UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
RIVERSIDE DIVISION

In re: Maria Elena Rodriguez Debtor(s).	CHAPTER 7 Case No.: 6:14-bk-18824-MW Adv No: 6:19-ap-01047-MW
Ford Walker Haggerty & Behar, LLP Plaintiff(s), v. Larry D Simons Defendant(s).	**MEMORANDUM DECISION AND ORDER** Date: December 5, 2019 Time: 9:00 AM Courtroom: 225

Howard J. Steinberg, on behalf of Ford, Walker, Haggerty & Behar, LLP and Timothy P. McDonald

Jon D. Robinson, on behalf of Ford, Walker, Haggerty & Behar, LLP, and Timothy P. McDonald

Daniel A. Lev, on behalf of Larry D. Simons, Chapter 7 trustee

Larry D. Simons, Chapter 7 trustee

WALLACE, J.

Plaintiffs Ford Walker Haggerty & Behar, LLP (the "Law Firm") and Timothy McDonald ("Mr. McDonald") (collectively, "Plaintiffs") and defendant Larry D. Simons, in his capacity as chapter 7 trustee (the "Trustee") of the bankruptcy estate of Maria Elena Rodriguez (the "Debtor"), bring these cross-motions for summary judgment with respect to Plaintiffs' action for a declaratory judgment determining that the Trustee lacks standing in a malpractice action in state court against the Law Firm, because such malpractice action and a related cause of action for breach of fiduciary duty allegedly are not property of Debtor's bankruptcy estate.

FACTUAL BACKGROUND

Plaintiffs and the Trustee have provided the Court with a Joint Statement of Uncontroverted Facts in support of their cross-motions for summary judgment.

The salient facts are as follows: While driving intoxicated in Debtor's 2005 Toyota Camry, Elba Jimenez ("Jimenez") crashed the Camry, killing Claudia Fernandez. Rachel Fernandez ("Ms. Fernandez") brought suit against Jimenez, Debtor and others for wrongful death and against Debtor for negligent entrustment of the Camry to Jimenez. The Law Firm was engaged by Infinity Insurance Company to defend Debtor and Jimenez. Such representation continued through trial to the filing of a notice of appeal and post-trial motions. The Law Firm filed an answer to the complaint on November 25, 2013. The answer consisted of a general denial of the complaint's allegations and an assertion of 11 affirmative defenses. The eighth affirmative defense prayed for an allocation of any damages based upon degree of fault (as opposed to joint liability for all damages). However, it can be argued that the eighth affirmative defense is limited to the assertion of comparative fault as against parties other than Debtor and Jimenez as opposed to Debtor asserting comparative fault as against Jimenez.

Debtor filed a chapter 7 petition on July 9, 2014. The Debtor received a discharge on October 20, 2014, and the bankruptcy case was closed on October 21, 2014. Ms. Fernandez was not given actual notice of the Debtor's bankruptcy case while it was pending and only learned of it after a judgment had been entered in her favor against Jimenez and Debtor. As of the petition date, there had been no rulings on any substantive issues in the state court action against Jimenez and Debtor.

Ms. Fernandez won the state court action against Debtor and Jimenez. A judgment of $58,520,600 was entered in her favor on April 6, 2018, following a jury verdict on September 2, 2016. There was no allocation of fault as between Jimenez and Debtor with the result that Debtor is jointly and severally for at least $45,000,000 of the judgment and possibly for its entirety. The Debtor and Jimenez took an appeal from the judgment and that appeal is still pending.

Debtor's bankruptcy case was reopened on January 29, 2018, on motion by the Office of the United States Trustee. The Trustee was appointed chapter 7 trustee of the bankruptcy estate and filed a "Notification of Asset Case." Ms. Fernandez filed a proof of claim in the amount of $58,520,600. The Trustee brought suit against the Law Firm in California state court for legal malpractice and breach of fiduciary duty. The Law Firm commenced an adversary proceeding in this Court seeking a declaratory judgment that the alleged malpractice and breach of fiduciary duty causes of action (which are based upon identical facts) asserted by the Trustee in California state court are not property of the bankruptcy estate under 11 U.S.C. § 541(a). The California state court action has been stayed pending the resolution of this adversary proceeding.

