

Commonwealth of Kentucky

Court of Appeals

NO. 2012-CA-000458-MR

JOHN MOKHTAREI AND
KAELINS, INC.

APPELLANTS

v. APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE MARY M. SHAW, JUDGE
ACTION NO. 08-CI-001104

PATRICK J. SOHAN

APPELLEE

OPINION
AFFIRMING

** ** * ** * ** *

BEFORE: CAPERTON, LAMBERT, AND MAZE, JUDGES.

LAMBERT, JUDGE: John Mokhtarei and Kaelins, Inc. (collectively, “plaintiffs” or “appellants”) have appealed from the summary judgment dismissing their legal malpractice complaint against attorney Patrick J. Sohan as well as the order denying their Kentucky Rules of Civil Procedure “CR” 59.05 motion to alter,

amend, or vacate. The Jefferson Circuit Court ruled that the appellants' assignment of their claim pursuant to an agreement and order in a separate case was improper pursuant to *Davis v. Scott*, 320 S.W.3d 87 (Ky. 2010). We agree, and we affirm the summary judgment on appeal.

In 2005, Mokhtarei hired Sohan to draft an Agreement and Bill of Sale, along with other legal services, related to Mokhtarei's purchase of Alcott & Bentley, Inc. ("A&B"), a Louisville business. This purchase included A&B's assets and was completed in April 2005. In February 2006, a fire at the business destroyed the inventory. Later that year, Stock Yards Bank & Trust Co. ("Stock Yards") claimed a lien on the inventory Mokhtarei purchased from A&B based upon liens it filed in February and May 2005 against A&B's former owner. These liens were not identified prior to the sale to Mokhtarei.

Stock Yards filed a separate action against A&B and its former owners in Jefferson Circuit Court to enforce its security interest when they defaulted on various note and guaranty obligations.¹ The plaintiffs in the present case appeared as the new owners of the business. In December 2007, the parties reached an agreement, and they entered into an Agreed Order in the circuit court and executed a Settlement Agreement and Mutual Release ("Settlement Agreement"). Pursuant to the Agreed Order, the parties split the insurance proceeds that had been held in escrow, with \$24,650.00 disbursed to Stock Yards and \$21,762.67 to Mokhtarei. The Agreed Order then provided as follows:

¹ Civil Action No. 06-CI-00842.

IT IS FURTHER ORDERED that John Mokhtarei and/or Kaelins, Inc. shall assign to Stock Yards Bank & Trust Co. their right to pursue a potential legal malpractice action (the “Malpractice Claim”) against their closing attorney, with regard to their purchase of the assets (the “Sale”) of the Defendant, Alcott & Bentley, Inc. Said Malpractice Claim will be vigorously pursued by Stock Yards Bank & Trust Co.’s undersigned counsel, who will bear the entire expense in prosecuting the said [claim] and any net proceeds recovered therefrom shall be split on a 60 percent/40 percent basis (60 percent to Stock Yards Bank & Trust Co. and 40 percent to John Mokhtarei and/or Kaelins, Inc.) until Stock Yards Bank & Trust Co. shall have received the sum of \$43,250.00, and thereafter, the percentages shall be reversed (i.e., 40 percent to Stock Yards Bank & Trust Co. and 60 percent to John Mokhtarei and/or Kaelins, Inc.), provided however, that no party to this Agreed Order shall be deemed to have warranted the viability or collectability of said Malpractice Claim.

Included in the Settlement Agreement entered into the same day were provisions addressing the split of the insurance proceeds, as set forth in the Agreed Order, and the pursuit of a malpractice claim. Regarding the malpractice claim, the Settlement Agreement provided:

2. Proceeds from Malpractice Claim. Mokhtarei agrees to vigorously pursue and litigate his malpractice claim against his closing attorney with regard to the Purchase Agreement (the “Malpractice Claim”). Mokhtarei further agrees to assign any proceeds he may recover in pursuit of said Malpractice Claim as follows: Stock Yards shall receive sixty percent (60%) of the net proceeds and Mokhtarei shall receive forty percent (40%) of the net proceeds until Stock Yards shall have recovered net proceeds in the amount of \$43,250.00, and thereafter Mokhtarei shall receive sixty percent (60%) of the remaining net proceeds, if any, recovered on the Malpractice Claim and Stock Yards shall receive forty percent (40%) of the remaining net proceeds, if any.

