2nd Civ. No. B256314

COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION FOUR

SHEPPARD, MULLIN, RICHTER & HAMPTON, LLP,

Plaintiff and Respondent,

v.

J-M MANUFACTURING COMPANY, INC., dba JM EAGLE,

Defendant and Appellant.

Appeal from the Los Angeles County Superior Court
Honorable Stuart Rice, Judge; Case No. YC067332

APPELLANT'S OPENING BRIEF

GREINES, MARTIN, STEIN & RICHLAND LLP
Kent L. Richland, SBN 51413
Barbara W. Ravitz, SBN 86665
Jeffrey E. Raskin, SBN 223608
5900 Wilshire Boulevard, 12th Floor
Los Angeles, California 90036
(310) 859-7811 // Fax (310) 276-5261
krichland@gmsr.com; bravitz@gmsr.com

Attorneys for Defendant and Appellant
J-M MANUFACTURING COMPANY, INC., dba JM EAGLE

Court of Appeal
State of California
Fourth Appellate District

CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

Court of Appeal Case Number: B256314

Case Name: Sheppard, Mullin, Richter & Hampton, LLP v. J-M Manufacturing Company, Inc., dba JM Eagle

Please check the applicable box:

[X] There are no interested entities or parties to list in this Certificate per California Rules of Court, Rule 8.208.

[ ] Interested entities or parties are listed below:

Name of Interested Entity or Person	Nature of Interest
1.	
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Signature of Attorney/Party Submitting Form

Printed Name: Barbara W. Ravitz
Address: Greines, Martin, Stein & Richland LLP
5900 Wilshire Blvd., 12th Floor
Los Angeles, CA 90036
State Bar No: 86665
Party Represented: Appellant J-M MANUFACTURING COMPANY, INC., dba JM EAGLE

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INTRODUCTION

The duty of loyalty—the absolute and complete fidelity that an attorney owes every client—is the most fundamental obligation of the attorney-client relationship. The duty even survives that relationship, since it is owed to former clients as well. The duty of loyalty is inviolate. It cannot be waived.

This is a case where attorneys attempted to do just that. They prepared and entered into a retainer agreement with a new client that contained an explicit waiver of their duty of loyalty to that client, knowing that they currently represented another client in other matters who was adverse to the new client in the new matter. In addition, the retainer agreement contained a general waiver of all client conflicts—past, present and future. The attorneys neither disclosed the actual conflict to the new client nor obtained the client's informed consent to the conflicting representation.

The retainer agreement is illegal. Its unlawful object—to waive the attorneys' duty of loyalty—was plain on its face. It is black letter law that California courts will not enforce an illegal contract or one against public policy; this contract was both.

The fact that the parties' dispute was arbitrated, pursuant to an arbitration provision in the agreement, and that the attorneys prevailed, makes no difference. The arbitration award validated an illegal agreement, which no court can enforce. The award cannot stand on any higher ground than the agreement itself. One cannot do through arbitration what cannot be done through litigation.

The superior court erred in confirming the arbitration award, thereby enforcing an illegal agreement. The judgment must be reversed.

STATEMENT OF FACTS AND OF THE CASE

A. Background.

1. JM approaches Sheppard to defend it in an ongoing qui tam action.

J-M Manufacturing Company (JM) and another party were co-defendants in a federal qui tam action originally filed under seal in 2006; the action concerned the defendants' sale of PVC (plastic) pipes to government entities. (1 Appellant's Appendix (AA) 191, ¶ 2; 3 AA 671.)[1] Around February 2010, JM became dissatisfied with its counsel in the qui tam action and began to search for new counsel. (2 AA 473-475.) JM's general counsel, Camilla Eng, identified Bryan Daly and Charles Kreindler, partners at Sheppard Mullins Richter & Hampton, LLP (Sheppard), as candidates to replace JM's former counsel; Ms. Eng was impressed with their extensive experience litigating similar cases. (2 AA 474, ¶ 13.)

Messrs. Daly and Kreindler met with Ms. Eng, JM's CEO Walter Wang, and other JM representatives on February 22 for about three hours. (2 AA 474, ¶ 14; 491, ¶ 16.) The Sheppard lawyers informed Ms. Eng and her colleagues that they had "considerable experience" with the lawyer representing the intervenors in the qui tam suit; that they recently had "great success" in another false claims case involving brass pipe; and that they had "independent, direct relationships" with several potential intervenors in the qui tam suit. (2 AA 474-475, ¶¶ 15-16.) Ms. Eng said she was impressed by the lawyers' qualifications, contacts and proposed strategy. (2 AA 475, ¶ 18.) Within a few days, JM expressed its desire to hire Sheppard. (*Ibid.*)

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[1] AA cites are preceded by the volume number and followed by the page number.

During the interview process leading to JM's retention of Sheppard, the Sheppard attorneys assured Ms. Eng "that there were no conflicts with the firm's proposed representation" in the qui tam action. (1 AA 191, ¶ 4.)

2. Sheppard discovers a conflict between JM and its existing client, South Tahoe, conceals it from both clients and its own partner, and agrees to represent JM.

Messrs. Daly and Kreindler ran a conflicts check to see if Sheppard represented any other parties in the qui tam action. (2 AA 475, ¶ 19.) The conflicts check "identified South Tahoe Public Utilities District as a client . . . ." (2 AA 317, ¶ 5.)

South Tahoe was a plaintiff in the qui tam action, directly adverse to defendant JM. (2 AA 283, ¶ 6.) In February 2010, South Tahoe had filed an election to intervene in the qui tam action as a plaintiff. (2 AA 283, ¶ 6; 294.)[2]

South Tahoe had been a Sheppard client since 2002, with partner Jeffrey Dinkin in charge of the representation. Mr. Dinkin had done employment-related work for South Tahoe at his former firm and continued doing it periodically at Sheppard until March 2011. (2 AA 275-276, ¶¶ 2, 4, 5; 278-279, ¶¶ 11, 13.)

Messrs. Daly and Kreindler discussed the results of their conflicts check—revealing that South Tahoe was a client of the firm—with Sheppard's General Counsel and an Assistant General Counsel. Both

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[2] In a qui tam action under the False Claims Act, once the complaint is unsealed and served on the defendants, various government agencies such as South Tahoe, which had previously been named as real-parties-in-interest, are permitted to intervene as plaintiffs. (2 AA 489, ¶¶ 6-8.)

advised that an "advance conflict waiver" in South Tahoe's engagement letter with Sheppard eliminated any problem. (2 AA 476, ¶ 20; 317, ¶ 5.)

Without disclosing the conflict to South Tahoe or JM or seeking an informed waiver of that conflict—and expressly assuring JM there were no conflicts—Sheppard entered into a retainer agreement with JM on March 4, 2010 (Agreement). (1 AA 191-192, ¶¶ 3, 4, 7.) The Agreement stated, in part:

> 4. Conflicts with Other Clients. . . . We may currently or in the future represent one or more other clients (including current, former, and future clients) in matters involving [JM]. We undertake this engagement on the condition that we may represent another client in a matter in which we do not represent [JM], even if the interests of the other client are adverse to [JM] . . . *provided* the other matter is not substantially related to our representation of [JM] . . . . By consenting to this arrangement, [JM] is waiving our obligation of loyalty to it so long as we maintain confidentiality and adhere to the foregoing limitations.

(1 AA 201.)

Ms. Eng signed on behalf of JM, indicating that JM "has waived any conflict of interest on the part of this Firm [Sheppard] arising out of the representation described above." (1 AA 204.)

Sheppard also concealed the conflict from Jeffrey Dinkin, its own partner in charge of the South Tahoe account, who, along with colleagues, continued to provide legal services to South Tahoe until March 2011, a full year after the firm took on JM as a client. (2 AA 278-279, ¶¶ 13, 14.) Mr. Dinkin did not learn about the conflict until South Tahoe raised the issue in March 2011. (2 AA 280, ¶ 17.)

