Dated: January 30, 2012
The following is SO ORDERED:

Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re	EARL BENARD BLASINGAME and MARGARET GOOCH BLASINGAME, Debtors.	Case No. 08-28289-L Chapter 7

ORDER GRANTING MOTION FOR DERIVATIVE STANDING

BEFORE THE COURT is the "Motion for Order Authorizing Creditor to Pursue, on a Derivative Basis, (Not An Assignment of Claim) Estate Claims and/or Causes of Action Against Counsel for Debtors" filed jointly by Edward L. Montedonico, Chapter 7 Trustee ("Trustee"), and Church Joint Venture ("Church JV") (collectively, the "Movants"), on October 17, 2011. Objections were filed by Joseph T. Townsend and Tommy L. Fullen, by their attorney, Charles Exum, and by Martin Grusin, by his attorney, Michael Johnson. A limited objection was filed by the Debtors through their attorney, David J. Cocke. The court conducted a hearing on November 16, 2011, at which the court requested additional briefing. Briefing was completed on December 20, 2011. For the reasons set forth below, the court concludes that the motion should be granted.

I. ISSUES PRESENTED

The issues raised by the motion and objections are:

1. Whether Townsend, Fullen, and Grusin, who are the targets of potential litigation that the Trustee and Church JV have asked that Church JV be permitted to pursue, have standing to object to the motion?
2. What standard should be applied for determining whether a "colorable" claim exists?
3. Whether the motion should be granted under the facts and circumstances of this case?

II. JURISDICTION

The motion arises in the bankruptcy case of Earl Benard Blasingame and Margaret Gooch Blasingame, which is pending before this bankruptcy court. All actions arising in bankruptcy cases pending in this judicial district have been referred to the bankruptcy judges of this district for decision. *In re Bankruptcy Jurisdiction and Procedure under the Bankruptcy Amendments Act of 1984*, Misc. Order No. 84-30 (W.D. Tenn. July 11, 1984). Therefore, this court has jurisdiction and authority to decide this core proceeding. 28 U.S.C. §§ 1334(b), 157(b)(1).

III. FACTUAL BACKGROUND

This bankruptcy case was commenced with the filing of a voluntary petition under Chapter 7 of the Bankruptcy Code on August 15, 2008. Dkt. No. 1. Montedonico was appointed trustee pursuant to an order entered on the day of filing. Dkt. No. 2. The petition was signed by Tommy Fullen as attorney for the Debtors. Dkt. No. 1.

On September 29, 2009, the Trustee, Church JV, and Farmers and Merchants Bank of Adamsville, Tennessee ("FMB") filed a complaint against the Debtors and certain trusts and entities

involving the Debtors seeking, inter alia, the denial of the Debtors' discharge. Adv. Proc. No. 09-00482. On February 22, 2011, the court entered its order granting the plaintiffs' motion for partial summary judgment, denying the Debtors' discharge. Adv. Dkt. No. 117. On February 23, the Clerk entered his Notice of Entry of Judgment. Adv. Dkt. No. 118. On March 8, 2011, the Debtor-Defendants filed their motion to alter or amend the judgment. Adv. Dkt. No. 126. Attached to the motion were the affidavits of Grusin and Fullen setting forth facts concerning the formation, intention, funding, and purpose of the corporate and trust defendants and the preparation of the Debtors' bankruptcy schedules and statements that the Trustee believes support a claim of legal malpractice against Fullen and Grusin. *See* Dkt. No. 354, ¶ 8.

On April 19, 2011, Church JV and FMB filed their motion to disqualify counsel for the defendants, which was granted (Adv. Dkt. Nos. 142, 187). The court determined that as the result of conflicts of interest, Townsend, Fullen, and Grusin are not qualified to represent the defendants in the adversary proceeding. A timely appeal was taken from this order. Adv. Dkt. No. 200. The appeal was later dismissed for lack of prosecution. Adv. Dkt. No. 222.

The Trustee believes that some or all of the potential malpractice claims belong to the bankruptcy estate. The Trustee requested that debtors' counsel[1] put their malpractice carriers on notice of the potential that malpractice claims might be filed against them and their firms. Church JV made demand upon the Trustee to investigate and pursue any claims belonging to the estate. At the hearing on November 16, 2011, the court heard the testimony of the Trustee

[1] Townsend appeared as counsel for the Debtors in the adversary proceeding. Although he was included in the scope of the disqualification order, it is not clear from the record that he participated in the drafting of the bankruptcy schedules and statements. He did not provide an affidavit in support of the motion to alter or amend. The court thus is unclear about whether Mr. Townsend is a target of any potential claim belonging to the bankruptcy estate.

concerning his belief, based upon the affidavits filed by Fullen and Grusin, that their legal malpractice is "patent." The Trustee further testified that the estate is without sufficient resources to bring the litigation on an hourly fee basis, and that he had been unable to locate counsel willing to represent the estate on a contingency basis.

The Trustee requests that the court authorize Church JV to pursue the legal malpractice claims on a derivative basis, acting by counsel of its choosing. The terms of the Trustee's proposed agreement with Church JV are these:

- The Claims are, and will continue to be property of the Debtor's estate.
- Church JV shall be entitled to bring an action or actions on the Claims in its own name, derivatively on behalf of the bankruptcy estate.
- Church JV shall be entitled to retain and pay the fees and expenses of counsel of its choosing to pursue an action or actions on the Claims;
- Church JV will consult with the Trustee and/or his counsel of record with respect to material decisions involving actions taken on the claims including settlement;
- Any settlement of any action brought on the Claims must be approved by the Court after notice and an opportunity for hearing;
- Church JV shall be entitled to file an application in the Case to recover attorneys' fees and/or expenses it has incurred in prosecuting actions on the Claims as an administrative priority claim; provided, however, any payment of approved fees and expenses shall be paid only from sums recovered in an action brought by Church JV on the Claims; and
- Trustee agrees to waive any and all attorney-client and/or work product privileges that may exist as between Debtors and Debtors' Counsel relating to the Claims.[2]

Dkt. No. 354, ¶14.

