Study J-111 May 13, 2002

Memorandum 2002-13

Statute of Limitations for Legal Malpractice (Discussion of Issues)

The Commission has been studying the statute of limitations for legal malpractice (Code Civ. Proc. § 340.6). The Commission commenced work on this topic in early 2000 and made progress at a number of meetings, but had to interrupt its work in mid-2001 due the demands of the legislatively-mandated study on *Statutes Made Obsolete by Trial Court Restructuring*. This memorandum reintroduces the topic, describes the Commission's previous work for the new Commissioners, and raises issues regarding the direction of this study. The following materials are attached as exhibits:

The Commission is working towards preparation of a tentative recommendation. As discussed below, the Commission still needs to decide some basic points before the staff begins drafting.

(Unless otherwise indicated, all further statutory references are to the Code of Civil Procedure.)

THE GOVERNING STATUTE: SECTION 340.6

Section 340.6 sets forth the limitations period for attorney malpractice:

> 340.6. (a) An action against an attorney for a wrongful act or omission, other than for actual fraud, arising in the performance of professional services shall be commenced within one year after the plaintiff discovers, or through the use of reasonable diligence should have discovered, the facts constituting the wrongful act or omission, or four years from the date of the wrongful act or omission, or whichever occurs first. In no event shall the time for commencement of legal action exceed four years except that the period shall be tolled during the time that any of the following exist:
>
> (1) The plaintiff has not sustained actual injury;

(2) The attorney continues to represent the plaintiff regarding the specific subject matter in which the alleged wrongful act or omission occurred;

(3) The attorney willfully conceals the facts constituting the wrongful act or omission when such facts are known to the attorney, except that this subdivision shall toll only the four-year limitation; and

(4) The plaintiff is under a legal or physical disability which restricts the plaintiff's ability to commence legal action.

(b) In an action based upon an instrument in writing, the effective date of which depends upon some act or event of the future, the period of limitations provided for by this section shall commence to run upon the occurrence of such act or event.

The provision codifies the discovery doctrine, under which the limitations period does not begin to run until the client discovers, or through the use of reasonable diligence should have discovered the attorney's malpractice. The client must commence the action within one year from the date of discovery. To preclude endless potential exposure, however, the statute also requires the client to bring the action within four years from the date of the wrongful act or omission.

These alternate limitations periods (one-year-from-discovery and four-years-from-occurrence) are tolled so long as the allegedly negligent attorney continues to represent the client regarding the specific subject matter in which the alleged wrongful act or omission occurred. Even after the client replaces the attorney, the limitations periods are tolled until the client suffers actual injury. The limitations periods are also tolled when the client is under a legal or physical disability that prevents the client from commencing legal action. The four-year period, but not the one-year period, is tolled when the attorney willfully conceals the malpractice. The provision is inapplicable to an action for actual fraud.

PRELIMINARY DECISIONS

The Commission has been exploring the following ideas, for possible inclusion in a tentative recommendation:

(1) Whether Section 340.6 should be revised to incorporate equitable tolling, so as to address the problem of simultaneous litigation. Minutes (Feb. 2000), p. 7; *see also* Memorandum 2000-14.

(2) Whether Section 340.6 should be revised with regard to transactional malpractice. Minutes (Feb. 2000), p. 7; Minutes (June 2000), p. 10; *see also* Memorandum 2000-43, p. 3 & Attachment pp. 14-15.

(3) Whether Section 340.6 should be revised to specify that the plaintiff bears the burden of proving when the plaintiff discovered or should have discovered the facts constituting the alleged malpractice. Minutes (March 2001), pp. 11-12; see also Memorandum 2001-30.

(4) Whether Section 340.6 should be revised to address the concerns raised by the State Bar Estate Planning, Trust, and Probate Law Section regarding extended exposure to claims of estate planning malpractice and difficulty obtaining affordable malpractice insurance. Minutes (Dec. 2000), pp. 6-7; *see also* Memorandum 2000-61; First Supplement to Memorandum 2000-61.

(5) Whether Section 340.6 should be revised with regard to the types of cases to which it applies. Memorandum 2001-30, p. 1; Memorandum 2000-43, p. 4.

Each of these ideas is discussed below.

SIMULTANEOUS LITIGATION AND EQUITABLE TOLLING

The Commission started this study by considering the problem of simultaneous litigation: Litigation of a malpractice action while an underlying action is still pending. Whether simultaneous litigation is necessary depends on how the malpractice statute of limitations applies where a malpractice claim relates to an underlying action. In particular, the matter turns on how "actual injury" is defined for purposes of tolling the malpractice limitations period:

- If the statute is interpreted to mean that actual injury does not occur until the underlying action is resolved and all appeals exhausted, the limitations period is tolled through the appellate process and the malpractice action need not be commenced until the underlying action is over.

- If the statute is interpreted to mean that actual injury does not occur until the underlying action is either settled or resolved by the trial court or other initial tribunal, simultaneous litigation is necessary only where a party seeks to overturn the initial determination of the underlying action.

- If the statute is interpreted to mean that actual injury can occur before the underlying action is resolved by the initial tribunal, it may be necessary to commence the malpractice action while the underlying action is still pending in the initial tribunal.

The California Supreme Court has considered the issue of actual injury four times, dividing in each case and reversing course as court personnel changed. See *Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739, 958 P.2d 1062, 76 Cal. Rptr. 2d 749 (1998); *Adams v. Paul*, 11 Cal. 4th 581, 904 P.2d 1205, 46 Cal. Rptr. 2d 594 (1995); *ITT Small Business Finance Corp. v. Niles*, 9 Cal. 4th 245, 885 P.2d 965, 36 Cal. Rptr. 2d 552 (1994); *Laird v. Blacker*, 2 Cal. 4th 606, 828 P.2d 691, 7 Cal. Rptr. 2d 550 (1992). There have been many court of appeal decisions on the point, such as the very recent decision in *Seheult v. Jeffer, Mangels, Butler & Marmaro*, __ Cal. App. __, 2002 WL 798585 (May 6, 2002).