Mokhtarei has hired Morgan & Pottinger, P.S.C. as his counsel in prosecuting the Malpractice Claim. Mokhtarei must obtain agreement from Stock Yards before settling the Malpractice Claim.

In January 2008, the plaintiffs filed suit against Sohan in Jefferson Circuit Court pursuant to the terms of the Settlement Agreement and Agreed Order. The plaintiffs claimed that Sohan negligently drafted the purchase agreement, causing them to sustain damage. Sohan filed an answer and moved for summary judgment on the basis that the action was being prosecuted by counsel for Stock Yards pursuant to an assignment by the plaintiffs of the right to pursue the malpractice claim. This assignment, Sohan argued, was prohibited in Kentucky, and therefore the plaintiffs' claim was barred as a matter of law, citing *Coffey v. Jefferson County Bd. of Educ.*, 756 S.W.2d 155 (Ky. App. 1988). The plaintiffs filed a response to the motion, arguing that they had not assigned the malpractice claim itself, but rather the proceeds from the claim, distinguishing this case from *Coffey*. They also relied upon Kentucky Revised Statutes "KRS" 355.9-109 of the Uniform Commercial Code to support the assignment. In his reply, Sohan pointed out that Stock Yards maintained control over the malpractice claim and that KRS 355.9-109 addressed priority rules, not the assignment of a legal malpractice claim. In an opinion and order entered May 14, 2008, the circuit court declined to dismiss the action, holding that *Coffey* did not compel a dismissal of this particular assignment at that time.

In early 2011, Sohan filed a renewed motion for summary judgment, this time citing the recently rendered opinion of *Davis v. Scott*, 320 S.W.3d 87 (Ky. 2010), in which the Supreme Court of Kentucky held that the type of assignment at issue in the present case was prohibited. He argued that the circumstances surrounding this case were substantially the same as in *Davis*. The plaintiffs opposed Sohan's renewed motion, arguing, among other things, that *Davis* was distinguishable from the facts of the present case. The plaintiffs also argued that the circuit court should not dismiss the complaint, but should instead permit them to amend their complaint in order to provide them with a remedy.

The circuit court granted Sohan's motion in an opinion and order entered June 8, 2011. The court held that *Davis* controlled and mandated a dismissal of the complaint. Accordingly, the court dismissed the plaintiffs' complaint without prejudice. The plaintiffs filed a CR 59.05 motion to alter, amend, or vacate, which the court denied on February 9, 2012. This appeal now follows.

On appeal, the plaintiffs (now appellants) continue to raise the same arguments as they did below. Namely, that the assignment was valid and *Davis* does not apply, that *Davis* should not have been applied retroactively, that KRS 355.9-109 makes the assignment valid, and that even if the assignment issue had been correctly decided, the complaint should not have been dismissed, but they should have been permitted to file an amended complaint. Sohan disputes each argument.

Our standard of review is well-settled in the Commonwealth. “The standard of review on appeal when a trial court grants a motion for summary judgment is ‘whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law.’” *Lewis v. B & R Corp.*, 56 S.W.3d 432, 436 (Ky. App. 2001), citing *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky. App. 1996); *Palmer v. International Ass'n of Machinists & Aerospace Workers*, 882 S.W.2d 117, 120 (Ky. 1994); CR 56.03. “Because summary judgment involves only legal questions and the existence of any disputed material issues of fact, an appellate court need not defer to the trial court's decision and will review the issue *de novo*.” *Lewis*, 56 S.W.3d at 436, citing *Scifres*, 916 S.W.2d at 781; *Estate of Wheeler v. Veal Realtors and Auctioneers, Inc.*, 997 S.W.2d 497, 498 (Ky. App. 1999); *Morton v. Bank of the Bluegrass and Trust Co.*, 18 S.W.3d 353, 358 (Ky. App. 1999).

Because there are no disputed issues of material fact related to the assignment of the legal malpractice claim, we shall confine our review to the circuit court’s resolution of the assignment issue, which is a legal issue. Accordingly, our review is *de novo*.

The first issue we shall address is whether the Supreme Court of Kentucky’s decision in *Davis v. Scott*, *supra*, controls in this case. The appellants contend that the facts of the present case are distinguishable from those in *Davis* based upon the allocation of the proceeds. We disagree.

