations are sufficiently important to justify encouraging employees to challenge employers who ignore those policies." (*Id.* at pp. 71, 76-77, citing Lab. Code, § 1102.5, subd. (b).) The Legislature, however, has done nothing similar to suggest that the policies embodied in the specific Rules of Professional Conduct justify expansive judicial review of arbitration awards.

Accordingly, the Court should confirm that the Rules of Professional Conduct cannot be used override the CAA's strict limitations on judicial review of arbitration awards.

C. The Court of Appeal's Expansive View of the Illegality Exception Cannot Be Salvaged Based on the Contention That the Engagement Agreement Was "Entirely" Illegal

The Court of Appeal believed that *Moncharsh* supported its broad view of the illegality exception because J-M supposedly had "challenged the legality of the contract as a whole." (Opn. at pp. 13-15.) But this justification rests on (1) a misreading of *Moncharsh*, and (2) a distortion of J-M's challenge to the arbitration award.

While *Moncharsh* did indicate that courts, not arbitrators, should decide illegality when it is "claimed [that] the entire contract or transaction was illegal" (*Moncharsh*, *supra*, 3 Cal.4th at p. 32), that does not authorize courts to review a claim that a contract is entirely illegal based on non-legislative expressions of public policy. Indeed, the two cases *Moncharsh* cited for the proposition that judicial review is appropriate where an entire contract is allegedly illegal—*Loving* and *All Points Traders*—both involved illegality challenges to arbitration awards based on *statutory* violations. (See *ibid.*; *Loving*, *supra*, 33 Cal.2d at pp. 604, 607; *All Points Traders*,

supra, 211 Cal.App.3d at pp. 737-738.) Neither authorized judicial review absent violations of a legislative expression of public policy, which demonstrates that "illegality" in the arbitration context must be premised on legislative enactments.

The Court of Appeal's decision in *Cotchett* directly supports this principle. (See *Cotchett*, *supra*, 187 Cal.App.4th at p. 1417, fn. 1.) There, an arbitration award was challenged on the ground that the "underlying contract or transaction was illegal in its entirety"; the court noted that this claim was "necessarily resolve[d]" by its determination that a violation of the Rules of Professional Conduct could not be used to challenge an arbitration award. (*Ibid.*, citing *Loving*, *supra*, 33 Cal.2d at p. 614.) *Cotchett* thus held that an illegality challenge to the whole of a contract cannot be predicated on the Rules of Professional Conduct.

The Legislature's "strong support for private arbitration and the finality of arbitral awards," reflected in the narrowness of judicial review under the CAA, cannot possibly hinge on the arbitrary distinction between challenges to the whole or portion of a contract. (*Moncharsh*, *supra*, 3 Cal.4th at p. 32.) If it did, the illegality exception would "swallow the rule of limited judicial review" (*id.* at p. 28), and thus frustrate the Legislature's intent. The Court therefore should clarify that *Moncharsh* does not require judicial review if a contract is claimed to be entirely illegal due to the violation of *non*-legislative expressions of public policy.[2]

---

[2] As the Court of Appeal recognized, courts interpreting the Federal Arbitration Act have not treated claims that a contract was entirely illegal any different than other illegality claims—all such claims go to the arbitrator unless the arbitration provision itself is specifically challenged as illegal. (Opn. at pp. 11-12.)

Even if the Court of Appeal's reading of *Moncharsh* were correct, that still would not change the result here because the engagement agreement was not challenged as illegal in its entirety. The agreement reached far beyond Sheppard Mullin's supposedly "illegal" representation of J-M in the qui tam action. Its terms—including the fees for Sheppard Mullin's services, the waiver of conflicts, and how the parties could terminate their relationship—were also to "apply to other engagements for [J-M]." (1AA199.) Moreover, other provisions "survive[d] ... termination of [Sheppard Mullin's] representation of [J-M]," such as those addressing third-party discovery demands pertaining to the representation. (1AA200.) And the arbitration provision extended beyond the qui tam action to cover "any other dispute between or among" J-M and Sheppard Mullin, including any "claim of any kind regardless of the facts or the legal theories." (1AA202.)

Despite the multifaceted scope of the agreement, the Court of Appeal concluded that J-M was "argu[ing] that the entire Agreement was unenforceable because Sheppard Mullin had a conflict of interest." (Opn. at p. 15.) It did not explain how all the provisions of the agreement—including those that survived termination of the qui tam representation, or addressed matters unrelated to that representation—were rendered illegal by the asserted conflict. Nor did it explain how a conflict that it held arose three weeks after the agreement was executed rendered it retroactively illegal in its entirety. (*Id.* at pp. 18-19.)

Other courts have refused to view similar illegality arguments as challenges to the entirety of a contract. For example, *Ahdout* held that an illegality challenge based on alleged violations of statutes governing the licensing of general contractors concerned only a portion of the underlying contract. (*Ahdout*, *supra*, 213 Cal.App.4th at p. 36.) Because the contract

had "a broad scope" and covered a range of topics, it was distinct from the "construction contract ... at issue in *Loving*." (*Ibid.*) And *Epic Medical Management, LLC v. Paquette* (2015) 244 Cal.App.4th 504 held that a payment method for patient referrals, allegedly illegal under Business and Professions Code section 650, did not implicate the "entirety of the contract" where the agreement covered several topics beyond referrals. (*Id.* at p. 513.)

Here, the engagement agreement governed the broader relationship between the parties, not just the qui tam action. Thus, even if the Court of Appeal were correct that judicial review is warranted where the Rules of Professional Conduct are invoked to "challenge[] the legality of the contract as a whole" (Opn. at p. 15), J-M has not asserted such a challenge here.

* * *

The Court therefore should reverse the Court of Appeal on this first issue. In so doing, it need not reach the other issues presented.