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[2] See discussion of attorney-client privilege *infra*.

Townsend and Fullen filed a response in opposition to the joint motion on November 1, 2011, as did Grusin on November 2, 2011. Dkt. Nos. 361, 363. The Debtors, by their new counsel, David J. Cocke, filed a limited objection making clear that they were not waiving their right to claim as their own the causes of action to be pursued by the Trustee and Church JV. Dkt. No. 365. The Trustee and Church JV filed a reply to the responses filed by Townsend and Fullen and by Grusin. Dkt. No. 367. In their reply, the Trustee and Church JV question the standing of Townsend, Fullen, and Grusin to oppose their motion. The court conducted a hearing on November 16, 2011, at which it heard the testimony of the Trustee. Following arguments of counsel, the court requested additional briefing, which is now complete.

IV. LEGAL ANALYSIS

The parties agree that the test for determining whether derivative standing should be approved consists of the following four factors: (1) whether a demand was made on the trustee (or debtor-in-possession) to act; (2) whether the trustee (or debtor-in-possession) declined to act; (3) whether a colorable claim exists that would benefit the estate; and (4) whether the trustee's (or debtor-in-possession's) inaction was an abuse of discretion. *Hyundai Translead, Inc. v. Jackson Truck and Trailer Repair, Inc. (In re Trailer Source, Inc.)*, 555 F.3d 231, 244-45 (6th Cir. 2009) ("*Trailer Source I*"), citing *Canadian Pac. Forest Prods. Ltd. v. J.D. Irving, Ltd. (In re Gibson Group, Inc.)*, 66 F. 3d 1436, 1446 (6th Cir. 1995). The parties disagree about whether Townsend, Fullen, and Grusin have standing to oppose the motion, and whether the Movants have shown that a colorable claim exists that would benefit the estate. Townsend, Fullen, and Grusin also argue that the Movants' motion involves an impermissible attempt to assign a legal malpractice action.

A. STANDING TO OPPOSE THE MOTION

Before the court considers the substance of the pending motion, it first takes up the question of standing to oppose it. The limited objection filed by the Debtors asks only that the Debtors' rights be preserved. The Movants do not oppose that request, and the court freely grants it. Because acts of malpractice may have occurred both pre- and post-petition, it is entirely possible that the Debtors are entitled to some part of any recovery. This entitlement would become especially important (and potentially valuable) in the event that the court's order denying discharge is overturned on appeal.

Townsend, Fullen, and Grusin, however, are not parties to the pending adversary proceeding nor are they debtors in the bankruptcy case. The court has found that each of them has claimed at one time or other to represent the Debtors. *See* Adv. Dkt. No. 187, pp. 6-7. Grusin denies that he was ever legal counsel for the Debtors, but the appeal from the court's order was abandoned, and the order, including its factual findings, is final. Dkt. No. 363; Adv. Dkt. No. 222. Townsend, Fullen, and Grusin no longer represent the Debtors or any of the other defendants in the adversary proceeding. They are, however, potential targets of the claims that Church JV wishes to pursue on behalf of the estate.

In order to determine whether Townsend, Fullen, and Grusin should be permitted to object to the Movants' motion, the court will look to the "person aggrieved" doctrine, generally used to determine whether a party has standing to appeal from a bankruptcy court order. That doctrine says that standing to appeal from a bankruptcy court order is limited to persons having a financial stake in the order. *Mogernstern v. Revco D.S., Inc. (In re Revco, Inc.)*, 898 F.2d 498, 499 (6th Cir. 1990). The order must diminish a person's property, increase his burdens, or impair his rights. *Fidelity*

Bank, Nat. Ass'n v. M.M. Group, Inc., 77 F.3d 880, 882 (6th Cir. 1996). Although it is true that in Chapter 11 cases a party in interest may appear and be heard on any issue (11 U.S.C. § 1109), that section does not specify the weight that the court should give to statements of persons who have no pecuniary interest in the matter before the court. The only issue presently before the court is an administrative one: Should Church JV be permitted to pursue a claim on behalf of the estate? If the court grants the motion, there will be no direct impact on Townsend, Fullen, and Grusin unless and until suit is actually brought against them. At that time, they will have a full and fair opportunity to present their defenses. *See In re El San Juan Hotel*, 809 F.2d 151, 155 (1st Cir. 1987) (appellant, whose only interest is as a party defendant to potential action, lacks appellate standing to challenge order permitting action to proceed); *Fondiller v. Robinson (In re Fondiller)*, 707 F.2d 441, 443 (9th Cir. 1983) (appellant cannot appeal from bankruptcy order authorizing the employment of special counsel for the estate to investigate and recover assets allegedly concealed by the appellant).

Townsend, Grusin and Fullen rely heavily on the district court's decision in *Office Committee of Unsecured Creditors of Grand Eagle Companies v. Asea Brown Boveri, Inc.*, 313 B.R. 219, 224-25 (N.D.. Ohio 2004) for the proposition that potential defendants of a suit that a party seeks to bring derivatively on behalf of a bankruptcy estate are "persons aggrieved" and may object to the motion for derivative standing. *Grand Eagle* differs from the present case both because it was a case under Chapter 11, in which section 1109(b) permitted any party in interest to "appear and be heard on any issue" and because the objecting creditors had a pecuniary interest in a fund that was proposed to be the subject of the derivative litigation.

