Appellate Reports and Cases in Brief

Lee v. Hanley

Articulates the rules governing the application of Code Civ. Proc., § 340.6, the statute of limitations for legal-malpractice claims

By Jeffrey I. Ehrlich

Lee v. Hanley

(2015) _ Cal.4th _, 191 Cal.Rptr.3d 536 (Cal. Supreme)

Why it's important: Articulates the rules governing the application of Code Civ. Proc., § 340.6, the statute of limitations for legal-malpractice claims. Holds that section 340.6 applies to claims whose merits necessarily depend on proof that an attorney violated a professional obligation in the course of rendering professional services. Accordingly, a claim for conversion, which does not necessarily depend on such proof, is not subject to section 340.6.

Synopsis: Lee's complaint pleaded that she had advanced $120,000 to her attorney, Hanley, to cover attorney's fees and costs in litigation, but that after she terminated Hanley, he refused to refund the unearned fees. Lee's new attorney sent Hanley a demand letter on December 6, 2010, seeking a refund. On December 28, 2010, Hanley returned $9,725 in unused expert-witness fees, but he did not refund any attorney's fees. Lee filed suit against Hanley on December 21, 2011, more than a year after sending her demand letter. Hanley demurred, arguing that the claim was barred under the section 340.6 one-year limitation period. The trial court sustained the demurrer without leave to amend. The Court of Appeal reversed, finding that Lee's complaint could be construed to state a cause of action for conversion, which would not be barred by section 340.6. Affirmed.

Section 340.6, by its terms, applies to "an action against an attorney for a wrongful act or omission, other than for actual fraud, arising in the performance of professional services . . . ." Hence, Lee's complaint would not survive demurrer to the extent that her claims arise in the performance of professional services by Hanley. But, while section 340.6(a) applies to claims other than strictly professional negligence claims, it does not apply to claims that do not depend on proof that the attorney violated a *professional* obligation.

In this context, a "professional obligation" is an obligation that an attorney has by virtue of being an attorney, such as fiduciary obligations, the obligation to perform competently, the obligation to perform the services contemplated in a legal services contract into which an attorney has entered, and the obligations embodied in the Rules of Professional Conduct. By contrast, as the Court of Appeal observed, section 340.6(a) does not bar a claim for wrongdoing – for example, garden-variety theft – that does not require proof that the attorney has violated a professional obligation, even if the theft occurs while the attorney and the victim are discussing the victim's legal affairs. Section 340.6(a) also does not bar a claim arising from an attorney's performance of services that are not "professional services," meaning "services performed by an attorney which can be judged against the skill, prudence and diligence commonly possessed by other attorneys."

Misconduct does not "aris[e] in" the performance of professional services for purposes of section 340.6(a) merely because it occurs during the period of legal representation or because the representation brought the parties together and thus provided the attorney the opportunity to engage in the misconduct. Nor does section 340.6(a) necessarily apply whenever a plaintiff's allegations, if true, would entail a violation of an attorney's professional obligations. The obligations that an attorney has by virtue of being an attorney are varied and often overlap with obligations that all persons subject to California's laws have. For example, everyone has an obligation not to sexually batter others (see Civ.Code, § 1708.5, subd. (a)), but attorneys also have a professional obligation not to do so in the particular context of the attorney-client relationship (see Cal. Rules of Prof. Conduct, rule 3-120). For purposes of section 340.6(a), the question is not simply whether a claim alleges misconduct that entails the violation of a professional obligation. Rather, the question is whether the claim, in order to succeed, necessarily depends on proof that an attorney violated a professional obligation as

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opposed to some generally applicable nonprofessional obligation.

Here, Lee's allegations, if true, may also establish that Hanley has violated certain professional obligations, such as the duty to refund unearned fees at the termination of the representation (Cal. Rules of Prof. Conduct, rule 3-700(D)(2)), just as an allegation of garden-variety theft, if true, may also establish a violation of an attorney's duty to act with loyalty and good faith toward a client. But because Lee's claim of conversion does not necessarily depend on proof that Hanley violated a professional obligation, her suit is not barred by section 340.6(a).

Short(er) takes

Products liability, component parts, consumer-expectation test, summary judgment: *Johnson v. U.S. Steel Corp.* (2015) __ Cal.App.4th __ (1st Dist.)

David and Laura Johnson filed a products-liability action against the manufacturers and retailers of various paints, adhesives, lubricants, solvents, and other ingredients containing benzene. They alleged that David's chronic exposure to benzene-containing products as an auto mechanic caused him to develop cancer. One of the defendants was U.S. Steel, which sold a benzene-containing coal residue called "raffinate," which was once the principal ingredient in a product called "Liquid Wrench," a solvent for loosening rusted bolts and machine parts. The trial court granted summary judgment to U.S. Steel based on the bulk-supplier defense. The court held that raffinate was not inherently defective, and so U.S. Steel could not be held liable on a design-defect theory. Reversed.