3. South Tahoe, discovering that its connsel is also representing its adversary in the qui tam action, threatens disqualification; Sheppard denies any conflict and still says nothing to JM.

In January 2011, South Tahoe became aware that Sheppard was simultaneously representing it and JM, its adversary in the qui tam action, and in March of that year South Tahoe demanded from Sheppard an "immediate explanation of the circumstances" surrounding the "clear conflict of interest." (2 AA 284, ¶ 9; 303-304.) Sheppard replied that South Tahoe's engagement letter contained a "conflict waiver"; that in response to South Tahoe's recent demand letter, Sheppard had erected an "ethical wall" separating those personnel working for South Tahoe from those working for JM; and that "there is no conflict pursuant to the California Rules of Professional Conduct, and certainly no conflict that hasn't already been waived" (2 AA 306, 311). Around April 11, South Tahoe formally notified Sheppard it was contemplating bringing a motion to disqualify Sheppard from the qui tam action. (1 AA 193, ¶ 12.) Finally, on April 19, Sheppard admitted to South Tahoe that the conflicts check it had run before agreeing to represent JM "showed South Tahoe to be an existing client." (2 AA 284, ¶ 14.)

Still, Sheppard said nothing to JM about the threatened disqualification until April 20, 2011. (1 AA 193, ¶ 15; 214.) And Sheppard *never* directly told JM about the conflicts check; JM learned of it through a court filing in late June. (1 AA 192, ¶ 7.) Nor did Sheppard ever inform JM it had erected an "ethical wall." (1 AA 193, ¶ 11.)

4. In the disqualification proceedings, the District Court finds the "advance waiver" signed by South Tahoe to be "ineffective."

In May 2011, South Tahoe filed its motiou to disqualify Sheppard. (2 AA 319.) JM, relying on Sheppard's assurances that there was "'nothing to worry about'" and the motion "'will be denied,'" entrusted Sheppard to fight the disqualification motion and to continue the defense of the qui tam action. (1 AA 194, ¶¶ 17-19; 218.)

In its June 6 tentative ruling, the District Court rejected Sheppard's arguments against disqualification. (2 AA 345.) The court found, among other things, that the so-called advance waiver signed by South Tahoe was "ineffective" and did not amount to the "informed written consent" that is required of each client by rule 3-310(C)(3) of the California Rules of Professional Conduct (hereafter, Rules). (2 AA 346-349.) The court also rejected Sheppard's claim that "it should be permitted to drop South Tahoe as a client . . . ." (2 AA 351.) As the court observed, "'[a] lawyer may not avoid the automatic disqualification rule applicable to concurrent representation of conflicting interests by unilaterally converting a present client into a former client.'" (*Ibid.*; original quote from *American Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton* (2002) 96 Cal.App.4th 1017, 1037, 1044, where the Court of Appeal determined that Sheppard and its partner "exhibited an absence of loyalty when they jettisoned [their client] American in order to assume a preferred position" with an entity adverse to American.)[3]

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[3] The District Court found it "somewhat remarkable" that Sheppard "proposes simply dropping South Tahoe as a client in seeking to resolve this matter," since Sheppard "was the named defendant law firm in the (continued...)

Finally, the District Court rejected Sheppard's suggestion that "its recent institution of an 'ethical wall' should resolve the issue." (2 AA 351, fn. 7 [citing cases holding that an ethical wall cannot cure a breach of the duty of loyalty, as opposed to the duty of confidentiality, and in any event cannot be erected long after the conflict arises].)

The District Court requested additional briefing on Sheppard's suggestiou to bifurcate South Tahoe from the qui tam action and to require JM to obtain separate counsel for that portion of the case. (2 AA 352.) Sheppard attorneys Daly and Kriendler advised JM that bifurcation "was not in JM's best interest and was not their 'preferred course' of action." (1 AA 196, ¶ 28; 239.)

5. After unsuccessfully attempting to purchase a conflict waiver from South Tahoe and to obtain a bifurcation agreement from JM, Sheppard is disqualified.

On June 9, 2011, Sheppard sent South Tahoe a conciliatory letter, offering its client $100,000 to waive the conflict and—ignoring the District Court's tentative ruling condemning Sheppard's concurrent representation of South Tahoe and JM—to continue representing South Tahoe and provide it with "up to 40 hours of free labor and employment legal advice and services." (2 AA 391.) Sheppard apologized "[i]f we have offended [South Tahoe] due to the positions we have taken in connection with the disqualification motion." (*Ibid.*) When South Tahoe refused the offer (2 AA 392), Sheppard sweetened the deal, increasing its offer to $250,000,

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[3] (...continued)
American Airlines case," which held in a published opinion that the practice constituted a violation of the duty of loyalty. (2 AA 351, fn. 9; *American Airlines, supra*, 96 Cal.App.4th at p. 1044.)

promising to "maintain the ethical wall" and assuring South Tahoe that Jeffrey Dinkin would provide the free legal services (2 AA 395-396). Once again, Sheppard apologized to its longtime client, and once again, South Tahoe rejected the offer. (*Ibid.*)

The District Court held its continued hearing on July 7, 2011. (2 AA 398.) For the first time, outside malpractice counsel appeared to represent Sheppard's interests. (*Ibid.*) Sheppard did not advise JM to obtain independeut counsel. (1 AA 195, ¶¶ 23-24.) At the hearing, the court stuck to its earlier ruling and gave JM one week to decide whether to accept the proposed bifurcation of South Tahoe, while noting "the dearth of controlling precedent in this area" and expressing doubt that bifurcation "has any purchase in the duty of loyalty context." (2 AA 398-400.) Despite having recently advised JM that bifurcation "was not in JM's best interest," Sheppard suddenly opined that there wasn't "any significant downside" to bifurcation, and strongly encouraged JM to agree to bifurcation to avoid the firm's disqualification. (1 AA 196, ¶¶ 27, 28; 235-236, ¶ 2.) Based on advice given to JM by independent counsel, JM rejected the proposed bifurcation as not being in JM's best interest. (1 AA 197, ¶¶ 30-31.)

On July 14, 2011, the District Court granted South Tahoe's motion to disqualify Sheppard from representing JM in the qui tam action. (2 AA 405.) JM then retained new counsel to replace Sheppard. (1 AA 197, ¶ 32.)

B. Sheppard vs. JM—Initial Trial Court Proceedings.

1. The pleadings.

In June 2012, Sheppard filed a complaint against JM in the superior court alleging claims for specific performance, breach of contract, account stated, services rendered and quantum meruit, and seeking unpaid legal fees of approximately $1.1 million. (1 AA 1, 4, ¶ 11.) The specific performance

claim sought an order compelling the parties to arbitrate the controversy, based on a clause in the March 4, 2010 engagement agreement between them. (1 AA 4, ¶ 16.) JM filed a cross-complaint against Sheppard alleging claims for breach of contract, accounting, breach of fiduciary duty and fraudulent inducement. (1 AA 8.) The cross-complaint asserted that due to Sheppard's conflict of interest and violation of the Rules, the Agreement was illegal under California law, and that Sheppard was required to disgorge the approximately $2.7 million in fees previously received from JM and to forfeit the further fees Sheppard sought from JM. (1 AA 13-15, 21, ¶ 48.)

2. The superior court decides that the question of the Agreement's legality is for the arbitrators, not the court.

In August 2012, Sheppard petitioned for an order compelling arbitration, and the parties filed briefs and supporting evidence. (1 AA 41.) JM objected to arbitration on grounds including that the entire Agreement, including the arbitration clause, was illegal and void against public policy. (1 AA 54-58.)

