Supreme Court Case No. S232946

IN THE SUPREME COURT

OF THE STATE OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON, LLP *Plaintiff and Respondent,* vs. J-M MANUFACTURING CO., INC., *Defendant and Appellant.*	Court of Appeal, Second Appellate District, Division Four Case No. YC067332 San Bernardino County Superior Court/Central Justice Center Case No. CIVDS 1108273 Honorable Stuart Rice, Judge

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INTRODUCTION

As much as petitioner Sheppard, Mullin, Richter & Hampton LLP (Sheppard) would like this case to be about a crafty client cheating its lawyer out of fees by reneging on a conflict waiver that was completely above-board (Opening Brief on the Merits (OBM), p. 1), that narrative doesn't survive even the most casual review of the *undisputed* facts and the *unbroken* lines of legal authority that govern here. Those facts and law show that Sheppard induced its client J-M Manufacturing Co. (J-M) to sign a broad, open-ended waiver of all future *and current* conflicts—a waiver invalid under the law of any jurisdiction—by concealing the present or impending conflict that Sheppard knew about and instead assuring J-M there were "no conflicts." Following the rules applied in every California appellate decision that has ever considered the issues, the Court of Appeal held the engagement agreement that was forged by this deception was entirely illegal and unenforceable as against public policy, because it violated the most fundamental duty a lawyer owes to a client—the duty of loyalty, which goes to the very heart of the attorney-client relationship.

Sheppard's three disparate arguments seeking to undo the Court of Appeal's all-but-inevitable conclusion share one thing in common: As to all three, even the authorities that Sheppard relies upon are directly against it.

First, Sheppard argues that *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1 (*Moncharsh*) held that a contract with an arbitration clause is illegal and unenforceable only if it violates a statute or an "explicit *legislative* expression" of public policy. (OBM, pp. 12-13.) But *Moncharsh* and Sheppard's other authorities actually hold that this rule only applies where there is a claim that the contract is *partially* illegal—an issue that must be decided in the first instance by the arbitrator, whose decision is subject to only the most limited review. Where the issue is, as here, whether the entire contract that contains the arbitration clause is illegal, the

Legislature has expressly directed that that question must be decided by the trial court in the first instance, and that the arbitration clause is unenforceable if the entire contract is illegal for any reason that any other California contract would be illegal.

Second, Sheppard's conduct violated the ethical conflict rules even under the advance waiver rules of the jurisdictions on which Sheppard relies. No jurisdiction permits an attorney to conceal information about existing or impending conflicts by using a generalized, open-ended advance waiver. That is true regardless of the client's level of sophistication. Moreover, California's Rules of Professional Conduct are incompatible even with the relaxed advance waiver rules that have been adopted by other jurisdictions. And even the State Bar's currently-proposed rule change explicitly rejects that relaxed standard.

Third, Sheppard is wrong that California law requires a showing of compensatory damages before a law firm must forfeit its fees under a contract rendered illegal under the circumstances here. In the first place, Sheppard is wrong that J-M agreed it suffered no such damages—harm is undeniable. Moreover, Sheppard's own authority holds that compensatory damages are not—and should not be—a prerequisite to an attorney's forfeiture of fees for the violation of fundamental ethical duties like the conflicted representation here. California law is clear that an attorney is not entitled to compensation for services that are themselves prohibited by the rule against accepting actually-conflicting representations.

Sheppard's flagrant violation of the most basic attorney duty—the duty of loyalty to its client—cannot be immunized from judicial review by the inclusion of an arbitration clause in the engagement agreement. Nor do the ethical rules governing conflict waivers (advance or otherwise) of *any* jurisdiction permit a lawyer to obtain an open-ended waiver of current and future conflicts while concealing pertinent information about a present or impending conflict, as occurred

here. California law is clear and unequivocal: An attorney engagement agreement executed under these circumstances is illegal, and as a matter of public policy the attorney can receive no fees for the services tainted by the violation.

STATEMENT OF THE CASE

A. The Underlying Qui Tam Action.

In 2010, J-M approached Sheppard about handling its defense in a $1 billion qui tam action. (Opinion, pp. 3-4.) Sheppard partners Daly and Kreindler met with J-M. They mentioned that the firm had "relationships" that might be beneficial in the qui tam action. (2AA474-475.) In particular, they explained that their firm had experience working opposite the lawyer representing plaintiffs. (*Ibid.*) They also told J-M that one of the governmental intervenors—LADWP—was a *former* litigation client of the firm. (2AA475.)

B. Sheppard Is Aware Of The Conflict Of Interest Between J-M And South Tahoe.

Sheppard ran a conflicts check that "identified South Tahoe Public Utilities District [South Tahoe] as a client . . . ." (2AA317, ¶ 5; Opinion, p. 4.) South Tahoe was a plaintiff-side intervenor in the qui tam action and, thus, directly adverse to J-M. (2AA283, 294.)

South Tahoe had been Sheppard's client since 2002, with labor-and-employment partner Jeffrey Dinkin in charge of the representation. (Opinion, p. 4.) South Tahoe had been Dinkin's client since the beginning of his career, following him when he joined Sheppard. (2AA275-276, 278-279; Opinion, p. 4.) At his former firm, Dinkin would handle all of South Tahoe's employment-related issues. (2AA275.)

Sheppard twice memorialized its relationship with South Tahoe. (2AA276, 288-291.) Neither engagement agreement defined the attorney-client relationship as limited to "any particular matter" or time period. (2AA277.) Instead, they described the representation's scope as broadly covering "general employment matters," with Sheppard providing periodic advice on labor-and-employment issues

on an "as-needed" basis, year in and year out. (2AA278-279, 288; Opinion, p. 4.) South Tahoe had most recently obtained Sheppard's advice five months before the conflict check. (Opinion, p. 4.)

The open-ended engagement agreement provided that either party could terminate their relationship with notice. (2AA290.) No evidence showed either had done so.

C. Sheppard Does Not Disclose The Conflict To J-M, South Tahoe Or Even To Dinkin.

Concerned about the conflict, Daly and Kreindler consulted Sheppard's general counsel and assistant general counsel. (Opinion, p. 4.) They thought that South Tahoe could not stand in the way of the J-M representation because South Tahoe's had signed a broad advance conflict waiver. (2AA317, 476.)

But no agreement had yet been signed with J-M, and Sheppard did not inform J-M of the known conflict. To the contrary, it "assured [J-M's general counsel] that there were no conflicts with the firm's proposed representation in the Action." (1AA191.)

The firm then proffered an engagement agreement that contained the provision, "We *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 provision said J-M waived its "obligation of loyalty" by allowing Sheppard to represent this broad, undefined class of clients in matters adverse to J-M. (*Ibid.*)

Sheppard never discussed the waiver with J-M. (Opinion, p. 5.) Based on assurance that there were no conflicts, J-M signed the agreement. (1AA191, 204.) Both before and after this, J-M's practice has been to ensure outside counsel had no conflicts of interests. (1AA191-192.)

Sheppard did not just conceal the conflict from J-M; it concealed it from Dinkin, the Sheppard partner in charge of South Tahoe's account. (2AA280.)

D. South Tahoe Discovers The Conflict And Threatens Disqualification. Sheppard Still Remains Silent.

Three weeks after J-M signed the engagement agreement, Sheppard resumed active work on another South Tahoe employment issue—without any new engagement agreement—and continued to do so for a full year. (Opinion, p. 6; 2AA278-279.) Still, Sheppard did not inform either client—or Dinkin. (2AA280; Opinion, p. 18.)

In January 2011, South Tahoe discovered the conflict and demanded that Sheppard provide an "immediate explanation" regarding the "clear conflict of interest." (2AA284, 303-304.) On April 11, it notified Sheppard that it would disqualify Sheppard in the qui tam action. (1AA193.) Sheppard then acknowledged to South Tahoe that the conflicts check it had run before undertaking the J-M representation had "showed South Tahoe to be an existing client." (2AA284.)

Sheppard did not inform J-M about the issue until April 20—months after South Tahoe had raised it. (1AA193, 214.) Sheppard *never* directly told J-M about the conflicts check; J-M learned about that from a late-July court filing. (1AA192.)

Unbeknownst to J-M, Sheppard tried to buy its way out of the conflict, offering South Tahoe $100,000 plus free legal services if South Tahoe would waive the conflict; it later upped the offer to $250,000. (Opinion, pp. 7-8; 1AA194-195 [J-M never would have permitted such offer].)[1/]

[1/] In its correspondence, Sheppard confirmed the "'long-standing relationship between [South Tahoe] and our Firm'" and that it had "'been pleased to provide labor advice to you for the last 9 years.'" (Opinion, p. 7.)

Sheppard then suggested bifurcating South Tahoe's claim and requiring J-M to obtain separate counsel for that portion. (Opinion, p. 7.) It urged that there was no "significant downside" even though Sheppard had previously advised J-M that bifurcation was against J-M's interests. (1AA196, ¶¶ 27-28; 235-236, 239.) J-M declined. (Opinion, p. 8.)

The district court disqualified Sheppard. (*Ibid.*) It rejected Sheppard's argument that it could unilaterally drop South Tahoe as a client, noting that a published decision had disapproved Sheppard's attempt to use that very tactic in another case. (Opinion, p. 7 [citing *American Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton* (2002) 96 Cal.App.4th 1017, 1037].)

E. *Sheppard vs. J-M.*

1. The trial court compels arbitration.

Sheppard sued J-M for unpaid legal fees arising from the qui tam representation. (Opinion, p. 8.) J-M cross-complained for damages and disgorgement. (*Ibid.*; 1AA8-27.)

Sheppard petitioned for an order compelling arbitration under the engagement agreement's arbitration provision. (Opinion, p. 8; 1AA41-53, 202.) J-M opposed, arguing the entire agreement containing the arbitration provision was void as against public policy. (Opinion, p. 8.)

The trial court compelled arbitration. (*Ibid.*) J-M's writ petition challenging that order was denied. (Opinion, p. 9.)

