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U.S. District Court Disqualification Case Highlights Importance of Engagement Agreements—or the Lack Thereof...

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A recent disqualification decision by the federal district court in Seattle highlights the importance of engagement agreements—and the problems that can occur if a law firm doesn't have one. In *Atlantic Specialty Insurance Company v. Premera Blue Cross*, 2016 WL 1615430 (W.D. Wash. Apr. 22, 2016), the court disqualified defendant Premera's counsel in a large insurance coverage case because the law firm had also been representing one of plaintiff Atlantic Specialty Insurance's (referred to as "ASIC" in the opinion) corporate affiliates—Homeland Insurance Company—in another unrelated coverage case. Both ASIC and Homeland were wholly-owned subsidiaries of OneBeacon Insurance Group. One Beacon was structured so that all of its member companies shared the same address and claims were handled by a centralized unit.

The law firm was hired in 2015 by Homeland in an Oregon coverage dispute. As the court put it, "[s]urprisingly, no formal engagement agreement was ever executed." *Id.* at *2. Therefore, the law firm missed the opportunity to limit its representation in the Oregon case to the specific entity involved—Homeland. Instead, the internal claims attorney at the carrier sent the firm a

copy of its case handling guidelines that defined the client as “OneBeacon Insurance, and its specialty business segments.” *Id.*

Also in 2015, the law firm began representing long-time firm client Premera in a series of data breach actions stemming from a cyberattack that were eventually consolidated into a class action. Premera tendered the defense of that litigation to ASIC. ASIC, in turn, filed a declaratory judgment action in federal district court in Seattle seeking a determination that it did not have a duty to either defend or indemnify Premera. When the law firm filed notices of appearance in the declaratory judgment action, ASIC objected to the law firm’s representation of Premera at the same time it was representing Homeland in the Oregon matter. The law firm refused to withdraw from representing Premera and, instead, withdrew from representing Homeland in the Oregon case. ASIC then moved to disqualify the law firm from representing Premera in the declaratory judgment case.

ASIC argued that it was plain that Homeland and ASIC were both affiliates of OneBeacon and, therefore, asserted that the law firm had a current multiple client conflict under RPC 1.7(a)(1). ASIC also argued that the law firm’s attempt to cure the conflict by firing Homeland in the Oregon matter was invalid under a judicial gloss on conflicts recognized in the Ninth Circuit as the “hot potato rule”

(as in a firm can't drop a client in this scenario "like a hot potato"). The court agreed on both points and disqualified the law firm.

In doing so, the court first concluded that ASIC and Homeland should essentially be treated as one entity (with OneBeacon) for conflict purposes because they shared central management—including legal affairs management. Although the court did not cite it, this is the general approach taken by the leading ABA ethics opinion on corporate family conflicts—ABA Formal Opinion 95-390. The court also noted pointedly (at *13) that the law firm had not limited its representation in the Oregon case to Homeland alone through an engagement agreement:

“During oral argument, [the law firm] . . . could not explain why an engagement letter was not executed at the outset of the Homeland representation. Similarly troubling to the Court was the fact that . . . [the law firm] . . . could not advise the Court as to whether OneBeacon was identified as a firm client in . . . [the law firm's] . . . conflicts check system.”

On the “hot potato rule,” the court observed (at *8) that “Premera concedes that for purposes of this analysis, an attorney may not dissipate a conflict of interest by converting a present client into a former client by withdrawing from representation of a disfavored client.”

This case serves as a useful reminder of one of the principal reasons that an engagement agreement is a cornerstone of law firm risk management: it

allows the lawyer or law firm to define precisely who is—and who is not—being represented. Lacking that clear definition, conflicts can arise and it is the law firm’s responsibility to both detect and clear them. As the court put it pungently (at *12): “the Rules of Professional Conduct impose duties on lawyers, and not their clients, to identify potential conflicts of interest and obtain informed consent, if necessary.”

ABOUT THE AUTHOR

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