Supreme Court Case No. S232946

IN THE SUPREME COURT

OF THE STATE OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON, LLP *Plaintiff and Respondent,* v. J-M MANUFACTURING CO., INC., *Defendant and Appellant.*	Court of Appeal, Second Appellate District, Division Four Case No. B256314 Los Angeles Superior Court Case No. YC067332 Honorable Stuart Rice, Judge

ANSWER TO PETITION FOR REVIEW

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INTRODUCTION

This is a case of lawyers behaving badly and trying to avoid the consequences of having done so. Here, lawyers sought to evade the most basic ethical duty—to be loyal and zealous advocates for their client. They focused entirely on the welfare of their own law firm instead of its clients, turning their fiduciary duty on its head. Perhaps some hypothetical case may present nuanced ethical issues, but this is not that case.

This case involves a straightforward ethical violation that goes to the very heart of the attorney-client relationship and therefore voids the contract between the parties: a law firm represented one of its clients in litigation against another client. Although its conflict check revealed this actual conflict, the law firm chose not to tell the litigation client that it was also representing an opposing party in other matters. It didn't breathe a word about the conflict to the litigation client until the opposing party sought (successfully) to disqualify the law firm from representing the litigation client. That's not a complicated ethical scenario; it's not even a close call.

Despite the law firm's handwringing over the Court of Appeal getting the decision wrong in this particular case, its Petition fails to meet either requirement for review: the need to secure uniformity of decision or to settle an important question of law. In short:

1. The Petition asserts that the Court of Appeal violated the rules governing the proper forum for determining whether a contract containing an arbitration provision is illegal. But the decision the Petition relies on, *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1 (*Moncharsh*), unambiguously established two different rules. The one that applies here involves the purely judicial determination of whether a contract is *entirely* illegal and thus, whether the case should not have

been compelled to arbitration in the first place. The other standard, inapplicable here, applies when a *single provision* of the contract is challenged; that question must be determined by the arbitrator, subject to minimal judicial review. The Petition also argues that the Court of Appeal erred in finding that the contract at issue was illegal in its entirety. This is largely a new argument not raised in the Court of Appeal. In any event, the legal standard, properly applied by the Court of Appeal, is well-worn.

2. The Petition's second issue—the push by some large law firms to validate boilerplate, non-specific "advance" waivers of conflicts of interest—fares no better. Whatever the general merits of such "advance waivers" (and we submit they are dubious), there is and can be no doubt that a client—in advance or otherwise—cannot without knowing the relevant facts waive a direct, actual, existing conflict of interest known to the attorney. Such a waiver completely undermines the attorney's loyalty to the client. There is simply no plausible argument—much less legal authority—that by generic, obscure, amorphous language, a law firm can knowingly hoodwink clients into waiving actual conflicting loyalty duties. In any event, the Court of Appeal's decision did not undermine all advance conflict waivers—just those, as here, involving undisclosed, known conflicts of interest. To the extent that the Petition urges this Court to broadly change the ethical rules regarding advance conflict waivers, the proper process is not judicial fiat, but the quasi-legislative, rule-making process—a process that recently considered but declined to make changes in the ethical rules governing conflicts of interest.

3. That leaves the Petition's claim that attorneys need not disgorge ill-gotten fees obtained when acting under an actual conflict of interest that undermines their duty of loyalty. The established law is otherwise. There's no conflict or important unresolved question of law presented.

The Court of Appeal made clear that it was applying established law. And so it was. The Petition challenges the Court of Appeal's application of that established law, but that's not a ground for review. Review should be summarily denied.

RELEVANT BACKGROUND

A. The Law Firm Discovers—And Conceals—Its Actual Loyalty Conflict In Simultaneously Representing J-M And South Tahoe.

J-M Manufacturing Company, Inc. (J-M) approached Sheppard Mullin to defend J-M in a federal qui tam action. (Opn., pp. 3-4.)

Sheppard Mullin ran a conflict check and discovered that the firm represented South Tahoe, an adverse party in the qui tam action. (Opn., pp. 2, 4.) For many years, Sheppard Mullin had provided South Tahoe with labor and employment advice on an ongoing, as-needed basis. (Opn., p. 4; 2 AA 288.)

The Sheppard Mullin partners responsible for the J-M litigation did not inform J-M or South Tahoe what their conflict check revealed. (Opn., p. 4.) They claimed they thought it was unnecessary because Sheppard Mullin had not performed any actual work for South Tahoe in the past five months and South Tahoe had signed an engagement letter that broadly waived conflicts. (*Ibid.*) They did not even mention the issue to Jeffrey Dinkin, the Sheppard Mullin partner responsible for South Tahoe. (2 AA 278-280, ¶¶ 13-14, 17.) Instead, "Sheppard Mullin attorneys assured [J-M] there were no conflicts in representing J-M in the Qui Tam Action." (Opn., p. 5.) They then provided J-M with an engagement agreement that purported to waive Sheppard Mullin's duty of loyalty regarding all "current, former, and future clients" that Sheppard Mullin "may" currently have or later obtain. (*Ibid.*) Sheppard Mullin never discussed or explained the conflict waiver provision or told J-M about its relationship with South Tahoe. (*Ibid.*)

B. South Tahoe Raises The Conflict; The Law Firm Still Says Nothing To J-M And Tries To Pay South Tahoe To Waive The Conflict.