The court granted Sheppard's petition to compel arbitration. (1 AA 61.) It found that the issue of whether the entire Agreement was invalid and void or whether it was properly entered into and enforceable "is a decision for the arbitrator." (1 AA 62:7-9.) The court also found that the parties had "properly" contracted out of the "procedural requirements of the Federal Arbitration Act ('FAA') . . . ." (1 AA 62:2-5.)

3. The Court of Appeal summarily denies JM's challenge to the arbitrability decision.

JM filed a petition for writ of mandate arguing that California law prohibits the arbitration of illegal contracts and requires the court, not the arbitrators, to adjudicate claims of illegality. (1 AA 66, 92.) Sheppard filed preliminary opposition (1 AA 116) and JM filed a reply (1 AA 150).

On February 28, 2013, the Court of Appeal, Second District, Division Four, summarily denied the writ petition "for failure to demonstrate entitlement to extraordinary relief." (1 AA 163.)

C. Sheppard vs. JM—The Arbitration.

The parties submitted briefs and evidence in the arbitration, which was held in December 2013 before retired Judge Gary L. Taylor, retired Justice Charles Vogel and James. W. Colbert, III. (3 AA 670.) The arbitration award was rendered on January 30, 2014. (3 AA 679.)

In their award, the arbitrators acknowledged that "California law prohibits an attorney from simultaneously representing two clients who are adverse to each other, even in separate and unrelated matters, without the informed written consent of each client." (3 AA 673:11-13, citing rule 3-310(C)(3).) "Such an informed consent requires that all material facts relating to the conflict be disclosed and explained to the client. [Citation.] Informed consent requires an adequate basis of knowledge of the facts and an awareness of the consequences of an important decision. [Citation.]" (3 AA 673:13-18.)

Yet despite finding that Sheppard's failure to seek JM's informed consent "put J-M in the position where, to its surprise, its attorneys were conflicted out of the case a year later," and that "the better practice would have been to disclose the full South Tahoe situation to J-M, and seek J-M's

waiver of it," the arbitrators concluded that "this issue need not be decided." (3 AA 673:22-25, 674:3-5.) Instead, they "assumed that the ethical violation occurred," but concluded that "fee disgorgement and forfeiture are not appropriate under the facts of this case" because the violation was not sufficiently "serious or egregious." (3 AA 674:7-9, :22-24.) In so deciding, the arbitrators rejected cases holding or suggesting that disgorgement/forfeiture is automatic if the offending attorney has violated fundamental conflict-of-interest requirements. (3 AA 674:19-677:5.)[4]

Sheppard was awarded $1,118,147 plus interest. (3 AA 679:2-5.)

D. Sheppard vs. JM—Trial Court Confirmation Proceedings.

1. The superior court confirms the arbitration award.

In response to the parties' cross-requests, the court granted Sheppard's petition to confirm the arbitration award and denied JM's petition to vacate it. (3 AA 824.)

The court first determined it had the power to review the award under Code of Civil Procedure section 1286.2, subdivision (a)(4), which provides for vacation of an arbitration award when "'[t]he arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted.'" (3 AA 825:6-8.) The court reasoned that "[t]he court may decide whether the arbitrators exceeded their powers," and "[t]he arbitrators exceeded their powers if they enforced an illegal contract." (3 AA 826:9-11.) Since JM contended that "the award seeks to enforce a void and illegal contract that

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[4] The arbitrators also found that Sheppard was not liable for fraudulent concealment. "[T]he firm honestly and in good faith believed that no conflict existed when it undertook the Qui Tam defense." (3 AA 674:10-17.)

was entered into in violation of the public policy provisions of California Rule of Professional Responsibility 3-310(c)(3)," the court concluded it had the power to review the award. (3 AA 824:21-23, 826:13-15.)

On review, the court found that the arbitrators did not exceed their powers. "The contract was not illegal or void, and the arbitration award did not violate public policy or a statutory right." (3 AA 826:19-21.)

As to remedy, the court deferred to the arbitrators. (3 AA 828:1-3 ["The question of whether an attorney should be entitled to attorney's fees despite the existence of an ethical violation is at the heart of the factual determination made by the arbitrators in the instant action. The court cannot disrupt the legal and factual findings of the arbitrators"].)

2. JM appeals.

Judgment was entered in Sheppard's favor and against JM on March 18, 2014. (3 AA 831.) On May 12, JM timely appealed from the judgment on the order confirming the arbitration award. (3 AA 835.) The judgment is final and appealable. (Code Civ. Proc., § 904.1, subd. (a)(1).)

ARGUMENT

THE TRIAL COURT ERRED IN CONFIRMING THE ARBITRATION AWARD, THEREBY ENFORCING AN ILLEGAL CONTRACT THAT CONTRAVENES THE MOST FUNDAMENTAL PUBLIC POLICIES GOVERNING THE ATTORNEY-CLIENT RELATIONSHIP.

A. California Courts May Not Enforce Illegal Contracts Or Those Violative Of Public Policy, Whether In Or Outside The Arbitration Context.

The object of a contract must be lawful, and a contract without a lawful object is void and therefore unenforceable. (Civ. Code, §§ 1550, 1598, 1608.) As the Supreme Court has put it, "No principle of law is better settled than that a party to an illegal contract cannot come into a court of law and ask to have his illegal objects carried out." (*Wong v. Tenneco, Inc.* (1985) 39 Cal.3d 126, 135 [refusing to enforce contract related to farming operation conducted in violation of Mexican law]; *Birbrower, Montalbano, Condon & Frank v. Superior Court* (1998) 17 Cal.4th 119, 138, 140 ["courts will not ordinarily aid in enforcing an agreement that is either illegal or against public policy"; California corporation's agreement with New York attorney unlicensed in California was void for work in California],[5] accord, *Homani v. Iranzadi* (1989) 211 Cal.App.3d 1104, 1109, 1113 ["a contract which has as its object an illegal purpose is contrary to public policy and void"; reversing judgment that enforced contract].)

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[5] The *Birbrower* court further held that fees may be recoverable for work performed in New York if the contract was severable. (*Id.* at p. 140.) A necessary corollary to the severability rule is that, "if the court is unable to distinguish between the lawful part of the agreement and the unlawful part, the illegality taints the entire contract, and the entire transaction is illegal and unenforceable." (*Keene v. Harling* (1964) 61 Cal.2d 318, 321.)

Our Supreme Court has explained that the strict no-enforcement rule "is based on the rationale that 'the public importance of discouraging such prohibited transactions outweighs equitable considerations of possible injustice between the parties.'" (*Asdourian v. Araj* (1985) 38 Cal.3d 276, 291.) And as another court put it, the no-enforcement rule "is not applied in order to correct injustice between the parties, 'but from regard for a higher interest—that of the public, whose welfare demands that certain transactions be discouraged.'" (*Homami v. Iranzadi, supra,* 211 Cal.App.3d at pp. 1112, 1113 ["'Knowing that they will receive no help from the courts and must trust completely to each other's good faith, the parties are less likely to enter an illegal arrangement in the first place'"].)

The prohibition against enforcing illegal contracts and those against public policy is just as inviolate in the context of the California Arbitration Act. (Code Civ. Proc., § 1280 et seq.)[6] When parties seek to vacate or confirm an arbitration award in court, the court "shall vacate" the award if (among other reasons) "[t]he arbitrators exceeded their powers . . . ." (§ 1286.2, subd. (a)(4).) One way arbitrators exceed their powers is by enforcing a contract that "is illegal or in violation of public policy." (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 29 (*Moncharsh*); *Loving & Evans v. Blick* (1949) 33 Cal.2d 603, 610 (*Loving*) ["'an award springing out of an illegal contract, which no court can enforce, cannot stand on any higher ground than the contract itself'"].) The point is well illustrated in *Department of Personnel Administration v. California Correctional Peace Officers Assn.* (2007) 152 Cal.App.4th 1193. There, the superior court had vacated the arbitration award, and the Court of Appeal affirmed. (*Id.* at

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[6] All further statutory references are to the Code of Civil Procedure unless otherwise noted.

pp. 1195, 1204.) It held that, "An arbitrator exceeds his or her powers if the arbitration award violates a statutory right or otherwise violates a well-defined public policy" (*id.* at p. 1195) and that courts "must vacate" such an award (*id.* at p. 1200).

