

**Prospect Capital Corp. v Morgan Lewis & Bockius
LLP**

2023 NY Slip Op 33797(U)

October 25, 2023

Supreme Court, New York County

Docket Number: Index No. 653941/2022

Judge: Margaret A. Chan

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 49M

-----X
PROSPECT CAPITAL CORPORATION,

Plaintiff,

- v -

MORGAN LEWIS & BOCKIUS LLP and MATTHEW
SCHERNECKE,

Defendants.
-----X

INDEX NO. 653941/2022

MOTION DATE 05/26/2023

MOTION SEQ.
NO. 005

**DECISION + ORDER ON
MOTION**

HON. MARGARET A. CHAN:

The following e-filed documents, listed by NYSCEF document number (MS 005) 63, 64, 65, 66, 67, 68, 71, 73, 74, 75, 76, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 89

were read on this motion to/for REARGUMENT/RECONSIDERATION.

On October 21, 2022, Plaintiff Prospect Capital Corporation (Prospect or plaintiff) commenced this action against Defendants Morgan Lewis & Bockius LLP (Morgan Lewis) and Matthew Schernecke (together, defendants), alleging a claim for legal malpractice in connection with legal services rendered by defendants while negotiating the terms of a debt subordination agreement on plaintiff's behalf (NYSCEF # 2 – compl). Defendants thereafter moved pursuant to CPLR 3211(a)(1) and (a)(7) for an order dismissing plaintiff's complaint, and by Decision and Order, dated May 2, 2023, this court granted defendants' motion (NYSCEF # 61). Plaintiff now moves for reargument pursuant to CPLR 2221 or, in the alternative, for leave to file a First Amended Complaint pursuant to CPLR 3025 (NYSCEF # 63). For the following reasons, plaintiff's motion for reargument is granted, and upon reargument, defendants' motion to dismiss is denied.¹

Background

The court assumes the parties' familiarity with the background of this case, which was detailed in the court's prior order dated May 2, 2023 (NYSCEF # 61 – Prior Order). In short, Prospect retained Morgan Lewis for transactional legal services, including Prospect's \$17 million senior secured term loan (the Prospect Loan) to non-party Venio LLC (Venio) (compl ¶¶ 5-7). After Prospect extended the Prospect Loan to Venio, Venio's parent company, Keane Holdings, Inc. (KHI)

¹ Plaintiff's motion for leave to file an amended complaint is accordingly denied as academic.

obtained a \$12 million loan from non-party Silicon Valley Bank (SVB) (the SVB Loan) (*id.* ¶ 9). Given that Venio's parent company was obtaining the SVB Loan, Prospect engaged defendants to negotiate a debt subordination agreement to protect its rights as a senior lender to Venio (the Subordination Agreement) (*see id.* ¶ 9). Under the terms of the Subordination Agreement, the SVB Loan would be subordinate to the Prospect Loan (*id.* ¶ 9). Specifically, in the event of a default by Venio, section 1 of the Subordination Agreement prohibited SVB from receiving payments on the SVB Loan before Prospect was paid in full on the Prospect Loan (NYSCEF # 23 at 31).

The parties to the Subordination Agreement also negotiated the inclusion of a turnover provision (section 5 of the subordination agreement), pursuant to which a junior lender (i.e. SVB) would be required to disgorge and pay to a senior lender (i.e. Prospect) any payments received from a "Keane Entity" (compl ¶ 12). The turnover provision had originally provided Prospect with a turnover right against SVB for any payment SVB received from KHI by virtue of KHI being included in the definition of "Keane Entity" (*see id.* ¶¶ 11-12). Yet in a revised draft of the Subordination Agreement circulated to Morgan Lewis, KHI was excluded from the definition of Keane Entity, meaning that the turnover provision no longer applied to wrongful payments from KHI to SVB (*id.* ¶¶ 15-16). Prospect alleges that defendants failed to flag this change, instead advising Prospect that the draft subordination "still works for us substantively" (*id.* ¶ 18). Based on this advice, Prospect executed this revised subordination agreement on December 23, 2014 (*see id.* ¶¶ 19-22).