2. The arbitration.

The arbitrators did not decide whether the engagement agreement was illegal. (*Ibid.*) Their award observed that "'the better practice would have been [for Sheppard] to disclose the full South Tahoe situation to J-M and seek J-M's waiver of it.'" (*Ibid.*) "But the arbitrators concluded that they need not decide whether

[Sheppard's] failure to seek such a waiver constituted an ethical violation, and for purposes of their analysis assumed that the ethical violation occurred." (*Ibid.*) The arbitrators then concluded that compensation-forfeiture was not automatic and awarded Sheppard $1,118,147 in unpaid fees. (Opinion, pp. 9-10.)

The trial court confirmed the award. (Opinion, p. 10.)

3. The Court of Appeal decision.

The Court of Appeal unanimously reversed the trial court's order compelling arbitration.

First, it recognized that the court failed to decide J-M's challenge to the legality of the entire contract. (Opinion, pp. 2, 11-16.)

Second, applying long-established principles, it held that the entire agreement was illegal and thus, that the parties should never have been compelled to arbitration. (Opinion, pp. 11-22.) It held that (a) Sheppard violated its ethical duty by failing to disclose conflict information known to Sheppard; (b) this violation presented a public policy issue of "paramount concern" to the public trust in the administration of justice and the integrity of the Bar; and (c) the public policy violation struck at "the very foundation of an attorney-client relationship" created by the agreement and permeated the relationship, thus rendering the entire agreement illegal and unenforceable. (Opinion, pp. 16-26.)

Third, applying well-established law regarding actual conflicts, the court held that Sheppard was not entitled to its fees for work it performed while the actual conflict existed. (Opinion, pp. 29-31.) It remanded so that the trial court could determine whether the conflict existed when J-M signed the engagement agreement or a few weeks later when Sheppard resumed active work for South-Tahoe. (Opinion, pp. 30-31.)

ARGUMENT

I. CALIFORNIA STATUTES AND CASELAW MAKE CLEAR THAT NO "LIMITED," "DEFERENTIAL" STANDARD APPLIES TO THE PURELY JUDICIAL QUESTION OF THE LEGALITY OF AN ENTIRE CONTRACT CONTAINING AN ARBITRATION PROVISION.

A. As Statutes Dictate, California Courts Determine The Judicial Question Of *Entire* Contract Illegality De Novo But Are Deferential When Reviewing An Arbitrator's Determination Of *Partial* Contract Illegality.

Sheppard insists that California has *always* severely circumscribed courts' determination of the legality of an entire contract that contains an arbitration provision—that it is established that deference to arbitration awards prohibits courts from invalidating the contract unless it violates a *statutory* public policy, rather than a regulation or other source of law. (OBM, pp. 12-26 ["wall of authority" purportedly supporting Sheppard; J-M's supposed "misreading" of authority].)

Sheppard's argument is founded on confusion of two very different issues—the deferential review of an arbitrator's determination of a challenge to the legality of a *portion* of a contract, as opposed to a court's determination of the threshold challenge to the legality of an *entire* contract before deciding whether the matter should go to arbitration. As explained below, the arbitration statutes and an unbroken chain of California decisions are explicit on the distinction and governing standards: The court's analysis in the latter setting does not and cannot defer to the arbitrator's determination, so there is no limitation on the court's ordinary exercise of determining contract validity.

Supreme Court and Court of Appeal decisions explain this. The statutes applicable to the respective types of challenges demand it. And a contrary conclusion would allow parties to violate fundamental public policy by inserting an arbitration clause into an illegal contract.

1. *Moncharsh* recognizes that courts must decide entire-illegality and provision-illegality challenges at different stages and under different standards.

a. *Moncharsh*'s enunciation of the two standards.

Moncharsh, supra, 3 Cal.4th at pp. 31-33 took pains to "contrast" the two types of challenges and the different standards governing them.

Moncharsh's central holding was that an arbitrator's determination is ordinarily immune from claims of legal or factual error—"arbitral finality" precludes such challenges. (*Id.* at pp. 8-14.) But turning to judicial review of claims of illegality, the Court emphasized that the "'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 present. (*Id.* at p. 31, italics in original.) Thus, California law "permitted judicial review of an arbitrator's ruling where a party claimed the entire contract or transaction was illegal." (*Id.* at p. 32.) As the decision then indicates, the Court meant that where the question is the legality of the entire contract, judicial review is not limited:

The Court noted that the case before it did not involve entire-illegality. The *Moncharsh*-appellant "challenges but a single provision of the overall employment contract. Accordingly [California law does not] authorize[] judicial review of his claim"—that is, the normal rule of limited review of an arbitration award applies. (*Ibid.*)

In the very next sentence, the Court set forth the narrower form of judicial review applicable to such provision-illegality challenges: "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.* Such cases would include those in which granting finality to an arbitrator's decision would be inconsistent with the protections of a party's statutory rights." (*Ibid.*, italics added.)

The decision repeats this in its conclusion. "[T]he 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.)

Moncharsh thus makes the analytical distinction crystal clear.

b. *Moncharsh*'s explanation of the statutory underpinnings of the two rules.

Moncharsh also explains different statutes and policies drive the differing standards for the two types of challenges.

Provision illegality. *Moncharsh* noted that provision illegality is decided by arbitrators, and thus judicial review of that determination is narrowly circumscribed by Code of Civil Procedure sections 1286.2 and 1286.6:

- Parties bargain for the arbitrator's determination of arbitrable disputes. (*Id.* at pp. 8-14.) Through the vacatur and correction statutes (section 1286.2 and 1286.6), the Legislature expressed a policy in favor of "arbitral finality," requiring the arbitrator's determination of arbitrable issues to stand immune from ordinary claims of legal error. (*Ibid.*)

- Provision illegality is an arbitrable issue. (*Id.* at p. 30 [when "alleged illegality goes to only a portion of the contract . . . the issue of illegality, remains arbitrable"].) The Legislature thus intended that the arbitrator's determination of provision-illegality to be final and section 1286.2 mandates imposition of the "normal rule of limited judicial review" when a provision's illegality is challenged. (*Id.* at pp. 32-33.)
- *Moncharsh* recognized a narrow exception to that "normal rule" when "according finality to the arbitrator's decision" regarding the legality of a "provision of the contract" violates a "statutory right." (*Id.* at p. 33.)

Entire illegality. A different set of statutes and policies apply to challenges to the legality of the entire contract containing an arbitration provision. "'[T]he rules which give *finality* to the arbitrator's determination of ordinary questions of fact or of law are *inapplicable*" to such challenges. (*Id.* at p. 31, italics added.).

- Entire illegality is *not* an arbitrable issue. Instead, trial courts must decide it when ruling on a petition to compel arbitration. (*Id.* at pp. 29-30.) Because arbitrators do not decide the issue, there is no "final" arbitral ruling on entire-illegality that requires limited judicial review. (See pp. 7-8, *ante* [arbitrators here did not decide issue].)
- Courts adjudicate entire illegality based on Code of Civil Procedures sections 1281 and 1281.2, governing petitions to compel arbitration—not the vacatur statute. (*Id.* at p. 29.) Section 1281.2 requires that a court deny arbitration if "'[g]rounds exist for the revocation of the agreement,'" and *Moncharsh* explained that "section 1281 states 'A written agreement to submit to arbitration an existing controversy . . . is valid . . . save upon such grounds as exist for the

> revocation of *any contract*.'" (*Ibid.*, italics altered, ellipses in original.) "If a contract includes an arbitration agreement, and grounds exist to revoke the entire contract, such grounds would also vitiate the arbitration agreement." (*Ibid.*) *Moncharsh* consequently determined that the "Legislature must have meant" that "if an otherwise enforceable arbitration agreement is contained in an illegal contract, a party may avoid arbitration altogether." (*Ibid.*)

A petition to compel arbitration "in essence, requests specific performance of a contractual agreement to arbitrate the controversy." (*Green v. Mt. Diablo Hospital Dist.* (1989) 207 Cal.App.3d 63, 69, cited approvingly by *Moncharsh, supra*, 3 Cal.4th at p. 30.) But trial courts have no power to enforce entirely illegal contracts. And the standard for judicial determination of that question is whether there exist "grounds for revocation of *any* contract." As Sheppard concedes, courts routinely look to all sources of law in determining whether an agreement is void as against public policy. (OBM, pp. 21-22; Opinion, pp. 24-26 [citing relevant cases].) Indeed, the Legislature has specifically directed courts to invalidate contracts that are "(1) Contrary to an express provision of law; (2) Contrary to the policy of express law, though not expressly prohibited; or (3) Otherwise contrary to good morals." (Civ. Code, § 1667.)

Indeed, the very concept of deference to the arbitration award is nonsensical in the context of a challenge to the legality of the entire contract. When a trial court decides that issue as part of a petition to compel arbitration—pre-arbitration—the trial court *cannot* review an arbitrator's determination; there aren't any arbitral determinations at that point. Finality cannot be afforded to an award that does not yet exist. And appellate courts can review the trial court's decision either before or

after the arbitration.[2/] Either way, they are reviewing the *trial court's order* on the petition to compel—not an arbitral determination that would be subject to finality concerns.[3/]

* * * * *

Moncharsh is clear both in its statement of the two different standards and in its explanation of the statutory reason for the difference. Courts adjudicate challenges to the entire contract under ordinary standards.

[2/] Courts of Appeal review such determinations before arbitration if the trial court denies arbitration *or* on a writ petition from an order compelling arbitration. (Code Civ. Proc., § 1294, subd. (a) [order denying arbitration immediately appealable]; *Young Seok Suh v. Superior Court* (2010) 181 Cal.App.4th 1504, 1511 [writ review]). Otherwise, an order compelling arbitration is only appealable after confirmation of the award. (*State Farm Fire & Casualty v. Hardin* (1989) 211 Cal.App.3d 501, 506.) Certainly the court's standard of review of the trial court order cannot depend on the date on which an appeal can be taken.

