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Introduction

This quarter brings the California Supreme Court decision in *Sheppard, Mullin, Richter & Hampton, LLP v. J-M Manufacturing Co. Inc.*, which addresses conflicts of interest, advance conflict waivers, disqualification, when conflicts void a lawyer's fee agreement, and fee disallowance and disgorgement. The Court also held that the Rules of Professional Conduct articulate the public policy of California. The Court's decision, unanimous on all issues except whether the law firm might still be allowed to establish a quantum meruit fee entitlement (two justices dissented), is important due to its scope and the issues the Court addressed. Accordingly, we gave it additional attention.

Disqualification is a theme running through other cases in this quarter's issue—an administrative law judge and lawyers—as well as prosecutorial misconduct, the obligation to obey court orders, and proper handling of entrusted funds.

As always, if you become aware of a decision or opinion you think would be of interest to the *Ethics Quarterly* audience, please let us know and we will consider it for next quarter's edition. We appreciate hearing from you.

In This Issue:

18.3.1 *Sheppard, Mullin, Richter & Hampton, LLP v. J-M Manufacturing Co. Inc.*, (2018) 6 Cal. 5th 59 – Supreme Court of California (August 30, 2018)

Issue:
Is an advance conflict waiver provision in a law firm's engagement agreement that does not expressly disclose a known actual conflict sufficient to shield the firm from a claimed violation of Rules of Professional Conduct, rule 3-310 (conflict of interest) and protect its contractual fee agreement with the conflicted client?

Analysis:
No. The California Supreme Court, unanimous on all issues but one, held that the advance conflict waiver was insufficient because the firm knew about an actual conflict that it did not disclose to either client and that the law firm's ethical violation voided its engagement agreement. But, five justices held that the firm should be allowed to develop a record that it might be entitled to a quantum meruit fee. Justice Chen and the Chief Justice dissented; they would have disallowed the firm any fees, and disgorged any fees already paid.

The Facts

J-M Manufacturing, a defendant in a federal qui tam action that numerous public entities brought, was changing counsel. The law firm's conflict check showed that one of its lawyers represented a plaintiff-public entity in employment matters, most recently four months before the firm began representing J-M Manufacturing in the qui tam action.

The law firm did not disclose that representation either to the public entity or to J-M Manufacturing. It concluded such disclosure was unnecessary because the public entity had signed, and J-M Manufacturing was about to sign, an engagement agreement with an advance conflict waiver that provided, in effect, because the firm might currently or in the future represent another client with interests adverse to the client signing the waiver, the client waived any such conflict so long as the matters for each client were not the same or substantially related.

The firm did further legal work for the public entity client within a few weeks after the firm's engagement with J-M Manufacturing.

A year later, the public entity learned of the dual representation of it and J-M Manufacturing, successfully moving for the law firm's disqualification to represent J-M Manufacturing in the federal action. The fee dispute followed.

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The law firm prevailed in contractually-required arbitration and in the Superior Court. The Court of Appeal reversed, voided the fee agreement, found the waiver ineffective, and held that the firm was entitled to no compensation, requiring disgorgement of fees already paid.

The Ethics Violation Voided the Firm's Engagement Agreement

The Supreme Court held that the firm's violation of the Rules of Professional Conduct, rule 3-310(C), by concurrently representing two clients with adverse interests—although in different matters—without the informed written consent of each client, voided the engagement agreement and its arbitration provision. To reach this conclusion, the Court held that the Rules of Professional Conduct constitute the public policy of California, and an engagement contract that has as its object conduct constituting a violation of the Rules—here representing two clients with conflicting interests—is contrary to public policy and unenforceable. It rejected the firm's contention that only the Legislature can declare the state's public policy.

The Conflict and the Waiver

The Court held that the firm's representation of the public entity was ongoing—rejecting the firm's "framework" agreement argument, under which the relationship would be renewed each time the client had a new assignment for the firm—and that the law firm had agreed to represent, and was concurrently representing two clients with conflicting interests, without the informed written consent of either. That violated rule 3-310(C) and the firm's duty of loyalty to each client. Because the representations were in separate matters, the firm's conflicted representation did not involve its duty of confidentiality.