By December 2017, Venio's financial performance was deteriorating (*id.* ¶¶ 28-29). KHI therefore sought a \$12 million loan from Citizens Bank N.A. to pay off the SVB Loan (the Citizens Loan), which was in breach of the Subordination Agreement (*id.*). Upon learning of the Citizens Loan, defendants erroneously relied on the wrong version of the Subordination Agreement to advise Prospect it triggered Prospect's turnover right against SVB for any funds it wrongfully accepted (*see id.* ¶¶ 24-33). Relying on defendants' advice, Prospect did not immediately seek to enforce its rights under the Subordination Agreement (*id.* ¶ 34). Instead, after considering several options, it strategically consented to a sale of Venio with the erroneous belief that it could then enforce its turnover right if the sale proceeds fell short of repaying the Prospect Loan (*id.* ¶¶ 34-37).

The sale proceeds from the Venio's assets were ultimately insufficient to satisfy the Prospect Loan (*id.* ¶ 38). Hence Prospect commenced an action against SVB asserting a cause of action to enforce the turnover provision (section 5) of the subordination agreement, as well as a cause of action under the subordination provision (section 1) (the SVB Litigation) (*id.* ¶ 40). Counsel for SVB informed Prospect that its complaint relied upon the wrong version of the Subordination Agreement, forcing Prospect to withdraw that claim and its corresponding ability to pursue a turnover remedy (*see id.* ¶¶ 40, 55; NYSCEF #s 29-30). Prospect thereafter

resolved the remaining claim under the subordination agreement with SVB by settlement (*id.* ¶ 40).

Prospect commenced this action on October 21, 2022 (NYSCEF # 2). On December 9, 2022, defendants moved to dismiss pursuant to CPLR 3211(a)(1) and (a)(7), arguing that (1) Prospect was responsible for reading and understanding the agreement it signed and could not blame defendants for failing to explain an unambiguous provision, (2) Prospect's proximate cause allegations were speculative, and (3) Prospect's voluntary settlement of the SVB Litigation also precluded a finding proximate cause (NYSCEF # 17). Prospect opposed defendants' motion, contending, in part, that it sufficiently alleged that it would have had a turnover remedy against SVB and would have collected the \$12 million from SVB (NYSCEF # 45). Prospect further averred that its settlement of the remaining claim in the SVB Litigation was irrelevant precisely because Prospect could not pursue any claims arising out of the turnover provision of the subordination agreement in the first place (*id.*).

On May 2, 2023, this court issued the Prior Order. The court first addressed the issue of defendants' negligence, concluding that plaintiff's allegations were sufficient to raise a reasonable inference that "defendants 'failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession'" (Prior Order at 4, quoting *Rudolf v Shayne, Dachs, Stanisci, Corker & Sauer*, 8 NY3d 438, 442 [2007]). The court observed that the turnover provision is "one of the key remedies to a senior lender," that defendants' alleged conduct "effectively deprived plaintiff's turnover right against SVB on the SVB Loan," and that defendants negligently relied on the wrong version of the subordination agreement to erroneously advise plaintiff that it had a turnover right (*id.*). In reaching this conclusion, the court rejected defendants' contention that they could not be held liable because Prospect should have read and known the contents of the subordination agreement (*id.* at 5).

Despite this conclusion, the court held that Prospect failed to adequately allege causation and damages (*id.* at 5-7). To start, the court considered Prospect's theory that if defendants had detected the narrowed turnover provision and informed Prospect of the change, Prospect would have pushed back in negotiations to ensure that the subordination agreement included the correct turnover right, which it then could have properly enforced in the SVB Litigation (*id.* at 6). On this point, the court determined that, even assuming SVB agreed to Prospect's negotiation request, Prospect had not sufficiently alleged that, with the turnover remedy, it would have necessarily collected \$12 million from SVB (*id.*). The court reasoned that, in light of the SVB Litigation's settlement, Prospect failed to explain how the turnover remedy would have yielded it a more favorable economic result when the subordination provision seemingly provided a basis for full recovery (*id.* citing NYSCEF # 36 at 3). The court further reasoned that settlement severed the causal chain because Prospect failed to allege that it would not have opted to settle

the SVB Litigation if it had the turnover remedy, or it would have otherwise achieved a better result in its settlement (*id.* at 6-7).

The court next turned to Prospect's alternative theory that, had it been aware it lacked a turnover remedy, it would have proceeded with other proposed options with respect to Venio instead of consenting to the sale of Venio's assets (*id.* at 7). On this issue, the court determined that Prospect's allegations were premised on nothing more than mere speculation of unspecified future events (*id.*).

