

CASE COMMENTARIES

ANTITRUST

As the Market Evolves So Must the Laws Which Regulate Its Participants; the Per Se Dr. Miles Rule Is No Longer Applicable When Judging Vertical Pricing Policies. *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 127 S.Ct. 2705 (2007).

By Jeremy Hale

In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), the United States Supreme Court ruled that vertical minimum resale price agreements constituted a per se violation of the Sherman Act. Referred to as the “Dr. Miles Rule,” manufacturers are in violation of the Sherman Act if they require retailers to agree to minimum resale prices. For almost a century, the Dr. Miles Rule has controlled in antitrust litigation; however, *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.* brought this rule to its end.

Leegin Creative Leather Products, Inc. (“Leegin”) designs, manufactures, and distributes leather goods. Leegin sells women’s fashion accessories under the “Brighton” brand name. PSKS, Inc., doing business as Kay’s Kloset . . . Kay’s Shoes (“Kay’s”) is a retailer of Leegin’s Brighton products. In 1997, Leegin created the “Brighton Retail Pricing and Promotion Policy” under which Leegin refused to sell to any retailer that discounted Brighton goods below Leegin’s suggested prices. Leegin’s justification for the new policy was based on marketing. Leegin believed consumers viewed reduced-priced goods as lower quality. To help maintain the exclusivity of the Brighton brand, Leegin required the products to be sold without discounting.

In 2002, Leegin learned that Kay’s had been discounting the entire Brighton line of products by twenty percent. Kay’s claimed it had discounted Leegin’s goods to match other area retailers’ pricing. Leegin requested that Kay’s cease the discounting, but Kay’s refused. As a result, Leegin stopped supplying Kay’s with the Brighton products and Kay’s suffered a pecuniary loss. Kay’s sued Leegin alleging a violation of the antitrust laws, specifically a violation of the Dr. Miles per se rule that any type of vertical price fixing violated § 1 of the Sherman Act.

At trial, Kay’s alleged that the Brighton Retail Pricing and Promotion Policy was price fixing. Leegin attempted to introduce evidence of the pro-competitive effects of its policy, but the United States District Court for the Eastern District of Texas relied on the per se Dr. Miles Rule and excluded the evidence. The Court of

Appeals for the Fifth Circuit affirmed the trial court's ruling. On appeal to the Supreme Court of the United States, Leegin did not dispute that it had entered into vertical price-fixing agreements with retailers. Leegin contended that a "rule of reason" rather than a per se rule should apply to the examination of its policy. The rule of reason would include pro-competitive justifications for the pricing policy, such as those excluded by the lower court. The Court granted certiorari to determine whether such pricing policies should continue to be treated as a per se violation of antitrust law.

The rule of reason is the accepted standard for determining whether a practice should be considered a restraint of trade and therefore prohibited. When a per se rule exists, the rule of reason is unnecessary as the per se rule provides clear guidance. However, the Court has stated that any departure from a rule of reason standard must be supported by economics, not by simple line drawing.

The Court stated, "economics literature is replete with pro[-]competitive justifications for a manufacturer's use of [vertical pricing policies]." Additionally, the Court found that there are numerous justifications for vertical price fixing, including stimulation of inter-brand competition, facilitation of market entry by new firms or brands, and encouragement of retailer services. According to the majority of the Court, these pro-competitive effects cast doubt that a per se rule is appropriate for such pricing policies.

While the Court acknowledged that vertical pricing policies have economic dangers, it stated that the rule of reason was designed to eliminate only anticompetitive transactions. Because there are pro-competitive effects with vertical pricing policies, the Court found that the rule of reason was better suited for judging vertical pricing policies. Therefore, the court overruled the per se Dr. Miles Rule and replaced it with the rule of reason.

When dealing with vertical pricing policies, the transactional attorney should weigh all surrounding circumstances to determine whether a practice restrains trade. Weight must be given to historical considerations of the policy's nature and effect as well as to the industry and business itself. Only upon applying the rule of reason to pricing policies can the transactional attorney determine whether enough pro-competitive effects are present to render the policy lawful.

ARBITRATION

The Federal Arbitration Act Only Ensures Enforcement of Arbitration Agreements to Which Both Parties Have Manifestly Agreed. *Terry Paul v. Merit Constr., Inc.*, No. E2006-00839-COA-R3-CV, 2007 Tenn. App. LEXIS 397 (Tenn. Ct. App. June 27, 2007).