Townsend and Fullen also rely upon the decision of the Bankruptcy Appellate Panel *In re V Companies*, 292 B.R. 290 (6th Cir. BAP 2003). In that case, the issue was whether the Sixth

Circuit's decision in *Gibson Group* had been effectively overruled by the Supreme Court's decision in *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000). The Panel concluded that *Gibson Group* is not inconsistent with *Hartford Underwriters*, which was likewise the conclusion of the Sixth Circuit in *Trailer Source I*, 555 F.3d at 244 ("In conclusion, we reaffirm the continued vitality after *Hartford Underwriters* of granting derivative standing to creditors to pursue avoidance actions on behalf of the estate and hold that this practice is available in both Chapter 11 and 7 proceedings."). With respect to the question of standing to object to derivative standing, the posture of *V Companies* is substantially different from the present case. In that case, an adversary proceeding had already been filed to which the defendants filed a motion to dismiss on the basis that the plaintiff (a County Board of Commissioners who filed a complaint in the face of the refusal of the debtor and insiders to act) lacked standing to bring the complaint. The bankruptcy court denied the motion to dismiss and substituted the newly-appointed Trustee as sole party plaintiff. The appellants/defendants were permitted to pursue an appeal of the order denying the motion to dismiss on an interlocutory basis, and were permitted to raise in that context the question of derivative standing. No objection was raised with respect to their standing to do so, as they clearly were the parties aggrieved by the bankruptcy court's order denying their motion to dismiss.

The court concludes that Townsend, Fullen, and Grusin will not be "persons aggrieved" by its order granting derivative standing to Church JV to bring causes of action against them for legal malpractice. As a result, they will not have the right to appeal from the court's administrative order permitting Church JV to proceed. This does not mean, however, that the court may grant the Movants' motion without a careful review of the factors articulated in *Gibson Group*.

B. WHETHER A COLORABLE CLAIM EXISTS

As stated previously, the court must consider four factors to determine whether to grant derivative standing to Church JV to proceed on behalf of the estate: (1) whether a demand was made on the trustee (or debtor-in-possession) to act; (2) whether the trustee (or debtor-in-possession) declined to act; (3) whether a colorable claim exists that would benefit the estate; and (4) whether the trustee's (or debtor-in-possession's) inaction was an abuse of discretion. The court heard proof on each of these elements from the Trustee. The Trustee testified that demand had been made upon him to pursue claims against Townsend, Fullen, and Townsend. He stated that he declined to act because the estate does not have the funds necessary to do so. He indicated that he had contacted two knowledgeable attorneys to ask whether they would be willing to pursue the action on a contingency basis. Both of them declined because of the complexity of the potential litigation and prior litigiousness in this bankruptcy case. The court finds that the Trustee's failure to act under these circumstances is not an abuse of discretion. *Trailer Source I*, 555 F.3d at 244 (failure of trustee to pursue claim due to lack of funds not an abuse of discretion). Indeed, the Trustee joins in the motion to authorize Church JV to proceed on behalf of the estate. The Movants have clearly satisfied the first, second, and fourth *Gibson* factors. Townsend, Fullen, and Grusin argue, however, that the estate has no colorable claim against them. This factor will be discussed in greater detail.

1. Standard for Determining Whether Claim is "Colorable"

The court asked the parties to brief what standard it should apply to determine whether a colorable claim exists. It is clear that the court should not substitute its judgment for the trial court's, and that to determine whether a claim is colorable, the court need not conduct a mini-trial. The court is to look to the face of the proposed complaint to determine whether the claim would

benefit the bankruptcy estate if successful. *Trailer Source I*, 555 F.3d at 245; *Gibson Group*, 66 F.3d at 1446.

The court is somewhat hampered in this case because no complaint has been proposed for its review. The Movants suggest that in the absence of a complaint, the court can assume known facts, assume that they are to be embraced in a complaint, apply the liberal pleading rules applicable under the Federal Rules of Civil Procedure, and determine whether the hypothetical complaint would past muster under Rule 12(b)(6). Dkt No. 367, ¶ 21.

The parties agree and the court will apply the Rule 12(b)(6) standard to determine whether the estate has a colorable claim that may be the subject of the motion to authorize derivative standing.

2. Statute of Limitations

Counsel for Church JV asserts that in determining whether a claim is colorable for purposes of derivative standing, the court should not consider affirmative defenses, such as the statute of limitations, but instead should look to the face of the complaint to determine whether it would withstand a motion to dismiss for failure to state a claim under Federal Rule 12(b)(6), relying upon *America's Hobby Center, Inc. v. Official Comm. Of Unsecured Creditors (In re America's Hobby Center, Inc.),* 223 B.R. 275, 282 (Bankr. S.D.N.Y. 1998) ("Because the creditors' committee is not required to present its proof, the first inquiry is much the same as that undertaken when a defendant moves to dismiss a complaint for failure to state a claim."); and *Tennessee Valley Steel Corp. v. B.T. Commercial Corp. (In re Tennessee Valley Steel Corp.),* 183 B.R. 795, 800 (Bankr. E.D. Tenn. 1995) ("Determining whether the Committee has asserted colorable claims in its Amended

Complaint is not the equivalent of determining whether the Defendants are entitled to summary judgment.”).

Counsel for Townsend and Grusin argues that the potential claim is not colorable because a well-pled complaint would not survive a motion to dismiss both because of the statute of limitations and because collateral estoppel would bar the claim. Dkt. No. 361, p. 7. Mr. Exum says that the statute of limitations defense would be apparent from the face of the complaint, and therefore would be considered in the context of a potential motion to dismiss for failure to state a claim. Counsel for Grusin makes the same arguments. Dkt No. 363, no p.n.

