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25 SUPERIOR COURT OF THE STATE OF CALIFORNIA
26 COUNTY OF SANTA CLARA

27 In re MERCURY INTERACTIVE CORP.)
28 SHAREHOLDER DERIVATIVE)
LITIGATION)

Case No. 1:05-cv-50710

(Derivative Action)

29 This Document Relates To:)

Assigned to: Judge James Kleinberg

30 ALL ACTIONS.)
31)
32)

PLAINTIFFS' MEMORANDUM OF POINTS
& AUTHORITIES IN SUPPORT OF MOTION
FOR DISQUALIFICATION OF WILSON
SONSINI GOODRICH & ROSATI P.C. AS
COUNSEL

33 DATE: November 3, 2006

34 TIME: 9:00 a.m.

35 DEPT: 14

36 DATE ACTION FILED: November 4, 2005

1 **I. INTRODUCTION**

2 Plaintiffs move this Court to disqualify Wilson Sonsini Goodrich and Rosati P.C. (“Wilson
3 Sonsini”) as counsel for defendant Kenneth Klein (“Klein”) in this action due to a conflict of interest
4 arising from Wilson Sonsini’s representation of both Klein and Hewlett Packard (“HP”), a corporation
5 that has entered into a merger agreement with Mercury Interactive Corporation (“Mercury” or the
6 “Company”), and as such stands to inherent Mercury’s claims against Klein that Mercury has
7 authorized plaintiffs to pursue. Wilson Sonsini’s simultaneous representation of Klein and HP violates
8 California Rule of Professional Conduct (“Cal. Rule”) Rule 3-310 and numerous conflict of interest
9 rules, raises ethical questions and mandates Wilson Sonsini’s automatic disqualification. To avoid the
10 actual conflicts that have arisen in this case, Wilson Sonsini must be disqualified as counsel for Klein
11 and HP.

12 Under Cal. Rule 3-310, such an actual conflict involving “simultaneous representation” requires
13 “*per se*” or “automatic” disqualification “in all but a few instances.” *Flatt v. Superior Court*, 9 Cal. 4th
14 275, 284 (1994). The rule is not complicated – allowing an attorney to represent clients “whose
15 interests are *directly* adverse *in the same litigation*,” as is the case here, is “patently improper.” *Id.* at
16 285 n.3 (emphasis in original).¹ Nor is the reason for the rule difficult to understand – “[s]omething
17 seems radically out of place if a lawyer sues one of the lawyer’s own present clients in behalf of another
18 client . . . the client who is sued can obviously claim that the lawyer’s *sense of loyalty* is askew.” *Id.*
19 at 285. Thus the outcome of this motion, which seeks a disqualification that is “automatic,” should not
20 be much in doubt. Wilson Sonsini has undertaken simultaneous representation of clients whose
21 interests are directly adverse, and therefore must be jettisoned from this litigation.

22 This is a shareholder action for Mercury against certain of the Company’s former directors and
23 officers – including Klein – for breaches of fiduciary duty, waste of corporate assets and other
24 violations of California law. As detailed in the Consolidated Complaint for Breach of Fiduciary Duty,
25 Violations of the California Corporations Code, Abuse of Control, Gross Mismanagement, Waste of

27 ¹ Unless otherwise stated all emphasis is added and citations omitted.

1 Corporate Assets and Unjust Enrichment (the "Complaint"), Klein, the Company's former Chief
2 Operating Officer and a member of the Company's Board, authorized and participated in a decade-long
3 illegal option backdating scheme at the Company that resulted in the systematic overcompensation of
4 himself and his fellow defendants, and caused the Company to materially overstate its net income by
5 \$570 million. As a result of his misconduct, Klein profited to the tune of at least \$50 million by
6 exercising impermissibly backdated options, and trading in the Company's stock on the basis of
7 material non-public information that the Company's net income was being systematically overstated.