II. For Sophisticated Clients Represented by Independent Counsel, "Informed Written Consent" Means Understanding the Scope of the Waiver and the Nature of the Conflicts It Covers

Even if judicial review of the arbitration award were proper, there was no violation of Rule 3-310(C)(3) because J-M gave its informed written consent to waive any conflict regarding South Tahoe. After Sheppard Mullin disclosed in writing that it "may currently or in the future" represent clients in matters adverse to J-M, J-M executed a waiver of conflicts with Sheppard Mullin's "current" and "future" clients, including in "litigation" or "arbitration." (1AA201.) This waiver covered matters not "substantially related" to Sheppard Mullin's representation of J-M, and

where Sheppard Mullin had "not obtained confidential information of [J-M] material to [Sheppard Mullin's] representation of the other client." (1AA201.) J-M has never claimed that its General Counsel and CEO—who both extensively reviewed the engagement agreement—did not read or fully understand the explicit waiver. Nor has J-M disputed that the conflict at issue here—arising from the provision of labor advice to South Tahoe by a different Sheppard Mullin lawyer in a different office—had nothing to do with the qui tam action, and squarely fell within the waiver's terms.

This agreement fully complied with Rule 3-310(C)(3)'s "informed written consent" requirement, and constituted a waiver of any conflict regarding South Tahoe, irrespective of when it arose. Whether a client's consent to a conflict waiver is informed necessarily focuses on the client's understanding of the scope of the waiver and the nature of the conflicts that it covers. The American Bar Association, other leading bar associations, the Restatement, prominent scholars, and many courts agree that sophisticated clients represented by independent counsel need far less specific disclosures to render their consent to waive conflicts sufficiently informed. This sensible standard recognizes that increasingly savvy and powerful corporate clients often conclude it is in their best interest to broadly waive both current and future conflicts in order to hire the counsel of their choice.

A. Under Rule 3-310(C)(3), a Sophisticated Client Represented by Independent Counsel Can Give Informed Consent to a Comprehensive Waiver of Conflicts

A lawyer may "[r]epresent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter" so long as the lawyer obtains "the informed written consent of each client." (Rules Prof.

Cond., rule 3-310(C)(3).) "For purposes of [the] rule," "'[i]nformed written consent' means the client's ... written agreement to the representation following written disclosure[.]" (*Id.*, rule 3-310(A)(2).) "'Disclosure'" is defined as "informing the client ... of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client[.]" (*Id.*, rule 3-310(A)(1).)

This Court has not yet had an opportunity to address client consent to conflicts of interest involving circumstances like those here—a sophisticated client represented by independent counsel. *Anderson v. Eaton* (1930) 211 Cal. 113 addressed whether a mother, pursuing claims stemming from her son's death during his employment, had consented to an attorney's simultaneous representation of her and the insurance carrier of the son's employer. (*Id.* at pp. 114-116.) *Maxwell v. Superior Court* (1982) 30 Cal.3d 606 concerned whether an indigent criminal defendant with an eighth-grade education could consent to a fee agreement that permitted his retained counsel to exploit his life story. (*Id.* at pp. 610-611, 622.)

Because there is no directly "on-point California authority" regarding the waiver of conflicts by sophisticated clients represented by independent counsel, the ABA Model Rules "may serve as guidelines" to clarify the meaning of California law. (*City & Cnty. of San Francisco v. Cobra Solutions, Inc.* (2006) 38 Cal.4th 839, 852; see also Rules Prof. Cond., rule 1-100(A) ["Ethics opinions and rules and standards promulgated by other jurisdictions and bar associations may also be considered"].) The Model Rules and accompanying comments directly address this issue.

Like Rule 3-310(C)(3), Model Rule 1.7 allows a lawyer to represent a client notwithstanding a concurrent conflict if, among other things, "each affected client gives informed consent, confirmed in writing." (ABA Model Rules of Prof. Conduct, rule 1.7(b)(4).) The comments to the Model Rules instruct that "[t]he effectiveness of such waivers is generally determined by the extent to which the client reasonably understands the material risks that the waiver entails." (*Id.*, rule 1.7, com. 22.) "[I]f the client agrees to consent to a particular type of conflict with which the client is already familiar, then the consent ordinarily will be effective with regard to that type of conflict." (*Ibid.*) And "if [a] client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise," its consent to an advance 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." (*Ibid.*)

The ABA thus noted in a 2005 ethics opinion "the likely validity of an 'open-ended' informed consent" where the client is (1) "an experienced user of legal services," (2) "has had the opportunity to be represented by independent counsel," and (3) "the consent is limited to matters not substantially related to the subject of the prior representation." (ABA Com. on Prof. Ethics, Opn. No. 05-436 (2005), p. 4 (hereafter ABA Opn. No. 05-436).) The ABA also withdrew a 1993 opinion that limited conflict waivers "to circumstances in which the lawyer is able to and does identify the potential party or class of parties that may be represented in the future matter(s)." (*Id.* at pp. 3-4.) The 1993 opinion was "no longer consistent with the Model Rules" because it did "not vary its conclusions as to the likely effectiveness of informed consent to future conflicts when the client is an experienced user of legal services or has had the opportunity to be

represented by independent counsel in relation to such consent." (*Id.* at p. 4.)

The ABA's view of the informed-consent inquiry is consistent with a 1989 ethics opinion by the California State Bar's Standing Committee on Professional Responsibility and Conduct interpreting Rule 3-310. This opinion recognized that blanket conflict waivers can satisfy the informed written consent requirement "in appropriate circumstances and with knowledgeable and sophisticated clients." (State Bar Standing Com. on Prof. Responsibility & Conduct, Formal Opn. No. 1989-115.) It emphasized that "[w]hether a client's waiver of the protections provided by rule 3-310 ... is 'informed' is obviously a fact-specific inquiry," and concluded that "the execution of an advance waiver of conflict of interest and confidentiality protections" can be appropriate depending on the circumstances, such as the client's sophistication. (*Ibid.*)

Other prominent bar associations agree. The Washington, D.C. Bar Association, for example, concluded that "[a]n advance waiver given by a client having independent counsel (in-house or outside) available to review such actions presumptively is valid ... even if general in character." (D.C. Bar Assn., Ethics Opn. 309 (2001) (hereafter D.C. Bar Assn.).) According to the New York City Bar Association's Committee on Professional and Judicial Ethics, "'[b]lanket' or 'open-ended'" conflict waivers "that permit the law firm to act adversely to the client on matters not substantially related to the law firm's representation of the client should be limited to sophisticated clients," because they "need less disclosure." (N.Y.C. Bar Assn. Com. on Prof. & Jud. Ethics, Formal Opn. 2006-1 (2006) (hereafter N.Y.C. Bar Assn.).)