By David Goodman

The Federal Arbitration Act (“FAA”) provides for the strict enforcement of arbitration agreements while allowing parties great flexibility in crafting the rules and scope of arbitration. The FAA preempts state statutes invalidating arbitration agreements and provides a strong presumption of arbitrability. However, the FAA cannot be used to enforce an arbitration provision where both parties have not manifested their assent to be bound by its terms.

In *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351 (Tenn. Ct. App. 2001), the Tennessee Court of Appeals applied an objective contracts conception of the FAA, finding that automobile sales contracts were not contracts of adhesion and, therefore, these sales contracts’ arbitration provisions were enforceable under the FAA. Relying on *Pyburn*, the appellate court in *Terry Paul v. Merit Construction, Inc.* held that where the parties only agreed to the terms of an oral contract, the defendant could not fall back on the FAA to enforce arbitration provisions found in a subsequent written contract not signed by the plaintiffs.

In late August 2004, Terry Paul and Alan Paul, owners of Paul Brothers Construction (“Brothers Construction”), entered into an oral contract with Merit Construction, Inc. (“Merit”) to perform masonry work on the first four of five sections of a construction project. Brothers Construction submitted weekly invoices for bricklaying per the terms of the oral contract, and Merit initially made timely payments.

During January 2005, however, when the parties first began to contemplate executing a written instrument, Merit balked at paying further invoices. Under the terms of the written instrument, Brothers Construction would be responsible for additional masonry work on the fifth section of the construction project, as well as bound by certain arbitration provisions. The parties reached a second verbal agreement to complete the fifth section, but never formally executed the written instrument, which Merit backdated to November 1, 2004. Despite Merit’s nonpayment, Brothers Construction continued to submit invoices and provide masonry work under the oral contract. Although Merit eventually paid the invoices submitted in January, in early February it informed the plaintiffs that no further

amounts owed would be paid until the written instrument was executed. When Brothers Construction again refused to provide signatures, a Merit representative seized and kept the instrument without comment.

Consequently, Brothers Construction filed suit against Merit alleging breach of contract. Merit moved to stay proceedings and compel arbitration under the terms of the written instrument, pursuant to the FAA. The trial court dismissed Merit's motion on the grounds that Brothers Construction had not signed the written instrument and therefore had not agreed to its arbitration provisions. Merit immediately filed a notice of appeal under Tenn. Code Ann. § 29-5-319, which provides for a direct appeal from an "order denying an application to compel arbitration" However, the Tennessee Court of Appeals affirmed the trial court's judgment.

Applying *Pyburn's* analysis of the FAA under objective contracts standards, the appellate court in *Terry Paul* found several facts particularly noteworthy to the issue of whether the parties mutually consented to arbitration. First, Brothers Construction inserted certain requested information into the contract but never formally signed it, whereas Patrick O'Hara signed the contract on behalf of Merit. The court reasoned because O'Hara thought his signature was necessary, a reasonable inference arose that O'Hara would think it was equally necessary for Alan Paul to sign on behalf of Brothers Construction. As the court noted, Terry Paul stated that he purposefully did not sign the instrument because he was satisfied with the oral contract and did want to be bound to arbitrate.

Second, while acknowledging that a signature is not required for the formation of a binding contract, the court was further persuaded against a meeting of the minds regarding arbitration because Merit presented Brothers Construction with the instrument after masonry work had begun and payments were due. Merit never mentioned arbitration or mediation either before discussion of a written contract or after it began to withhold payments.

Third, the court disagreed with Merit's contention that by completing work on the first four sections and beginning work on the fifth section, Brothers Construction accepted the terms of the written instrument. Instead, the court quoted Terry Paul's description that Merit had put his company in a "take it or leave it" position," forced to continue performance under the oral contract without corresponding adequate assurances of payment from Merit. Thus, the court concluded that the actions provided "nothing more than a manifestation of their intent to keep working under the previous oral agreement."

Pyburn and *Terry Paul* together clarify the scope of enforceability for arbitration provisions under the FAA. The FAA carries great force, allowing parties

to freely shape the terms of arbitration, preempting state laws against such provisions, and creating a heavy presumption of arbitrability where questions of contract formation remain unresolved. This force, however, is delimited by traditional contracts principles. In *Pyburn*, the Tennessee Court of Appeals found that arbitration provisions in a legitimate, signed sales contract were enforceable under the FAA, but suggested that an opposite conclusion would follow from a contract of adhesion. Later in *Terry Paul*, the appellate court recognized that even an unsigned contract might be enforceable where the parties manifested their mutual assent to its terms. Because Merit made a direct appeal rather than accepting the trial court's invitation to offer proof of contract formation, the appellate court found little reason to sustain even the strong presumption favoring arbitration. Legal practitioners should recognize that the FAA does not provide for absolute enforcement of every arbitration clause in the record, but instead requires some modicum of proof that the parties mutually consented to arbitrate the specific matter at issue.

