2d 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 REPLY BRIEF

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INTRODUCTION

Sheppard's respondent's brief fails to come to grips with several fundamental, undisputed and dispositive facts:

- When JM sought to hire Sheppard in 2010, Sheppard's conflicts check revealed that JM's litigation adversary, South Tahoe, had an ongoing attorney-client relationship with Sheppard dating from 2002.

- Rather than disclose that fact (or any information about its representation of South Tahoe) and seek a fully-informed conflicts waiver as expressly required by rule 3-310(C) of the Rules of Professional Conduct, Sheppard had JM sign an engagement agreement containing a nonspecific, broad waiver both of Sheppard's duty of loyalty to JM and of any conflicts with clients Sheppard "may currently or in the future" represent whose "interests . . . are adverse" to JM.

- California law is clear that such a contract is illegal and against public policy and that the attorney may neither collect nor keep any fees resulting from the conflicted representation. Since no California court may enforce an illegal contract, the judgment below purporting to do so must be reversed.

Sheppard's respondent's brief labors to sidestep these fundamental facts and their inescapable consequences. Initially it argues that JM waived its contract illegality claims. But even if Sheppard's argument were not belied by the record (which shows that JM raised the illegality issue at *every stage* of these proceedings), it contravenes a basic rule: The claim that an entire contract was illegal *cannot* be waived. Sheppard's dubious assertion that the *Moncharsh* case changed this rule in arbitration matters doesn't survive a reading of *Moncharsh.* There, the Supreme Court held that the type of claim that must be raised before the arbitrators is a claim that a

provision of a contract is unlawful—not, as here, a claim that the *entire contract* is infected by the illegality.

Sheppard's arguments on the merits similarly fail to withstand scrutiny. Sheppard contends that the judgment below rested on disputed facts and is therefore unreviewable. But the *critical* facts are not in dispute, and they inexorably lead to a legal conclusion fatal to Sheppard's position. And Sheppard's assertion that "[w]aivers of current and future conflicts are commonplace and enforced by California and other courts" (RB 27) is fine as far as it goes, but it's irrelevant: What Sheppard cannot show (because it does not exist) is *any* case or authority from *any* jurisdiction validating a nonspecific, broadly-worded waiver of the duty of loyalty and current and future conflicting representations like the one Sheppard foisted on JM here.

Sheppard lards its brief with a variety of other hair-splitting arguments it claims relieves it of responsibility. First, it argues that South Tahoe was not a "current" Sheppard client when the JM "waiver" was signed in early March 2010, because Sheppard had last done work for South Tahoe in November 2009 and South Tahoe only "reemerged" as a client later in March 2010. But even if this factual issue could be raised for the first time at this late stage, there is no question that under Sheppard's written contract with South Tahoe, Sheppard and South Tahoe maintained an ongoing attorney-client relationship even when Sheppard was not working on a specific project for South Tahoe.

Second, Sheppard insists that it "honestly and in good faith believed" that the broad, nonspecific conflicts waiver it presented to JM was effective. That belief is simply beside the point. "Good faith" is no defense to an illegal contract that violates public policy. Besides, if ignorance of the law is no excuse, then relying on the self-serving advice of self-designated in-house "experts" is no better. The fact that Sheppard's in-house ethics

consultants (who, as partners in Sheppard, had their own interest in maximizing Sheppard's client base) blessed the illegal waiver provision carries about as much weight as Sheppard's brief's heavy reliance on the legal opinions of its hired-for-litigation ethics expert—which is to say, absolutely none.

Finally, Sheppard laments that it is "virtually impossible" for a large law firm like itself to represent large numbers of clients or handle cases like qui tam actions "with scores or hundreds of parties" without nonspecific, broadly-worded conflicts waivers like the one at issue here. (RB 26-29.) The argument has a familiar ring. But "too big to be ethical" is an even worse excuse than "too big to fail."

Under California law, a law firm commits a fundamental ethical violation by accepting representation of a client while simultaneously, in an unrelated matter, representing a party adverse to that client—at least without a specific, fully-informed written waiver of the conflict. A law firm that does so is entitled to no fees. And an engagement agreement entered into in such circumstances containing only a nonspecific, broadly-worded conflicts waiver is illegal as a matter of law. That's the case here. The judgment must be reversed.

ARGUMENT

I. SHEPPARD'S WAIVER ARGUMENTS ARE MERITLESS.

JM's central claim on appeal is that the parties' retainer agreement (Agreement) is illegal and against public policy and therefore cannot be enforced by any court. (AOB 1, 13-16.) Sheppard initially seeks to avoid responsibility for its unethical conduct by asserting a technical defense, arguing that JM "waived its illegality arguments by failing to raise them before the [arbitration] Panel." (RB 17.) Sheppard states that JM, in its arbitration briefing, "never argued that the Engagement Agreement was illegal" and "did not address—or even mention—illegality." (RB 18, emphasis omitted.) Sheppard concludes that JM is "barred from attacking the Award on grounds it never raised before the Panel." (RB 19.)

Sheppard cannot evade the issue so easily. Not only does the record show that JM unequivocally preserved its claim (and that Sheppard forfeited any right to claim otherwise), but the law is clear that contract illegality is so fundamentally offensive to public policy that it *cannot* be waived. Thus, as a matter of both fact and law, Sheppard's waiver arguments are utterly meritless.

A. JM Preserved Its Illegality Arguments, And In Any Event, Sheppard Forfeited Any Right To Claim That JM Waived Them.

1. Even the limited record before this Court shows that JM raised and preserved its illegality arguments.

The full record of the arbitration proceedings is not before this Court, because neither JM nor apparently Sheppard saw a need for it. Yet the record that has been provided leaves no doubt that JM repeatedly raised

the issue of contract illegality before the arbitration panel and exhibited no intent to waive it. (*In re S.B.* (2004) 32 Cal.4th 1287, 1293, fn. 2 ["a waiver is the intentional relinquishment or abandonment of a known right," internal quotation marks omitted].)[1]

In JM's Response And Counterclaims submitted in the arbitration, JM's very first affirmative defense ("Illegal Contract—All Claims") states that JM "alleges that the Claims are barred because *the contract sued upon is illegal.*" (3 AA 574, emphasis added.) JM specifically requested relief that included "[a] declaratory judgment that the Retainer Agreement is (1) *unenforceable as an illegal contract . . . .*" (3 AA 576, emphasis added.) In the same document, JM stated that it "*does not waive any of these [illegality] arguments*" by arbitrating the dispute, "but expressly reserves them in their entirety." (3 AA 577, fn. 2, emphasis added.) In response to Sheppard's arbitration interrogatory asking JM to explain the facts that support its affirmative defenses, JM stated, "The retainer agreement between J-M and Sheppard is *unenforceable as an illegal contract* and a contract in violation of public policy, because Sheppard Mullin was in conflict of interest in that it simultaneously represented both J-M and South Tahoe, two litigation adversaries." (3 AA 601, emphasis added.)

In their award, the arbitrators found that the evidence did not support *any* of JM's affirmative defenses (which included "Illegal Contract"). (3 AA 672.) There was no suggestion—by the arbitrators or by Sheppard—that JM had waived that defense.

---

[1] JM argued below, and argues again on appeal, that the issue of the illegality of the entire contract is one for the trial court, not the arbitrators; JM raised the issue in the trial court both before and after the arbitration. (See, e.g., 1 AA 13-15, 54-58, 66, 92; 3 AA 732-735.)

Following the arbitration, and consistent with JM's express non-waiver of its illegality arguments, JM reasserted those arguments in the superior court proceedings to vacate or confirm the award. (See, e.g., 3 AA 733-735, 752-754, 761-762.) And as that court properly recognized, it had the power to review the award because JM "contends that the award seeks to enforce a void and illegal contract . . . ." (3 AA 824.)

Based on even this limited record, it is clear JM preserved its illegality arguments.

2. Sheppard cannot now claim waiver before the arbitrators, because it failed to make that claim in the trial court below.

In fact, it is Sheppard that has forfeited its right to claim that JM waived its illegality claim by failing to make it before the arbitral panel, because *Sheppard* failed to preserve that issue in the trial court.