In the most recent Supreme Court decision, a five-member majority endorsed four principles: "(1) determining actual injury is predominately a factual inquiry; (2) actual injury may occur without any prior adjudication, judgment, or settlement; (3) nominal damages, speculative harm, and the mere threat of future harm are not actual injury; and (4) the relevant consideration is the fact of damage, not the amount." *Jordache*, 18 Cal. 4th at 743. The Court thus rejected the notion of focusing on termination of the underlying action. *Id.* at 764. Instead, the Court emphasized the need for particularized assessment of the facts and circumstances of each case. *Id.* Chief Justice George and Justice Mosk each authored a vigorous dissent, advocating use of a bright-line test based on termination of the underlying action.

Because the Court held that actual injury may occur before termination of the underlying action, in some cases a client may have no choice but to engage in simultaneous litigation. That poses a number of serious problems, which are discussed at length in Ochoa & Wistrich, *Limitation of Legal Malpractice Actions: Defining Actual Injury and the Problem of Simultaneous Litigation*, 24 Sw. U. L. Rev. 1 (1994).

Professor Ochoa and Judge Wistrich advocate application of the doctrine of equitable tolling in the context of legal malpractice. Under that doctrine, the statute of limitations on a potential claim will be tolled during the pendency of a related claim, so long as three elements are met: (1) timely notice to the potential defendant, (2) lack of prejudice to the defendant in gathering evidence to defend

against the potential claim, and (3) good faith and reasonable conduct on the part of the potential plaintiff. *Id.* at 51. Professor Ochoa and Judge Wistrich explain:

> [C]ourts must weigh the desirability of guaranteeing repose and minimizing deterioration of evidence against the desirability of avoiding the problems which may result from simultaneous litigation of the malpractice claim and the underlying action. … [T]hese competing policies can best be balanced by defining "actual injury" in a manner consistent with [the equitable tolling] doctrine, *thereby tolling the commencement of the limitation period for the malpractice action until an adverse judgment or other appealable order is entered against the client at the trial court level in the underlying action,* provided that the other requirements of the doctrine are satisfied.

Id. at 79 (emphasis added). In other words, where a malpractice claim relates to underlying litigation (either because the malpractice occurred during the litigation or because the malpractice led to or may affect the litigation), Professor Ochoa and Judge Wistrich would interpret the actual injury requirement of Section 340.6 to incorporate the equitable tolling doctrine. Under this view, if the client gives the attorney timely notice of the potential malpractice claim, affords the attorney adequate opportunities to gather evidence relating to that claim, and acts in good faith, actual injury does not occur, and thus the limitations period on the malpractice claim is tolled, until the underlying litigation has been resolved in the trial court.

Recent court decisions have concluded, however, that the doctrine of equitable tolling is inapplicable under Section 340.6. *People ex rel. Dep't of Corporations v. SpeeDee Oil Change Systems, Inc.*, 95 Cal. App. 4th 709, 116 Cal. Rptr. 2d 497 (2002) (dictum); *Gordon v. Law Offices of Aguirre & Meyer*, 70 Cal. App. 4th 972, 83 Cal. Rptr. 2d 119 (1999). These decisions focus on the language and legislative history of the statute, not on policy considerations.

The Commission considered the concept of equitable tolling and the competing policy considerations in detail in February 2000, and directed the staff to "prepare a draft revising Code of Civil Procedure Section 340.6 to expressly incorporate equitable tolling." Minutes, p. 7; see Memorandum 2000-14. The staff subsequently prepared such a draft (see Memorandum 2000-43), which the Commission reviewed and asked the staff to revise in certain respects. Minutes (June 2000), p. 10. Among other matters, the Commission decided to solicit input on whether equitable tolling should continue only until the trial court or other

initial tribunal fully resolves the underlying action, or also during the pendency of an appeal or other attempt to overturn the initial decision. *Id.*

The staff has not yet prepared a new draft, because the Commission was exploring other aspects of the statute and then had to interrupt its work on this study. **In preparing the next draft for the Commission, we plan to proceed on this issue as previously directed,** unless the Commission revises its instructions.

TRANSACTIONAL MALPRACTICE

The Commission has also expressed interest in whether revisions of Section 340.6 are necessary with regard to malpractice that occurs in the course of a transaction ("transactional malpractice"). In some instances, transactional malpractice is linked to litigation, as when a lawyer fails to obtain a signature on a contract and the client later sues to enforce the contract. The proposed codification of the equitable tolling doctrine would affect such cases. In other instances, transactional malpractice is unconnected to litigation, as when a lawyer mistakenly advises a client regarding a legal matter, causing the client to forego a business opportunity ("pure transactional malpractice").

Issues relating to proof of causation in transactional malpractice cases are pending before the California Supreme Court. *Viner v. Sweet* (No. S101964). The key question is whether the case-within-a-case method of establishing causation is applicable in transactional malpractice cases, or only in cases alleging that malpractice occurred in the course of litigation. Briefing is in progress; it is unclear when the case will be heard and decided. The decision might have implications for this study, because it requires consideration of when damages are sufficiently nonspeculative to pursue in court. **The staff is tracking this matter and will provide further information for a future meeting.** We would appreciate any input or suggestions that the Commissioners or others have regarding transactional malpractice and application of the statute of limitations.

BURDEN OF PROVING TIME OF DISCOVERY

Under Section 340.6, the one-year limitations period does not begin to run until the client discovers, or through the use of reasonable diligence should have discovered the attorney's malpractice. The statute does not specify who bears the burden of proving the time of discovery.

In *Samuels v. Mix*, 22 Cal. 4th 1, 5, 989 P.2d 701, 91 Cal. Rptr. 2d 273 (1999), the California Supreme Court held that for purposes of applying the one-year limitations period of Section 340.6, *the defendant* bears the burden of proving when the plaintiff discovered, or through the use of reasonable diligence should have discovered, the facts constituting the alleged legal malpractice. The court based its decision primarily on the plain language and legislative history of the statute.