Court Applies Ohio Law and Finds Choice of Law and Arbitration Provisions Enforceable *Credit Gen. Ins. Co. v. Ins. Serv. Group, Inc.*, No. E2007-00033-COA-R3-CV, 2007 Tenn. App. LEXIS 495 (Tenn. Ct. App. July 31, 2007).

By Amy E. Michaelson

When a choice of law provision specifies Ohio law as the law governing disputes arising from a contract, it can be difficult to determine at which point a Tennessee court should begin to apply Ohio's law. Should Ohio law govern what law to apply to disputes arising under the contract, or should it apply directly to the disputes arising under the contract? This was the issue in *Credit General Insurance Co. v. Insurance Service Group, Inc.*, which held that Ohio law applied to determine which source of law should govern the parties' dispute.

Credit General Insurance Company involves an October 1998 agreement (the "Agreement") between Credit General Insurance Company ("Credit General") and Insurance Service Group, Inc. ("ISG"). Under the terms of the Agreement, ISG promised to pay Credit General specified premiums and commissions in exchange for becoming the "agents/brokers in the underwriting, sale, and/or servicing of [Credit General's] insurance policies . . ." The parties also agreed that Ohio law would govern the "performance, administration, and interpretation" of the Agreement and that disputes between the parties would be resolved by arbitration.

Credit General became insolvent and was placed in liquidation in early 2001. An Ohio court appointed a liquidator to “collect and administer all of Credit General’s assets.” Shortly after the liquidator’s appointment, Credit General filed a lawsuit in the Chancery Court of Anderson County, Tennessee, against ISG, the sole shareholder of ISG, Appalachian Underwriters Inc (AUI), and the officers of ISG and AUI. In its complaint, Credit General alleged that ISG and AUI breached the Agreement by “failing to refund premiums and unearned commissions due Credit General” and raised claims of conversion and breach of fiduciary duty against the officers of ISG and AUI.

In the trial court, the defendants collectively moved the court to require arbitration pursuant to the Agreement’s arbitration provision. The trial court granted the defendants’ motion. The court, however, also granted Credit General permission to file an interlocutory appeal and stayed the arbitration pending the outcome of the appeal. The defendants also appealed, arguing that the trial court erred in granting Credit General permission to file the interlocutory appeal and staying the arbitration. The Tennessee Court of Appeals consolidated both appeals and held: (1) pursuant to the Agreement, Ohio law applied to the dispute; (2) pursuant to Ohio law, Tennessee law applied to determine the enforceability of the arbitration provision; and (3) under Tennessee law, the arbitration provision was enforceable.

To determine whether the arbitration provision was enforceable, the court first had to determine whether Ohio law applied to the question of enforceability or merely to the question of which law to apply to the question of enforceability. Ordinarily, the court would apply Ohio law directly to the question of enforceability, consistent with the parties’ choice of law provision. However, Ohio case law unequivocally states that the issue of whether a dispute must be arbitrated is procedural in nature and, therefore, must “be decided pursuant to the law of the forum state.” As a result, the court held that Ohio law required the application of Tennessee law to determine the enforceability of the arbitration provision.

Next, the court considered whether the arbitration agreement was enforceable under Tennessee law. Tennessee case law demonstrates Tennessee courts’ respect for arbitration provisions. However, a Tennessee court will invalidate an arbitration provision when considerations of “laches, estoppel, waiver, fraud, duress, and unconscionability” (the “exceptions”) render the provision unenforceable. In this case, the court was persuaded by Tennessee’s position favoring arbitration provisions and found no basis to invoke the exceptions. Finding no error on behalf of the trial court, the appellate court affirmed and remanded the case for arbitration.

The significance of this case is that it evidences Tennessee courts’ emphasis on enforcing contracts as written. The court followed the parties’ agreement to the

letter, but neglected the parties' likely intentions for Ohio law to govern all aspects of any disputes arising under the contract. Thus, this case diminishes the effectiveness of choice of law provisions in Tennessee courts. To avoid unpredictability of applying a state's common law, transactional attorneys include choice of law provisions to ensure a particular state's law applies. To circumvent the problem encountered in *Credit General Insurance Co.*, transactional attorneys should draft choice of law provisions that specify a source of law to govern both substantive and procedural aspects of disputes. For additional protection, Tennessee practitioners should also consider drafting choice of venue provisions, which can keep parties out of Tennessee courts altogether.