The Court also rejected the law firm's argument that J-M Manufacturing had waived both current and future conflicts. Rather, because the law firm had known the conflict, the Court held that the firm had a duty to disclose it to J-M Manufacturing, and could not rely on the general language in its waiver. Further, the Court held that the whole engagement agreement was void and unenforceable as contrary to public policy; hence, the law firm was not entitled to any contractual fee for its services—which constituted about 10,000 hours of attorney time.

No Contractual Fee, But Quantum Meruit Possible

Relying on a series of cases in which courts had denied compensation in the face of serious ethical breaches, the Court of Appeal had determined that the firm was not entitled to any quantum meruit payment for the services it had rendered. The five-Justice majority reversed.

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The Court held that there is no categorical rule barring compensation, even when serious ethical breaches occur, and remanded the case to the trial court for the firm, which will have the burden of proof, to be allowed to develop facts to support some equitable recovery. Thus, the Court said, while forfeiture of compensation is often an appropriate response to conflicted representation, quantum meruit compensation is not categorically barred. Further, the Court observed that, although a law firm may be entitled to some compensation for its work, its ethical breach will ordinarily require it to relinquish some or all of the profits for which it negotiated.

The Concurring, Dissenting Opinion

Justice Chen, joined by the Chief Justice, agreed with the majority on every issue except for the firm's ability to seek quantum meruit compensation. He based his analysis primarily on *Huskinson & Brown v. Wolf* (2004) 32 Cal.4th 453. He argued that permitting such a recovery here would be contrary to what the violated rule itself seeks to accomplish; rule 3-310's purpose precludes lawyers from simultaneously representing clients with conflicting interests absent informed written consent. He also argued that quantum meruit payment here was inconsistent with case law, including that discussed in *Huskinson*, and that the Legislature had made no policy determination that a quantum meruit fees were available in these circumstances, as it has, for example, when a lawyer does not comply with Business and Professions Code sections 6147 and 6148. Finally, Justice Chen felt the Court had sufficient facts and law in the record before it to make the determination about quantum meruit recovery, such that remand was unnecessary. The Chief Justice joined in his concurring and dissenting opinion.

18.3.2 *Fisher v. State Personnel Board* (2018) 25 Cal. App. 5th 1 – Court of Appeal of California, Third Appellate District (June 11, 2018)

Issue:
Should an administrative law judge be dismissed for failing to disclose an of counsel relationship with a law firm that represented clients facing administrative actions?

Analysis:
Yes. Fisher, a serving administrative law judge joined a law firm as "of counsel." That firm regularly represented clients facing administrative actions, including those heard by the same board that Fisher served on. Another administrative law judge discussed a matter where Fisher's firm was representing a party in a meeting that Fisher attended, and sent a draft opinion to colleagues, including Fisher. Fisher's connection with the law firm was revealed only when another administrative law judge was asked about the matter during a local bar function. Once this discovery was made, the board dismissed Fisher from his administrative law judge position.

Working for a firm that regularly appeared before the board that Fisher served on was incompatible with his service as an administrative law judge. Such conduct violates Government Code section 19990 and the board's own incompatibility statements. Moreover, Fisher was criticized for his judgment both in joining the firm during his service as an administrative law judge, and then in failing to disclose it to the board, which resulted in him learning information that otherwise would not have been shared by an administrative law judge colleague.

18.3.3 *Fluidmaster, Inc. v. Fireman's Fund Ins. Co.* (2018) 25 Cal. App. 5th 545 – Court of Appeal of California, Fourth Appellate District, Division Three (June 26, 2018)

Issue:
May a law firm continue representation of a client in a matter where it was vicariously disqualified due to a lawyer who departs the firm while an appeal of the disqualification order is pending?

