Case No. S232946

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP,

Plaintiff and Respondent,

v.

J-M MANUFACTURING CO., INC.,

Defendant and Appellant.

Court of Appeal of the State of California, Civil No. B256314
Superior Court of the State of California, Los Angeles County
Civil Case No. YC067332

APPLICATION FOR LEAVE TO FILE AMICI CURIAE BRIEF; AMICI CURIAE BRIEF OF PROFESSIONAL LIABILITY INSURERS AF BEAZLEY SYNDICATE 623/2623 AT LLOYD'S, CNA FINANCIAL CORPORATION, ENDURANCE US HOLDINGS CORP., AND W. R. BERKLEY IN SUPPORT OF PLAINTIFF AND RESPONDENT SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

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APPLICATION TO FILE AMICI CURIAE BRIEF

Pursuant to Rule 8.520(f) of the California Rules of Court, AF Beazley Syndicate 623/2623 at Lloyd's, CNA Financial Corporation, Endurance US Holdings Corp., and W. R. Berkley respectfully request leave to file the accompanying *amici curiae* brief in support of Plaintiff and Respondent Sheppard, Mullin, Richter & Hampton LLP ("Sheppard Mullin").

Amici are four of the nation's leading providers of professional liability insurance for attorneys. Collectively, they provide professional liability insurance for hundreds of law firms and thousands of attorneys throughout California. Amici also work closely with attorneys to prevent potential claims by consulting with law firms on best practices and risk management.

Amici and their insureds have a substantial interest in professional conduct rules that are practical and fair, and that reflect the modern practice of law. Rules that are ill-adapted to developments in the legal industry limit the ability to obtain representation of one's choice, promote gamesmanship, and contribute to the unnecessary rise in the cost of professional liability insurance – all of which undermines the integrity of the judicial system and harms the very clients whom the rules are supposed to protect.

Amici thus request leave to file the attached brief in support of Plaintiff and Respondent Sheppard Mullin on the second issue presented.[1] Amici agree with Sheppard Mullin that under the applicable rules of professional responsibility, a sophisticated consumer of legal services

[1] Pursuant to rule 8.520(f)(4) of the California Rules of Court, Amici represent that no party other than those identified in this application and their counsel have authored the proposed amicus brief, in whole or in part, or financially contributed to the brief's preparation or submission.

represented by independent counsel can give informed consent to a general or open-ended waiver of conflicts of interest.

Amici believe that their proposed brief will aid the Court by discussing, in greater detail than the merits briefs, the current legal market and relevant developments in the legal industry. These include the dramatic changes driven by the rise of sophisticated corporate counsel and how those trends implicate the policies and assumptions underlying the rules of professional conduct. The brief addresses the necessary and appropriate role general conflict waivers play in modern practice. It also highlights how an unduly stringent, absolutist approach will only encourage tactical disqualification motions or malpractice claims, to the detriment of clients, law firms, and the courts.

Accordingly, Amici respectfully request that the Court grant this application and accept for filing the included Amici Curiae Brief.

AMICI CURIAE BRIEF

INTRODUCTION AND SUMMARY OF ARGUMENT

The relationship between corporate clients and their outside counsel is evolving dramatically. Heightened competition between law firms, economic pressures on the businesses themselves, and the rise of in-house counsel have driven companies to become increasingly sophisticated consumers of legal services. These sophisticated clients now exercise great bargaining power in selecting counsel and controlling the terms of the relationship. As a result, the concerns that have justified absolutist approaches to the standards of professional conduct – such as whether the client can understand the terms of an engagement agreement, is being taken advantage of, or can effectively monitor the quality of representation – are mitigated. Instead, the public interest lies in rules that are practical and promote client autonomy.