The Effect of Arbitration Clauses on Claims for Tortious Interference with Other Contracts. *Bodor v. Green Tree Servicing, LLC*, No. M2007-00308-COA-R10-CV, 2007 Tenn. App. LEXIS 548 (Tenn. Ct. App. Aug. 24, 2007).

By Aaron J. Kandel

Occasionally, the scope of an arbitration clause is called into question. Can a broad arbitration clause in one contract require the parties to arbitrate claims for a tortious interference claim? The Tennessee Court of Appeals recently addressed this issue in *Bodor v. Green Tree Servicing*.

Bodor entered into a series of identical, fill-in-the-blank form financing agreements with Green Tree Servicing ("Green Tree"), a financing corporation. Under the terms of these financing agreements, Bodor gave Green Tree Servicing a security interest in fifteen mobile homes that he leased to tenants. Each financing agreement contained an identical arbitration clause stating that "the parties agreed to arbitrate [a]ll disputes, claims or controversies arising from or relating to [the] Contract or the relationships which result from [the] contract."

On June 23, 2003, Green Tree Servicing, "in the apparent belief that Bodor was in default under the financing [agreements]", presented twenty four of Bodor's tenants with written notice to vacate the mobile homes. In response, Bodor filed suit alleging that Green Tree Servicing "unlawfully induced his tenants to breach their leases by effectively instructing the tenants to vacate their units and quit paying their rent" in violation of Tennessee Code Annotated § 47-50-109.

On October 16, 2006, Green Tree Servicing moved to compel arbitration under the financing agreements' arbitration clauses. However, Bodor successfully

resisted the motion to compel by arguing that his tortious interference action against Green Tree Servicing arose out of the leases with his tenants, not the financing agreements. On appeal, the sole issue before the court was “whether the allegations of tortious conduct by [Green Tree Servicing fell] within the scope of the arbitration clause[s]” contained in the financing agreements.

The court held that the arbitration clauses covered Bodor’s tortious interference claim regarding the fifteen mobile homes for three reasons. First, Tennessee courts recognize a “heavy presumption of arbitrability” which requires a court to resolve questions regarding the scope of an arbitration clause in favor of arbitration. Second, under the plain language of the arbitration clause, Bodor’s tortious interference claim “[arose] from or relate[d] to the financing agreement or the relationships created by those agreements.” Specifically, the court noted that Green Tree Servicing “took the action [it] did because of the perceived default under the financing [agreements] that contain the arbitration clauses.” Finally, the court concluded that the fact that Bodor’s claim “sounds in tort rather than contract does not remove [it] from the ambit of the arbitration clause.” Thus, the court ordered arbitration of Bodor’s claim arising out of the fifteen mobile homes covered by the financing agreements.

Although parties “cannot be forced to arbitrate claims that they did not agree to arbitrate”, *Bodor* illustrates that Tennessee courts recognize a heavy presumption favoring arbitration. Thus, a transactional attorney ought to advise clients that they may be required to arbitrate a wide variety of claims, including claims for tortious interference with other contracts.

BANKRUPTCY LAW

Loan from Trustee to Beneficiary, Secured with Beneficiary’s Future Distributions from the Testamentary Trust, Survives Chapter 7 Challenge. *Warren v. Sec. Nat’l Bank (In re Oelrich)*, No. 07-8002, 2007 Bankr. LEXIS 2961 (B.A.P. 6th Cir. Sept. 11, 2007).

By Chad Jarboe

Absent explicit language to the contrary, Ohio courts interpret testamentary trusts in favor of free alienation. In *In re Oelrich*, the United States Bankruptcy Appellate Panel for the Sixth Circuit, interpreting Ohio law, considered whether a beneficiary/debtor could grant a trustee a security interest in future distributions under the trust in order to obtain a loan. The court denied the chapter 7 trustee’s objection to the loan because no language in the trust explicitly restricted the

beneficiary's right to transfer his interest and the loan did not involve any coercion or fraud on the part of the trustee.

Melvin Oelrich (the "Testator") executed a will establishing a testamentary trust for the benefit of his two children. The trust named Security National Bank and Trust Company (the "Bank") as the trustee. Under the trust, the Bank must make monthly distributions, at a predetermined amount, to the children for a period of twenty years, at which time the trust funds would be exhausted. If both children died before the twenty years elapsed, the remaining distributions went to a contingent beneficiary. The trust provided for no additional distributions. Furthermore, the trust granted the Bank broad powers to handle the property "fully and freely as if it were the absolute owner of the same." The trust did not contain any specific anti-alienation language or a spendthrift provision.

