

Firm's Agreement With Opposing Party Creates Unconsentable Conflict

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Johnson v. Nextel Communications, Inc., ___ F.3d ___, 2011 WL 4436263 (2d Cir. 2011)

Brief Summary

The U.S. Court of Appeals for the Second Circuit held that an agreement between an opposing party and a law firm which called for the firm to aggregate its clients' claims created a unconsentable conflict.

Complete Summary

In an underlying action, plaintiff employees hired defendant law firm to bring discrimination claims against the employees' employer. The firm subsequently entered into a Dispute Resolution and Settlement Agreement (DRSA) with the employer. Under that agreement, the employer was to pay the firm \$2 million if the firm could persuade the employees to drop their claims and instead agree to resolve their dispute under the terms and procedures set out in the DRSA. Moreover, the employer was required to pay additional amounts to the firm that were contingent upon how quickly litigation progressed. The DRSA required a number of additional concessions from the employees, including the requirement that they continue to be represented by the firm throughout the litigation. Finally, the agreement required the employer to retain the firm as a legal consultant for two years following resolution of the employees' claims. The total potential value of the DRSA to the firm was \$7.5 million.

When the firm presented an outline of the DRSA's terms to the employees and sought their agreement to the DRSA's terms, the firm simultaneously procured conflict waivers from each client. Because a handful of the clients did not agree to the DRSA, the firm and the employer reduced the initial \$2 million payment accordingly.

The employees then brought the present suit alleging, *inter alia*, breach of fiduciary duty, breach of contract, and fraud in the inducement claims against the firm based on its entry into the DRSA. The U.S. District Court for the Southern District of New York granted the firm's motion to dismiss for failure to state a claim.

On appeal, the Second Circuit vacated the trial court's dismissal of the lawsuit and remanded the case. Regarding the employees' breach of fiduciary duty claim, the court held that the DRSA created a unconsentable conflict for the firm.

The court held that the conflict was unconsentable for two reasons. First, the class-protection provisions of Fed. R. Civ. P. 23 were not at play, and therefore the firm had a duty to represent the employees' interests individually rather than collectively. Similarly, the DRSA created an irresistible incentive for the firm to handle its clients' claims in the aggregate rather than individually. The court held that the additional incentives in the DRSA, beyond the initial \$2 million payment, severely aggravated the already unconsentable conflict.

The conflict was also unconsentable because its nature was too complex for the clients to give *informed* consent without hiring another attorney. A lawyer does not fulfill his or her representational obligations, the court held, by presenting a proposal to a client which requires the hiring of a second attorney to make an informed decision.

The court also held that the employees had viable claims for breach of contract and fraud in the inducement based on the fact that the retainer agreements allegedly called for individualized representation, whereas the DRSA required the aggregation of the employees' claims. Without discussion, the court additionally held that the employees had a viable claim for malpractice. Finally, the court held that the employees had adequately alleged a cause of action against the employer for aiding and abetting the firm's breach of fiduciary duty.

Significance of Opinion

This opinion demonstrates how a conflict of interest can help form the basis for certain civil claims.

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