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PERSPECTIVE

State high court soon to decide conflict waivers case

By Stephen L. Raucher

Will the California Supreme Court invalidate broad advance conflict waivers commonly used by large law firms in their engagement agreements? That is the central issue in *Sheppard, Mullin, Richter & Hampton LLP v. J-M Manufacturing Co., Inc.*, S232946, which was argued on June 6, with a decision anticipated in the next few weeks. Based on the comments of the justices at oral argument, the court was not comfortable with the lack of detailed disclosure regarding conflicts enabled by advance waivers. However, the court also signaled that it may ultimately find a way to dispose of the *Sheppard Mullin* case without having to reach that issue.

Sheppard Mullin represented J-M Manufacturing in a qui tam action stemming from allegedly defective PVC pipe products. The qui tam action involved over 200 governmental entity plaintiffs, seeking over $1 billion in damages.

Sheppard Mullin's engagement agreement with J-M included the following broad conflict waiver: Sheppard Mullin "has many attorneys and multiple offices. We may currently or in the future represent one or more other clients ... in matters involving [J-M]. We undertake this engagement on the condition that we may represent another client in a matter in which we do not represent [J-M] ... provided the other matter is not substantially related to our representation of [J-M] and in the course of representing [J-M] we have not obtained confidential information of [J-M] material to

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representation of the client. By consenting to this arrangement, [J-M] is waiving our obligation of loyalty to it so long as we maintain confidentiality and adhere to the foregoing limitations." J-M was represented by in-house counsel while negotiating the engagement agreement, although the issue of the conflict waiver was not discussed.

Unbeknownst to J-M — but known to Sheppard Mullin from the outset of its representation of J-M — the firm had a long-term attorney-client relationship with one of the plaintiffs, South Tahoe Public Utility District, pursuant to which Sheppard Mullin provided occasional labor and employment work. While the firm was not actively providing such services to South Tahoe when it started representing J-M, it had done so less than five months earlier and began actively working again on an employment matter for South Tahoe within weeks of starting work on the qui tam action. Sheppard Mullin did not disclose the conflict to either South Tahoe or J-M because it concluded that its advance conflict waiver — contained in both clients' engagement agreements — obviated any need to do so.

When South Tahoe discovered the conflict, it moved to disqualify Sheppard Mullin in the qui tam action. That motion was granted by the federal district court, which concluded that the prospective waiver was "ineffective to indicate South Tahoe's informed consent to the conflict at issue here." J-M then refused to pay Sheppard Mullin's outstanding fees of $1.3 million and demanded the return of the approximately $2.5 million it had already paid.

The fee dispute was submitted to binding arbitration, resulting in an award in favor of Sheppard Mullin. The arbitrators found that, even assuming Sheppard Mullin's conflict waiver was insufficient, the ethical violation was not serious enough to justify disgorgement or forfeiture of fees. The trial court confirmed the award.

However, the Court of Appeal found that J-M's challenge to the enforceability of the engagement agreement as a whole based on the alleged conflict of interest had to be decided by the court, not the arbitrators. *Sheppard, Mullin, Richter & Hampton LLP v. J-M Manufacturing Co., Inc.*, 244 Cal. App. 4th 590 (2016). The Court of Appeal proceeded to find that Sheppard Mullin had failed to provide J-M with sufficient disclosure to allow for informed written consent, as required by Rule of Professional Conduct 3-310(C), notwithstanding the advance conflict waiver, and that the engagement agreement was unenforceable. As a result, Sheppard Mullin was ordered to disgorge its fees. The Supreme Court granted review.

As noted in the preamble to Sheppard Mullin's advance conflict waiver, it is a large firm with "many attorneys and multiple offices." So too are the many law firms nationwide which commonly employ similar advance waivers. These waivers free large firms from having to worry that some other lawyer in some far-flung office may unwittingly represent a party adverse to another client in an unrelated matter — representation which would otherwise implicate the duty of loyalty. And under the American Bar Association Model Rules in effect in almost every state, such advance waivers have generally been upheld. *See, e.g.,* D.C. Bar Assn., Ethics Opn. 309 (2001); N.Y.C. Bar Assn. Com. on Prof. & Jud. Ethics, Formal Opn. 2006-1 (2006).