The component-parts doctrine provides that the manufacturer of a component part (or a supplier of bulk materials) is not liable for injuries caused by the finished product into which the component has been incorporated unless the component itself was defective and caused harm. If the component itself is not defective, it would be unjust and inefficient to impose liability solely on the ground that the manufacturer of the integrated product utilizes the component in a manner that renders the integrated product defective. Under the cases applying this rule, the manufacturer of a product component or ingredient is not liable for injuries caused by the finished product unless it appears that the component itself was "defective" when it left the manufacturer.

Two features distinguish the cases in which component raw materials have been found to be defective under the consumer expectations test from cases absolving the seller of the raw material from liability: first, the raw material in question is itself harmful and, without change in its composition, remains so when incorporated into other products and, second, the raw material renders the product into which it is incorporated harmful, contrary to ordinary consumer expectations.

The trial court held that the raffinate sold by U.S. Steel was not defective because Johnson "has not cited any decisional authority for the proposition that benzene is inherently defective, or that raffinate is inherently defective because it contains benzene." But it must be emphasized that the product in question is not benzene but U.S. Steel's coal-based raffinate.

The benzene contained in the raffinate may render the raffinate harmful, but it is the raffinate that is claimed to be defective under the consumer expectations test. Whether that product is defective is a question of fact, not to be decided by "decisional authority" unless by application of collateral estoppel. So far as indicated by the authorities brought to our attention, no case has determined whether the coal-based raffinate produced and sold by U.S. Steel is a defective product, and the record contains no evidence from which this factual determination can be made. The record contains no evidence tending to disprove the toxicity of raffinate or of the products into which it is incorporated in ways that would not be apparent to most people, no evidence showing that the composition of the raffinate was altered in the process of formulating Liquid Wrench, and no evidence showing that it was possible to incorporate the raffinate into Liquid Wrench or any other product without rendering that product less safe than ordinary consumers would expect. Raffinate may well be a substance with which ordinary consumers are unfamiliar and have no expectations concerning its properties or effects. Nonetheless, should the evidence show that its incorporation into Liquid Wrench, and indeed into any finished product, without change in its chemical structure causes that product to be less safe than ordinary consumers would expect, the raffinate will have been shown to contain a design defect under the consumer expectation test.

To obtain summary judgment, it was U.S. Steel's burden to present evidence negating the existence of a design defect in the raffinate. Having failed to do so, the burden of presenting contrary evidence never shifted to Johnson. In addition, the record does contain evidence creating a triable issue of this material fact. There is evidence the raffinate contained between 1 and 14 percent benzene, a known carcinogen. U.S. Steel admitted that the raffinate lacked "any objective features (a burning sensation instead of no sensation, or a foul smell instead of a sweet smell) that would alert ordinary consumers that its intended use was extremely dangerous." U.S. Steel also presented no evidence that Radiator (the maker of Liquid Wrench) added any chemical or did anything in formulating or packaging Liquid Wrench that increased the toxicity or danger of the final product from that existing when the raffinate was delivered to Radiator by U.S. Steel.

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Rescission; restoring other party to status quo; basis for denying rescission: *Wong v. Stoler* (2015) __ Cal.App.4th __ (1st Dist., Div. 1):

The Wongs purchased a home in San Carlos from the Stolers for $2.35 million. Several months after they moved in, the Wongs discovered that they and 12 of their neighbors were connected to a private sewer system and were not directly serviced by the City's public system. Believing they had been deceived, they sued the Stolers and the real estate agents who brokered the sale alleging various causes of action, including rescission. After the Wongs settled their dispute with the real estate agents for $200,000, a court trial was held on the rescission claim only. Although the court found that the Stolers, with reckless disregard, made negligent misrepresentations to the Wongs, it declined to effectuate a rescission of the contract. Instead, it ordered the Stolers to be, for a limited time, indemnifiers to the Wongs for sewer maintenance and repair costs exceeding the $200,000 they obtained in their settlement with the agents. Reversed. The trial court declined to effectuate a rescission of the contract based on incorrect justifications and its alternative remedy failed to provide the Wongs with the complete relief to which they were entitled.

A party to a contract has two different remedies when it has been injured by a breach of contract or fraud and lacks the ability or desire to keep the contract alive. The party may disaffirm the contract, treating it as rescinded, and recover damages resulting from the rescission. Or, it may affirm the contract, treating it as repudiated, and recover damages for breach of contract or fraud. Rescission and damages are alternative remedies; election of one remedy bars recovery under the other.

Before 1961, California recognized two methods by which a party to a contract could obtain rescissionary relief: (1) unilateral rescission, followed by an action to enforce the out-of-court rescission; or (2) an action for judicial rescission in which specific judicial relief is granted. In 1961, the Legislature abolished the action to obtain judicial rescission and left only an action to obtain relief based on a party effecting rescission. Hence, any post–1961 rescission must necessarily be accomplished by a party to the contract. The court does not rescind contracts but only affords relief based on a party's rescission. Both the grounds for rescission and the means by which parties may rescind their contract are governed by statute. (See Civ.Code, § 1688, et seq.) Section 1689, subdivision (b)(1) permits rescission when "the consent [to the contract] of the party rescinding was given by mistake or obtained through fraud by the party as to whom he rescinds.