The Restatement (Third) of the Law Governing Lawyers also provides that "[i]nformed consent" requires that the "client have *reasonably adequate information* about the material risks" of a conflict. (Rest.3d Law Governing Lawyers (2000) § 122(1), italics added.) Thus, "[a] client's open-ended agreement to consent to all conflicts" is effective if the client "possesses sophistication in the matter in question and has had the opportunity to receive independent legal advice about the consent." (*Id.*, cmt. d.) Many courts recognize this approach as reflecting the "national standard for informed consent." (*Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC* (N.D.Tex. 2013) 927 F.Supp.2d 390, 394, 404 (*Galderma*); see also, e.g., *Macy's, Inc. v. J.C. Penn[e]y Corp.* (App. Div. 2013) 968 N.Y.S.2d 64, 65.)

B. J-M Gave Informed Written Consent to the Waiver of the Conflict Regarding South Tahoe

The asserted conflict in this case arose not from Sheppard Mullin's representation of South Tahoe in any litigation against J-M, but instead from 12 hours of unrelated labor counseling, periodically over 16 months, by a different Sheppard Mullin lawyer in a different office. This representation was neither adverse to J-M nor related to the qui tam action, and none of J-M's confidential information was ever used (or was even remotely relevant to the labor advice to South Tahoe). Further, J-M stipulated that it suffered no damage from this conflict and that it had no challenge to the quality of Sheppard Mullin's 10,000 hours of work in the qui tam action. This is precisely the type of conflict that Rule 3-310(C)(3) permits clients to waive. And that is exactly what J-M did when it retained Sheppard Mullin and agreed to a comprehensive waiver of conflicts after receiving written disclosure of the scope of Sheppard Mullin's practice and the possibility of both current and future conflicts:

- Sheppard Mullin disclosed that it "has many attorneys and multiple offices" and "may *currently or in the future* represent one or more other clients (including current, former, and future clients) in matters involving [J-M]";

- Sheppard Mullin disclosed that it sought the conflict waiver "to allow [Sheppard Mullin] to meet the needs of *existing and future* clients, to remain available to those other clients and to render legal services with vigor and competence";

- J-M waived conflicts *only* to the extent that "the other matter [was] *not substantially related*" to Sheppard Mullin's representation of J-M and where Sheppard Mullin had "*not obtained confidential information*" from J-M that would be "material" to Sheppard Mullin's "representation of the other client"; and

- With those limitations, Sheppard Mullin undertook its engagement with J-M "on the condition" that Sheppard Mullin could represent a different client in another matter in which Sheppard Mullin did not represent J-M, "even if the interests of the other client are adverse to [J-M] (*including ... in litigation or arbitration*)."

(1AA201, italics added.)

This conflict waiver was not entered into lightly, or by a client who was unfamiliar with such waivers or did not grasp the potential for a firm like Sheppard Mullin to represent its adversaries in unrelated matters:

- J-M's General Counsel was familiar with conflict waivers, and had refused requests to waive conflicts from other law firms, including from

Morgan Lewis the same day it agreed to the conflict waiver with Sheppard Mullin. (1AA192.)

- Before agreeing to the conflict waiver with Sheppard Mullin, "JM had never waived any conflict for any of its other (past or present) attorneys." (1AA192.)

- J-M's General Counsel discussed the engagement agreement for two hours with Sheppard Mullin's lead partner. (2AA476-477.) During that discussion, she successfully negotiated a complex fee structure resulting in a 22% fee reduction. (2AA477.)

- J-M's General Counsel reviewed the engagement agreement over several days with J-M's CEO, and she "edited the paragraph preceding the conflict waiver provision, [but] she did not edit the conflict waiver provision." (Opn. at pp. 5-6; 2AA477-478.)

- Sheppard Mullin told J-M about its former client relationship with another of J-M's adversaries in the qui tam action—the Los Angeles Department of Water and Power, which had exponentially greater claims than South Tahoe. J-M's General Counsel did not express any concern when told that Sheppard Mullin "hoped to represent the LADWP again in the future," instead stating that this relationship would be helpful in potentially resolving the qui tam action. (MJN Decl., Ex. E at p. 2; 2AA474-475, 490-492.)

Nonetheless, J-M now contends that it did not give informed consent to the unrelated conflict with South Tahoe. That claim cannot be squared with either the facts or the law.

The fact that J-M undisputedly was represented by independent counsel—its General Counsel—when it agreed to waive conflicts alone ensured that J-M's consent was sufficiently informed. (E.g., Rest.3d Law Governing Lawyers (2000) § 122, com. c(i) [a client is "independently represented" when it is represented by "inside legal counsel"]; Painter, *Advance Waiver of Conflicts* (2000) 13 Geo. J. Legal Ethics 289, 329 [endorsing the enforcement of advance conflict waivers "in cases where the client giving the waiver was independently represented by counsel at the time the waiver was given"].) J-M's General Counsel, who was familiar with conflict waivers, plainly understood the risks and consequences of Sheppard Mullin's written disclosures concerning the scope of its practice and a clear description of the conflicts that J-M was agreeing to waive, even though particular entities, such as South Tahoe, were not enumerated.