An arbitration award "that has not been confirmed or vacated has the same force and effect as a contract in writing between the parties to the arbitration." (§ 1287.6; *Jones v. Kvistad* (1971) 19 Cal.App.3d 836, 840.) In other words, by agreeing to arbitrate their dispute, the parties have decided to let the arbitrator resolve it, and the arbitrator's award becomes part of the contractual agreement between the parties. (See *Walter v. National Indem. Co.* (1970) 3 Cal.App.3d 630, 634 [unconfirmed arbitration award is binding on parties as a written contract and becomes an asset of the estate of the recipient upon his death].) If the underlying contract is illegal or in violation of public policy and the arbitrator finds to the contrary, the resulting award enforces an illegal contract. And when a court confirms such an award, it, too, is enforcing an illegal contract—precisely (as explained above) what California courts *may not do.* "[I]t would violate public policy to allow a party to do through arbitration what it cannot do through litigation." (*Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 312, 317, fn. 2; *Lindenstadt v. Staff Builders, Inc.* (1997) 55 Cal.App.4th 882, 892.)

In sum, in whatever context or at whatever time the issue arises, no California court may enforce an illegal contract or one in violation of public policy. "Whenever a court becomes aware that a contract is illegal, it has a duty to refrain from entertaining an action to enforce the contract." (*Bovard v. American Horse Enterprises, Inc.* (1988) 201 Cal.App.3d 832, 837-838, 844 [trial court properly dismissed case involving sale of business on third day of trial when seller testified that business manufactured drug

paraphernalia]; *Loving, supra,* 33 Cal.2d at p. 607 [whenever the illegality appears, "'the disclosure is fatal to the case'"].)

B. The Retainer Agreement Between Sheppard And JM Was Illegal And In Violation Of Public Policy.

The ironclad rule forbidding courts from enforcing illegal agreements or those in violation of public policy requires reversal of the judgment confirming the arbitration award in this case. As we now demonstrate, the contract between Sheppard and JM was illegal for three different reasons: (1) JM's purported waiver of Sheppard's mandatory and unwaivable duty of undivided loyalty to JM rendered the Agreement illegal and void on its face; (2) after Sheppard's conflicts check revealed a conflict with an existing client, Sheppard failed to disclose the conflict to JM or to procure JM's informed consent pursuant to the Rules; and (3) the contract purportedly authorized Sheppard to further violate its duty of loyalty by concealing multiple significant matters from JM, in violation of Business and Professions Code section 6068, subdivision (m).

1. The explicit waiver of Sheppard's unwaivable duty of loyalty was illegal and in violation of public policy.

a. Factual background.

After assuring JM's general counsel that "there were no conflicts," Sheppard partner Bryan Daly signed Sheppard's retainer agreement with JM. (1 AA 191, ¶ 4, 203.)

The portion of the parties' Agreement titled "Conflicts With Other Clients" purported to permit Sheppard to represent current, former or future clients adverse to JM so long as the matters are not "substantially related" and no "confidential information" has been obtained. (1 AA 201, ¶ 4.)

Then appears the following sentence:

> By consenting to this arrangement, *[JM] is waiving our [Sheppard's] obligation of loyalty to it* so long as we maintain confidentiality and adhere to the foregoing limitations.

(*Ibid.*; emphasis added.)

The express loyalty waiver does not appear to be mere boilerplate. It is not found in Sheppard's agreement with South Tahoe, which states instead: South Tahoe's "consent to this arrangement is required because of its possible adverse effects on performance of our duties as attorneys to remain loyal . . . ." (1 AA 53F-53G.) Under both versions, Sheppard clearly understood that simultaneously representing clients with conflicting interests could undermine its loyalty to both clients.

b. A lawyer's duty of loyalty cannot be waived.

An attorney's duty of undivided loyalty to his or her client is fundamental to the attorney-client relationship. (*Flatt v. Superior Court* (1994) 9 Cal.4th 275, 289 (*Flatt*).) That duty "forbids any act that would interfere with the dedication of an attorney's 'entire energies to [the] client's interests. . . .'" (*Ibid.*) It matters not whether the attorney "has been negligent or has performed to perfection." (*Baker Manock & Jensen v. Superior Court* (2009) 175 Cal.App.4th 1414, 1421.) If this duty of undivided loyalty is violated, "'public confidence in the legal profession and the judicial process' is undermined." (*Truck Ins. Exchange v. Fireman's Fund Ins. Co.* (1992) 6 Cal.App.4th 1050, 1057.)

The "attorney's duty—and the client's legitimate expectation—of *loyalty*, rather than confidentiality," is the "primary value at stake" in conflict-of-interest situations involving simultaneous representations of adverse clients, even in different matters. (*Flatt, supra,* 9 Cal.4th at p. 284; *Dettamanti v. Lompoc Union School Dist.* (1956) 143 Cal.App.2d 715, 723

["Where there is a duty of loyalty to different clients it is impossible for an attorney to advise either one as to a disputed claim against the other"].)

This is so "[e]ven though the simultaneous representations may have *nothing* in common, and there is *no* risk that confidences to which counsel is a party in the one case have any relation to the other matter. . . ." (*Flatt, supra*, 9 Cal.4th at p. 284.) The reason is evident:

> 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. All legal technicalities aside, few if any clients would be willing to suffer the prospect of their attorney continuing to represent them under such circumstances.

(*Id.* at pp. 285, 287 [client is "'likely to doubt the loyalty of a lawyer who undertakes to oppose him in an unrelated matter'"].) Not surprisingly, "in all but a few instances, the rule of disqualification in simultaneous representation cases is a *per se* or 'automatic' one." (*Id.* at p. 284, citing cases.)

A lawyer's duty of loyalty "*not* to represent [a] second client in light of an irremediable conflict with the existing client" is "mandatory and unwaivable" (*Flatt, supra,* 9 Cal.4th at p. 279), and any agreement that compels a waiver of an unwaivable right is "contrary to public policy and unenforceable as a matter of state law" (*Iskanian v. CLS Transp. Los Angeles, LLC* (2014) 59 Cal.4th 348, 383-384).[7]

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[7] Because the "principle of loyalty is for the *client's* benefit," in rare cases an attorney may be permitted to undertake the simultaneous representation of clients with adverse interests in unrelated matters, "provided full disclosure is made and both agree in writing to waive the conflict." (*Flatt, supra,* 9 Cal.4th at p. 286, fn. 4.) However, "overcoming (continued...)

These conclusions are consistent with general California waiver law: "Any one may waive the advantage of a law intended solely for his benefit. But a law established for a public reason cannot be contravened by a private agreement." (Civ. Code, § 3513; *Simmons v. Ghaderi* (2008) 44 Cal.4th 570, 585 [§ 3513 applies "to all rights and privileges that a person is entitled to, including [but not limited to] those conferred by statute"].) There is no question that JM's right to its counsel's undivided loyalty was established "for a public reason." (See *People ex rel. Dept. of Corporations v. SpeeDee Oil Change Systems, Inc.* (1999) 20 Cal.4th 1135, 1146 ["Attorneys have a duty to maintain undivided loyalty to their clients to avoid undermining public confidence in the legal profession and the judicial process"].)

c. JM's purported waiver of Sheppard's duty of loyalty invalidated the Agreement.