THE COMPETING LEGAL THEORIES

The complaint in the California state court action alleges that the Law Firm committed breach of fiduciary and legal malpractice by (1) representing both Debtor and Jimenez despite their divergent interests under percentage-of-fault (this claim sounds in conflict of interest); and (2) failing to prosecute an affirmative defense of percentage-of-fault (or comparative fault) on Debtor's behalf. Plaintiffs contend that even if they committed malpractice or breached their fiduciary duties, these causes of action had not accrued as of the petition date, with the result that any malpractice chose in action is not property of the Debtor's bankruptcy estate. The Trustee takes an opposite position, arguing that a cause of action for malpractice and breach of fiduciary duty had accrued – and therefore became bankruptcy estate property – as of the petition date.

ANALYSIS

In re Pacific Cargo Services, LLC, BAP No. OR-14-1036 KiKuJu, 2015 WL 728048 (B.A.P.

9th Cir., Feb. 19, 2015) (unpublished but cited by this Court for its persuasive reasoning) establishes the validity of several important propositions relating to this case: An estate is created when a bankruptcy petition is filed and is comprised of all legal or equitable interests of the debtor in property as of the case's commencement. Although state law defines the nature of a debtor's interest in property, whether this interest is estate property is a matter of federal bankruptcy law. Property for purposes of federal bankruptcy law is construed broadly to include any state law right that has some potential value to the debtor. Assets of the estate include any of the debtor's existing causes of action. A cause of action that has accrued prior to a debtor's petition date is an estate asset. However, if a cause of action did not accrue prior to the petition date, it is not estate property, and a debtor has no obligation to schedule it. A bankruptcy court should look to state law to determine when a cause of action accrues. *See also Folks v. Folks,* 211 B.R. 378 (B.A.P. 9th Cir. 1997).

Under California law, it is black-letter law that a cause of action for legal malpractice does not accrue until the client suffers damage. *Budd v. Nixen,* 6 Cal. 3d 195, 198 (1971) (Tobriner, J.). A mere breach of a professional duty, causing only nominal damages, speculative harm or the threat of future harm -- not yet realized – does not suffice to create a cause of action for legal malpractice. *Id.* at 200. However, a client need not suffer all or even the greater part of his damages for the cause of action to accrue. "Any appreciable and actual harm flowing from the attorney's negligent conduct establishes a cause of action upon which the client may sue." *Id.* at 201.

The foregoing rules of California law were analyzed and applied in *Callahan v. Gibson, Dunn & Crutcher*, 194 Cal. App. 4th 557 (2d Dist. 2011). Gibson Dunn prepared a limited partnership agreement containing allegedly defective succession and termination provisions and omitted any method for replacement of the general partners if they became incompetent or retired. Thus, in a sense, Gibson Dunn's work resulted in a kind of ticking time bomb, but a bomb that was not certain to go off, as the Court of Appeal pointed out: "So, too, in the case at bar, Gibson, Dunn's alleged negligence in drafting the succession and termination provisions in the partnership agreement created only a potential for harm prior to Oliver's death and the onset of Robert's purported disabling physical and mental condition. If Robert had survived Oliver's death and then died himself while fully engaged in managing Inge Realty Company as its sole general partner, paragraph 13.3(b) of the limited

partnership agreement would have governed; and Sophia, Robert's surviving spouse, could have been elected as the successor general partner. In that event, the partnership would have continued on the same terms and conditions as before, and Gibson Dunn's alleged negligence in failing to provide a succession plan in the event of the retirement or incapacity of the surviving general partner would have never ripened into actual injury." 194 Cal. Ap. 4th at 573-574. As events turned out, Robert became incapacitated, triggering dissolution of the limited partnership with no provision for continuing the partnership's business.

The California Court of Appeal determined that the Robert Inge family members suffered damages about the time Robert was incapacitated (sometime in the first few months of 2004) even though the full amount of damages could not then be determined. *Id.* at 574. The California Court of Appeal flatly rejected the notion that the plaintiffs in the malpractice injury first sustained actual injury when the limited partnership agreement became effective in October 1988. *Id.* at 575.