J-M also has never disputed that it is a sophisticated client that had significant experience with legal matters and retaining lawyers, including familiarity with conflict waivers. (E.g., ABA Model Rules of Prof. Conduct, rule 1.7, com. 22; ABA Opn. No. 05-436, *supra*, at p. 4 [noting "the likely validity of an 'open-ended' informed consent if the client is an experienced user of legal services"]; N.Y.C. Bar. Assn., *supra* ["[s]ophisticated clients need less disclosure"].)

The Court of Appeal, however, held the conflict waiver was invalid because it "did not mention South Tahoe," and "[i]nstead ... broadly waived all current and future conflicts with any client[.]" (Opn. at pp. 21-22.) In so doing, the Court of Appeal relied primarily on two inapposite cases—(1) *Zador Corp. v. Kwan* (1995) 31 Cal.App.4th 1285, which involved an unrepresented individual, not a sophisticated corporate client represented by in-house counsel like J-M (see *id.* at pp. 1289-1291); and (2) *Visa U.S.A. Inc. v. First Data Corp.* (N.D. Cal. 2003) 241 F.Supp.2d

1100, a federal district court decision that relied heavily on the ABA's now-withdrawn 1993 ethics opinion (see *id.* at pp. 1105-1107). (Opn. at pp. 18-22.)

More fundamentally, the Court of Appeal did not ask the right question—whether J-M's consent was sufficiently "informed," in that it understood the scope of the waiver it was consenting to and the nature of the actual or potential conflicts the waiver covered. Rather, it held that informed consent always requires specifically identifying any adverse party that may be covered by the waiver, even if (a) such specificity is unnecessary for the client to actually understand the waiver, (b) the waiver specifically noted that it covered conflicts with current, former, and future clients of the law firm, and (c) the sophisticated client and its independent counsel understood what they were waiving and, had they been concerned with the specific identity of any Sheppard Mullin clients, clearly would have insisted on those details before agreeing to the waiver. Thus, in the Court of Appeal's view, specific client names must *always* be disclosed, even if they do not meaningfully add to the client's understanding of the material risks of the waiver.[3] Going even further, the court held that renewed consent must be obtained for any conflict that arises in the future (Opn. at pp. 18-19)—which would nullify advance waivers altogether.

The Court of Appeal's interpretation of Rule 3-310 cannot be squared with either the "national standard for informed consent"

---

[3] Such an absolute rule would harm a firm's current clients, as it would require disclosure of representations those clients may prefer not to have publicized, regardless of whether such disclosure enhances the prospective client's understanding of the consequences of the conflict waiver.

(*Galderma*, *supra*, 927 F.Supp.2d at p. 404), or the facts of this case, which demonstrate that J-M was fully informed about the nature and scope of the conflicts it was waiving. That is true regardless of whether the conflict with South Tahoe existed at the time Sheppard Mullin's representation of J-M commenced (as J-M contends and Sheppard Mullin disputes), or arose three weeks later (as the Court of Appeal held). In either scenario, Sheppard Mullin's clear written disclosures told J-M everything it wanted and needed to know in order to make an informed decision about the conflict waiver—including that it would cover "current, former, and future clients." (1AA201.)

J-M—a sophisticated, billion-dollar corporation represented by independent counsel—plainly understood that South Tahoe, like any of the approximately 200 governmental entities with qui tam claims, could have been among the "current, former, [or] future" clients that the language of the waiver covered. That Sheppard Mullin did not specifically identify any of J-M's possible adversaries in the qui tam action (or otherwise) covered by that waiver cannot mean that J-M did not "reasonably understand[] the material risks that the waiver entail[ed]" (ABA Model Rules of Prof. Conduct, rule 1.7, com. 22), or that J-M did not have "*reasonably adequate information* about the material risks" of a conflict. (Rest.3d Law Governing Lawyers (2000) § 122(1), italics added.)

In short, J-M knowingly waived both current and future conflicts in order to hire Sheppard Mullin. There is no reason for the Court to disrupt this bargain between two sophisticated parties.

C. The Modern Legal Marketplace Calls for an Informed Consent Standard Tailored to Sophisticated Clients Represented by Independent Counsel

This case exemplifies the reasons why sophisticated clients represented by independent counsel—like J-M—frequently give informed written consent to comprehensive waivers of conflicts, and should be bound by such waivers when they do. These clients have decided—with full understanding and advice of their independent counsel—that their interests are best-served by executing such waivers and securing counsel of their choice. The law should not, in the name of protecting sophisticated clients, preclude such decisions.

Preventing sophisticated clients from waiving conflicts would hamper their ability to obtain the legal representation of their choice. Without "an enforceable prospective conflicts waiver, law firms, especially smaller law firms or those concentrating in specific areas of the law, may be unwilling to accept [a] new client if the firm fears that by doing so it could expose the firm's other clients to the loss of their counsel." (Lerner, *Honoring Choice by Consenting Adults: Prospective Conflict Waivers As a Mature Solution to Ethical Gamesmanship—A Response to Mr. Fox* (2001) 29 Hofstra L.Rev. 971, 1002 (hereafter Lerner).) By contrast, strict rules against waiving conflicts may "strip even a long-standing client of the right to counsel of its choice." (N.Y.C. Bar Assn., *supra*.) For example, a client could be precluded from using its longtime law firm's services because the law firm represents the client's adversary in an entirely unrelated matter. (*Ibid.*)

Changes in the structure of the corporate legal market amplify this concern. "The days when a large corporation would send most or all of its legal business to a single firm are gone." (D.C. Bar Assn., *supra* see also

Wendel, *Pushing the Boundaries of Informed Consent: Ethics in the Representation of Legally Sophisticated Clients* (2015) 47 U.Tol. L.Rev. 39, 51-52 (hereafter Wendel) ["One result of the rise of in-house legal departments has been to break up legal work into discrete matters, which are then placed with a number of different outside law firms based on some combination of price and expertise"].) And "general counsels of large corporations," like J-M's General Counsel, "have a highly competitive legal market from which to select the counsel of their choice." (Lerner, *supra*, 29 Hofstra. L.Rev. at p. 1010.)