Analysis:
Potentially yes. A lawyer worked for a technology services company that assisted Fluidmaster with class action litigation. She then was hired to work in the Los Angeles office of a law firm whose Orange County office represented Fireman's Fund in a subrogation action adverse to Fluidmaster. The firm established an ethical wall around the lawyer, but was nonetheless disqualified. The trial court reasoned that the balancing of factors weighed against the efficacy of the ethical screen, even though there was no evidence that confidential information had been shared. While the firm was appealing its disqualification, the lawyer left the firm.

The Court of Appeal adopted the reasoning in *Kirk v. First American Title Insurance Company* (2010) 183 Cal.App.4th 776, and concluded that vicarious disqualification should not be automatic when an ethical screen is imposed around the disqualified attorney. Rather, courts should determine the issue on a case-by-case basis. One thing the Kirk court suggested is that each member of the firm who is working on the matter or received information leading to the erection of the ethical screen should provide a declaration identifying what information they learned from the disqualified lawyer. That would help determine whether any confidential information was actually conveyed. Additionally, in such cases, courts should examine the size of the firm, geographic or other physical limitations on communications among lawyers at the firm, rules or policies in place to prevent disclosure of confidential information, financial incentive of the disqualified lawyer regarding the former client, supervisory authority of the disqualified lawyer over those working on the former client's case, and the speed of notification to the former client about employment of the disqualified lawyer. The Court of Appeal remanded for a determination consistent with *Kirk*.

18.3.4 *In the Matter of Metoyer* (Review Dept. 2018) Case No. 15-O-12907 - State Bar Court of California, Review Department (July 5, 2018)

Issue:
May a lawyer disobey a court order to proceed with trial to attend a previously scheduled medical appointment?

Analysis:
No. A public defender who answered ready for trial, requested time off the next day for an MRI related to a back injury she had suffered a week earlier. The court denied the request and told her to reschedule. The lawyer was distressed and crying and received permission to use the restroom. But instead went to her supervisor, who removed her from the case and reassigned the matter. When the court sanctioned the lawyer $1,500 for disobeying the court order and for abandoning the client, the lawyer failed to report the sanction.

The review department concluded that the lawyer had not improperly left employment in violation of Rule of Professional Conduct 3-700 because there was no foreseeable prejudice to her client. The client was continuously represented by the public defender's office, and the court granted a continuance for the lawyer's replacement to prepare for the trial.

But the lawyer failed to report a judicial sanction in violation of Business and Professions Code section 6068, subdivision (o)(3) and failed to obey a court order, to report for trial rather than get the MRI, in violation of Business and Professions Code section 6103.

Notes:
Due to the situations here, including an unexpected emotional episode, the review department recommended a departure from the presumption of actual suspension, and instead recommended a public reproval with conditions.

18.3.5 *In the Matter of Luti* (Review Dept. 2018) Unpublished, Case No. 15-O-11994 - State Bar Court of California, Review Department (August 6, 2018)

Issue:
May a lawyer retain escrow funds of a colleague's client for debts owed when the colleague, but not the client, grants permission?

Analysis:
No. A lawyer agreed to hold $15,000 in escrow to be paid to a third party upon completion of a contract. The lawyer had no attorney-client relationship with either party to the contract. But the escrow agreement could be modified only if agreed to in writing by the lawyer and the two parties to the agreement.

The lawyer asked a tenant who had referred the parties to him to pay rent into escrow since the lawyer had used the funds for personal matters. That tenant paid $7,830, leaving the escrow account $7,170 short. When the parties attempted to terminate the escrow agreement, the lawyer claimed that the tenant had released him as escrow agent five years earlier and that she authorized him to use the escrow funds for back rent for her office. After disciplinary charges were filed, the lawyer wrote a check for the missing $7,170.

The hearing judge found that the lawyer failed to maintain the $15,000 in escrow funds in violation of Rule of Professional Conduct 4-100(A) and failed to pay funds upon request in violation of rule 4-100(B)(4). The review department disagreed because the funds were for a business transaction, not an attorney-client matter. Nonetheless, the review department agreed with the hearing judge that the misappropriation of the funds was intentional and constituted an act of moral turpitude in violation of Business and Professions Code section 6106 because the lawyer failed to comply strictly with the escrow instructions. Also, because the lawyer used the funds to pay personal expenses, he had commingled personal assets with client funds in his client trust account.