8 Following disclosure of Klein's and his fellow defendants' misconduct, plaintiffs brought this
9 action in November 2005. Throughout the prosecution of this litigation, Klein and Wilson Sonsini have
10 engaged in a pattern of conduct designed to delay and forestall this litigation in an attempt to avoid
11 judicial scrutiny of Klein's misconduct. During this same time period – at least since January 2006 –
12 Wilson Sonsini has been simultaneously representing HP in negotiations with Mercury to purchase the
13 Company. Wilson Sonsini has engaged in this simultaneous representation despite the knowledge that,
14 if HP purchases Mercury, HP stands to inherit Mercury's cause of action against Klein and his fellow
15 defendants, a cause of action that could and should result in defendants paying to HP as Mercury's
16 successor in excess of \$100 million.

17 Wilson Sonsini's simultaneous representations of HP and Klein are at best materially adverse,
18 and at worst have placed Wilson Sonsini in a position to pass confidential information along to Klein
19 regarding HP's negotiations with Mercury. Indeed, it is no surprise that Klein has recently taken the
20 position in this litigation that, if Mercury is merged into HP, not only will HP inherit Mercury's
21 claims against Klein, the event may also, under Delaware law, serve to extinguish plaintiffs' standing to
22 pursue the Company's claims against Klein. In light of Klein's continuous efforts to stall this litigation,
23 it begs the question as to whether Klein, and Wilson Sonsini on behalf of Klein, engaged in these tactics
24 precisely because both knew that the HP/Mercury merger was on the horizon, thus possibly providing
25 Klein with a way out of this litigation without any adjudication of his fault. Under these circumstances,
26 California law mandates that Wilson Sonsini be disqualified as counsel for Klein and HP.

1 **II. STATEMENT OF RELEVANT FACTS**

2 Wilson Sonsini, a California-based law firm, has acted as counsel for Klein since plaintiffs filed
3 this action in November 2005. See Declaration of David T. Wissbroecker in Support of Plaintiff's
4 Motion to Disqualify Wilson Sonsini Goodrich & Rosati P.C. at ¶3 ("Wissbroecker Decl.").
5 Throughout this litigation, Klein has taken extraordinary steps to short-circuit plaintiffs' prosecution of
6 this case, including filing a Motion for an Order Requiring Plaintiff to Furnish Bond on December 6,
7 2005, and filing a Motion for a Protective Order on August 28, 2006. See *id.* at ¶4. Klein has also
8 refused to produce any documents pursuant to plaintiffs' document requests. See *id.* at ¶5. In a
9 response to plaintiffs' document requests filed July 27, 2006, Klein took the position that he should not
10 have to produce any documents "on the grounds that plaintiffs will lose standing to proceed with this
11 litigation when [Mercury] . . . merges with [HP], which will likely occur by the end of 2006."² See
12 Defendant Kenneth Klein's Objections and Responses to Plaintiffs Morillo & Conrardy's Request for
13 Documents Dated July 27, 2006, attached as Exhibit A to the Wissbroecker Decl.

14 Wilson Sonsini has also acted as counsel for HP in its merger negotiations with Mercury, at least
15 since January 2006. Moreover, Wilson Sonsini has a longstanding relationship with HP, for whom it
16 has served as outside counsel for years, along with a number of other Silicon Valley companies now
17 sorting out option-backdating scandals. See David Streitfeld, *2 Scandals Hang Over Top Tech Lawyer*,
18 L.A. Times, Sept. 17, 2006, attached as Exhibit B to the Wissbroecker Decl.; Peter Burrows and Robert
19 D. Hof, *Sonsini Under Scrutiny*, BusinessWeek, Oct. 2, 2006, attached as Exhibit C to the Wissbroecker
20

