

## **Conflicts of Interest And Institutional Litigants**

By

Curtis E.A. Karnow<sup>©</sup>

“Too often, the small, free-standing game is viewed as *the* game being played, when often the free standing game is actually embedded in a much larger game. Embedding a small game in a large game often will have substantial implications for the play of the small game.”<sup>1</sup>

### **1. Introduction**

This paper uses techniques borrowed from the field of game theory to describe rational bargaining among institutional litigants, and explains how the results, while often not leading to the rational outcome in a given case, do rationally serve a more general strategy. The paper then reviews the law on conflicts of interests and concludes that such conflicts—as between attorney and client, and among clients—will often result when institutional litigants bargain. The paper continues with a review on the law of waiver and provides a basis to accommodate the conflicts of interests. That accommodation however will often not be practical, and so conflicts of interests will often result. I conclude with a suggestion that the rules of professional responsibility be modified.

While this paper refers to mathematical models inspired by technical game theory research, there is no original mathematical proof here. The numbers are only illustrative, used to test and expand on our intuition on litigation and settlement strategies.

### **2. The Institutional Litigant**

By an institutional litigant (IL) I mean a party who is a repeat user of the court system. For example, landlords may be ILs and as such generally take the same position again and again. A given tenant may not qualify. Insurance companies are ILs; although again insurers generally are not. In the criminal justice system, the offices of the public defender and of the district attorney are ILs, although generally (one hopes) individual defendants are not. Many types of cases generate ILs, such as the Vioxx drug litigation in which the company Merck is a now party in thousands of apparently similar cases.

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<sup>©</sup> Judge of the Superior Court, County of San Francisco.

<sup>1</sup> D. Baird, et al., *Game Theory and the Law* 188-89 (Cambridge, Massachusetts: Harvard University Press, 1994)(hereafter “Game Theory”).

Similarly, lead paint, tobacco, some mold, and other toxic exposure cases have defendants who are ILs. The recent Catholic church litigation, too, qualifies: the Church as such may not be the institutional defendant, but a variety of Dioceses now have that dubious distinction. *See* note 18.

And it is not only defendants who qualify as ILs. Certain plaintiff law firms both have such a broad experience in a certain type of litigation, and operate sufficiently apart from the desires of individual clients, that they too may qualify as ILs. For example, firms in certain types of class actions, securities fraud litigation, aircraft crashes, Indian gaming, and asbestos cases may qualify. Governmental agencies such as the Securities and Exchange Commission, district attorneys, state and federal departments of justice and US attorney offices too are repeat litigants, bringing similar cases against a variety of defendants. Companies with patents and other intellectual property are often plaintiff institutional litigants. Below, I term the repeat or institutional litigant the “common” party, and those who oppose a common party only once “isolated” parties. At the risk of some confusion, I will also describe some lawyers as common parties, when they are repeat players in their own right as they represent one client after another. *See infra*, § (C)(iii)(d). As we will see, the core conflicts issues are presented by lawyers who are, in effect, institutional litigants.

The central characteristic of the IL or common party is that it knows (or expects) a sequence of putatively similar cases after the one (or many) it is currently engaged in. Its behavior in the present case, then, will be a function not only of the merits of that case but also exigencies stemming from future cases. Because most cases settle—the usual figure given is somewhere around 90%<sup>2</sup>--it is especially interesting to consider how and to what extent settlement is a function of future cases. Game theory provides a vocabulary and techniques to discuss these situations.

### **3. Game theory**

#### **A. The Simple Game**

A formal approach to game theory is commonly thought to have originated with John von Neumann<sup>3</sup> and developed by e.g., in the fifties, John Nash.<sup>4</sup> There are many sources of this history.<sup>5</sup> Here it is enough to provide an outline through the presentation of a simple

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<sup>2</sup> Judicial Council Of California, *2006 Court Statistics Report* 49 (available at <http://www.courtinfo.ca.gov/reference/documents/csr2006.pdf>). Looking at figures for total civil unlimited cases (those where the claim exceeds \$25,000), 1% went to jury trial and 8.7% were tried by a judge.

<sup>3</sup> Morgenstern, Oskar and John von Neumann, *The Theory of Games and Economic Behavior* (Princeton University Press, 1947).

<sup>4</sup> Nash, John (1950) "Equilibrium points in n-person games" *Proceedings of the National Academy of the USA* 36(1):48-49; Nash, John (1951) "Non-Cooperative Games" *The Annals of Mathematics* 54(2):286-295. See generally, Ed., H. Kuhn, S. Nasar, *The Essential John Nash* (Princeton, 2002).

<sup>5</sup> M. Osborne, *An Introduction to Game Theory* 1-4 et seq. (2004); *see generally*, Wikipedia's entries available at [http://en.wikipedia.org/wiki/Game\\_theory](http://en.wikipedia.org/wiki/Game_theory).

game. In such a game, two players develop strategies to maximize their returns, or pay offs. Each player knows his pay off is dependent on the actions of the other player and that the other player will also seek to maximize his pay off.

If we assume rational players engaged in a single or ‘one shot’ game, we may portray the results of cooperation and antagonistic behavior (“defection” in the vernacular). Such a simple game requires a decision made without knowing what the other player will do.

Assume, for example, a cake: if the two players each decide to take only moderate amounts (to cooperate), they will share the cake. If one decides to take as much as possible (aggressive behavior, also known as ‘defection’) and the other still seeks only a moderate share (shy behavior), the aggressive player will get  $\frac{3}{4}$  of the cake and the shy player will obtain  $\frac{1}{4}$ . If both are aggressive, the cake is ruined and each gets only  $\frac{1}{8}$ .

We can map the payoffs as follows:

1↓ Player 2→	Aggressive	Shy
Aggressive	0.125, 0.125	0.75, 0.25
Shy	0.25, 0.75	0.5, 0.5

The convention is to state pay offs in order, Player 1 and then Player 2 separated by commas. As Player 2 considers his options he first considers those of Player 1. Player 2 sees that if Player 1 is aggressive and Player 2 is shy, 2’s pay off is superior to that if 2 is also aggressive, so he will be shy if he thinks 1 will be aggressive. And vice versa: 2 will be aggressive if he thinks 1 is shy. For this game, no strategy will ensure anything other than a 50-50 chance of making the best decision. But if we assume that there are additional costs to being aggressive (it takes time, energy, or more damage is done to the cake than under the first game etc.), then we might have a pay off table such as this:

1↓ Player 2→	Aggressive	Shy
Aggressive	0.1, 0.1	0.5, 0.25
Shy	0.25, 0.5	0.5, 0.5

Here it is clear that there is no benefit to being aggressive. If both are aggressive each gets only 0.1; if only one is aggressive the best one can do is 0.5, which result a player can guarantee by risking nothing and being shy. Thus each player will chose the shy strategy and end up with the best pay off, 0.5.

## B. The One Shot Settlement Game

In the settlement game, the players may have the same, or differing, beliefs about the likelihood of success at trial, where success is a function of both (i) establishing liability and (ii) proving damages. Thus, we must state assumptions about the possible pay offs. Assuming the case is worth \$100, and the odds of success are 80%, it is rational to settle

the case for \$80 where there are no costs of litigation (COL).<sup>6</sup> Because there are always COL (assume COL= \$10) the actual minimal settlement value is, for the

Plaintiff:  $80-10 = \$70$  (recovery less costs to get it)

Defendant:  $80+10 = \$90$  (paying the recovery plus the costs of litigating)

The difference between \$70 and \$90 may be referred to as the surplus, created as a function of the costs of litigation, that is, the friction of the legal system created as it operates to generate the just result. This surplus may also be thought of as the envelope of rational settlement: any settlement within its confines is rational to both sides. Indeed, consider that a settlement at, say \$75 is a ‘win’ for both sides, since plaintiff will get more than his net after trial and defendant will pay less. Thus, where one might normally be tempted to think of litigation as a zero sum game (for every \$1 that goes to one player, the other player must pay \$1), the friction inherent in the system provides otherwise. And the higher the friction, the higher the COL, the larger the surplus or settlement envelope.<sup>7</sup>

While any settlement within the envelope is rational, each side nevertheless desires to increase its pay out (the payout for a plaintiff is more money; the pay out for a defendant is paying less). Thus in settlement negotiations within the envelope outlined above, D will try to convince P to take e.g. \$71, and the P will try to get D to give it \$89. Many factors go into this process. First, the parties may have different beliefs as to the likely outcome at trial, and/or try to convince the other side that its beliefs are unduly optimistic. In the example above, \$71 sounds pretty good if the plaintiff thinks his odds at trial are at best 60%.