Without a doubt, the Agreement was void from the beginning because it lacked a lawful object. (See Civ. Code §§ 1550, 1598, 1608.) The object of the parties' Agreement was for Sheppard to represent JM in the ongoing federal qui tam action (1 AA 199); however, Sheppard's representation was expressly undertaken without assumption of the duty of loyalty to its client JM (*id.* at p. 201). Thus, Sheppard's representation of JM lacked the "sacred attribute[]" of "undivided loyalty which [is] the heart of the relationship between lawyer and client." (*Jackson v. Rogers & Wells* (1989) 210 Cal.App.3d 336, 343, fn. 3; *Goldfisher v. Superior Court* (1982) 133 Cal.App.3d 12, 22.)

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[7] (...continued)
the presumption of 'prima facie impropriety' is not easily accomplished. [Citations.]" (*Ibid.*) Here, of course, there was no disclosure or agreement as to either client.

Since the Agreement contained a waiver of a fundamental obligation that cannot be waived, the entire Agreement (including its arbitration provision) was void, unlawful and unenforceable.

2. The Agreement violated the fundamental public policy embodied in rule 3-310(C) of the Rules of Professional Conduct, which required JM's informed written consent to any conflicting representation by Sheppard.

Although the question of the Agreement's legality and enforceability was squarely presented to the arbitrators, they declined to decide it. (3 AA 674:1-5.) Rather, they *assumed* Sheppard had violated rule 3-310(C)(3), but concluded it didn't matter because JM was not entitled to any relief, in that Sheppard's conduct was not sufficiently "serious or egregious" to warrant disgorgement or forfeiture. (3 AA 674:5-9, :22-25.)[8]

In response to the parties' cross-motions to confirm and vacate the arbitration award, the trial court confirmed the award, on similar reasoning. It found that "the arbitrators did not exceed their powers," and that the retainer agreement was not "illegal, void [or] unenforceable" simply because it may have violated a Rule of Professional Conduct. (3 AA 826:19, 22-23.)[9] On the question of whether JM was entitled to disgorgement of the fees it had paid Sheppard, the court deferred

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[8] Rule 3-310(C)(3) states: "A member shall not, without the informed written consent of each client . . . [r]epresent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter."

[9] The specific rule cited by the court was rule "3-310(A)(1)." (3 AA 826:22.) That rule, however, merely recites the definition of "Disclosure." (See below, p. 23.)

completely to the arbitrators' legal and factual conclusions denying JM all recovery. (3 AA 828:1-3.)

As we demonstrate below, the court erred in concluding that the Agreement was not illegal, void or unenforceable for violation of rule 3-310(C), the rule that governs an attorney's most fundamental duty—that of loyalty to the client—by prohibiting the representation of clients with conflicting interests without informed consent.

a. Informed written consent requires *full* written disclosure to *each* client of *all* relevant circumstances *after* the specific conflict arises.

California's Rules of Professional Conduct embody "*explicit and unequivocal ethical norms*" that reflect "fundamental public policies." (*General Dynamics Corp. v. Superior Court* (1994) 7 Cal.4th 1164, 1189 (*General Dynamics*).) The Rules "are intended not only to establish ethical standards for members of the bar [citations], but are also designed to protect the public. [Citations.]" (*Ames v. State Bar* (1973) 8 Cal.3d 910, 917.) "It is clearly contrary to the public policy of this state to condone a violation of the ethical duties which an attorney owes to his client." (*Kallen v. Delug* (1984) 157 Cal.App.3d 940, 951.)

Rule 3-310, dealing with conflicts of interest, is particularly vital. (See *Flatt, supra,* 9 Cal.4th at pp. 279, 289.) By setting out explicit and unequivocal requirements for "avoiding the representation of adverse interests," the rule is "designed to 'assure the attorney's absolute and undivided loyalty. . . .'" (Rule 3-310; *Sharp v. Next Entertainment Inc.* (2008) 163 Cal.App.4th 410, 427 (*Sharp*); *Great Lakes Constr., Inc. v. Burman* (2010) 186 Cal.App.4th 1347, 1355 ["The principle of 'undivided

loyalty' is embraced in the rules of professional conduct governing potential and actual conflicts in joint representation cases"].)

Most relevant here is subdivision (C)(3) of rule 3-310, which addresses conflicts of interest in simultaneous representation cases like this one. (For text, see fn. 8, above.) It prohibits attorneys from accepting employment adverse to a current client even if the employment is completely unrelated to the representation of the current client, "without the *informed written consent of each client.*" (Rule 3-310(C)(3), emphasis added; see *Santa Clara County Counsel Attys. Assn. v. Woodside* (1994) 7 Cal.4th 525, 548, fn. 6.) Moreover, "[t]he attorney who claims his client consented 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," and "lack of disclosure . . . strongly indicates that any consent given . . . was not an informed one." (*Civil Service Com. v. Superior Court* (1984) 163 Cal.App.3d 70, 83.)

Sheppard defended itself in the arbitration proceedings by contending that the parties' Agreement contained an "advance conflict waiver" that completely satisfied Sheppard's disclosure and informed-consent obligations, thus allowing it to represent both JM and its litigation adversary South Tahoe at the same time and without notifying either client. (2 AA 451-458.)

That position is far off the mark. In no way does the Agreement's "advance conflict waiver" meet rule 3-310's explicit and unequivocal requirements for ensuring informed consent. Indeed, if Sheppard's contention were correct, attorneys with such provisions in their retainer agreements could dispense with conflicts checks entirely, thus violating their "duty to check for potential conflicts before accepting representation." (Vapnek, et al., Cal. Practice Guide: Professional Responsibility (The

Rutter Group, 2014) ¶ 4:25.5, p. 4-13 [citing Cal. State Bar Form. Opn. 2011-182 and Rest.3d Law Governing Lawyers § 121].) What good is a conflicts check if, as occurred here, the attorney does nothing after discovering a conflict?

"Informed written consent" means the "client's written agreement to the representation *following written disclosure*." (Rule 3-310(A)(2), emphasis added; see *Anderson v. Eaton* (1930) 211 Cal. 113, 116 [client's "free and intelligent consent" must be given "*after* full knowledge of all the facts and circumstances," emphasis added].) "Disclosure" means "informing the client . . . of the *relevant circumstances* and of the *actual and reasonably foreseeable adverse consequences to the client* . . . ." (Rule 3-310(A)(1), emphasis added.) "In order for there to be valid consent, clients must indicate that they 'know of, understand and acknowledge the presence of a conflict of interest. . . .'" (*Sharp, supra,* 163 Cal.App.4th at p. 429.) A writing by the client is of paramount importance; "[i]t will 'impress upon [the] clients the seriousness of the decision the client is being asked to make and to avoid disputes or ambiguities that might later occur in the absence of a writing.'" (*Id.* at p. 430; *Chambers v. Kay* (2002) 29 Cal.4th 142, 157-158 ["affirm[ing] the importance of [client's] written consent" to attorney's fee sharing agreement].) In *Sharp,* the court held that conflicts were properly waived where "all clients who were directly affected by any purported conflict . . . . made rational choices armed with full disclosures and provided informed written consent to the simultaneous representation by the [law] firm".) (163 Cal.App.4th at p. 431.)

Sheppard not only failed to disclose to JM (in writing or otherwise) that it was concurrently representing JM's adversary South Tahoe, and failed to secure JM's consent (written or otherwise) to that representation, it

made a conscious decision *to keep the dual representation a secret* from JM, from South Tahoe, and from its own partner in charge of South Tahoe matters. The Agreement's "advance waiver" clause—which ostensibly validated all this—indisputably violated the letter and spirit of the mandatory informed consent rules, making the Agreement unenforceable. (*Chambers v. Kay, supra,* 29 Cal.4th at pp. 158-160, 162 [fee sharing agreement unenforceable absent compliance with rule mandating disclosure and written consent of client]; *Scolinos v. Kolts* (1995) 37 Cal.App.4th 635, 639 [fee agreement unenforceable on public policy grounds where there was no written disclosure or client consent].)

b. The Rules are statutory in origin and constitute a legislative and clearly-defined expression of public policy.