These new dynamics are at play in the question presented regarding the enforceability of a general waiver of conflicts of interest agreed to by a sophisticated client represented by in-house counsel.[2] The Court of Appeal held that a conflict waiver can never be effective unless it identifies the specific client and conflict at issue, regardless of the client's sophistication, and even if the conflict arises only after the engagement began. (*See* Opn. 18-19.) Defendant-Appellant J-M Manufacturing Co., Inc. ("J-M") supports this absolutist approach, contending that California law should be interpreted more stringently than the American Bar Association ("ABA") Model Rules and approaches adopted in other jurisdictions. While the merits briefs review the relevant rules and case law, Amici seek to place the

[2] This brief focuses on the role of in-house counsel, but the same considerations apply when a company uses an outside firm in a corporate counsel role – *i.e.*, where the outside firm acts a liaison in engaging more specialized counsel for a particular matter.

question presented in the context of the modern legal industry and to demonstrate why the Court of Appeal's approach is impractical and unsound on both professional responsibility and public policy grounds.

In the current legal market, general or "open-ended" conflict waivers play a legitimate role in the ability to obtain counsel of one's choice. Sophisticated clients with independent counsel have the capacity to understand the scope, nature, and implications of such waivers, and they have the bargaining power to negotiate their terms if they choose. While an attorney's duty of loyalty is important, it is premised on client expectations. It does not undermine attorney professionalism or the integrity of the judicial process for sophisticated clients to define their own expectations and to waive the kind of remote, imputed conflict presented here – where a different attorney, in a different office, is representing an adversary in an unrelated matter. If the waiver is clear and limited to unrelated matters, and confidentiality and the quality of representation are not impaired, the waiver should be enforced according to its terms, like any provision in an agreement between sophisticated parties represented by counsel.

Moreover, the approach followed by the Court of Appeal and advocated by J-M would merely encourage gamesmanship – harming clients and law firms alike. Courts recognize that disqualification motions often are brought for purely strategic reasons, rather than any sincere concern with the quality of representation or the integrity of the judicial process. That appears to be the case here. Encouraging such tactics leads to increased disputes and malpractice claims, needlessly inflating the costs of professional liability insurance, harming client choice, and burdening the courts. Public policy weighs in favor of crafting rules in a practical way to avoid such results.

Amici thus support Sheppard Mullin's position that the Court of Appeal's decision should be reversed.

ARGUMENT

I. THE RISE OF SOPHISTICATED CLIENTS HAS CREATED A PARADIGM SHIFT IN THE LEGAL INDUSTRY

The traditional paradigm of the attorney-client relationship was one in which a layperson was totally dependent on the attorney for legal advice. This was true even in the context of corporate clients: the historical model was one in which a company relied almost exclusively on a single firm as its "trusted advisor" for all of the company's legal needs. (*See, e.g.*, Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney/Client Relationship*, 78 Fordham L. Rev. 2067, 2067-2068, 2077 (Apr. 2010) [hereinafter Wilkins].) Under this model, the client lacked both the bargaining power and the substantive legal knowledge to monitor its attorney effectively. (*See id.* at pp. 2077-2078; Wendel, *Pushing the Boundaries of Informed Consent: Ethics in the Representation of Legally Sophisticated Clients*, 47 U. Tol. L. Rev. 39, 41-42 (Fall 2015) [hereinafter Wendel].) The rules of professional responsibility have been developed, in significant part, to protect vulnerable clients from unscrupulous behavior or situations that compromise the attorney's ability to provide effective representation.

The rise of sophisticated in-house counsel – what some have called the in-house counsel "movement" – has dramatically changed the model for the attorney-client relationship with corporate clients. (Wilkins, 78 Fordham L. Rev. at pp. 2080-2084; Wendel, 47 U. Tol. L. Rev. at pp. 48-49.) As a result of this movement, corporate clients have increasingly relied on in-house counsel to take over the "trusted advisor" role and assume greater responsibility for the company's strategic utilization of legal services. (*Ibid.*) Sophisticated in-house counsel enable their companies to be less dependent on particular outside firms and drive outside firms to compete more aggressively for the client's business. (*Ibid.*) Indeed, "the

dominant theme over the last thirty years has been corporate clients' ability to reduce dramatically the information asymmetries that used to characterize their relationship with outside counsel." (Wilkins, 78 Fordham L. Rev. at p. 2105.)