Second, parties can also increase the COL asymmetrically, which pressures one side but not the other. For example, if plaintiff serves vast quantities of pointless discovery demands, we might have this situation:

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<sup>6</sup> This paper obviously assumes an ordinary tort, contract or other case where the entire dispute can be reduced to a legal dispute over how much money, if any, defendant should pay plaintiff. Not all cases are precisely like this, although I suspect they generally can be reduced to this. For example, in some intellectual property cases such as patent and trade secret matters, the stakes can be highly disparate and not directly involve money because the central remedy is equitable, not legal. If a defendant loses a patent case it may have to shut down; if the plaintiff loses, it may only see a reduction in its sales. However, these outcomes can be modeled using dollars. Nevertheless, some cases will not fit the model because the bargaining and dispute is over an “indivisible item”. Daughety, A., “Settlement,” V ENCYCLOPEDIA OF LAW AND ECONOMICS (Ed. Bouckaert and G. DeGeest, June 2000) 95, 109-110 (hereafter “*Settlement*”). Those disputes accordingly must be excluded from this discussion.

<sup>7</sup> Thus it is that settlement judges will often argue to both sides that the forecast litigation will be extremely expensive, focusing on high ticket items such as experts, international travel, and review of extensive documents.

Plaintiff:  $80-10 = \$70$  (recovery less costs to get it)

Defendant:  $80+20 = \$100$  (paying the recovery plus the asymmetrically higher costs of litigating)

This shifts the median rational settlement from \$80 to \$85, favoring plaintiff. Of course defendant can do the same to plaintiff by sending in billions of pointless pages of paper discovery ('opening up the warehouse' as it is sometimes termed), providing electronic discovery in an obscure proprietary format, making frivolous arguments, etc. Much the same effect is generated by litigants who have sunk costs in COL, which will include many ILs. For example, we may have a company represented by a captive law firm paid on a yearly retainer, or which is represented by its general counsel (who too is paid anyway, whether or not a case is in litigation), or the pro se litigant (who pays himself nothing, and assuming he has no other costs to the time he spends on the case). We may also have another type of IL, the experienced firm that has sued this defendant (or this type of defendant) in the past on very similar bases, which, while not having initially sunk all costs, will have marginal COL which are relatively low. In these sorts of situations we will have for example,

Plaintiff:  $80-10 = \$70$  (recovery less costs to get it)

Defendant:  $80+1 = \$81$  (paying the recovery plus the marginal costs of litigating)

This shifts the median rational settlement from \$80 to \$75.50, to the benefit of the 'low cost' (or more experienced) defendant.

But even symmetrical increases in costs will have an effect. Below we look at two cases, one in which the COL are "normal" or non-aggressive (e.g., \$10 per side) and another in which the costs are higher, or aggressive (e.g., \$35 per side).

(i) *Sample Game*

With 80% odds of success and COL of \$10 ("normal"), the settlement envelope is (80-10) to (80+10), or \$70-\$90. We will call this 80% a "strong" case. The median rational settlement (MRS) is \$80. In an aggressively litigated case where e.g., COL=\$35, the MRS remains the same and settlement envelope is larger, ranging from \$45 to \$115.

We may also map out a weak case where the odds of success are 45%, litigated both normally and aggressively, as follows:

Normal COL \$10, MRS = \$45, settlement envelope = \$35-\$55

Aggressive COL \$35, MRS = \$45, settlement envelope = \$10-\$80

Given these samples, we note that Plaintiff will bring both the strong and weak cases if he thinks the cases will be normally litigated (COL=\$10). If he thinks his case is weak and the defendant will vigorously litigate it, he will be very chary of bringing the case;

any evaluation much below 45% is a bad bet.<sup>8</sup> We may map these outcomes in game terms (as note 8 suggests we use a negative sign associated with the pay out of the defendant):

*Pay offs: P, D* (“weak” and “strong” here are from the plaintiff’s perspective):

“Strong” (80%) case		“Weak” (45%) case	
Normal	Aggressive	Normal	Aggressive
70, -90	45, -115	35, -55	10, -80

These figures are referred to below as the Sample Game.

As our intuition would suggest, an aggressively litigated strong case is the worst case scenario for the defendant (\$-115); and an aggressively litigated weak case is the worst case scenario for the plaintiff (\$10). Thus a rational defendant will litigate a simple game *normally* if the plaintiff’s case is strong, and *aggressively* if the plaintiff’s case is weak; the plaintiff will litigate conversely. While this will be discussed below, note that a defendant who litigates aggressively, therefore, either is—or is mimicking—a defendant who considers the plaintiff’s case to be weak; and a plaintiff who believes he has a weak case will rationally take any settlement above \$35 (the best he could do in a weak case), which is worse than what he can expect with a strong case, no matter how aggressively that is litigated.

(ii) *Asymmetrical Information*

Parties may not agree on the odds of success, often because they have different, or asymmetric, information about the case. For example, the plaintiff may have good information on his damages, such as in a personal injury case, and defendant may have better information on liability, having conducted an investigation into his past actions.<sup>9</sup> While some settlements take place on the “courthouse steps” that is, after all discovery and exchange of information is theoretically done, even those settlements are usually based on asymmetric information since the costs of becoming exactly as informed about the other side’s case as is the other side is generally not reasonable: it would require the same amount and quality of access to the other side’s witnesses, and documents, as that other side has. Except for situations then where all the relevant information is equally accessible (perhaps because it resides in the hands of third parties), generally speaking we will have asymmetric information even when the settlement is done just before trial; and *a fortiori* we will have such conditions when the settlement is done earlier, that is, when

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<sup>8</sup> Another way to calculate the same numbers applying our intuitions on evaluating the odds of success: Because litigation is in fact winner take all, it is important to take account of the fact that at e.g., 45%, the plaintiff is in effect agreeing that it is more likely than not that he will lose the case- that is, that the pay off will be -35 (if COL = \$35). There is a 55% chance of that; with a 45% chance of a payoff of (100-35) or \$65. We can sum these odds as follows: (.55 x -35)+(.45 x 65) = \$10 for the value to plaintiff. Similarly, for defendant we have a 55% chance of a -35 payoff plus a 45% of a -135 payoff, which is a -\$80 value. As this show, the pay off numbers associated with the paying defendant may be expressed with negative numbers.

<sup>9</sup> See generally, *Settlement*, supra n.6 at 103.

the costs of litigation have not yet been expended and so the settlement envelope and surplus are the largest.

(iii) *Use of Imperfect Information*

In addition to situations where parties have asymmetrical information, they both may equally ignorant of important information, such as the state of evidence, the import of expected expert testimony, and more centrally how the fact finder (the judge or the jury) is likely rule even when all the evidence is known to the parties. Accordingly, in many if not all cases, even when the parties have roughly symmetrical information, they do not know the *actual* value of the case because they do not have *perfect* (accurate and complete) information, and they are likely to have different evaluations of the case based in part on their differing access to the evidence. This is, of course, something both parties know about each other, and they know the other party knows. But each party may be uncertain of how much the other side knows.

Accordingly, even where there is roughly symmetric information, the parties are likely to send signals to the other designed to entice settlement on relatively favorable grounds, and those signals cannot be known to be accurate or not. Referring back to the example of aggressive litigation above, we would expect settlement negotiations in which defendant seeks to signal plaintiff that the odds of success are low, and the plaintiff sends the converse signal. We also see that the defendant is likely to send the signal that even if the odds for plaintiff are fairly good, say 70%, the COL will be so high (e.g. \$35) that the suit should not be maintained. Each side will seek to convince the other that it will aggressively pursue the litigation (even if that's not true) in an effort to obtain settlement on more favorable terms:

Pay off below listed in this order: P, D (extracted from Sample Game):

Aggressive (COL \$35)		Not aggressive (COL \$10)	
Strong case	weak case	strong case	weak case
45, -115	10, -80	70, -90	35, -55

In the Sample Game, no party would chose the aggressive approach since pay off for both parties is better if they are not aggressive. But if one party convinces the other that it will be aggressive then the other party will be motivated to accept settlement worse than that available under the non-aggressive approach, but better than that expected under the aggressive approach, no matter how strong or weak the case is. The threat of aggression may be credible: The defendant may be aggressive in order to send the signal that he thinks the plaintiff's case is weak, and the plaintiff may do so sending the signal that the case is strong. These signals may be effective because in each case the sender would not act aggressively unless it really thought it was in a strong position. That is, one party, knowing his case is weak or not knowing how strong his case is, might *mimic* the behavior of a party who knows the case is strong. The figures used above show that in some cases this predictable behavior will result in worse pay offs for both sides, because,

again, no party would chose the aggressive approach since pay offs are better if parties are not aggressive.