21 ² Plaintiffs do not agree that a merger between Mercury and HP will extinguish plaintiffs'
22 standing to pursue these claims. Presumably, Klein's position is based on Delaware law, which holds
23 that "[a] plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason,
24 loses standing to continue a derivative suit." *Lewis v. Anderson*, 477 A.2d 1040, 1049 (Del. 1984).
25 This is the so-called "continuous ownership" rule. California, however, has no similar continuous
26 ownership rule. See *Gaillard v. Natomas Co.*, 173 Cal. App. 3d 410, 418 (1985) ("The fact that a
27 merger occurred here does not preclude Gaillard from having a pecuniary interest in the outcome.").
28 And although Mercury is a Delaware corporation, California, and not Delaware law applies here
because this litigation involves the misconduct of officers and directors of a corporation whose principal
place of business is California, and defendants' misdeeds have had a uniquely localized effect. See
Friese v. Superior Court, 134 Cal. App. 4th 693, 707-08 (2005). Thus California law, and the equitable
principles that underlie the *Gaillard* court's decision not to impose a continuous ownership rule, should
apply here, and maintain plaintiffs' standing to pursue this litigation.

1 Decl. Indeed, Wilson Sonsini, serving as outside counsel for HP, recently conducted an internal
2 investigation into whether HP board members were leaking confidential information, a well-publicized
3 investigation that was conducted under questionable circumstances. *See* Damon Darlin, *Leak, Inquiry*
4 *and Resignation Rock a Boardroom*, N.Y. Times, Sept. 7, 2006, attached as Exhibit D to the
5 Wissbroecker Decl. The improper conduct of this investigation – another situation where Wilson
6 Sonsini is burdened by a conflict of interest, *see id.* – has dislodged HP’s Chairman of the Board,
7 Patricia Dunn. *See* Jordan Robertson, *HP Chair Resigns Amid Probe Fallout*, Associated Press, Sept.
8 22, 2006,³ attached as Exhibit E to the Wissbroecker Decl. Remarkably, Larry Sonsini, a Wilson
9 Sonsini partner, has been serving as *de facto* chairman of HP as HP tries to sort out the imbroglio – a
10 move that has “stunned” corporate governance experts both because Sonsini is not on the HP Board and
11 because Sonsini is implicated in the investigation. *See* Streitfeld, *supra*.

12 Notably, if the Court were to disqualify Wilson Sonsini for its concurrent representation of
13 adverse parties in this case, it would not be the first time Wilson Sonsini has been impermissibly
14 burdened by conflicts that required its removal from a case. For example, in *Asyst Techs., Inc. v.*
15 *Empak, Inc.*, 962 F. Supp. 1241 (N.D. Cal. 1997), Wilson Sonsini was disqualified from defending a
16 party in a litigation alleging patent infringement when it was shown that two partners at Wilson Sonsini
17 had previously prosecuted the same patent for the plaintiff suing to enforce the patent. *Id.* at 1241-43.
18 In disqualifying Wilson Sonsini, the *Asyst Techs.* court stated: “I cannot ignore the appearance of
19 impropriety that would cloak this case if Wilson Sonsini continues to represent the defendants.” *Id.* at
20 1243. Similarly, in *Quark, Inc. v. Power Up Software Corp.*, 812 F. Supp 178 (D. Colo. 1992), Wilson
21 Sonsini was disqualified from defending a party in a trademark infringement case when a Wilson
22 Sonsini partner had previously represented the plaintiff in the case in substantially related previous
23 trademark infringement actions. *Id.* at 178-180. The *Quark* court not only disqualified the entire
24
25

26 ³ In addition, a second defendant to this action, Susan Skaer, is a former attorney with Wilson
27 Sonsini. Moreover, Wilson Sonsini formerly served as outside counsel for Mercury (along with a
28 number of Silicon Valley corporations now embroiled in backdating controversies).

1 Wilson Sonsini firm, it also issued an order that prevented Wilson Sonsini from sharing its work
2 product with successor counsel as a step to ensure that client confidences were protected.