These developments have caused "a paradigm shift in the relationship—and the balance of power—between lawyers and their clients." (Davis & Fielder, *Indemnity Provisions in Outside Counsel Guidelines: A Tale of Unintended Consequences*, 23 The Professional Lawyer No. 4 (ABA Center for Professional Responsibility 2016) [Davis & Fielder]; *see also* Wendel, 47 U. Tol. L. Rev. at p. 59 [observing "sea change in the attorney-client relationship" that has involved a "dramatic shift of power from law firms to clients"]; Wilkins, 78 Fordham L. Rev. at 2077-2084.) The global recession has only exacerbated the economic conditions driving this trend, as it has increased the pressure on outside firms to compete for business while also increasing the pressure on in-house counsel to control outside counsel costs and activities. These developments manifest in various ways relevant to understanding how the practice of law no longer conforms to the traditional model and why general conflict waivers with sophisticated clients should be enforceable.

Sophisticated clients and their in-house counsel exercise increased power in defining the terms of the engagement. As explained by the Association of Corporate Counsel ("ACC"), a bar association for in-house attorneys: "With many law firms struggling to attract or retain corporate clients, companies now often have the upper hand in negotiating new engagements." (Thomas & Bulacan, *Outside Counsel Retention Agreements* (ACC Sept. 16, 2011), http://www.acc.com/legalresources/quickcounsel/ocra.cfm.) This "increased bargaining power" is now part of the "New Normal." *Ibid.* Nor is this bargaining power limited to requiring alternative fee arrangements or

other cost-cutting measures. Whether through "Outside Counsel Guidelines" or other measures, sophisticated in-house counsel are capable of defining a broad range of parameters, such as staffing controls, diversity requirements, and media policies. (*Ibid.*) Sophisticated clients may, and often do, insert their own conflicts provisions; in some cases clients may even seek to impose terms beyond what are required by any ethical rules, including for competitive purposes. (*Ibid*; *see also* Practical Law, *Working Effectively with Outside Counsel Checklist* (Thompson Reuters 2016), http://us.practicallaw.com/7-617-8668.)

Thus, it simply is not true that sophisticated clients are compelled to accept law firms' conflict waivers as if they were part of a take-it-or-leave contract of adhesion. Rather, in the modern legal industry, "the relationship between a legally sophisticated client and outside counsel is as close to an ordinary arms-length negotiation as any professional relationship can be." (Wendel, *supra*, at p.49.)

Sophisticated clients use a range of providers. A related feature of the modern legal industry is that "[c]lients that once utilized the legal services of a single law firm for all their needs, especially large multinational corporations, now frequently engage numerous firms to handle discrete and highly specialized legal problems." (Lerner, *Honoring Choice by Consenting Adults: Prospective Conflict Waivers As a Mature Solution to Ethical Gamesmanship -- a Response to Mr. Fox*, 29 Hofstra L. Rev. 971, 973 (2001) [hereinafter Lerner].) In the current market, "[i]ncumbency is no longer a guarantee," as the "steady trends" in the corporate legal world include "increased sophisticated law firm selection" and a willingness "to entertain moving work" to different kinds of legal service providers to increase value. (Satkunas, *6 Consistent Corporate Legal Trends in Data, Staffing and Spend*, LexisNexis Business of Law

Blog (Apr. 28, 2015), http://businessoflawblog.com/2015/04/corporate-legal-trends-2/.)