Just three weeks after J-M signed the engagement letter, Sheppard Mullin resumed active work for South Tahoe. (Opn., p. 6.) It continued actively working for South Tahoe for a full year. (2 AA 278-279.) Still, Sheppard Mullin did not advise either client (or even Dinkin) about the conflict. (2 AA 280; Opn., p. 18.)

A year later, South Tahoe discovered the truth and demanded that Sheppard Mullin disqualify itself from simultaneously representing J-M and South Tahoe. (Opn., p. 6.) Sheppard Mullin still did not inform J-M of the issue for another fifty days. (*Ibid.*)

Ultimately, Sheppard Mullin tried to buy its way out of the conflict. In a letter to South Tahoe, it acknowledged that it had "'provide[d] labor advice to you for the last 9 years.'" (Opn., p. 7.) It offered to "'promptly pay to [South Tahoe] the sum of $100,000'" and to provide free "'legal advice and services'" if South Tahoe would "'consent to the Firm's continued representation of J-M in the pending federal district court action and any other state or federal action that [South Tahoe] and J-M may be involved in.'" (*Ibid.*) South Tahoe declined. (*Ibid.*) Sheppard Mullin upped the offer to $250,000, but South Tahoe continued pressing for disqualification. (Opn., pp. 7-8.)

The district court granted South Tahoe's motion to disqualify Sheppard Mullin. (Opn., p. 8.) The court rejected the firm's argument that it could unilaterally drop South Tahoe as a client, noting that a published decision in another case had previously rejected Sheppard Mullin's attempt to use that very tactic. (Opn., p. 7.)

C. Trial Court And Arbitration Proceedings.

Sheppard Mullin sued J-M for $1.3 million in unpaid legal fees arising from the qui tam action. (Opn., p. 8.) J-M cross-complained for various remedies, including disgorgement, based on both contract and tort theories. (*Ibid.*)

Over J-M's objection, the trial court compelled the case to arbitration. (Opn., p. 8.) J-M had opposed arbitration, arguing that the entire engagement agreement was illegal and void as against public policy. (*Ibid.*) The Court of Appeal summarily denied J-M's writ petition for interlocutory relief, and the parties proceeded to arbitration. (Opn., p. 9; see *State Farm Fire & Casualty v. Hardin* (1989) 211 Cal.App.3d 501, 506 [order compelling arbitration not immediately appealable].)

The trial court ultimately confirmed the arbitrators' award in favor of Sheppard Mullin. (Opn., p. 10.)

D. Court Of Appeal Decision Applying Established Law.

The Court of Appeal reversed, explaining that each step of its multi-step analysis followed existing California law. (Opn., pp. 2-3, 12-15, 17, 19-22, 26-29.)

First, the court recognized that under well-established California law, a challenge to the legality of an entire contract that contains an arbitration provision must be determined by the court rather than the arbitrator. (Opn., pp. 2, 12-15.) While judicial review of an arbitration decision is typically limited to the statutory grounds for vacatur, established principles require courts to determine the legality of the entire contract de novo. (Opn., pp. 11-16.) The decision quoted and discussed the unambiguous language of multiple Supreme Court and Court of Appeal cases and Witkin, which all repeat the same rule. (*Ibid.*, quoting *Moncharsh, supra*, 3 Cal.4th 1, *Loving & Evans v. Blick* (1949) 33 Cal.2d 603 (*Loving*), *Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21 (*Ahdout*), *Lindenstadt v.*

Staff Builders, Inc. (1997) 55 Cal.App.4th 882 and 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 450, p. 490.) The same authorities make it clear that challenges to the entire contract must be treated differently than challenges to only a portion of the contract, since if the entire contract is illegal, "the arbitration clause would not be enforceable" whereas the illegality of a portion of a contract is an arbitrable issue. (Opn., pp. 13-15, quoting *Moncharsh, supra*, 3 Cal.4th at pp. 29-32.)

Next, the Court of Appeal determined that under the particular facts here, Sheppard Mullin violated the rules of professional responsibility by failing to disclose the conflict with South Tahoe. (Opn., pp. 16-22.) It held that this violation rendered the entire engagement agreement unenforceable because the duty of loyalty presents a public policy of "paramount concern"—the preservation of public trust in the administration of justice and in the integrity of the Bar—that strikes at "the very foundation of an attorney-client relationship" created by the engagement agreement and permeates the contract relationship. (Opn. pp. 22-26.) The Court explained that public policies created by a variety of sources, including the rules of professional responsibility, can invalidate contracts as a whole. (Opn., pp. 22, 24-26.)

Finally, the Court of Appeal held that Sheppard Mullin's ethical violation precludes it from recovering compensation for its services and entitles J-M to disgorgement of fees previously paid. (Opn., pp. 26-30.) The Court again expressly applied existing California law that had "drawn a line between cases involving serious ethical violations such as conflicts of interest, in which compensation is prohibited, and technical violations or potential conflicts, in which compensation may be allowed." (Opn., p. 26.) The Court rejected Sheppard Mullin's argument that prior cases required a showing that the client had suffered damages from the attorney's misconduct; no such showing is required in cases of

direct conflicts, as opposed to mere technical violations of conflict rules. (Opn., pp. 28-29.)