3 Despite the adverse interests of Klein and HP in this case, Wilson Sonsini purports to represent
4 both parties. Because California's ethical rules and case law prohibit simultaneous dual representation
5 of adverse parties, Wilson Sonsini must be disqualified from further representation of Klein and HP in
6 this action.

7 **III. WILSON SONSINI MUST BE DISQUALIFIED FROM FURTHER**
8 **REPRESENTATION OF KLEIN IN THIS ACTION**

9 **A. This Court Has the Authority to Disqualify Wilson Sonsini**

10 California trial courts have the authority to disqualify a law firm under its inherent power to
11 control the conduct of all persons connected with a judicial proceeding before it. C.C.P. §128(a)(5).
12 California's Rules of Professional Conduct govern the professional and ethical behavior of attorneys
13 practicing before the state's trial courts. Cal. Rule 1-100(D)(1). Consequently, this Court may look to
14 the California Rules for the standards governing attorneys practicing before it. *See, e.g., Flatt*, 9 Cal.
15 4th at 283.

16 **B. Wilson Sonsini's Dual Representation of HP and Klein Mandates**
17 **Disqualification**

18 It is settled law in California that a lawyer cannot simultaneously represent clients with adverse
19 interests. *See Flatt*, 9 Cal. 4th at 284-86; *Cal West Nurseries v. Superior Court*, 129 Cal. App. 4th
20 1170, 1174-75 (2005); *La Jolla Cove Motel & Hotel Apartments, Inc. v. Superior Court*, 121 Cal. App.
21 4th 773, 785-86 (2004); *Forrest v. Baeza*, 58 Cal. App. 4th 65, 74 (1997). Indeed, Cal. Rule 3-310
22 provides that an attorney "shall not . . . [a]ccept or continue representation of more than one client in a
23 matter in which the interests of the clients actually conflict." Cal. Rule 3-310(C)(2). Conflicts
24 "embrace all situations in which an attorney's loyalty to, or efforts on behalf of, a client are threatened
25 by his responsibilities to another client." *People v. Hardy*, 2 Cal. 4th 86, 135 (1992) (quoting *People v.*
26 *Bonin*, 47 Cal. 3d 808, 835 (1989)) (citation omitted). *See also Spindle v. Chubb/Pac. Indemnity*
27 *Group*, 89 Cal. App. 3d 706, 713 (1979) (conflicts of interest between jointly-represented clients occur
28 whenever their common lawyer's representation of one is rendered less effective by reason of his
representation). Disqualification is automatic or *per se* in simultaneous representation cases in all but a

1 few instances. *Flatt*, 9 Cal. 4th at 284. “The mandatory rule of disqualification in cases of dual
2 representations involving unrelated matters – analogous to the biblical injunction against ‘serving two
3 masters’ (Matthew 6:24) – is such a self-evident one that there are few published appellate decisions
4 elaborating on it.” *Id.* at 286.

5 Specifically in the context of a situation such as the one before the Court, involving a dispute
6 between a corporation and its officers, “once a conflict has arisen between a corporation and one or
7 more of its officers, directors or shareholders, *corporate counsel may not simultaneously represent the*
8 *corporation and the adverse officer, director or shareholder.*” *La Jolla Cove Motel & Hotel*
9 *Apartments*, 121 Cal. App. 4th at 785. Where, as here, “a shareholder has filed an action questioning its
10 management or the actions of individual officers or directors . . . corporate counsel cannot represent
11 both the corporation and the officers, directors or shareholders with which the corporation has a conflict
12 of interest.” *Id.* at 785-86; *see also Forrest*, 58 Cal. App. 4th at 74. But that is exactly what Wilson
13 Sonsini is attempting to get away with here. Wilson Sonsini represents both the corporation, HP, who
14 stands to inherit this cause of action that is being prosecuted for the benefit of Mercury against Klein,
15 and also represents Klein himself. Thus, Wilson Sonsini is impermissibly attempting to represent a
16 corporation against its own defalcating officer. There can be no doubt that this is an actual conflict that
17 requires Wilson Sonsini’s disqualification from representing both HP and Klein.

