Judicial Discretion Advised:

A Critique of California's Per Se *Disqualification Rule in Concurrent Representation Cases*

By Mark T. Drooks and Jessica S. Chen

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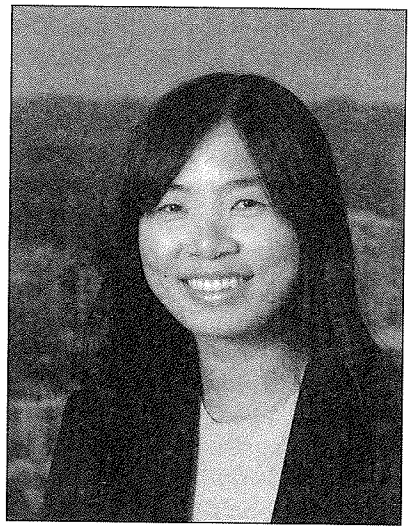

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The scenario reads like a standard MPRE question: A law firm inadvertently takes on a new client whose interests are adverse to an existing one, without obtaining written consent from either. The representation involves a clear conflict of interest, and in California, many courts say that the law firm is subject to automatic, or *per se*, disqualification.

Much of law school is devoted to learning that, in the law, general principles are by definition false. Where the facts are supposed to be critical to decision-making, *per se* rules such as this one often undermine analytical rigor. While the *per se* disqualification rule seems straightforward, the consequences of implementing such a rule can be complicated, particularly in the modern legal landscape, where lawyers within the same law firm have no knowledge of their colleagues' cases, and strict adherence to the duty of loyalty may actually harm the clients to whom the duty is owed. Indeed, other jurisdictions have applied a more flexible standard for evaluating whether disqualification is appropriate, and California should do the same.

Existing California Law on Disqualification

California courts have established two separate standards to analyze whether disqualification is appropriate when there is a conflict of interest. In a successive representation situation, where an attorney's current client has interests adverse to the attorney's former client, the test is whether there is a "substantial relationship" between the subject matter of the current and former representations. (*Flatt v. Super. Ct.* (1994) 9 Cal.4th 275, 283.) In successive representation, "the chief fiduciary value jeopardized is that of client confidentiality." (*Ibid.*)

'Moreover, the per se *rule contradicts the general rule that disqualification motions are always confided to the discretion of the court in light of the competing interests specific to the case.'*

But in a concurrent representation situation, where an attorney's representation of one client is adverse to the interests of another current client, the duty of loyalty is implicated, and many courts conclude that *per se* disqualification is required even if the representations are unrelated in subject matter and there is no risk concerning confidential information. (*State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co.* (1999) 72 Cal.App.4th 1422, 1431.)

Moreover, in the case of concurrent representation, the so-called Hot Potato Rule prohibits counsel from withdrawing from representation of one client prior to disqualification in order to convert a concurrent representation into a successive representation for purposes of assessing the conflict of interest. (*Truck Ins. Exchange v. Fireman's Fund Ins. Co.* (1992) 6 Cal.App.4th 1050, 1060.) Although this rule originally applied to prohibit dropping the preexisting client in favor of a new one, the rule has been interpreted broadly to prohibit a firm from dropping the new client in order to honor its obligations to its original client. (*State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co., supra*, 72 Cal.App.4th at p. 1431.)

Why *Per Se* Disqualification is Bad Policy

While the rationale behind the *per se* rule is to protect the clients' interests, absent issues of confidentiality, the harm to the client from violation of the duty of loyalty often verges on the metaphysical. In certain cases, the *per se* rule may be used as a tactical move by one client to disqualify counsel to the detriment of the other.

Consider the following hypothetical: Lawyer A in Los Angeles has been representing Client No. 1 in a complex litigation in California for five years. Lawyer B, in the New York office of the same Law Firm as Lawyer A, agreed to represent Client No. 2 in a minor

matter in New York. Client No. 2 is adverse to Client No. 1 in the California litigation, but no confidences relating to the two cases were shared between Lawyer A and Lawyer B, and the California and New York matters are unrelated. No waivers were obtained because the Law Firm's conflicts check inadvertently failed to disclose any conflict.