This trend reflects that, in the modern legal industry, relationships between law firms and sophisticated clients are more transactional in nature, or at best more closely resemble strategic business relationships, than what was envisioned by the traditional model. Even when clients adopt "preferred provider" programs, they typically still use a number of firms – thus preserving the ability to shift work from one firm to another as necessary – and they have adopted such programs specifically to increase their ability to shape the relationship and governing policies with those firms. (Wilkins, 78 Fordham L. Rev. at pp. 2085-2088; Levine et al., 1 Successful Partnering Between Inside and Outside Counsel (rev. Apr. 2016) § 7:4 ; *cf.* Fong, *Doing More With Less*, 27 No. 2 ACC Docket 4 (2009) [describing "Preferred Provider Network of 47 firms"].)

Sophisticated clients focus on hiring the individual lawyer. Another trend driven by sophisticated in-house counsel is that they are more focused on hiring a particular attorney or practice team with specialized expertise, rather than hiring the "firm." As the Chief Counsel for Litigation at AON explained: "[L]et's just stop asking whether clients hire lawyers or firms. If clients have any sense at all, they hire lawyers." (Herrmann, *Inside Straight: Hiring Law Firms or Lawyers?*, Above the Law (Apr. 21, 2011), at http://abovethelaw.com/2011/04/inside-straight-hiring-law-firms-or-lawyers/.) Another "sophisticated buyer" explains: "I hire individual lawyers—the firm is incidental." (Cohen, *Lawyers, Law Firms, and a Sophisticated Buyer*, Bloomberg Law, Big Law Business Blog (Oct. 14, 2015), https://bol.bna.com/lawyers-law-firms-and-a-sophisticated-buyer/.)

ACC-sponsored programs provide the same advice, explaining that, "[h]istorically, corporations typically selected a law firm," but the better practice is that "corporations should select the lawyer and not the law firm."

(Best Practices in Hiring Outside Counsel 6, 10 (2003), http://www.acc.com/vl/public/ProgramMaterial/loader.cfm?csModule=security/getfile&pageid=20527&recorded=1.) That is the case even as law firms have expanded in size to offer "one stop shopping" experience:

> At a time when over a dozen law firms have 1000+ lawyers in the United States, and 200 lawyers will not even place a law firm among the 200 largest, retention decisions cannot be based solely on firm versus firm assessments.... [S]uccess will be driven primarily by the skill, efficiency and strategic choices of the individual lawyer(s) responsible for the matter.

Robinson, et al., 1 Successful Partnering Between Inside and Outside Counsel (rev. Apr. 2016) § 4:10.

Developing deep and sustained relationships still matters a great deal in the practice of law, and the relationships between particular firms and clients of course will vary in their depth and breadth. But this trend shows that to a sophisticated consumer of legal services, the "heart of the attorney-client relationship" often lies with *particular attorneys or teams*, more so than with other attorneys who just happen to work at the same firm.

II. THE COURT SHOULD CONFIRM THE ENFORCEABILITY OF GENERAL CONFLICT WAIVERS AGREED TO BY SOPHISTICATED CLIENTS REPRESENTED BY COUNSEL

A. General Conflict Waivers Between Law Firms and Sophisticated Clients Represented by Counsel Play an Appropriate Role in the Modern Legal Industry

Rule 3-310(C) of the California Rules of Professional Conduct requires "informed written consent" before a law firm represents a client in a matter adverse to another client, even if its work for the other client is unrelated. Under the rule of imputed conflicts, the client of one attorney at a law firm is considered a client of the entire firm. Thus, a conflict can arise when one attorney seeks to represent a new client in a matter that incidentally involves a party that a different attorney in the firm, in a

different office, represents for a completely unrelated matter. That kind of imputed conflict is at issue in this case: Sheppard Mullin's white-collar defense attorneys were representing J-M in the qui tam action at the same time that an employment attorney in another office had provided sporadic employment advice to South Tahoe Public Utility District ("South Tahoe"), which joined the qui tam action after it began as an intervenor with a fractional stake.