Thus in a one shot game rational players will not usually litigate aggressively. But of course they often do: Those of us actually immersed in litigation will recognize this behavior. The discussion below will explain this apparently irrational behavior as rational in the context of multiple games including those where the lawyers are also ILs.



### C. The Supergame

The discussion so far has assumed parties who negotiate once, that is, the single or one shot game. The dynamics change when we have multiple games with the same players, for in such cases the players know that their behavior in the first game will affect behavior in the second, and so on. We may call these conjoined games a *supergame*, comprised of *subgames*.

For example, a threat of aggressive behavior mimics a party with a very strong case; this may be credible in the first subgame but might be incredible in the next subgame if the first subgame results in trial which reveals the weaknesses of one's position. We may call this the creation of a *reputation*. Reputations might be for aggressive, or non aggressive behavior, and may be effective in modifying the opposing side's bargaining as long as they are credible.<sup>10</sup>

Information may become more symmetric, and more perfect, over time and over multiple games. Assume a party willing to signal a powerful position in one game, even at the risk of increasing COL and forcing a trial which may be lost. This party would know that there are further costs in the ensuing subgames because the first loss would signal weakness in its position (assuming a *correlation of damages* among subgames, discussed below). Under these conditions, the weaker player in the first subgame would be willing to settle for less than an ideal payoff in the first subgame in order to avoid trial and the concomitant disclosure of information about the strength or weakness of his case.<sup>11</sup> That is, weak defendants will be willing to pay out a premium, and weak plaintiffs will be willing to take less, in order to mask their positions in order to maintain an advantage for the next game. In short, neither wishes to set an adverse precedent, and is willing to reduce its payout to accomplish that goal.

The present payment of a premium (accepting a lower pay off) is rational only as long the party expects to make up the premium in subsequent rounds of the supergame. At first blush, this condition may be anticipated for a variety of reasons. These include: (1) the discount factor; (2) increasing sunk costs and concomitantly shrinking marginal costs of each subgame; and (3) continued asymmetry of information.

The first factor refers to the fact that a party prefers a payoff today to one tomorrow; discount rates reflect uncertainties and delays in future payments. It is possible for parties to have different discount rates based on their evaluation of the case, since one party may have more uncertainty about the case than the other. But this will generally inversely correlate with the revealing of information over the course of the supergame,<sup>12</sup> and so this factor has an effect similar to the third factor here, asymmetry of information.

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<sup>10</sup> See generally, e.g., D. Kreps & R. Wilson, "Reputation and Imperfect Information," 27 *Journal Of Economic Theory*, 253 (1982), available at <http://levine.sscnet.ucla.edu/archive/krepwilson.pdf>

<sup>11</sup> YK Che & JG Yi, "The Role of Precedents in Repeated Litigation," 9 *Journ.L, Econ. & Org.* 399 (1993)(hereafter "Che & Yi").

<sup>12</sup> This will not always be so. One player may operate close to the margin of bankruptcy and need a payoff now more than the other player. Well heeled litigants can afford to wait while poor litigants cannot.

Absent that asymmetry, the parties should employ the same discount factor.<sup>13</sup> The point is that the discount factor helps fund settlement negotiations which postpone trial and ultimate revelation of the strength of a case.<sup>14</sup>

The second factor here is that as parties progress from subgame to subgame, their sunk costs go up and so their marginal costs decline. The first case may take \$35 to prepare for trial, but the second one is likely to cost less. This suggests that a party will be willing to give up less over time to settle cases. If the COL per subgame decreases equally for both sides, the only result will be to decrease the size of the settlement envelope, not to shift the median rational settlement.

But assume only one party is common across the subgames (I will term this the *common* party), and the other party is new each time (an *isolated* party). For example, consider a single defendant faced with a multitude of plaintiffs, such as in a groundwater contamination, lead paint or cigarette (smoking) case; or where a single firm such as the Securities and Exchange Commission sues a variety of defendants for essentially the same failure such as a type of stock fraud or the same patent holder sues a variety of infringers. In such a case the [marginal] COL decreases for the common party, but not the isolated party. As the common party's expenses are increasingly sunk costs, the median rational settlement will edge in its direction. The common party can afford to be aggressive and drive up COL, mimicking a party with a stronger case.<sup>15</sup>

Finally, we have the third factor, maintaining information asymmetry. Again, this is likely where one, but not both parties, are common. To the extent there is what we might call a *correlation of damages*<sup>16</sup> among the cases, the common party will have information that the isolated party does not.<sup>17</sup> Where we have this common-isolated pairing, the common party will continue to have an incentive, from game to game, to pay a premium to hide information about the weakness of its case.

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<sup>13</sup> Except as suggested in note 12.

<sup>14</sup> Also, holding onto money by delaying settlement may specifically benefit the defendant. *Settlement* at 120-21. But this effect is moderated in cases where prejudgment interest is awarded, as in many contract cases, or the award is for value as of the day of verdict, which is often true in many tort actions.

<sup>15</sup> This asymmetric dynamic can be upset if the isolated parties communicate with each other, that is, as they begin to approach the status of a common party. This may happen if the premium settlements are not secret, if the putatively isolated parties share the results of their investigations, if they conduct joint discovery, and share the expenses of litigation. This is exactly what otherwise isolated parties do. For example, plaintiffs' lawyers in the Vioxx cases gather to share their experiences. See e.g., [http://www.boston.com/business/articles/2005/01/21/lawyers\\_gather\\_to\\_plan\\_strategy\\_for\\_vioxx\\_litigation/](http://www.boston.com/business/articles/2005/01/21/lawyers_gather_to_plan_strategy_for_vioxx_litigation/). Defendants often hire the same group of lawyers with substantial experience with a charging agency to defend them. This also explains the hotly contested legislation banning secret settlements, as well as the fact that institutional litigants oppose the legislation. See *infra* at n.19.

<sup>16</sup> To make a more general point, I am conflating here what Che and Yi distinguish as correlation of damages and correlation of liability. *Supra* n.11 at \_\_\_.

<sup>17</sup> I also recognize that we may have asymmetric information where both parties are common, but have different sets of information. For example, plaintiffs may always know more about their damages than defendants, and defendants may always know more about their liability; each side generally will always know more about their own evidence, such as the content of documents and the power of their expert testimony, than will the other side.

(i) *Correlation of Damages*

Correlation of damages exists where damages after trial in one case are predictive, or correlate, with damages in the next case. Correlation of damages may be present for many reasons, with varying levels of effect. (i) The subgame cases may all have the same jury pool and geographical locus, suggesting a similar treatment of similar facts. (ii) The dominant issue may be the defendant's liability centering on a single series of events, such as an airplane crash, a toxic spill, or a design defect, as opposed to cases in which the dominant issue is a matter of causation or damages on a per plaintiff basis, perhaps such as in the Vioxx drug cases or the Catholic abuse cases where liability depends on what an individual clergyman did in situations unique to each plaintiff.<sup>18</sup> (iii) The cases may use the same experts, (iv) the same trial counsel may conduct the case, (v) the same trial judge may preside, (vi) there may be the same standing orders and common procedures; (vii) cases may be tried in close proximity in time (not spread out over many years), and (viii) there may be the same appellate court and governing law. Obviously many of these factors correlate with each other: the same jury pool, judge, procedures, and appellate court are all likely to correlate, and likely correlate with the existence of a common party. The more trials there are, the less the information asymmetry as between the common and isolated party. By contrast, the more settlements—secret settlements are the best for this purpose<sup>19</sup>--the higher the information asymmetry.

This information asymmetry, as well as the increasingly sunk costs for common parties, suggests that where we have a common-isolated pairing we will have the strategy of paying a premium for early settlements. Assuming the strategy is successful in edging settlements in favor of the common party, the premiums should be at least offset by the resultant favorable settlements. This is just the pattern we see in e.g., patent litigation, where early settling defendants are rewarded by assertedly low settlements, i.e. low patent royalty rates, all in aid of establishing a consensus that the plaintiff has a strong case (a valid patent).