Three months into the New York matter, Client No. 2 brought the conflict to the Law Firm's attention, and the Law Firm dropped out of the minor matter, but declined to drop out of the complex litigation due to concern for prejudicing Client No. 1. The latter, a sophisticated business with in-house counsel capable of assessing the issues, wishes to retain the Law Firm as counsel, but Client No. 2 subsequently moves to disqualify the Law Firm in the California litigation.

In the above scenario, the Law Firm would likely be disqualified under California's *per se* rule, regardless of whether Client No. 2 suffers actual prejudice from the conflict. And because of the Hot Potato Rule, broadly defined, the Law Firm can do nothing to cure the conflict. The tactical advantage for Client No. 2 to bring a disqualification motion is clear, while it is Client No. 1 that suffers and is forced to find new counsel.

The wisdom behind the *per se* rule is questionable given the current legal landscape. There are international and national law firms with many lawyers and offices, such that there is no genuine risk that a lawyer in Los Angeles would be influenced by, or even have knowledge of, actions of a lawyer in New York on an unrelated case. Moreover, given the size of law firms and the complexity of litigation, conflict checks can be a complicated affair; and the occasional conflict of interest is likely inadvertent and results in no actual prejudice.

Perhaps more important, lawyers often serve corporate clients with far-flung business interests and large portfolios of litigation; they do not necessarily view the duty of loyalty as a matter of personal fealty that prevents them from representing a client where other attorneys in the same firm may be adverse to that client in some unrelated matter. Many corporate clients routinely waive conflicts that are brought to their attention. Indeed, if the conflict described above had been discovered in a check, it is entirely possible that the clients would have waived it.

California courts have noted the outdated assumptions underlying conflict law in other contexts. For example, the Court of Appeal, in ruling against automatic vicarious disqualification, acknowledged: "In a situation where the 'everyday reality' is no longer that all attorneys in the same law firm actually 'work together,' there would seem to be no place for a rule of law based on the premise that they do." (*Kirk v. First Am. Title Ins. Co.* (2010) 183 Cal.App.4th 776, 802; see also *In re County of Los Angeles* (9th Cir. 2000) 223 F.3d 990, 997 ["The changing realities of law practice call for a more functional approach to disqualification[.]"].) These outdated assumptions are no less true in concurrent representation cases, and the talismanic invocation of loyalty should not render them irrelevant.

Disqualification may result in substantial harm to the innocent client who wishes to retain conflicted counsel. As courts have acknowledged, disqualification "can be misused to harass opposing counsel, or to intimidate an adversary into accepting settlement on terms that would not otherwise be acceptable." (*Gregori v. Bank of America* (1989) 207 Cal.App.3d 291, 301.) Disqualification also causes substantial delays and increased costs. It is the disqualified attorney's client who bears the financial and strategic cost of finding a replacement, and the prejudice is especially pronounced if disqualified counsel has expertise in the subject area or is familiar with the complex facts and issues in long-standing litigation.

Finally, the added deterrent value of a *per se* disqualification rule instead of a discretionary rule is questionable. Law firms make substantial efforts to avoid conflicts, and there is no reason to believe that a draconian

remedy enhances those efforts. In reality, many concurrent conflicts arise through inadvertence, innocent error, or some failure to connect related corporate entities.

Why *Per Se* Disqualification is Bad Law

It is a distortion of the Hot Potato Rule to conclude that disqualification from representation of Client No. 1 should be automatic on motion by Client No. 2, when the purpose of the rule is to protect Client No. 1. In *Truck Ins. Exchange v. Fireman's Fund Ins. Co., supra*, 6 Cal.App.4th 1050, the seminal case on the Hot Potato Rule, counsel withdrew from representing Client No. 1 in two small lawsuits to represent Client No. 2, with interests adverse to Client No. 1, in another lawsuit; the law firm effectively fired its existing client after the latter client refused to consent to concurrent representation. (*Id.* at pp. 1053-54.) The holding in *Truck Ins. Exchange* is narrow: "[A] law firm that knowingly undertakes adverse concurrent representation may not avoid disqualification by withdrawing from the representation of the less favored client before hearing." (*Id.* at p. 1057.)