The dynamics of the modern legal industry, including those discussed above, have dramatically increased the potential for these kinds of technical, imputed conflicts. (*See* Jones & Davis, *In Defense of a Reasoned Dialogue About Law Firms and Their Sophisticated Clients*, 121 Yale L.J. Online 589, 592-593 (2012); Lerner, 29 Hofstra L. Rev. at p. 973.) Commercial enterprises have become more complex, and they face a broadening range of legal issues, including regulatory, litigation, corporate governance, transactional, employment matters, and more. These sophisticated clients have shown a preference for using a range of providers and shopping for individual attorneys with specialized expertise to handle particularized matters. At the same time – and in response to the demands of their clients – law firms are growing in size, including through mergers, lateral acquisitions, and other expansions into new geographic or practice areas. These firms may have hundreds or thousands of current clients for which they have done or are doing varying amounts work in different practice areas.

Thus, "changes on both sides of the equation in the practice of law have resulted in a proliferation of potential lawyer-client conflicts." (Matusky & Suglia, *Nostradamus, Esquire?*, New Jersey Lawyer, the Magazine (Dec. 2011), at pp. 60, 61 [hereinafter Matusky].) But frequently these conflicts are arising "in situations where the core values of loyalty and confidentiality are *not* threatened in the same direct and serious way

they were when the canons and rules were adopted and the predominant business model was very different." (*Ibid.* [emphasis added].)

Faced with this reality, and the increased potential that even small matters could prevent a law firm from working on unrelated matters for different clients in the future, law firms frequently include in their engagement agreements a provision for the advance or general waiver of conflicts of interest for unrelated matters. (*See* Lerner, 29 Hofstra L. Rev. at p. 973; DiLernia, *Advance Waivers of Conflicts of Interest in Large Law Firm Practice* (2009) 22 Geo. J. Legal Ethics 97, 97; *see also* Matusky, *supra*, at pp. 61-62.) Such waivers serve a fundamental purpose of promoting the ability of sophisticated clients to "exercis[e] their important right to select counsel of choice." (Lerner, *supra*, at p. 974; *see also* Matusky, *supra*, at p. 62.) Without the ability to obtain such waivers, firms would be less willing to accept smaller clients or matters, to avoid being disqualified from taking on a more lucrative client or matter at a later time. That concern also, and especially, applies to pro bono work and work for government entities. Moreover, without enforceable open-ended waivers, legacy clients would be able to exercise a "veto" over new engagements for purely strategic reasons, simply to deny an adverse party the attorney of its choice.

B. Sophisticated Clients Represented by Counsel Have the Capacity to Provide Informed Consent to a General Conflict Waiver

In the decision on review, the Court of Appeal held that a general conflict waiver is never enforceable. Part of the dispute in this case involves whether an actual – as opposed to a prospective – conflict with South Tahoe existed at the time that the engagement with J-M began. But the Court of Appeal did not rely on that point, holding that "[e]ven assuming Sheppard Mullin was not representing South Tahoe at the time it

entered into the agreement with J–M," Sheppard Mullin was required to obtain a "second waiver" from each party once the conflict arose. (Opn. at 18-19.) Thus, according to the Court of Appeal, consent cannot be "informed" unless the party involved in the "potential or actual conflict" is specifically identified. *Id.* Requiring a "second waiver," of course, would eviscerate the utility of having an open-ended or prospective waiver in the first place, especially given that, in most cases, it would be infeasible or even impossible to enumerate all of the potential conflicts that could arise.

The Court of Appeal's approach reflects an impractical and unnecessarily paternalistic approach to "informed consent" when dealing with sophisticated clients represented by independent counsel.[3] As reflected in the discussion in Part I, sophisticated corporate in-house counsel are fully capable of understanding the nature, purpose, and impact of an open-ended conflict waiver. They understand the dynamics of the modern legal industry and the potential for technical, imputed conflicts to arise. Some clients may balk at providing a prospective or open-ended waiver. Others may not have an issue with it, especially when – as here – the client is hiring particular lawyers for a specific matter rather than hiring the "firm" for ongoing work across practice areas. In any event, sophisticated clients represented by counsel have the ability to negotiate the terms of an engagement agreement and revise, limit, or reject the conflict waiver if they so choose.