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<sup>18</sup> While we have weak or no correlation when the focus is on the individual clergyman allegedly responsible for abuse, we expect a relatively higher correlation when the focus is on the behavior of the archbishop and the case concerns *supervision* extending over the behavior of many clergy. See, e.g., <http://www.latimes.com/news/local/la-me-abuse20sep20,1,233357.story?ctrack=1&ccset=true>. This illustrates the notion that the more general the proposition the more powerful it is, although it might be concomitantly more difficult to establish. These sorts of considerations influence the sort of games plaintiffs are willing to play.

<sup>19</sup> A. Daughety et al., "Economic Theories Of Settlement Bargaining," 1 *Annual Review of Law And Social Science* 35, 42 (December 2005) ("confidentiality improves the likelihood of settlement and raises the expected settlement amount"). Thus institutional litigants tend to oppose legislation outlawing secret settlements. E.g., "Nevada senator pushes bill to block secret settlements," *Reno Gazette Journal*, available at <http://www.rgj.com/news/printstory.php?id=37343>. See e.g., "I have Never Seen A Case Disappear Like This" [http://www.businessweek.com/@@W1wGpWQQQET6yQUA/1999/99\\_45/b3654192.htm](http://www.businessweek.com/@@W1wGpWQQQET6yQUA/1999/99_45/b3654192.htm) (sealed papers relating to earlier lawsuits); C. Notebottom, "Courts get Wise to Harmful Secret Settlements," <http://www.law.com/jsp/article.jsp?id=1032128721406>; <http://www.cbsnews.com/stories/2003/01/15/60II/main536641.shtml> (CBS Newscast); D. Dana, "Secret Settlements and Practice Restrictions Aid Lawyer Cartels And Cause Other Harms," [http://home.law.uiuc.edu/lrev/publications/2000s/2003/2003\\_5/dana.pdf](http://home.law.uiuc.edu/lrev/publications/2000s/2003/2003_5/dana.pdf).

(ii) *Common-Common Pairings*

Where we have a common-common pairing, one of these factors (asymmetrical sunk costs) may not be present, and the other factor (asymmetrical information) will be of less consequence, since, for example, settlements are not secret. Accordingly where both parties are common it will be less likely that settlement of an early case will be a function of setting expectations for future cases.

But even where we appear to have equally common parties, such as where asbestos litigation is conducted on behalf of one defendant and one law firm represents multiple plaintiffs, we should recall the possibility of additional, as yet unrepresented plaintiffs. There is usually always the possibility of additional parties. Even where this appears unlikely such as in a certified class action or in an airplane crash where all victims are represented, there is always the possibility of opt-out class members and defecting clients. Rational common players will conduct settlements of their subgames aware of the possibility of new, isolated players coming onto the scene. Indeed, where (a) all possible parties in all possible subgames are currently represented by the players and no client defections occur and (b) there is high damages correlation among subgames, there is no reason for the negotiations not to resolve all games at once, collapsing the subgames to a single game generating, in effect, a one shot game. Both sides will utilize the substantial surplus created by not litigating a length series of trials; such are the contemplated benefits of the class action. But this is not a common situation, and accordingly the goal of maintaining information asymmetry will often be rational, including its strategy of paying a premium to avoid trial of a weak case.

In common-common pairings, a party can use the threat of future punishment to change the other party's behavior in the current game. Again, to the extent this is successful the result of the subgame bargain must differ from that of a one shot game. That threat of future punishment—to increase COL, for example—is credible when a party has a reputation for doing so (see below, § (b)).

(iii) *Finite and Infinite games*

Some supergames consist a few subgames, some consist of many, and in some the number of subgames is not predictable. For example, in a plane crash there may be a predictable number of subgames equal to the number of passengers, each of whom brings a case against the airline or aircraft manufacturer. Toxic tort groundwater contamination cases likely involve a large or unpredictable number of cases, as may an antitrust case with an alleged monopolist who has assertedly injured a broad spectrum of consumers and competitors. A defective product case might involve a large but fairly predictable number of cases. This is all a matter of degree. But let us assume for discussion's sake a clear distinction between (1) a limited predictable number of subgames, a *finite* supergame, and (2) an unpredictable number of subgames, an *infinite* supergame.<sup>20</sup>

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<sup>20</sup> Even if the number of subgames happens to be small, it is the fact that there are an *unpredictable* number of them which constitutes an infinite supergame. *Game Theory* at 167-168.

(a) *Finite Games*

In a finite game the parties are aware that there is a predictable ‘last’ game at which time no strategy based on threats of aggressive behavior which imitate a stronger party, founded on later recouping a premium payment, will make sense. The last negotiation, then, is likely to settle at the value of the case (as that is understood by the parties at the time) and not reflect the mimicking of a stronger player. At the second-to-last negotiation, the players know this and will be able to predict that ‘true value’ last settlement. Thus the players have the same incentive to settle the penultimate game without trying to have in place an incredible threat for the last subgame. This “unraveling”<sup>21</sup> will proceed back towards the initial games, undermining the credibility of initial threats. This in turn makes it more likely that in these finite games settlements will reflect the parties’ actual evaluation of the worth of each case; that is, that there will be little or no discrepancy between the rational (1) one shot and (2) supergame resolutions.

(b) *Infinite Games And Reputation*

In infinite games, by contrast, we may expect mimicking of irrational play (aggressive COL). Merck’s announcement that it will litigate every single one of the cases against it follows this pattern.<sup>22</sup> Here, the marginal COL will decrease over time as the sunk costs will rise for the common player.<sup>23</sup>

Without the unraveling described above in connection with finite games, infinite games generate significantly different outcomes:

The set of equilibria of an infinitely repeated game can be very different from that of the corresponding finitely repeated game because players can use self-enforcing rewards and punishments that do not unravel from the terminal date.<sup>24</sup>

Throughout the subgames involving a common-isolated pairing, there will be a continuing rational strategy on the part of the common player to mimic the strong and aggressive party (unless and until there’s proof of weakness). The common player can predict that he will continuously (up to a limit) lower his COL, whereas this will not be possible for the isolated parties.

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<sup>21</sup> *Game Theory* at 168. See also, Branislav L. Slantchev, “Game Theory: Repeated Games” (March 7, 2004) at <http://www.polisci.ucsd.edu/~bslantch/courses/gt/07-repeated-games.pdf> (hereafter “Slantchev”).

<sup>22</sup> See, e.g., [http://www.boston.com/business/globe/articles/2006/07/14/merck\\_gets\\_boost\\_in\\_suits\\_on\\_vioxx\\_with\\_winn\\_in\\_nj/?rss\\_id=Boston+Globe+---+Today's+paper+A+to+Z](http://www.boston.com/business/globe/articles/2006/07/14/merck_gets_boost_in_suits_on_vioxx_with_winn_in_nj/?rss_id=Boston+Globe+---+Today's+paper+A+to+Z).

<sup>23</sup> This effect here will be less in a common-common pairing: There, the parties are likely to come increasingly close to symmetrical information and costs, which undermines the ability of one such party to make threats not based on accurate estimates of the values of each subgame case. But as noted above, (a) common-common pairing should often be treated as common-isolated pairings, and (b) even where we have a common-common pairing, the threat of future punishment can cause a deviation from the best one shot strategy.

<sup>24</sup> *Slantchev* at 5.

Further, we have noted that the settlement envelope increases as the COL increases, including when the parties plan to aggressively litigate the case. While this alone does not shift the median rational settlement, it does (by definition) broaden the spectrum of relatively favorable and unfavorable settlements and results. This in turn favors the party who can play off of information asymmetry and convince the other side that the odds of its success are high and it will therefore act aggressively. This is a posture that the common player can usually credibly maintain. This posture is the player's *reputation*.<sup>25</sup> When the isolated player is somewhat uncertain of the common player's rational settlement and litigation strategy, the common player's reputation may convince the isolated player to take a settlement he otherwise would not. *See, infra* § (B)(3)(in Sample Game, aggressive play encourages opposing player to take lower settlement). This, in turn, is a powerful incentive for the common player to maintain his reputation; and the common player's sunk costs enables him to afford that reputation, increasing its credibility.