Justice Baxter dissented, criticizing the majority's analysis as "overliteral and exaggerated." 22 Cal. 4th at 24 (Baxter, J., dissenting). In his view, placing the burden of proof on the attorney puts the attorney in an unfair legal and practical bind:

> This is because discovery of one lawyer's malpractice will most often arise, as it did here, from the substance of the client's consultations with *another attorney*. Proof of the time of discovery will thus depend, as it did here, on the content of those interviews. But such attorney-client communications are confidential and privileged by law. (Evid. Code, § 954.) Unless the client waives the privilege, neither he nor the attorney he consulted can be compelled to disclose the substance of their discussions.
>
> If the *client* bears the burden of proving when the malpractice claim was discovered, as the trial court ruled here, he may feel obliged, as [the plaintiff] did here, to present evidence about the timing and nature of his consultations with a second lawyer. But if, as the majority hold, that burden rests with the attorney sued, there is no necessity, and no incentive, for the client to waive the privilege to aid his adversary in establishing a limitations defense. No lawyer worth his salt would allow his client to do so. Thus, it is unclear at best how an attorney sued for malpractice will be able to sustain his burden of proving when the client's discussions with a second lawyer led to actual or constructive discovery of the malpractice claim.

Id. at 27-28 (emphasis in original).

Last year, the Commission examined the *Samuels* decision in detail and considered whether to revise Section 340.6 to assign the burden of proof to the plaintiff. Memorandum 2001-30. The Commission expressed tentative interest in that approach, but also decided that it would be helpful to have further input from interested parties before taking a stance on the point. Minutes (March 2001), p. 12.

To date, the Commission has not received any new input on the issue. The staff is not aware of any new developments in this area. **Unless the Commission instructs otherwise, our draft for the next meeting will include proposed revisions assigning the burden of proof to the plaintiff.** That might help stimulate discussion of the issue.

ESTATE PLANNING MALPRACTICE

The State Bar Estate Planning, Trust, and Probate Law Section ("EPTPL Section") has raised concerns regarding extended exposure to claims of estate planning malpractice and difficulty obtaining affordable malpractice insurance. In December 2000, the Commission decided that steps should be taken to address these concerns. Minutes, pp. 6-7. The Commission did not resolve what steps to take.

Background

Historically, estate planning attorneys were rarely subject to malpractice claims. Under the doctrine of privity, a beneficiary under a will could not sue the drafter for negligence in preparing the will, because the beneficiary did not have a contractual relationship with the drafter. Moreover, the malpractice statute of limitations ran from occurrence of the malpractice (the "occurrence rule"), not discovery of the malpractice (the "discovery rule"), so most claims for estate planning malpractice were time-barred before the client died and the malpractice was discovered. M. Begleiter, *Attorney Malpractice in Estate Planning — You've Got to Know When to Hold Up, Know When to Fold Up*, 38 U. Kan. L. Rev. 193, 194-95, 208-10 (1990).

Several decades ago, the California Supreme Court abolished the privity defense. *Lucas v. Hamm*, 56 Cal. 2d 583, 589, 364 P.2d 685, 15 Cal. Rptr. 821 (1961). The Court also overturned the occurrence rule. *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, 6 Cal. 3d 176, 179, 491 P.2d 421, 98 Cal. Rptr. 837 (1971). In 1977, the Legislature codified the discovery rule by enacting Section 340.6 in its present form.

As a result of these developments, litigation for estate planning malpractice has dramatically increased in recent years. *See* M. Begleiter, *First Let's Sue All the Lawyers — What Will We Get: Damages for Estate Planning Malpractice*, 51 Hastings L.J. 325, 326-28 (2000); M. Begleiter, *Attorney Malpractice in Estate Planning — You've Got to Know When to Hold Up, Know When to Fold Up,* 38 U. Kan. L. Rev. at

193-212. Such malpractice claims may be brought long after the alleged malpractice occurs, because the limitations period is tolled until there is "actual injury" and that typically does not occur until the client dies and the estate is distributed. *See Heyer v. Flaig*, 70 Cal. 2d 223, 230-34, 449 P.2d 161, 74 Cal. Rptr. 225 (1969).

Problem

The EPTPL Section considers that situation unacceptable, because it

> effectively subjects the attorney to an open statute of limitations that may involve counsel in litigation decades after the work leading to the malpractice was performed. Moreover, the case may be initiated after the client's death by dissatisfied persons who may have no actual knowledge of attorney-client communications or the client's goals and wishes.
>
> These suits are difficult to defend since the attorney's actions are being judged by hindsight, standards of practice may have changed after the actions took place, and memories may have faded over the intervening decades.

Exhibit p. 2. The EPTPL Section further reports that the long and uncertain limitations period may make it difficult to obtain affordable malpractice insurance. Email from Marshal Oldman to Barbara Gaal (September 20, 2000) (hereafter, "Oldman email"); *but see* First Supplement to Memorandum 2000-61, p. 2 & Exhibit pp. 7-9.

Similarly, a commentator recently observed that the 1980's and 1990's had seen "the increasing exposure of the estate planner to claims of professional malpractice." E. Koren, 1 Estate & Personal Financial Planning, § 1:30 (2001). According to the commentator, these claims "are particularly troublesome because the liability can arise so long after the service was performed." *Id.*

That problem is particularly acute for an attorney who is retired or is approaching retirement. James Cowley of Cowley & Chidester explains:

> As an attorney who is contemplating the prospect of retirement in the next few years, I find it very disturbing to realize that I will need to purchase and carry expensive malpractice "tail coverage," assuming it is available, long after my income-earning years are over just because California seemingly has *no* statute of limitations on malpractice claims in connection with wills and trusts.

Exhibit p. 6 (emphasis in original).

