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ATTORNEY ETHICS

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Conflicted Representation May Result In Forfeiture and Disgorgement of Fees

Case law suggests that attorneys who fail to clear apparent conflicts may not recover attorneys' fees in quantum meruit

Due to the complexity of business litigation and the growth of large multistate and multioffice law firms, attorney-client conflict situations are arising with increasing frequency.

The New Jersey Rules of Professional Conduct provide a road map for attorneys to follow in deciding client conflict issues. Attorneys may face discipline if they fail to obtain informed consent for conflicted representation.

However, it is not clear whether New Jersey courts would conclude that attorneys who engage in multiple representation of clients, without first having obtained their consent, would also face forfeiture and disgorgement of their attorneys' fees.

No New Jersey case has directly addressed the issue of fee forfeiture or disgorgement as a result of a law firm's representation of a client whose interests are adverse to that of another client. Although courts in other jurisdictions have considered whether and when the fee forfeiture or disgorgement is appropriate, there is no uniformity of thought

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among them.

The Restatement (Third) of the Law Governing Lawyers §37 (2002), which advocates a middle of the road approach, states: "[a] lawyer engaging in clear and serious violation of duty to a client may be required to forfeit some or all of the lawyer's compensation for the matter."

Comment b to §37 provides the rationale for denying compensation, stating that the "serious violation ... destroys or severely impairs the client-lawyer relationship and thereby the justification of the lawyer's claim to compensation," and that forfeiture serves to deter future violations.

Under the Restatement approach, forfeiture would not be warranted where violations are inadvertent or do not significantly harm the client. Thus, the Restatement advocates that courts should deny fees with discretion, reserving the sanction for cases involving a clear violation of the attorney's duty to the client, that is, when a lawyer knows or reasonably should know that his conduct is wrongful.

The Restatement approach allows total forfeiture only where the attorney's violation is serious and is inappropriate when a lawyer performs valuable service

before the misconduct occurred. See comment c, d and e.

Most courts from other jurisdictions that have considered the issue have generally adopted the Restatement approach: unless the ethical violation is serious, total forfeiture of fees is inappropriate and would only provide a windfall to the client who has received valuable services. Colorado, Idaho, Illinois, Maryland, Missouri, Tennessee and Texas are among the states that have adopted the Restatement approach.

In a significant minority of cases, however, courts have concluded that deterrence is best achieved by forfeiture of all fees following a conflicted representation, irrespective of whether the client suffered actual harm. Indeed, some states even order disgorgement of attorneys' fees already paid. Alaska, Minnesota, New Hampshire, New York, Washington and the District of Columbia follow this approach.

Although no New Jersey case directly addresses the question of whether an attorney may be compensated for representing a client clouded by conflict of interest, courts routinely hold that lawyers whose services have been terminated — with or without cause — nonetheless are entitled to quantum meruit recovery unless they have engaged in illegal or immoral acts.

Thus, it is recognized that the formation of the lawyer-client relationship gives rise to the client's obligation to pay the lawyer the fair value of his services. See *Vaccaro v. Estate of Gorovoy*, 303 N.J. Super. 201 (App. Div. 1997). And in *Starkey, Kelly, Blaney & White v. Estate of Nicolaysen*, 172 N.J. 60 (2002) (quot-

ing the Restatement (Third) of Law Governing Lawyers), the Supreme Court noted that “denying compensation would be unfair to the lawyer and a windfall to the client. ... Quantum meruit recovery then provides compensation in circumstances in which it would be contrary to the parties’ expectation to deprive the lawyer of all compensation.”

In *Starkey*, the Court set forth what a plaintiff must establish to recover under a theory of quantum meruit:

- the performance of services in good faith;
- the acceptance of the services by the person to whom they are rendered;
- an expectation of compensation therefore; and
- the reasonable value of the services.

Although New Jersey permits quantum meruit recovery of fees when an attorney has violated a Rule of Professional Conduct, no cases directly consider whether such recovery would be allowed where the attorney engaged in conflicted representation.

Clearing Conflicts

However, several cases suggest that New Jersey courts would hold that an attorney who engages in conflicted representation may not recover in quantum meruit, and may even be subject to disgorgement of fees already paid.