The Court of Appeal remanded for a determination of whether the actual conflict existed at the beginning of the J-M engagement or emerged three weeks later, when Sheppard Mullin resumed active work for South Tahoe. (Opn., pp. 30-31.)

The Court of Appeal denied Sheppard Mullin's rehearing petition.

ARGUMENT: THERE IS NO GROUND FOR REVIEW

Review is appropriate only when "necessary to secure uniformity of decision or to settle an important question of law." (Cal. Rules of Court, rule 8.500(b)(1).) Neither ground exists here. The Court of Appeal simply applied well-established law—often, law repeatedly pronounced by this Court—to the particular facts here. There is no conflict or any need to clarify an unsettled issue.

I. THERE IS NO IMPORTANT QUESTION OF LAW TO RESOLVE.

A. The Law Regarding Challenges To The Legality Of An Entire Contract Containing An Arbitration Provision Is Well Established.

The Petition claims that the Court of Appeal created a "new rule" for reviewing arbitration cases in which a party challenges the contract's overall legality. (Petition, pp. 8-13.) Not so.

The Court of Appeal followed well-established law regarding review of a claim that the *entire contract* is illegal. The rule that the Petition relies on applies only to the illegality of a *single provision*. (Opn., pp. 2, 12-16.) That distinction is well settled by multiple pronouncements of this Court and other courts, as recognized by Witkin.

1. The established rule: The legality of the entire contract is for the court—not for arbitrators; when a court decides that issue, it is not reviewing an arbitration award.

This Court has repeatedly held that the legality of the *entire* contract is a purely judicial determination—not one for arbitrators. Courts must undertake that analysis *before*, and as part of, ordering the case to arbitration.

This Court could not have been more clear in *Moncharsh*: "If a contract includes an arbitration agreement, and grounds exist to revoke the entire contract, such grounds would also vitiate the arbitration agreement. Thus, if an otherwise enforceable arbitration agreement is contained in an illegal contract, a party may avoid arbitration altogether." (*Moncharsh*, *supra*, 3 Cal.4th at p. 29, citing Code Civ. Proc., § 1281.2.)

"By contrast," when "the alleged illegality goes to *only a portion of the contract* (that does not include the arbitration agreement), the entire controversy, including the issue of illegality, remains arbitrable." (*Moncharsh, supra,* 3 Cal.4th at p. 30, italics added.) In those circumstances, the parties must submit the illegality issue to the arbitrator, and the courts can only narrowly review the arbitrator's determination. (*Id.* at p. 32.)

In fact, this Court recognized the same distinction decades earlier in *Loving*, *supra*, 33 Cal.2d 603. Again, the Court was crystal clear that the legality of the entire transaction is an issue for judicial determination. (*Id.* at pp. 609-610.) "The question of the validity of the basic contract being essentially a *judicial* question, it remains such whether it is presented" in a proceeding to compel arbitration or to vacate an award. (*Id.* at p. 610, italics added.) If presented during a proceeding to compel arbitration, the court should deny arbitration if the contract is entirely illegal. (*Ibid.*) And if presented during a proceeding to vacate the award, the award

must be vacated for excess of power, because if the case was not arbitrable, the arbitrator had no power to make any decision whatsoever. (*Ibid.*) Even if the arbitrator decides the issue of legality of the entire transaction, that issue is still "one for judicial determination upon the evidence presented to the trial court, and any preliminary determination of legality by the arbitrator, whether in the nature of a determination of a pure question of law or a mixed question of fact and law, should not be held to be binding upon the trial court." (*Id.* at p. 609.)

The rule is so well established that Witkin repeats it. (1 Witkin, Summary of Cal. Law, *supra*, Contracts, § 450, p. 490.)

The issue on appeal here was the trial court's initial order compelling arbitration and its reaffirmation of that order in refusing to vacate. *Both* orders were reviewable in the appeal from the final judgment. (*State Farm Fire & Casualty v. Hardin, supra,* 211 Cal.App.3d at p. 506.) J-M raised the "entire illegality" issue in opposing both the petition to compel arbitration (Opn., pp. 8-9) and the petition to confirm (Opn., p. 10). Thus, there is no question that the appeal here went to the illegality of the entire contract—by challenging the *trial court's* pre-arbitration determination granting the motion to compel and its post-arbitration reaffirmation of that ruling.

Unbroken precedent holds that those are judicial issues for *courts*, trial and appellate, to decide.

2. Only challenges to the legality of a particular provision are reviewed narrowly on public policy grounds.

This Court's *Moncharsh* decision recognized a rule of limited judicial review of an arbitrator's decision as to the legality of a "single provision of the overall employment contract." (*Moncharsh, supra*, 3 Cal.4th at p. 32.) Such provision-illegality challenges must be decided by the arbitrator and thus, can trigger concerns

about arbitral finality. (*Id.* at pp. 30-33.) *Moncharsh* authorizes a narrow public-policy review of such single-provision arbitral decisions: "We recognize that there may be some limited and exceptional circumstances justifying judicial review of an arbitrator's decision *when a party claims illegality affects only a portion of the underlying contract.*" (*Id* at p. 32, italics added.)