[3/] In a footnote, Sheppard notes that federal courts applying the FAA employ the same limited public policy review for both entire- and provision-illegality. (OBM, p. 24 fn. 2, citing Opinion, pp. 11-12.) That's true. But it is because under the FAA *both types* of challenges are "decided by the arbitrator" and so, the FAA requires deferential review of the arbitrator's determination of both types of challenges. (See Opinion, pp. 11-12, citing *Phillips v. Sprint PCS* (2012) 209 Cal.App.4th 758, 774.)

Sheppard acknowledges that California law is different—trial courts must decide entire-illegality claims before arbitration. (E.g., OBM, p. 23.) Sheppard does not ask this Court to change that rule. And the federal rule is based on the FAA's unique statutory language. (E.g., *Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440, 443-448.) In *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 312, this Court adopted a similar rule regarding arbitrability of fraudulent inducement, but it did not do so based on the language of the California statutes. As *Moncharsh* observed, *Ericksen* (1) relied on concerns about the similarity between fraudulent inducement and breach of contract claims and (2) "distinguished [fraudulent inducement cases] from those in which a party claimed illegality of the underlying agreement," which under California law constitute a pre-arbitration issue for the courts. (*Moncharsh*, *supra*, 3 Cal.4th at p. 30, fn. 13.)

2. Intermediate appellate decisions.

Court of Appeal decisions adhere to the same distinction. For instance, *Singerlewak LLP v. Gantman* (2015) 241 Cal.App.4th 610, 616, explains that judicial review is available "where the party claims the *entire* contract or transaction is illegal, not just one provision of the contract. Yet, the *Moncharsh* court noted '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'" when the award violates an "'explicit legislative expression of public policy.'" (Italics in original, internal citation omitted.)

In fact, appellants often challenge a single provision as an alternative to their entire-illegality challenge. And courts confronted with both issues address them separately because they implicate different standards: *First*, courts devote a substantial amount of analysis to whether the legality of the entire contract really is at issue. (*Epic Medical Management, LLC v. Paquette* (2015) 244 Cal.App.4th 504, 513 (*Epic Medical*) [heading on entire illegality]; *Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21, 33-36 (*Ahdout*) [heading and three-page analysis].) *Second*, only after concluding that the challenge only went to a single provision do the courts apply *Moncharsh*'s narrow review that requires a statutory public policy. (*Epic Medical*, *supra*, 244 Cal.App.4th at pp. 513-514 [separate heading]; *Ahdout*, *supra*, 213 Cal.App.4th at pp. 36-39 [same].) If there really were a single, unvarying standard, the two issues would be analyzed as one. They are not because statutes and case law require different standards.

3. Sheppard's arguments do not demonstrate that California courts employ a different rule.

The above analysis fully disposes of Sheppard's argument. However, in the interests of completeness, we respond briefly to Sheppard's points.

First, Sheppard argues that *Moncharsh* prohibited judicial review based on violation of the Rules of Professional Conduct. (OBM, pp. 18-20.) But the Court explained that was only because it was considering the narrow rule applicable to an arbitrator's determination of provision-illegality. (§ I.A.1., *ante*.)

Second, Sheppard contends that "procedural gamesmanship" will follow if parties disappointed by an arbitration award are permitted to broadly challenge the contract. (OBM, p. 17.) *Moncharsh* already solved that concern: Parties cannot contest entire-illegality unless they "raise the illegality question prior to participating in the arbitration process." (*Moncharsh, supra,* 3 Cal.4th at pp. 30-31 [discussing "procedural gamesmanship"].) There is no gamesmanship where, as here, a party raises illegality in opposition to a petition to compel and then appeals and seeks writ review of an adverse trial court decision at the earliest possible time. (See pp. 7, 14, fn. 2, *ante*.) In any event, this Court has no authority to overturn the rules governing arbitration contracts that the Legislature has established.

Third, Sheppard states that *Moncharsh* relied on two cases in which the illegality was based on a statutory violation. (OBM, p. 23-24.) A statutory violation is certainly *sufficient*, just not *necessary* to establish contract illegality. (Civ. Code, § 1667.) *Moncharsh* makes clear that a statutory violation is only required to challenge an arbitrator's determination of provision-legality. (§ I.A.1., *ante*.)

Fourth, Sheppard contends that on a petition to compel arbitration, the trial court should look only to public policies expressed in statute because anything else "would require trial courts to resolve highly factual disputes on the merits to determine if arbitration agreements are enforceable." (OBM, p. 20.) Sheppard does not explain why the analysis would be any more factual just because the public policy is expressed in a regulation rather than a statute—it isn't. Nor does Sheppard explain why it would take substantially longer for a court to identify a fundamental

public policy based on a regulation than one based on a statute—it wouldn't. Moreover, the Legislature established this rule. (§ I.A.1., *ante.*) And the alternative would be to allow parties to immunize a contract from the strictures of fundamental public policy simply by including an arbitration clause.

Fifth, Sheppard contends that J-M's interpretation would thwart arbitration in a wide variety of attorney-client cases. (OBM, p. 20.) Sheppard does not explain why its examples would invalidate an *entire* engagement agreement. As the Court of Appeal held here, the duty of loyalty goes to the very heart of the relationship created by the engagement agreement; it assaults the fundamental understanding of clients and the public that attorneys will vigilantly represent their clients free from any divided loyalties unless the clients provide informed consent to a conflict. (P. 8, *ante.*) That is nothing like an unconscionable fee provision—which impacts only the compensatory component of the relationship—or an ordinary malpractice claim.

In any event, the law as set forth by the Legislature and followed by this Court is clear: When a contract containing an arbitration provision is entirely illegal, the parties' dispute is not subject to arbitration. That does not thwart the purpose of arbitration. It just means that parties can't thwart public policy by agreeing to arbitrate their rights under an entirely illegal contract. (See *Loving v. Evans & Blick* (1949) 33 Cal.2d 603, 610 ["an award springing out of an illegal contract, which no court can enforce, cannot stand on any higher ground than the contract itself"].)

Sixth, Sheppard misconstrues *Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405 (*Cotchett*). (OBM, p. 24.) There, the only issue was provision-illegality—not entire illegality that results in an avoidance of arbitration altogether. (*Moncharsh*, *supra*, 3 Cal.4th at p. 29; *Cotchett*, *supra*,

187 Cal.App.4th at p. 1417 [appellant made no claim that "the fee dispute should not have been submitted to JAMS"].)[4/]

The *Cotchett* footnote cited by Sheppard does support Sheppard's theory. For one thing, it describes entire-illegality as an "other" basis for review—different, but bearing "some overlap." (187 Cal.App.4th at p. 1417, fn. 1.) For another, it does not state that the same limited scope of review applies. Rather, it says that "our resolution of the public policy claim necessarily resolves" any entire-illegality challenge. (*Ibid.*) That is hardly surprising since the court rejected "on the merits" the claim that the award "violates public policy." (*Id.* at pp. 1418-1424.)

B. J-M's Challenge Goes To The Entire Agreement.

Sheppard makes only one other argument about the scope of review. It contends that "[e]ven if the Court of Appeal's reading of *Moncharsh* were correct," J-M's challenge did not render the entire contract illegal. (OBM, pp. 25-26.) The argument does not withstand scrutiny.

First, Sheppard does not even attempt to address the appellate court's reasoning that the duty of loyalty "constitutes the very foundation of an attorney-client relationship," which is the subject of the agreement and that the illegality thus vitiates the entire agreement. (Opinion, pp. 11, 22-26.)

Second, there is no merit to Sheppard's reliance on *Ahdout* or *Epic Medical.* (OBM, pp. 25-26.) In both cases, the court held that the alleged illegality did not

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[4/] "'Reference to briefs is a permissible method of ascertaining what issues were before a court.'" (*McAdory v. Rogers* (1989) 215 Cal.App.3d 1273, 1277, citations omitted; see also *Moore v. Superior Court* (1970) 13 Cal.App.3d 869, 873-874 [interpreting decision in light of issues raised in briefs].) In *Cotchett*, the appellant argued that his claim did not need to be raised in the trial court pre-arbitration because that waiver-rule only applied to entire-illegality challenges, whereas appellant raised a provision-illegality challenge that only needed to be raised during the arbitration. (Appellant's Reply Brief, *Cotchett, supra*, No. A126149, 2010 WL 1747717 at *20-21.)

infect the entire agreement because the illegal provision did not relate to the contract's central purpose. (*Ahdout, supra*, 213 Cal.App.4th at p. 36 [provision that company would use particular contractor was tangential because the contract was "not a construction contract" with the third-party contractor, but rather the company's operating agreement that defined capitalization requirements, distribution of profits, management, and dissolution]; *Epic Medical, supra*, 244 Cal.App.4th at p. 513 [illegal patient-referral clause did not infect entire agreement because "[t]he agreement was not a referral agreement, but one for management services, of which referrals played only an incidental part"].) Here, on the other hand, the illegality struck at the very foundation of the relationship created by the contract. (See *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1166 [undisclosed conflict voided contract].)

Third, Sheppard tries to diminish the centrality of the illegality by claiming that the agreement went far beyond the qui tam engagement. The record does not bear this out:

a) Sheppard says that the agreement's terms applied to "other engagements" with J-M. (OBM, p. 25.) But it is beyond question that the primary purpose—and the only one contemplated at the time—was the qui tam engagement. (1AA199 [defining "Scope of Representation"].) The agreement merely stated that its terms would apply to other engagements "that we *may* undertake, except as we may otherwise agree." (*Ibid.*, italics added.)

b) Sheppard observes that some of the contract terms survived the engagement. (OBM, p. 25.) That's true, but those duties arose from the qui tam engagement—not some broader purpose. They required J-M to pay Sheppard if "as a result of our engagement," the firm was required to appear as a witness or produce documents. (1AA200.)

c) Sheppard contends that the arbitration provision "extended beyond the qui tam action to cover 'any other dispute.'" (OBM, p. 25.) But the phrase "other disputes" cannot reasonably be read as meaning disputes arising from a source other than the representation. The arbitration provision addresses two types of claims, those that relate to Sheppard's fees and "other" disputes because fee disputes were subject to a different arbitration mechanism through the State Bar. (1AA202.) There is no reason to think that the parties would have contemplated arbitration of disputes having nothing to do with the contractual relationship that is the subject of the agreement, especially since that was their only relationship.

