Why This California Case Is Driving a Wedge Between Law Firms and Clients

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SAN FRANCISCO—Dozens of major law firms are lining up against their corporate clients in an awkward faceoff at the California Supreme Court that lays bare the increasing tension between companies' expectations of loyalty and Big Law's economic incentives to take on more and more business.

In papers filed last week, more than 50 law firms including Arnold & Porter, Latham & Watkins, Sidley Austin and Wilson Sonsini Goodrich & Rosati urged the state high court to adopt a ruling that would allow them to represent clients with opposing interests, though not in the same matter, through the use of broad conflict waivers—and ensure they still get paid.

That notion rankles in-house lawyers who say their interests are being stepped on to boost law firm profits. In briefs opposing the law firms, the Association of Corporate Counsel (ACC) and an unusual alliance of corporations including the paper giant Kimberly-Clark Corp. and networking hardware maker Netgear Inc. argue that conflicts must be disclosed and that companies must not be left to foot legal bills if the firms they hire are secretly playing dual roles.

"As law firms grow in size, there is undoubtedly pressure on their partners to bring in ever more clients and business. This provides incentive for the law firm to ignore conflicts," the coalition of companies wrote in an amicus brief authored by Gordon Fauth, a solo practitioner in Alameda, Calif.

Such public discord between law firms and their clients is atypical, to say the least. While spats over legal fees erupt from time to time, rarely do law firms and corporations stake out opposing positions at a venue as significant as the California Supreme Court.

At the heart of the fight is a case pitting Sheppard, Mullin, Richter & Hampton against a former client, J-M Manufacturing Company Inc. The company, a PVC pipe manufacturer, refused to pay Sheppard Mullin over $1 million in legal fees in a whistleblower case after it came to light that the firm also represented a plaintiff in that action—albeit in unrelated employment matters—and the firm had failed to disclose it.

Sheppard Mullin sued in 2012 and routed the case to arbitration, where it was awarded its $1.3 million in outstanding fees. In January a Los Angeles appeals court turned the tables, finding that

because of the undisclosed conflict, Sheppard Mullin had not only forfeited its claim to the unpaid fees but also must disgorge $2.7 million already received from J-M. The law firm successfully petitioned the state high court for review.

Sheppard Mullin declined to comment through its lead attorney, Gibson, Dunn & Crutcher partner Kevin Rosen. In its opening brief to the high court, Sheppard Mullin said the decision delivered an unwarranted windfall to J-M "that fails to account for either J-M's lack of injury or Sheppard Mullin's good faith effort to comply with the rules."

To law firms that do business in California, the appeals court's decision is worrisome. No state court has imposed fee forfeiture, let alone full fee forfeiture, "without considering such factors as the presence or absence of lawyer good faith and client harm," Holland & Knight partners Paul Workman and Peter Jarvis wrote in the law firms' brief.

J-M had sophisticated in-house lawyers who knew what they were doing when they agreed to waive conflicts, they argue, and total fee forfeiture is too harsh a remedy.

Speaking Monday, Jarvis acknowledged that it is uncomfortable for law firms to so publicly oppose the companies that are typically their clients. But he said clients ultimately benefit from a system where they are free to hire the lawyers of their choice and set the terms of that relationship.

Amar Sarwal, chief legal strategist at the ACC, has a different view. He called the Sheppard Mullin case an "egregious" example of what has become a larger trend of law firms seeking to represent companies that are either adverse to each other in separate litigation or clear economic competitors. It's a dynamic that companies have watched with a great deal of unease, Sarwal added.

"In-house counsel don't want to see their lawyers on the other side of the 'v.' They just don't," he said in an interview Monday. "What the law firms are trying to do in this context is prevent their clients from even knowing that the law firm could be on the other side from them."

Firms do so, he explained, with broad waivers in their client contracts that permit the firm to maintain current conflicts or even take on conflicting business in the future. Often firms do this at the behest of their insurers, in order to limit their liability, Sarwal said.

Attorneys acknowledged that waivers of current conflicts are commonplace, and that future conflict waivers are becoming more so.

The firms allied with Sheppard Mullin say that "sophisticated" consumers of legal services—major corporations with in-house lawyers, like J-M—can oppose those kinds of waivers if they wish. They also say that law firms shouldn't carry the burden of cataloguing specifics about every potential conflict that they might have to a potential client.

Sarwal said that masks the real issue. "I think they well know the moment they provide notice, the client will say no," he said.

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