As a general rule, “[a]lthough the statute of limitations is an affirmative defense, it may be resolved on a Rule 12(b)(6) motion to dismiss ‘when the dates given in the complaint make clear that the right sued upon has been extinguished.’” *Torrez v. Eley*, 378 Fed. Appx. 770, 2010 WL 1948679, at *2 (10th Cir. 2010); *Aldrich v. McCulloch Props., Inc.*, 627 F.2d 1036, 1041 n.4 (10th Cir. 1980); *see also Anthony v. Tidwell*, 560 S.W.2d 908,909 (Tenn. 1977) (“A complaint is subject to dismissal under [Tenn. R. Civ. P.] rule 12.02(6) for failure to state a claim if an affirmative defense clearly and unequivocally appears on the face of the complaint. It is not necessary for the defendant to submit evidence in support of his motion when the facts on which he relies to defeat plaintiff’s claim are admitted by the plaintiff in his complaint.”), citing *Berry v. Chrysler Corp.*, 150 F.2d 1002, 1003 (6th Cir. 1945) (“The defense of statute of limitations is covered by clause (6) [of Fed. R. Civ. P. 12(b)], and therefore is properly raised by motion.”).

The statute of limitations for a legal malpractice claim in Tennessee is one year from the time the cause of action accrues. Tenn. Code Ann. § 28-3-104(a)(2). The cause of action accrues and the limitations period begins to run “when the plaintiff knows or in the exercise of reasonable care

and diligence should know that an injury has been sustained as a result of wrongful or tortious conduct by the defendant." *John Kohl & Co., P.C. v. Dearborn & Ewing*, 977 S.W.2d 528, 532 (Tenn. 1998). The Tennessee Supreme Court has further explained this "discovery rule":

> In legal malpractice cases, the discovery rule is composed of two distinct elements: (1) the plaintiff must suffer legally cognizable damage – an actual injury – as a result of the defendant's wrongful or negligent conduct, and (2) the plaintiff must have known or in the exercise of reasonable diligence should have known that this injury was caused by the defendant's wrongful or negligent conduct. *Carvell v. Bottoms*, 900 S.W.2d 23, 28-30 (Tenn. 1995). An actual injury occurs when there is the loss of a legal right, remedy or interest, or the imposition of a liability. *See LaMure v. Peters*, 122 N.M. 367, 924 P.2d 1379, 1382 (1996). An actual injury may also take the form of the plaintiff being forced to take some action or otherwise suffer "some actual inconvenience," such as incurring an expense, as a result of the defendant's negligent or wrongful act. *See State v. McClellan*, 113 Tenn. 616, 85 S.W. 267, 270 (1905) ("[A negligent act] may not inflict any immediate wrong on an individual, but ... his right to a remedy ... will [not] commence until he has suffered some actual inconvenience.... [I]t may be stated as an invariable rule that when the injury, however slight, is complete at the time of the act, the statutory period then commences, but, when the act is not legally injurious until certain consequences occur, the time commences to run from the consequential damage...."). However, the injury element is not met if it is contingent upon a third party's actions or amounts to a mere possibility. *See Caledonia Leasing v. Armstrong, Allen*, 865 S.W.2d 10, 17 (Tenn. App.1992).

John Kohl, 977 S.W.2d at 532. The statute does not begin to run until an attorney's negligence has actually injured the client, and there is no injury until there is a loss of a right, remedy, or interest or the imposition of a liability. *Cherry v. Williams*, 36 S.W.3d 78, 84 (Tenn. Ct. App. 2000).

Townsend and Fullen argue that the statute of limitations began to run on any potential malpractice claim against them on September 29, 2009, when the Trustee and the creditors filed their complaint to deny discharge. Dkt. No. 361, p. 9. They assert that upon the filing of the complaint, the Debtors were forced to expend time and money responding to the complaint, and that this constituted injury for purposes of the discovery rule. *Id.* Grusin echoes this argument. The Debtors have not taken a position on when they learned of their injury, but they received the court's order

denying their discharge on or about February 23, 2011. The Trustee testified that although he, too, received the order denying discharge, he was not aware of the roles of Townsend, Fullen, and Grusin in the preparation of the bankruptcy schedules and statements until he received the affidavits in support of the motion to alter or amend on or about March 8, 2011.

In the order denying discharge, the court determined that the Debtors omitted significant assets from the bankruptcy schedules and statements, and that Mr. Blasingame failed to account for significant assets. Discharge was denied pursuant to section 727(a)(4)(A) for making a false oath as to both defendants and pursuant to section 727(a)(5) for failing to satisfactorily explain the loss of assets as to Mr. Blasingame. Adv. Dkt. No. 117. "In litigation, the most easily identifiable time when rights, interests and liabilities become fixed is when a court enters judgment." *Cherry*, 36 S.W.3d at 84. This court's adjudication that the Debtors' discharge should be denied was the point in time when the Debtors actually suffered loss.

The Debtors indicated in their Response to the Motion for Partial Summary Judgment and in their Motion to Alter or Amend the Judgment that they relied upon the advice of their counsel in preparing their bankruptcy schedules and statements. Moreover, because they continued to be represented by the same counsel, they stoutly maintained that their attorneys' advice was correct. Under the influence of counsel, the Debtors could not have known that they would actually suffer injury as the result of the filing of the complaint against them. Their injury depended on the action of a third party, in this case the bankruptcy court, declaring that their actions, taken on the advice of counsel, were improper.