Due to these changes, "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, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship* (2010) 78 Fordham L.Rev. 2067, 2105.) Sophisticated corporations like J-M "can readily appreciate the potential impact of agreeing to [forgo] objections to lawyers from the same law firm from being directly adverse in any unrelated case," just as they assess and "allocate[] business risks in running [their] business." (Lerner, *supra*, 29 Hofstra L.Rev. at p. 1007.) Many clients do precisely that in order to hire the lawyers of their choosing and avail themselves of those lawyers' particular expertise. (See Morgan, *Finding Their Niche: Advance Conflicts Waivers Facilitate Industry-Based Lawyering* (2008) 21 Geo. J. Legal Ethics 963, 978.) And "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" because "large corporations have access to the independent professional judgment of a lawyer when dealing with the outside world, including other lawyers." (Wendel, *supra*, 47 U.Tol. L.Rev. at p. 49.)

Because outside law firms must "compete for [their] business," corporations like J-M who are significant consumers of legal services "have the economic leverage" (Wendel, *supra*, 47 U.Tol. L.Rev. at pp. 48-49), and thus "call most of the shots." (Lipson et al., *Foreword: Who's in the House? The Changing Nature and Role of In-House and General Counsel* (2012) 2012 Wis. L.Rev. 237, 243.) These clients wield substantial bargaining power to set the terms of their engagements and the scope of any conflict waiver, and some have even created "engagement letters of their own" with specific conflicts terms. (Kobak, *Dealing with Conflicts and Disqualification Risks Professionally* (2015) 44 Hofstra L.Rev. 497, 529-530.)

Here, J-M clearly had leverage in negotiating the terms of its engagement with Sheppard Mullin, as it successfully negotiated a 22% fee reduction and made handwritten revisions to the engagement agreement before signing. (2AA475-477.) But even though J-M had not agreed to waive conflicts when hiring other law firms, it was willing to do so with Sheppard Mullin to obtain Sheppard Mullin's expertise in qui tam litigation. (1AA192.)[4] Sophisticated clients like J-M should be allowed to make such choices, particularly where, as here, they are represented by independent counsel. (See, e.g., Wendel, *supra*, 47 U.Tol. L. Rev. at p. 50 [sophisticated clients may be "willing to incur" the risks of a conflict

---

[4] Even after the risk of a conflict materialized here with South Tahoe's disqualification motion, J-M did not fire Sheppard Mullin, but instead called Sheppard Mullin and J-M "a 'team' and a 'family'" and encouraged it to fight disqualification *and* continue working aggressively on the case; that only changed when J-M learned of the potential for disgorgement and fee forfeiture. (1AA196-197; 1AA242-254; 1AA256-267; 2AA482-486; 2AA502-506.)

waiver and "should be permitted to make the judgment call and not be stuck with a context-insensitive rule of professional conduct"].)

* * *

The Court should hold that the conflict waiver here complied with Rule 3-310(C)(3), and reject J-M's post-hoc, opportunistic claim that it did not give informed written consent to a waiver of any conflict arising from Sheppard Mullin's unrelated labor advice to South Tahoe.

III. Even If the Conflict Waiver Is Deemed Invalid, Sheppard Mullin Was Entitled to Retain and Recover Its Attorneys' Fees Under the Circumstances Here

J-M argued below, and the Court of Appeal agreed, that any conflict of interest—no matter how minor or unrelated; no matter when or how it arose; irrespective of the attorney's good faith; and regardless of whether confidential information was used or whether the conflict damaged the client—requires automatic disgorgement of all earned legal fees, and precludes quantum meruit recovery of any unpaid fees. Imposing such a penalty on attorneys regardless of their good faith and in the absence of any harm violates fundamental legal principles and incentivizes opportunistic litigation between attorneys and their clients of the sort that J-M has pursued here.

It is not and cannot be the law that a firm would be subject to losing nearly $4 million it earned for providing over 10,000 hours of legal services because a court—contrary to a large body of authority, including the ABA Model Rules and the Restatement—later viewed a conflict waiver provision as insufficiently specific for a sophisticated client represented by independent counsel. Far from the sort of egregious misconduct that has given rise to fee forfeiture in some cases, Sheppard Mullin's conduct, at

worst, was the mistaken reliance on the validity of a type of conflict waiver widely used in California and elsewhere and the fact that it had not performed work for South Tahoe for five months. That alone cannot be the basis of complete, automatic, and punitive fee forfeiture.

A. J-M Cannot Obtain Disgorgement of Past Fees Because It Stipulated That It Suffered No Damages

J-M stipulated in this action that it was not challenging "the value or quality of Sheppard Mullin's work ... and any claim for costs (fees included) associated with replacing Sheppard Mullin [as counsel]." (Opn. at p. 9; see also 3AA580-581; 3AA677-678.) In other words, J-M stipulated that it suffered no damages and was not injured in any respect by the purported conflict with South Tahoe or the disqualification of Sheppard Mullin in the qui tam action. This should have been fatal to J-M's request for disgorgement of $2.7 million in previously-paid fees as a remedy under its tort claim for breach of fiduciary duty; such a claim, like any tort claim, requires proof of damages as an element. (*Oasis W. Realty, LLC v. Goldman* (2011) 51 Cal.4th 811, 820-821.) The Court of Appeal nonetheless held that it was "irrelevant whether J-M suffered damage"; J-M was automatically entitled to disgorgement because, in its view, all "serious ethical violations"—which included *all* "conflicts of interest"—require automatic denial of any compensation to an attorney. (Opn. at pp. 26-29.)[5]

This Court has refused to allow fee disgorgement where a client has suffered no injury or damages as the result of a violation of the rules

[5] As explained below, that J-M suffered no damages also supports awarding Sheppard Mullin quantum meruit recovery for the unpaid $1.1 million in legal services it provided to J-M.

