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1999 Survey of Rhode Island Law: Cases: Commercial Law

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Commercial Law. *Cerberus Partners, L.P. v. Gadsby & Hannah,* 728 A.2d 1057 (R.I. 1999). The Rhode Island Supreme Court determined that legal malpractice claims, which were transferred as part of a larger commercial transaction, were assignable.

FACTS AND TRAVEL

On December 3, 1992, Fleet Credit Corporation (Fleet), acting both as a lender and as an agent for a number of other financial institutions (the Lenders) entered into a loan and security agreement with SLM International, Inc. (SLM).[1] Gadsby & Hannah (Gadsby) served as counsel for Fleet in this transaction.[2] In 1994, Masca, USA, an SLM subsidiary, purchased a business in New Hampshire.[3] As a result, the original loan and security agreement was amended to include this acquisition.[4] Gadsby filed financing statements in New Hampshire for the assets and inventory of the newly acquired business; however, it did not file such a statement in New Hampshire for Masca's assets and inventory.[5] As a result, when Masca later moved its own inventory from Vermont to New Hampshire, the interest of Fleet and the other Lenders in those assets and inventory were rendered unperfected.[6]

SLM started having financial problems in late 1994.[7] Two law firms, Schatz & Schatz and Ribicoff & Kotkin (collectively, Schatz), took over as counsel for Fleet and the other Lenders.[8] In March of 1995, several of SLM's creditors filed claims against SLM in Delaware and Canada bankruptcy courts.[9] All of these claims were ultimately dismissed.[10] On October 24, 1995, SLM voluntarily petitioned to be reorganized under Chapter 11 of the Bankruptcy Code.[11] On the same day, Masca initiated a lawsuit against Fleet. It sought "to avoid the lien from the Lenders' security interest in

1. *See* Cerberus Partners, L.P. v. Gadsby & Hannah, 728 A.2d 1057, 1058 (R.I. 1999).
2. *See id.*
3. *See id.*
4. *See id.*
5. *See id.*
6. *See id.*
7. *See id.*
8. *See id.*
9. *See id.*
10. *See id.*
11. *See id.*

Masca's inventory in New Hampshire."[12] That lawsuit was eventually settled.[13]

After the initiation of bankruptcy proceedings against SLM in March of 1995 by several of its creditors, a number of Lenders, including Fleet, started to sell off their SLM loans, along with the privileges and duties associated with those loans, to other financial institutions.[14] Plaintiffs in the this lawsuit are all financial institutions who purchased these loans.[15]

Because of the earlier failure to perfect in New Hampshire the security interest stemming from the loans, the plaintiffs did not receive the complete value of their purchased loans and, as a result, had to settle with SLM for a smaller amount.[16] Plaintiffs sued the two law firms, Gadsby and Schatz, who had represented the Lenders in the commercial transactions with SLM.[17] Plaintiffs argued that Gadsby was negligent for not perfecting the Lenders' security interest in SLM's assets and that Schatz was negligent for not uncovering Gadsby's failure to do so, especially in light of the fact that Schatz was aware of SLM's financial problems.[18] Plaintiffs further alleged

> that as successors in interest to the original Lenders, they are entitled to assert their claims for legal malpractice, negligent misrepresentation and omissions, breach of a third-party beneficiary contract, and breach of contract against those law firms and their partners and that the claims should be determined in accordance with the law of New York.[19]

Defendants did not agree.[20] Gadsby moved to dismiss the plaintiffs' claims for failure to state a cause of action.[21] The hearing justice treated defendants' motion to dismiss for failure to state a cause of action as a motion for summary judgment because he had allowed plaintiffs to submit materials other than the pleadings for consideration (i.e., loan documents, agreements and an affida-

12. *Id.*
13. *See id.*
14. *See id.*
15. *See id.*
16. *See id.*
17. *See id.* at 1057.
18. *See id.* at 1058.
19. *Id.*
20. *See id.*
21. *See id.*

vit).[22] He then granted the motion for summary judgment for two reasons.[23] First, there was no attorney-client relationship between the plaintiffs and the defendants, which the hearing justice concluded was mandatory under Rhode Island law in order to maintain a legal malpractice claim.[24] Second, public policy prohibited assigning legal malpractice claims.[25]