"Waiver is an intensely factual determination," to be decided by the trial court. (*Hodge v. Kirkpatrick Development, Inc.* (2005) 130 Cal.App.4th 540, 552; *Hefferan v. Freebairn* (1950) 34 Cal.2d 715, 722.) "The burden is on the party claiming a waiver of right to prove it by clear and convincing evidence that does not leave the matter to speculation." (*In re Noreen G.* (2010) 181 Cal.App.4th 1359, 1394, internal citations and quotation marks omitted.) Because a claim of waiver requires a factual inquiry, it cannot be raised for the first time on appeal. (*Bartley v. Karas* (1983) 150 Cal.App.3d 336, 341.) This rule applies to respondents as well as appellants. (*LaChance v. Valverde* (2012) 207 Cal.App.4th 779, 789 [respondent who failed to raise factual argument in trial court but did so for first time in appellate brief forfeited argument].)

At no time in the proceedings below did Sheppard even hint that it believed JM had waived its illegality arguments. Sheppard did not claim—as it does now—that JM waived its arguments by failing to address or mention "illegality" in its arbitration briefing. In its own responsive arbitration briefing, Sheppard addressed JM's arguments on the merits. (See 3 AA 640-642.) Similarly, in the subsequent trial court proceedings, in which JM argued illegality at length, Sheppard responded on the merits, never suggesting waiver by JM. (See 3 AA 773-775, 781-782.)

Had Sheppard made its waiver claim in the trial court, JM would have had the opportunity to ensure that the trial court and this Court would have a full record on which to decide the issue. Since Sheppard failed to raise the issue below, the issue was not explored below, the trial court never ruled on it, and the record before this Court was not designated with the issue in mind. In short, by remaining silent below, Sheppard forfeited its waiver argument.

B. Sheppard's Waiver Argument Contravenes California Law, Including *Moncharsh*, Because A Claim That A Contract Is Illegal As Against Public Policy Can Be Raised At Any Time.

As just demonstrated, JM properly preserved its illegality arguments, and Sheppard forfeited its right to claim waiver by not raising the issue in any forum below. But even if that were not so, Sheppard's waiver argument is a non-starter as a matter of law.

1. The defense of contract illegality cannot be waived, and it may be raised even for the first time on appeal.

As our Supreme Court explained decades ago, "A party to an illegal contract cannot ratify it, cannot be estopped from relying on the illegality, and *cannot waive his right to urge that defense.*" (*City Lincoln-Mercury Co. v. Lindsey* (1959) 52 Cal.2d 267, 274, emphasis added [automobile seller may not enforce illegal conditional sale contract; reversing judgment that allowed seller to recover amount of deficiency].) No tribunal may grant relief under an illegal contract, even if the parties acted in the utmost good faith. (*Prime v. Hyne* (1968) 260 Cal.App.2d 397, 402-403.)

Since a party's right to claim contract illegality cannot be waived, it may be raised *at any time* in the proceedings. (See AOB 15-16, quoting *Bovard v. American Horse Enterprises, Inc.* (1988) 201 Cal.App.3d 832, 837-838 ["Whenever a court becomes aware that a contract is illegal, it has a duty to refrain from entertaining an action to enforce the contract"]; *Loving & Evans v. Blick* (1949) 33 Cal.2d 603, 607 (*Loving*) [whenever illegality appears, "'the disclosure is fatal to the case'"]; *South Bay Radiology Medical Associates v. W.M. Asher, Inc.* (1990) 220 Cal.App.3d 1074, 1081) ["the illegality defense may be raised for the first time in opposition to a motion to confirm" an arbitration award].) Indeed, even if JM had not raised the issue repeatedly at all stages below, a claim of contract illegality may be made "even for the first time on appeal." (*LaFortune v. Ebie* (1972) 26 Cal.App.3d 72, 75, citing *Lewis & Queen v. N.M. Ball Sons* (1957) 48 Cal.2d 141, 147-148; *Yoo v. Jho* (2007) 147 Cal.App.4th 1249, 1251.)

2. Nothing in *Moncharsh* or any other decision supports Sheppard's claim of waiver.

a. *Moncharsh.*

Purporting to base its waiver argument on *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 31 (*Moncharsh*), Sheppard broadly states, "In *Moncharsh*, the Supreme Court found that the failure to challenge the legality of a contract during arbitration 'waives the claim for any future judicial review.'" (RB 18.) Sheppard concludes that under *Moncharsh,* JM "waived its illegality arguments by failing to raise them before the Panel." (RB 17, 19.)

As we have explained, JM *did* raise its illegality arguments during arbitration. (See above, pp. 4-6.) But even if JM had not, Sheppard's argument would still fail, because it ignores the limited context of the Court's remarks in *Moncharsh* and the case's actual holding.

Attorney Moncharsh contended that a fee-splitting provision in his employment contract with his former firm was illegal. (3 Cal.4th at p. 7.) As the Court noted, he "does not contend the alleged illegality constitutes grounds to revoke the entire employment contract. Nor does he contend the alleged illegality voids the arbitration clause of that contract." (*Id.* at p. 30.) In that circumstance—when "the alleged illegality goes to only a portion of the contract (that does not include the arbitration agreement)"—"the entire controversy, including the issue of illegality, remains arbitrable," and "the legality of the fee-splitting provision was a question for the arbitrator in the first instance." (*Ibid.*) Accordingly, the Court held, a party "need not raise the illegality question prior to participating in the arbitration process, so long as the issue is raised before the arbitrator. Failure to raise the claim [i.e., the illegal-provision claim] before the arbitrator, however, waives the claim for any future judicial review." (*Id.* at p. 31.)

The Court explicitly contrasted that situation—where the claimed illegality affected only a portion of the contract—with the very different situation not present in *Moncharsh* but present here—where "grounds exist to revoke the entire contract" for illegality, and the contract "includes an arbitration agreement." (*Id.* at p. 29.) *Moncharsh* made clear that where the legality of an entire contract containing an arbitration provision is at issue, the court, not the arbitrator, decides the enforceability of the contract. "'[T]he rules which give finality to the arbitrator's determination . . . are inapplicable *where the illegality of the entire transaction* is raised in a proceeding for the enforcement of the arbitrator's award.'" (*Id.* at p. 31, quoting *Loving, supra,* 33 Cal.2d at p. 609, and adding italics.)

With respect to waiver, *Moncharsh* concluded: "We thus hold that *unless* a party is claiming (i) the entire contract is illegal, or (ii) the arbitration agreement itself is illegal, he or she need not raise the illegality question prior to participating in the arbitration process, so long as the issue is raised before the arbitrator. Failure to raise the claim before the arbitrator, however, waives the claim for any future judicial review." (*Id.* at p. 31, emphasis added.) It necessarily follows that where, as here, a party *is* claiming the entire contract is illegal, that party need *not* raise the illegality question before the arbitrator.

Sheppard does not just disregard *Moncharsh*'s entire-contract vs. single-provision distinction. By quoting key passages out of context and omitting critical language, Sheppard actively distorts *Moncharsh*'s language and holding. Sheppard states: "In *Moncharsh*, the Court noted that a party 'need not raise the illegality question prior to participating in the arbitration process' (3 Cal.4th at p. 31), because illegality is a 'question for the arbitrator in the first instance' (*id.* at p. 29 [*sic*, p. 30])." (RB 19.) Sheppard's first quote omits the sentence's critical qualifying phrase,

"*unless* a party is claiming . . . the entire contract is illegal." (3 Cal.4th at p. 31, emphasis added.) That, of course, is the situation here. Sheppard's second quote also omits the crucial fact that distinguishes *Moncharsh* from the facts here. The Court stated:

> Moncharsh does not contend the alleged illegality constitutes grounds to revoke the entire employment contract. Nor does he contend the alleged illegality voids the arbitration clause of that contract. Accordingly, *the legality of the fee-splitting provision* was a question for the arbitrator in the first instance.

(3 Cal.4th at p. 30, emphasis added.)

Thus, under *Moncharsh,* failure to raise an illegal-contract claim in arbitration does *not* waive the claim for judicial review, because that issue is for the court in the first instance, not the arbitrators. Not only is *Moncharsh* clear on this point, but any other interpretation would run afoul of long-established California law holding that, "A party to an illegal contract . . . cannot waive his right to urge that defense." (*City Lincoln-Mercury Co. v. Lindsey, supra,* 52 Cal.2d at p. 274.; see above, p. 8.)

b. As post-*Moncharsh* case law confirms, claims that the entire contract is illegal are *always* subject to judicial review.