But *Moncharsh* made clear that the concerns that require limited review of an arbitral determination of a particular provision's illegality do not apply to challenges to the entire contract, which are not arbitrable: "[T]he normal rule of limited judicial review [of an arbitrator's decision] 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.) But such "'rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable *where the issue of illegality of the entire transaction*'" is raised. (*Id.* at p. 31, quoting and adding italics to *Loving, supra,* 33 Cal.2d at p. 609.)

This Court recently reaffirmed the *Moncharsh* distinction in *Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909. It recognized "that [full] judicial review may be warranted when a party claims that an arbitrator has enforced an entire contract or transaction that is illegal." (*Id.* at p. 917.) It then stated that more limited judicial review is appropriate only "'when a party claims illegality affects only a portion of the underlying contract.'" (*Ibid.*)

The Courts of Appeal have consistently done the same. (E.g., *Epic Medical Management, LLC v. Paquette* (2015) 244 Cal.App.4th 504, 513 [applying *Moncharsh*'s "'limited and exceptional circumstances'" review of arbitrator's

determination regarding partial illegality only *after* rejecting argument that the contract was entirely illegal].)

* * * * *

Precedent sets forth the well-worn distinction between challenges to the legality of the entire contract and challenges to a particular provision. There is no undecided issue warranting this Court's attention.

B. The Desire Of Some Large Law Firms To Obtain So-Called Advance Conflict Waivers Presents No Important, Unresolved Issue.

The Petition essentially argues that some large law firms are too big to be hamstrung by long-established ethical rules that govern other lawyers, such as the rule requiring clients' informed consent to potential conflicts. But this case concerns an *actual* conflict, not a potential one. The rules governing this situation are clear; they pose no important, unresolved question of California law. And to the extent that the Petition seeks to remake California's ethical rules, the Petition is the wrong vehicle.

1. This case is about an actual conflict of interest, not a potential one that might be addressed by an advance conflict waiver.

This case does not present any real issue concerning advance conflict waivers. As the Petition's authorities hold, an advance conflict waiver is "one that is granted *before* the conflict arises and generally *before* its precise parameters (e.g., specific adverse client, specific matter) are known." (D.C. Bar Assn., Ethics Opn. 309 (2001) (D.C. Ethics Opn. 309), italics added; see also ABA Model Rules of Prof. Conduct, rule 1.7, com. 22 [advance waiver concerns "conflicts that might arise in the future"].) But here, the clients—J-M and South Tahoe—were known

adversaries in the J-M qui tam action. The law firm failed to disclose an existing, actual conflict.

It is undisputed that South Tahoe was the firm's client long before J-M engaged the firm to defend it. (Opn., pp. 4, 17.) That representation, as defined by the engagement agreement between Sheppard Mullin and South Tahoe, was not limited to a particular case or time period. Rather, South Tahoe retained the firm to provide periodic advice on labor and employment issues on an as-needed basis, year in and year out. (2 AA 288.) The firm provided such advice just five months before and within three weeks after undertaking the J-M representation. (Opn., pp. 4, 6, 17.)

There is no hint that the firm or South Tahoe terminated their on-going relationship before J-M signed its engagement agreement, or that South Tahoe entered into a new engagement agreement in the weeks following the J-M agreement. The firm's own, post-dispute correspondence confirmed the "'long-standing relationship between [South Tahoe] and our Firm,'" during which the firm had been "'pleased to provide labor advice to you for the last 9 years.'" (Opn., p. 7.)

And it is undisputed that the firm's conflict check identified the conflict with South Tahoe. (Opn., p. 17.) The conflict-waiver provision acknowledged that the firm "may *currently* or in the future represent" other clients, "including *current*, former, and future clients . . . in matters involving [J-M]." (Opn., p. 5.) The firm never discussed with J-M or explained to it what these conflicts might be. (*Ibid.*) In fact, the firm lied, telling J-M that there were no conflicts. (*Ibid.*)

Even under the Petition's proffered view, where advance waivers are allowed, the lawyer still "must make full disclosure of facts of which she is aware, and hence cannot seek a general waiver where she knows of a specific *impending*

adversity unless that specific instance also is disclosed." (D.C. Ethics Opn. 309, italics added.) Here, there is no doubt that the South Tahoe representation was at least impending. The firm had contracted to provide South Tahoe with periodic labor-and-employment advice. (2 AA 288.) J-M's lawyers at the firm did not even bother to check with the partner handling South Tahoe, which presumably would have revealed that the conflict was impending—it would spring into existence the moment South Tahoe returned for its next installment of periodic advice, as it had done for the better part of a decade and as it did just three weeks after the J-M engagement agreement. (See pp. 9-10, *ante*.) Even if the firm were not actively representing South Tahoe at the moment J-M signed the engagement agreement, an advance waiver would not permit the firm to hide an impending, actually-contemplated adversity.

2. Initiating changes to the rules for advance conflict waivers is appropriately left to other forums.

The current ethical status of advance conflict waivers presents no unresolved issue in California. The existing rules are clear.