Based on this analysis, the court granted defendants' motion to dismiss, dismissed complaint in its entirety, and directed that costs and disbursements be taxed by the Clerk of the Court. Prospect now seeks to reargue the Prior Order, averring that the court overlooked three points. *First*, Prospect contends that the court misapprehended the nature of the turnover provision as alleged in the complaint by (1) assuming, without factual basis, that Prospect could have recovered full damages from a breach of section 1 of the Subordination Agreement alone and (2) overlooking that defendants' negligence resulted in Prospect losing a cause of action under the subordination agreement that had a separate and distinct remedy for damages (NYSCEF # 67 – MOL at 5-6). *Second*, Prospect argues that the court misapprehended or overlooked the law on settlements by concluding that Prospect's settlement with SVB broke the causal chain of damages arising from defendants' malpractice (*id.* at 8-11). *Finally*, Prospect avers that the court misapprehended the nature of Prospect's damages claims related to payment of legal fees and costs (*id.* at 11-12).

Defendants oppose Prospect's motion. They argue that Prospect is improperly advancing a new argument that its claim under section 1 of the subordination agreement had a different burden of proof with respect to causation and damages as compared to its claim pursuant to its turnover rights (NYSCEF # 74 – Opp at 6-8). In any event, defendants contend, Prospect's argument is directly refuted by its arguments in the SVB Litigation that it incurred between \$12 and \$15 million in damages as a result of SVB's purported breach of section 1 (*id.* at 7-8). Turning to Prospect's contentions concerning the law of settlements in relation to legal malpractice claims, defendants aver that the court correctly applied relevant authorities to reach its conclusion and that Prospect's motion does nothing more than rehash prior arguments (*id.* at 8-9). And with regard to the contention that the court misapprehended the nature of Prospect's damages, defendants respond that these arguments were never previously raised (*id.* at 10-11).

Discussion

"A motion for leave to reargue pursuant to CPLR 2221 is addressed to the sound discretion of the court and may be granted only upon a showing that the court overlooked or misapprehended the facts or the law or for some reason mistakenly arrived at its earlier decision" (*William P. Pahl Equip. Corp. v Kassis*,

182 AD2d 22, 27 [1st Dept 1992] [quotation marks omitted]). Such a motion “is designed to afford a party an opportunity to establish that the court overlooked or misapprehended the relevant facts, or misapplied any controlling principle of law” (*Pro Brokerage, Inc. v Home Ins. Co.*, 99 AD2d 971, 972 [1st Dept 1984] [internal quotation marks and citation omitted]). The determination to grant leave to reargue lies within the sound discretion of the court (*V. Veeraswamy Realty v Yenom Corp.*, 71 AD3d 874, 874 [2d Dept 2010]).

Here, as noted above, the parties’ dispute centers around the issue of causation. To plead a claim for legal malpractice, a party must sufficiently allege proximate cause and actual damages (*Reibman v Senie*, 302 AD2d 290, 290-291 [1st Dept 2003]). If an attorney’s actions resulted directly in the loss of a cause of action, the “measure of damages is generally the value of the claim lost” (*McKenna v Forsyth & Forsyth*, 280 AD2d 79, 80 [4th Dept 2001], *lv denied* 96 NY2d 720 [2001]). And when the alleged injury is the value of the claim lost, plaintiff “must meet the ‘case within a case’ requirement, demonstrating that ‘but for’ the attorney’s conduct the client would have prevailed in the underlying matter or would not have sustained any ascertainable damages” (*Weil, Gotshal & Manges, LLP v Fashion Boutique of Short Hills, Inc.*, 10 AD3d 267, 271-272 [1st Dept 2004]). In order to survive a pre-answer motion to dismiss, a pleading “need only state allegations from which damages attributable to the defendant’s conduct may reasonably be inferred” (*Lappin v Greenberg*, 34 AD3d 277, 279 [1st Dept 2006]).