One of the trial court's stated reasons for determining that the arbitration award here was not illegal, void or unenforceable was that "a violation of a Rule of Professional Conduct does not constitute a violation of a 'statutory' right." (3 AA 826:26-27.) But denying relief in this case because the Rules do not confer "statutory" rights is contrary to California law.

The Supreme Court has stated that "courts should be reluctant to invalidate an arbitrator's award" on public-policy grounds "[w]ithout an explicit legislative expression of public policy. . . ." (*Moncharsh, supra,* 3 Cal.4th at p. 32.) Courts are not permitted to create public policy and must rely on other sources—including legislatively-based administrative regulations—to define those policies. (*Green v. Ralee Engineering Co.* (1998) 19 Cal.4th 66, 80 (*Green*) ["fundamental public policy may be enunciated in administrative regulations that serve the statutory objective"].)

There is no question that the Rules constitute "an explicit legislative expression of public policy." In 1939, the Legislature declared: "With the approval of the Supreme Court, the Board of Governors may formulate and enforce rules of professional conduct for all members of the bar in the State." (Bus. & Prof. Code, §§ 6076[10], 6077 [Rules binding on all State bar members]; *Chambers v. Kay, supra,* 29 Cal.4th at p. 156 [Rules were adopted and approved "*pursuant to Business and Professions Code sections 6076 and 6077* to protect the public and to promote respect and confidence in the legal profession," emphasis added]; *People v. Donaldson* (2001) 93 Cal.App.4th 916, 919 [the "*Legislature has authorized*" the State Bar to enact the Rules, emphasis added]; *Margolin v. Shemaria* (2000) 85 Cal.App.4th 891, 894, fn. 2 [Rules are adopted by the Board and approved by the Supreme Court "*at the directive of the Legislature,*" emphasis added]; *Hernandez v. Mukasey* (9th Cir. 2008) 524 F.3d 1014, 1019, fn. 2 ["[I]n California, the rules of professional conduct are fully incorporated into state law" by Bus. & Prof. Code, § 6077].) The Rules, like statutes, originate with the Legislature; they are enacted, approved and enforced only by legislative mandate.

In confirming the arbitration award here, the superior court stated that the Supreme Court in *Moncharsh, supra*, 3 Cal.4th at p. 33, "found that alleged violations of the Rules of Professional Responsibility did not render an employment agreement illegal or void against public policy in what was essentially a fee dispute." (3 AA 826:23-25.)

But *Moncharsh* is a very different case than the present one. It involved a fee-splitting provision in an employment contract between an

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[10] Section 6076 was amended in 2011 to substitute "Trustees" for "Governors" and "State Bar" for "bar in the State." (Bus. & Prof. Code, § 6076, as amended by Stats. 2011, ch. 417, § 37.)

attorney and his former firm. (3 Cal.4th at p. 6.) The Rules at issue there prohibited unconscionable fees, certain types of fee-splitting agreements and agreements restricting an attorney's right to practice. (*Id.* at pp. 32-33.) The *Moncharsh* court concluded that there was "nothing in the Rules . . . *at issue in this case*"—"essentially an ordinary fee dispute"—that would render the employment contract illegal or void against public policy. (*Id.* at p. 33, emphasis added.)

In stark contrast, the present case is not an "ordinary fee dispute" between attorneys, and the Rules "at issue in *this* case" go to the very heart of the attorney-client relationship. This case deals with the mandatory, unwaivable and sacred duty of loyalty owed by attorneys to clients—a duty that bars conflicts of interest unless the attorney facing such a conflict follows the explicit and unequivocal informed-consent requirements of rule 3-100. Sheppard indisputably did not follow those requirements. *Moncharsh* does not support confirmation of the arbitration award, since the Agreement was void and against public policy.

Several California courts, including the Supreme Court, have recognized that the Rules and various non-statutory enactments are legitimate sources of public policy. (See, e.g., *General Dynamics, supra,* 7 Cal.4th at p. 1189 [Rules reflect "fundamental public policies"]; *Margolin v. Shemaria, supra*, 85 Cal.App.4th at p. 901 ["We find no impediment to our conclusion from the fact that [Civil Code] section 1624 is a statute while rule [of Professional Conduct] 2-200 is an administrative regulation. Both legislative enactments and administrative regulations can be utilized to further this state's public policy of protecting consumers"]; *Green, supra,* 19 Cal.4th at pp. 79-82 [recognizing that administrative regulations, including the Rules, may express fundamental public policy just as statutes and constitutional provisions do].)

The Rules indisputably originate in statute and express well-defined public policies. The trial court erred in declining to find the Agreement violative of fundamental public policies of this state.

3. The Agreement violated JM's separate statutory right, codified in Business & Professions Code section 6068, subdivision (m), to be kept informed of significant developments relating to Sheppard's representation.

The fiduciary attorney-client relationship imposes on the attorney "a duty to communicate to the client whatever information the attorney has or may acquire in relation to the subject matter of the transaction. [Citations.]" (*Beery v. State Bar* (1987) 43 Cal.3d 802, 813.) The duty to communicate is embodied not only in the Rules (rule 3-500) but also in statute: Attorneys must "keep clients reasonably informed of significant developments in matters with regard to which the attorney has agreed to provide legal services." (Bus. & Prof. Code, § 6068, subd. (m); *Chambers v. Kay, supra*, 29 Cal.4th at p. 157.) An attorney can hardly fulfill his or her duty of undivided loyalty to a client by concealing from the client vital information about the client's case, including the existence of a conflict, as happened here. And when—as here—the attorney's duty of loyalty is expressly waived, the contract would appear to condone and authorize the attorney's concealment of significant information from the client, at least where that information relates to another client of the firm that is adverse to the first client.

Without question, Sheppard shirked its statutory duty of communication under the aegis of the contractual waiver of loyalty. Sheppard failed to communicate to JM the following significant

developments relating to the qui tam action in which Sheppard had agreed to defend JM:

- Sheppard did not inform JM that its conflicts check revealed that Sheppard's existing client, South Tahoe, was one of the qui tam plaintiffs;
- Sheppard did not inform JM that South Tahoe had discovered the conflict and was threatening to seek Sheppard's disqualification in the qui tam action;
- Sheppard did not inform JM that it had erected—or claimed to have erected—an "ethical wall" to separate those working on JM matters from those working on South Tahoe matters; and
- Sheppard did not inform JM that Sheppard had admitted to South Tahoe that its conflicts check "showed South Tahoe to be an existing client." (1 AA 192-193.)

Business and Professions Code section 6068, subdivision (m) is "an explicit legislative expression of public policy," a violation of which provides grounds for invalidating an arbitrator's award. (See *Moncharsh, supra,* 3 Cal.4th at p. 32.) The public policy underlying an attorney's duty to communicate significant developments to his or her client—and Sheppard's deliberate flouting of that duty—could not be clearer. The trial court erred in not vacating the award for this reason as well.

C. Since The Agreement Is Unenforceable Because It Has An Illegal Object That Violates Fundamental Public Policy, Sheppard May Not Recover Or Retain Any Payment Under It.

The arbitrators had applied an "equitable weighing test" to determine if Sheppard's conduct was "serious or egregious" enough to warrant

disgorgement,[11] and they concluded that it was not. (3 AA 677:4-5, :16-17.) As a result, Sheppard was awarded the full amount of fees it sought. In confirming the award, the superior court deferred to the arbitrators' use of the balancing test. (3 AA 828:1-3.) Thus, the judgment awarded Sheppard a total of $1,386,340.64, representing unpaid legal fees, plus interest and costs. (3 AA 833.) JM was ordered to "take nothing" by way of the judgment (*ibid.*), meaning that Sheppard was not required to return the approximately $2.7 million in fees that JM had already paid Sheppard under the Agreement.