II. WHERE, AS HERE, AN ATTORNEY HAS SPECIFIC KNOWLEDGE ABOUT A PRESENT OR IMPENDING CONFLICT OF INTEREST, CLIENTS DO NOT GIVE INFORMED CONSENT BY SIGNING A BROAD, NON-SPECIFIC CONFLICT WAIVER THAT DOES NOT DISCLOSE THE RELEVANT CIRCUMSTANCES, NO MATTER HOW "SOPHISTICATED" THE CLIENT.

Sheppard argues for something far different than the issue that it urged this Court to review. It acknowledges the issue on review is whether a "sophisticated consumer of legal services, represented by independent counsel, [can] give its informed consent to an advance waiver of conflicts of interest." (OBM, p. 1.) But because it must do so in order to prevail, it urges a startlingly broader rule that permits an attorney to ethically conceal facts about a particular conflict that the attorney *knows* either exists or is impending. (OBM, § II.) That is not consistent with California law. It isn't even the law in the advance-waiver jurisdictions that Sheppard relies upon—those jurisdictions expressly reject the rule Sheppard urges.

First, the California Rules of Professional Conduct (California Rules) define "informed written consent" in a manner that forecloses the use of generalized, open-ended advance waivers that some jurisdictions permit for sophisticated clients.

Using materially different language than the ABA Model Rule and the D.C. Rule, the California Rule unequivocally mandates written disclosures of the relevant circumstances. (§ II.B., *post.*) In fact, the State Bar's currently-pending proposal for an advance-waiver rule continues this approach; it rejects the ABA's allowance of open-ended advance waivers by sophisticated, independently-represented clients. (*Ibid.*) At very least, the California Rules cannot be interpreted as permitting an attorney to use a generalized, open-ended waiver when he is actually aware of relevant circumstances regarding an existing or impending conflict.

Second, the Court can and should resolve this case without even addressing these differences between California and other jurisdictions. That is because *no jurisdiction's* advance-waiver rules permit the extreme rule that Sheppard urges. In fact, they *expressly reject* the notion that an attorney can use a generalized waiver to conceal known information about existing or impending conflicts. (§ II.A.1.-2., *post.*) Likewise, the policy arguments in favor of open-ended advance waivers of hypothetical future conflicts have no force when considering existing and impending conflicts known to the attorney. (§ II.A.3., *post.*) We aren't even sure why Sheppard believes that an *existing* conflict can be the subject of an *advance* waiver other than that Sheppard must argue that in order to prevail.

We address the latter issue first because it is all that is necessary to decide the case and, as will be explained below, because the Court should be cautious about further defining advance-waiver standards at this juncture.

A. Sheppard's Own Authorities Prohibit Attorneys From Concealing The Fact Of An Existing Or Impending Conflict.

Even if the California Rules permitted the approach of some other jurisdictions regarding sophisticated clients and advance waivers (see § II.B., *post*), that still would not allow the rule that Sheppard urges and needs in order to prevail. As Sheppard's own citations explain, no jurisdiction accepts the extraordinary,

unjustified and unethical rule that allows attorneys to conceal known information about existing and impending conflicts.

1. Sheppard's authorities reject its assertion that a non-specific, open-ended client consent constitutes a valid informed consent to an existing conflict concealed by the attorney.

No conflict waiver rule permits an attorney to conceal conflicts of interest that "existed at the time" the attorney seeks a broad, open-ended waiver to all conflicts that "may currently or in the future" exist, Sheppard's argument to the contrary notwithstanding. (OBM, pp. 26, 32, 36, italics omitted.) And it doesn't matter how sophisticated the client is. Sheppard's own authorities explain this.

The Restatement. Sheppard quotes a Restatement comment as saying, "'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.'" (OBM, p. 31, quoting Rest.3d Law Governing Lawyers (Restatement), § 122, com. d.) But context matters. As the heading and substance of that comment make plain, the quotation refers to "[c]onsent to future conflicts" that "might" hypothetically arise at some later time—not existing conflicts of which the attorney knows. (Restatement, § 122, com. d.)

The Restatement separately addresses the situation presented here—an existing conflict where the attorney is aware of particularized information bearing on informed consent. (*Id.* at com. c(i).) In that context, it does not allow open-ended agreement to all conflicts that "may" already exist. Rather, "[i]nformed consent requires that each affected client be aware of the material respects in which the representation could have adverse effects on the interests of that client" so that

the client can make an "informed decision." (*Ibid.*) "The lawyer is responsible for assuring that each client has the necessary information." (*Ibid.*)

The Restatement expressly notes that sophisticated clients with independent counsel need to be made aware of the fact that a conflict exists: "A client independently represented—for example by inside legal counsel or by other outside counsel—will need less information about the consequences of a conflict but nevertheless may have need of information adequate to reveal its scope and severity." (*Ibid.* [using the qualified "may need" immediately after observing that clients do not need disclosure of facts already known from some other source].)

D.C. Bar Opinion. The D.C. Bar Opinion likewise explains that open-ended conflict waivers are only permissible in the advance waiver context—not existing conflicts. (D.C. Bar Assn., Ethics Opn. 309 (2001), cited at OBM, pp. 30, 37.) So, it would not help Sheppard even if California law were susceptible to the same interpretation as the D.C. Rules. The D.C. Opinion states that an advance waiver provides informed consent if (1) the consent is specific as to the types of potentially-adverse clients and representations, or (2) the waiving client has in-house counsel to consider a general advance waiver. (D.C. Bar Assn., Ethics Opn. 309.) In the very next sentence, the Opinion adds a vital caveat to the latter category: "[T]he lawyer 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." (*Ibid.*) In fact, it reinforces the need for the attorney to disclose known information, cautioning that if the attorney cannot disclose the adversity because of the duty of confidentiality to the other client, the lawyer cannot seek a waiver and hence may not accept the second representation. (*Ibid.*)

ABA Model Rule 1.7. The ABA likewise narrowly circumscribes its discussion of open-ended waivers to advance—not existing—conflicts. The issue is

addressed entirely in a comment titled "Consent to Future Conflict," which repeatedly states that the issue is the effectiveness of waivers of "conflicts that might arise in the future." (ABA Model Rules of Prof. Conduct, rule 1.7, com. 22.) The related ABA Opinion Letter likewise addresses "informed consent that is *limited to future matters* that are not substantially related." (ABA Com. on Prof. Ethics, Opn. No. 05-436 (2005) at p. 4, italics added.) Neither hints at the startling notion that the ABA has blessed the practice of attorneys concealing existing conflicts by obtaining generalized waivers.

New York City Bar Opinion. The New York City Bar Association provides several samples of advance conflict waivers. One of those samples does seek consent for adversity "now or in the future." (N.Y. City Bar Assn., Opn. 2006-1 (2006), Sample B.) But that should not be confused with a rule allowing blanket waiver of existing conflicts. The Opinion itself discusses only the waiver of "future conflicts" through "advance waivers." Why then does one of the sample waivers mention existing conflicts? Because New York attorneys are required to disclose known circumstances, but they are not required to make those disclosures in writing; only the waiver itself must be in writing. (N.Y. Rules Prof. Conduct, rule 1.7, com. 20.) So, it is not surprising that a sample New York waiver does not actually specify the existing conflicts that the attorney disclosed. This stands in contrast to the California rule which requires "written disclosures." (California Rule 3-310(A)(2).) And it bears no resemblance to Sheppard's approach of concealing information.

2. Even a client's consent to future conflicts is neither informed nor valid if the attorney conceals known information about an impending conflict, as occurred here.

Sheppard's cited authorities also do not permit an open-ended waiver to constitute informed consent even if Sheppard were correct that the conflict with

South Tahoe only arose three weeks after J-M engaged Sheppard. (OBM, p. 36.)[5/] Even then, advance conflict rules require disclosure of Sheppard's knowledge that South Tahoe was a long-time client, whose engagement covered periodic employment advice for almost a decade, and that South Tahoe would likely return for another round of employment advice as soon as a need arose.

As the D.C. Bar Opinion puts it, even where general advance waivers can be used—i.e., only with sophisticated clients—"the lawyer 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. Bar Assn., Ethics Opn. 309.)

3. Sheppard's authority does not permit concealment of relevant information precisely because public policy forbids such a rule.

It is no small wonder that Sheppard's authority itself prohibits attorneys from using generalized waivers to conceal information known to the attorney. Universally-recognized public policy prohibits that.

a. Requiring disclosure protects the client.

Attorney-ethics rules protect clients—not a firm's per-partner profits. (Fox, *All's O.K. Between Consenting Adults: Enlightened Rule On Privacy, Obscene Rule On Ethics* (2001) 29 Hofstra L. Rev. 701, 720 (*All's O.K.*).) Conflicts of interest rules safeguard the attorney's duty of loyalty, which goes to the very heart

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[5/] Sheppard asserts that "the Court of Appeal held" that the conflict only arose three weeks after J-M signed the waiver. (OBM, p. 36.) That isn't true. The Court of Appeal decided that Sheppard violated its duty if there was an existing conflict *and* "[e]ven assuming" the conflict arose three weeks later. (Opinion, p. 18.) It then remanded the case so that the trial court could determine precisely when the conflict of interest arose in order to determine the scope of the monetary relief to which J-M was entitled. (Opinion, pp. 30-31; see pp. 4-6, *ante* [Sheppard's repeated description of existing-client relationship with South Tahoe].)

of the attorney-client relationship, ensuring that attorneys provide the highest level of services, without even the specter of divided loyalties. "The effective functioning of that fiduciary relationship depends on the client's trust and confidence in counsel." (*People ex rel. Dept. of Corporations v. SpeeDee Oil Change Systems* (1999) 20 Cal.4th 1135, 1121 (*SpeeDee Oil*).) "A client who learns that his or her lawyer is also representing a litigation adversary, even with respect to a matter *wholly unrelated* to the one for which counsel was retained, cannot long be expected to sustain the level of confidence and trust in counsel that is one of the foundations of the professional relationship." (*Flatt v. Superior Court* (1994) 9 Cal.4th 275, 285.) With proper information, of course, a client can evaluate whether it is in its best interest to waive a particular conflict that, in the client's determination, will not taint the fiduciary relationship. But without that information, there can be no rational consideration and there can be no trust.

