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Focus

NAVIGATING MALPRACTICE LIABILITY

By **Stephen Raucher**
and **Matthew Bartek**

How long does a law firm remain exposed to a potential malpractice claim after an attorney leaves the firm and takes a client with him or her? Until recently, it was unclear whether the statute of limitations for malpractice claims against the former firm was tolled while the client continued to be represented in the same matter by the attorney who left the firm. A matter could drag on for years, with any potential acts of malpractice long in the past, and, so long as the attorney who left the firm continued to represent the former client in the same matter, the former firm faced a potential malpractice claim.

Tempering Concerns

In September, the California Supreme Court issued a unanimous decision that should temper these concerns, because the decision limits the potential long-term exposure of former firms to malpractice claims. In *Beal Bank SSB v. Arter & Hadden LLP*, 42 Cal.4th 503 (2007), the Supreme Court held that tolling based on a continuing attorney-client relationship does not apply to a former firm and its partners after the attorney representing the client leaves the firm.

The underlying facts in *Beal Bank* were relatively simple. *Beal Bank* had retained Arter & Hadden to handle collection of default interest that it claimed it was owed. The collection case made its way to bankruptcy court after the debtor filed for bankruptcy, and an associate at Arter & Hadden assumed primary responsibility for the case.

Arter & Hadden filed a motion for summary judgment on behalf of *Beal Bank* in the bankruptcy court, which was denied. *Beal Bank* appealed to the district court. Soon after, the associate left Arter & Hadden and took the case with him. Thereafter, the district court affirmed the bankruptcy court's ruling. An appeal to the 9th U.S. Circuit Court of Appeals was also unsuccessful.

Just less than one year after the final unsuccessful appeal (which was decided more than three years after the associate had left Arter & Hadden), *Beal Bank* filed a malpractice suit against the attorneys who had represented it in the litigation, including Arter & Hadden. Arter & Hadden demurred, arguing that *Beal Bank* suffered actual injury on the initial denial of its motion for summary judgment and that the statute of limitations was tolled only until the associate left the firm, making *Beal Bank's* lawsuit against Arter & Hadden untimely.

The trial court agreed with Arter & Hadden and sustained its demurrer without leave to amend. The 2nd District Court of Appeal reversed, holding that for equitable reasons the statute remained tolled for Arter & Hadden so long as its former associate continued to represent *Beal Bank* in the underlying matter, which made *Beal Bank's* malpractice suit timely. The Supreme Court granted review and reversed the Court of Appeal, finding that the statute of limitations was tolled only until the associate left the firm.

Resolving Conflicts

The Supreme Court's *Beal Bank* decision resolved a conflict that had developed

among the lower courts. One former case, *Crouse v. Brobeck, Phleger & Harrison*, 67 Cal.App.4th 1509 (1998), decided by the 4th District, found that continuing representation by a firm's former attorney did not toll the statute of limitations against the former firm. *Crouse* held that, if the statute were tolled, the attorney would in effect be waiving a statute-of-limitations defense for his former firm by continuing to represent the client, a result contrary to the principal that such a defense is personal to the defendant who may assert it. *Crouse* also found that the former firm would be paying the "statutory price" of tolling, without the connected benefit of having the opportunity to correct any acts of malpractice.

Another decision, by the 3rd District, *Beane v. Paulson*, 21 Cal.App.4th 89 (1993), held that tolling based on continuing representation should apply to the former firm, because of equitable considerations. *Beane* found that disruption to the attorney-client relationship may result if not for tolling, because if the client were required to sue the former firm while the client was represented in the same matter by an attorney who had left the firm, the firm likely would sue the departed attorney for indemnity, thereby disrupting an attorney-client relationship.

The *Beane* decision also found that, if not for tolling, the former firm may benefit inequitably from a statute-of-limitations defense because of the continued representation by the departed attorney. The attorney-client relationship could "lull the client into inaction," effectively eliminating any possibility that the client would sue anyone for malpractice (including the former firm) while the matter continued, while time ran out on suing the former firm for malpractice.