Proposal of the EPTPL Section

The EPTPL Section proposes to address these problems by permitting an estate planning attorney to send a notice to a client that would limit the period in which the attorney could be sued for malpractice. Specifically, the group proposes to add the following provision to the Code of Civil Procedure:

> 340.8. An attorney may end the tolling of the statute of limitations as provided under subparagraph (1) of paragraph (a) of Section 340.6 by sending the notice set forth in this section and if available to the counsel giving the notice by tendering the client's file and original documents in the possession of the attorney to the client. The notice shall be sent to the client at the client's last known address by certified mail, return receipt requested. The notice shall be deemed as effective to commence the statute of limitations to run at such time that the notice has been deposited in the United States mail whether or not the notice reaches the client.
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> (b) The notice shall be in at least 10 point bold type and shall state the following:
>
> NOTICE OF TERMINATION OF ATTORNEY CLIENT RELATIONSHIP FOR ESTATE PLANNING MATTERS AND TENDER OF FILE AND ORIGINAL DOCUMENTS
>
> The undersigned as your attorney will no longer take responsibility for your estate planning file. By this notice, you are hereby notified that your attorney is tendering to you your file and all documents in the undersigned's possession, available to the undersigned, if any. Since the undersigned as your attorney is no longer taking any further responsibility for your file, you are encouraged to seek the advice of new counsel and to review the estate plan for any corrections that may need to be made to fit your current family situation or any mistakes that may have occurred during the undersigned's representation of you as your attorney for this estate planning matter. Further, even if mistakes exist in your estate planning documents, the undersigned as your attorney will no longer be liable to you or to any person taking under or seeking to enforce your estate planning documents on the fourth anniversary of the mailing of this notice and tender of your estate planning documents.

A conforming revision would be made in Section 340.6. Exhibit pp. 3-5.

State Bar Position

The State Bar Board of Governors has deferred consideration of the EPTPL proposal until the Commission has had an opportunity to consider the issues that

the proposal raises. First Supplement to Memorandum 2000-61, Exhibit p. 1. In taking this action, the Board "expressed the belief that issues relating to the potentially very long statute of limitations now applicable to estate planning matters are worthy of further study." *Id.* The Board recommended that the Commission consider these issues in its ongoing study of the statute of limitations for legal malpractice. *Id.*

In deciding to defer action on the EPTPL proposal, the Board considered a letter from the State Bar Litigation Section questioning "whether, in light of the difficult times the State Bar has endured before the Legislature in the last five years, this is an appropriate occasion for the State Bar to be proposing anti-client legislation." First Supplement to Memorandum 2000-61, Exhibit p. 4. This comment underscores the importance of **developing a balanced proposal for reform of Section 340.6,** one that has advantages for both clients and lawyers. While it may be appropriate to address the concerns raised by the EPTPL Section, any reform along these lines should be sensitive to the needs of clients and probably would fare best if coupled with one or more reforms favoring clients, such as the equitable tolling proposal. Otherwise, the reform may be perceived as self-serving, particularly if it is proposed by those who stand to benefit from it, rather than by a neutral body like the Commission. *Cf.* Mikva & Pfander, *On the Meaning of Congressional Silence: Using Federal Common Law to Fill the Gap in Congress's Residual Statute of Limitations*, 107 Yale L.J. 393, 401-02 (1997) ("Not surprisingly," estate planners were motivating force for elimination of estate planning exception to Illinois' six-year statute of repose for attorney malpractice).

Manner of Proceeding

In deciding how to address the concerns of the EPTPL Section, **a logical starting point is to examine the EPTPL proposal in detail.** The Commission can then consider whether to incorporate that proposal (as is, or with modifications) into its own comprehensive proposal for reform of Section 340.6, or explore other alternatives.

Policy Considerations

In considering the EPTPL proposal, the Commission should consider the following policy considerations:

- The interest in affording clients and their beneficiaries an effective remedy for estate planning malpractice.

- The interest in litigating cases while memories are fresh, evidence is accessible, and witnesses are available.

- The interest in guaranteeing repose, affording a measure of certainty and stability in planning for the future.

- The interest in judicial economy, avoiding unnecessary litigation of malpractice claims and unnecessary legal work. To the extent that a reform would prevent malpractice claims by prompting correction of documents before harm occurs, it would further this interest. To the extent a reform would force early assertion of malpractice claims that may ultimately prove unnecessary due to lack of damage, or cause unnecessary review of documents, it would undermine judicial economy.

- The interest in ensuring that affordable malpractice insurance is available, for the benefit of attorneys (who seek security against liability), clients (who may be forced to bear the cost of high insurance rates), and victims of malpractice (who may be unable to recover if a large judgment is entered against an uninsured attorney).

Key Features

Key features of the EPTPL proposal include (1) the notice requirement, (2) the four year deadline for filing suit after mailing the prescribed notice, (3) the ability to select which clients receive the notice, and (4) the restriction of the proposal to estate planning.

Requirement of Notice

The proposed notice of termination would alert clients to the four year period in which to sue. It would also inform a client that counsel is withdrawing from the case and urge the client "to seek the advice of new counsel and to review the estate plan for any corrections that may need to be made to fit your current family situation or any mistakes that may have occurred" during counsel's representation. This encouragement to seek the advice of new counsel could generate estate planning work that clients might not otherwise request.

The EPTPL Section explains, however, that the "reason that seeking the advice of new counsel was inserted in the notice was to advise the client that documents should be reviewed periodically and that the prior estate planning counsel will no longer take responsibility." Oldman email. "Since these documents are transitory and can be amended and corrected prior to becoming

irrevocable," the EPTPL Section believes that notice would help ensure that errors are discovered while an inexpensive solution still exists. *Id.* This would benefit both clients and attorneys, as well as the overburdened legal system.

As a commentator recently stated, the "well-advised client should be reminded to review and revise his or her estate planning from time to time." Mahon, *Intent, Process and Liability in Estate Planning*, N.J. Lawyer 26, 30 (Aug. 2001). "[G]iven the pace at which personal relationships, wealth and the laws may change, clients should engage in this process at least every five years, or more frequently as the circumstances dictate." *Id.* **The notice feature of the EPTPL proposal would promote such regular review of estate plans.** In evaluating the notice requirement, however, the Commission should bear in mind the expense and logistics of providing notice to numerous clients, particularly in the context of an attorney's retirement.

Length of the Statutory Period

Under the proposal, the mailing of a notice of termination ends "actual injury" tolling under Section 340.6. Thus, the client to whom the notice is directed has a maximum of four years (the longer of the limitation periods in Section 340.6) from the date of mailing in which to sue for malpractice. This four year deadline applies even if the client (or a beneficiary of the client) does not discover the malpractice or sustain any damage from the malpractice before the deadline elapses.