governing the practice of law. In *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 (*Frye*), a former client of a nonprofit corporation whose attorneys had successfully represented him in litigation brought an action seeking to recover attorneys' fees that the corporation had retained as part of a judgment in the action. (*Id.* at pp. 29-31.) The client argued that disgorgement of fees was warranted because the nonprofit corporation had "engaged in the unauthorized practice of law" and "should have registered and complied with [Corporations Code] section 13406(b)." (*Id.* at p. 47.) But the Court held that the "remedy he sought was not available" because the corporation's alleged "failure to register with the State Bar or to comply with section 13406(b) was not a cause of any injury to [the client]." (*Id.* at p. 48.) Given this lack of injury, "'[t]o require disgorgement of fees because of a failure to register the corporation ... is disproportionate to the wrong.'" (*Ibid.*, quoting *Olson v. Cohen* (2003) 106 Cal.App.4th 1209, 1215.) The Court also held that disgorgement was not available "with respect to any claim for misrepresentation or concealment" because "there was no damage." (*Ibid.*)

Applying *Frye*, the Court of Appeal in *Slovensky v. Friedman* (2006) 142 Cal.App.4th 1518 (*Slovensky*) held that "although disgorgement of fees is a recognized [tort] remedy ... *it is available only if the alleged misconduct caused damage.*" (*Id.* at p. 1527, italics added.) The plaintiff there sought fee disgorgement based on tort claims against her attorneys alleging that they, among other things, violated Rule 3-310 and their "duty of confidentiality, in violation of Business and Professions Code section 6068." (*Id.* at pp. 1524-1526.) Although the alleged ethical violations were undisputed (*id.* at p. 1534), the plaintiff's tort claims still failed as a matter of law because she could not "prov[e] damages from [the] defendants' conduct." (*Id.* at p. 1527.)

Here, the Court of Appeal acknowledged that disgorgement, "when sought as a tort remedy," "may require evidence of actual damages," but held that a plaintiff is excused from proving this essential element of a tort claim "[w]hen a serious ethical breach is at issue." (Order Modifying Opn. at p. 2.) That reasoning cannot be reconciled with *Slovensky*, which involved multiple, undisputedly serious ethical breaches, including violations of Rule 3-310. For example, the attorneys in *Slovensky* "misrepresented to [the] plaintiff that they were evaluating and pursuing her case on its own merits," "made repeated false statements ... to pressure [the plaintiff] into accepting the settlement," "breached confidentiality," "used pressure tactics to break down her resistance," and appropriated their fees from the settlement funds without permission. (*Slovensky*, *supra*, 142 Cal.App.4th at p. 1534.) They also violated Rule 3-310 by not obtaining a waiver or advising the plaintiff to consult independent counsel. (*Id.* at pp. 1523-1524.) *Slovensky* nevertheless held that the plaintiff's lack of damages from these breaches precluded disgorgement.[6]

As this case shows, eschewing proof of damages before permitting disgorgement of legal fees can result in unfair, disproportionate forfeitures and can powerfully affect client behavior. Here, when South Tahoe moved to disqualify Sheppard Mullin, J-M initially encouraged Sheppard Mullin to fight disqualification and continue working aggressively on the qui tam case. (2AA482-483; 2AA502-506.) But once J-M received advice from

---

[6] The Court of Appeal distinguished *Slovensky* because the court there had "accepted as true the plaintiff's allegations." (Order Modifying Opn. at pp. 1-2.) But the attorneys there "did not controvert plaintiff's fiduciary breach allegations" when given the opportunity. (*Slovensky*, *supra*, 142 Cal.App.4th at p. 1534.) That the attorneys did not even contest the allegations against them hardly mitigates the severity of the unethical conduct at issue in *Slovensky*.

other law firms that it might obtain disgorgement of fees if Sheppard Mullin were disqualified, J-M refused the federal court's reasonable proposal to resolve the disqualification issue. (1AA196-197; 1AA269; 2AA405.) The Court of Appeal's per se rule that *any* conflict automatically requires a firm to disgorge all fees—even where, as here, the client has suffered no damages—thus would incentivize clients to avoid resolving conflicts when they develop, knowing they might later obtain a windfall in free legal services.

The Court should hold that J-M's request for disgorgement fails as a matter of law because it suffered no damages.[7]

B. A Conflict of Interest Does Not Automatically Require Forfeiture of All Legal Fees

The Court of Appeal held that any conflict of interest automatically requires full fee disgorgement and also precludes recovery of the reasonable value of an attorney's unpaid work in a quantum meruit action. (Opn. at pp. 26-30.) But the propriety and appropriate amount of any fee disgorgement, as well as the availability of fee recovery under quantum meruit, turns on the circumstances of each case, not automatic rules. And here—where there is no evidence of bad faith, no J-M confidential information was shared with South Tahoe, the quality of Sheppard Mullin's work was never questioned, and J-M suffered no damages—there is no reason to deny Sheppard Mullin any, much less all, of its fees.

---

[7] Even if J-M were able to seek some disgorgement despite the lack of damages, the Court of Appeal still erred in requiring full disgorgement of all paid fees regardless of the circumstances, as explained below.

In *Clark v. Millsap* (1926) 197 Cal. 765 (*Clark*), the Court "observed" that a court "may," in its discretion and in certain circumstances, "refuse to allow an attorney any sum as an attorney's fee if his relations with his client are tainted with fraud," or if the attorney "acts in violation or excess of authority" or with "impropriety inconsistent with the character of the profession, and incompatible with the faithful discharge of [his] duties." (*Id.* at p. 785, quotation marks and citation omitted.) *Clark* thus recognized that in particularly egregious circumstances, precluding an attorney from recovering his fees may be warranted. But the Court had no opportunity to expound on the scope of this principle because there was no objection from the client in *Clark* to a partial award of fees even though the attorney engaged in various "fraudulent acts." (*Ibid.*)

More recently, the Court in *Huskinson & Brown, LLP v. Wolf* (2004) 32 Cal.4th 453 (*Huskinson*) reaffirmed the "settled principle that an attorney who is barred from recovering against a client under an invalid or unenforceable compensation agreement may nonetheless recover in quantum meruit the reasonable value of his or her legal services." (*Id.* at p. 462.) The Court thus concluded that a law firm could recover the reasonable value of its legal services despite violating the fee-splitting prohibitions in Rule 2-200 because allowing that recovery would not undermine what that rule sought "to accomplish" or "compliance with the Rules of Professional Conduct." (*Id.* at pp. 458-461.)

