

Fifth Circuit Holds That Malpractice Plaintiff Has Suffered Compensable Damages Even If Judgment Debt Resulting From Alleged Malpractice Is Discharged in Bankruptcy.

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When a lawyer's malpractice results in a large money judgment against the client and the client is forced to file bankruptcy to avoid that judgment, has the client suffered any damages if the client is discharged of that liability? The Fifth Circuit recently answered that question yes.

In *Stanley v. Trinchard*ⁱ, the client Gary Hale alleged that the negligence of Trinchard & Trinchard LLC and certain of its attorneys resulted in an adverse uninsured judgment against him for more than \$4,000,000. Hale was forced into an involuntary bankruptcy, and the bankruptcy trustee filed suit against the Trinchard defendants for legal malpractice. Hale was later discharged in the bankruptcy proceeding. The district court granted summary judgment for the defendants in the malpractice action, concluding that Hale's bankruptcy discharge made it impossible for the trustee to show that any damages resulted from the alleged malpractice. The trustee appealed.

On appeal, the Fifth Circuit confirmed that when a legal malpractice cause of action has accrued to a debtor as of the commencement of the bankruptcy case, it becomes part of the debtor's bankruptcy estate.ⁱⁱ The trustee of a debtor's bankruptcy estate may pursue any claims that are property of the bankruptcy estate. Therefore, "[b]ecause the claims are property of the bankruptcy estate, the trustee is the real party in interest with exclusive standing to assert them."ⁱⁱⁱ This tenet of federal bankruptcy law trumps any state laws that would otherwise prohibit the assignment of legal malpractice claims.

The court then considered whether the trial court was correct in granting summary judgment in favor of the Trinchard defendants on the basis that the trustee could not demonstrate any compensable damages. In seeking to uphold the summary judgment, the Trinchard defendants urged the court to apply the holding of a Michigan bankruptcy court in *McClarty v. Gudenau*.^{iv} In that case, the bankruptcy court found that "[the trustee] will be unable to prove damages in the amount of the [underlying judgment] because the debtor, in whose shoes [the trustee] stands, no longer owes this debt as a result of her discharge."^v

The Fifth Circuit disagreed, noting that its prior decisions in *In re Edgeworth*^{vi} and *In re Segerstrom*^{vii} establish that a bankruptcy discharge eliminates only the debtor's personal liability

and not the debt itself. The court wrote that, when the bankruptcy proceedings commenced, Hale was a multi-million dollar judgment debtor, allegedly because of the defendants' negligence. Concluding that it was improper to excuse the malpractice liability of a potentially negligent attorney simply because of the "financial misfortunes" of the client/tort victim, the Fifth Circuit held that "Hale's subsequent discharge from personal liability through the bankruptcy proceedings is irrelevant."^{viii}

The Trincharde defendants also argued that Hale's unpaid judgment debt did not constitute a legal injury. Because no Louisiana or Fifth Circuit case had specifically addressed this issue in the context of a legal malpractice case, the court made an "Erie guess" as to whether Louisiana would adopt the "judgment rule" – which premises a legal malpractice injury on the entry of an adverse judgment whether or not any money has been paid or whether or not the judgment is collectible, or the "payment rule" – which provides that a plaintiff suffers no damage until he actually pays all or part of a judgment allegedly caused by legal malpractice. After considering (1) the "general rule" evident from Louisiana court decisions in contexts other than legal malpractice, (2) decisions from other jurisdictions,^{ix} and (3) general policy concerns, the Fifth Circuit predicted that Louisiana would be more likely to follow the judgment rule under the circumstances present in *Stanley*. The court wrote: "we do not believe that Louisiana would adopt a rule that would require its courts to recognize the legal malpractice cause of action of a solvent claimant but reject an otherwise identical action brought by a claimant forced by that very malpractice to seek bankruptcy protection."^x The court therefore ruled that Hale had incurred a legal injury – in the form of an adverse money judgment.

The court therefore reversed the summary judgment and remanded to the trial court for further proceedings.

ⁱ *Stanley v. Trincharde*, Nos. 06-30120, 06-30299, 2007 WL 2669828 (5th Cir. Sept. 13, 2007).

ⁱⁱ *Id.* (citing *In re Segerstrom*, 247 F.3d 218, 233 (5th Cir. 2001)).

ⁱⁱⁱ *Id.* at *3 n.14 (quoting *Wieburg v. GTE Southwest, Inc.*, 272 F.3d 302, 306 (5th Cir. 2001)).

^{iv} 176 B.R. 788 (E.D. Mich. 1995).

^v *Stanley*, 2007 WL 2669828 (quoting *McClarty*, 176 B.R. at 790).

^{vi} 993 F.2d 51 (5th Cir. 1993).

^{vii} 247 F.3d 218 (5th Cir. 2001).

^{viii} *Stanley*, 2007 WL 2669828, at *6.

^{ix} The court noted that both the Texas and Virginia supreme courts have adopted the judgment rule in the legal malpractice context. Citing *Montfort v. Jeter*, 567 S.W.2d 498, 499 (Tex. 1978) and *Shipman v. Kruck*, 593 S.E.2d 319, 326 (Va. 2004).

^x *Stanley*, 2007 WL 2669828.