18 Courts throughout the country agree that situations like this, where counsel is attempting to
19 simultaneously represent a corporation and its current or former officers in litigation where the parties’
20 interests are directly adverse, mandate that counsel be disqualified from further representation of both
21 parties. *Lewis v. Shaffer Stores Co.*, 218 F. Supp. 238, 239-40 (S.D.N.Y. 1963) (disqualifying counsel
22 from representing both a corporation and its officers in litigation against the officers brought on behalf
23 of the corporation because their interests were “clearly adverse”); *In re Oracle Sec. Litig.*, 829 F. Supp.
24 1176, 1188 (N.D. Cal. 1993) (“there is a substantial body of authority proscribing dual representation of
25 corporate and individual defendants in a derivative action”); *Cannon v. U.S. Acoustics Corp.*, 398
26 F. Supp. 209 (N.D. Ill. 1975) (the court disqualified a law firm representing both a company and the
27 company’s directors in a derivative action); *Murphy v. Wash. Am. League Base Ball Club, Inc.*, 116
28

1 U.S. App. D.C. 362 (1963) (the court held that dual representation in a shareholder derivative action
2 was improper because counsel could not guide the litigation in the best interests of the corporation).

3 Here, Wilson Sonsini's dual representation of clients with adverse interests – HP (who via
4 merger stands to become the ultimate beneficiary of this action) and Klein (an alleged wrongdoer in this
5 action) – mandates disqualification of Wilson Sonsini. It is impossible for Wilson Sonsini to maintain
6 loyalty to its clients with adverse interests in the same action. Wilson Sonsini's past associations with
7 defendant Susan Skaer and nominal plaintiff Mercury further undermines Wilson Sonsini's ability to
8 maintain loyalty to each of its clients in this action.

9 And it does not matter that the merger has not yet closed, and HP has not yet been put in a direct
10 adversarial position with Klein. Klein's own position is that it is just a matter of time before HP
11 inherits Mercury's cause of action against him – he made it clear in his response to plaintiffs' document
12 request that he anticipates this litigation dropping in HP's lap no later than December 2006. Cal.
13 Rule 3-310(C) proscribes concurrent representation in situations where the interests of clients
14 “potentially conflict” in addition to situations where client are actually and presently adverse. Cal.
15 Rules 3-310. “In the disqualification situation, any doubt is to be resolved in favor of disqualification.”
16 *Hull v. Celanese Corp.*, 513 F.2d 568, 571 (2d Cir. 1975). Thus, Wilson Sonsini must be disqualified
17 from representing Klein or HP in this action.

18 **C. Confidences Obtained by Wilson Sonsini Create the Likelihood that**
19 **Confidences May Be Violated**

20 Additionally, Wilson Sonsini's dual representation presents the opportunity for the confidences
21 obtained from HP to be used in Wilson Sonsini's representation of Klein. *People ex rel. Dept. of*
22 *Corrections v. Speedee Oil Change Sys., Inc.*, 20 Cal. 4th 1135, 1151 (1999); *see also Quark*, 812 F.
23 Supp. at 120; *Asyst Techs.*, 962 F. Supp. at 1242. Indeed, in situations where, as here, a law firm is
24 attempting to simultaneously represent adverse clients, “[d]isqualification is required to protect the
25 client's confidences.” *Pound v. DeMera DeMera Cameron*, 135 Cal. App. 4th 70, 78 (2005); *see also*
26 *Spee Dee Oil*, 20 Cal. 4th at 1151.

27 Where an attorney [concurrently or] successively represents clients with adverse
28 interests . . . the need to protect the [client's] confidential information requires that the
attorney be disqualified from [either] representation. For the same reason, a

1 presumption that an attorney has access to privileged and confidential matters relevant
2 to [the other] representation extends the attorney's disqualification to the entire firm.