Applying the above principles, the court agrees with Prospect that it misapprehended the complaint’s allegations concerning Prospect’s turnover remedy when determining that the complaint failed to plead causation. Thus, reargument on the issue of causation is warranted.²

When the court addressed the issue of causation under Prospect’s first theory in the Prior Order, it had determined that Prospect failed to explain how the addition of the turnover remedy would have yielded it a more favorable outcome (Prior Order at 6). The court further held that Prospect failed to allege how defendants’ negligence either caused it to settle rather than obtain a more favorable result in litigation or prevented it from obtaining a more favorable settlement (*id.* at 6-7). The basis for the court’s decision was that Prospect’s loss of a turnover remedy did not implicate its ability to pursue contractual damages under the Subordination Agreement during the SVB Litigation or otherwise impact the settlement it eventually obtained (*see id.*). A careful review of Prospect’s claim, however, reveals that, as alleged, the true causal link between defendants’ negligence and Prospect

² The court determined in the Prior Order that Prospect had sufficiently alleged that defendants “failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession” (Prior Order at 4, citing *Rudolf*, 8 NY3d at 443). That conclusion is not impacted on this motion.

harm flows from the loss of a cause of action and not the end result of the SVB litigation (including its eventual settlement).

According to the complaint, defendants failed to identify edits to a draft subordination agreement that significantly narrowed Prospect's turnover remedy against SVB and created a mismatch between the debt subordination provision of section 1 and the turnover remedy set forth in section 5 (compl ¶¶ 14-18). Despite this error, defendants nevertheless continued to advise Prospect that it had a broad turnover remedy by referencing an incorrect version of the subordination agreement (*id.* ¶¶ 20-24). Prospect, in turn, detrimentally relied upon that advice by (1) holding off on enforcing its rights and remedies under the subordination agreement upon learning of the Citizens Loan, (2) allowing Venio to sell its assets, and (3) upon the conclusion of Venio's sale, pursuing a turnover remedy it erroneously believed it possessed under Subordination Agreement (*id.* ¶¶ 29-40). In reality, Prospect lacked a turnover remedy under the correct version the Subordination Agreement, and, as a result, it was forced to withdraw that claim (*see id.* ¶¶ 40, 55; NYSCEF #s 29-30). The import of defendants' alleged negligence is significant because the remedy that Prospect had lost—the disgorgement of unpermitted payments to SVB (here, \$12 million)—is distinct from that available under the more general subordination provision (*see* compl ¶¶ 12, 27, 52).

This is the precise causal link that the court evidently overlooked when reaching its conclusion on causation in the Prior Order (*cf.* Prior Order at 6-7). Instead, accepting the complaint's allegations as true and drawing all reasonable inferences in Prospect's favor (as this court must), the court should have determined, as it does now upon reargument, that the purported harm flowing from defendants' alleged negligence was Prospect's loss of a cause of action and its distinct remedies, rather than its ability to obtain a more favorable economic result in the SVB Litigation after losing the turnover remedy.³ With this understanding of Prospect's allegations in mind, the court is able to reasonably conclude that Prospect sufficiently alleged the requisite causation flowing from defendants' negligence, as well as a reasonable inference of damages, that is needed to survive a motion to dismiss⁴ (*see Lappin*, 34 AD3d at 280; *cf. also Dodge v King*, 19 AD3d 359, 360 [2d Dept 2005] [concluding that complaint sufficiently alleged claim for legal malpractice where plaintiff alleged that defendant failed to assert viable claim for

³ Consequently, as Prospect notes in its motion, the court should not have delved into, or otherwise inferred, what damages, if any, Prospect could have obtained through its breach of contract claim under section 1 of the subordination agreement (*see* Prior Order at 6).

⁴ As noted in the Prior Order, Prospect's claim relies upon a presumption that SVB would have been willing to amend the turnover provision (Prior Order at 6). And whether Prospect can establish this fact remains to be seen. However, accepting, as true, its allegations that such turnover provisions are "typical and customary remedy" (*see* compl ¶¶ 12, 17, 54), the complaint supports a reasonable inference that SVB and other parties would have agreed to restore this provision upon Prospect's push back—a point that the court inherently recognized in the Prior Order (*see* Prior Order at 6).

adverse possession in underlying action, thereby causing plaintiff to lose claim to title of property]; *David v Mallilo & Grossman*, 17 Misc 3d 1103[A], at *4 [Civ Ct, NY County, 2007], *affd* 19 Misc 3d 142[A] [App Term, 1st Dept, 2008] [concluding that plaintiffs met initial burden of establishing malpractice claim where despite settlement of underlying claim, record indicated that counsel filed personal injury claim in civil court rather than supreme court, thereby depriving plaintiffs of full value of their claim]).