But if there is to be a challenge, the appropriate forum is the ethics rule-making process. As recently as 2010, the State Bar considered a proposal to change Rule 3-310 to permit advance conflict waivers to function more like the way the Petition urges. (Proposed Rule 1.7, com. 22 <http://ethics.calbar.ca.gov/LinkClick.aspx?fileticket=7MbhFr6ih-w%3D&tabid=2161> [as of Mar. 28, 2016] (Proposed Rule. 1.7, com. 22) [draft dated Feb. 28, 2010].) That proposal was never adopted. A petition for review is the wrong vehicle to attempt to revive that unsuccessful rule-making effort to weaken California ethical standards.

Here is the backstory: In early 2002, the ABA revised the Model Rules of Professional Conduct to specifically permit broad, open-ended advance conflict

waivers by sophisticated parties represented by independent counsel. (ABA Model Rules of Prof. Conduct, rule 1.7, com. 22; see ABA Com. on Prof. Ethics, Opn. No. 05-436 (2005) p. 2.) In 2005, the ABA issued Formal Opinion 05-436 elaborating on that model rule and its comments. The D.C. Bar Association and the Restatement tackled the issue in the same time frame. (See Petition, p. 22.)

In 2008, with all of this information in hand and "[f]ollowing intensive lobbying efforts by large law firms," the California Rules Revision Commission proposed a draft revision to California's Rules of Professional Conduct that was modeled on ABA Model Rule 1.7. (Buckner, *Addressing the Intricacies of Future Conflict Waivers* (2008) 50-NOV Orange County Law. 46, 47; see Proposed Rule 1.7, com. 22.) Proposed California Rule 1.7 tracked much of the sea-change that the Petition now advocates, i.e., open-ended advance conflict waivers if the client is an "experienced user" of legal services and is represented by independent counsel. (*Ibid.*) The proposal was considered as recently as 2010. (See Proposed Rule 1.7 [dated Feb. 28, 2010].)

Proposed Rule 1.7 was never adopted. Thus, California considered, but never changed, the rules that protect clients by ensuring their attorneys' loyalty. End-running that process via a petition for review is improper.

For one thing, it is not this Court's proper role to change professional responsibility rules in the guise of reviewing a Court of Appeal decision that applies existing law. The rule-making process affords *all* stakeholders with *notice* and the opportunity to *comment* in a way that the briefing process does not. End-running that process is particularly inappropriate when, as here, the suggested change was considered, but failed to be adopted just a few years ago. Significantly, the proposal failed despite the so-called "trend" toward adopting the view of the ABA Model's Rules.

In addition to being more open and accessible, the rule-making process is fairer and more credible where the issue at stake is whether to change ethical rules in a way that helps attorneys to the detriment of their clients.

C. The Court Of Appeal Applied Existing Law Holding That Disgorgement Is Required For Some But Not All Conflicts Of Interest.

The Petition asserts that the Court of Appeal "created a per se rule 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 the conflict damaged the client—automatically requires an attorney to disgorge all earned legal fees." (Petition, p. 23; see also Petition, pp. 26-30.) The Court did no such thing. It expressly stated that it "follow[ed] established California law" to determine that *in these particular circumstances* the law firm was not entitled to fees. (Opn., p. 3.)

On its face, the Opinion states that not every conflict of interest is sufficient to warrant disgorgement and denial of fees. It distinguishes between "serious" conflicts of interest and "technical violations or potential conflicts." (Opn., pp. 26-29 & fn. 10.) It devotes numerous pages to explaining that the firm's violation was so serious that it cut to "the very foundation of [the] attorney-client relationship." (Opn., pp. 18, 22-27.) The Petition itself candidly acknowledges that the Court of Appeal held that disgorgement and forfeiture were required because the firm had committed a "'serious ethical breach.'" (Petition, p. 24.) So, contrary to the Petition's assertion, the Court of Appeal did not create a per se rule requiring fee forfeitures for minor ethical breaches. Rather, the Court made a factual determination that the ethical breach here was very serious, requiring disgorgement.

This is nothing new. California case law consistently draws the same distinction. It requires forfeiture as a matter of law when an attorney violates ethical duties by agreeing to represent one client in a suit against another client. (*Goldstein v. Lees* (1975) 46 Cal.App.3d 614 (*Goldstein*); *Jeffry v. Pounds* (1977) 67 Cal.App.3d 6 (*Jeffry*); *A.I. Credit Corp., Inc. v. Aguilar & Sebastinelli* (2003) 113 Cal.App.4th 1072 (*A.I. Credit Corp.*).) That situation is deemed so serious as to require forfeiture as a matter of law; by contrast, minor "technical violations" of conflict rules may allow some balancing of the equities. (*A.I. Credit Corp., supra*, 113 Cal.App.4th at p. 1079; see *Jeffry, supra*, 67 Cal.App.3d at p. 12 [for serious violations, forfeiture is as a matter of law; reversing trial court's finding that no ethical violation occurred and instructing that forfeiture is mandatory].)