Notes:
The review department recommended disbarment.

18.3.6 *Monster Energy Co. v. Schechter* (2018) 26 Cal. App. 5th 54 – Court of Appeal of California, Fourth Appellate District, Division Two (August 13, 2018)

Issue:
When a settlement agreement provided that the clients and their lawyer agree to keep the terms of the agreement confidential, and when the lawyer signs the agreement "approv[ing] as to form and content," can the lawyer be liable to the defendant for breach of the confidentiality provision?

Analysis:
No. Plaintiffs' lawyer sued Monster in a personal injury action for the death of their daughter. The case settled with a confidentiality provision in the settlement agreement. The Plaintiffs signed the agreement; the lawyer signed under the heading, "Approved as to form and content." Later, the lawyer participated in an interview and gave a statement that unquestionably referred to the settled case. The Court of Appeal held that the lawyer was not bound because he did not sign the settlement agreement as a party to be bound. The court noted, however, that a lawyer who discloses confidential settlement provisions faces ethical risks, and that the issue should be expected to arise only rarely. The lawyer acknowledged that, although he had no contractual duty to Monster, he did have a duty to his clients "not to cause or create any potential litigation for them."

18.3.7 *In the Matter of Nassar* (Review Dept. 2018) Case No. 14-O-00027 - State Bar Court of California, Review Department (August 23, 2018)

Issue:
Does a prosecutor violate obligations to timely produce exculpatory information if the materials are not produced within 30 days of originally-scheduled trial dates that are then continued?

Analysis:
Yes. During prosecution of charges for child abuse and torture of a five-year-old victim, a prosecutor placed a "mail cover" that caused mail, excluding attorney-client communications, be sent to the prosecutor before being released to the prisoner. The prosecutor failed to advise the defendants or their counsel of the mail cover and failed to produce any of the more than 1,000 pages of collected material.

When the prosecutor rotated out of the department and the matter was reassigned, the successor counsel confirmed with her supervisor that the documents should have been produced to the defendant in response to requests for documents. Successor counsel collected the materials, produced them, and canceled the mail cover.

At a motion to dismiss or, in the alternative, to recuse the district attorney's office, the initial prosecutor testified that she was aware of the obligation to produce all exculpatory documents, believed only one was exculpatory, and had not finished turning over all discovery. She also did not reveal the mail cover because it "relates to trial strategy."

The State Bar Court found and the Review Department confirmed that the prosecutor had failed to disclose discoverable evidence at least 30 days before trial as required by Penal Code section 1054.1 and Rule of Professional Conduct 5-220. Trial had been scheduled to proceed four times while the prosecutor remained on the matter and continued less than 30 days before trial. The mere fact that trial did not go forward as scheduled did not absolve the prosecutor of her duty. Lawyers may not rely on their predictions of whether trial will be continued to determine whether they have a duty to produce. Here, the prosecutor's tactics rose to the level of moral turpitude.

Notes:
The prosecutor was given six months actual suspension from the practice of law.

18.3.8 *Bridgepoint Construction Services, Inc. v. Newton* (2018) 26 Cal. App. 5th 966 – Court of Appeal of California, Second Appellate District, Division Six (September 4, 2018)

Issue:
When a lawyer represents more than one client, each of which seeks damages from a pool of money controlled by another party, does the lawyer have a conflict of interest requiring disqualification?

Analysis:
Yes. In this series of actions, a lawyer who had represented three clients in different actions, each against the same limited liability company and another individual. Each plaintiff sought damages from the same $2 million pool that the defendants controlled. The Court of Appeal held that a conflict existed because every dollar that one of the lawyer's clients received from the defendants, was a dollar that his other clients could not receive. Because the conflict involved concurrent conflicts, disqualification was automatic.

In addition, in a separate action, the lawyer represented one client adverse to another in substantially related matters, also requiring disqualification. Finally, the lawyer obtained confidential information from an expert witness he had hired to review financial documents of one of the conflicted clients—also requiring disqualification.