Cases subsequent to *Moncharsh* have acknowledged the unalloyed right to judicial review of illegality claims that infect the entire contract, as opposed to those that do not. Our Supreme Court itself has recently reaffirmed the distinction. (*Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909, 917 (*Richey*) ["*Moncharsh* noted that judicial review may be warranted when a party claims that an arbitrator has enforced an *entire contract or transaction* that is illegal," emphasis added].) So has this Court, which recognized the exception to arbitral finality for an award that enforces an illegal contract, but finding the exception inapplicable because, "As in

Moncharsh, . . . the alleged illegality in the instant case *does not infect the entire contract.*" (*Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21, 33-36 (*Ahdout*), emphasis added; see also *Alternative Systems, Inc. v. Carey* (1998) 67 Cal.App.4th 1034, 1040 ["The defense of illegality of the *entire transaction* can be raised at any stage of the proceeding, including opposition to a motion to confirm," emphasis added].)

Sheppard, ignoring what *Moncharsh* actually says and holds, relies on general language in two post-*Moncharsh* cases, without discussing the facts of either case or mentioning that neither dealt with a claim of illegality of the entire contract. (RB 18 [quoting (1) *Reed v. Mutual Service Corp.* (2003) 106 Cal.App.4th 1359, 1372-1373 (*Reed*), "'Any claim of illegality must be raised before the arbitrator or it is deemed waived'" and (2) *Comerica Bank v. Howsam* (2012) 208 Cal.App.4th 790, 829 (*Comerica*), "'In order to challenge an award in court, a litigant must have raised the point before the arbitrator'"].) The holdings of these decisions, like all holdings, are "limited by the facts of the case being decided, notwithstanding the use of overly broad language by the court . . . ." (*McGee v. Superior Court* (1985) 176 Cal.App.3d 221, 226.)

Thus in *Reed,* the parties' contract incorporated the procedural rules of the association they had agreed would arbitrate any dispute, including a rule barring arbitration when more than six years had elapsed since the dispute arose. (106 Cal.App.4th at pp. 1363-1364, 1366, 1369.) Without a hearing, the arbitrators granted the defendant's motion to dismiss the arbitration under the six-year rule. (*Id.* at p. 1364.) In seeking to vacate the award, the plaintiffs argued for the first time that "*the contractual six-year time-bar provision* . . . was void and contrary to public policy." (*Id.* at p. 1364, emphasis added.) The court confirmed the award and the Court of Appeal affirmed, holding that the plaintiffs had waived the issue by failing

to address it "either when they initiated the arbitration, or in response to [the defendant's] motion to dismiss." (*Id.* at pp. 1372-1373.)

In *Comerica,* the defendants withdrew from an arbitration and their default was entered. (208 Cal.App.4th at p. 798.) In their appeal from the order confirming the award, they argued that the award was "in manifest disregard of the law" because it exceeded the amount specified in the arbitration demand. (*Id.* at p. 829.) The Court of Appeal held that the defendants had "forfeited this issue by withdrawing from the arbitration. In order to challenge an award in court, a litigant must have raised the point before the arbitrator." (*Ibid.*, citing *Moncharsh.*)

Thus, in both *Reed* and *Comerica*, the finding of waiver or forfeiture was completely consistent with *Moncharsh.* Neither decision involved a claim that the entire contract was illegal; neither decision controls the result here.

Finally, in supposed support of its misleading quotations from *Moncharsh* (see above, pp. 10-11), Sheppard cites three *post-Moncharsh* decisions, *Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440, 442, 449; *Preston v. Ferrer* (2006) 552 U.S. 346, 349-359; and *Phillips v. Sprint PCS* (2012) 209 Cal.App.4th 758, 774. (RB 19.) But none of those cases is applicable here, since each was decided under or relies on federal law, under which the arbitration panel, not the court, decides the issue of illegality where the entire contract is claimed to be illegal. (Knight et al., Cal. Practice Guide: Alternative Dispute Resolution (The Rutter Group 2014) ¶¶ 5:111.15-5:111.17.) The parties here explicitly agreed that their contract "will be governed by the laws of California" (1 AA 203), and the trial court found that the parties had properly contracted out of federal law (1 AA 62).

Moreover, even without this express agreement, federal law would be inapplicable. It governs only arbitrations under contracts "evidencing a transaction involving [interstate] commerce" (9 U.S.C. § 2), and the party asserting that state law is preempted by federal law has the burden of proving the contract involved interstate commerce. (*Woolls v. Superior Court* (2005) 127 Cal.App.4th 197, 211-214; *Shepard v. Edward Mackay Enterprises, Inc.* (2007) 148 Cal.App.4th 1092, 1099-1101.) No one in this case—not Sheppard, not the trial court, not the arbitration panel—has ever suggested federal law applies here. Sheppard's cases thus add nothing to the analysis, and they detract not at all from the holding of *Moncharsh.*

II. THE ENGAGEMENT AGREEMENT WAS ILLEGAL AND VIOLATED PUBLIC POLICY.

A. The Standard Of Review Is De Novo.

In a two-page section of its brief entitled "Standard Of Review," Sheppard actually never specifies the standard of review. (RB 15-17.)

The standard is de novo. JM asserts that the parties' contract is illegal and violative of public policy as a matter of law, and therefore the trial court erred in confirming an award it had no power to confirm and the arbitrators had no power to make. (See *Moncharsh, supra,* 3 Cal.4th at pp. 31-33 [arbitrators exceed their powers by enforcing an illegal contract or one in violation of public policy].)

"On appeal from an order confirming an arbitration award," where "one of the parties claims that the entire contract . . . is illegal . . .[,] we review the trial court's order (not the arbitration award) under a de novo standard." (*Lindenstadt v. Staff Builders, Inc.* (1997) 55 Cal.App.4th 882, 892, fn. 7 (*Lindenstadt*), citing, inter alia, *Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9 Cal.4th 362, 376, fn. 9; see also *Richey, supra,*

60 Cal.4th at p. 918, fn. 1 ["As the Court of Appeal recognized, the question whether the arbitrator exceeded his powers and thus whether we should vacate his award on that basis is generally reviewed on appeal de novo"]; *Ahdout, supra*, 213 Cal.App.4th at p. 33 [same][2]; *Anaheim Union High School Dist. v. American Federation* (2013) 222 Cal.App.4th 887, 890 [citing *Ahdout*].)

Here, the question of the Agreement's illegality is reviewed de novo. And because the relevant facts are not in dispute (see below, pp. 15-18), there is no occasion to apply the substantial evidence test to factual questions. (Cf. *Lindenstadt, supra,* 55 Cal.App.4th at p. 892, fn. 7.)

B. JM's Illegality Arguments Are Based On Undisputed Evidence.

In addition to arguing waiver, Sheppard's brief principally argues that JM cannot prevail because the case turns on disputed evidence. (See, e.g., RB 20 ["J-M's illegality arguments are entirely based on factual disputes"].)

Sheppard is dead wrong. The following undisputed facts establish that the parties' Agreement was illegal and in violation of public policy:

- **On February 22, 2010, representatives of JM met with Sheppard lawyers to discuss Sheppard's taking on JM's defense in an ongoing federal qui tam action.**

(2 AA 417, 474, 491; RB 5.)

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[2] In *Ahdout*, this Court cited to the Court of Appeal's opinion in *Richey* shortly before the Supreme Court granted review in that case. (*Ahdout, supra,* 213 Cal.App.4th at p. 33.) As the Supreme Court later observed, the Court of Appeal in *Richey* properly recognized the de novo standard of review in these circumstances. (*Richey, supra,* 60 Cal.4th at p. 918, fn. 1.)

- **Shortly after the February 22 meeting, Sheppard lawyers ran a conflicts check to see if Sheppard represented any other parties in the qui tam action.**

(2 AA 475, 538; RB 7.)

- **The conflicts check identified South Tahoe Public Utilities District (South Tahoe) as a Sheppard client in other matters.**

(2 AA 317; 3 AA 678; RB 7.)

- **South Tahoe was a plaintiff in the qui tam action and thus was directly adverse to defendant JM.**

(2 AA 283, 294.)

- **Two Sheppard partners who were its in-house ethics consultants advised that the "advance conflict waiver" in South Tahoe's engagement agreement allowed the firm to represent JM in the qui tam action.**

(2 AA 317, 476.)

- **Sheppard did not disclose to JM that South Tahoe was a Sheppard client, and it did not seek JM's informed consent to simultaneously represent JM and South Tahoe.**

(3 AA 671, 674; RB 8.)

- **During the interview process leading to JM's retention of Sheppard, Sheppard expressly assured JM that there were no conflicts with the proposed retention.**

(1 AA 191; RB 6.)