Instead of applying the actual holding of *Huskinson*, the Court of Appeal here relied on this Court's observation that some courts have "disallowed quantum meruit recovery to attorneys who violated ... the rule prohibiting attorneys from engaging in conflicting representation." (*Huskinson*, *supra*, 32 Cal.4th. at p. 463, citing *Jeffry v. Pounds* (1977) 67 Cal.App.3d 6 (*Jeffry*); *Goldstein v. Lees* (1975) 46 Cal.App.3d 614

(*Goldstein*); see Opn. at p. 29.) But *Huskinson* did not hold that, as a categorical matter, quantum meruit recovery is unavailable whenever a conflict arises; in fact, the case did not involve conflicts at all. And at least in circumstances like those here—involving an *unrelated* conflicting representation that a client can permissibly waive—allowing quantum meruit recovery would not "undermine compliance with the Rules of Professional Conduct" because attorneys still would have significant incentive to obtain informed consent to avoid the disruption of ongoing client relationships, damages claims from clients, reputational harm, and disciplinary action. (*Huskinson, supra*, 32 Cal.4th at p. 459.)

Consistent with *Clark* and *Huskinson*, California courts have refused to adopt automatic rules requiring fee forfeiture where an attorney has violated the Rules of Professional Conduct, and instead have focused on the egregiousness of the violation and whether the attorney acted in bad faith—*including* in cases involving conflicts of interest. For example, *Mardirossian & Associates, Inc. v. Ersoff* (2007) 153 Cal.App.4th 257 (*Mardirossian*) explained that "[a]lthough the breach of a rule of professional conduct may warrant a forfeiture of fees, *forfeiture is not automatic* but depends on the egregiousness of the violation." (*Id.* at p. 278, italics added.) *Mardirossian* thus affirmed a trial court's ruling that an alleged "violation of rule 3-310 was not sufficiently egregious under the circumstance to justify a total forfeiture of fees." (*Id.* at pp. 278, 280.)

Other Court of Appeal decisions likewise have employed a fact-specific, case-by-case approach focused on the seriousness and egregiousness of the rule violation. *Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000 (*Pringle*) concluded that neither *Jeffry* nor *Goldstein* (nor any other case) stood "for the proposition that a violation of [Rule 3-310] automatically precludes an attorney from obtaining fees," and noted that

"Rule 3-310 ... do[es] not so provide." (*Id.* at pp. 1005-1006 & fn. 4.) Rather, "there must be a serious violation of the attorney's responsibilities before an attorney who violates an ethical rule is required to forfeit fees." (*Id.* at p. 1006, citing *Clark, supra*, 197 Cal. at p. 785.)

Similarly, *Sullivan v. Dorsa* (2005) 128 Cal.App.4th 947 (*Sullivan*), which relied on *Pringle* and also involved an alleged violation of Rule 3-310, explained that fee forfeiture was not "*automatic[]*." (*Id.* at p. 965, original italics.) *Sullivan* thus rejected an attack on a fee award where the client "fail[ed] to show that any violation of the rules governing representation of adverse interests was *serious* enough to *compel* a forfeiture of fees." (*Id.* at pp. 965-966, original italics.)

These decisions are consistent with the Restatement (Third) of the Law Governing Lawyers, which provides that "[a] lawyer engaging in a *clear and serious* violation of duty to a client *may* be required to forfeit some or all of the lawyer's compensation for the matter." (Rest.3d Law Governing Lawyers (2000) § 37, italics added.) The Restatement further instructs that "[c]onsiderations relevant to the question of forfeiture include the gravity and timing of the violation, its willfulness, its effect on the value of the lawyer's work for the client, any other threatened or actual harm to the client, and the adequacy of other remedies." (*Ibid.*)

The Restatement thus rejects categorical rules in favor of a fact-specific approach. And that approach "or something similar ... appears to have been adopted in most other jurisdictions that have considered the issue," including multiple state supreme courts. (*Burrow v. Arce* (Tex. 1999) 997 S.W.2d 229, 242 & fn. 45 [collecting cases from 15 jurisdictions]; see, e.g., *Internat. Materials Corp. v. Sun Corp.* (Mo. 1992) 824 S.W.2d 890, 895 [noting that "[f]orfeiture is generally inappropriate

when the lawyer has done nothing willfully blameworthy"]; *In re Marriage of Pagano* (Ill. 1992) 607 N.E.2d 1242, 1250 [holding that it "will not always be the case" that a breach of fiduciary duty is "so egregious as to require the forfeiture of compensation"]; *Gilchrist v. Perl* (Minn. 1986) 387 N.W.2d 412, 417 [holding that where "no actual fraud or bad faith is involved" and "when no actual harm to the client is sustained" multiple factors should be considered "to determine the amount of the fee forfeiture"].)

