

Plaintiffs Counsel as Escrow in Class Actions —

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It's Plain Wrong

Some of the biggest and most complex litigation involves class action cases. It is common in these cases for settlement proceeds to be placed in escrow accounts to be disbursed according to the court's order. Often plaintiffs counsel in these class actions prefers to be the escrow holder.

From the point of view of plaintiffs counsel, there are important advantages to the class for counsel to act as escrow. First, with direct control over disbursement of the funds, plaintiffs counsel can ensure that the court's orders are precisely followed. Second, plaintiffs counsel acting as escrow eliminates the need to pay an escrow. With the size of some settlements, even a small percentage escrow charge could be in the tens of thousands of dollars.

Third, a layer of bureaucracy is removed. Plaintiffs counsel does not have to oversee the escrow and act as an intermediary between the court and the escrow. This should allow the settlement to be more efficiently accomplished.

The common practice of plaintiffs counsel serving as escrow is rarely scrutinized by either defense counsel or the court. In contrast, in class action cases, courts often closely scrutinize settlements and attorney fee awards. This failure to consider the role of plaintiffs counsel as an escrow in class action cases misses an important conflict of interest.

The starting place to understand this conflict is the duty of an escrow holder. Most people are familiar with escrows from buying or selling houses. The buyer puts money into the escrow and gets title to the house out of escrow. The seller gets the money out. Both parties can give instructions to the escrow, which the escrow is bound to follow (unless they conflict). The escrow has a contractual and fiduciary duty to both parties. An escrow holder is an agent and fiduciary of the parties to the escrow. *Summit Financial Holdings LTD. v Continental Lawyers Title Company*, 27 Cal. 4th 705 (2002).

In a class action case the parties to the escrow are the defendants who deposit money and the plaintiffs who stand to receive some benefit from the fund. Since defendants have placed money into the escrow, they are entitled to give instructions

to the escrow, and to have those instructions followed.

This is where the difficulty arises. By acting as an escrow, the plaintiffs law firm assumes a fiduciary duty to defendants! The dilemma can easily become quite real if there is a difference in interpretation of a settlement provision. If defense counsel gives an instruction and plaintiffs counsel refuses to follow it, not because of a conflicting instruction but because of their advocacy for plaintiffs, the escrow has subordinated its fiduciary duty as an escrow to its duty to its clients.

At first glance, the only losers in this situation appear to be defendants and their counsel. It is predictable that plaintiffs counsel will put its client's interests first; defense counsel should have realized this when the settlement was signed.

But there is another serious side to this problem. For plaintiffs counsel to act as an escrow causes a division of loyalty. The California Supreme Court held:

"One of the principal obligations [that] bind[s] an attorney is that of fidelity By virtue of this rule an attorney is precluded from assuming any relation which would prevent him from devoting his entire energies to his client's interests. Nor does it 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." *Flatt v Superior Court*, 9 Cal.4th 275 (1994) (citations and quotations omitted).

Under *Flatt*, an attorney cannot place himself or herself in a position where a duty is owed to a party with an adverse interest. For plaintiffs class counsel to assume the fiduciary duty of an escrow while simultaneously owing a duty to their clients is exactly the type of conduct which is barred by *Flatt*.

Flatt explains that it does not matter if the motives are noble. Even the good reasons that might be advanced for having plaintiffs counsel serve as escrow do not justify or permit the division of the duty of loyalty.

Class counsel might ask whether a conflict is created by a situation in which an attorney is not representing another client, but merely serving as an escrow. That issue was addressed in *Raley v Superior Court*,



149 Cal.App.3d 1042 (1983):

"Professional responsibilities do not turn on whether a member of the State Bar acts as a lawyer. One who is licensed to practice as an attorney in this state must conform to the professional standards in whatever capacity he may be acting in a particular matter. . . . [A] conflict of interest may arise where an attorney's relationship with a person or entity creates an expectation that the attorney owes a duty of fidelity. (Citations and quotations omitted.)

In *Raley* a conflict was found when a member of a law firm represented one party, and another member was a trustee of the opposing party. The trustee's fiduciary duties to another party were a key part of the conflict. This is precisely the situation with class counsel acting as escrow.

Having identified a conflict, the usual next step is to determine whether it can be waived. However, before making that determination, the standard of care must be considered.

When evaluating conflicts of interest, a different standard of care applies to plaintiffs counsel in a class action. *Cal Pak Delivery Inc. v United Parcel Service, Inc.*, 52 Cal.App.4th 1 (1997), was a review of an order disqualifying class counsel. *Cal Pak* held that the standard for determining whether class counsel has committed an ethical violation or placed itself in a conflict of interest is a heightened standard.

The reason is that class counsel repre-

sents many clients that are not actively involved in the case and therefore must take extra care to protect their rights and interests. *Cal Pak* then addressed whether class counsel can obtain a waiver of conflicts of interest:

"The fact that [counsel] seek to represent a national class of plaintiffs makes the decision to disqualify even more compelling. If [counsel] were representing only an individual plaintiff, he could conceivably seek a written waiver of conflict of interest. But in this case, [counsel] seeks to represent a large, unenumerated and as yet unidentified class of plaintiffs. Unidentified class members cannot waive a potential conflict of interest." (quotations omitted).

This is a severe rule. Class counsel cannot obtain consent to conflicts of interest such as conflicts of loyalty.

Having determined that the simultaneous representation of a class and acting as an escrow is a conflict that cannot be cured, it is important to examine the consequences that could result for class counsel that divides its loyalty by acting as an escrow holder. *Jeffry v Founds*, 67 Cal.App.3d 6 (1977), addressed the issue of what compensation is available to a lawyer when the lawyer becomes enmeshed with conflicting client interests. The general rule is that counsel is entitled to compensation for services until the conflict of interest occurred, but not after. Class action counsel who venture down the road of being an escrow, even if the effort is solely intended for the client's benefit, violate their ethical duties by placing themselves in a position in which they owe a fiduciary duty to defendants. Class counsel may not be entitled to fees for any work done after the escrow is begun.

For class counsel to act as an escrow is an extremely perilous road. It is remarkable that the cases in which this has occurred, and is occurring, are among the biggest and most publicized cases in the country. Although these cases have been scrutinized by some of the most capable counsel and judges, class counsel routinely continue to act as escrow.

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