Pringle v. La Chapelle (1999) 73 Cal.App.4th 1000, illustrates the distinction. There, an attorney defended aligned (not adverse) parties—a corporation and a corporate officer—against a harassment claim. (*Id.* at p. 1002.) Both the officer and the corporation waived the *potential* conflict, but the corporation's waiver was signed by the wrong corporate officer. (*Id.* at pp. 1004-1005.) *Pringle* held that the officer could not avoid paying his own legal fees by relying on a purely technical problem with the corporation's waiver of a purely potential conflict. (*Id.* at pp. 1005-1006.)

By contrast, *A.I. Credit Corp.* made clear an equity-balancing test is neither necessary nor appropriate for disqualifiable *actual* conflicts committed when an attorney represents one client in a suit against another of his clients. (*A.I. Credit Corp., supra*, 113 Cal.App.4th at p. 1079.)

That has long been the law. The attorney forfeits his fees even when no relevant confidential information could have been revealed. (*Jeffry, supra*, 67 Cal.App.3d at pp. 9-10.) This rule applies even when the attorneys did not act

"with dishonest purpose or deliberate unethical conduct." (*Id.* at p. 11.) And it holds regardless whether the client suffered harm or disgorgement may result in a "windfall" for the client. (*Goldstein, supra*, 46 Cal.App.3d at pp. 623-624 [rejecting argument; windfall is irrelevant; forfeiture is not for client's sake, but because courts do not give effect to illegal contracts]; cf. Petition, pp. 23, 29.) Indeed, this Court cited this line of cases approvingly, noting that courts disallow compensation in cases of direct conflicts because those cases involve "violations of a rule that proscribed the very conduct for which compensation was sought." (*Huskinson & Brown, LLP v. Wolf* (2004) 32 Cal.4th 453, 463 [distinguishing such violations from lesser ethical violations involving fee-sharing agreements between attorneys, where referral fee-splitting is not permissible, but quantum meruit is allowable to collect for actual services performed].)

In sum, the Court of Appeal *agreed* with the position advanced by the Petition that not every violation of ethical and conflict rules goes to the heart of the attorney-client relationship. (Petition, p. 29.) But, the *kind* of violation is crucial. Some violations are so serious as to require forfeiture.

II. THERE IS NO CONFLICT AMONG THE COURTS OF APPEAL THAT NEEDS TO BE SETTLED.

A. There Is No Conflict In California Law Regarding Review Of Illegality Of Contracts.

1. The Courts of Appeal consistently hold that limited judicial review applies only to the arbitral issues of particular-provision illegality—not illegality of the entire contract.

The Petition points to a number of decisions it claims conflict with the Court of Appeal's analysis of judicial review of contractual illegality. There is no conflict. There is just a distinction between the review of *court* decisions regarding

entire-contract illegality and arbitral decisions regarding single-provision illegality—a distinction recognized by the opinion and cases before it (§ I.A., *ante*).

For example:

- The Petition contends that *Cotchett, Pitre & McCarthy v. Universal Paragon Corporation* (2010) 187 Cal.App.4th 1405, 1418 "*rejected* the proposition" that contract illegality was to be decided by the courts. (Petition, pp. 11-12.) Not so. *Cotchett* is a particular-provision illegality case that was properly subject to arbitration: "UPC makes no claim that the arbitration clause in the retainer agreement was itself invalid or unenforceable, *or that the fee dispute should not have been submitted to JAMS.*" (*Cotchett, supra,* 187 Cal.App.4th at p. 1417, italics added.) The appellant challenged only the unconscionability of a single provision—the amount of fees—that did not go to the very heart of the attorney-client relationship created by the engagement agreement. (*Ibid.*)
- A number of cases require an explicit legislative expression of public policy (under the narrower arbitration-review standard) to vacate the award. (Petition, p. 10.) But those cases did not involve challenges to the entire agreement. Instead, they were all particular-provision disputes, requiring limited judicial review of the arbitrator's determination. (E.g., *City of Palo Alto v. Service Employees Internat. Union* (1999) 77 Cal.App.4th 327, 338-339 [arbitrator's award of reinstatement as a remedy violated public policy].) When those cases considered claims of entire-contract as well as particular-provision illegality, they articulated the distinction between the two types of challenges. (E.g., *Ahdout, supra,* 213 Cal.App.4th 21, 33-38 [first

deciding that agreement was not entirely illegal and thus not subject to review under *Loving*; then considering partial-illegality rule that required limited judicial review].)

2. The decision creates no conflict regarding challenges to the entire contract.

Relying on *Loving, supra,* 33 Cal.2d 603, the Petition argues that a contract can only be entirely illegal if it violates a statute. (Petition, p. 9.) But *Loving* did not hold or suggest that this is the *only* way a contract can be entirely illegal. A contract is unlawful when it is contrary to an express provision of law; a policy of express law, though not expressly prohibited; or otherwise contrary to good morals. (Civ. Code, § 1667.) It is well established that a contract can be illegal when it violates non-statutory rules and regulations, e.g., ethical rules, as the Opinion's authorities establish. (Opn., pp. 24-26.)

The Petition fares no better in its next argument: The assertion that the decision creates "confusion" about what constitutes a challenge to the illegality of an entire agreement. (Petition, pp. 14-16.)

The public policy violation here infects the entire agreement; it undermines the "very foundation of the attorney-client relationship" that was the subject of the engagement agreement. (Opn., pp. 22-26.) The violation permeates the relationship. The Opinion devotes page after page to explaining how the ethical violation of the duty of loyalty here strikes to the heart of the relationship.