(c) *Reputation's Influence in Low Cost One Shot Games and in Infinite Supergames*

Note that this mechanism only operates in cases where there is a relatively substantial sum at stake. To see why this is so, we note first, as stated above that reputation is effective where the settlement envelope and surplus are large. Now let us look at a case where these are small or almost nonexistent: such a case would cost almost nothing to litigate, and we may term this frictionless litigation. But even in frictionless litigation each party has an incentive to convince the other that the MRS is higher or lower, and it is worth spending money to modify the other side's estimate of the value of the case. For example, it is worth spending \$10 to convince the other side to lower its demand by \$11. This increases COL by \$10 for each party (assuming symmetric COL). But in a case with small stakes, no party will be willing to spend much to adjust the other's beliefs about the worth of the case. So in cases where both sides know the stakes are low, reputation will likely have little effect.

In infinite supergames, however, the parties by definition do not know how long the game will continue, and cannot estimate that the stakes, all told, are low, even if the stakes in a single subgame are low. Thus, insurance companies may be tempted to play "hardball" in even small stakes automobile accident cases.<sup>26</sup> The institutional problem with infinite supergames, as it were, is that there is no such thing as frictionless litigation. There is rather an incentive on the part of common parties to transform, or threaten to transform, what might otherwise be frictionless litigation into high cost, high surplus litigation, specifically to create the room for reputation to have its effect.<sup>27</sup>

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<sup>25</sup> *Game Theory* at 178 et seq.

<sup>26</sup> *See e.g., RLI Ins. Co. v. CNA Cas. of California*, 141 Cal.App.4th 75 (2006)(duty to settle within policy limits). California rejected a move in 2000 to allow the third party claimants to sue the defendant's insurance companies for bath faith tactics such as refusing to settle reasonably. <http://www.smartvoter.org/2000/03/07/ca/state/prop/30/>.

<sup>27</sup> There are many techniques to increase COL, all having in common increasing the complexity and uncertainty of the case. For example, a party may file a cross complaint, especially one that injects high complexity and factual uncertainty into the case, even if the odds of success are low; one may seek delay,

*(d) Reputation: The Lawyer as Player*

Even apparently finite supergames may be played as infinite supergames. This occurs when the lawyers as players span the multiple subgames, even though their clients do not. Lawyers routinely concentrate their efforts in a given area, perhaps types of tax or patent cases, or more generally they may be known as experienced litigators. Often the experience will be in types of cases such as asbestos, representing insurance companies, internet and computer companies, first amendment and media cases, and so on. Their clients may come and go—they may be isolated parties—but the lawyers may routinely be opposed to a common player or type of player on similar cases. Lawyers will advertise their familiarity with a certain opposing party. Their negotiations, the credibility of their threats, will carry over from subgame to subgame. They are therefore common players as well. These lawyers have reputations which they desire to use in an *infinite* number of cases into the future. They may thus rationally wish to imitate a strong player and threaten high COL. Their ability to do so is augmented to the extent it is the client, and not the lawyer, who pays the COL, either through an agreement to do so, or because the lawyer takes his fee as a contingency percentage of the recovery after all expenses are paid.

Furthermore, any “win” may be good for their reputation; that is, *any* pay out at or above the marginal worth of the case may enhance the lawyer’s reputation. Whereas the client is interested solely in the absolute net pay out of a game, the lawyer not working on a contingency fee basis may be more interested in simply a success as opposed to a failure (where failure is either loss at trial or a settlement less than the COL). If so, the lawyer is necessarily willing to pay a premium (take a smaller pay out) in a given subgame in aid of his expected future negotiations (his reputation) as long as this can be classified as a “win”.

As we will see in section 5(B), discussing conflicts of interest and the results suggested by game theory, the most interesting and difficult situations arise as a result of the fact that lawyers are common parties.

*(e) Front Loading*

In both common-common and common-isolated pairings (where at least some information is transmitted among the isolated parties), another mechanism will contribute to the treatment of each subgame differently than it would were it a one shot game. As Che and Yi have shown,<sup>28</sup> there remains the incentive to “front load” the early cases, most especially the first one, to set a favorable precedent which is expected to influence all parties’ views of the worth of subsequent cases. The parties can be expected to try to pick very strong cases (i.e., the plaintiff his strongest case, and the defendant will seek to litigate the weakest plaintiff case) and then very aggressively litigate that case. The COL

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oppose summary judgments, expand the universe of potentially relevant facts, witnesses and documents; multiply the fora by filing in multiple jurisdictions, and so on.

<sup>28</sup> Che & Yi supra n.11 at \_\_\_.

for the first case will be much higher than would otherwise be justified and generally the COL for the early cases will be higher than any one case as a one shot game would ever justify. Furthermore, under the assumption that marginal costs diminish over time, the early cases will bear the brunt of overall litigations costs. Combining these two factors (front loading and decreasing marginal costs), we see that the early cases provide a [relatively] free ride for the subsequent cases. Subsequent isolated plaintiffs obtain recoveries at the expense of early plaintiffs given a common defendant, and subsequent isolated defendants will benefit at the expense of early isolated defendants given a common plaintiff.

Now, assuming as we must in any invocation of game theory that both sides understand this reasoning, we see that each side has a perfectly credible early threat of conducting very aggressive litigation. Parties unable to sustain this level of expense will find themselves eviscerated. In a one shot game, we have seen that high COL is associated with plaintiffs requiring stronger cases (e.g. at least 70% in the hypothetical discussed above). In a supergame, the parties in effect understand that the COL is in part spread across subgames: the ‘front loading’ notion is shorthand for the willingness of parties to spend more on an early case than they would in a one shot case. In a supergame a player who believes his early case has a good chance of success, especially if vigorously pursued, will be willing to litigate that case through trial to secure a precedential verdict—increasing COL—whereas in a one shot game he would be more willing to settle. The reasoning of Che and Yi appear applicable to both infinite and finite supergames.<sup>29</sup>

For these reasons, “defendant with a high likelihood of being found liable in the first case will be more eager to settle so as to avoid setting an unfavorable precedent, whereas a defendant with a low likelihood of being found liable in the first case will be more eager to go to trial so as to set a favorable precedent for the next case.”<sup>30</sup>

*(iv) Comparison of One Shot Game and Infinite Supergame*

From the Sample Game we extract these payoffs in a one shot game: Payoffs, P, D:

<i>Strong case (80%)</i>		<i>Weak case (45%)</i>	
Normal	Aggressive	Normal	Aggressive
70, -90	45, -115	35, -55	10, -80

In a one shot game, (i) a plaintiff with a weak case and defendant with a strong case, as well as (ii) a plaintiff with a strong case and defendant with a weak case, will all litigate normally. Aggressive litigation hurts both sides. But in an infinite supergame the effects of (a) front loading and (b) mimicking an aggressive play and creating a reputation

<sup>29</sup> I have supposed that if, say, a \$10 premium is worth paying in the first of a two round supergame to avoid bad precedent, that more is worth paying to avoid the effect in a third, fourth rounds, and so on.

<sup>30</sup> This is Professor Daughety’s summary of the Che and Yi finding. 1 *Annual Review of Law and Social Science* 35-59 (December 2005). I am indebted to Professor Daughety’s elegant reviews of the literature for many of the papers I rely on here.



effective for future games will cause the parties to litigate the game aggressively. While we have seen that median rational settlements (MRS) does not change depending on whether the case are litigated normally or aggressively, the MRS does shift depending on whether the parties settle on the basis that the case is “strong” (\$80) or “weak” (\$45). And as the common party increasingly has sunk costs, the MRS over the course of subgames will increasingly favor the common party.