At the time of the filing of the complaint, the Debtors knew no more than that there was a potential for injury and appear to have been assured by their attorneys that the possibility for actual

injury was remote. Under the continuing influence of counsel, the Debtors did not know that there was a real possibility that they would suffer actual and significant injury until the court issued its order denying discharge on February 23, 2011. In appropriate circumstances, continuing representation may toll the statute of limitations for legal malpractice. *See, e.g., Greene v. Greene*, 56 N.Y.2d 86, 94, 436 N.E.2d 496 (1982). The continuing representation doctrine was first recognized in personal injury cases involving medical malpractice and "was prompted by the practical concern that the plaintiff's cause of action for malpractice might expire 'while he was still a patient receiving care and treatment related to the conditions produced by the earlier wrongful acts and omissions.'" In a broader sense, the rule recognizes that a person seeking professional assistance has a right to repose confidence in the professional's ability and good faith, and realistically cannot be expected to question and assess the techniques employed or the manner in which the services were rendered. On this basis the continuous treatment rule has been held applicable to other types of professionals, including lawyers. *Id.* at 94 (internal citations omitted).

The Tennessee Supreme Court has indicated that the continuing representation doctrine is "particularized application of the discovery rule." *Stanbury v. Bacardi*, 953 S.W.2d 671, 676 (Tenn. 1997); *see also Cherry*, 36 S.W.3d at 87. When the continuing representation of Townsend, Fullen, and Grusin is taken into consideration, the date of the court's order denying discharge again emerges as the date that the cause of action for legal malpractice was discovered by the Debtors.

Notwithstanding this conclusion, upon the filing of the Debtors' bankruptcy petition, their inchoate claim for legal malpractice became property of their bankruptcy estate such that it was the Trustee's knowledge of the claim, not the Debtors', that became paramount. Although the Trustee knew, of course, that he had filed a complaint against the Debtors, he testified that he did not

become aware of the potential claim for legal malpractice until he read the Affidavits of Fullen and Grusin filed with the motion to alter or amend on March 8, 2011. The Trustee testified that he promptly made demand upon Townsend, Fullen, and Grusin to put their malpractice insurers on notice of his potential claims.

The bankruptcy estate's action arising out of the alleged legal malpractice of Townsend, Fullen, and Grusin did not accrue until the discovery by the Trustee of facts supporting those claims. That date appears to be March 8, 2011. Because the one-year limitations period after that date has not expired, the motion for derivative standing should not be dismissed on the basis of the running of an applicable period of limitation.

3. Collateral Estoppel

In addition to their claim that the statute of limitations would render any claim that could be asserted by the Trustee not colorable, Townsend, Fullen, and Grusin argue that any claim would be barred by the application of collateral estoppel. They assert that the court has already determined that the attorneys' advice did not result in the denial of the debtors' discharge.

The Tennessee Supreme Court describes collateral estoppel as follows:

> The doctrine of collateral estoppel or estoppel by judgment is an extension of the principle of res judicata, and is generally held to be applicable only when it affirmatively appears that the issue involved in the case under consideration has already been litigated in a prior suit between the same parties, even though based upon a different cause of action, if the determination of such issue in the former action was necessary to the judgment....Collateral estoppel operates to bar a second suit between the same parties and their privies on a difference cause of action only as to issues which were actually litigated and determined in the former suit....To sustain a plea of collateral estoppel it must be shown, inter alia, that the issue sought to be concluded not only was litigated in the prior suit but was necessary to the judgment in that suit.

Massengill v. Scott, 738 S.W.2d 629, 631-32 (Tenn. 1987), quoted in *State v. Mann*, Slip Op., 2011 WL 856967, at *9 (Tenn. Crim. App. March 11, 2011). The application of collateral estoppel is appropriate when: (1) the issue [in the second lawsuit] is identical to the issue decided in the earlier suit; (2) the issue was actually litigated and decided on its merits; (3) the judgment in the earlier suit has become final; (4) the party against whom collateral estoppel is asserted was a party to the prior suit; and (5) the party against whom collateral estoppel is asserted had a full and fair opportunity in the earlier litigation to litigate the issue. *Beaty v. McGraw*, 15 S.W.3d 819, 824-25 (Tenn. Ct. App. 1998).

Townsend, Fullen, and Grusin claim that each of the elements for application of collateral estoppel are met in this case barring the relitigation of the question of their responsibility for the injury suffered by the Debtors. This court disagrees. First, the issue in the first case is not identical to the issue that would be tried in a malpractice case, and the issue of counsels' malpractice was not actually litigated on the merits. The issue in the first case was whether the Debtors should be held responsible for their failure to disclose assets and income in the bankruptcy schedules and statements. The Debtors interposed as an affirmative defense advice of counsel with respect to their failure to list certain interests in trusts. The court initially ruled that the Debtors could not rely upon this defense because they failed to point to any facts in the record that supported that defense. The court said, "The mere assertion that Debtors relied upon the advice of counsel in determining which assets to disclose and which to omit is insufficient. The Debtors must show that their attorney was fully informed and that his or her advice was reasonable." Adv. Dkt. No. 111, p. 27, citing *In re Oliver*, 414 B.R. 361, 376 (Bankr. E.D. Tenn. 2009). In the court's order denying the Debtors' motion to alter or amend that judgment, the court reiterated that the record contained no support for

the advice of counsel defense. Further, the court said that even if it were to accept counsels' legal argument (that the Debtors were under no duty to disclose their interests in trusts), "there was more than enough omitted information that the Debtors concluded should have been included in their schedules and statement of financial affairs to result in denial of their discharge under Code section 727(a)(4)." Adv. Dkt. No. 154, pp. 8-9. The court went on to list the serious omissions that were the subject of very late amendments to the schedules and statements. The court then stated that even if the defense had been supported by the record:

> [T]he defense of reliance upon counsel is unreasonable in light of the volume of omissions and the evident attempt to conceal significant assets from the knowledge of the Trustee and of creditors. Even *an unrepresented debtor may be held responsible* for correctly disclosing his beneficial interest in a trust based upon the plain language of the Official Bankruptcy Forms.