There are two steps to rescind a contract, which are set forth in section 1691: (1) Give notice of rescission to the party as to whom he rescinds; (2) Restore to the other party everything of value which he has received from him under the contract or offer to restore the same upon condition that the other party do likewise, unless the latter is unable or positively refuses to do so. When notice of rescission has not otherwise been given or an offer to restore the benefits received under the contract has not otherwise been made, the service of a pleading in an action or proceeding that seeks relief based on rescission shall be deemed to be such notice or offer or both.

In rescission cases involving a real estate purchase, the seller must refund all payments received in connection with the sale. If the buyer has taken possession of the property, the buyer must restore possession to the seller. Such recovery of the consideration exchanged is part of restitution. As consequential damages, rescinding buyers or sellers may recover such items as real estate commissions paid in connection with the sale, escrow expenses, interest on specific sums of money paid to the other party, and attorney fees in appropriate cases.

The Stolers' negligent misrepresentations about the sewer system was sufficient to constitute "actual fraud" to support rescission, because negligent misrepresentation is a species of actual fraud and a form of deceit. The trial court's refusal to effectuate the rescission based on potential prejudice to the Stolers was an abuse of discretion. The focus on the prejudice to the sellers was an improper legal consideration. "[W]here defendant has been guilty of fraudulent acts or conduct which have induced the agreement between him and the plaintiff, courts of equity are not so much concerned with decreeing that defendant receive back the identical property with which he parted in the transaction, as they are in declaring that his nefarious practices shall result in no damage to the plaintiff."

The trial court also appears to have been overly concerned with the complications of unwinding the transaction. Changes were made to the property and years have transpired. But the changes in the property were commenced before the Wongs learned of the Stolers' misrepresentations, and much of the time that has elapsed has been due to the Stolers contesting the Wongs' rescission. The Wongs were entitled to recover the commissions, and other expenses they paid, which would be offset against the reasonable rental value of the property while the Wongs occupied it. "While untangling the deal may not be easy, we are unaware of any insurmountable obstacles." The case was remanded to the trial court to effectuate the rescission.

Joint and several liabilities; separate lawsuits, collateral estoppel; res judicata, claim and issue preclusion: *DKN Holdings, LLC v. Faerber* (2015) 61 Cal.4th 813 (Cal. Supreme):

Commercial landlord obtained judgment against one tenant after a trial on the merits. It later filed a second lawsuit against two co-tenants, who were jointly and severally liable under the lease, seeking money due under the lease. The trial court dismissed the complaint without leave to amend as barred by res judicata. The Court of Appeal affirmed. Reversed.

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There is no conflict between the doctrines of claim preclusion and joint and several liability. Parties who are jointly and severally liable on a contract may be sued in separate actions. Judgment in the first action does not bar judgments in later actions, even when they allege the same claim of wrongdoing, as long as the suits are against *different parties*. Because the tenants were each jointly and severally liable according to the terms of the lease they signed on the property, the landlord had separate claims against each tenant, and was entitled to pursue those claims in separate actions.

The Supreme Court admitted that its use of the terms "res judicata," "claim preclusion," and "issue preclusion" in prior cases has not always been consistent or clear. To avoid future confusion, the Court will use the terms "claim preclusion" to describe the primary aspect of the res judicata doctrine and "issue preclusion" to encompass the notion of collateral estoppel. It is important to distinguish these two types of preclusion because they have different requirements.

Claim preclusion prevents relitigation of the same cause of action in a second suit between the same parties or parties in privity with them. Claim preclusion arises if a second suit involves: (1) the same cause of action (2) between the same parties (3) after a final judgment on the merits in the first suit. If claim preclusion is established, it operates to bar relitigation of the claim altogether.

Issue preclusion prohibits the relitigation of issues argued and decided in a previous case, even if the second suit raises different causes of action. Under issue preclusion, the prior judgment conclusively resolves an issue actually litigated and determined in the first action.

Issue preclusion differs from claim preclusion in two ways. First, issue preclusion does not bar entire causes of action. Instead, it prevents relitigation of previously decided issues. Second, unlike claim preclusion, issue preclusion can be raised by one who was not a party or privy in the first suit.

Here, claim preclusion does not bar DKN from suing the second tenant (Faerber) because Faerber is not "the same party" who defended the cause of action in the first suit, nor was he in privity with that party (Caputo) based on their business partnership or cosigner status.

Nor does joint and several liability put co-obligors in privity with each other. As applied to questions of preclusion, privity requires the sharing of "an identity or community of interest," with adequate representation of that interest in the first suit, and circumstances such that the nonparty should reasonably have expected to be bound by the first suit. A nonparty alleged to be in privity must have an interest so similar to the party's interest that the party acted as the nonparty's "virtual representative" in the first action. Joint and several liability alone does not create such a closely aligned interest between co-obligors. The liability of each joint and several obligor is separate and independent, not vicarious or derivative. Thus, joint and several obligors are not considered to be in privity for purposes of issue or claim preclusion.


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