3 *Id.* at 1146.

4 Wilson Sonsini, as counsel for HP and Klein, has undoubtedly obtained confidences from each.
5 Indeed, Wilson Sonsini's litigation tactics on behalf of Klein, which seem tailored to delaying this
6 action as long as possible, calls into question whether Wilson Sonsini undertook such tactics based on
7 confidential information regarding the pending merger gained through its representation of HP. Indeed,
8 because Klein has recently taken the position that the merger will cause plaintiffs to lose standing to
9 prosecute this suit, one cannot help but consider whether Wilson Sonsini's delay tactics were
10 undertaken with this possibility in mind.

11 An appearance of impropriety is created by Wilson Sonsini's continued representation of Klein,
12 since it has already obtained confidences from its clients with adverse interests and will continue to
13 obtain such confidences through the course of this litigation. "[A] court must not hesitate to disqualify
14 an attorney when it is satisfactorily established that he or she wrongfully acquired an unfair advantage
15 that undermines the integrity of the judicial process and will have a continuing effect on the proceedings
16 before the court." *Gregori v. Bank of Am.*, 207 Cal. App. 3d 291, 300 (1999). The integrity of the
17 attorney-client relationship and the judicial process would be compromised if Wilson Sonsini was
18 permitted to represent either Klein or HP in this action. *See Truck Ins. Exch. v. Fireman's Fund Ins.*
19 *Co.*, 6 Cal. App. 4th 1050, 1057 (Cal. 1992). Indeed, the same concerns over the protection of client
20 confidences that have required Wilson Sonsini's disqualification in the past are present here, and
21 mandate that Wilson Sonsini be removed from this litigation. *See Asyst Techs.*, 962 F. Supp. at 1242;
22 *Quark*, 912 F. Supp. at 180.

23 **D. California Law Does Not Permit Wilson Sonsini to Erect an "Ethical
24 Wall" to Vitiating its Simultaneous Representation Conflict**

25 Moreover, Wilson Sonsini cannot rely on its use of an "ethical wall" set up within the law firm
26 to segregate attorneys working for HP and Klein. "[T]he ethical wall concept has not found judicial
27 acceptance in California," and can only be used to prevent automatic disqualifications in situations
28 where a government attorney moves to private practice. *Henrikson v. Great Am. Sav. & Loan*, 11 Cal.
App. 4th 109, 115-16 (1992). In California, "there simply [is] no gray area . . . the entire firm must be

1 vicariously disqualified even if [a conflicted attorney] has been screened from day one.” *Id.*
2 Accordingly, even if Wilson Sonsini did “wall-off” its attorneys who represented Klein and HP, the
3 firm cannot avoid disqualification.

4 **E. The Conflict Cannot Be Waived Under California Law**

5 Although Cal. Rules 3-310 and 3-600(E) will permit dual representation in certain instances
6 where the attorney has received informed and written consent from each client, in shareholder
7 derivative actions there can be no waiver of the right to independent counsel. *Forrest*, 58 Cal. App. 4th
8 at 76. Indeed, “reliance on consent is ill founded in the context of derivative litigation.” *Id.* Here, there
9 is an actual conflict in Wilson Sonsini’s dual representation of clients with directly adverse interests,
10 precluding written consent by any defendant of the dual representation and mandating disqualification.
11 Thus, even if there were waiver of the conflict, where there is an actual conflict between dually
12 represented clients, “an attorney’s duty to maintain the confidence of each [client] would preclude such
13 representation.” *Klemm v. Superior Court*, 75 Cal. App. 3d 893, 899-900 (1977).

14 **IV. CONCLUSION**

15 Because of the conflict created by Wilson Sonsini’s dual representation of Klein and HP,
16 plaintiff respectfully requests that the Court disqualify Wilson Sonsini from representing both Klein and
17 HP in this action for the reasons set forth above.

18 DATED: September 28, 2006

Respectfully submitted,

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