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[3] As explained in Sheppard Mullin's merits briefs, the Court of Appeal's approach also runs contrary to the recognition in the ABA Model Rules and by other courts and bar associations that a sophisticated client represented by counsel can provide a "general [and] open-ended waiver," without requiring identification of "a particular party, class of parties, or the nature of the potentially conflicting future matter." (*Galderma Laboratories, L.P. v. Actavis Mid Atlantic LLC* (N.D.Tex. 2013) 927 F.Supp.2d 390, 401; *see also* Opening Br. at 27-31.)

In this case, for example, there is no dispute that the language of the waiver was clear and specifically alerted J-M that it was intended to cover imputed conflicts arising from the fact that Sheppard Mullin "has many attorneys and multiple offices." (*See* Opn. 5.) Discussions with J-M about Sheppard Mullin's representation of another intervenor – the Los Angeles Department of Water and Power – also alerted J-M to that kind of conflict. J-M obviously understood that, under the terms of the waiver, Sheppard Mullin was allowed to represent an adverse intervenor, as long as it was in an unrelated matter and confidences were preserved. J-M apparently was not concerned that doing so would endanger the quality of Sheppard Mullin's defense and agreed to the waiver after its general counsel had the opportunity to review and negotiate the terms of the engagement agreement.

As one court has explained in a related context, when a "sophisticated corporate client" is represented by counsel and has the opportunity to negotiate the terms of the engagement agreement with the law firm, the result is "a private business transaction between equally matched parties, pure and simple." (*Cotchett, Pitre & McCarthy v. Universal Paragon Corp.* (2010) 187 Cal.App.4th 1405, 1420-1421 [rejecting challenge to contingency fee agreement as unconscionable and in violation of California ethics rules].) Enforcing such agreements validates and promotes client autonomy both because it facilitates clients' ability to hire counsel of their choosing and because it respects clients' contracting decisions. A sophisticated client who agrees to a general conflict waiver should not be able to get the benefit of that agreement (*i.e.*, securing counsel of its choice) without satisfying the consideration it promised in returned (*i.e.*, permitting the firm to represent other clients in unrelated matters). Allowing sophisticated clients to manipulate the system in this manner harms both the law firm and its other clients.

J-M argues that "in-house counsel are sometimes unsophisticated, young, and inexperienced" and hire outside firms "*because* those firms are more sophisticated." (Answer Br. 30.) The argument that in-house counsel are too inexperienced and too outmatched by firm attorneys to effectively represent their client is condescending and baseless. Contrary to the past perception that in-house departments were merely "less prestigious destinations for young lawyers," there has been "significant increase in the educational credentials and prior work experience" of in-house counsel, many of whom are recruited from major law firms. (Wilkins, *The In-House Counsel Movement: Metrics of Change*, The Practice (Harvard Law School Center on the Legal Profession May 2016); *see also* Wendel, 47 U. Tol. Rev. at p. 48.) Moreover, while in-house counsel may hire outside firms for their expertise or resources in handling a particular matter, it is the essence of an in-house counsel's job to be an expert *on the process and conditions for retaining outside counsel.* (*See* Wendel, 47 U. Tol. Rev. at p. 59 ["What good is an in-house lawyer who does not understand the effect of language in a contract he is signing for the client?"].)

J-M further argues that clients have no effective bargaining power because (a) a "long-time client" of a firm would face expense and hardship in moving work to a new firm, while (b) a new client lacks the clout to force a change in a firm's standard terms. (Answer Br. 30.) Neither argument matches reality, as explained in Part I. Given the fierce competition among law firms, "long-time clients" – *i.e.*, those that maintain a volume of business for the firm – exercise substantial power over the relationship, and most sophisticated clients use a range of service providers, so they would not face undue hardship in shifting work from one firm to another. Fierce competition among law firms also means that even "new clients" have bargaining power in a new engagement, and those "new