The Court of Appeal here, however, imposed a per se rule that precludes any retention or recovery of fees irrespective of the circumstances and seriousness of the conflict—no matter how minor, unrelated, or unintentional, and irrespective of good faith. (Opn. at p. 26.) It claimed that this per se rule was recognized in *Goldstein* and *Jeffry*, which it read as holding that all "conflicts of interest" are "serious ethical violations" for "which compensation is prohibited." (*Id.* at pp. 26-27.) But other decisions—including *Mardirossian*, *Pringle*, and *Sullivan*—have correctly rejected this interpretation of *Goldstein* and *Jeffry*.[8]

As the facts here demonstrate, not all conflicts are the same, and thus a per se rule requiring complete forfeiture is unwarranted. Sheppard Mullin made substantial, good faith efforts to comply with Rule 3-310(C)(3), and it

---

[8] *Goldstein* does broadly state that "[i]t is settled in California that an attorney may not recover for services rendered if those services are rendered in contradiction to the requirements of professional responsibility," citing *Clark* to support this proposition. (*Goldstein*, *supra*, 46 Cal.App.3d at p. 618.) But there is no such absolute language in *Clark*. Moreover, *Goldstein* involved egregious facts—an attorney's intentional use of a former client's confidential information (its "innermost secrets") in representing a different client against the former client in a substantially related matter. (*Id.* at pp. 617-619.)

genuinely believed that it had obtained valid conflict waivers from both South Tahoe and J-M. (2AA475-476; 2AA538-540.) Indeed, the arbitration panel concluded that Sheppard Mullin acted "honestly and in good faith believed that no conflict existed" (3AA674), and that any ethical violation "was not so serious or egregious as to make appropriate ... forfeiture of fees." (3AA677.)

Moreover, the asserted conflict here arose from a small amount of unrelated labor counseling by a different Sheppard Mullin lawyer in another firm office three weeks *after* J-M's retention of Sheppard Mullin. (2AA512-514; Opn. at p. 17.) J-M stipulated that this conflict did not affect the value or quality of Sheppard Mullin's work, and that it caused no damages. (Opn. at p. 9; 3AA580-581; 3AA677-678.) No confidential information concerning J-M was ever disclosed to, or used by, South Tahoe, and no Sheppard Mullin lawyer worked for both J-M and South Tahoe. (2AA513-514.) J-M also hired Sheppard Mullin partly because of the firm's relationships with some of J-M's potential opponents in the qui tam action. (2AA474-475; 2AA490-492.)

Under these circumstances, requiring Sheppard Mullin to forfeit all of its fees would impose a wildly disproportionate and unjust penalty, award J-M a nearly $4 million windfall, and reward opportunistic behavior. Indeed, without injury, fee forfeiture is necessarily punitive rather than compensatory. And like any punitive measure, it must be proportionate to the nature of the asserted wrongdoing. As this Court has recognized, due process requires "reasonable proportionality between punitive damages and actual or potential harm to the plaintiff," and "what ratio is reasonable necessarily depends on the reprehensibility of the conduct." (*Johnson v. Ford Motor Co.* (2005) 35 Cal.4th 1191, 1207.) Requiring automatic

forfeiture of all fees for any actual conflict of interest, and holding that good faith is not a valid defense, contravenes this fundamental principle.

Indeed, attorneys frequently can find themselves representing conflicting interests inadvertently despite exercising good faith and reasonable diligence. For example, it can be difficult to determine whether there is a positional conflict on a specific legal issue. (Mallen et al., *Legal Malpractice* (2016) § 17:5.) It is also "common for the attorney engaged in corporate or partnership representation" to "fail[] to recognize that an adverse party is a client." (*Id.* § 17:22.) And that assessment is further complicated because "whether a lawyer represents a corporate affiliate of a client" for conflict of interest purposes "depends not upon any clearcut per se rule but rather upon the particular circumstances." (ABA Com. on Prof. Ethics, Opn. No. 95-390 (1995), p. 4.) These and other common scenarios are further reason not to impose *automatic* fee forfeiture for any actual conflicts of interest; well-meaning lawyers can and do come to different conclusions on these issues.

The Court should reject the Court of Appeal's categorical approach, and hold that Sheppard Mullin is entitled both to retain $2.7 million in paid fees and recover $1.1 million in unpaid fees.

CONCLUSION

The Court should reverse the Court of Appeal's judgment.

DATED: June 27, 2016

Respectfully submitted,

GIBSON, DUNN & CRUTCHER LLP

By: 

Kevin S. Rosen

Attorneys for Plaintiff and Respondent
Sheppard, Mullin, Richter & Hampton LLP

CERTIFICATE OF WORD COUNT

Pursuant to California Rules of Court, rule 8.520(c)(1), the undersigned certifies that this Opening Brief on the Merits contains 13,968 words as counted by the word count feature of the Microsoft Word program used to generate this brief, not including the tables of contents and authorities, the court of appeal's order, the cover information, the signature block, and this certificate.

DATED: June 27, 2016 By: _____

Kevin S. Rosen

CERTIFICATE OF SERVICE

I, Teresa Motichka, declare as follows:

I am employed in the County of San Francisco, State of California, I am over the age of eighteen years and am not a party to this action; my business address is 555 Mission Street, San Francisco, CA 94105-0921, in said County and State.

On June 27, 2016, I served the following document(s):

OPENING BRIEF ON THE MERITS

on the parties stated below, by the following means of service:

SEE ATTACHED SERVICE LIST

Unless otherwise noted on the attached Service List, **BY MAIL:** I placed a true copy in a sealed envelope or package addressed as indicated above, on the above-mentioned date, and placed the envelope for collection and mailing, following our ordinary business practices. I am readily familiar with this firm's practice for collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited with the U.S. Postal Service in the ordinary course of business in a sealed envelope with postage fully prepaid. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing set forth in this declaration.

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

Executed on June 27, 2016, at San Francisco, California.

Teresa Motichka

Teresa Motichka

SERVICE LIST

Kent L. Richland Barbara W. Ravitz Jeffrey E. Raskin Greines, Martin, Stein & Richland LLP 5900 Wilshire Boulevard, 12th Floor Los Angeles, California 90036	*Attorneys for Defendant and Appellant J-M Manufacturing Co., Inc.*
Office of the Clerk of Court Los Angeles Superior Court 111 North Hill Street Los Angeles, CA 90012	
Office of the Clerk of Court Court of Appeal Second Appellate District, Division Four 300 South Spring Street Los Angeles, CA 90013	