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Some Lessons From Recent Conflicts Cases

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This article reviews some recent conflicts of interest cases, which, although from courts outside New York, have relevance and significance for New York lawyers.

‘Sheppard, Mullin’

The most important decision in this area in 2018 was *Sheppard, Mullin, Richter & Hampton v. J-M Manufacturing Co.*, 6 Cal. 5th 59 (2018). The critical issues were: What are the requirements for obtaining waivers of existing conflicts; is it possible to draft an effective and enforceable advance waiver of potential conflicts; and does a client’s sophistication matter in determining the adequacy of the disclosure necessary to obtain the client’s informed consent?

In March 2010, Sheppard, Mullin, Richter & Hampton (Sheppard Mullin) agreed to take over the representation of J-M Manufacturing (J-M) in a federal qui tam suit brought against J-M on behalf of over 200 public entities for the alleged sale of faulty PVC pipes. J-M faced an exposure of over \$1 billion in damages. Sheppard Mullin’s conflict check revealed that a Sheppard Mullin attorney in a different office previously represented one of the plaintiffs, South Tahoe Public Utility District (South Tahoe), in unrelated employment matters, most recently in November 2009. Because South

Tahoe had signed an advance conflict waiver for non-employment matters, Sheppard Mullin concluded that it could take on the representation of J-M. The engagement agreement between Sheppard Mullin and J-M was negotiated, and, J-M’s general counsel revised certain portions of the agreement, she made no changes to the conflict waiver provision. Sheppard Mullin did not tell J-M about its representation of South Tahoe either orally or in the engagement agreement. The engagement agreement provided for arbitration of any dispute arising under the agreement. After J-M engaged Sheppard Mullin, the firm billed South Tahoe for about 12 hours of work. In 2011, South Tahoe discovered Sheppard Mullin’s representation of both parties and moved to disqualify Sheppard Mullin in the qui tam action. The district court granted the motion, ruling that the simultaneous representation was undertaken without adequately informed waivers in violation of Rule 3-310(C)(3) of the California Rules of Professional Conduct (the Rules) then in effect.

Sheppard Mullin had billed nearly \$3.8 million in fees in representing J-M and over \$1 million was outstanding when it was disqualified. Sheppard Mullin sued for the unpaid fees and sought specific performance of the arbitration provision in their agreement. J-M filed a cross-complaint for breach of contract, breach of fiduciary duty, fraudulent inducement, and sought disgorgement of previously paid fees and exemplary damages. The trial court granted the request to compel arbitration. The arbitrators ruled in favor of Sheppard Mullin, finding, in short, that the conflict of interest did not cause J-M any harm. Sheppard Mullin petitioned to confirm the award and J-M petitioned to vacate it on the basis that the engagement agreement was unenforceable due to the violation of Rule 3-310(C)(3). The trial court confirmed the award, but the Court of Appeal reversed, holding that the matter never should have been arbitrated because Sheppard Mullin’s undisclosed concurrent conflict violated the Rules and rendered the engagement agreement with J-M unenforceable and disentitled it to any fees from J-M while it represented South Tahoe in other matters. Sheppard Mullin appealed.

The California Supreme Court affirmed in part, and reversed and remanded in part. The court agreed that Sheppard Mullin’s failure to inform J-M of its attorney/client relationship with South Tahoe constituted a conflict of interest that

rendered its engagement agreement with J-M unenforceable as against public policy. However, it also ruled, contrary to the Court of Appeal, that the ethical violation did not categorically disentitle the firm from recovering the value of its services under a quantum meruit theory.

There are three elements of this decision that are instructive. First, the seemingly minuscule number of hours the firm worked for South Tahoe was irrelevant to the court's analysis as to whether South Tahoe was a current or former client. Because this engagement had not been terminated, there was a reasonable expectation that it was ongoing at the time J-M retained the firm. The firm had argued that the fact that it continued representation of South Tahoe should not be determinative because it had properly obtained both clients' informed written consent by way of the conflict waiver in both clients' engagement agreements. The court rejected this argument because J-M's consent could not have been "informed" where Sheppard Mullin concealed the identity of a known, current client, and thus an actual conflict. Second, with respect to advance waivers, the court did not reject their use in future cases under the revised California Rules of Professional Conduct. However, the court was emphatic that: "Because this case concerns the failure to disclose a current conflict, we have no occasion here to decide whether, or under what circumstances, a blanket advance waiver ... would be permissible."