That is the direct opposite of the cases that the Petition describes as conflicting. (E.g., *Ahdout, supra*, 213 Cal.App.4th at pp. 24-25, 36 [provision calling for an unlicensed contractor to work for LLC did not "infect the entire" LLC operating agreement that principally defined the company's structure, each parties' capital contributions, members' rights, management duties, and terms for

dissolution]; *Epic Medical Management, LLC v. Paquette, supra,* 244 Cal.App.4th at p. 513 [only a referral provision of the contract was allegedly illegal; the overall agreement was one for management services, of which referrals played only an "incidental" part].)[1]

B. There Is No Conflict In California Law Regarding Advance Conflict Waivers.

The Petition is completely silent regarding any conflict among the Courts of Appeal regarding advance conflict waivers. The Court of Appeal considered and distinguished two cases. (Opn., pp. 18-22.) It devoted nearly four pages to the topic, explaining that those cases presented drastically different facts—in both, the attorney identified the *potential* conflict with sufficient specificity so that the waiver constituted informed consent. (*Ibid.*) The Petition does not disagree.

California has not adopted the ABA Model Rules approach to advance conflict waivers that the Petition promotes. No California case has approved that standard. Attempts to relax the ethical rules applicable here to resemble that standard have not succeeded. The law is uniform and consistent.

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[1] The Petition also argues that the conflict of interest did not go to the *entire* contract because the agreement "appl[ied] to other engagements" between J-M and the firm. (Petition, p. 15.) The issue was not raised below and amounts to nothing more than an argument that the Court of Appeal got the facts wrong in this particular case. In any event, the agreement states that its "purpose" is "to confirm our engagement by [J-M] to represent it *in connection with the Litigation*," that is "the lawsuit filed by Qui Tam plaintiff." (1 AA 199, italics added.) If the contract was ethically barred in its main purpose—the *only* purpose for which the firm charged J-M fees—it was barred in its entirety.

C. There Is No Conflict In California Law Regarding Disgorgement And Forfeiture When An Attorney Represents One Client In Litigation Against Another Client.

1. The decision does not conflict with the distinct rules allowing disgorgement as a *tort* remedy.

The Petition asserts that *Slovensky v. Friedman* (2006) 142 Cal.App.4th 1518 (*Slovensky*) and *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135 (*Fair*) reach different results from this case. Not so. These decisions require damages proof for an award of disgorged fees as a "'tort'" remedy. (Petition, pp. 23-26.) But the Court of Appeal did not purport to award disgorgement as a *tort* remedy. It did so as a *contract* and *equitable* remedy. The entire point of the decision was that the engagement agreement was entirely illegal and "void" as a violation of public policy, not as a matter of tort law. The Court of Appeal said this again and again. (Opn., pp. 2-3, 11-16, 22-26.)

Disgorgement of compensation received under a void contract is consistent with contract principles. Public policy renders the contract unenforceable and requires the undoing of the contract's end. *Fair* itself recognized that given serious ethical violations, attorneys can be prohibited from recovering fees without any showing that the ethical violation caused damages. (Petition, p. 25, citing *Fair, supra*, 195 Cal.App.4th at pp. 1153-1154.) Proof of damages is *not* required when an ethical violation is "sufficient to warrant voiding of an agreement," because in contract cases forfeiture is not a form of compensatory damages. (*Fair, supra*, 195 Cal.App.4th at p. 1153.) As the decision here puts it, J-M's damages are irrelevant because the firm's violation was so "serious" and "central" to the attorney-client relationship as to render the agreement unenforceable. (Opn., pp. 22-29 & fn. 10.)

Slovensky, on the other hand, did not consider a contract claim, much less whether disgorgement was an appropriate contract remedy. In *Slovensky*, the plaintiff brought only *tort* claims for legal malpractice and breach of fiduciary duty based on misrepresentations. (*Slovensky, supra,* 142 Cal.App.4th at pp. 1521, 1533-1535.)

2. There is no conflict in the cases. No conflict exists as to the degree of ethical violation requiring attorney fee forfeiture.

Nor is there a conflict as to what circumstances require disgorgement. The cases that the Petition cites involve mere technical violations of the conflict rules, issues concerning *potential* conflicts, or other violations of the Rules of Professional Responsibility that are not "serious." (*Mardirossian & Associates, Inc. v. Ersoff* (2007) 153 Cal.App.4th 257, 278 [representing two co-plaintiffs in litigation against a third party is not so egregious as to require forfeiture when "at most, a potential conflict of interest existed" and both clients provided their written consent and acknowledged the opportunity to consult outside counsel concerning the issue]; *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23, 48 [forfeiture not warranted simply because non-profit legal corporation failed to register with State Bar; no issue of conflicting representations]; *Slovensky, supra*, 142 Cal.App.4th at pp. 1534-1536 [disgorgement not required when attorneys' misrepresentation or concealment causes no harm; representation of two, aligned plaintiffs is not inherently serious violation particularly where it allows plaintiff to recover a greater settlement than if she was separately represented]; *Sullivan v. Dorsa* (2005) 128 Cal.App.4th 947, 951, 964-965 [in property sale, attorney's dual representation of referee and prospective purchaser is not necessarily serious].)