Adv. Dkt. 117, p. 28, quoted by Townsend, Fullen, and Grusin with emphasis added. The language highlighted by Townsend, Fullen, and Grusin refers to a case discussed by the court, *The Cadle Co. v. Taras (In re Taras)*, 2005 WL 6487202 (Bankr. N.D. Ga. 2005), in which the bankruptcy court denied a pro se debtor's discharge as the result of his failure to list his interest in a trust on his bankruptcy schedules. The court intended by this reference to indicate the seriousness of the Debtors' omissions in connection with its discussion of the duty of the Debtors to make full disclosure. The court was unable to determine whether and to what extent the Debtors relied upon counsel in the preparation of their schedules and statements because of the inadequacy of the record. Even if the Debtors had been able to show reliance in fact, the court determined that their reliance would not have been reasonable for purposes of avoiding responsibility for the preparation of the schedules and statements. Without further factual information, the court did not and does not express an opinion about whether the advice that Debtors' counsel gave or omitted to give deviated

from the standard of care expected of lawyers in this judicial district, or whether that advice or admission overrode the Debtors' subjective understanding of their duty to disclose. It is one thing to apply an objective standard to the Debtors' conduct and hold them responsible for it – i.e., to find that it was unreasonable for them not to complete their schedules in the way dictated by the Official Bankruptcy Forms – and another thing to say that counsel can escape liability for negligent or improper legal advice based upon the Debtors' subjective misunderstanding of their duty. It is simply not the case that the court has previously ruled on the merits of the issue of counsels' legal malpractice.

Second, the prior orders of this court are not final for purposes of application of collateral estoppel. As the parties well know, the court's prior orders are the subject of a pending appeal.

Third, while the party against whom collateral estoppel would be asserted (the Trustee and/or Church JV) was a party to the prior litigation, that party did not have a full and fair opportunity to litigate the issue of Debtors' counsels' negligence or misfeasance. That issue did not come before the court for decision because it was not supported by the record.

Counsel have failed to demonstrate that the elements of collateral estoppel would apply in the event that a complaint for legal malpractice was filed against them. In the event of litigation, it would be their burden to do so: "The party seeking to rely on the doctrine of collateral estoppel has the burden of proof." *Beaty v. McGraw*, 15 S.W.3d at 824. For this additional reason, Townsend, Fullen, and Grusin have failed to raise an issue that would prevent there being a colorable claim that could be brought on behalf of the estate.

4. An Action for Legal Malpractice May Be Maintained by the Bankruptcy Estate

In addition to their potential affirmative defenses, Townsend, Fullen, and Grusin argue that the Trustee's motion should be denied because it involves the same policy concerns underlying Tennessee's prohibition upon the assignment of a claim for legal malpractice. Townsend, Fullen, and Grusin recognize that the proposed arrangement does not involve the *actual* assignment of the claims. Any pre-petition claims for malpractice that the Debtors had became property of their bankruptcy estate pursuant to Bankruptcy Code section 541(a), which provides in pertinent part: "The commencement of a case under section 301, 302, or 303 of this title creates an estate ... comprised of ... all legal and equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). As a result, legal malpractice claims that accrue under state law prior to the filing of the bankruptcy petition and those that accrue as the result of the filing of the bankruptcy petition are property of the estate. *See, e.g., Mueller v. Hall (In re Parker),* 368 B.R. 86, 2007 WL 1376081, *8 (BAP 6th Cir. 2007); *Winick & Rich, P.C. v. Strada Design Assocs., Inc. (In re Strada Design Assocs.),* 326 B.R. 229, 236 (Bankr. S.D.N.Y. 2005); *In re J. E. Marion, Inc.,* 199 B.R. 635, 637 (Bankr. S.D. Tex. 1996).

To be sure, legal malpractice claims are not assignable in Tennessee. *Can Do, Inc. Pension and Profit Sharing Plan and Successor Plans v. Manier, Herod, Hollabaugh & Smith, P.C.,* 922 S.W.2d 865 (Tenn. 1996). In *Can Do, Inc.,* the Tennessee Supreme Court reversed the decision of the court of appeals and reinstated the decision of the Davidson County Chancery Court that "'the assignment of a legal malpractice claim in Tennessee is void and invalid as against public policy because it constitutes champerty and maintenance and would frustrate, if not entirely endanger, the attorney-client relationship.'" *Id.* at 866 quoting the decision of the Chancery Court. The underlying

facts were these: Holder employed the defendant law firm to perform certain services for himself. Later, he filed a voluntary bankruptcy petition. Holder owned all the stock of Can Do, Inc, and was the primary beneficiary and trustee of its pension and profit sharing plan. The bankruptcy trustee transferred certain assets to the plan including any cause of action that the bankruptcy estate might have against the defendant law firm. The Tennessee Supreme Court applied public policy considerations rather than the traditional test of whether an action would survive the death of the assignor to the analysis of the question whether the assignment of the claim to the pension plan as void as against public policy. It found these considerations to be appropriate both because it has exclusive jurisdiction over matters pertaining to the practice of law in Tennessee and because it felt that resolution of the question should not turn on classification of the legal malpractice claim as either a breach of contract claim or a personal injury claim. *Id.* at 868. The court noted that a majority of decisions have concluded that public policy considerations militate against assignment of legal malpractice claims, based upon the unique and highly personal nature of the attorney's duty to a client and the confidentiality of the attorney-client relationship. Based upon those considerations the court reinstated the decision of the chancery court that dismissed the complaint filed by Can Do, Inc. on the basis that the cause of action belonged to Holder and could not be assigned as a matter of law.