Third, the court addressed the subject of client sophistication in connection with the comprehensive amendments to California's Rules of Professional Conduct, approving language from Rule 1.7 of the Model Rules. The court said that, with respect to advance waivers, "the client's experience and sophistication and the presence of independent representation in connection with the [informed] consent are 'relevant' to the effectiveness of that consent, and that the new rule 'does not preclude an informed written consent [] to a future conflict in compliance with applicable case law.'" However, the client's level of sophistication does not come into play where—as in this case—there is an actual conflict to disclose.

This case has several lessons that are important for lawyers and law firms everywhere. First, advance waivers of potential future conflicts are permissible in appropriate circumstances, subject to compliance with the applicable rules of professional conduct. Second, a client's sophistication may be considered in determining whether its consent was informed. Third, an advance waiver can never be used to support the

argument that the client had given informed consent when the conflict actually existed, but had not been explicitly disclosed at the time of the commencement of the conflicting engagement.

'Regal Cinemas'

Another case from California, *Regal Cinemas v. Shops at Summerlin*, 2017 U.S. Dist. LEXIS 149497 (E.D. Cal. 2017), illustrates one way to avoid having a marginally current client create a concurrent conflict. Regal Cinemas (the plaintiff) sued certain defendants, including Howard Hughes Corp. (HHC) for breach of contract and related claims. The defendants moved to disqualify plaintiff's counsel (the firm) on the basis that the firm had terminated its representation of HHC for the purpose of representing Regal Cinemas in the litigation. According to the defendants, HHC and the firm entered an "ongoing" attorney-client relationship pursuant to an engagement letter executed in 2015 and the firm provided legal advice to HHC as late as June 2016. In October 2016, the firm informed HHC that it had hired a new partner who represented a client that intended to sue HHC. The firm asked HHC for a conflict waiver which HHC declined to provide. Shortly thereafter, the firm sent a letter to HHC terminating the attorney-client relationship "effective immediately," and filed the litigation on behalf of the plaintiff. The defendants argued that the firm could not engage in a "classic hot potato maneuver" in order to avoid the rule against concurrent representations by terminating an existing client for the purpose of taking on a representation adverse to that client. In response, the plaintiff argued that the firm's attorney-client relationship with HHC was not ongoing because the matter that was the subject of the 2015 engagement letter concluded in January 2016 and that the legal advice that the firm provided to HHC in June 2016 was nothing more than follow up. As evidence that the 2015 engagement was discrete, the plaintiff pointed to the 2015 engagement letter, which stated that the firm would perform additional legal services as the parties "may agree upon from time to time." The plaintiff further argued that the termination letter was directed to HHC as a former client and was sent only out of an abundance of caution. The court agreed that the engagement letter language that the parties would agree to additional work from "time to time" indicated that 2015 representation was discrete and not ongoing, and that the June 2016 follow-up communications that the firm had with HHC regarding the concluded matter did not mean that the matter was ongoing. On this basis, the court ruled that (1) HHC was a former client and (2) the subject matter of the litigation did not substantially

relate to the subject matter of the firm's representation of HHC.

This case illustrates the dual importance of clearly articulating the scope of a representation in an engagement letter and timely drafting and sending termination letters closing the file and ending the representation. Where, out of an abundance of caution, a firm elects to send a termination letter sometime after the representation has concluded, the letter should state that the representation ended at the completion of the matter and that the letter is intended only to confirm the prior termination. It is also critical that confirmation of termination be completed before the commencement of representation in a matter adverse to the now former client. Failure to do so could lead to disqualification, as happened in another recent decision, *McClain v Allstate Prop. & Cas. Ins. Co.*, Case No. 3:16CV843-TSL-RHW (S.D. Miss. Northern Div., April 25, 2017), where a lawyer was disqualified when the termination letter was sent one day after execution of engagement agreement with a new client. Similarly, continued involvement in an engagement even after delivering a clear termination letter will void the value of the termination and the client will be treated as a continuing and not a former client. This was borne out in the case of *Cesso v. Todd*, 82 N.E.3d 1074 (Mass. App. 2017), where the lawyer's continued involvement after purportedly terminating the engagement left him vulnerable to a malpractice claim arising after the date of what would otherwise have been an effective termination letter.

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