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## Tower Homes v. Heaton, Nev. Adv. Op. 62, (Aug. 12, 2016)

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## BANKRUPTCY LAW; ASSIGNMENT OF MALPRACTICE CLAIM

### **Summary**

The Nevada Supreme Court determined that granting creditors control over a debtor's legal malpractice claim and any proceeds resulting from the action constituted an improper assignment of a legal malpractice claim that was contrary to public policy.

### **Background**

Appellant Tower Homes developed the Spanish View Towers Project with plans to build condominium towers. Attorney William Heaton and the law firm Nitz Walton & Heaton, Ltd. (collectively Heaton, the appellee) were retained by Tower Homes for legal guidance related to the project. Individual investors (hereinafter the purchasers) entered into contracts with Tower Homes and put down deposits to reserve condominium space. The project failed, and Tower Homes entered Chapter 11 bankruptcy. The purchasers became creditors during the bankruptcy proceedings. Per the bankruptcy plan, the trustee and the bankruptcy estate retained all legal claims.

Because the bankruptcy trustee lacked the funds to pursue a legal malpractice claim arising out of the loss of the purchasers' deposits, the trustee entered into a stipulation with the purchasers allowing them to pursue a claim in Tower Homes' name. In 2010, the bankruptcy court issued an order giving the purchasers authorization to pursue a claim. The purchasers filed a legal malpractice lawsuit against Heaton in 2012, naming Tower Homes as plaintiff. The district court was not satisfied that the purchasers had standing to pursue the claim, but allowed the purchasers to seek an amended order.

In 2013, the trustee and the bankruptcy court again attempted to grant the purchasers authorization to pursue the malpractice claim. The second stipulation stated that the trustee had insufficient funds and no intent to pursue the claim, and that the trustee gave permission to the Tower Homes purchasers to pursue it. The bankruptcy court issued an order stating that the purchasers could pursue the claims on Tower Homes' behalf, and that any recovery would benefit the Tower Homes purchasers. Heaton argued that this was an unallowable assignment of a legal malpractice claim. The district court granted Heaton's motion for summary judgment. Tower Homes appealed.

### **Discussion**

Filing a bankruptcy petition translates all of the debtor's property into the property of the bankruptcy estate (with some exceptions).<sup>2</sup> A bankruptcy trustee is charged with managing the estate and recovering assets for the creditor.<sup>3</sup> A trustee is allowed to pursue a debtor's legal

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<sup>1</sup> By Sydney Campau.

<sup>2</sup> 11 U.S.C. § 541(a) (2012).

<sup>3</sup> 11 U.S.C. § 704(a) (2012); 11 U.S.C. § 1123(b)(3)(B) (2012).

claim.<sup>4</sup> However, whether the bankruptcy court's order granted an impermissible assignment of a legal malpractice claim is at issue here.

*Under Nevada law, the assignment of legal malpractice claims is generally prohibited*

The Court has found that enforcing a transferred legal malpractice claim that was never pursued by the original client is contrary to public policy, because the choice as to whether to bring a malpractice action belongs uniquely to the client.<sup>5</sup> In the present case, the purchasers argued that, as named representatives of the estate, they had permission to bring a claim on behalf of the estate without an assignment, or, alternatively, that only the recovery was assigned, not the claim itself. Heaton argues that the 2013 stipulation did not appoint the purchasers as representatives of the estate, but rather improperly granted them authorization to pursue the claim on their own behalf in the name of Tower Homes, and that this constituted an unlawful assignment of a malpractice claim.

*Bankruptcy statutes permit bankruptcy creditors to bring debtor malpractice claims under certain conditions*

Nevada law generally prohibits the assignment of legal malpractice claims, but when, in accordance with a bankruptcy plan, a Chapter 11 creditor brings a claim as a representative of the estate, and “has no independent claim to any proceeds from a successful prosecution, there has been no assignment” of the claim.<sup>6</sup> A representative must be prosecuting the claim “on behalf of the estate.”<sup>7</sup> This means that the representative “does not own the claim and is entitled only to reimbursement for incurred expenses and a reasonable hourly fee for its services.”<sup>8</sup> Otherwise, it is an impermissible assignment. “[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.”<sup>9</sup> The purchasers were given control over the proceeds.

*The legal malpractice claim against Heaton was improperly assigned to the purchasers*

The purchasers' contention that they were only assigned proceeds, not the entire claim against Heaton, was not convincing to the Court. The difference between an assignment of an entire case and an assignment of proceeds is whether the original party retains control.<sup>10</sup> The purchasers were given control over the action and the proceeds in the 2013 stipulation and order without limitation. Allowing the purchasers to bring this claim would threaten the personal attorney-client relationship, and potentially breach the duty of confidentiality Heaton owes to Tower Homes. Formal language is not required to constitute a valid assignment.

## **Conclusion**

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<sup>4</sup> Office of Statewide Health Planning & Dev. v. Musick, Peeler & Garrett, 90 Cal. Rptr. 2d 705, 707-08 (Ct. App. 1999); see also In re J.E. Marion, Inc., 199 B.R. 635, 637 (Bankr. S.D. Tex. 1996).

<sup>5</sup> Chaffee v. Smith, 98 Nev. 222, 223-34, 645 P.2d 966, 966 (1982).

<sup>6</sup> Appletree Square I Ltd. P'ship v. O'Connor & Hannan, 575 N.W.2d 102, 106 (Minn. 1998).

<sup>7</sup> Musick, 90 Cal. Rptr. 2d at 708.

<sup>8</sup> Id.

<sup>9</sup> Id.

<sup>10</sup> Edward J. Achrem, Chartered v. Expressway Plaza Ltd. P'ship, 112 Nev. 737, 741, 917 P.2d 447, 449 (1996).

The Court concluded that the district court was correct in their determination that the legal malpractice claim was improperly assigned to the purchasers, and affirmed the district court's summary judgment.