Flatt v. Superior Court cited *Truck Ins. Exchange* for the proposition that concurrent representation conflicts may not be cured "by the expedient of severing the relationship with the preexisting client." (*Flatt v. Super. Ct., supra*, 9 Cal.4th at p. 288.) The rule thus exists to protect the *pre-existing* client from losing its counsel. The facts in the Flatt case — rarely described by courts that quote this language — demonstrate this point. In *Flatt*, the attorney (of that name) met with Client No. 2, a prospective client, to discuss potential claims against Client No. 1, a preexisting one. One week after the meeting, Flatt stated she could not represent Client No. 2 because her firm was representing Client No. 1 in an unrelated matter. Client No. 2 later sued Flatt, claiming that Flatt had breached a duty to advise him of the statute of limitations. The Supreme Court rejected this claim, holding that Flatt had a duty of loyalty to the *existing* client (whom the law firm had continued to represent).

Though the initial cases only concerned protection of the preexisting client, subsequent case law interpreted *Truck Ins. Exchange* and *Flatt* broadly to support the proposition that under no circumstances may an attorney in a concurrent-representation conflict drop one client and retain the other, and that even where the conflict was short-lived and inadvertent, counsel could do noth-

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ing to cure it. The Hot Potato rule, originally intended to protect the original client, thus morphed into a "gotcha" rule that prejudiced the original client.

Moreover, the *per se* rule contradicts the general rule that disqualification motions are always confided to the discretion of the court in light of the competing interests specific to the case. (*Oaks Mgmt. Corp. v. Super. Ct.* (2006) 145 Cal.App.4th 453, 462 [citing Code Civ. Proc., § 128, subd. (a)(5)].) Indeed, even cases affirming a *per se* rule recognize exceptions. (*See State Farm Mut. Auto. Ins. Co. v. Federal Ins. Co., supra*, 72 Cal.App.4th at p. 1432 [an exception where the conflict "occurred by 'mere happenstance'"]; *Forrest v. Baeza* (1997) 58 Cal.App.4th 65, 80 [recognizing an exception in the shareholder derivative context].)

A Discretionary Approach — to Disqualification in — Concurrent Representation Cases

A less expansive interpretation of the Hot Potato Rule would allow counsel to cure conflicts by dropping the new client and keeping the preexisting one, which is more accurately in line with the *Flatt* and *Truck Ins. Exchange* cases. If a disqualification motion is brought, judges should be permitted to exercise their discretion to consider all the relevant facts to reach the most equitable result in the individual case.

Other jurisdictions already have adopted a more flexible approach toward disqualification in concurrent representation cases. For example, in *Parkinson v. Phonex Corp.* (D. Utah 1994) 857 F.Supp. 1474, 1477, the court denied disqualification where two attorneys in the same law firm simultaneously represented the plaintiff and defendant in two separate matters for a one-month period; one matter was a three-year litigation, whereas the other was a one-month estate planning representation. The court weighed "the relatively minor harm" alleged by the defendant in the one-month representation versus harm to the client in the three-year litigation, and noted that there was no evidence that confidential information was shared. (*See also SWS Financial Fund A v. Salomon Bros. Inc.* (N.D. Ill. 1992) 790 F.Supp. 1392, 1400 [denying disqualification where plaintiff would suffer "substantial costs" if disqualification were granted]; *Research Corp. Techs., Inc. v. Hewlett-Packard Co.* (D. Ariz. 1996) 936 F.Supp. 697, 702-03 [denying disqualification where plaintiff's counsel simultaneously represented defendant in a minor matter, but had spent 19 months preparing plaintiff's case].)

In evaluating whether disqualification is appropriate, California courts could consider such relevant factors as: (i) the nature of clients and length and significance of each representation; (ii) whether the conflict was inadvertent; (iii) prejudice to Client No. 1, including financial burdens or burdens in parting with counsel familiar with a case; and (iv) prejudice to Client No. 2 from continued representation of Client No. 1. This is not unlike the discretionary standard already employed by courts for determining propriety of disqualification generally. (*See Oaks Mgmt. Corp. v. Super. Ct., supra*, 145 Cal. App.4th at pp. 464-65.)

While an attorney's breach of ethical duties should not be condoned, California courts should adopt a discretionary approach to disqualification in concurrent representation cases, where interests of both affected clients are to be carefully weighed and considered. Such an approach is consistent with existing disqualification law and would more effectively protect client interests than the *per se* rule, which aims to protect the duty of loyalty but may ultimately harm the interests of innocent clients.

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