A sophisticated client, even one with in-house counsel, is in no better position to evaluate the risks of an existing or impending conflict where the facts are concealed. (*All's O.K., supra*, 29 Hofstra L. Rev. at p. 716.) No amount of experience makes a client more knowledgeable about something they know nothing about. (*Ibid.*) At most, J-M's experience gave it the forethought to ask Sheppard whether there were any conflicts; rather than disclosing the known facts, Sheppard assured J-M there were none. (P. 5, *ante*.)

Sheppard argues that J-M did not "express any concern" at Sheppard's hope to represent LADWP in some capacity in the future. (OBM, p. 33.) Even assuming a failure to express concern could be affirmative assent, Sheppard's *aspirations* for a hypothetical future representation are entirely different than an existing or impending conflict with a long-time client that inevitably returns for periodic advice. Indeed, Sheppard's express mention of LADWP and its concealment of its

relationship with South Tahoe smacks of a tactical choice that was intended to leave a false impression of forthrightness.

Even sophisticated clients need to be made aware of known facts surrounding existing or impending conflicts so that they can properly evaluate their risks.

b. Requiring disclosure furthers public trust in the legal profession and the administration of justice.

The conflict rules serve purposes beyond client protections. Indeed, "[t]he paramount concern must be to preserve public trust in the scrupulous administration of justice and the integrity of the bar." (*SpeeDee Oil, supra,* 20 Cal.4th at pp. 1145-1146.) There can be no such trust and no perception of integrity if the ethical rules approve an attorney's concealment from her client of information directly bearing on the duty of loyalty. That is particularly so since there is only one conceivable reason the attorney might engage in such concealment: the attorney has decided to put her own interests ahead of the client's.

c. Requiring disclosure protects the public.

Requiring disclosure also protects the public's interest that flow from the representation. For instance, where attorneys represents a client in a private attorney general action to vindicate rights of societal importance (E.g., *Woodland Hills Residents Assn., Inc. v. City Council* (1979) 23 Cal.3d 917, 924-925), the public is ill-served by a rule that permits the nominal client to waive all conflicts without a requirement that the attorney disclose relevant information.

Similarly, when a sophisticated client has too little information to appreciate a conflict's existence or significance, it is not just the client's business that is put at risk by the attorney's divided loyalties. Rather, the "consequences can extend to society as a whole." (Markovic, *The Sophisticates: Conflicted Representation And*

The Lehman Bankruptcy (2012) 2012 Utah L. Rev. 903, 939-940 (*Sophisticates*) [evaluating advance conflicts from the perspective of societal impact of Lehman Brother's bankruptcy that precipitated the 2008 economic meltdown].)

d. Countervailing interests do not permit general waivers as a substitute for disclosure of existing and impending conflicts.

Proponents of open-ended advance waivers argue that countervailing policies must be weighed. (OBM, pp. 37-39.) But those policies do not justify non-specific waivers to existing or impending conflicts known to the attorney. No legitimate goal does.

(1) Protecting clients' choice of counsel has no bearing on attorneys' duty to disclose known information.

Sheppard urges the Court to place its imprimatur on broad, non-specific, open-ended waivers because sophisticated clients should not be "prevented" from waiving conflicts. (OBM, p. 37.) That's nonsense. A rule requiring disclosure of a particular existing or impending conflict does not "prevent" the client from waiving the conflict. Informing the client is the necessary first step to informed consent.

Sheppard is correct that advocates of advance waivers stress that they aid clients' choice of counsel. (*Ibid.*) But that interest is not implicated in circumstances of existing or impending conflicts:

First, advocates of open-ended advance waivers depict them as a "type of 'insurance policy' or a way to neutralize '*unforeseeable* downstream conflicts'": Without an advance waiver, a firm looking out for its own interests might decline a representation, fearing that it could conflict them out of some hypothetical future

representation that might be more lucrative. (Morgan, *Finding Their Niche: Advance Conflict Waivers Facilitate Industry-Based Lawyering* (2008) 21 Geo. J. Legal Ethics 963, 964, italics added, cited at OBM, p. 38; D.C. Bar Ethics Opinion 309.) But an insurance policy for "unforeseeable downstream conflicts" does not justify a rule permitting the attorney to conceal *known* information about existing or impending conflicts.

Second, some argue that when required of new clients, open-ended advance waivers protect existing, long-time clients from gamesmanship—the use of an unimportant conflict as a "litigation tactic" to disqualify an opponent's counsel in later-filed litigation. (E.g., N.Y. City Bar Assn., Opn. 2006-1; 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, 975-976 (*Honoring Choice*), cited at OBM, pp. 37-38.) The theory is that a new client should "rationally" evaluate and waive future conflicts at a stage when the client "does not have an antagonistic relationship with any of the firm's other clients." (*Honoring Choice, supra*, 29 Hofstra L. Rev. at p. 995.) Otherwise, the new client might tactically choose to disqualify the attorney from representing one of the firm's long-time clients and thus, "strip" a long-standing client's choice of counsel. (OBM, p. 37.)

But requiring disclosure of known facts about existing or impending representations does not permit a client to later game the system by using disqualification as a litigation tactic. It simply permits the client to make a rational decision about whether to hire the attorney. Had Sheppard disclosed the relevant facts, that would not have "strip[ped]" South Tahoe of its right to counsel of its choice. (*Ibid.*) And if Sheppard could not reveal sufficient information about South Tahoe's representation due to confidentiality concerns, J-M would be unable to give

informed consent and would have to find other counsel—again, there would be no impact on South Tahoe or any other client. (P. 23, *ante*.)

e. Even if arguments about a prospective client's substantial bargaining strength were valid, that fact would not justify concealing conflict information.

Sheppard also contends that because sophisticated clients wield substantial bargaining power to negotiate the terms of an engagement, attorneys should be ethically permitted to seek broad, open-ended conflict waivers even to conceal a current or impending conflict. (OBM, pp. 38-39.) The argument is empirically unsound and ethically troubling.

First, in-house counsel are sometimes unsophisticated, young and inexperienced. (*All's O.K.*, *supra*, 29 Hofstra L. Rev. at p. 722.) They hire powerhouse firms *because* those firms are more sophisticated. (*Ibid.*) And a rule that distinguishes between different levels of sophistication produces its own untoward results: It creates a system in which determining whether conduct is ethical turns on after-the-fact litigation over the client's level of sophistication. (*Ibid.*)

Second, even for highly-experienced in-house counsel, bargaining power can have little, if any, practical impact here. When a long-time client approaches the firm with a new matter, it has little choice but to acquiesce to an advance waiver since moving the client's work to a new firm will create hardships and additional expenses as new counsel must develop institutional knowledge. (*Id.* at pp. 716-717.) And for new clients, bargaining power is practically meaningless in this context: Few clients will have such great power that they can convince a top firm that another, similar firm would be willing to make an exception to their standard practice of using open-ended advance waivers. (*Id.* at p. 717 [bargaining power is a "hollow promise].) Already, firms view advance waivers as "'a routine large firm

practice'" that increase their profits. (*Sophisticates, supra*, 2012 Utah L. Rev. at p. 938.) And the number of firms appearing as amicus in support of review in this case only underscores firms' appetite for open-ended waivers.

Third, bargaining-power arguments lose all perspective when applied to Sheppard's extreme view of open-ended waivers as a means to conceal information about existing and impending conflicts. Sheppard's approach would reduce a fiduciary relationship of dependence and trust into an arm's length commercial transaction between two businesses, where one business can use information disparity against the other. That isn't legal ethics. *It's caveat emptor*. That a client is sophisticated or has in-house counsel is no justification for depriving the client of relevant information the attorney knows and could easily provide. Attorneys are fiduciaries—and they must act like fiduciaries, regardless of their client's level of sophistication.

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Sheppard's argument would fail even if this Court were to follow those jurisdictions that permit generalized, open-ended advance waivers by sophisticated clients. No authority or policy permits Sheppard's extreme view. As we next demonstrate, the California Rules is not even susceptible to the far more limited advance waiver rule that has been adopted elsewhere.

B. California Rule 3-310 Is Not Susceptible Even To The Advance Waiver Rule Adopted By Other Jurisdictions, Much Less Sheppard's Extreme Departure From Those Other Jurisdictions.

Whatever the rule in other jurisdictions, the California Rules do not permit attorneys to conceal information about existing or impending conflicts. In fact, they do not even permit the far less extreme rule that permits attorneys to obtain informed consent of sophisticated clients through generalized, open-ended advance

waivers of hypothetical conflicts as opposed to more specific advance waivers given to other clients.

1. California's rule requires actual disclosures of relevant information—not blind, open-ended waivers.

This Court's role in *interpreting* the California Rules must begin with the text of the rules. California's Rules embody "explicit and *unequivocal* ethical norms" that reflect fundamental public policies. (*General Dynamics Corp. v. Superior Court* (1994) 7 Cal.4th 1164, 1189, italics altered.) For instance, Rule 3-310 unequivocally defines "informed written consent" as only possible "following *written disclosure*," which is defined as the attorney "*informing* the client or former client [in writing] of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the client or the former client." (California Rule 3-310(A), italics added.) "The attorney who claims his client consents to a conflicting representation bears a heavy burden of demonstrating that all relevant facts relating to the conflict were disclosed and explained to the client." (*Civil Service Com. v. Superior Court* (1984) 163 Cal.App.3d 70, 83.) That unequivocal definition of informed consent applies regardless of the client's level of sophistication and the availability of independent counsel.