Affirming *Crouse*, and disapproving of *Beane*, the Supreme Court found the equitable considerations relied on in *Beane* insufficient to justify tolling against the former firm. First, the Supreme Court stated that potential disruption of an attorney-client relationship because of an indemnity suit could be minimized by the use of voluntary

tolling agreements or stays of litigation. According to the court, tolling agreements or stays would, among other things, “allow current counsel, to the extent practicable, to continue to work to ameliorate the consequences of any past mistakes.”

Second, the court discounted the possibility of adverse effects resulting from a client being lulled into inaction by the attorney. The court noted that attorneys have a fiduciary obligation to disclose material facts to their clients, including acts of malpractice. By not fulfilling those disclosure obligations, current counsel would only be putting himself at greater risk, because the statute of limitations could run on the former law firm while the attorney continued to represent the client. Thus, the court found that Section 340.6 provides an additional incentive for attorneys to fulfill their fiduciary obligations of keeping clients informed and not to lull their clients into complacency.

Emphasizing Statutes

In contrast to the *Crouse* and *Beane* decisions, which were decided essentially on equitable grounds, the Supreme Court in *Beal Bank* placed its main emphasis on the text of the relevant statute. Code of Civil Procedure Section 340.6, subdivision (a) provides that a malpractice action against “an attorney” shall start within one year after the plaintiff discovers, or should have discovered, a wrongful act or omission or within four years from the act or omission, whichever is earlier. Subdivision (a)(2) of Section 340.6, meanwhile, provides that the statute of limitations is tolled while “[t]he attorney continues to represent the plaintiff regarding the specific subject matter in which the alleged wrongful act or omission occurred.”

Under Section 340.6, the statute of limitations is tolled for an individual attorney who continues to represent the client in the same matter, even if that attorney moves from one firm to another. In deciding that this same tolling does not apply to the attorney’s former firm, the Supreme Court seized on subdivision (a)(2)’s instruction that tolling applies to “the attorney.”

The court wrote, “Under ordinary rules of grammar, [t]he ‘attorney’ in subdivision (a)(2) refers back to the ‘attorney’ who is the target of the action in subdivision (a). (Citation). Thus, under the most natural reading of the statute, an action against an individual attorney is tolled so long as that attorney continues representation; conversely, an attorney’s continued representation tolls an action only against that attorney.” Presumably, under the Supreme Court’s analysis, if subdivision (a)(2) had referred instead to “an” attorney, then the statute could be tolled against the former firm. The use of the phrase “the attorney,” however, precluded any such tolling.

Section 340.6, which went into effect in 1978, was intended to address two main issues: (1) in order to protect the interests of clients, Section 340.6 codified the rule that the statute of limitations begins to run only when the negligent act was or should have been discovered, rather than running from the time that the act occurred; and (2) in order to afford attorneys a practical ability to purchase malpractice insurance, Section 340.6 provided a definite outside-limitations period of four years (if there were no definite outside-limitations period, attorneys would be subjected to a greater risk of eventually being sued for malpractice, and malpractice insurance policy rates would be significantly higher to account for the greater risk).

The court found that an interpretation of Section 340.6 which allowed tolling against a former firm would undermine the Legislature’s intent, because it would “revive indeterminate liability for firms every time an attorney leaves and takes a client with him or her. In each such instance, exposure would extend indefinitely based on forces outside the firm’s control. In an era of ever increasing attorney mobility, the consequence of the Court of Appeal’s interpretation would be a significant increase in uncertainty over exposure, with inevitable consequences for the cost and availability of liability insurance.”

Comfort Factor

The *Beal Bank* decision should provide some level of comfort for law firms that have had attorneys leave and take clients with them. Of course, the statute of limitations on a malpractice claim does not begin to run until the negligent act or omission was or should have been discovered, so firms do not automatically become free and clear of a malpractice action one year after a matter has left the firm. Before the *Beal Bank* decision, however, a firm could have been liable for evident malpractice committed years ago by a formerly associated attorney, who, after leaving the firm, continued to represent the client in the same matter but did nothing to correct the error. The *Beal Bank* decision should eliminate this potential liability. Whether it results in lower malpractice insurance premium rates remains to be seen.

Stephen Raucher is a partner and **Matthew Bartek** is an associate at Reuben, Raucher & Blum in Los Angeles.