The deadline is thus akin to a statute of repose, rather than a statute of limitations. While a statute of limitations "normally sets the time within which proceedings must be commenced once a cause of action accrues, the statute of repose limits the time within which an action may be brought and is not related to accrual." *Giest v. Sequoia Ventures, Inc.*, 83 Cal. App. 4th 300, 99 Cal. Rptr. 2d 476, 479 (2000). A statute of repose reflects a determination that "there comes a time when the benefits gained by an absolute barrier to suit outweigh the costs to potential claimants who are denied judicial redress." M. Byrne, *Let Truth Be Their Devise:* Hargett v. Holland *and the Professional Malpractice Statute of Repose*, 73 N. C. L. Rev. 2209, 2221 (1995).

A classic example of a statute of repose is Code of Civil Procedure Section 337.15, which establishes an absolute ten year deadline for suits for latent construction defects. The proposed four year deadline for estate planning malpractice is substantially shorter, but the notice requirement would mitigate

this to some extent by alerting clients to the deadline and encouraging them to have their estate plans reviewed for errors. Most statutes of repose do not include a notice requirement, so the potential plaintiff may be unaware of the deadline and oblivious to errors that would be obvious even on cursory review. Mr. Oldman of the EPTPL Section believes that a ten year deadline would be inappropriate in the group's proposal, because it "would defeat some of the major goals of the proposal such as focusing the client on document review and providing affordable tail coverage for retiring estate planners." Oldman email.

If the Commission is interested in the EPTPL proposal, it will need to assess whether a four-year deadline is appropriate. This will require balancing of the policy considerations previously identified.

Selection of Clients to Receive Notice

The proposal would permit an attorney to select which clients receive a notice of termination. An attorney would not have to notify all estate planning clients at once.

This flexibility is intended to allow counsel "to send a notice to clients who are out of touch while maintaining other files where the client remains in contact." Oldman email. **The Commission should consider, however, whether the ability to pick and choose among clients could be abused, and whether any safeguards are needed.**

One possibility would be to limit the proposal to attorneys who are retiring, or attorneys who are ceasing estate planning work. Such an approach would further the goal of permitting estate planning attorneys to retire from such work and cut off their potential liability. But it would not be as effective as the EPTPL proposal in encouraging clients to have estate planning mistakes corrected before the harm becomes irreparable.

Restriction of Proposal to Estate Planning

The EPTPL proposal would apply only to malpractice in estate planning, not to malpractice in other areas of practice. Mr. Oldman explains that the "difference between estate planning and other areas of transactional drafting is that estate planning involves the creation of a large number of transitory documents that are subject to revocation and amendment." Oldman email. The statute of limitations "is tolled since no damage has accrued until the document has become irrevocable." *Id.* Counsel are thus "subject to an open ended statute

of limitations that is as uncertain as it is incalculable." Exhibit pp. 2-3. Because the client retains the ability to correct errors during his or her lifetime, "much litigation may be avoided years later" by encouraging the client to seek a review of his or her estate plan. Oldman email.

In contrast, most other documents drawn by counsel, such as leases or other contracts, "are irrevocable at the time of execution." Exhibit p. 3. The EPTPL Section interprets cases such as *Jordache v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739, 958 P.2d 1062, 76 Cal. Rptr. 2d 749 (1998), and *Hensley v. Caietti*, 13 Cal. App. 4th 1135, 16 Cal. Rptr. 2d 837 (1993), to mean that damage from malpractice in preparing an irrevocable document occurs at the time the document is executed, even though the damage may not be discovered until much later. Exhibit p. 2; see also Oldman email. Under this interpretation, the statute of limitations is triggered upon execution of the irrevocable document, so counsel are not subject to lengthy tolling.

The staff does not consider the situation so clear-cut. Case law on actual injury tolling under Section 340.6 has been in flux. See Memorandum 2000-14; Memorandum 2000-43. A recent decision holds that "creation of an enforceable obligation is 'actual injury' whether or not attorney fees or other quantifiable costs have yet been incurred in efforts to defeat or limit the liability." *Seheult v. Jeffer, Mangels, Butler & Marmaro*, __ Cal. App. __, 2002 WL 798585 (May 6, 2002). But Justice Johnson authored a vigorous dissent. It is hard to predict how courts will apply the actual injury rule in circumstances such as malpractice in preparing a long-term lease with an option to renew, or malpractice in drafting a right of first refusal on a piece of real property.

Nonetheless, problems of delay are probably most acute in the estate planning context, where a will or revocable trust is often drafted long before the client dies and the documentation causes harm. The benefits of encouraging clients to have their documents reviewed would also be greater in that context, because malpractice in preparing other types of documents is not readily corrected. **It may be appropriate to limit the proposed approach to estate planning, as the EPTPL Section suggests.**

Constitutional Constraints

Statutes of repose "have been challenged on constitutional grounds with mixed results." M. Byrne, *Let Truth Be Their Devise:* Hargett v. Holland *and the Professional Malpractice Statute of Repose*, 73 N. C. L. Rev. 2209, 2221 (1995). The

staff has done preliminary research regarding constitutional issues relating to statutes of repose, but has not yet completed its analysis. **We will provide further information regarding constitutional issues as this study progresses.**

From our research thus far, we are aware that some statutes of repose have been held unconstitutional. These decisions are usually based on state constitutional grounds. *See, e.g.*, *Hazin v. Montgomery Elevator Co.*, 861 P.2d 625 (Ariz. 1993) (twelve-year statute of repose for products liability actions violates state constitutional prohibition against abrogation of right of action to recover damages for injuries); *Brennaman v.* R.M.I. Co., 70 Ohio St. 3d 460, 639 N.E.2d 425 (1994) (ten-year statute of repose violates Ohio constitutional right to remedy); *Turner Construction Co., Inc. v. Scales*, 752 P.2d 467 (Alaska 1988) (six-year statute of repose on suits against design professionals violates equal protection clause of state constitution); *see also* Werber, *The Constitutional Dimension of a National Products Liability Statute of Repose*, 40 Vill. L. Rev. 985 (1995) (tort-based statutes of repose should be held unconstitutional).

