Seeking Quantum Meruit Recovery in the Aftermath of Sheppard Mullin: Be Careful What You Wish For.

Elizabeth L. Bradley is a partner with Rosen Saba, LLP, the current Chair of LACBA's Professional Responsibility and Ethics Committee, and a Founding Member of the California Lawyers Association Ethics Committee. She and her partner James Rosen represented J-M Manufacturing, Inc. in trial court proceedings in Sheppard, Mullin, et al. v. J-M Manufacturing, Inc. following remand by the California Supreme Court. The opinions expressed herein are her own.

If you haven't read the California Supreme Court's 2018 decision in *Sheppard, Mullin, Richter and Hampton, LLP v. J-M Manufacturing Co., Inc.*[i] ("*Sheppard")*, you should. While it is at first glance easy to characterize the case as involving the enforceability of advance conflict waivers, that issue was ultimately a red herring and it would be a mistake to view the Supreme Court's opinion through such a narrow lens.[ii]

In *Sheppard*, the plaintiff law firm ("Sheppard Mullin") took over the representation of defendant J-M Manufacturing, Inc. ("J-M") in a long-running and expensive bet-the-company qui tam action. The written engagement agreement contained what is commonly referred to as an "advance" or "blanket" conflict waiver. In the agreement, Sheppard Mullin asked J-M to agree to the firm's representation of any other client, "currently or in the future," in matters not substantially related to its representation of J-M, "even if the interests of the other client are adverse" to J-M's.[iii] It did not disclose any particular actual or potential conflicts.

A little over one year and approximately $4 million dollars into the representation, an opposing party in the qui tam action successfully moved to disqualify Sheppard Mullin based upon the law firm's concurrent representation of that party in unrelated employment matters. The evidence showed that prior to entering into the engagement agreement, Sheppard Mullin did not disclose to either of its clients its concurrent representation of the adverse parties. The law firm stood on the advance waiver. After J-M was forced to onboard new counsel shortly before trial, Sheppard Mullin sued J-M for approximately $1 million in unpaid fees. J-M cross-complained for breach of contract, an accounting, breach of fiduciary duty and fraudulent inducement, sought disgorgement of fees, and fought arbitration claiming the entire engagement agreement was unenforceable due to Sheppard Mullin's ethical violations. J-M alleged Sheppard Mullin was not entitled to any recovery due to its intentional failure to disclose a known, actual conflict of interest arising out of its undisclosed concurrent adverse representation, and its failure to obtain J-M's informed written consent to the adverse representation, both of which J-M claimed violated former rule 3-310(C)(3).[iv]

The Court of Appeal reversed an arbitration award in Sheppard Mullin's favor on its contract claim, holding not only that the ethical violation rendered the entire engagement agreement unenforceable, but also that such a violation disallowed Sheppard Mullin any quantum meruit recovery. It ordered disgorgement of all fees collected.[v]

The California Supreme Court affirmed in part, and reversed in part. It held that the fee agreement violated public policy and was unenforceable due to the law firm's failure to disclose to J-M a known concurrent adverse representation, and its failure to obtain J-M's *informed* written consent. It further held that Sheppard Mullin's unconsented-to conflict of interest affected the whole of its engagement agreement with J-M, rendering it unenforceable in its entirety (including the arbitration provision).[vi]

Nonetheless, relying on a long line of cases wherein lawyers recovered in quantum meruit even after invalidation of the engagement agreement due to various types of ethical violations, the Court refused to adopt a bright-line rule prohibiting a lawyer from recovering in quantum meruit for legal services performed subject to an improperly waived conflict of interest which renders an engagement agreement unenforceable. In doing so, it cited to numerous cases involving ethical transgressions including but not limited to conflicted representations. Those cases acknowledged that, depending on the factual circumstances, a lawyer may be entitled to recover in quantum meruit despite a violation of the rules: "The Court of Appeal Cases demonstrate that forfeiture of compensation is often an appropriate response to conflicted representation. But they do not stand for the proposition that quantum meruit recovery for legal services performed while the attorney suffers from an unwaived conflict of interest is categorically barred."[vii]

Instead of imposing a bright-line bar on quantum meruit recovery where an engagement agreement is deemed unenforceable as a matter of public policy for violation of the Rules of Professional Conduct, the Court held that the issue is generally one for the discretion of the trial court, to be exercised in light of all the circumstances that gave rise to the conflict. It further held that when a law firm seeks fees in quantum meruit that it is unable to recover under the contract because it has breached an ethical duty to its client, the burden of proof on these or other factors lies with the firm.[viii]

"To be entitled to a measure of recovery, the firm must show that its conduct was neither willful nor egregious, and it must show that its conduct was not so potentially damaging to the client as to warrant a complete denial of compensation. And before the trial court may award compensation, it must be satisfied that the award does not undermine incentives for compliance with the Rules of Professional Conduct. For this reason, at least absent exceptional circumstances, the contractual fee will not serve as an appropriate measure of quantum meruit recovery. (Citations.) Although the 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."[ix] Notably, the client is under no obligation to present evidence that it was injured as, "the harm resulting from a violation of the duty of loyalty often being intangible and difficult to quantify."