For example, if we assume a “strong” case with COL in the first game at \$45, the MRS is \$80:

$$P: \$80 - \$45 = \$35; D: \$80 + \$45 = \$125. \text{ MRS} = (35 + 125) / 2 = \$80.$$

As the common defendant party sinks costs and his marginal cost drops to, say \$10, we have these figures:

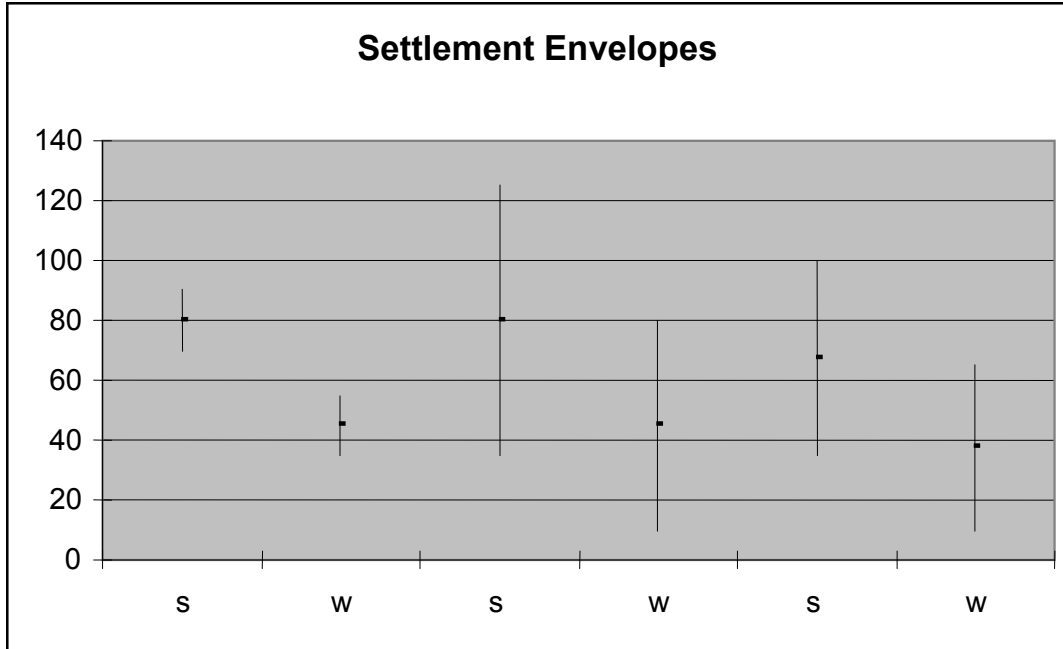
$$P: \$80 - \$45 = \$35; D: \$80 + \$10 = \$90. \text{ MRS} = (35 + 90) / 2 = \$62.5.$$

The MRS will continue to shift over the series of subgames favoring the common party.

Now we can compare three sets of numbers: (1) a normal (COL=\$10) one shot game; (2) an early subgame in a supergame, and (3) a later subgame in a supergame. In the early subgame we assume frontloading and very aggressive litigation, with COL=\$45 for both strong (80% odds of winning) and weak (45% odds of winning) cases. In the later subgame, we assume the isolated plaintiff must still litigate aggressively (COL=\$35), but that the common defendant has marginal COL now of only \$20. In all three cases, we can state the payoffs for strong and weak cases:

One shot		Supergame (early)		Supergame (late)	
strong	weak	Strong	Weak	Strong	weak
D 90	55	125	80	100	65
P 70	35	35	10	35	10
MRS 80	45	80	45	67.5	37.5

And we can plot these settlement envelopes as follows:



The first two lines show the one shot game (strong and weak case respectively), the second pair shows the early supergame, and the last pair shows the later supergame. The ticks in the center of each line show the MRS. Note (i) the greatly expanded envelopes in supergames, including greater risks and rewards of litigation, and greater room for the effects of reputation; (ii) the fact that as the supergame progresses from early to late subgame, the worst case scenario for the common defendant remains the same but the upside for the isolated plaintiffs gets worse; and (iii) while there is substantial overlap between the strong and weak cases in both the early and late subgames, there is no such overlap in the one shot game. This means that differences between the parties on the merits of each case—whether it is strong or weak—are likely to be decisive in efforts to settle the one shot case; but the merits are likely to be overtaken by other issues, such as COL (which creates the overlap) in supergames.

#### D. Summary

For a series of interlocking reasons, “the concern over precedent induces a repeat player to deviate from a short-term best strategy.”<sup>31</sup> “The general idea of repeated games is that players may be able to deter another player from exploiting his short-term advantage by threatening punishment that reduces his long-term payoff.”<sup>32</sup> We have seen that while this effect may not be apparent in finite games, many such games will play out as infinite games, and in such circumstances there will be a discrepancy between one shot and supergame strategies. The mean rational settlements differ and the expected pay offs differ.

<sup>31</sup> *Che & Yi* at 418.

<sup>32</sup> *Slantchev* at 2.

## 4. Law of Conflicts

### A. Conflicts Generally

Lawyers are bound by a variety of conflict of interest rules. Some situations require disclosure, some also require waiver of the conflict by the client. The California Rules of Professional Conduct, for example, require (i) written disclosure to the client of certain of the attorney's relationships with others involved in the matter,<sup>33</sup> and (ii) informed written consent from the client if the attorney represents clients whose interests might or do conflict.<sup>34</sup> Attorneys must also maintain client confidences,<sup>35</sup> and successive or concurrent representations of a client with adverse or potentially adverse interests to a new client might make it impossible to, at the same time, preserve inviolate those confidences and still represent the other client with the "utmost zeal".<sup>36</sup> "An attorney is precluded from assuming any relation which would prevent him from devoting his entire energies to his client's interests."<sup>37</sup> In sum, counsel owes a "duty of undivided loyalty" to the client.<sup>38</sup> It may not be moderated either by allegiances to other clients nor to the lawyer herself.<sup>39</sup> The usual bar against joint representation of clients with interests in conflict obtains even if the lawyer represents them on separate matters.<sup>40</sup>

To guard against benefiting one client at the expense of another, a joint defense undertaken without their informed consent is a breach of the lawyer's fiduciary duty.<sup>41</sup>

Notionally, the rules differ depending on whether the conflict is between current clients or between current and prior clients:

Distinguish--successive representation: A lesser standard applies where the conflict is between former and existing clients ('successive representation,' ¶ 4:160 ff.). In such cases, the duty of *confidentiality*, rather than the duty of loyalty, is at risk; and disqualification is required only if there is a *substantial*

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<sup>33</sup> RPC 3-310 (B).

<sup>34</sup> RPC 3-310 (C); see also RPC 3-310(D). [1:47] "If the conflict is merely potential (there being no existing dispute between the clients in question), the attorney may accept the case with full disclosure to and informed written consent of both clients. [*Klemm v. Sup.Ct. (County of Fresno)* (1977) 75 CA3d 893, 899, 142 CR 509, 512]. If the potential conflict later develops into an actual conflict, the attorney must obtain an *additional* written consent, describing in particular the conflict that has arisen. [See CRCP 3-310 'Discussion']. I. Brown & R. Weil, *California Practice Guide: Civil Procedure Before Trial* CH. 1-A (200\_).

<sup>35</sup> RPC 3-310; Bus. & Prof.Code § 6068(e).

<sup>36</sup> See e.g., *People v. Baylis*, 139 Cal.App.4th 1054, 1065 (2006). See generally, *Farris v. Fireman's Fund Insurance* (2004) 119 Cal.App.4th 671.

<sup>37</sup> *Santa Clara County Counsel Attys. Ass'n v. Woodside*, 7 Cal.4th 525, 548 (1994) (internal quotes omitted).

<sup>38</sup> *City and County of San Francisco v. Cobra Solutions, Inc.*, 38 Cal.4th 839, 846 (2006), citing *Flatt v. Superior Court*, 9 Cal.4th 275, 282 (1994).

<sup>39</sup> See generally, B. Witkin, *California Procedure, Attorneys* §118 (4<sup>th</sup> ed. 2006); P Vapneck et al., *California Practice Guide: Professional Responsibility* (Chapter 4, Conflicts Of Interest)(200\_)(hereafter "Vapneck").

<sup>40</sup> *Vapneck* 4:35.

<sup>41</sup> *Mosier v. Southern Calif. Physicians Ins. Exchange*, 63 Cal.App.4th 1022, 1044 (1998).

*relationship* between the former and current representations. [*Flatt v. Sup.Ct. (Daniel)* (1994) 9 C4th 275, 283, 36 CR2d 537, 541; *see* ¶ 4:186 ff.]<sup>42</sup>

Nevertheless, in the usual types of cases discussed in this paper, there will always be a *substantial relationship* between the former and present clients, and sometimes all the clients will in fact be represented simultaneously. Accordingly, the strongest rules barring conflicts of interests, which treat even potential conflicts as actual conflicts,<sup>43</sup> will likely obtain in these cases.