Most recently, in *Straubinger v. Schmitt*, 348 N.J. Super. 494 (App. Div. 2002), the Appellate Division considered whether a law firm that represented two parties under a conflict of interest, which was apparent at the outset of the case, was properly allocated attorneys’ fees pursuant to a contingent fee arrangement it entered into with its clients.

The conflict arose as a result of the firm’s representation of an injured driver and a passenger in their personal injury claim against another driver where the claims of the clients were likely to exceed the defendant’s insurance policy limits. One of the clients fired the firm because she felt she was not being adequately represented, and a new firm was retained.

After the case settled, a fee dispute arose between the two firms. Following

a hearing, the trial court divided the counsel fees, awarding two-thirds to the first firm and one-third to the substituting firm, concluding that the conflicts of interest were inconsequential and the original firm had done the bulk of the work on the case.

On appeal, the Appellate Division agreed in part and disagreed in part, finding that the original firm’s failure to clear the conflict of interest as to the available policy limits was not inconsequential. The court reversed the fee award and remanded the case for a rehearing to determine a proper fee allocation, noting that a conflict “in connection with the representation of a client may jeopardize that attorney’s right to collect fees for services rendered.” *Straubinger v. Schmitt*, 348 N.J. Super. 494 (App. Div. 2002).

On remand, the Law Division was instructed to consider “the nature and extent of the proper allocation of the fee to be apportioned between the firms.” Significantly, the Appellate Division also raised the possibility of fee forfeiture:

The initial question is whether under the circumstances any of the fee should be allocated to Brady. In the case of violations of the RPCs which materially affect the value of the services to the client, there should be no hesitancy to deny fees.

Thus, the court suggested that fee forfeiture may result when a firm fails to clear a conflict if (a) the conflict was apparent, and (b) it had a negative impact on the value of the services.

Fourteen years prior to *Straubinger*, in *DeBolt v. Parker*, 234 N.J. Super. 471 (Law Div. 1988), the Law Division suggested that fee forfeiture could result from the representation of conflicting parties. Although the court determined that the attorney had not violated any ethical obligation and allowed the attorney to recover attorneys’ fees, it stated in dicta that “[w]hen an attorney represents potentially and foreseeably adverse interests ... and the adversity becomes actual, counsel must withdraw from any representation of both parties and all fees may be forfeited.”

Noting that the forfeiture issue had not been resolved, and speculating that it

was a “risk attorneys accept when undertaking the joint representation of potentially adverse clients,” the court suggested that forfeiture was “a consequence which would secure the enforcement of conflict rules,” and would protect the interests of the client.

Also, in *Goodwin Motor Corp. v. Mercedes-Benz of N. Am., Inc.*, 172 N.J. Super. 263 (App. Div. 1980), the Appellate Division suggested in dicta that a lawyer may suffer perilous consequences if a foreseeable conflict evolves into an actual inherent conflict — even if he has the consent of the multiple client.

In *Dewey v. R.J. Reynolds Tobacco Co.*, 109 N.J. 201 (1988), the Supreme Court considered a case in which the firm that initially represented the defendant dissolved. One of the attorneys of the dissolved firm joined the plaintiff’s firm, but the firm failed to seek the defendant’s consent for the representation of both parties.

The court considered disqualifying the plaintiff’s firm, but balanced such an approach with its concern for the client, finding that another firm could not substitute as counsel for the plaintiff given the remaining time to prepare and the complicated nature of the litigation. The court concluded that the plaintiff’s firm could collect a fee for services performed before the opinion, but that the client would retain the remainder of any award that would otherwise go to the firm. See also Advisory Comm. on Prof’l Ethics, Op. 304 (1975) (stating that when the lawyer acts in good faith, and “with the knowledge of all in prosecuting the matters,” he may seek reasonable fees up to the point of the conflict).

The split among jurisdictions other than New Jersey demonstrates that there is no uniformity of opinion as to whether an attorney who has engaged in conflicted representation may be compensated.

Nevertheless, if an attorney represents multiple clients under a conflict of interest, New Jersey case law suggests the attorney may be precluded from recovering any fees.

This, along with the well-known risk of discipline, make it imperative that attorneys carefully conduct conflict checks prior to agreeing to represent a client and when becoming affiliated with new firms or other lawyers. ■