The sharply worded dissent by Justice Chin should not be overlooked, as some trial judges may be aligned with his reasoning. He disagreed with the majority that under the facts presented, Sheppard Mullin should have been permitted to pursue recovery in quantum meruit. He concluded that a quantum meruit award would clearly be contrary to what the violated rule

"seeks to accomplish," namely, the preclusion of attorneys from simultaneously representing clients with conflicting interests absent the clients' informed written consent.[x] "Because Sheppard Mullin did not get that consent, a quantum meruit award would compensate it for legal services that the rule expressly precluded it from providing." Citing the majority, "[t]he conflict resulting from Sheppard Mullin's concurrent representation… *affect[ed] the representation itself*, not merely the attorney's compensation…"[xi]

Justice Chin continued, "[i]n my view, knowingly representing clients with conflicting interests, without disclosing the conflict to either client and obtaining the clients' written consent to the simultaneous representation, *is* an " 'act[] of impropriety inconsistent with the character of the [legal] profession, and incompatible with the faithful discharge of its duties.' "[xii] "…Sheppard Mullin's simultaneous and undisclosed representation… violated 'the most fundamental of all duties' that a lawyer owes a client: the 'duty of loyalty.'"[xiii] "This 'inviolate' duty is a fundamental value of our legal system."[xiv]

Notwithstanding, Justice Chin agreed that clearly *any* violation of *any* of the Rules of Professional Conduct does not automatically preclude recovery, citing the Court's 2004 opinion in *Huskinson & Brown v. Wolf.*[xv] There, the Court held that quantum meruit recovery is available when law firms violate ethical disclosure and consent requirements regarding fee-sharing agreements. Similarly, in *Hance v. Super Store Industries,*[xvi] in what appears to be the first California published opinion applying the quantum meruit analysis set forth in *Sheppard*, the Court of Appeal recently affirmed an award of quantum meruit recovery to class counsel who sued co-counsel for payment under a fee sharing agreement, despite its failure to disclose to the client in its fee agreement the fact it did not carry liability insurance. Despite the firm's violation of the rule that requires such a disclosure, the court not only affirmed the award of the reasonable value of the firm's fees as reflected in its time records, it also affirmed the award for the reasonable value of the referral made to experienced class counsel.

Practitioners should be aware and appreciate that the pursuit of quantum meruit recovery in anticipation of or following the invalidation of an engagement agreement for violation of the lawyer's ethical duties may invite invasive discovery tactics, in order to establish or refute the elements set forth by the Court in *Sheppard.* Examples may include written discovery and/or depositions seeking details regarding the gravity and timing of the violation (i.e., dates and results of any conflict checks or the absence of any conflict checks, identities of witnesses with knowledge of relevant facts, etc.), or facts supporting a finding of willfulness and the egregiousness of the violation (i.e., internal law firm communications). Worse still, the *Sheppard* opinion specifically acknowledges the relevance of discovery into the claiming law firm's *profits* (!) as a means of determining the fair value of its services under the circumstances. These are factors the lawyer should consider when deciding whether to assert a quantum meruit claim, along with the possibility of a public trial, coupled with the remote possibility that an alleged ethical transgression may become the subject of a widely discussed published opinion. Depending upon just how bad the alleged ethical violation may be, and how much money is sought to be recovered, these factors may weigh heavily in the lawyer's decision whether to seek recovery.

Not surprisingly, J-M and Sheppard Mullin confidentially resolved their remaining non-contract claims, such as the law firm's quantum meruit claim and J-M's breach of fiduciary duty and fraud claims, prior to trial. However, the Court's opinion in *Sheppard,* and Justice Chin's blistering dissent, both serve as a stark reminder to all lawyers to diligently comply with their ethical duties under the Rules, or face possible disgorgement of fees paid, and a prohibition on any recovery in quantum meruit.

---

[i] (2018) 6 Cal.5th 59 ("*Sheppard*").

[ii] Comment [10] to California Rules of Professional Conduct rule 1.7, which took effect on November 1, 2018, shortly after publication of *Sheppard Mullin*, expressly addresses the issue of advance conflict waivers.

[iii] *Sheppard Mullin*, at p. 81.

[iv] Rule 3-310(C)(3) provides that an attorney "shall not, without the informed written consent of each client ... [¶] ... [¶] ... [r]epresent a client in a matter and at the same time in a separate matter accept as a client a person or entity whose interest in the first matter is adverse to the client in the first matter.

[v] (2016) 244 Cal.App.4th 590, as modified on denial of rehearing (February 26, 2016), and judgment affirmed in part and reversed in part in (2018) 6 Cal.5th 59.

[vi] *Sheppard*, at pp. 80-81.

[vii] Id., at p. 94.

[viii] Id.

[ix] Id., at pp. 94-95.

[x] Id., at p. 102.

[xi] Id.

[xii] Id., at p. 104, citing *Clark v. Millsap* (1926) 197 Cal. 765, 785.

[xiii] Id., at p. 105, citing *State Compensation Insurance Fund v. Drobot* (C.D. Cal. 2016) 192 F.Supp.3d 1080, 1084.

[xiv] Id., citing *People ex rel. Dept. of Corporations v. SpeeDee Oil Change Systems, Inc.* (1999) 20 Cal.4th 1135, 1146, citations omitted.

[xv] (2004) 32 Cal.4th 453 ("*Huskinson*").

[xvi] (2020) 44 Cal.App.5th 676.