

Supreme Court of Nevada Holds That Legal Malpractice Claim Was Impermissibly Assigned

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[Tower Homes, LLC v. Heaton, ___ P.3d ___, 2016 WL 4273578 \(Nev. 2016\)](#)

Brief Summary

The Supreme Court of Nevada held that a bankruptcy trustee's stipulation and court's order permitting creditors to pursue the debtor's legal malpractice claim constituted an assignment of the claim in violation of public policy against assignments of legal malpractice claims.

Complete Summary

Tower Homes, LLC (Tower Homes) began developing a residential common ownership project (hereinafter the project). Tower Homes planned to build three 18-story condominium towers as a part of the project. Defendants were retained by Tower Homes for legal guidance. A number of individual investors (hereinafter the purchasers) entered into contracts with Tower Homes and made earnest money deposits to reserve condominium space. The project failed, and Tower Homes entered Chapter 11 bankruptcy protection.

The purchasers were among the many creditors during the bankruptcy proceedings. A plan of reorganization was created by the bankruptcy trustee, and a confirmation order was entered by the bankruptcy court in 2008. The plan and the confirmation order stated that the trustee and the bankruptcy estate retained all legal claims. In 2010, the bankruptcy trustee entered into a stipulation with the purchasers recognizing that the trustee did not have sufficient funds to pursue any legal malpractice claims arising out of the loss of the purchasers' earnest money deposits and permitting the purchasers to pursue that claim in the Tower Homes' name. The bankruptcy court then entered an order authorizing the trustee to release to the purchasers all of Tower Homes' claims against any individual or entity that was liable for the loss of the earnest money deposits.

Pursuant to the 2010 order, the purchasers filed a legal malpractice lawsuit in 2012 against defendants, naming Tower Homes as plaintiff, alleging negligence and breach of fiduciary duty claims. The district court was not satisfied that the purchasers had standing under the 2010 order to pursue the claim, but it allowed the purchasers to ask the bankruptcy court for an amended order to remedy any potential concerns.

In 2013, the trustee and bankruptcy court again attempted to allow the purchasers to pursue the claims. The second stipulation agreed to by the trustee and the purchasers stated, in relevant part, as follows:

1) The Trustee has determined that he does not intend and, in any event, does not have sufficient funds in the Estate to pursue claims on behalf of the Debtor ...

5) The Trustee hereby stipulates and *agrees to permit the Tower Homes Purchasers to pursue ... the action currently filed in the Clark County District Court styled as Tower Homes, LLC v. William H. Heaton, et al. ...*

The relevant portion of the bankruptcy court's corresponding order stated:

[T]his Order authorizes the *Trustee to permit the Tower Homes Purchasers to pursue any and all claims on behalf of Tower Homes, LLC* (the "Debtor") ... which shall specifically include ... pursuing the action currently filed in the Clark County District Court styled as *Tower Homes, LLC v. William H. Heaton et al. ...*

[T]his Court hereby authorizes the law firm of Marquis Aurbach Coffing, and/or Prince & Keating LLP ... to recover any and all earnest money deposits, damages, attorneys fees and costs, and interest thereon on behalf of Debtor and the Tower Homes Purchasers and that any such recoveries *shall be for the benefit of the Tower Homes Purchasers.*

Defendants moved for summary judgment in the district court, arguing that the 2013 bankruptcy stipulation and order constituted an impermissible assignment of a legal malpractice claim to the purchasers. The district court agreed and granted summary judgment in favor of defendants. Plaintiff appealed.