Such cases do not conflict with the very different test applied to the distinct "serious" actual conflict situation here (or in *Goldstein*, *Jeffry*, or *A.I. Credit Corp.*). Different factual scenarios do not create different rules.

III. THERE IS NO BASIS FOR THE PETITION'S "SKY IS FALLING" CLAIMS NOR ARE THEY A BASIS FOR REVIEW.

The Petition makes a number of arguments, proclaiming vast, untoward results if the Court of Appeal decision is left standing. Those arguments are baseless. The sky is not falling. Hyperbole creates no basis for review.

For instance, the Petition claims that the Opinion's supposedly new rules for determining whether a contract is entirely illegal will have widespread impact in disputes between attorneys and their clients, applying to everything from malpractice claims to fee disputes. (Petition, p. 13.) Nonsense. As demonstrated above, the rule is not "new"—it is a rule that this Court has repeatedly declared. And the decision makes plain that its scope is limited. It explains at length that (1) the rule applies only to challenges to the legality of the *entire* contract containing an arbitration provision (Opn., pp. 12-16) and (2) the entire contract here was rendered illegal only because of the serious nature of the ethical violation—a clear violation of the duty of loyalty by representing one client in a suit against another client. It explains that the key ingredient is that the violation strikes at "the very foundation of an attorney-client relationship" and the "paramount concern . . . to preserve the public's trust in the scrupulous administration of justice and the integrity of the bar." (Opn., pp. 16-26.)

There is no reason to think that every fee dispute and every act of malpractice rises to this level. Nor is there reason to think that generic fee disputes and ordinary acts of malpractice could render an entire contract invalid. At most, a fee dispute might challenge the legality of a single provision of the overall contract

that creates the attorney-client relationship. Under *Moncharsh* and the decision here, such a claim would be arbitrable and the arbitrator's determination would be subject to limited judicial review. (§ I.A., *ante*.)

Likewise, there is no basis for the claim that the decision "casts doubt on the viability of *all* advance waivers under virtually *any* circumstances." (Petition, pp. 16-17, italics in original.) That's pure exaggeration. The decision acknowledged and distinguished the two "advance waiver" cases that the Petition relied on—a California decision and a federal decision decided in California. (Opn., pp. 19-22 [discussing *Zador Corp. v. Kwan* (1995) 31 Cal.App.4th 1285 and *Visa U.S.A. Inc. v. First Data Corp.* (N.D.Cal. 2003) 241 F.Supp.2d 1100].) It is difficult to imagine how the Opinion casts doubt on *all* advance conflict waivers when it factually distinguishes cases where an advance conflict waiver was approved because it provided sufficient detail to provide informed consent.

Nor is the decision an obstacle to California adopting the so-called trend toward permitting expansive advance conflict waivers, should ethical rule changes be submitted through the normal rule-making channels. But, to date, California has considered and decided not to adopt such a change.

CONCLUSION

There is no basis for review. There is no unresolved legal issue. There is no conflict in the law. There is just a law firm dissatisfied with established existing law and an appellate decision based on the particular facts in this case.

DATED: March 29, 2016

Respectfully submitted,

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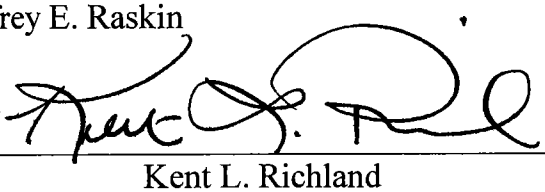
By 
Kent L. Richland

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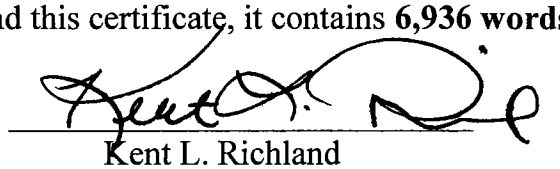
CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.204(c)(1), I certify that the attached **ANSWER TO PETITION FOR REVIEW** is proportionately spaced and has a typeface of 13 points or more. Excluding the caption page, tables of contents and authorities, signature block and this certificate, it contains **6,936 words**.

DATED: March 29, 2016



Kent L. Richland

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

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

On March 29, 2016, I served the foregoing document described as: **ANSWER TO PETITION FOR REVIEW** on the interested parties in this action by serving:

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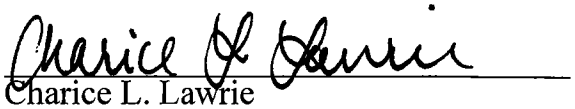
(✓✓) By U.S. Mail: The envelope was deposited in the mail at Los Angeles, California. The envelope was mailed with postage thereon fully prepaid.

I am "readily familiar" with firm's practice of collection and processing correspondence for mailing. It is deposited with U.S. Postal Service or Federal Express on that same day in the ordinary course of business. I am aware that on motion of party served, service is presumed invalid if postal cancellation date or postage meter date is more than 1 day after date of deposit for mailing in affidavit.

Executed on March 29, 2016 at Los Angeles, California.

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



Charice L. Lawrie