Given the above conclusion, Prospect's settlement of the SVB Litigation should not have any bearing on the court's causation analysis at this juncture. As the complaint indicates, although Prospect originally included a claim under the turnover provision in the SVB Litigation, its cause of action was never viable under the plain terms of the Subordination Agreement given defendants' alleged negligence (*see* compl ¶¶ 40, 55). Once Prospect was forced to withdraw its turnover claim, the SVB Litigation only involved a claim under a separate provision of the subordination agreement, which Prospect then settled (*id.* ¶ 40). But by that point, the apparent harm flowing from defendants' alleged negligence was already done (*see id.* ¶¶ 12, 17, 40, 54-55). Consequently, based on the facts alleged in complaint, there is no basis to conclude that Prospect's settlement severed the requisite causal link between negligence alleged and the harm suffered. In any event, even if Prospect's settlement is considered in the court's causation analysis, the complaint's allegations, as properly framed upon granting Prospect's motion for reargument, support a reasonable inference that the eventual settlement of the SVB Litigation was effectively compelled by defendants' mistakes (*see Bernstein v Oppenheim & Co., P.C.*, 160 AD2d 428, 430 [1st Dept 1990]).

To avoid this outcome, defendants aver that Prospect has failed to meet the standard for reargument because it raised entirely new arguments in its motion (Opp at 7). Specifically, defendants contend that Prospect raised a "newly-minted" causation theory on its motion based on the idea that claims under section 1 of the subordination agreement require "different burden[s]" of proof than claims under section 5 (*id.*). It is true that Prospect did not raise this particular argument in its prior opposition (*see generally* NYSCEF # 45). Prospect did, however, argue in its original motion that its loss of a turnover remedy deprived it of an opportunity to collect \$12 million in disgorgements from SVB (*see id.* at 13-15). And it is primarily on this point that Prospect now moves for reargument by arguing that the court misapprehended or overlooked certain allegations in its complaint (*see* MOL at 4, 6; *see also* NYSCEF # 86 at 2-4). Prospect's contentions are therefore properly before the court.

In conclusion, Prospect has established a basis for reargument on the issue of causation, and upon reargument, the court concludes, as explained above, that

Prospect has sufficiently pleaded a legal malpractice claim.⁵ It is of course Prospect's burden to ultimately establish the requisite elements of legal malpractice, including causation and damages, and whether it will be able to do so remains to be seen. But at this juncture, after accepting Prospect's allegations as true and providing it with every possible favorable inference (*see Leone v Martinez*, 84 NY2d 83, 87 [1994]), the court cannot conclude that dismissal under CPLR 3211 is warranted.

Defendants' motion to dismiss is denied.

Conclusion


For the foregoing reasons, it is hereby

ORDERED that plaintiff's motion for reargument pursuant to CPLR 2221 is granted; and it is further

ORDERED that, upon reargument, defendants' motion to dismiss (MS002) is denied; and it is further

ORDERED that plaintiff's complaint (NYSCEF # 2) is reinstated and the Clerk of the Court is directed to restore this matter to the court's active calendar; and it is further

ORDERED that that a preliminary conference to schedule discovery shall take place on November 29, 2023 at 11:30 a.m. or at such time as the parties may schedule with the court's law clerk, provided, however, that the parties shall first meet and confer to determine if there is agreement to stipulate to a preliminary conference order, available at <https://www.nycourts.gov/LegacyPDFS/courts/comdiv/NY/PDFs/part49-PC-Order-fillable.pdf>.

10/25/2023	
DATE	MARGARET A. CHAN, J.S.C.
CHECK ONE:	<input type="checkbox"/> CASE DISPOSED <input type="checkbox"/> GRANTED <input type="checkbox"/> DENIED <input checked="" type="checkbox"/> NON-FINAL DISPOSITION <input type="checkbox"/> GRANTED IN PART <input type="checkbox"/> OTHER
APPLICATION:	<input type="checkbox"/> SETTLE ORDER <input type="checkbox"/> SUBMIT ORDER <input type="checkbox"/> FIDUCIARY APPOINTMENT <input type="checkbox"/> REFERENCE
CHECK IF APPROPRIATE:	<input type="checkbox"/> INCLUDES TRANSFER/REASSIGN

⁵ Based on the above analysis, the court does not reach Prospect's other bases for reargument raised in its motion.