The court initially noted that when Tower Homes filed for bankruptcy protection, the trustee was allowed to pursue a potential legal malpractice claim against defendants. The issue presented here, however, was whether the bankruptcy order impermissibly assigned a legal malpractice claim under Nevada law. The court recognized that under Nevada law, like most jurisdictions, the assignment of legal malpractice claims is generally prohibited. "As a matter of public policy, we cannot permit enforcement of a legal malpractice action which has been transferred by assignment ... but which was never pursued by the original client." *Chaffee v. Smith*, 98 Nev. 222, 223–24, 645 P.2d 966, 966 (1982). "The decision as to whether to bring a malpractice action against an attorney is one peculiarly vested in the client." *Id.*

Notwithstanding the rule set forth in *Chaffee*, the purchasers argued that they were named representatives of the estate and under federal law, a Chapter 11 bankruptcy plan may permit such representatives to bring a legal malpractice claim on behalf of the estate without an assignment, or alternatively, that there was no assignment of the legal malpractice claim, only an assignment of proceeds. Defendants argued that the 2013 bankruptcy stipulation and order did not appoint the purchasers to represent the bankruptcy estate in a legal malpractice

claim on behalf of the estate as permitted under 11 U.S.C. § 1123(b)(3)(B) (2012), but instead purported to authorize the purchasers to prosecute a legal malpractice action on their own behalf and benefit in Tower Homes' name, thus constituting an unlawful assignment of a legal malpractice claim.

Courts recognize that creditors can bring a debtor's legal malpractice claim under bankruptcy law when certain conditions are satisfied. See *Musick*, 90 Cal.Rptr.2d at 708. 11 U.S.C. § 1123(b)(3)(B) (2012) states: "a plan may ... provide for ... the retention and enforcement [of a claim of the estate] by the debtor, by the trustee, or *by a representative of the estate* appointed for such purpose, of any such claim or interest." (emphasis added). Where a Chapter 11 bankruptcy plan of reorganization grants a creditor the right to pursue a claim belonging to the debtor's estate pursuant to 11 U.S.C. § 1123(b)(3)(B) as a representative of the estate, and where the representative "has no independent claim to any proceeds from a successful prosecution, there has been no assignment." *Appletree Square I Ltd. P'ship v. O'Connor & Hannan*, 575 N.W.2d 102, 106 (Minn.1998). Pursuit of such a claim by a bankruptcy estate representative is not contrary to the rule prohibiting assignment because the representative "does not own the claim and is entitled only to reimbursement for incurred expenses and a reasonable hourly fee for its services," as permitted by federal bankruptcy law. "[I]f a party seeks to prosecute the action on its own behalf, it must do so as an assignee, not as a special representative."

Here, although the purchasers argued the bankruptcy stipulation and order authorized them to bring the legal malpractice action in Tower Homes' name on behalf of the estate as set forth in section 11 U.S.C. § 1123(b)(3)(B), the bankruptcy court's order transferred control and proceeds of the claim to the purchasers. The court thus concluded that the purchasers were not pursuing a legal malpractice action on behalf of Tower Homes' estate as provided under 11 U.S.C. § 1123(b)(3)(B).

When the 11 U.S.C. § 1123(b)(3)(B) conditions are not satisfied, Nevada law prohibits the assignment of legal malpractice claims from a bankruptcy estate to creditors. To overcome these problems, the purchasers argued they were only assigned proceeds, not the entire malpractice claim. The court held, however, even if an assignment of the claim is distinguished from a right to proceeds in the legal malpractice context, the 2013 bankruptcy stipulation and order constituted an assignment of the entire claim. The court previously determined that the difference between an assignment of an entire case and an assignment of proceeds was the retention of *control*. When only the proceeds are assigned, the original party maintains control over the case. When an entire claim is assigned, a new party gains control over the case. Here, the bankruptcy court gave the purchasers the right to "pursue any and all claims on behalf of ... [d]ebtor." No limit was placed on the purchasers' control of the case, and the purchasers were entitled to any recovery. The court thus concluded that the district court properly determined that the legal malpractice claim was assigned to the purchasers. Summary judgment in favor of defendants was therefore affirmed.

Significance of Opinion

In most jurisdictions, legal malpractice claims are not assignable, and this case underscores the dangers of creative attempts to pursue legal malpractice actions by persons other than the former client.

For more information, please contact [Terrence P. McAvoy](#).

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Terrence P. McAvoy

Of Counsel

☎ 312-704-3281