- **On or around March 4, 2010, Sheppard and JM entered into an Agreement that included a waiver by JM of conflicts with Sheppard's "current, former, and future clients." The agreement also stated: "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," i.e., the matters are "not substantially related," and Sheppard has "not obtained confidential information" from JM concerning the other client. Sheppard did not at that time disclose that South Tahoe was a Sheppard client, and the contract contained no details or further explanation of the nature of Sheppard's simultaneous representation of JM and its qui tam adversary South Tahoe.**

(1 AA 201; 3 AA 671, 673, 674; RB 8.)

- **At the time JM signed the Agreement, it did not know that South Tahoe was a Sheppard client.**

(1 AA 192.)

- **In July 2011, the district court disqualified Sheppard from representing JM in the qui tam action, finding that (1) South Tahoe was Sheppard's "current client at the time [it] took on representation of J-M," and (2) the waiver signed by South Tahoe was "ineffective" because**

Sheppard did not obtain South Tahoe's informed written consent to the dual representation. Sheppard did not seek review of that ruling.

(2 AA 346-349.)

- **Sheppard performed work for South Tahoe until March 2011—a year after JM became its client.**

(2 AA 278-279, 512-513; RB 9.)

- **In 2014, the arbitral panel in this case found that Sheppard did not "disclose the full South Tahoe situation to J-M" and did not "seek J-M's waiver of it." The panel assumed that the "ethical violation occurred."**

(3 AA 674.)[3]

These undisputed facts demonstrate that the Agreement was illegal and in violation of public policy. Sheppard undertook the representation of JM knowing its conflicts check revealed an actual conflict between JM and South Tahoe, a long-time Sheppard client. Yet Sheppard failed to do what California law demands in such situations: disclose the conflict to both clients in clear and specific terms and obtain both clients' informed written consent to the conflict. (Rules of Professional Conduct, rule 3-310(C); *Flatt v. Superior Court* (1994) 9 Cal.4th 275, 285, fn. 4 (*Flatt*) [attorney may simultaneously represent clients with adverse interests

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[3] Sheppard asserts that the arbitrators "confirmed" that Sheppard "obtained conflict waivers from both J-M and South Tahoe . . . ." (RB 24.) If what Sheppard means is that the arbitrators found that Sheppard obtained *valid* conflict waivers, it is being disingenuous. The arbitrators found just the opposite. (3 AA 674 [finding that Sheppard did *not* disclose the South Tahoe situation to JM and seek JM's waiver of it, and assuming Sheppard committed an ethical violation].)

as to unrelated matter "provided full disclosure is made and both agree in writing to waive the conflict"].) The undisputed facts here, coupled with the Agreement's blanket waiver of present and future conflicts and explicit waiver of Sheppard's duty of loyalty to JM, rendered the Agreement illegal as a matter of law. (See *McIntosh v. Mills* (2004) 121 Cal.App.4th 333, 344, 346 [in light of "public interest concerns," attorney's fee-sharing agreement with non-attorney was illegal because it violated "a professional ethics rule enacted to govern the conduct of members of the State Bar"].)

C. The Agreement's Broad, Nonspecific Waiver Of All Present And Future Conflicts Contravened California Law; Sheppard's Actual, Existing Conflict Of Interest—Of Which JM Indisputably Knew Nothing—Was Not Validly Waived.

Sheppard argues that the Agreement's conflict waiver was "plainly legal," asserting that "[w]aivers of current and future conflicts are commonplace and enforced by California and other courts." (RB 26-27.)[4] But there is nothing commonplace, defensible or legal about the conflict waiver in this case, as Sheppard's own authorities establish.

Sheppard relies principally on two decisions—*Zador Corp. v. Kwan* (1995) 31 Cal.App.4th 1285, 1301 (*Zador*) and *Visa U.S.A. Inc. v. First Data Corp.* (N.D. Cal. 2003) 241 F.Supp.2d 1100, 1105 (*Visa U.S.A.*)—but, tellingly, omits any mention of their facts. (RB 27.) Neither decision

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[4] As we discuss below, the legality of "advance conflict waivers" has been a subject of much debate and controversy in recent years, and fully-informed and knowledgeable advance conflict waivers have been upheld in some cases. (See below, pp. 31-32, fn. 9.) But no case or other authority has ever suggested that a nonspecific, broadly-worded purported waiver of the duty of loyalty as to all current and future conflicts, like that in this case, could conceivably be lawful.

supports Sheppard's argument, because both involved specific and detailed conflict waivers that were found to comply with California's informed consent requirements. Our case is completely different.

In California, the validity of a conflict waiver is governed by the Rules of Professional Conduct, including rule 3-310(C), which prohibits the representation of multiple clients under certain scenarios without each client's "informed written consent." (See AOB 21-23; *Zador, supra,* 31 Cal.App.4th at p. 1295 [discussing sections (C)(1), (C)(2)]; *Visa U.S.A., supra,* 241 F.Supp.2d at pp. 1104 [discussing section (C)(3)].) Both decisions upheld the client's conflict waivers on the ground that they satisfied the informed-consent requirements of rule 3-310.

In *Zador*, a corporation (Zador) and an individual (Kwan) consented to be jointly represented by a law firm, Heller Ehrman, White & McAuliffe (Heller); Kwan agreed that if a conflict or dispute arose in the future, he would not seek to disqualify Heller from continuing to represent Zador. (31 Cal.App.4th at pp. 1289-1290.) A conflict of interest did arise; Kwan retained new counsel and moved to disqualify Heller. (*Id.* at pp. 1291-1292.) The trial court granted the motion, and the Court of Appeal reversed. (*Id.* at pp. 1292, 1303.)

The appellate court concluded that Kwan's two conflict waivers complied with the requirements of rule 3-310. The first (pre-conflict) waiver letter specifically advised Kwan that Heller "would continue to represent Zador if a conflict existed," and it explicitly stated, "'[W]e are now asking that you consent to our continued and future representation of [Zador] and agree not to assert any such conflict of interest or seek to disqualify us from representing [Zador], *notwithstanding any adversity that may develop*.'" (*Id.* at p. 1300.) The second conflict letter—after Heller decided a possible conflict existed—advised Kwan to retain separate

counsel and to reaffirm his consent to the firm's continued representation of Zador. Again Kwan agreed, in writing. (*Ibid.*) The Court of Appeal held that the conflict waivers were "detailed" and "explicit" (*id.* at pp. 1299, 1300, 1301), that "Kwan consented to Heller's continued representation of Zador 'notwithstanding any adversity' that developed" (*id.* at p. 1301) and thus that Heller should not have been disqualified (*id.* at p. 1303).

Visa U.S.A. relies heavily on the reasoning of *Zador.* (*Visa U.S.A., supra,* 241 F.Supp.2d at pp. 1104, fn. 4, 1105-1106.) Heller (the same law firm as in *Zador*) had a long-standing relationship with Visa when it was approached by First Data to represent it in a patent infringement action unrelated to Visa. (241 F.Supp.2d at p. 1102.) After running a conflicts check, Heller informed First Data about its relationship with Visa, stating that although it did not see any current conflicts between the two, there was a "significant risk of future adversity because Visa and First Data were major competitors." (*Id.* at pp. 1102, 1107.) Thus, Heller explained, it would need First Data's agreement to represent Visa in any future disputes that might arise between them, including litigation; First Data consented. (*Id.* at p. 1102.) A few months later, Visa sued First Data over trademark issues, and First Data moved to disqualify Heller as counsel for Visa in that matter. (*Id.* at p. 1103.)

The district court denied the motion, reasoning that under California law, a law firm may "simultaneously represent two adverse clients *if full disclosure of the situation is made to both clients and both agree in writing to waive the conflict.*" (*Id.* at p. 1105, citing *Flatt, supra,* 9 Cal.4th at p. 285, fn. 4, emphasis added.) It was undisputed that Heller and First Data had executed such an agreement. (*Ibid.*) The court also determined that an "advance waiver of potential future conflicts, such as the one executed by First Data and Heller, is permitted" so long as "the waiver was fully

informed." (*Ibid.*) The court found that Heller's waiver letter "identifies the adverse client, Visa, and discloses as fully as possible the nature of any potential conflict that could arise between the two parties," "'including litigation.'" (*Id.* at p. 1107.) The court concluded that Heller met the requirements of rule 3-310(C) when it "disclosed the existence of the potential Visa conflict *before forming an attorney-client relationship with First Data and obtained a written conflict waiver agreement.* (*Id.* at p. 1109, emphasis added.)