“An attorney's simultaneous representation of clients with differing interests poses the classic conflict situation. A client is entitled to his attorney's unimpaired loyalty and the danger is that an attorney representing conflicting or potentially conflicting interests will be tempted to favor one client over the other. [Citation.]” (*Johnson v. Haberman & Kassoy* (1988) 201 Cal.App.3d 1468, 1475, 247 Cal.Rptr. 614.) “ [It does not] matter that the intention and motives of the attorney are honest. The rule is designed not alone to prevent the dishonest practitioner from fraudulent conduct, but as well to preclude the honest practitioner from putting himself in a position where he may be required to choose between conflicting duties, or be led to an attempt to reconcile conflicting interests, rather than to enforce to their full extent the rights of the interest which he should alone represent. ’ ”<sup>44</sup>

The model rules suggested by the American Bar Association are similar. The client's confidential information may be disclosed by the lawyer with the client's consent,<sup>45</sup> and conflicts of interest may be obviated if the lawyer reasonably believes he or she may still competently represent both clients and they provide informed written consent.<sup>46</sup>

## **B. Conflicts And Confidentiality**

As suggested above, the central concern with representing successive clients has to do with the possibility that confidential communications and information pertaining to one client will be used by the lawyer on behalf of the other client. That is what lies at the heart of the “substantial relationship” test: that relationship exists when information a lawyer has about a past client is material to the new client's case.<sup>47</sup> But as with virtually all conflicts, this can be waived with a knowing, intelligent waiver.

## **C. Non waivable Conflicts**

While there is scant authority on the matter, there appears to be only one situation where a conflict is not waivable, such that even the clients' knowing, written consents are

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<sup>42</sup> *Vapneck* 4:31.7. *See also*, *People v. Baylis*, 139 Cal.App.4th 1054, 1065 (2006).

<sup>43</sup> *Vapneck* 4:28.

<sup>44</sup> *Asbestos Claims Facility v. Berry & Berry*, 219 Cal.App.3d 9, 26 (1990).

<sup>45</sup> Rule 1.6 Confidentiality Of Information, [http://www.abanet.org/cpr/mrpc/rule\\_1\\_6.html](http://www.abanet.org/cpr/mrpc/rule_1_6.html).

<sup>46</sup> Rule 1.7 Conflict Of Interest: Current Clients, [http://www.abanet.org/cpr/mrpc/rule\\_1\\_7.html](http://www.abanet.org/cpr/mrpc/rule_1_7.html).

<sup>47</sup> *People v. Baylis*, 139 Cal.App.4th 1054, 1066 (2006). *See also* *Pound v. DeMera DeMera Cameron*, 135 Cal.App.4th 70, 76 (2005).

insufficient to ameliorate the problem. That is when counsel represents both sides of a dispute.

[I]n *Forrest v. Baeza*, *supra*, 58 Cal.App.4th 65, 67 Cal.Rptr.2d 857...the court concluded “[c]urrent case law clearly forbids dual representation of a corporation and directors in a shareholder derivative suit, at least where, as here, the directors are alleged to have committed fraud.” (*Id.* at p. 74, 67 Cal.Rptr.2d 857.) In *Forrest*, the corporate officers were accused of, among other things, embezzling from the corporation. The *Forrest* court found the corporation and the individual officers had an actual, unwaivable conflict of interest precluding dual representation because the corporation, while nominally a defendant, was actually a plaintiff and if the allegations in the shareholder's complaint were proved, the corporation stood to benefit from the recovery for the individual corporate officer defendants' wrongful conduct.<sup>48</sup>

The Court retains the inherent authority to reject a waiver of conflicts of interest if it is not satisfied that the lawyer may adequately represent two parties with an actual conflict of interest.<sup>49</sup> The American Bar Association's model rules of professional conduct contemplate nonwaivable conflicts (or “nonconsentable” conflicts, as the ABA phrases it), where the clients are directly aligned against each other in the same proceeding.<sup>50</sup>

Limitation--no representation of conflicting interests at hearing or trial:

Despite the clients' purported "informed written consents," counsel may not represent two clients at a hearing or trial if there is an existing, actual conflict between them. In such circumstances, any purported "consent" to the conflicting representation would be "neither intelligent nor informed" as a matter of law.<sup>51</sup>

Even if as a formal matter conflicts can be waived, it can be very difficult (at least in criminal cases) to show adequate disclosures for a valid waiver.<sup>52</sup>

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<sup>48</sup> *Electro K, Inc. v. Karpeles*, 2002 WL 31475421, \*2 (Cal.App.2002)(unpublished). See also *Flatt v. Superior Court*, 9 Cal.4th 275, 279 (1994)(“circumstances typified by this case—one in which the attorney is confronted with a mandatory and unwaivable duty not to represent the second client in light of an irremediable conflict with the existing client”). See also *McPhearson v. Michaels Co.*, 96 Cal.App.4th 843, 850 (2002)(disqualification is automatic where an attorney, while still representing a client, undertakes to simultaneously represent a new client in an action against the first client).

<sup>49</sup> *In re A.C.*, 80 Cal.App.4th 994, 1001-1002 (2000), quoting *Wheat v. United States* 486 U.S. 153, 162 (1988). The Court is not bound by, and may reject, the party's waiver of a conflict. *U.S. v. Hall*, 200 F.3d 962, 965 (6<sup>th</sup> Cir. 2000).

<sup>50</sup> [http://www.abanet.org/cpr/mrpc/rule\\_1\\_7\\_comm.html](http://www.abanet.org/cpr/mrpc/rule_1_7_comm.html). The ABA's comments also refer to nonconsentable waivers where for example law blocks governmental entities from consenting to a conflict, or bars an erstwhile governmental lawyer from taking certain types of cases. *Id.*

<sup>51</sup> Rutter Group Guide \_\_\_, citing, *Tsakos Shipping & Trading, S.A. v. Juniper Garden Town Homes, Ltd.* 12 Cal.App.4th 74, 97 (1993); *Klemm v. Sup.Ct. (County of Fresno)*, 75 Cal.App.3d 893, 898 (1977).

<sup>52</sup> *People v. Mroczko*, 35 Cal.3d 86, 112 (1983). Cf., *In re Maloney* 2005 WL 103063, \*17 (Cal.Bar Ct., 2005)(“RVN's litigation and political strategies. Given there was an actual conflict, as opposed to a potential conflict, respondents could not represent the various entities and individuals they asserted were their clients in the absence of obtaining their written, informed consent. (Rules Prof. Conduct, rules 3-700(c) & 3-310.) They claimed that the “appropriate” conflicts waivers had been obtained when they had not.”)

Finally, even where a waiver based on an adequate disclosure is enough, the parties' consent will not be enough to protect the lawyer from allegations of incompetence or malpractice:

[T]he execution of an advance waiver of conflict of interest and confidentiality protections is not per se improper; that to the extent that the waiver of confidentiality is "informed," it is valid; that to the extent that a potential conflict ripens into an actual conflict, the advance waiver may or may not be sufficient depending upon the degree of involvement and the nature of the subsequent conflict; that regardless of the validity of the waiver, it cannot be asserted as a defense to a disciplinary proceeding charging incompetent performance of legal services; and that under no circumstances may the agreement be used for the purposes of limiting the lawyer's civil liability for malpractice.<sup>53</sup>

The general rule, then, is that lawyers cannot represent clients directly juxtaposed with one another. Other conflicts are likely waivable, including those in which a lawyer uses otherwise confidential information of one client to benefit the other.

#### **D. Knowing Waivers**

Waivers, however, must be informed, and generally in writing.<sup>54</sup>

Such consent requires the former client's written agreement to the representation following written disclosure of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences to the former client.<sup>55</sup>

It is interesting to note this prerequisite of informed written consent in the specific context of settlement:

A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.<sup>56</sup>

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<sup>53</sup> CA Eth.Op. 1989-115, "Issue: is it ethically proper for an attorney to require a potential client to execute a blanket waiver of the client's right to disqualify the attorney in any other matter, based on a breach of the attorney's duty to ma," 1989 WL 253263, \*4. See also, Comments to Cal.Rule Professional Responsibility 3-310 ("There are some matters in which the conflicts are such that written consent may not suffice for non-disciplinary purposes.."), citing *Woods v. Superior Court* 149 Cal.App.3d 931 (1983); *Klemm v. Superior Court* 75 Cal.App.3d 893 (1977); *Ishmael v. Millington* 241 Cal.App.2d 520 (1966).

<sup>54</sup> CRPC 3-310 (E).

<sup>55</sup> *Baylis, supra*, 139 Cal.App.4th at 1068. See generally, Vapnek Ch. 4-A.