A possible analysis in the case was that the Robert Inge family members suffered damages at some point in time after the limited partnership agreement became effective because such family members would have had to incur attorneys' fees to amend the agreement to correct Gibson Dunn's error. However, the Court of Appeal rejected this analysis as well: "That is, if Inge Realty Company or Oliver or Robert personally had incurred attorney fees to remedy the defects in the partnership agreement caused by Gibson Dunn's drafting errors, those fees would be tort damages recoverable in a malpractice action and would constitute actual injury within the meaning of section 340.6(a) . . . . But no such remedial action was ever taken in this case, and the cost of amending the agreement was merely hypothetical, not "actual."[1]

The case at bar is closely analogous to *Callahan* but not entirely like it. An attorney zealously and competently representing Debtor's interest (and, hypothetically, taking over Debtor's representation from the Law Firm after the answer was filed) would have sought to amend the answer to make it perfectly clear that Debtor was asserting that she was much less at fault than Jimenez in comparative fault terms and would have pressed this issue hard at trial. However, no such attorney

[1] *Id.* at 577. To be sure, the Court of Appeal's analysis of the issues is with respect to tolling of the statute of limitations. However, there is nothing in the opinion suggesting that "actual injury" for tolling purposes is different than "actual injury" with respect to the accrual of a cause of action.

ever appeared – just as no attorney was ever engaged in *Callahan* to correct the limited partnership agreement – and under *Callahan* it would seem to follow that damages at that stage of the case were merely hypothetical, not actual.

Nevertheless, an important difference between the case at bar and *Callahan* may be that here, unlike in *Callahan*, it is an open question whether by the time the answer was filed (given all the facts in the state court proceeding), it was inevitable or at least strongly probable as of the petition date that the ship on which Debtor was aboard was sailing into disaster. Because the California state court did not address the health of Robert or Oliver as of the date the limited partnership agreement was drafted, it can be inferred that it was not inevitable or strongly probable as of that date that Robert or Oliver would become prematurely incapacitated (leading to the limited partnership's dissolution with no right to continue the partnership's business).

Evidence has not been presented to the Court on this question, but the question must be answered before the Court can reach a conclusion as to whether the malpractice and breach of fiduciary duty causes of action accrued before the petition date. For instance, assume hypothetically that internal Law Firm memoranda (normally protected by work product privilege but likely discoverable here because it is a malpractice action) show that the Law Firm had made a studied decision before the answer was even filed – perhaps because of the Law Firm's dual representation of Debtor and Jimenez – to permanently refrain from asserting the comparative fault doctrine as between Debtor and Jimenez and not to assert this doctrine at any time during the proceeding. If such were the facts, a case can be made that actual injury occurred on the date the Law Firm made that decision, because Debtor would have effectively lost at that point in time as a practical matter a legal defense available to her (comparative fault). *See, e.g., Jordache Enterprises, Inc. v. Brobeck, Phleger & Harrison*, 18 Cal. 4th 739, 744 (1998): "The loss or diminution of a right or remedy constitutes injury or damage." Again, all this is hypothetical, but what is not hypothetical is that evidence has not been presented to the Court on the factual issue of whether the Law Firm had in fact made a conscious, studied decision to abandon a comparative fault defense (vis-à-vis Jimenez) prior to the petition date.

Another issue on which no evidence has been provided to the Court is whether the state court would have been likely to grant a motion to amend the answer to more clearly assert comparative fault

as against Jimenez. The Court has the sense that the state court would have granted a motion to amend the answer under modern pleading rules but this is speculation on an issue where the Court should not be put in a position of guessing.

The conflict of interest cause of action may be inextricably interwoven with the failure-to-assert-comparative-fault-against-Jimenez issue. No evidence has been presented to this Court on whether the Law Firm chose not to assert comparative fault on Debtor's behalf against Jimenez because it was well aware of the conflict of interest issue such a defense would make manifest. The Court is not saying that this actually happened, only that no evidence has been presented on the point and that the issue goes to when the cause of action accrued.

For these reasons, the Court determines that neither Plaintiffs nor the Trustee have shown that they are entitled to judgment as a matter of law. Fed. R. Bankr. P. 7056, Fed. R. Civ. P. 56(a). For these reasons, the Court denies each of the cross-motions for summary judgment.

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Date: December 16, 2019

Mark S. Wallace
United States Bankruptcy Judge