Our case stands in stark contrast to both *Zador* and *Visa U.S.A.* Here, Sheppard knew there was an actual, existing conflict between its potential client (JM) and its existing client (South Tahoe) but decided not to disclose the conflict to either client. Armed with knowledge of the conflict, Sheppard entered into a retainer agreement with JM that contained only a broad and vague waiver of all current and future conflicts, coupled with an explicit waiver of its duty of loyalty to JM. The conflict waiver was neither specific nor detailed, and it identified no adverse client or conflict; it thus gave JM no basis for providing the requisite informed consent.[5]

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[5] In addition to *Zador* and *Visa U.S.A.*, Sheppard cites several non-California opinions. (RB 27-28, fn. 4.) None was decided under California law and none condoned the situation here—the purported waiver of an actual, current conflict with an existing client of which the lawyer is aware but fails to disclose to the potential new client. In fact, some of Sheppard's authorities expressly disapprove of such a "waiver." (See, e.g., Washington, D.C. Bar Ethics Committee, Op. 309 (2001) [general waiver invalid where lawyer is aware of existing conflict; lawyer must "make full disclosure of facts of which [it was] aware"]; *Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC* (N.D. Tex. 2013) 927 F.Supp.2d 390, 402-403 ["If a conflict of interest is known to an attorney at the time he seeks a waiver, the attorney is not allowed to hide that conflict, regardless of whether the client is sophisticated or not"];

(continued...)

Sheppard several times mentions that JM's General Counsel "reviewed the conflict waiver" and negotiated and signed the Agreement. (RB 1, 5, 6, 31.) These assertions are irrelevant, as they have absolutely no impact on the illegality of the contract. As the Supreme Court made clear almost a century ago:

> [I]t has been universally held that a party to [an illegal] agreement may not, either by stipulation at the time of the execution thereof, or afterwards, waive his right to urge the illegality . . . . No consent of the defendant can neutralize its effect. A stipulation in the most solemn form to waive the objection is tainted with the vice of the original contract, and void for the same reason.

(*American Nat. Bank of San Francisco v. A.G. Sommerville, Inc.* (1923) 191 Cal. 364, 371.) JM's agreement to an illegal contract has no legal significance whatsoever.

The evidence is undisputed that Sheppard did not (and made no effort to) comply with the requirements of rule 3-310. (See above, pp. 15-18.) Sheppard's patent violation of that fundamental rule—coupled with its deliberate repudiation of its duty of loyalty to JM—renders the Agreement illegal. (*McIntosh v. Mills, supra*, 121 Cal.App.4th at p. 344, 346 [fee-sharing agreement illegal because it violated "a professional ethics rule enacted to govern the conduct of members of the State Bar"]; see also AOB 24-27.)

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[5] (...continued)
In re IH 1, Inc. (Bankr. D. Del. 2011) 441 B.R. 742, 746-747 ["[g]eneral and open-ended waivers are generally not effective"; waivers must be "explicit and narrow"].)

Sheppard also cites to the reports of its litigation expert, Lawrence C. Marshall. (See RB 27 [citing 2 AA 437-441 (Sheppard's opening brief) and RJN Decl. Ex. C at pp. 103-105 (expert report)].) As demonstrated below (pp. 29-30), Mr. Marshall's opinions about the law of conflict waivers law are irrelevant.

III. NONE OF SHEPPARD'S EXCUSES VALIDATES THE PLAINLY UNLAWFUL CONTRACT, IN LIGHT OF SHEPPARD'S UNDISPUTED FAILURE TO OBTAIN JM'S INFORMED CONSENT TO SHEPPARD'S SIMULTANEOUS REPRESENTATION OF JM AND SOUTH TAHOE.

In addition to arguing that the Agreement's conflict waiver met the requirements of California law, Sheppard offers two excuses to try to legitimize the Agreement: (1) South Tahoe was not Sheppard's client when the Agreement was executed, so there was no conflict, and (2) Sheppard honestly and in good faith believed that the Agreement was legal. Neither claim provides any basis for Sheppard to avoid the consequences of its clearly unethical conduct.

A. Sheppard's Denial That South Tahoe Was Its Client At The Time Sheppard Agreed To Represent JM Contravenes The Law And Undisputed Facts.

Sheppard concedes that its conflicts check identified South Tahoe as a client of the firm, but argues that South Tahoe was not an "existing" client when the Engagement Agreement was signed in early March 2010 because Sheppard had not done any work for South Tahoe since November 2009. (RB 8.) According to Sheppard, South Tahoe "reemerged" as a client in late March 2010, i.e., three weeks after the Agreement was signed. (RB 9; 2 AA 278.) Sheppard's "reemergence" theory is contrary to the undisputed evidence and California law.

South Tahoe had been Sheppard's client since 2002, consulting with Sheppard partner Jeffery Dinkins on discrete employment-related matters when they arose, pursuant to the parties' contract. (2 AA 276-277.) That contract, renewed in 2006, provided that Sheppard would represent South

Tahoe "in connection with *general employment matters* (the 'Matter')." (1 AA 53-E, emphasis added.) The contract's termination provision stated:

> You have the right to terminate our representation of you at any time. Subject to our ethical obligation to give you reasonable notice to arrange for alternate representation, we may terminate our representation of you at any time. Unless we agree to render other legal services to the District, our representation will terminate upon completion of the Matter.

(1 AA 53-G.)

The contract is consistent with California law, which holds that a "lawyer's authority terminates when 'the representation ends as provided by contract or because the lawyer has completed the contemplated services.'" (Vapnek, et al., Cal. Practice Guide: Professional Responsibility (The Rutter Group 2014) ¶ 10:210, citing Rest.3d Law Governing Lawyers, § 31 (2)(e) and Comment "h," and *Matter of Allen* (Rev.Dept. 2010) 5 Cal. State Bar Ct.Rptr. 198, 204.) Neither condition happened here. There is no evidence that South Tahoe terminated the contract, that Sheppard gave South Tahoe notice of termination, or that the "employment matters" Sheppard agreed to handle were completed. Indeed, Sheppard wrote to South Tahoe's lawyers as late as June 2011 "to address the long-standing relationship between the District and our Firm," and noting, "We have been pleased to provide labor advice to you for the last 9 years." (2 AA 390.)

The arbitrators assumed that South Tahoe was a Sheppard client when the Agreement was signed; Sheppard did not claim otherwise. Had they not made that assumption, there would have been no need to discuss California law prohibiting attorneys "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, emphases added.) In "assum[ing] that the ethical violation occurred," the

panel necessarily assumed that Sheppard had represented two adverse clients. (3 AA 674.)

This is not the first time Sheppard has impermissibly tried to "avoid the automatic disqualification rule applicable to concurrent representation of conflicting interests by unilaterally converting a present client into a former client." (*American Airlines, Inc. v. Sheppard, Mullin, Richter & Hampton* (2002) 96 Cal.App.4th 1017, 1037, 1044 (*American Airlines*), citing *Truck Ins. Exchange v. Fireman's Fund Ins. Co.* (1992) 6 Cal.App.4th 1050, 1057 [discussing "hot potato rule," the bar on curing dual representation conflicts by the expedient of severing the relationship with the pre-existing client] and *Flatt, supra,* 9 Cal.4th at p. 288 [same].) Sheppard's efforts failed in the qui tam action, where the district court, citing *American Airlines*, roundly criticized Sheppard for claiming "it should be permitted to drop South Tahoe as a client." (2 AA 351; see AOB 6-7 & fn. 3.) The reason the courts have condemned this tactic in the strongest terms is that converting a present client into a former one breaches "the duty of loyalty which the concurrent representation rule is designed to avoid," and "may itself be a breach of loyalty." (*American Airlines, supra,* 96 Cal.App.4th at p. 1037.)

Sheppard's theory that South Tahoe was not its client at the time Sheppard agreed to represent JM—but then "reemerged" as a client three weeks later—is directly contrary to the undisputed facts, the law, and ethical practice.