The ABA and the D.C. Bar interpret their rules differently at least in part because their rules are different—not so absolute:

The ABA Model Rules define "informed consent" as agreement "after the lawyer has communicated *adequate* information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct." (ABA Model Rule 1.0(e), italics added.) Not surprisingly, the comments explain that the amount of information and explanation that is "adequate" depends on a variety of factors, including whether the client is sophisticated and represented by independent counsel. (*Id.* at com. 6.) And when the ABA applies that definition to

advance waivers, it concludes that that language admits of an interpretation that some clients might not need any specific information to be "adequately" informed about the risk of all hypothetical conflicts that might arise in the future. (ABA Model Rule 1.7, com. 22.)

The D.C. Code of Professional Responsibility employs a similar relativistic definition: "Consent" is assent "'following consultation with the lawyer'" and "consultation" is defined as "'communication of information *reasonably sufficient to permit the client to appreciate the significance* of the matter in question.'" (D.C. Bar Opn. 309, quoting D.C. rules, italics added.) Thus, "[a] waiver must be predicated upon disclosure *sufficient to allow the client*" to make an informed decision. (*Ibid.*, quoting D.C. rules.) Again, in the advance waiver context, this language arguably permits the interpretation that for some clients, no information is needed to do a "reasonably sufficient" job of apprising the client of the risks of purely hypothetical conflicts.

The California Rules are strikingly different. They require disclosure of relevant information in absolute terms. "Informed written consent" is defined as the client's written agreement to the representation "following written disclosure." (California Rule 3-310(A)(2).) That is, there can be no informed consent absent "written disclosure." And written "disclosure" is defined as a writing "*informing the client* or former client *of the relevant circumstances and* of the actual and reasonably foreseeable *adverse consequences* to the client or former client." (*Id.*, rule 3-310(A)(1), italics added.) There is nothing relativistic about it. "Written disclosure" must be made of the "relevant circumstances" regardless of the client's level of sophistication or the presence of in-house counsel.

California's unequivocal rule brings certainty and public confidence. California attorneys are not left to wonder whether the client's degree of sophistication is sufficient to permit non-specific or less-specific waivers. The

public is not left wondering whether attorneys' advance waiver practices are primarily out of concern for the client or the attorney's pocketbook.

In short, the California Rules do not allow for disclosure-less, generalized, open-ended advance waivers of all hypothetical conflicts. But at a minimum, the obligation to "inform" the client of "relevant circumstances" prohibits an attorney from obtaining informed consent while withholding relevant information known by the attorney concerning existing and impending conflicts.

2. Even California's proposed advance waiver rule reflects California's rejection of the ABA's approach.

The California State Bar's currently-pending proposed advance-waiver rule further illuminates that the current California Rule prohibits open-ended advance waivers. That's because the State Bar proposal *rejects* the ABA's decision to recognize generalized, open-ended advance waivers for sophisticated clients.

As part of its comprehensive revision of the California Rules, the State Bar Rules Commission recently adopted Proposed California Rule 1.7, which is currently open for public comment.[6/] Notably, while the Bar's proposal is otherwise based on the ABA Model Rule, the redline prepared by the Commission shows it explicitly *rejected* the ABA language permitting open-ended advance waivers by sophisticated, independently-represented clients.[7/] The current proposal also

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[6/] Proposed Rule 1.7, com. 8 http://ethics.calbar.ca.gov/Portals/9/documents/2d_RRC/Public%20Comment%20X/RRC2%20-%201.7%20[3-310]%20-%20Rule%20-%20DFT3%20(04-01-16)%20w-ES.pdf; see http://ethics.calbar.ca.gov/Committees/RulesCommission2014/ProposedRules.aspx.

[7/] The redline strikes the ABA Model Rule's statements that "if the client is an experienced user of the legal services involved and is reasonably informed regarding the risk that a conflict may arise, such consent 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." (Bar's Redline Comparison of ABA Model Rule

(continued. . .)

eschews the language of a 2010 proposal by the prior Rules Commission, which would have permitted open-ended advance waivers for sophisticated clients.[8/]

The proposed rule allows advance waivers, but *continues* to adhere to California's existing rule that open-ended waivers without disclosure do not constitute informed consent. Even if the State Bar ultimately changes its proposal, the current proposal demonstrates that permitting broad, open-ended waivers would be a significant change not supported by the current rules.

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All paths lead to the same result: California law does not permit what Sheppard tried to do. The current (and even the proposed) California Rules do not permit attorneys to obtain informed consent from sophisticated clients through generalized, open-ended advance waivers that make no disclosures about relevant circumstances. Even other jurisdictions that are more lenient are still crystal clear that generalized, open-ended waivers cannot be used where, as here, the attorney possesses but does not disclose facts about an existing or impending conflict. And public policy only reinforces the problems inherent in Sheppard's unique view of the law.

(. . . continued)

1.7, comment 22 and California Proposed Rule 1.7, comment 8 http://ethics.calbar.ca.gov/Portals/9/documents/2d_RRC/Public%20Comment%20X/RRC2%20-%201.7%20[3-310]%20-%20Rule%20-%20DFT3%20(04-01-16)%20w-ES.pdf at redline p. 8.)

[8/] Gone from the current proposed rule is the 2010 proposal's language that "even a general and open-ended advance consent can be in compliance when given by an experienced user of the type of legal services involved that was independently represented regarding the consent or was advised in writing by the lawyer to seek the advice of an independent lawyer of the client's choice and was given a reasonable opportunity to seek that advice." (Compare current Proposed 1.7, com. 8 with 2010 Proposed Rule 1.7, com. 22 http://ethics.calbar.ca.gov/LinkClick.aspx?fileticket=7MbhFr6ih-w%3D&tabid=2161.)

In light of the undisputed facts here, this case is a poor vehicle for deciding the hypothetical question whether broad, open-ended waivers are sometimes permissible for true advance conflict situations. Moreover, the State Bar should be permitted to complete its multi-year endeavor to answer that question. (§ II.B.2., *ante*.) That rule change—not an interpretation of the current rule—will guide California legal ethics in years to come.

III. THE SERIOUSNESS OF SHEPPARD'S ETHICAL VIOLATION—WHICH WENT TO THE HEART OF THE ATTORNEY-CLIENT RELATIONSHIP—REQUIRES FORFEITURE OF FEES REGARDLESS OF INJURY.

As we next explain, Sheppard's ethical violation—knowingly undertaking conflicting representations of two clients without obtaining an informed waiver from either (indeed, concealing the relevant facts)—is a fundamental transgression of the attorney's core duty of loyalty, and California cases uniformly preclude the attorney from profiting from the tainted relationship even without proof of damages. Indeed, many of the non-California authorities that Sheppard cites explicitly hold that damages are not a prerequisite. First, however, we must correct a factual assertion that is the premise of Sheppard's argument.

A. Contrary To Sheppard's Repeated Assertion, J-M Did Not Agree That It Was Unharmed.

Sheppard is wrong: J-M never stipulated that it was "not injured in any respect." (OBM, p. 41.) In fact, the injury is undeniable.

Sheppard relies on the parties' arbitration stipulation that "JM will not seek, and hereby waives any claims for, any and all transition costs" associated with hiring replacement counsel. (3AA581; see OBM, p. 41.) But that obviously does

not mean that J-M did not *incur* any transition costs. It only means that J-M agreed that it would not "seek" those compensatory damages.[9/]

There are inevitable strategic and financial costs when a client has to replace its counsel after a year of complex litigation involving hundreds of plaintiffs. At very least, there would be the cost of staying trial court proceedings, obtaining new counsel, and getting new counsel up to speed. (E.g., 1AA226.) Indeed, J-M initially permitted Sheppard to resist disqualification because it wanted to avoid disruption and additional costs that never would have arisen had Sheppard disclosed the conflict. (1AA194 ¶ 19.) And during the disqualification proceedings, Sheppard prepared a J-M declaration confirming that extending the pendency of the allegations against J-M was itself damaging. (1AA195, 225-227.) This is the opposite of *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23 (*Frye*), cited at OBM, pp. 41-42, where "[u]nder no *imaginable* circumstance would Frye have fared better had" the firm complied with its obligation to register with the State Bar. (38 Cal.4th at p. 48, italics added.)

Likewise, that J-M "waive[ed] any argument challenging, the value or the quality" of Sheppard's work (3AA580) is not tantamount to a concession that it was uninjured. Instead, J-M recognized—as does Sheppard's own legal authority that permits disgorgement without proof of injury—that it is extraordinarily difficult to prove that an attorney pulled punches due to divided loyalty. (See p. 45, *post.*)

As we next explain, Sheppard's legal arguments are meritless as well.

[9/] J-M agreed to forego its transition-cost claim to force Sheppard to stop seeking discovery from J-M's replacement counsel. (3AA581.)

B. California Cases Uniformly Hold That Public Policy Requires That Attorneys Forfeit Their Right To Fees When They Represent One Client In Litigation Against Another Client.

This Court has explained the unvarying California rule that an attorney may not recover the value of her services in cases involving "violations of a rule that proscribed the very conduct for which compensation [is] sought, i.e., the rule prohibiting attorneys from engaging in conflicting representations or accepting professional employment adverse to the interests of a client or former client without the written consent of both parties. (E.g., *Jeffry v. Pounds* (1977) 67 Cal.App.3d 6, 12; *Goldstein v. Lees* (1975) 46 Cal.App.3d 614.)" (*Huskinson & Brown, LLP v. Wolf* (2004) 32 Cal.4th 453, 463 (*Huskinson*), parallel citations and parentheticals omitted.) Any less definite rule—including the approach urged by Sheppard—would thwart the purpose of the proscription.

1. Actual conflicting representations are treated differently than other types of ethical violations because they are by their nature serious.

According to Sheppard, neither *Goldstein, supra*, nor *Jeffry, supra*, stand for the proposition that forfeiture is automatically required for "*all* 'conflicts of interests.'" (OBM, p. 48, italics added.) True, but irrelevant, because the cases distinguishes between different *types* of conflicts: Forfeiture is mandatory in the per-se serious situation when an attorney represents one client in litigation against another client—*actual conflicts* like the one here. On the other hand, "*technical*" violations regarding *potential conflicts* require exacerbating factors to be serious.

a. Actual conflicts requires forfeiture irrespective of harm or bad faith motives.

