Client Agreement and Failure to Terminate Representation Under the Terms of Client Agreement Results in Firm's Disqualification Under Concurrent Representation Rule

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M'Guinness v. Johnson, 2015 WL 9583486 (Cal. App. Dec. 30, 2015)

Brief Summary

In 2013, three shareholders sued: (1) each other for breach of fiduciary duties; and (2) their company for involuntary dissolution. The law firm that represented one of the shareholders had been retained by the company in 2006 as corporate counsel. The Sixth District for the California Court of Appeal held that the law firm's representation of one shareholder against the company constituted concurrent representation of adverse clients, which was a conflict of interest mandating disqualification. The court also held that disqualification "is not generally disfavored," meaning that there is no presumption or policy in favor of permitting the representation to go forward.

Complete Summary

The company — Think It, Love It, Construct It, Inc. (TLC) — was a small construction firm with three shareholders: James M'Guinness; Steven Johnson; and Scott Stuart. TLC was incorporated in 2002. In May 2006, TLC retained the law firm. The client agreement provided that the nature of the legal representation was "[a]dvice and representation concerning [TLC] and other general legal work directed by you from time to time." It also advised TLC that it might "terminate" the relationship "at any time," and that "at the conclusion of [the] engagement, at your request and at your cost for any file review, copy and delivery charges, we will review and deliver your files to you, along with any of your funds or property in our possession, charged at our hourly rate." A retainer of $2,500 was deposited into the firm's client trust account. Over the next six years, the law firm performed approximately 25 hours of legal work for TLC. In October 2012, the firm's accounting records showed a balance of $1,417 in the client trust account. The firm sent monthly invoices, which sometimes contained simply a carry-forward balance, but no charges for new legal services during the invoicing period.

On January 23, 2013, M'Guinness sued Johnson and TLC, alleging that Johnson mismanaged the company and misappropriated control of the business. M'Guinness sought involuntary dissolution of TLC. The law firm

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appeared and answered on behalf of Johnson, and filed a cross-complaint against M'Guinness, Stuart and TLC. M'Guinness, Stuart and TLC moved to disqualify the law firm, arguing that it had impermissible conflicts of interest based on its concurrent and prior representation of TLC. Johnson and the firm argued that the representation ended in early March 2012 and that the prior representation did not create a conflict of interest because it was unrelated to the issues involved in the litigation.

The trial court denied the motion, holding that "the evidence was insufficient to warrant automatic disqualification based upon concurrent representation because 'disqualification is a drastic measure, it is generally disfavored and should only be imposed when absolutely necessary.'"

The Sixth District reversed, holding that the trial court abused its discretion:

> "The undisputed facts demonstrate that the Law Firm continued to represent TLC through the time the lawsuit was instituted. If a party moving to disqualify an attorney establishes concurrent representation, the court is required, 'in all but a few instances,' to automatically disqualify the attorney without regard to whether the subject matter of the representation of one client relates to the representation of a second client in the lawsuit."

Quoting Flatt v. Superior Court (1994) 9 Cal. 4th 275, 284–285.

The finding of concurrent representation was based on (1) the "open-ended nature" of the client agreement; (2) the firm's retention of the funds in the trust account, which indicated that the relationship was not "terminated" in accordance with the client agreement; (3) the actions of a firm partner (an "old football buddy" of Johnson's) up through April 2013, in which the partner exerted control over corporate property and sent emails to M'Guinness' counsel shortly after the lawsuit was filed, which created the implication that he still represented TLC; (4) the law firm's billing practices; and (5) "as a matter of corporate law, the Firm's ongoing duty to TLC precluded its representation of Johnson in a lawsuit involving allegations in which the interests of the corporation diverged from those of shareholder litigants."

Essentially, the court found critical that the firm had agreed to act as all-purpose corporate counsel for TLC and that the termination of that relationship could only be effected "by specific methods described in the agreement and under conditions that included the Firm's return of all property and funds to the client," which did not happen. It is also noteworthy that the court's holding rested in part on the law firm partner's guarded email response to M'Guinness' counsel's question "when, if ever, [did] your firm stop[] representing TLC." The partner said, "I have not yet looked at the possibility of representing TLC Builders in this case. I will do so today." The court reasoned that the response "could be viewed as having implied that his Firm still represented TLC" since he did not say when the representation ended, but did indicate he might be representing TLC "*in this case*." (emphasis in opinion)

Significance of Opinion

This case highlights the importance of engagement agreements as the defining structure for the representation. A lawyer's eagerness to be a "jack of all trades" for a single client may be good for business. But it can also expand the scope of duties owed to the client and thus the lawyer's malpractice exposure. Or, as in this case, it can lead to conflicts of interest and disqualification. The best practice is to be honest and clear in the engagement letter about the scope of the representation, including the method of termination, and abide by those terms. *See also*,Cal. Bus. & Prof. Code § 6147 (governing contingency fee agreements) and § 6148 (governing noncontingency fee agreements).