B. Sheppard's Belief—Even If "Honest"—That Its Agreement Was Legal Does Not Make It So.

Sheppard contends it should prevail on appeal "because, as the Panel found, Sheppard Mullin's attorneys 'honestly and in good faith' relied on the conflict waivers they received from J-M and South Tahoe." (RB 30;

3 AA 674 [arbitration award].) Sheppard argues that it honestly (and reasonably) believed that the broad and nonspecific waivers in the Agreement relieved it of the duty to obtain JM's informed consent as required by the Rules of Professional Conduct, even after the firm's conflicts check revealed an actual conflict of interest between JM and South Tahoe. (RB 30-32.) In view of the fact that the conflict waiver rules are designed for the protection of clients rather than the convenience of lawyers, it is no surprise that Sheppard's contention is without legal merit.[6]

1. There is no "honest belief" defense to contract illegality.

The arbitrators' finding that Sheppard "honestly and in good faith believed that no conflict existed when it undertook the Qui Tam defense" (3 AA 674) is legally irrelevant. However "honestly" Sheppard may have believed that its duty of loyalty to JM could be explicitly waived, and that broad conflict waivers in the Agreement meant that Sheppard need not get JM's informed consent to an actual, existing conflict, in the eyes of the law the Agreement was illegal and against public policy. (*Transamerica Corp.*

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[6] Sheppard distorts the arbitrators' finding and the evidence, stating repeatedly that the panel found Sheppard's belief and conduct to be *reasonable.* (See RB 4 [panel correctly held it was "reasonable" for Sheppard to represent J-M]; 6 [panel found Sheppard "reasonably believed that there was no conflict to disclose"]; 8 [panel found Sheppard "acted reasonably"]; 38 [same]; see also RB 30 [Sheppard "reasonably believed" that JM consented to Sheppard's conduct]; 33-34 [Sheppard "reasonably believed that South Tahoe was not an 'existing client'" and that "there were no conflicts to disclose to J-M"].)

In fact, the panel found no such thing. It found only that Sheppard was not guilty of fraudulent concealment, because Sheppard "honestly and in good faith believed that no conflict existed." (3 AA 674.) Whether Sheppard's belief and actions were *reasonable* was not an issue the panel decided. Indeed, the panel "assumed," without deciding, "that the ethical violation occurred." (3 AA 674.)

v. Parrington (1953) 115 Cal.App.2d 346, 357 ["neither pure motives nor honest belief in the validity of an illegal bargain will save it from condemnation"]; *Jeffry v. Pounds* (1977) 67 Cal.App.3d 6, 11 (*Jeffry*) [law firm that violated duty of loyalty by accepting conflicting engagements was subject to disgorgement of fees as a matter of law, even though attorneys had no "dishonest purpose" and did not engage in "deliberately unethical conduct"]; *Estate of Klauenberg* (1973) 32 Cal.App.3d 1067, 1070-1071 ["A contract is a result of the objective manifestations of the parties[,] and . . . the subjective intentions or *beliefs of the parties are immaterial*," emphasis added]; *Vierra v. Workers' Comp. Appeals Bd.* (2007) 154 Cal.App.4th 1142, 1146, 1148 ["A contract must be lawful (Civ. Code § 1550); i.e., it must not be in conflict with express statutes or public policy"; holding attorney fee agreement was unenforceable despite parties' belief that governing fee guidelines were "outdated"].)

As the United States Supreme Court recently observed:

> "[O]ur law is . . . no stranger to the possibility that an act may be 'intentional' for purposes of civil liability, even if the actor lacked actual knowledge that her conduct violated the law." [Citation.] Tortious interference with a contract provides an apt example. While the invalidity of a contract is a defense to tortious interference, *belief in validity is irrelevant.* [Citation.] In a similar way, a trespass "can be committed despite the actor's mistaken belief that she has a legal right to enter the property." [Citation.] And of course, "[t]he general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system." [Citation.] In the usual case, "*I thought it was legal" is no defense*.

(*Commil USA, LLC v. Cisco Systems, Inc.* (2015) 135 S.Ct. 1920, 1930, emphases added.)

Sheppard cites no authority to the contrary. The Agreement was illegal, whatever Sheppard's belief as to its legality may have been.

2. The opinions of Sheppard's expert as to the firm's beliefs and conduct—as well as the law—have no evidentiary significance.[7]

To support its argument that it "reasonably" relied on the legality of the conflict waivers in its Agreement, and that it was "'justified in proceeding with confidence'" that JM had waived any and all conflicts, throughout its respondent's brief, Sheppard regularly relies upon the opinions of its expert in the arbitration, Lawrence C. Marshall. (See, e.g., RB 30 [citing to "RJN Decl. Ex. C at pp. 133-134" (expert report)], and 34 [citing to "RJN Dec. Ex H at pp. 173-175" (supplemental expert report)].) Sheppard neither explains the source of its citations, nor indicates these are merely Mr. Marshall's opinions. (See, e.g., RB 30 [omitting introductory phrase, "It is my opinion, then, that" before quote starting "'Sheppard Mullin was justified . . . .'"]; see RJN Decl. Ex. C at p. 134.)

Because, as demonstrated, even an honest belief in the validity of one's contract is irrelevant to the question of contract illegality, an expert's opinion as to whether a party held such a belief is doubly irrelevant. The question of contract illegality is one of law for the court (*Dunkin v. Boskey* (2000) 82 Cal.App.4th 171, 183), as is the question whether a subjective

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[7] JM did not include any expert reports in its Appellants' Appendix or cite to them in its opening brief because it believed they were irrelevant. Sheppard, however, requested judicial notice of several documents, including its litigation expert's reports, and it liberally cites to the reports throughout its Respondent's Brief. (See, e.g., RB 26, 27, 28, 29, 30, 31, 33, 34, 35.) JM filed a conditional opposition and request for judicial notice if Sheppard's request were granted. (Dock. No. B256314 (Apr. 14, 2014).) The Court took judicial notice of both parties' documents "as to authenticity without prejudice as to further argument and decision as to pertinence of any of these documents." (Dock. No. B256314 (May 1, 2015).) As we explain, JM unequivocally contends that expert testimony is irrelevant to any issue before this Court.

belief was objectively reasonable (*Tamborino v. Superior Court* (1986) 41 Cal.3d 919, 925; *Union Oil Co. v. International Ins. Co.* (1995) 37 Cal.App.4th 930, 936). Moreover, California law is crystal clear that an expert's opinion on a question of law is inadmissible. (*Ferreira v. Workmen's Comp. Appeals Bd.* (1974) 38 Cal.App.3d 120, 126 ["The manner in which the law should apply to particular facts is a legal question and is not subject to expert opinion"]; *Summers v. A.L. Gilbert Co.* (1999) 69 Cal.App.4th 1155, 1178 (*Summers*) [same].) As this Court explained, "[E]ven lawyers may not testify as to legal conclusions, or state interpretations of the law . . . ." (*WRI Opportunity Loans II LLC v. Cooper* (2007) 154 Cal.App.4th 525, 532, fn. 3, interior quotation marks omitted.)

Sheppard also cites to other of Mr. Marshall's opinions about the law. (See, e.g., RB 26, 27, 35.) But just as "'[e]ach courtroom comes equipped with a "legal expert," called a judge . . . '" (*Summers, supra,* 69 Cal.App.4th at p. 1181), so do many arbitration panels. Indeed, this panel included two retired judges. (3 AA 670.) And the parties have the benefit of three legal experts on this Court. Mr. Marshall's opinions are utterly irrelevant.

IV. ALL CALIFORNIA ATTORNEYS ARE GOVERNED BY THE SAME ETHICAL RULES, NO MATTER HOW LARGE THEIR LAW FIRMS OR HOW COMPLICATED THEIR CASES; SHEPPARD'S "TOO BIG TO FOLLOW THE RULES" EXCUSE IS MERITLESS.

Sheppard, in claiming that the blanket conflict waiver in its Agreement relieved it of the duty to obtain JM's written informed consent pursuant to rule 3-310, makes a startling and disturbing policy argument: Large law firms and firms that handle major matters such as qui tam

actions, Sheppard contends, *must* rely on such conflict waivers in order to do the work they do. (RB 26-29.) Sheppard asserts:

> "[E]ach current client in a large firm affects whether many hundreds (and in some major law firms, well more than a thousand) of lawyers are precluded from representing certain new clients." [Citation.] Moreover, "when a firm is handling cases (like the qui tam action) with scores or hundreds of parties, the specter of being conflicted out is a fundamental concern." [Citation.]

(*Id.* at pp. 28-29.)[8]

The problem with Sheppard's argument is not that its premise is inaccurate. Large law firms, by their nature, represent many clients—often in complex multi-party matters—thus multiplying the possibility of conflicts of interest. No doubt this problem complicates large law firm practice, with the result that lawyers at large law firms have long sought revision of ethical standards, including urging the validity of controversial "advance conflict waivers." The debate on this subject is ongoing.[9]

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[8] The citations in the quotations above, and in this section of Sheppard's brief, are to the reports of Sheppard's expert, Mr. Marshall. His opinions on the needs and practices of large law firms are—like his other opinions—completely irrelevant. (See above, pp. 29-30.)