The facts in the present case are clearly distinguishable from those of *Can Do, Inc.* Most importantly, the Trustee does not propose to assign the estate's claim against Townsend, Fullen, and Grusin away from the estate. If Church JV is permitted to pursue the claim, it will be in the name of and for the benefit of the bankruptcy estate. There is no question that the action could be prosecuted by the Trustee. *See, e.g., In re Parker*, 2007 WL 1376081 at *6 ("Mueller acknowledges

that Parker's bankruptcy estate acquired any malpractice claim held by Parker as of the date of his bankruptcy filing."); *In re J. E. Marion*, 199 B.R. 635, 637 (Bankr. S.D. Tex. 1996) ("Legal malpractice claims may be prosecuted by the [bankruptcy] trustee."), citing *Ellwanger v. Budsberg (In re Ellwanger)*, 140 B.R. 891, 902 (Bankr. W.D. Wash. 1992).

The public policy concerns announced by the Tennessee Supreme Court that prevented assignment of legal malpractice from the bankruptcy trustee to another entity were the potential to (1) compromise the duty of confidentiality that an attorney owes his client and (2) promote the commercialization of legal malpractice claims. We have seen that notwithstanding these public policy concerns, a claim for legal malpractice may become property of a bankruptcy estate and may be pursued by a bankruptcy trustee. The pursuit of a legal malpractice claim by a bankruptcy trustee does involve some compromise of the duty of confidentiality, but for the benefit of the debtor's creditors, and thus, ultimately, for the benefit of the debtor. The pursuit of legal malpractice claims by a bankruptcy trustee does not, however, promote the commercialization of those claims. Neither does the pursuit of such claims by a creditor on a derivative basis. In other words, the pursuit of claims on behalf of a bankruptcy estate by a creditor on a derivative basis raises no additional public policy concerns than that raised by the inclusion of these claims in the bankruptcy estate. This results pursuant to the operation of federal law. Where no additional public policy concerns are raised by the pursuit of these claims on a derivative basis than are raised by the pursuit of these claims by the trustee, public policy provides no basis to deny the motion to authorize derivative standing.

5. Derivative Standing is Not Limited to Avoidance Actions

Counsel for Townsend and Fullen urges this court to deny the motion to authorize derivative standing for the additional reason that "[t]he Sixth Circuit has limited derivative standing by only 'granting derivative standing to creditors to pursue *avoidance actions* on behalf of the estate,'" Dkt. No. 380, p. 4, citing *Trailer Source I*, 555 F.3d at 245 (emphasis added by counsel). The actual words of the court of appeals are:

> In conclusion, we reaffirm the continued vitality after *Hartford Underwriters* of granting derivative standing to creditors to pursue avoidance actions on behalf of the estate and hold that this practice is available in both Chapter 11 and Chapter 7 proceedings.

Id. The court of appeals does not limit its holding to avoidance actions. The word "only" does not appear in the court's opinion; counsel inserted it prior to his quotation from the decision of the court of appeals creating the false impression that the court of appeals had limited the availability of derivative standing to avoidance actions. Whether derivative standing is available only in certain types of actions rather than others was not before the court.

Mr. Johnson also filed a supplemental brief on behalf of Grusin in which he claims that derivative standing is limited to avoidance actions. Dkt. No. 379, § A. Johnson correctly quotes the following passages from the district court opinion in *Trailer II (Hyundai Translead, Inc. ex rel. Estate of Trailer Source, Inc. v. Jackson Truck & Trailer Repair, Inc.,* 419 B.R. 749 (M.D. Tenn. 2009):

> The Sixth Circuit's discussion of the policy underlying the availability of derivative standing makes it clear that such standing applies only to fraudulent transfer avoidance claims. "Congress clearly intended for bankruptcy estates to recover assets fraudulently transferred by the debtor," and granting derivative standing to creditors prevents the bankruptcy system from " 'break[ing] down' " when a trustee "unjustifiably refuses to bring an avoidance action under [Bankruptcy Code] § 544(b)." *Id.* at 242-43; *see also In re The Gibson Group,* 66 F.3d at 1438 (holding

> that derivative standing is appropriate "if such standing furthers Congress's purpose in creating the avoidance actions found in [Bankruptcy Code] §§ 547 and 548"). Indeed, the court of appeals' entire discussion in *Trailer Source* and *Gibson Group* is framed in terms of derivative standing for a trustee's avoidance actions.
>
> Here, Claims 9 through 12 of the SAC do not fall within the scope of the derivative standing granted to Hyundai. These claims are for money had and received, illegal distributions to shareholders pursuant to Tennessee's corporations code (Tenn. Code Ann. § 48-16-401), recovery of payment for goods sold and delivered, and conversion. Such claims, which go beyond the avoidance claims expressly provided for in the Bankruptcy Code, are not the type of claims contemplated by the Sixth Circuit when it endorsed derivative standing in *Trailer Source.*

Id. at 754. The passage goes on, "Furthermore, these derivative claims were never authorized by any court.... Hyundai was never granted permission to bring these additional derivative claims ..." *Id.* at 755-56. I believe that this was the crux of the issue in *Trailer Source II* – not that the court of appeals intended to limit derivative standing to avoidance actions (I find no evidence of that intent), but that the creditor, Hyundai, had not sought permission of the court to bring additional claims and thus was attempting to usurp the authority of the trustee.

As we have seen, *Trailer Source I* provides no support for the assertion that derivative standing should be limited to avoidance actions. In addition to *Trailer Source I*, the district court also relied upon *In re Gibson Group, Inc.*, 66 F.3d 1436 (6th Cir. 1995). The issue in that case was "whether Congress intended to confer exclusive authority to file an action to avoid preferential or fraudulent transfers ... on a trustee or debtor in possession, or whether a creditor might have standing to file such an action." *Id.* at 1438. No other types of action were under consideration by the court except avoidance actions. Under those circumstances the court said, "We believe that Congress has not precluded the bankruptcy court from granting standing to a creditor if such standing furthers Congress's purpose in creating the avoidance actions found in 11 U.S.C. §§ 547 and 548 in the context of a Chapter 11 reorganization." *Id.* Neither *Gibson Group* nor *Trailer Source I* supports

the conclusion that derivative standing is to be limited to avoidance actions. Instead, they reinforce the policy that a creditor may not undertake the prosecution of a claim that is property of a bankruptcy estate without court authorization. To the extent that *Trailer Source II* says more than this, I respectfully disagree.