Kentucky law has long held that a legal malpractice claim is not assignable:

[A] claim for damages for legal malpractice has been held to be not assignable. *Goodley v. Wank & Wank, Inc.*, 62 Cal.App.3d 389, 133 Cal.Rptr. 83 (1976). The California Court aptly stated the crux of the matter here on page 395, 133 Cal.Rptr. 83:

Our view that a chose in action for legal malpractice is not assignable is predicated on the uniquely personal nature of legal services and the contract out of which a highly personal and confidential attorney-client relationship arises, and public policy consideration based thereon.

Coffey, 756 S.W.2d at 157.

In *Davis*, the Supreme Court of Kentucky recently addressed this issue in terms of whether a proceeds assignment was in reality a *de facto* assignment of the entire claim and therefore not permitted. The Court first considered the definition of an assignment: “An assignment is made when the assignor intends to assign a present right, identifies the subject matter assigned, and divests itself of control over the subject matter assigned.” *Davis*, 320 S.W.3d at 90, quoting 6 Am.Jur.2d *Assignments* § 82 (2010). The Court went on to recognize that:

“The creation and existence of an assignment is to be determined according to the intention of the parties, which is to be discerned not only from the instruments executed by them, if any, but from the surrounding circumstances.” 6A C.J.S. *Assignments* § 57 (2010). Courts will look to substance, not form, to determine whether an assignment has occurred. 6 Am.Jur.2d *Assignments* § 83 (2010).

Davis, 320 S.W.3d at 91. As in the present case, the appellants in *Davis* argued that their intention was to only assign the proceeds of the legal malpractice claim, not the entire claim. The *Davis* Court considered the circumstances surrounding the case and held otherwise:

By the terms of the settlement agreement, Global selected and retained Davis's counsel in the malpractice action and bore the financial responsibility for the cost of suing Scott. Because Davis is obligated to bring the action, he may not withdraw the suit. Davis is not permitted to settle the malpractice claim without Global's express written consent. Davis agreed to share privileged, attorney-client information with Global. Global retained control over the initiation, continuation and/or dismissal of the malpractice claim.

The allocation of the proceeds of the malpractice suit is also troublesome. Because Global receives the lion's share of any judgment—80%—its interest far outweighs Davis's and renders Davis merely a nominal plaintiff. Also, under the assignment, Global receives a percentage of the damages awarded as opposed to a specified dollar amount. Therefore, its interest is not only in a successful claim, but a claim with the largest judgment possible. This is further indication of Global's ownership of the lawsuit.

This level of control over a lawsuit is consistent with an assignment of the entire cause of action, not merely the proceeds of the litigation. *See Greene v. Leasing Associates, Inc.*, 935 So.2d 21, 25 (Fla. Dist. Ct. App. 2006) (noting that assignor “was not free to control the conduct of the litigation and to accept or reject any settlement offers,” in determining that prohibited assignment of legal malpractice claim occurred). *See also Kim v. O'Sullivan*, 133 Wash. App. 557, 137 P.3d 61 (2006) (prohibited assignment of entire legal malpractice claim occurred where assignee retained complete control over litigation and potential settlement, in addition to

entire proceeds of the malpractice claim). The terms of this settlement agreement essentially placed the control of the malpractice suit in Global's hands and rendered Davis's interest merely nominal. Though Global and Davis assert otherwise, what has occurred is an assignment not merely of the proceeds of the claim against Scott, but of the entire claim itself. Kentucky law does not permit an assignment of a legal malpractice claim.

Id.

The appellants urge this Court to focus on the allocation of proceeds portions of the Settlement Agreement and Agreed Order, which provide them with a lesser percentage of the proceeds than the agreement in *Davis*, as well as the inclusion of a specified dollar amount, which was also lacking in *Davis*. However, the *Davis* Court did not solely focus on the allocation provision, but rather considered all of the circumstances surrounding the agreement before holding that the level of control was consistent with an assignment of the entire malpractice claim. We hold that the same result is mandated in the present case.

Similar to *Davis*, the Settlement Agreement in this case provides that Mokhtarei was to pursue a legal malpractice against his closing attorney and assign an agreed-upon portion of the proceeds to Stock Yards. It further states that Mokhtarei had hired Morgan & Pottinger, P.S.C. to represent him in the claim and that Stock Yards had to approve any agreement before the case could be settled. As Sohan points out in his brief, the Agreed Order entered in the circuit court action is even more explicit. The Agreed Order states that Mokhtarei was to assign his right to pursue a legal malpractice action to Stock Yards, that the malpractice

claim would be vigorously pursued by Stock Yards' counsel, that Stock Yards would bear the expense of prosecuting the claim, and that the net proceeds would be split between Stock Yards and Mokhtarei in an agreed upon percentage. The level of control given to Stock Yards pursuant to the Settlement Agreement and Agreed Order was "consistent with an assignment of the entire cause of action, not merely the proceeds of the litigation." *Id.* Based upon the entirety of the circumstances, we must agree with the circuit court and Sohan that the assignment in this case was not just an assignment of the proceeds, but was in actuality a *de facto* assignment of the entire claim. Therefore, the assignment is not permissible pursuant to Kentucky law.