[9] As one commentator warned, "[B]ecause this principle [of loyalty] stands on such a solid ethical foundation[,] the cynical attempt to get around it via the advance conflict waiver is not only bad for clients, but also could profoundly damage the reputation of the legal profession. The advance conflict waiver represents what society hates most about lawyers: it feeds the perception that they are unethical and greedy; to the extent they are loyal it is to themselves and to profit. The advance conflict waiver is therefore a perfect storm: a confluence of law firm greed and client disloyalty blowing together in one disgraceful paragraph. It sends the wrong message to clients and to society." (Lane, *Opinion: Advance Conflict Waivers Send Wrong Message* (July 15, 2014) <www.law360.com/articles/555612/opinion-advance-conflict-waivers-send-wrong message>; but see Elbert & (continued...)

But in this case, the argument is a straw man. Because what makes the Agreement here illegal is the undisputed fact that Sheppard did not comply with the informed-consent rules governing *actual, present, ongoing* conflicts. Moreover, what makes Sheppard's argument particularly offensive in this setting is that it focuses entirely on the welfare of the law firm instead of its clients, turning the fiduciary nature of the lawyer-client relationship on its head.

The courts have expressed concern at the arguments of some large law firms that, because they wish to maximize their client base, the profession's ethical rules should not apply as strictly to them. As Justice Joyce Kennard of the California Supreme Court wrote, "[T]he purpose of rules of professional ethics is to restrain and guide the conduct of attorneys and to protect the public, not to protect the financial interests of law firms." (*Howard v. Babcock* (1993) 6 Cal.4th 409, 433 (dis. opn. of Kennard, J.) [disagreeing with majority opinion upholding validity of noncompetition covenant in law firm partnership agreement].) Justice Kennard called for "resolute action by this court to protect the legal profession from the insidious effects of an overzealous pursuit of economic gain." (*Id.* at p. 434.)

Similarly, Chief Justice William Rehnquist commented on "the apparent move toward profit-maximization" in the practice of law,

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[9] (...continued)
Malia, *Playing Both Sides? Navigating the Murky Waters of Advance Conflict Waivers* (Oct. 13, 2008) The Professional Lawyer, p. 21 ["The advance waiver will have a much greater likelihood of surviving . . . scrutiny . . . if a lawyer can demonstrate that the future matter has been identified with adequate specificity; if the party giving the waiver is sophisticated . . . and has been provided with as much information regarding the potential conflict as is available . . . ; and if the waiver is recent"].)

accompanied by "the apparent increase in ethical difficulties." (Rehnquist, *The Legal Profession Today* (1986) 62 Ind. L.J. 151,153, 154.) He explained:

> It is only natural, I suppose, that as the practice of law in large firms has become organized on more and more of a business basis, geared to the maximization of income, this practice should on occasion push towards the margins of ethical propriety. Ethical considerations, after all, are factors which counsel *against* maximization of income in the best Adam Smith tradition, and the stronger the pressure to maximize income the more difficult it is to avoid the ethical margins.

(*Id.* at p. 154.)

Yet, contrary to Sheppard's contention (RB 27, 29), it is not "virtually impossible" for lawyers in large law firms to follow the same rules as other lawyers, as demonstrated by the very authorities Sheppard relies on—*Zador, supra*, 31 Cal.App.4th 1238 and *Visa U.S.A., supra*, 241 F.Supp.2d 1100. (RB 27.) As demonstrated, Heller—the law firm in both cases (which in 2006 employed more than 730 attorneys in 15 offices worldwide, with annual revenues of $507 million)[10]—was held to have fully complied with California's informed-consent rules by making complete disclosures and obtaining specific and detailed conflict waivers from its clients. (See above, pp. 20-22.)

In sum, nothing prevented Sheppard from informing JM about its conflicts check revealing that JM's adversary, South Tahoe, was a client of the firm, and seeking JM's waiver of the conflict after knowing all the facts. Nothing, that is, except Sheppard's desire to represent "the largest manufacturer of PVC pipe in the world" (RB 4) in a massive lawsuit, and at

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[10] *Heller Ehrman* (Aug. 17, 2014) Wikipedia <https://en.wikipedia.org/wiki/Heller_Ehrman> (as of June 29, 2015).

the same time retain its representation of South Tahoe, without taking the risk that one or both of the clients would decline the waiver.

V. SHEPPARD'S ACCEPTANCE OF EMPLOYMENT ADVERSE TO A CURRENT CLIENT—EVEN WITHOUT A SHOWING OF SPECIFIC HARM—VIOLATES PUBLIC POLICY; THEREFORE SHEPPARD MAY NOT RECOVER OR RETAIN ANY PAYMENT UNDER THE ILLEGAL CONTRACT.

The opening brief demonstrated that when a lawyer accepts employment adverse to a client, disgorgement is required for public policy reasons even when the client seeking disgorgement can show no damages and may receive a windfall. (AOB 28-33.) And while a fact-intensive balancing test applies to some *other*, less serious, ethical violations, that analysis has been consistently rejected in cases involving the sort of direct conflict present here. (AOB 33-37.)

Sheppard's response is to ignore the argument. It does not even attempt to wrestle with the case law establishing a distinction between these two different types of ethical violations. Nor does it contest the clear holdings of the cases that the opening brief discussed at length.

JM addressed in great detail the holdings of three cases, *Goldstein v. Lees* (1975) 46 Cal.App.3d 614 (*Goldstein*), *Jeffry, supra*, 67 Cal.App.3d 6, and *A.I. Credit Corp., Inc. v. Aguilar & Sebastinelli* (2003) 113 Cal.App.4th 1072 (*A.I. Credit Corp.*). (AOB 30-33, 35.) Yet Sheppard claims that "[t]he cases J-M relies upon" were just *Goldstein* and *Anderson v. Eaton* (1930) 211 Cal. 113 (*Anderson*). (RB 38.)[11] Elsewhere,

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[11] The opening brief did cite *Anderson*, but it did not rely on it for the principle discussed in the section of the brief dealing with disgorgement. It (continued...)

Sheppard claims that "the cases that J-M relies upon" are *Rodriguez v. Disner* (9th Cir. 2012) 688 F.3d 645 and *Pringle v. La Chapelle* (1999) 73 Cal.App.4th 1000 (*Pringle*). (RB 35-36.) Sheppard's only reference to *Jeffry* and *A.I. Credit Corp.* is in a string cite, which claims that the disgorgement analysis in those cases actually involved a "fact-intensive" inquiry into the egregiousness of the particular conflict issue. (RB 36-37.)

Ignoring JM's argument and the basis for it doesn't make the argument go away. What little Sheppard does have to say on these topics does nothing to undercut the points made in the opening brief, as explained below:

Jeffry. According to Sheppard's string cite, *Jeffry* approved disgorgement only after conducting a "fact-intensive" balancing analysis. (RB 36-37.) Nonsense. There, the trial court concluded that the law firm had not violated its ethical duties, so there was no reason to decide whether disgorgement was an appropriate remedy. (*Jeffry, supra*, 67 Cal.App.3d at pp. 8-9.) The Court of Appeal reversed, held that the firm violated its duty of loyalty by accepting conflicting engagements, and ordered disgorgement *as a matter of law*. (*Id.* at p. 12; AOB 31.) That result would not have been possible if disgorgement required a "fact-intensive" inquiry into the reasonableness of the attorney's conduct, harm to the plaintiff or other factors. In fact, the Court of Appeal explained that disgorgement was required even though it did "not charge [the attorneys] with dishonest purpose or deliberately unethical conduct." (*Id.* at p. 11; AOB 32.) Had the *Jeffry* court thought a "fact-intensive" inquiry was necessary to determine

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[11] (...continued)
cited *Anderson* earlier for the definition of "informed written consent," and it noted that an internal quotation in *Goldstein* came from *Anderson*. (AOB 23, 29.)

the remedy, it would have had to remand so that the trial court could conduct that inquiry and balance the equities.