A recent United States Supreme Court decision supports use of a statute of repose in federal securities cases, but the Court did not address any constitutional issues. *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991). Similarly, the United States Supreme Court recently construed the Fair Credit Reporting Act to require a victim of identity theft to sue a credit reporting agency within two years of harm to the victim's credit rating, even though the victim did not learn about the harm until much later. *TRW, Inc. v. Andrews*, 534 U.S. 19 (2001). Many courts have upheld statutes of repose against constitutional challenges based on the equal protection clause, due process clause, or other grounds. *See* Kubalski, *Statutes of Repose and the Post-Sale Duty to Warn*, 32 Conn. L. Rev. 1027, 1033 (2000) (large majority of constitutional challenges to statutes of repose have failed); Hicks, *The Constitutionality of Statutes of Repose: Federalism Reigns*, 38 Vand. L. Rev. 627, 657-63 (1985) (appendix listing cases).

It will not be possible to provide ironclad assurance that a proposed statute of repose (whether as proposed by the EPTPL Section or otherwise) will pass constitutional muster. Based on our research thus far, however, it appears that California courts are likely to uphold a statute of repose, so long as it is not grossly unfair or arbitrary. *See, e.g.*, *Barnhouse v. City of Pinole*, 133 Cal. App. 3d 171, 183 Cal. Rptr. 881 (1982) (10-year statute of repose on actions against developers for latent defects upheld against equal protection and due process

challenges). Retroactive application of such a reform would present special questions. *See, e.g.*, *Souders v. Philip Morris, Inc.* (pending in Cal. Supreme Court, No. S096570); *In re Marriage of Bouquet*, 16 Cal. 3d 583, 591-92, 128 Cal. Rptr. 427, 546 P.2d 1371 (1976).

Certainly, a reform limiting a client's ability to sue for legal malpractice is more likely to withstand challenge if it includes measures to protect client interests. For example, California has a Client Security Fund, from which discretionary payments may be made to clients who have suffered loss due to theft or other dishonest conduct by an attorney. Bus. & Prof. Code § 6140.5. As presently structured, the Client Security Fund may not be used to compensate a client for attorney malpractice. If the Commission proposes a statute of repose for estate planning malpractice, **it might be appropriate to permit use of the Client Security Fund to cover a malpractice loss for which there is no relief due to the statute of repose.**

Alternatives

Options available to the Commission include at least the following:

(1) Incorporating the proposal of the Estate Planning, Trust and Probate Law Section into the Commission's own proposal on the statute of limitations for legal malpractice.

(2) Modifying one or more key features of the estate planning proposal, and incorporating the modified proposal into the Commission's proposal on the statute of limitations for legal malpractice. Possible modifications include eliminating the notice requirement, adjusting the proposed four year deadline, restricting counsel's ability to select clients for termination of liability, and extending the proposal to other areas of practice.

(3) Permitting a court to establish a trust to cover potential damages from an incident of estate planning malpractice, instead of tolling the limitations period until actual injury occurs. See M. Begleiter, *First Let's Sue All the Lawyers — What Will We Get: Damages for Estate Planning Malpractice*, 51 Hastings L.J. 325, 361-63 (2000). Because estate planning errors may be correctable before a client's death, this approach would primarily if not exclusively apply where beneficiaries seek redress for malpractice that has been discovered but has not yet resulted in non-speculative damages. The staff can provide additional information on this approach if the Commission is interested in pursuing it.

(4) Imposing an affidavit of merit requirement, such as the one recently adopted in New Jersey. Pursuant to the New Jersey statute, "if a claim for property damages such as a lost inheritance is made against a licensed professional, such as an attorney, the plaintiff is required, within 60 days of the filing of the answer, to provide each defendant with an 'affidavit of an appropriate licensed person that there exists a reasonable probability that the care, skill or knowledge exercised or exhibited in the treatment, practice or work that is the subject of the complaint, fell outside acceptable professional or occupational standards or treatment practices.'" Mahon, *Intent, Process and Liability in Estate Planning*, N.J. Lawyer 26 (Aug. 2001), *quoting* N.J. Stat. Ann. 2A:53A-27.

The staff could prepare additional material on alternative approaches if the Commission is interested.

Technical Issues

If the Commission decides to proceed with the EPTPL proposal (as is, or with modifications of one or more key features), a number of technical issues deserve attention:

Trigger for Statutory Period

Proposed Section 340.8 states in part that the notice of termination would be "effective to commence the statute of limitations to run at such time that the notice has been deposited in the United States mail." The provision also states, however, that an attorney may end actual injury tolling under Section 340.6 "by sending the notice set forth in this section *and if available to the counsel giving the notice by tendering the client's file and original documents in the possession of the attorney to the client*." (Emphasis added.)

It is not clear to the staff how courts would interpret this language. Is the attorney supposed to send the client's file and other documents to the client together with the notice of termination? Or is the client supposed to contact the attorney upon receiving the notice, to make arrangements for transfer of the file and other documents? If the file and other documents are transferred after receiving the notice of termination, then does four year period run from date of mailing the file and other documents to the client? From date the client receives the file? From the date of mailing the notice of termination?

To avoid unnecessary litigation, **the proposal needs to be more clear on these points.** Assuming that the client is supposed to request the file from the

attorney after receiving the notice, **there should also be some protection for the client if the attorney fails to provide access to the file** within a reasonable time after the client requests it.

Interrelationship of Deadlines

A notice of termination pursuant to proposed Section 340.8 would state in part that "even if mistakes exist in your estate planning documents, the undersigned as your attorney will no longer be liable to you or to any person taking under or seeking to enforce your estate planning documents *on the fourth anniversary of the mailing of this notice and tender of your estate planning documents*." (Emphasis added.) Regardless of whether the four years runs from the mailing of the notice or the transfer of the client's documents, this language gives the impression that the deadline will elapse no sooner than four years from the mailing of the notice.

In fact, however, a notice of termination and tender of documents pursuant to proposed Section 340.8 would only terminate actual injury tolling under Section 340.6(a)(1). As currently drafted, the provision does not appear to: (1) override the one-year-from-discovery rule, or (2) lengthen the four year limitations period under Section 340.6 if that period has already commenced. Consequently, the client may have substantially less than four years from the mailing of the notice of termination in which to sue. **The proposed notice should be revised to make this clear**, so that clients are not misled into thinking they necessarily have a full four years from the mailing of the notice (or even longer) to decide whether to sue.