We specifically reject the appellants' argument made in footnote 8 of their brief that the holding in *Davis* may not be retroactively applied to them without violating § 19 of the Kentucky Constitution. We agree with Sohan that *Davis* did not change the law, which has been in effect for many years, that the subject assignment is not permitted in Kentucky pursuant to *Coffey*.

The next issue we shall address is whether the assignment is valid under KRS 355.9-109 of Kentucky's Uniform Commercial Code. The appellants contend that KRS 355.9-109(4)(1) creates an exception to the common law: "An assignment of a claim arising in tort, other than a commercial tort claim, but KRS 355.9-315 and 355.9-322 apply with respect to proceeds and priorities in proceeds[.]" We disagree with the appellants that this provision somehow reverses

the holdings in both *Coffey* and *Davis* in this particular situation. Therefore, we hold that this argument has no merit.

Finally, the appellants argue that even if this Court were to hold that the assignment issue was correctly decided below, we should still reverse the dismissal and remand with directions that the appellants be permitted to file an amended complaint in the present action. In this way, the appellants would avoid any statute of limitations problems and be able to have a remedy. Again, we look to *Davis* for direction on this issue:

We now turn to the more difficult question in this case: what is the proper remedy? As both parties acknowledge, the general rule is that an invalid assignment has no effect on the validity of the underlying action. “[I]f an assignment is invalid or incomplete, the assignor may still maintain a suit in his or her name.” 6 Am.Jur.2d *Assignments* § 122 (2010). Thus, it would follow that Davis can pursue his malpractice claim as the real party in interest, as opposed to simply a nominal plaintiff. Indeed, several other jurisdictions considering similar circumstances have acknowledged that the underlying legal malpractice claim survives an invalid assignment. See *Weiss v. Leatherberry*, 863 So.2d 368, 373 (Fla.Dist.Ct.App. 2003) (remanding matter to trial court because “invalidity of the agreement [to assign] has no effect on the underlying cause of action for legal malpractice”). See also *Botma v. Huser*, 202 Ariz. 14, 39 P.3d 538, 542 (2002); *Weston v. Dowty*, 163 Mich.App. 238, 414 N.W.2d 165, 167 (1987); *Tate v. Goins, et al.*, 24 S.W.3d 627, 635 (Tex.App. 2000).

However, while we agree that Davis has not forfeited his claim, we also cannot ignore the fact that the present suit was born of the invalid assignment and is, therefore, tainted in some respect. As stated by the Court of Appeals of Arizona, to allow Davis to proceed on the present claim would be “to wink at the rule against

assignment of legal malpractice claims.” *Botma*, 39 P.3d at 543.

Davis, 320 S.W.3d at 91-92. The *Davis* Court ultimately held that dismissal without prejudice was the proper solution:

We believe the most appropriate solution under these circumstances is to remand the matter to the circuit court with directions to dismiss Davis's complaint without prejudice. As stated above, though Davis has not forfeited his malpractice claim, the current suit, born of the improper assignment, cannot be permitted to continue. Should Davis wish to reassert his claim against Scott, he will be able to do so only upon a showing that the attempted assignment is no longer in place and that he is the real party in interest.

Id. at 92. This is exactly what the circuit court did in the present case, and we find no error in this ruling.

The appellants cite to *Boone v. Gonzalez*, 550 S.W.2d 571, 574 (Ky. App. 1977), to argue that they should be permitted to amend their complaint: “Since facts may exist which, had they been pleaded, would have cured the defects in the complaint, the proper procedure was to dismiss the complaint with leave to amend.” However, *Boone* presented a different set of circumstances, and because of the taint of the improper assignment, we cannot hold that any facts could cure the inherent defects. Therefore, the circuit court properly dismissed the appellants’ complaint without prejudice.

For the foregoing reasons, the Jefferson Circuit Court summary judgment and dismissal, as well as the order denying the CR 59.05 motion, are affirmed.

ALL CONCUR.

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