A.I. Credit Corp. Similarly, Sheppard claims that *A.I. Credit Corp.* permitted disgorgement after conducting a "fact-intensive" analysis that turned on the law firm being "hired because it agreed to use and disclose confidential information about a former client to a new client and made no attempt to secure a waiver or consent from the former client." (RB 36-37.) The decision doesn't say that. It is devoid of any such fact-intensive inquiry. (*A.I. Credit Corp., supra,* 113 Cal.App.4th at pp. 1077-1081.) And the court's analysis made no mention of confidential information. (*Ibid.*) To the contrary, the court explained that the law firm "was disqualified based on its conflict of interest in representing [one client] in the collection proceeding against [another client]." (*Id.* at p. 1079.) Disgorgement was based on "[t]he general rule . . . that an attorney disqualified for violating an ethical obligation is not entitled to fees"—a rule that required judgment as a matter of law. (*Ibid.*)

In *Pringle, supra*, 73 Cal.App.4th 1000, there was a "fact-intensive inquiry," but that is because the case involved a "minor technical violation" of conflict rules. (See *A.I. Credit Corp., supra*, 113 Cal.App.4th at p. 1079; RB 31-32, 36-37; AOB 33-36.) *A.I. Credit Corp.* expressly *rejected* application of *Pringle*'s fact-intensive analysis where an attorney is disqualified for the serious violation of representing one party in a suit against another of the firm's clients. (*A.I. Credit Corp., supra,* 113 Cal.App.4th at pp. 1079.) Thus, *Pringle* required a balancing test rather than automatic disgorgement when (1) an attorney represents two clients who are presumably aligned (i.e., a corporation and a corporate officer, both sued by a third party), (2) both clients were fully informed of a potential conflict and both signed a waiver, but (3) the waiver form was

technically inadequate because it was signed on behalf of the corporation by the corporate officer who was a client rather than by an independent officer. (AOB 33-34.) Under those circumstances, the corporate officer could not capitalize on the technical violation to avoid paying his own fees. (*Ibid.*) As *A.I. Credit Corp.* holds, that sort of inquiry does not apply when an attorney is disqualified for conflict reasons. In those instances, forfeiture is required as a matter of law—a notion entirely at odds with a supposed fact-intensive inquiry. (*A.I. Credit Corp., supra*, 113 Cal.App.4th at p. 1079 [upholding summary judgment granting fee disgorgement].) Sheppard offers no response.

Confidential information. Sheppard maintains that the critical fact in the "cases J-M relies upon" was that the "attorney possessed and used confidential information from the adverse party to the client's detriment." (RB 38.) Not so.

In *Goldstein*, there was no evidence that the attorney actually used confidential information. Nor was that fact of concern to the Court of Appeal. The court explained that it was "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.) There didn't need to be an actual use of confidential information. That the attorney "*must have [been] tempted* . . . to reveal or to improperly monopolize the confidences and secrets of his former client" was mentioned by the court as one of the problems of a conflict between clients. (*Id.* at p. 619.) As the Court of Appeal explained, the ethical violation that required disgorgement was "'accept[ing] employment adverse to a client or former client,'" without informed consent. (*Id.* at pp. 618-619.)

Indeed, *Jeffry* is entirely clear on the matter. There, the trial court had found that the representations of Mr. Pounds "entailed *no confidential financial information* which might aid Mrs. Pounds' marital litigation." (*Jeffry, supra*, 67 Cal.App.3d at p. 9, emphasis added.) But the Court of Appeal held that disgorgement was required "without potential breaches of confidentiality," because the disgorgement 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" in the attorney's loyalty in acting as a zealous advocate, "not the attorney's inner conflicts" regarding whether to reveal confidential communications. (*Id.* at pp. 10-11.)

Harm to JM. According to Sheppard, a key part of the "fact-intensive" inquiry is whether and the extent to which Sheppard's conduct harmed JM. (RB 37-38.) But *Goldstein* holds just the opposite—that harm is not relevant in cases involving an attorney's representation of one client in litigation against another of the attorney's clients. "[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 defendants [the clients]," but to prevent attorneys from undertaking representations that are inherently antithetical to the attorney's role as a zealous advocate. (*Id.* at pp. 620, 623-624.) The opening brief explained this. (AOB 30-31.) Again, Sheppard offers no response.

Finally, Sheppard continues to rely on cases that apply *Pringle*'s factual balancing analysis to circumstances that do *not* involve the serious conflict of interest posed here—when a lawyer violates ethical duties by representing one client in a suit against another of the lawyer's clients.

(RB 32, 36-37.)[12] Those cases are irrelevant. As the opening brief demonstrated, a different rule applies to the disgorgement analysis when the attorney impermissibly represents a client in litigation against another of the attorney's clients. (AOB 34-37.) Our courts have consistently recognized that the prohibition on that type of representation, which goes to the heart of the attorney-client relationship, must be categorically discouraged. (*Fair v. Bakhtiari* (2011) 195 Cal.App.4th 1135, 1161 ["a conflict of interest that goes to the heart of the attorney-client relationship" is the sort of rule violation that "constitutes a serious breach of fiduciary duty"].) That circumstance is nothing like where an attorney makes a misrepresentation to his client—a circumstance that requires analysis of the nature of the misrepresentation and whether it actually warrants disgorgement. (See

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[12] The opening brief addressed most of these cases, explaining that they did not involve the substantial concerns that arise when a law firm accepts employment adverse to a client or former client. (AOB 35-36.) The additional case cited in the respondent's brief is of the same type. *Frye v. Tenderloin Housing Clinic, Inc.* (2006) 38 Cal.4th 23, 48, cited at RB 36, held that it would be disproportionate to require disgorgement of fees simply because a non-profit legal corporation failed to register with the State Bar; there was no issue of conflicting representations.

Sheppard also cites a number of other cases that say nothing about fact-intensive inquiries in cases posing the ethical issue involved here. For instance, in *Clark v. Millsap* (1926) 197 Cal. 765, cited at RB 37, the court decided the contractual issue of whether an attorney was required to return fees in excess of the $7,500 fee-cap he had agreed to. (*Id.* at p. 774.) In dicta, the Court of Appeal "observed" that the attorney might also have been stripped of the $7,500 in agreed-upon fees because the attorney committed fraud in stealing the client's property, but it did not disturb the trial court order permitting those fees because the client did not object to that issue. (*Id.* at p. 785.) Similarly, Sheppard cites *In re Fountain* (1977) 74 Cal.App.3d 715, 719, cited at RB 37, in which the court permitted a habeas petition after the criminal defendant's attorney failed to follow his client's direction to preserve his appellate rights. The court then ordered the attorney terminated from handling appellate proceedings and ordered the attorney to disgorge past-paid appellate fees because the attorney was unable to provide effective assistance. (*Ibid.*)

Slovensky v. Friedman (2006) 142 Cal.App.4th 1518, 1521-1522.) Nor is it like a mere "technical" violation of ethical rules or the representation of two co-plaintiffs in litigation against a third party when "at most, a potential conflict of interest existed." (See *Pringle*, *supra*, 73 Cal.App.4th at p. 1005, fn. 4; *A.I. Credit Corp., supra*, 113 Cal.App.4th at p. 1079; *Mardirossian & Associates, Inc. v. Ersoff* (2007) 153 Cal.App.4th 257, 277-279.) This fundamental difference is why the law accords each type of violation its own disgorgement inquiry. So, while disgorgement is not an "automatic" remedy for *every* ethical violation under the sun (RB 35), it is an automatic remedy when disqualification is required for the type of ethical violation that Sheppard committed. Sheppard does not even attempt to address this critical distinction.

Sheppard attempts to complicate what the law has made simple: Lawyers who violate the duty of loyalty by simultaneously representing two clients whose interests directly conflict, without disclosing the specific details of the conflict and obtaining the clients' informed consent, may not benefit in any way from their illegal contract. Accordingly, Sheppard must be required to return to JM all payments made under the Agreement, and it may not recover any further payment from JM.

CONCLUSION

For all of these reasons, JM respectfully requests that the judgment in Sheppard's favor be reversed, with directions ordering the trial court to enter judgment in favor of JM and ordering that Sheppard disgorge the sums JM has already paid and that it shall take nothing further from JM.

Dated: July 9, 2015

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CERTIFICATE OF COMPLIANCE

Pursuant to California Rules of Court, rule 8.204(c)(1), the attached Appellant's Reply Brief was produced using 13-point Times New Roman type style and contains **11,468** 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: July 9, 2015

GREINES, MARTIN, STEIN & RICHLAND LLP

By /s/ Barbara W. Ravitz
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 **July 9, 2015**, I served the foregoing document described as **Appellant's Reply 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.

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Executed on **July 9, 2015**, 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