6. The Attorney-Client Privilege Does Not Prevent the Prosecution of a Legal Malpractice Claim

Grusin raises as an additional issue in his original response in opposition to the motion for order authorizing Church JV to pursue a claim against him on a derivative basis the attorney client privilege. Dkt. No. 363, § B. Grusin acknowledges that the privilege belongs to the Debtors, not to him as attorney. Although the court has found that Grusin did in fact represent the Debtors, Grusin continues to deny it. *Id.* at unnumbered second page. Moreover, the court has disqualified Grusin from representing the Debtors or any of the other defendants in the related adversary proceeding. Adv. Dkt. No. 187. Although a timely appeal was taken from this order, the appeal was later dismissed for lack of prosecution. Adv. Dkt. Nos. 200, 222. The Debtors are now represented by other counsel. Dkt. No. 365. Counsel for the Debtors raised a limited objection to the motion to authorize derivative standing based upon the possibility that the Debtors may have their own, post-petition, causes of action against Townsend, Fullen, and Grusin. *Id.* They do not object on the basis of the attorney-client privilege, and in fact, at a recent hearing, acknowledged through their counsel that they had placed their conversations with prior counsel at issue when they raised the advice of counsel defense in the adversary proceeding. Statement of Mr. David J. Cocke, Hearing on Motion for Protective Order, January 25, 2012.

7. The Cause of Action for Legal Malpractice Arose, at Least in Part, Prepetition

Grusin raised another issue in his original response. He claims that any cause of action for legal malpractice does not belong to the bankruptcy estate as it must have accrued after the Debtors filed their bankruptcy petition. Grusin asserts that the Debtors did not suffer an injury and thus that their cause of action did not accrue until their discharge was actually denied. Grusin relies upon the decision of Bankruptcy Judge Benjamin Goldgar in *In re Holstein,* 321 B.R. 229 (Bankr. N.D. Ill. 2005) who did indeed decide that a claim for legal malpractice does not become property of the bankruptcy estate unless the debtor suffers injury prior to the filing of his petition.

The majority of decisions reach the opposite result. The Sixth Circuit BAP notes that although the "Sixth Circuit Court of Appeals has not yet spoken on the issue, ... a number of other courts have held that legal claims sufficiently rooted in a debtor's prepetition past are property of that debtor's bankruptcy estate." *Parker,* 2007 WL 1376081, at * 8. The cases cited by the BAP are the following: *Johnson, Blakely, Pope, Bokor, Ruppel & Burns, P.A. v. Alvarez (In re Alvarez),* 224 F.3d 1273 (11th Cir. 2000) (holding that the debtor's cause of action arose directly from his interactions with a law firm prior to filing, thus it constituted property of his estate); *In re Tomaiolo,* 205 B.R. 10, 14 (Bankr. D. Mass. 1997) (holding that claims are property of the bankruptcy estate despite not having accrued at the time of the bankruptcy filing); *Winick & Rich, P.C. v. Strada Design Assocs., Inc. (In re Strada Design Assocs., Inc.),* 326 B.R. 229, 236 (Bankr. S.D.N.Y. 2005) ("Section 541(a) is not restricted by state law concepts such as when a cause of action ripens or a statute of limitations begins to run, and 'property of the estate' may include claims that were inchoate on the petition date."); *In re Richards,* 249 B.R. 859, 861 (Bankr. E.D. Mich. 2000) ("Therefore, the Court must conclude that in determining whether a claim is property of the

bankruptcy estate, the test is not the date that the claim accrues under state law ..."); *In re J. E. Marion, Inc.*, 199 B.R. 635, 637 (Bankr. S.D. Tex. 1996) (finding that legal malpractice claims against the debtor's bankruptcy counsel were property of the bankruptcy estate); *Ellwanger v. Budsberg (In re Ellwanger)*, 140 B.R. 891 (Bankr. W.D. Wash. 1992) (holding that bankruptcy estate includes a contingent claim accruing upon completion of appeal).

The claims that Church JV seeks to assert on behalf of the bankruptcy estate are "sufficiently rooted" in the Debtors' "prepetition past" for the court to overrule Grusin's objection. Whether the Debtors also retain a claim against Townsend, Fullen, and Grusin is not before the court for decision at this time, but it is clear that the estate has an interest in any claims that arise out of the Debtors' prepetition dealings with their counsel.

V. CONCLUSION

For all of the foregoing reasons, the court finds that there is a colorable claim that could be brought on behalf of the estate. Moreover, the court finds that other factors favor the granting of authorization to Church JV to pursue these claims on behalf of the bankruptcy estate. The Trustee has joined in the motion and satisfactorily explained his inability to pursue the claims. No expense will accrue to the estate unless Church JV is successful in prosecuting one or more causes of action, and then all expenses will be deducted from that recovery. The court has reviewed the potential claims to determine whether they would withstand a Rule 12(b)(6) motion to dismiss and has found that they would. Although Townsend, Fullen, and Grusin are not "persons aggrieved" by this order granting derivative standing to Church JV to bring causes of action against them for legal malpractice (and thus will not have standing to appeal from this order), the court has carefully considered their arguments and has found that each of them lacks merit.

The "Motion for Order Authorizing Creditor to Pursue, on a Derivative Basis, (Not An Assignment Claim) Estate Claims and/or Causes of Action Against Counsel for Debtors" is **GRANTED.**

cc: Debtors
Attorney for Debtors
Chapter 7 Trustee
Attorneys for Trustee
United States Trustee
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