This was error. As explained above, the Agreement was unlawful for three separate reasons. No matter which of the three lenses the Agreement is viewed through, the conclusion is inescapable: because the Agreement has an unlawful object, it is void and unenforceable. (Civ. Code, §§ 1550, 1598, 1608.) As a result, Sheppard may not receive any monetary benefit from it.

1. Disgorgement is required as a matter of law to redress the ethical violation of accepting employment adverse to a client or former client, even when no actual harm results.

"It is settled in California that an attorney may not recover for services rendered in contradiction to the requirements of professional responsibility." (*Goldstein v. Lees* (1975) 46 Cal.App.3d 614, 618 (*Goldstein*).) Contracts to render such services "even if not tainted with actual fraud have been held to be 'clearly against public policy and void.'" (*Ibid.*, quoting *Anderson v. Eaton, supra*, 211 Cal. at p. 116.)

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[11] For convenience, we use the term "disgorgement" to refer both to the return of improperly received fees and to the forfeiture of earned fees not yet paid.

Where a lawyer accepts employment adverse to a client or former client, disgorgement is required even when the client seeking disgorgement has not been harmed and may receive a windfall, and even when the attorney did not act deliberately or dishonestly. In other words, no balancing test is employed. The remedy is absolute and is intended to serve the public policy of discouraging attorneys from engaging in representations that contravene the duty of loyalty owed to clients.

Thus, in *Goldstein, supra,* 46 Cal.App.3d 614, a client engaged the attorney's services in a proxy fight to gain control of a corporation. (*Id.* at pp. 617-618.) The client specifically selected the attorney because he had previously served as general counsel and outside counsel to the corporation and had intimate knowledge about the corporation. (*Ibid.*) There was no evidence that the attorney actually betrayed any confidences. Nevertheless, the attorney was found to have committed an ethical violation by "'accept[ing] employment adverse to a client or former client,'" without the required informed consent. (*Id.* at p. 619, fn. 3.) It was enough that the engagement "must have tempted him to reveal or to improperly monopolize the confidences and secrets of his former client." (*Id.* at p. 620.) The inherent nature of the conflict created the ethical violation that required disgorgement. (*Ibid.*)

The court also expressed concern for the clients in such a situation, finding it "difficult to believe" that a lawyer with adverse clients "can offer the kind of undivided loyalty that a client has every right to expect and that our legal system demands." (*Goldstein, supra*, 46 Cal.App.3d at p. 620.)

As the Court of Appeal explained, it did not matter that there was no resulting harm: "[T]here is no force to the objection that the result announced here [disgorgement] will work a windfall for" the client seeking to avoid attorney's fees. (*Goldstein, supra*, 46 Cal.App.3d at p. 623.) "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.)

Jeffry v. Pounds (1977) 67 Cal.App.3d 6 (*Jeffry*), reaches the same result. In that case, at the same time a law firm was representing Pounds in his automobile tort action, it took on the representation of Pounds' wife in her divorce action against Pounds. (*Id.* at p. 8.) The trial court determined that the firm had not violated its ethical duties and that Pounds was therefore required to pay his attorneys. (*Id.* at pp. 8-9.) The Court of Appeal reversed, holding that (1) the attorneys had violated their duty of loyalty by accepting the conflicting engagement, and (2) *as a matter of law* the attorneys were not entitled to any fees incurred after the law firm undertook the conflicting engagement (i.e., the divorce case). (*Id.* at p. 12.)

The Court of Appeal's holding belies any theory that harm to the client (or other factors) should be balanced in determining disgorgement. Indeed, if equitable balancing were required, the court would have remanded for the trial court to undertake that task. Rather, the court reversed with instructions that fees be limited to a reasonable amount incurred before the ethical violation. (*Jeffry, supra*, 67 Cal.App.3d at p. 12.) Disgorgement was absolutely required due to the inherent nature of the violation—simultaneous representation of clients with conflicting interests.

Nor is there anything in *Jeffry* suggesting that the ethical violation was any more harmful or egregious than in any other instance where a law firm represents clients on both sides of a litigation. The trial court had found that the representation of Pounds "entailed no confidential financial information which might aid Mrs. Pounds' marital litigation." (*Jeffry, supra*, 67 Cal.App.3d at p. 9.) The Court of Appeal recognized that

disgorgement was required even "without potential breaches of confidentiality." (*Id.* at p. 10.) The remedy was designed to "condemn acceptance of employment adverse to a client even though the employment is unrelated to the existing representation. The [b]asis of the condemnation is the client's loss of confidence, not the attorney's inner conflicts." (*Id.* at p. 11.) As the court observed, the "first client" is likely "to doubt his attorney's loyalty when the latter accepts unrelated but antagonistic employment." (*Id.* at p. 10.) Moreover, the Court of Appeal mandated disgorgement although it did "not charge [the attorneys] with dishonest purpose or deliberately unethical conduct." (*Id.* at p. 11.) Instead, the dual representations inherently "arouse concern" that warrants disgorgement. (*Ibid.*)

A.I. Credit Corp., Inc. v. Aguilar & Sebastinelli (2003) 113 Cal.App.4th 1072 (*A.I. Credit Corp.*), like *Goldstein*, mandates disgorgement as a matter of law where a firm represents one client in a suit against a former client of the firm. (*Id.* at pp. 1074-1076, 1079-1080.) As here, the firm was disqualified in the underlying litigation. (*Id.* at p. 1075.) The Court of Appeal applied the familiar rule that "an attorney disqualified for violating an ethical obligation is not entitled to fees." (*Id.* at p. 1079.)

The Court of Appeal acknowledged that an equitable balancing test applies to disgorgement claims based on *some* types of ethical violations. (*Ibid.*) But it explicitly *rejected* the argument that balancing applies to the sort of disqualifying conflicts of interests at issue in *A.I. Credit Corp.* and here. (*Ibid.*) Instead, the case was governed by the absolute rules applicable to disqualifying conflicts. What's more, the Court of Appeal easily dismissed similar arguments by the attorneys in their attempt to avoid the absolute nature of the remedy. For instance, they argued that the client seeking to avoid attorneys fees had waived the conflict. (*Id.* at pp. 1079-

1080.) That was found irrelevant. The attorneys had nevertheless violated their ethical duty by failing to obtain the former client's written waiver, and it was that failure that required disgorgement to the current client as a matter of law. (*Ibid.*) Moreover, it was irrelevant that the client seeking disgorgement had unclean hands—the attorney is denied fees for public policy reasons, even if the client sought to benefit from the attorney's ethical violation. (*Id.* at pp. 1080-1081.)

In sum, as a matter of law, when attorneys breach their duty of undivided loyalty by accepting employment adverse to a client or former client without informed consent, they may not recover fees for any services performed after accepting the conflicting employment.

2. The balancing test does not apply to the type of irreconcilable conflict of interest that arose here.

As noted, in deciding this matter, the arbitrators maintained that a different rule applies. (3 AA 674-677.) They relied on *Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000 (*Pringle*) and its progeny to support their conclusion that courts must balance various factors to determine whether the ethical violation was "serious" or "egregious" enough to warrant disgorgement. (3 AA 675-677.) But as the Court of Appeal explained in *A.I. Credit Corp.*, that argument misconstrues *Pringle*: *Pringle* provides the rule for *other* ethical violations—ones that do *not* involve accepting employment adverse to a former or current client. And it has always been limited to that context.