ANALYSIS AND HOLDING

Choice of Law

The court first held that Rhode Island law was applicable to the instant action.[26] The original loan and security agreements entered into by the Lenders and SLM specified that Rhode Island law was controlling.[27] The assignment agreements subsequently entered into by the Lenders and the financial institutions, who were plaintiffs in this lawsuit, specified that New York law was controlling.[28] The court determined that "[u]nder those assignment agreements, the plaintiffs acquired all of the rights and obligations that the Lenders had under the original loan agreements, no more and no less."[29] Consequently, the plaintiff financial institutions received "the same rights that the Lenders had to bring a legal malpractice action."[30] Thus, they were limited to the choice of law designated in the original agreements. New York law would apply only to the assignment agreements and any lawsuits resulting from those agreements.[31] Given that the legal malpractice action here arose from the original agreements, Rhode Island law governed.[32]

Assignment of Legal Malpractice Claims

The court then noted that "the assignment of legal malpractice claims as an integral part of a larger commercial transaction is an

22. *See id.*
23. *See id.* at 1058-59.
24. *See id.*
25. *See id.*
26. *See id.* at 1059.
27. *See id.*
28. *See id.*
29. *Id.*
30. *Id.*
31. *See id.*
32. *See id.*

issue of first impression in Rhode Island."[33] The court was particularly concerned with the specific circumstances present in the case. It determined that when the plaintiff financial institutions purchased the loans, they also received all of the duties and rights attendant with those loans, including the right of the Lenders to sue the defendants for legal malpractice.[34] This was very different from a situation where no duties or rights are transferred along with a legal malpractice claim, such as where the legal malpractice claim is the only thing transferred.[35] Other jurisdictions that have dealt with the issue of the assignability of legal malpractice claims have predicated their holdings of nonassignability specifically on the fact that no rights or duties other than the legal malpractice claim itself were transferred.[36] The court pointed to the fact that in March of 1999, the Massachusetts Supreme Judicial Court aligned itself with the five other jurisdictions holding that voluntary assignments of legal malpractice claims were enforceable.[37]

Furthermore, the court determined that no public policy reason existed for requiring a blanket prohibition of all cases dealing with assignments.[38] The Rhode Island Supreme Court agreed with courts in other jurisdictions "that have distinguished between the voluntary assignment of a bare legal claim for malpractice and the assignment of a claim for malpractice that is part of a general assignment in a commercial setting and transaction that encompasses a panoply of other assigned rights, duties, and obligations."[39]

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33. *Id.*

34. *See id.*

35. *See id.*

36. *See id.* at 1059-60 (quoting Goodley v. Wank & Wank, Inc., 62 Cal. App. 3d 389 (1976) (holding that "[i]t is the unique quality of legal services, the personal nature of the attorney's duty to the client and the confidentiality of the attorney-client relationship that invoke public policy considerations in our conclusion that malpractice claims should not be subject to assignment").

37. *See Cerberus,* 728 A.2d at 1060. *See also* New Hampshire Ins. Co. v. McCann, Inc. 707 N.E.2d 332 (Mass. 1999) (holding that a voluntary assignment of a legal malpractice claim was enforceable in that jurisdiction).

38. *See Cerberus,* 728 A.2d at 1060.

39. *Id. See also* Richter v. Analex Corp., 940 F. Supp. 353 (D.D.C. 1996) (holding that public policy did not prohibit the assignment of legal malpractice claims where there was no "fear that parties will sell off claims, particularly to opponents or completely unrelated third parties, and [no] concern about jeopardizing the personal nature of legal services").

Moreover, the court asserted that its determination that legal malpractice claims were assignable in circumstances like those present here was in accord with the General Assembly's legislation pertaining to the Rhode Island Depositors Economic protection Corporation (DEPCO).[40] This legislation seemingly "recognize[s] the assignability of a malpractice claim incident to a commercial banking transaction" as not being void as against public policy.[41] Therefore, the Rhode Island Supreme Court held that "a legal malpractice claim [could] be assigned when transferred as part of a larger commercial transaction assignment."[42]

CONCLUSION

In a case of first impression, *Cerberus Partners, L.P. v. Gadsby & Hannah,* the Rhode Island Supreme Court joined Massachusetts and five other jurisdictions in determining that legal malpractice claims could be assigned, along with other assets, duties, and rights, to assignees as part of larger commercial transactions. Such assignments were found to be consistent with both Rhode Island public policy and Rhode Island legislation.

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40. *See Cerberus,* 728 A.2d at 1061.
41. *Id.*
42. *Id.*