However, California's rules are different. Historically, the California Rules of Professional Conduct have been more favorable to client autonomy than the ABA with respect to waivers, but California's elevation of decisional freedom is balanced by its corollary emphasis on full disclosure. *See Maxwell v. Superior Court*, 30 Cal. 3d 606, 621-22 (1982), overruled in part on other grounds by *People v. Doolin*, 45 Cal. 4th 390 (2005) (upholding client's consent to a waiver of potential conflict that the Court found problematic because the Court determined that the client's waiver of potential conflicts was made "after extensive disclosure of the risks."). And while California's rules have undergone an overhaul which will bring them closer to the ABA Model Rules as of Nov. 1, 2018, the Com-

mission for the Revision of the Rules of Professional Conduct did not simply adopt ABA Rule 1.7 (governing conflicts) and its comments without modification, instead carefully drawing the language of California's version of the rule to retain the historic emphasis on full disclosure.

Reflecting this emphasis on the importance of disclosure, during oral argument, the justices certainly seemed sympathetic to J-M's position. While acknowledging that the relative sophistication of this client, which had its own in house counsel, might be a factor in Sheppard Mullin's favor, the justices repeatedly expressed concern over the lack of disclosure regarding a known conflict. For example, Justice Gilbert Nares (sitting by designation) asked, "But Sheppard Mullin had that information, why didn't they just tell J-M, we have previously engaged South Tahoe? Why didn't they do that?" And Justice Ming Chin agreed, "When you find out that you are representing two parties in a litigation, as Justice [Goodwin] Liu says, isn't there a duty to give notice rather than hiding it under all of this complexity?" Sheppard Mullin's counsel replied that the purpose of the advance conflict waiver was to obviate the need for such downstream notification.

While the justices' questions certainly seemed to reflect skepticism over the effectiveness of Sheppard Mullin's advance waiver, there is reason to think that the court may be looking for a way to resolve the case without having to reach that issue. Prior to oral argument, the court asked the parties to address the following question: "On March 4, 2010, when plaintiff and defendant signed their engagement agreement, was South Tahoe Public Utility District a current client of plaintiff?"

At oral argument, the parties looked to *Banning Ranch Conservancy v. Superior Court*, 193 Cal. App. 4th 903 (2011), for guidance on this question. In *Banning Ranch*, plaintiff's counsel had represented defendant, the city of Newport Beach, five years earlier pursuant to a "framework" engagement agreement, which provided that counsel would provide legal services to the city on an "as-requested" basis. The city moved to disqualify plaintiff's counsel, asserting that it remained a current client. The Court of Appeal ruled that disqualification was not appropriate, given that the framework agreement specifically conditioned the firm's obligation to handle new matters for the city on subsequent conflict checks and confirmation that the firm would actually take on the new matter. Since that never happened with respect to the Banning Ranch matter (or any other matter), the firm had no continuing attorney-client relationship with the city.

The engagement agreement between Sheppard Mullin and South Tahoe did not contain these crucial provisions. Moreover, the matter described in the South Tahoe engagement letter was simply "general employment matters." Accordingly, the court could distinguish the *Banning Ranch* case if it was inclined to do so.

However, the author predicts that the court will analogize the South Tahoe situation to that of the city of Newport Beach in *Banning Ranch*, meaning that South Tahoe was not a current client at the time that Sheppard Mullin and J-M executed their engagement agreement. If there was in fact no actual conflict as of that date, the court could find that the engagement agreement was not illegal at the time of execution, thus leaving resolution of all other issues to the arbitrators. This would allow the court to sidestep the question of whether Sheppard Mullin's broad advance waiver was effective and avoid the chaos that would result given the common use of similar waivers by large firms nationwide. While such a ruling would leave critics of advance waivers unsatisfied, it would defer for the moment the potential clash between California and other states on the issue.

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