It is also necessary to clarify the impact of proposed Section 340.8 on the tolling rules of Section 340.6(a)(2)-(a)(4) (continuous representation, willful concealment, and legal or physical disability). Suppose, for instance, that a client is under a legal or physical disability at the time of receiving a notice of termination, or sometime thereafter. Does a malpractice claim have to be asserted within four years from the mailing of the notice, regardless of the legal or physical disability? To prevent needless litigation, this issue should be resolved upfront.

Due Diligence

Proposed Section 340.8(a) states in part that the notice of termination "shall be deemed as effective to commence the statute of limitations to run at such time

that the notice has been deposited in the United States mail *whether or not the notice reaches the client*." (Emphasis added.) This may be unduly harsh on the client, particularly where the notice is returned to the attorney as undeliverable and obtaining a new address for the client would not be difficult. **It might be more appropriate to require the attorney to use due diligence to locate the client and attempt to ensure that the notice actually reaches the client**. The EPTPL Section "would not object to that concept." Oldman email. Possibly, however, "the statute should also encourage clients to keep counsel informed of their whereabouts so that notices can be given efficiently." *Id.*

TYPES OF CASES COVERED BY SECTION 340.6

In *Knoell v. Petrovich*, 76 Cal. App. 4th 164, 90 Cal. Rptr. 2d 162 (1999), a non-client sued an attorney for defamation due to statements that the attorney made on his client's behalf with regard to an easement. The non-client contended that the defamation action was timely under Section 340.6. The court of appeal disagreed, however, because the client had "cited no authority for the novel claim that a third party (i.e., a non-client) may invoke Code of Civil Procedure section 340.6 to toll the statute of limitations when suing an attorney for defamation." *Id.* at 169. In support of its position, the court relied not on the language of Section 340.6, but on a passage from *Laird v. Blacker*, 2 Cal. 4th 606, 609, 828 P.2d 691, 7 Cal. Rptr. 2d 550 (1992), which paraphrased the statute but substituted the word "client" for "plaintiff." *Knoell*, 76 Cal. App. 4th at 169.

A commentator has criticized the *Knoell* decision, explaining:

> [T]he rule articulated in *Knoell* distinguishing between clients and non-clients risks the creation of two different limitations periods for negligence cases of action asserted against an attorney; Section 340.6 for clients and Section 339(1) for nonclients.
>
> The revival of Section 339(1) as a limitations period for attorney malpractice would appear to substantially undermine the Legislature's goals in enacting Section 340.6 to supersede that provision. It would appear difficult to justify such a rule based upon the flimsy rationale, unsupported by any legislative intent, that when the Legislature used the term "plaintiff" in the statute it meant "client."

Boyd, *Unclear Application: Court May Review Statute of Limitations for Claims Against Attorneys*, San Francisco Daily Journal, p. 5 (March 7, 2000). A treatise by an attorney who helped draft Section 340.6 seems to support this analysis, stating

that the intent of the statute is "to encompass those liabilities that arise out of the practice of law *no matter the theory of liability*. R. Mallen, Legal Malpractice, § 21.8, at 762 (4th ed. 1996) (emphasis added).

These issues interrelate with the estate planning issues to some extent: The concerns raised by the EPTPL Section might be less pressing if it were established that Section 340.6 is inapplicable to non-clients. It is possible, however, that *Knoell* might be interpreted narrowly, such that Section 340.6 continues to apply to a non-client whose rights derive from a client. *See* Schwing, Cal. Affirmative Defenses 2d, *Legal Malpractice: One or Four Years*, § 25:33, n. 440 (2001). It would also be possible to revise the statute to make clear that it applies both to clients and to non-clients, regardless of whether the rights of a non-client derive from a client.

The Commission should consider clarifying whether and to what extent Section 340.6 applies to an action by a non-client. The staff can provide further analysis of this point for a future meeting.

Respectfully submitted,

Barbara S. Gaal
Staff Counsel

Exhibit

PROPOSAL OF STATE BAR ESTATE PLANNING, TRUST, AND PROBATE LAW SECTION

To: State Bar

Re: Project No. 00-05

SECTION / COMMITTEE AND CONTACT

Section: Estate Planning Trust and Probate Law Section
Date of Approval:

Author: Marshal A. Oldman
16133 Ventura Blvd., PHA
Encino, CA 91436
(818) 986-8080; (818) 789-0947 (fx)

Digest: Existing law at Section 340.6 of the Code of Civil Procedure provides a four year statute of limitations for legal malpractice actions against attorneys even though the client may not have discovered the malpractice. However, four exceptions to the statute of limitations may operate so as to extend the four year statute and allow later claims to be brought against an attorney. The exception that is affected by this proposal is number (1) which tolls the statute until damage has occurred. The section has been modified to allow an attorney give a notice to his client that his liability for any malpractice will end four years from the date of the notice.

Application: The proposal is designed to allow attorneys to retire or otherwise terminate their estate planning practice or attorney-client relationship and limit their liability by giving notice to their clients that counsel will no longer be responsible for the client's file. Since estate planning documents such as wills and revocable trusts are subject to change or correction, courts have ruled that no damage has

been suffered by the client or his beneficiaries until the client has become deceased. At that point, the beneficiaries are treated as third party beneficiaries of counsel's estate planning advice and are allowed to bring suit for damages caused by the malpractice. This effectively subjects the attorney to an open statute of limitations that may involve counsel in litigation decades after the work leading to the malpractice was performed. Moreover, the case may be initiated after the client's death by dissatisfied persons who may have no actual knowledge of attorney-client communications or the client's goals and wishes.

These suits are difficult to defend since the attorney's actions are being judged by hindsight, standards of practice may have changed after the actions took place, and memories may have faded over the intervening decades. The Executive Committee does not believe this is good policy since insurance companies are unwilling to provide affordable malpractice tail coverage to estate planners, attorneys cannot retire without the risk that they will be subject to suit in later years, and clients are not encouraged to correct mistakes that may be present in their estate plans until after death at which time corrections may become impossible. The current system only fosters litigation for malpractice without providing an incentive to discover and correct estate planning mistakes that may otherwise lead to malpractice actions.