In *Pringle*, plaintiff Zunaga filed a harassment suit against a corporation and one of its officers. (*Pringle, supra*, 73 Cal.App.4th at p. 1002.) The presumably-aligned defendants were represented by a single attorney. Defense counsel had never had any attorney-client relationship with Zunaga. 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 corporate officer. (*Ibid.*) The corporate officer attempted to avoid paying attorney 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 (i.e., an officer who was uot individually represented in the suit). (*Ibid.*)

The Court of Appeal noted that the corporate officer "has not cited a case in which the individual defendant, who executed the fee contract for himself as well as for the corporation, is not obligated to pay fees." (*Pringle, supra*, 73 Cal.App.4th at p. 1006.) Nor did any case stand for the proposition that "a violation of a rule of professional conduct automatically precludes an attorney from obtaining fees." (*Id.* at pp. 1005-1006.) In other words, a client cannot avoid fees by pointing to just any ethical violation in the Rules. Because no court had previously addressed the consequence of the particular ethical violation at issue, the Court of Appeal inquired whether it was the type that was sufficiently serious to require disgorgement. (*Ibid.*)

Indeed, *Pringle* distinguished between (1) technical violations involving potential conflicts and (2) the types of "irreconcilable conflict[s]" in *Jeffry* and *Goldstein* (and the present case)—conflicts where the attorney has inherently adverse clients and represents one of those clients in a suit in which the other is an adverse party. (*Pringle, supra*, 73 Cal.App.4th at p. 1006, fn. 4.) In *Pringle,* there wasn't even a hint that the interests of the corporation and the corporate officer were in conflict. (*Id.* at pp. 1006-1007.) Any potential conflict was hypothetical and not inherently "serious" or "incompatible with the faithful discharge of [the attorney's] duties."

(*Ibid.*) It was nothing like when an attorney's loyalties are divided between two directly-adverse clients. (See pp. 18-19, 30-33, *ante*.)

Other courts have recognized the same critical distinction and refused to apply *Pringle* outside of its appropriate context. For instance, *A.I. Credit Corp., supra*, held that *Pringle*'s analysis is not applicable when an attorney is disqualified due to direct conflicts of interest caused by representing one client in a suit against another of the attorney's clients. (113 Cal.App.4th at pp. 1074-1075, 1079.) As the Court of Appeal explained, *Pringle* involved only a "minor technical violation" arising from the identity of the individual who signed the conflict waiver on behalf of the corporation. (*Id.* at p. 1079.) Disqualification stemming from a direct conflict between clients on opposing sides of litigation is an entirely different matter and requires disgorgement as a matter of law. (See pp. 31-32, *ante*.) Similarly, the Ninth Circuit noted the distinction between *Pringle,* on the one hand, and *Jeffry* and *Goldstein,* on the other: California courts deny fees to attorneys "laboring under an actual conflict of interest" whereas they permit fees when the "ethical violation is less severe, for example where the attorney represented clients with only a potential conflict of interest. . . ." (*Rodriguez v. Disner* (9th Cir. 2012) 688 F.3d 645, 654-655.)[12] In the latter circumstance, the court may consider various factors. (*Ibid.*)

Consistent with this limitation, the cases applying *Pringle* have all involved ethical obligations other than direct conflicts between clients opposing each other as plaintiff and defendant. That is, none involves the

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[12] *Rodriguez v. Disner* was decided on federal common law principles—not application of California law (*id.* at pp. 653-657)—and involved conflicts between co-plaintiffs rather than direct conflicts between clients on opposite ends of litigation (*id.* at p. 652).

substantial concerns inherently posed by a law firm that accepts employment adverse to a client or former client. As in *Pringle,* these less fundamental violations are not per se egregious; they require a factual showing of egregiousness to establish forfeiture of fees. (See, e.g., *Mardirossian & Associates, Inc. v. Ersoff* (2007) 153 Cal.App.4th 257, 277-279 [representation of two co-plaintiffs in litigation against a third party is not so egregious as to require forfeiture when "at most, a potential conflict of interest existed" and both clients provided their written consent and acknowledged the opportunity to consult outside counsel concerning the issue]; *Slovensky v. Friedman* (2006) 142 Cal.App.4th 1518, 1521-1523 [attorney misrepresented to client that he was not handling similar toxic mold claims for similarly-situated plaintiffs and that settlement was not global on behalf of all plaintiffs; egregiousness must be established and therefore, forfeiture of fees not permitted where no harm resulted and instead global settlement increased client's recovery]; *Sullivan v. Dorsa* (2005) 128 Cal.App.4th 947, 951, 964-965 [in property sale, attorney's dual representation of referee and prospective purchaser is not necessarily so serious as to compel forfeiture of fees]; compare, *Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1169 [affirming determination that attorney acted egregiously in breaching his fiduciary duty by entering into business with the client without fully explaining some of the material terms of the business].)

Put simply, not every ethical violation is so serious as to justify disgorgement, and a client cannot dodge fees by pointing to some minor or technical violation. But the type of ethical violation in *Goldstein, Jeffry, A.I. Credit Corp.* and the present case has consistently been recognized as *per se* so serious as to require disgorgement. Undertaking representations in which two clients are in direct conflict necessarily precludes lawyers

from fulfilling their undivided duty of loyalty to each client. In that situation, public policy requires disgorgement even when there is no harm and even when the client will obtain a windfall (pp. 30-32, *ante*) because the violated conflict rule "proscribed the very conduct for which compensation was sought." (*Huskinson & Brown v. Wolf* (2004) 32 Cal.4th 453, 463.) When a trial court fails to order disgorgement under such circumstances, public policy demands reversal with directions that the attorney not recover any fees incurred after the ethical violation. (P. 31, *ante*.)

CONCLUSION

A retainer agreement that explicitly waives the attorney's duty of loyalty to a client the attorney knows is directly adverse to an existing client, and that includes a general broad conflict waiver as to which no informed consent was obtained, cannot be enforced by any California court because it is illegal and violative of fundamental public policies of the state.

In confirming the arbitration award here, the superior court enforced or aided in enforcing just such an agreement—something a court may not do. The judgment must be reversed, with directions ordering Sheppard to disgorge the sums JM has already paid and to forfeit the sums JM has not yet paid.

Dated: December 8, 2014

GREINES, MARTIN, STEIN & RICHLAND LLP
Kent L. Richland
Barbara W. Ravitz
Jeffrey E. Raskin

By _____
Barbara W. Ravitz
Attorneys for Defendant and Appellant
J-M Manufacturing Company, Inc., dba JM Eagle

CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.204(c)(1), the attached Appellant's Opening Brief was produced using 13-point Times New Roman type style and contains **10,139** words not including the tables of contents and authorities, caption page, or this Certification page, as counted by the word processing program used to generate it.

Dated: December 8, 2014

GREINES, MARTIN, STEIN & RICHLAND LLP

By_____
Barbara W. Ravitz

PROOF OF SERVICE

STATE OF CALIFORNIA)
) ss
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 **December 8, 2014**, I served the foregoing document described as **APPELLANT'S OPENING BRIEF** on the interested parties in this action by placing a true copy thereof enclosed in sealed envelopes as stated below.

BY MAIL

I mailed a copy of the document identified above as follows:

I placed the envelope(s) for collection and mailing on the date stated above, at Los Angeles, California, following our ordinary business practices. I am readily familiar with this business's practice of collecting and processing correspondence for mailing. On the same day that correspondence is placed for collection and mailing, it is deposited in the ordinary course of business with the U.S. Postal Service, in a sealed envelope(s) with postage fully prepaid.

The envelope was or envelopes were addressed as follows:

James Francis McShane, Esq.
Sheppard Mullin Richter & Hampton, LLP
333 South Hope Street, 48th Floor
Los Angeles, CA 90017-1448

Kevin S. Rosen, Esq.
Gibson, Dunn & Crutcher
333 South Grand Avenue, Suite 4700
Los Angeles, CA 90071-3197
Attorneys for Plaintiff and Respondent
SHEPPARD, MULLIN, RICHTER & HAMPTON, LLP

Office of the Clerk
Los Angeles Superior Court
111 North Hill Street
Los Angeles, CA 90012

Office of the Clerk **[Electronic service per Rule 8.212(c)(2)]**
California Supreme Court
350 McAllister Street
San Francisco, CA 94102

Executed on **December 8, 2014**, at Los Angeles, California.

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

Rebecca E. Nieto