<sup>56</sup> Rule 1.8 (g) Conflict Of Interest: Current Clients: Specific Rules, [http://www.abanet.org/cpr/mrpc/rule\\_1\\_8.html](http://www.abanet.org/cpr/mrpc/rule_1_8.html)

A conflict which is not the subject of a knowing written waiver (i.e., which follows a full explanation of the possible consequences of the multiple representation), or which is not waivable, subjects the lawyer to exceedingly unpleasant consequences, such as disqualification, malpractice actions, loss of fees, and disciplinary procedures.<sup>57</sup>

## **5. Game Theory and Conflicts**

### **A. The existence of conflicts in rational play of supergames**

It is clear from Section 3 above that conflicts of interest are likely to exist where a lawyer represents multiple clients in supergames. These conflicts arise for two reasons. First, lawyers are likely to settle subgame cases differently from one shot games. They will do so because, for example, they have front loaded the first or early subgames, and because they wish to mimic aggressive players. They will sink costs now, in the early games, to contain future settlement envelopes. And they will do so because they wish to enhance their own reputation. This creates (a) client-client conflicts and (b) client-lawyer conflicts, as when the lawyer is a common player in effect acting as an institutional litigant.

Secondly, conflicts between clients may arise as a result of confidential information pertaining to one client being used in connection with another client. I suggest that if a lawyer bargains a settlement in case #1 differently because he has access to confidential information about client #2, then we have the dubious use of that confidential information. And I suggest that information about the strength or weakness of a client's case counts as this sort of confidential information. Thus if a lawyer employs his understanding about the strength of client #2's case to inform his settlement or litigation strategy regarding client #1, he has transgressed the conflicts of interest rules (absent a valid waiver).

Thus, we may ask whether a lawyer will change his current settlement strategy because of what he knows about the next round of settlements? Section 3 (C)(iii)(e) shows that he will. He will change his litigation strategy by taking his best case first (front loading). When the lawyer mimics aggressive/strong behavior now to benefit later cases, he is in effect damaging the current client to benefit the later clients; and to benefit his lawyer reputation. And we recall that in an *infinite* supergame, there are always likely subsequent cases (by definition), so *every* settlement and litigation strategy will be tainted as described here.

### **B. Lawyers as Common Players**

The most difficult situations arise when the lawyers are institutional litigants—as they almost always are. We do not have conflicts of interest among a sequences of isolated clients. We do not have these conflicts when a client is a common party, engaged in a series of subgames with a variety of either common or isolated parties: the common party cannot be said to have a conflict of interest with itself. Rather, the conflict issue erupts

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when lawyers modify their litigation and settlement strategies for one isolated client<sup>58</sup> to the detriment of another client as a result of the lawyer's wish to augment his reputation.

Examples of where the clients are isolated but the lawyer acts as a common player include public defenders, district attorneys and most other governmental lawyers, and generally all lawyers who trade on their reputation, but not those such as general counsel who have as single client. It might include, however, a general counsel who represents more than one legal entity, such as subsidiaries, related companies, officers, and members of the board.<sup>59</sup>

*(i) Rationales for Waiver*

The subgames subject of this paper do not involve clients aligned against each other: they are not opposed to each other in the same game or series of games. Thus the conflicts of interest can likely be waived with a written, knowing waiver. And it is important to note that there are perfectly logical reasons why clients would, after being fully informed of the circumstances, sign such a waiver. The clients might themselves benefit from the enhanced reputation of the lawyers. They are likely to benefit from the increased knowledge the lawyer has after repeated experiences in similar cases. Lawyers who act as common parties have likely sunk costs which will benefit the current client. We know that in the past, lawyers were literally paid by the adverse side not to take on further clients in a given area or in connection with a given series of cases; that sort of agreement is now barred,<sup>60</sup> but it reflects the fact that such experienced lawyers are worth a premium, and clients could rationally determine that the premium is worth more than the downside inherent in the conflict of interest. The client may reasonably believe that with some types of complex cases, there is no economic way to litigate unless the costs are in effect spread over many cases. And even if that's not true, it can still be a rational to decline a new lawyer with lower odds of winning a higher amount in favor of an experienced lawyer with high odds of winning a lower net recovery.<sup>61</sup>

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<sup>58</sup> Note that a client can be common with respect to one set of cases, and still be an isolated party more generally. For example, a patent holder is a common party vis-à-vis defendants accused of infringing the patent, but an isolated party in the contexts of (i) its other litigation and (ii) other cases, for other clients, handled by its lawyer.

<sup>59</sup> A similar situation arises when insurance companies which retain control over the conduct of the litigation act as common players. Insurance companies, like lawyers, have reputations to protect and enhance. They bargain on behalf of their insureds; but at the same time, they realize that each case is only one in an infinite series. See generally, *Campbell v. State Farm*, \_\_\_\_\_ (2001 Utah) <http://www.drjohnbaker.com/campbelldecision.htm> (allegation of nationwide policy). Playing tough in one case may help set the tone for future cases and discourage suits, even if it increases the exposure in the one case. The issue is governed in the insurance context by insurance law in the area of bad faith coverage cases. See e.g., F. J. Maloney, "What Constitutes A 'Thorough' Investigation?" *Mealey's Insurance Bad Faith* (November 2, 1999), <http://www.mealeys.com/bad.html>.

<sup>60</sup> ABA Model Rules 5.6, [http://www.abanet.org/cpr/mrpc/rule\\_5\\_6.html](http://www.abanet.org/cpr/mrpc/rule_5_6.html).

<sup>61</sup> These rationales may underlie subsequent clients' decisions to hire a lawyer, but are less persuasive in justifying the first client's risk. (The exception is when the client reasonably believes that it is not economically feasible to litigate any case except as one in a series.)



## (ii) *Content of Waiver*

While conflicts of interest can be waived, the waiver must be in writing, and it must be “knowing,” that is, it must be predicated on full disclosure by the lawyer. The waiver is good only if “done with sufficient awareness of the relevant circumstances and likely consequences.”<sup>62</sup> It is safe to generalize that lawyers do not make this disclosure. They do not actually tell clients, in writing or otherwise, that the litigation and settlement strategy in their case is likely to be affected by considerations in other cases, for the benefit of other clients, and to enhance the lawyer’s reputation. They do not tell their early clients that costs in their cases are likely to be relatively high, or concomitantly that net recoveries in their cases are likely to be lower than they would be if the lawyers did not expect to take further (similar) cases.

Lawyers do not obtain informed waivers because they do not understand the conflicts of interest to exist. This note suggests the conflicts *are* likely to exist, and so these “common party” lawyers are subject to a wide variety of sanctions, outlined above at § 4(D). To remedy the problem, lawyers should inform clients in writing of the costs, risks—and the very real benefits—of hiring experienced lawyers who will litigate with a view to an indefinite series of cases. They should inform clients that general information about their cases, such as the relative strength and weakness, may be used indirectly in other cases. To be sure, this disclosure is awkward, since it includes statements that the client’s interests may be affected by those of other clients, or the lawyer’s own long term strategy of enhancing his reputation. These disclosures can however be sweetened by a forthright description of the benefits.

## **6. Conclusion**

This paper has borrowed terminology and techniques from game theory to illustrate the difference in litigation and settlement strategies employed by lawyers in (i) one shot and (ii) supergame settings. This discussion confirms the intuition that lawyers who know they may be engaged in an indefinite series of cases will often make decisions in a given case based not only on the merits of that one case, but in aide of benefits in effect spread out over what I have termed the infinite supergame. However this conflicts with counsel’s obligations under the rules of professional responsibility to represent each client with “utmost zeal” and without trading benefits for one client for those of another. The conflict of interests can be avoided by written disclosure, but as a matter of practice that disclosure is not provided.

The results here also suggest that current rules or professional conduct are premised on a fiction, the fiction that a lawyer must represent each client as if he had no other. The notion that any lawyer truly devotes “his entire energies to his client’s interests,”<sup>63</sup> or acts

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<sup>62</sup> *People v. Baylis*, 139 Cal.App.4th 1054, 1067-1068 (2006), quoting *People v. Mroczko* 35 Cal.3d 86, 109-110 (1983).

<sup>63</sup> *Santa Clara County Counsel Attys. Ass'n v. Woodside*, 7 Cal.4<sup>th</sup> 525, 548 (1994) (internal quotes omitted).

with “undivided loyalty,” is hortatory but not literally feasible. Matters are more complex than this. Strictly construed, the rules of professional responsibility impose a false and impossible duty, and as with any impossible rule, this diminishes their authority. Thus this paper suggests they be revisited.

Dividing one’s attentions and loyalties among a variety of clients with similar interests may, or may not, end up short-changing them. What is required, however, is an express appreciation of the manner in which bargaining and litigation strategies in individual related cases play off each other; which is this paper’s goal.