Three cases are particularly helpful in explaining the rule:

A.I. Credit Corp., Inc. v. Aguilar & Sebastinelli (2003) 113 Cal.App.4th 1072 held that forfeiture is required as a matter of law where a firm represents one client in a suit against another. (*Id.* at pp. 1074-1076, 1079-1080 ["attorney disqualified for violating an ethical obligation is not entitled to fees"].) The court acknowledged that a balancing test applies to *other* types of violations, including "minor technical violation[s]" of potential conflict rules. (*Ibid.* [discussing *Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000; see § III.B.1.b., *post*].) It did not matter that the client seeking disgorgement had waived the conflict—the attorney still violated its duty to the *other* client and public policy required forfeiture. (*Id.* at pp. 1080-1081.)

Jeffry v. Pounds, supra, likewise involved an actual conflict—a firm represented one client in an auto-accident case while accepting the representation of that client's wife in her divorce action. (67 Cal.App.3d at p. 8.) Forfeiture was automatic: After reversing the trial court's determination that the attorney had not violated any ethical duty, the appellate court held that the attorney was not entitled to fees *as a matter of law*—without remanding for any balancing. (*Id.* at pp. 8-9, 12.)

Contrary to what Sheppard says (OBM, pp. 44, 47-50), forfeiture was not based on the risk of disclosing confidential information or bad faith: The conflicting cases were unrelated and "entailed no confidential" information but forfeiture was required "without potential breaches of confidentiality." (67 Cal.App.3d at pp. 9-10.) And the court did "not charge [the attorney] with dishonest purpose or deliberately unethical conduct"—forfeiture was required to condemn the practice of accepting adverse employment. (*Id.* at p. 11.)

Similarly, in *Goldstein v. Lees, supra*, the inherently serious nature of "'accept[ing] employment adverse to a client'" required forfeiture. (46 Cal.App.3d at pp. 617-619 & fn. 3, 620.) Clients would find it "difficult to believe" that a conflicted lawyer "can offer the kind of undivided loyalty that a client has every right to expect and that our legal system demands." (*Id.* at p. 620.) Harm was irrelevant: "[T]here is no force to the objection that the result announced here will work a windfall for [the client]. This decision is not rendered for the sake of" the client; instead disgorgement is required because "'[c]ourts do not sit to give effect to . . . illegal contracts.'" (*Id.* at pp. 623-624, ellipses in original.)

Sheppard dismisses *Goldstein* as involving "an attorney's intentional use of a former client's confidential information." (OBM, p. 48 fn. 8.) Not so. The client retained the attorney, knowing that the attorney had insights about the opponent. (*Goldstein, supra*, 46 Cal.App.3d at p. 618.) But there was no evidence that the attorney actually used confidential information. (*Id.* at pp. 619-620 [attorney must have been tempted to reveal or monopolize secrets].) The dispositive "question is whether or not the employment of [the attorney] was adverse to the interests of the former client. Clearly, it was." (*Id.* at p. 619, italics omitted.)

b. Other types of conflicts require further consideration to determine seriousness.

On the other hand, exacerbating factors are required to show the seriousness of other types of violations that are not inherently as serious, including potential conflicts. (*Rodriguez v. Disner* (9th Cir. 2012) 688 F.3d 645, 654-655 [distinguishing forfeiture analysis for actual and potential conflicts].) The cases cited by Sheppard are illustrative:

In *Pringle v. LaChapelle, supra*, the plaintiff filed a harassment suit against a corporation and one of its officers. (73 Cal.App.4th at p. 1002.) An attorney represented the presumably-aligned defendants. The corporate officer waived

whatever potential conflict might later arise between himself and his co-defendant corporation. (*Id.* at pp. 1004-1005.) The corporation did so as well, but through the signature of the co-defendant officer. (*Ibid.*) The officer attempted to avoid paying fees on the ground that ethics rules required that the corporation could only waive the potential conflict if the waiver was signed by a *different* officer. (*Ibid.*)

Pringle distinguished the *technical* violation regarding a *purely potential conflict*—with no hint of actual adversity—from the types of "irreconcilable conflict[s]" in *Jeffry* and *Goldstein*. (*Id.* at p. 1005, fn. 4; see p. 39, *ante*.)

Mardirossian & Assoc., Inc. v. Ersoff (2007) 153 Cal.App.4th 257 likewise involved a technical issue about a potential-conflict waiver. The attorney obtained a waiver for the potential conflict between two co-parties and advised them to consult independent counsel. (*Id.* at pp. 277-279.) The client argued only that the written consent did not sufficiently "detail" the potential conflict—a violation that did not warrant forfeiture. (*Id.* at p. 279.)[10/]

c. The Restatement and other cited authority are not to the contrary.

Consistent with California's jurisprudence, the Restatement and Sheppard's out-of-state cases make clear that full forfeiture is not automatically appropriate for every ethical rule in the book. Not every rule is equally preclusive of all fees.[11/]

[10/] *Sullivan v. Dorsa* (2005) 128 Cal.App.4th 947 did not involve a suit by one client against another; a firm represented a land-sale referee while representing the prospective buyer in a different matter. (*Id.* at pp. 963-966.) The party seeking denial of fees never had an attorney-client relationship with the firm. (*Ibid.*)

[11/] Restatement, § 37 (broadly discussing all ethics rules); *International Materials Corp. v. Sun Corp.* (Mo. 1992) 824 S.W.2d 890, 894-895 (forfeiture not appropriate when attorney withdraws due to an "unforeseeable" conflict arising after the attorney accepts a case or if the client's actions precipitate the attorney's withdrawal); *Burrow v. Arce* (Tex. 1999) 997 S.W.2d 229, 232 (*Burrow*) (soliciting business through lay intermediary, failing to communicate offers, intimidating clients, etc); *In re Marriage of Pagano* (Ill. 1992) 607 N.E.2d 1242, 1246-1247

(continued. . .)

But that still allows certain *types* of violations to be categorically so serious as to require forfeiture regardless of proof of harm or other exacerbating factors.

None of these authorities holds that a client needs to prove harm or bad faith when an attorney conceals the results of a conflicts check and undertakes a representation despite an actual or imminent conflict known to the attorney. That is per se serious—it goes to the very heart of the attorney-client relationship, undermines the public's confidence in the justice system, and makes all of the attorney's services impermissible. The Restatement requires that courts consider "the gravity and timing of the violation." (Restatement, § 37.) When that is enough to demonstrate seriousness, the Restatement does not require consideration of whether harm or other factors further exacerbate the seriousness. Nor does it suggest that a serious violation is any less serious because it causes no provable harm. To the contrary, "forfeiture is justified for a flagrant violation even though no harm can be proved." (*Id.* at com. d.) Courts and "respected commentators, have also held that forfeiture is appropriate without regard to whether the breach of fiduciary duty resulted in damages." (*Burrow, supra,* 997 S.W.2d at pp. 239-240.)[12/]

(. . . continued)

(undue influence in obtaining waiver of statutory fees); *Gilchrist v. Perl* (MN 1986) 387 N.W.2d 412, 415, 419-420 (attorney hired adverse party's insurance adjuster in an unrelated context).

[12/] Sheppard references cases cited in *Burrow, supra.* (OBM, p. 47.) Those cases do not require balancing when an attorney undertakes a case when he knows or should know about an actual or imminent conflict. They do so for things like overbilling, retaining the client's property, and potential conflicts. On the other hand, *Burrow* cites *Cal Pak Delivery v. United Postal Serv.* (1997) 52 Cal.App.4th 1, 14-16 and *In re Estate of McCool* (N.H. 1988) 553 A.2d 761, 769, which held that attorneys forfeit all fees for services performed after an actual conflict arises. *Burrow* also cited *In re Estate of Brandon* (Alaska 1995) 902 P.2d 1299, which left the question open; in a subsequent case, the same court cited *Brandon* for the general rule that requires forfeiture (*Alaska Native Tribal Health Consortium v. Settlement Funds* (Alaska 2004) 84 P.35 418, 435 fn. 56).

In fact, the Restatement itself juxtaposes the two types of rules: As to most ethical violations, a "lawyer's improper conduct *can* reduce or eliminate the fee that the lawyer may" charge—there is a possibility of reduction or forfeiture. (Restatement, § 37, com. a, italics added.) But an absolute rule applies when the attorney violates the rule against undertaking a conflicted representation, which prohibits the very services for which compensation is sought. It is not a matter of "can reduce" fees. A "lawyer *is not entitled* to be paid *for services rendered in violation*" of the lawyer's duty. (*Ibid.*, italics added.) The Restatement's language is virtually identical to this Court's language explaining that in actual-conflict cases, forfeiture must apply because the violated rule "proscribed the very conduct for which compensation [is] sought." (*Huskinson , supra,* 32 Cal.4th at p. 463.) Of course, there are exceptions to that rule. For instance, when a conflict "arises during a representation because of the unexpected act of a client or third person," forfeiture might not be appropriate. (Restatement, § 37 com. d.) But nothing like that happened here.

2. Contrary to Sheppard's assertion, *Huskinson* only reaffirms that attorneys cannot be permitted to profit by undertaking a representation while operating under an undisclosed conflict of interest.

Sheppard contends that *Huskinson, supra*, supports an attorney's recovery of fees for undertaking a representation while concealing an actual conflict because attorneys will still have other incentives to act ethically. (OBM, pp. 45-46.) Not so.