This problem is somewhat unique to the estate planning area of practice. Most documents drawn by counsel, such as contracts are irrevocable at the time of execution. The four year malpractice limitation at Section 340.6 of the Code of Civil Procedure has been interpreted to run from the date of execution of the document even though the damage may not be discovered for more than four years. This first appeared in Hensley vs Caietti, 13 CalApp4th 1135, 16 CalRptr2d 837 where a family law stipulation was entered into on the record and the date of damage from measured from that date as opposed to the date that the court enforced the settlement. The Supreme Court in Jordache vs. Brobeck, Phleger & Harrison (1998) 18 C4th 739, 76 CalRptr2d 749 found that the statute of limitations ran from the moment that the plaintiff suffered legally cognizable harm and not when the damage was no longer speculative. Because of the limitation that damage must occur before the four year

statute starts to run, revocable estate planning instruments do not fall within the Hensley and Jordache opinions and counsel are subject to an open ended statute of limitations that is as uncertain as it is incalculable.

Illustration: An attorney will be able to start the running of a four statute of limitations by giving a notice to the client that the attorney is no longer taking responsibility for the file and that the client should have the file reviewed by new counsel. Whether or not the client seeks the advice of new counsel, the attorney's liability for any malpractice on the ground that no damage has occurred will terminate four years after the mailing of the notice.

Documentation: The sponsor is not aware of any formal studies or documentation.

History: No similar proposals by the State Bar are known.

Pending Litigation: The proposal has not been drawn with any pending litigation in mind. However, the Executive Committee anticipates that litigation may be in process at this time. This proposal is not designed to affect any current litigation.

Likely Support: The sponsor expects that this proposal is likely to excite little interest except from lawyers that prosecute and defend the type of malpractice actions that arise in this context.

Fiscal Impact: No fiscal impact is expected from this proposal.

Germaneness: The proposed legislation is directly related to the practice of the members of the Estate Planning, Trust and Probate Law Section. The Section has the particular expertise pertaining to the management of the affairs of persons seeking estate planning advice.

Text:

Section 1: Amendment to Section 340.6 of the Code of Civil Procedure:

Section 340.6.

(a) An action against an attorney for a wrongful act or omission, other than for actual fraud, arising in the performance of professional services shall be commenced within one year after the plaintiff discovers, or through the use of reasonable diligence should have discovered, the facts constituting the wrongful act or omission, or four years from the date of the wrongful act or omission, whichever occurs first. In no event shall the time for commencement of legal action exceed four years except that the period shall be tolled during the time that any of the following exist:

(1) Subject to Section 340.8, the plaintiff has sustained no actual injury;

(2) The attorney continues to represent the plaintiff regarding the specific subject matter in which the alleged wrongful act or omission occurred;

(3) The attorney willfully conceals the facts constituting the wrongful act or omission when such facts are known to the attorney, except that this subdivision shall toll only the four-year limitations; and

(4) The plaintiff is under a legal or physical disability that restricts the plaintiff's ability to commence the action.

(b) In an action based upon an instrument in writing, the effective date of which depends upon some act or event of the future, the period of limitations provided for by this section shall commence to run upon the occurrence of such act or event.

Section 2: Section 340.8 of the Code of Civil Procedure is hereby added to the Code.

(a) An attorney may end the tolling of the statute of limitations as provided under subparagraph (1) of paragraph (a) of Section 340.6 by sending the notice set forth in this section and if available to the counsel giving the notice by tendering the client's file and original documents in the possession of the attorney to the client. The notice shall be sent to the client at the client's last known address by certified mail, return receipt requested. The notice shall be deemed as effective to commence the statute of limitations to run at such time that the notice has been deposited in the United States mail whether or not the notice reaches the client.

(b) The notice shall be in at least 10 point bold type and shall state the following:

NOTICE OF TERMINATION OF ATTORNEY CLIENT RELATIONSHIP FOR ESTATE PLANNING MATTERS AND TENDER OF FILE AND ORIGINAL DOCUMENTS

The undersigned as your attorney will no longer take responsibility for your estate planning file. By this notice, you are hereby notified that your attorney is hereby tendering to you your file and all documents in the undersigned's possession, available to the undersigned, if any. Since the undersigned as your attorney is no longer taking any further responsibility for your file, you are encouraged to seek the advice of new counsel and to review the estate plan for any corrections that may need to be made to fit your current family situation or any mistakes that may have occurred during the undersigned's representation of you as your attorney for this estate planning matter. Further, even if mistakes exist in your estate planning documents, the undersigned as your attorney will no longer be liable to you or to any person taking under or seeking to enforce your estate planning documents on the fourth anniversary of the mailing of this notice and tender of your estate planning documents.

Please contact the office of the undersigned at the following address and telephone number:

ADDRESS
TELEPHONE NUMBER

Contact:

Marshal A. Oldman
16133 Ventura Boulevard, PHA
Encino, CA 91436
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(818) 789-0947 (fax)
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OF COUNSEL
MICHAEL FOLZ WEXLER*
KRISTINA A. HANCOCK

June 5, 2001

Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Study J—111: Statute of Repose

Dear Sir or Madam:

I read with great interest the "Practice Management Alert" on the above subject in California Trusts and Estates Quarterly. I understand this proposal would establish a four-year statute of limitations in estate planning matters, activated by written notice to a client or former client. I think this is a badly needed remedy to a serious deficiency in California law.

As an attorney who is contemplating the prospect of retirement in the next few years, I find it very disturbing to realize that I will need to purchase and carry expensive malpractice "tail coverage," assuming it is available, long after my income-earning years are over just because California seemingly has no statute of limitations on malpractice claims in connection with wills and trusts.

I strongly urge your active consideration and recommendation to the Legislature of a statute of limitations along the lines described in the "Practice Management Alert."

Very truly yours,

James M. Cowley
of COWLEY & CHIDESTER, LLP

cbi