First, *Huskinson* applied a two-part test. The first part—which Sheppard ignores—is fatal to its position. *Huskinson* considered whether allowing quantum meruit was "tantamount to permitting a division of client fees, in contravention of rule 2-200." (*Huskinson, supra*, 32 Cal.4th at p. 458.) "To resolve this issue, we look *first* to rule 2-200 to ascertain what it seeks to accomplish." (*Ibid.*, italics

added.) After analyzing the language of rule 2-200, the Court concluded that "rule 2-200 does not purport to restrict attorney compensation on any basis other than a division of fees" and that a quantum meruit recovery was "not a fee division" within the meaning of rule 2-200. (*Id.* at pp. 458-459.) Only because the case satisfied that first test did the Court "next examine whether" allowing compensation would nonetheless undermine compliance with Rule 2-200—an analysis that looked at incentives for compliance. (*Id.* at p. 459.) That is an additional test. It is not sufficient to allow compensation that would itself violate the purpose of the ethical rule.

Indeed, *Huskinson* later underscored this point. It contrasted its analysis of rule 2-200's purpose with the purpose of the rule against actual conflicts. It explained that attorneys are not entitled to fees when the violated rule "proscribed the very conduct for which compensation was sought" such as the rule forbidding attorneys from "accepting professional employment adverse to the interests of a client or former client without the written consent of both parties." (*Id.* at p. 463.) It then reiterated that rule 2-200 does not bar legal services; "it simply prohibits the dividing" of fees. (*Ibid.*)

As the Court itself observed, *Huskinson*'s first test is fatal here. Sheppard is not entitled to compensation, because the purpose of Rule 3-310 is to prohibit an attorney from providing the very services for which Sheppard seeks compensation. The prohibition against laboring under an actual conflict is central and fundamental to the attorney-client relationship, and that purpose would be violated if attorneys were entitled to compensation for impermissible services.

Second, Sheppard cannot prevail even under *Huskinson*'s second test. Sheppard argues that "attorneys still would have significant incentive" to follow conflict rules even if they can recover all of their fees, because attorneys will fear disciplinary action, reputational harm, and a damages claim by their clients.

(OBM, p. 46.) But that was not *Huskinson*'s standard. Rather, *Huskinson*'s second test permitted compensation because it would create "*no less* incentive"—not because some different, non-financial incentive exists. (32 Cal.4th at p. 460, italics added.) The Court explained that allowing quantum meruit would do *nothing* to reduce the *financial* incentive for compliance: Because a quantum meruit award based on the reasonable value of services can be far less than a negotiated fee division, "we may logically assume that . . . plaintiff and all other similarly situated law firms and attorneys remain fully motivated to see that all of their future fee-sharing agreements comply with rule 2-200." (*Ibid.*) The Court emphasized that an attorney would be "fully motivated" to comply because it meant the difference between receiving $18,000—under an agreed-upon percentage—or just $5,000 for hours worked. (*Ibid.*) Similarly, other authorities stress the important deterrent value of forfeited compensation. (E.g., Restatement, § 37, com. b; *Burrow*, *supra*, 997 S.W.2d at p. 238.)

By contrast, it cannot be "logically assum[ed]" that a firm will have "no less" incentive to comply with its duty of loyalty if it is entitled to receive its billed hours in quantum meruit rather than under the contract itself. That financial incentive is the key. Indeed, if Sheppard's approach were correct, *Huskinson* would not have gone through its financial analysis at all since it will always be true that some incentive remains in the risk of disciplinary action or reputational harm.

What's more, Sheppard's argument rings hollow:

- The risk of compensatory damages to a harmed client is relatively small. It is well-recognized that such damages are often very difficult to prove. (E.g., Restatement, § 37, com. b; *Burrow*, *supra*, 997 S.W.2d at p. 238.) Proving that an attorney pulled punches is practically impossible. The risk that a particular client will discover the conflict, be easily able to prove significant harm, and be willing

to litigate factual issues through trial hardly creates "no less" deterrent than the rule requiring forfeiture of fees.

- Likewise, the risk of reputational harm (if an issue becomes notoriously public) or of discipline (if the State Bar learns about and chooses to devote its limited resources to the violation) is "less" of a deterrent than the immediate and powerful consequence of forfeiting compensation.[13/]

3. Even if a multi-factor test should apply, there is no merit to Sheppard's request that this Court find in Sheppard's favor.

In any event, there is no merit to Sheppard's argument that this Court should find Sheppard entitled to all of its fees. (OBM, p. 50.) If courts must decide and weigh these issues, then the trial court must do so in the first instance and determine what, if anything, Sheppard should receive.

It is not enough that Sheppard asserts that it "genuinely believed" that it complied when it concealed information in a manner that is universally prohibited. (OBM, pp. 48-49; § II., *ante*.) Nor can Sheppard rely on the arbitration award (OBM, pp. 48-49), which is a nullity since the case should never have been compelled to arbitration. It is indisputable that J-M was harmed. (§ III.A., *ante*.) And Sheppard does not consider what its own authority says is the "[m]ost important[]" factor that courts "must consider"—"whether forfeiture is necessary to satisfy the public's interest in protecting the attorney-client relationship." (*Burrow*, *supra,* 997 S.W.2d at p. 246.)

[13/] Sheppard is in a particularly poor position proclaim the force of reputational and disciplinary risks. A published decision held that Sheppard had employed unethical means to avoid a conflict. That didn't stop Sheppard from attempting that same tactic here. (P. 7, *ante*.)

C. The Client Need Not Prove Compensable Damages As A Prerequisite For Disgorgement Of Fees An Attorney Collected.

Sheppard next contends that proof of injury is a prerequisite for disgorgement. (OBM, § III.A.) As demonstrated above, Sheppard's argument that J-M was "not injured" is baseless. (§ III.A., *ante*.) That alone eliminates applicability of Sheppard's argument. But the argument is legally meritless as well.

1. Disgorgement is an appropriate contract remedy without proof of damages.

Sheppard contends that damages must be proven to establish a tort claim. (OBM, § III.A.) Even if that were true, disgorgement is appropriate as a contract remedy.

Sheppard is not entitled to retain compensation obtained under an entirely illegal contract. Proof of damages is not required when an ethical violation is "sufficient to warrant voiding of an agreement" between attorney and client because such forfeiture is not a form of compensatory damages. (*Fair*, *supra*, 195 Cal.App.4th at p. 1153; cf., *Carson Redevelopment Agency v. Padilla* (2006) 140 Cal.App.4th 1323, 1336 [disgorgement authorized for void contract].)

Sheppard previously countered that "J-M sought only 'compensatory damages' as a remedy for its contract claim." (Reply to Petition for Review, p. 14, citing 1AA26.) But as to "all causes of action," J-M sought "[s]uch other and further relief as the Court may deem just and proper." (1AA27.) That was sufficient. (*Slovensky v. Friedman* (2006) 142 Cal.App.4th 1518, 1536 [identical prayer covers disgorgement].)

Sheppard also argued that "in the arbitration J-M limited its cross-claims to tort claims." (Reply to Petition for Review, p. 14, citing 3AA705.) Sheppard's record cite merely says that J-M "claimed ethical violation (with its potential for fee

disgorgement and forfeiture)." (3AA705.) Besides, since the case should never have been in arbitration, J-M's arbitration-tactics have no impact here. (§ I., *ante*.) And since entire-illegality issues are solely for the courts, it would not be surprising that the arbitration failed to seek a contract remedy for entire illegality. (*Ibid.*)

2. Sheppard's argument is meritless even if considered on tort principles.

In any event, disgorgement without proof of damages is appropriate even when a claim is based on tort. There is no reason to permit an attorney to retain compensation previously paid while insisting he forfeit receivables. Doing so would only reward the attorney for successfully concealing a breach long enough to receive payment. Forfeiture is a necessary deterrent specifically because attorneys know that damages will often be difficult to prove, particularly because a conflict can cause an attorney to compromise the client's case in myriad subtle ways that are, by their nature, almost impossible to assess.

Not surprisingly, many cases—all cited in the Restatement—recognize the availability of disgorgement without proof of damages. (E.g., *Burrow*, *supra*, 997 S.W.2d 229, 233, 237-240, 244-245 [harm is not a "prerequisite" to disgorgement; attorney should not be "insulated" by client late discovery of breach]; *Hendry v. Pelland* (D.C. Cir. 1996) 73 F.3d 397, 402 [clients "seeking disgorgement of legal fees as their sole remedy need prove only that their attorney breached that duty, not that the breach caused them injury"; "longstanding and fundamental principle of equity—that fiduciaries should not profit from their disloyalty"]; *In re Estate of Corriea* (D.C. 1998) 719 A.2d 1234, 1241 [disgorgement appropriate]; *Eriks v. Denver* (Wash. 1992) 824 P.2d 1207, 1213 [refund for conflict of interest without showing harm].)

Sheppard's reliance on *Frye, supra,* only reinforces the point. (OBM, pp. 41-42.) *Frye* did not hold that damages were a prerequisite. Rather, it held that

forfeiture was "disproportionate" to the particular wrong in the case—a non-profit firm's failure to register with the State Bar. (38 Cal.4th at pp. 49-50.) The State Bar urged the "unfair[ness]" of disgorgement since it had generally not enforced the registration requirement. (*Ibid.*) And permitting disgorgement would be incompatible with the "unique and indispensable" public function of non-profit law firms. (*Id.* at p. 50.) When combined with the fact that "[u]nder no imaginable circumstance" could the client have been harmed, the Court held that disgorgement was "disproportionate" to the particular wrong. (*Id.* at pp. 48-50.)[14/]

CONCLUSION

Sheppard violated its duty of loyalty even under the standards enunciated by the authorities Sheppard relies on. That violation of a lawyer's most fundamental duty was so central to the attorney-client relationship that it (1) renders the entire agreement illegal and the dispute non-arbitrable and (2) compels forfeiture of Sheppard's compensation.

Dated: September 12, 2016

Respectfully submitted,

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[14/] To the extent *Slovensky, supra,* 142 Cal.App.4th at p. 1536 applied a different understanding of "the *Frye* rule," it should be disapproved.

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 13,997 words.

DATED: September 12, 2016

Jeffrey E. Raskin

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 September 12, 2016, I served the foregoing document described as: **ANSWER BRIEF ON THE MERITS** on the interested parties in this action by serving:

******* See Attached Service List *******

(✓✓) 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 September 12, 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.

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