Subsequently, one of the children, Steven Oelrich ("Oelrich"), obtained, and later refinanced, a loan from the Bank. Oelrich also granted the Bank a security interest in his future distributions under the trust. Several years later, Oelrich filed a chapter 7 bankruptcy petition. Consequently, the Bank filed a motion for relief from the automatic stay to enforce the security interest in Oelrich's future cash distributions.

Thereafter, James Warren ("Warren"), the chapter 7 trustee, challenged the validity of the Bank's security interest. Warren argued that the security interest was invalid because the trust did not authorize a beneficiary to grant or the trustee to accept a security interest. Further, Warren claimed that the Bank violated its fiduciary duty as trustee because it personally benefited from the transaction, thereby rendering the security interest invalid. The bankruptcy court summarily denied Warren's objections and rejected both of his arguments. Warren appealed the ruling, and the bankruptcy appellate panel affirmed.

Warren's first argument, that the security interests are not authorized by the trust's terms or the testator's intent, is essentially a question of interpretation. Under Ohio law, the intent of the testator controls. If the trust's language is unambiguous, the court must honor the trust's terms as written. Additionally, courts will not interpret a trust to restrain the alienability of the beneficiary's interest unless the testator manifested such intent in clear, unequivocal language. This trust did not expressly impose any restrictions on the beneficiaries' interests. The trust merely provided for periodic distributions, with the only contingency being that the children were alive. Thus, the appellate panel found that the children's interests were freely alienable. Consequently, Oelrich was free to transfer his future distributions to the Bank as collateral for the loan.

Furthermore, the transaction did not upset the Testator's intent to

periodically distribute funds over a twenty-year period. Although Oelrich benefited from the distributions in advance by using his future distributions as collateral to obtain a loan, he could have achieved the same result by using different collateral. In addition, the monthly trust distributions were still to be dispersed in the predetermined amounts as the Testator intended; the only difference was that the Bank became the indirect recipient. Thus, the appellate panel found the Bank's lien permissible under the trust's terms and consistent with the Testator's intent.

Warren's second argument, that the Bank breached its fiduciary duties as trustee by accepting a security interest in the trust distributions, also failed to persuade the appellate panel. Given its ruling that the beneficiaries' interests are freely alienable, the appellate panel found that by accepting the security interest, the Bank simply recognized Oelrich's right to voluntarily transfer his interest.

However, the loan raised some fiduciary concerns. Generally, a trustee is not permitted to use its position to its advantage, nor may it have any self-interest that might conflict with its duties as trustee. First, the Bank personally benefited from the transaction with Oelrich by charging interest on the loan. Yet, The appellate panel found that the Bank did not use its position improperly because no evidence suggested that the Bank coerced Oelrich to choose it over another lender.

Second, the Bank had a potential conflict of interest due to its stake in the trust fund distributions. Under Ohio law, a potential conflict is not per se invalid. Because the Bank did not act in bad faith and Oelrich was not misinformed or prejudiced by the transaction, the potential conflict did not invalidate the transaction. Finally, the Bank's security interest only encumbered Oelrich's future interest in trust distributions, not the entire corpus of the trust.

Although the appellate panel rejected the chapter 7 trustee's challenges, *In re Oelrich* warns transactional attorneys of the consequences of poor drafting and the disruptive effects of bankruptcy on even the simplest testamentary trust. First, estate planners must understand their state's common law and interpretative rules, and should draft documents with sufficient precision and clarity to avoid triggering default rules, which might render an unwanted outcome. If the Testator did not want his children to use their trust distributions as collateral for loans, his attorney's drafting was flawed. Although no evidence suggests this was the Testator's intent, many clients may desire such a result, especially if the client does not believe the beneficiaries are responsible investors. Second, bankruptcy must be properly considered during estate planning. To avoid uncertainty, and the cost of challenging any pre-bankruptcy transactions, the parties must carefully account for the real possibility of bankruptcy in their testamentary documents. With proper drafting and fair consideration of bankruptcy's unique impact on testamentary documents, the prudent transactional attorney may avoid challenges to the documents, altogether.

A Personal Injury Claim that is Filed Before a Chapter 11 Petition for Relief is a “Prepetition” Claim Against Which a Landlord/Creditor Can Setoff Its Own Prepetition Claim on Judgment for Breach of Lease. *In re Gregg*, 371 B.R. 817 (Bankr. E.D. Tenn. 2007).

By Kacy Hunt

Once a debtor files for protection under chapter 11 of the Bankruptcy Code (“chapter 11”), an automatic stay is instituted which prevents a creditor from setting off any debt owed by the creditor to the debtor against a claim the creditor has against the debtor. A creditor may, however, apply for relief from the automatic stay in order to set off the debt from the claim. To exercise the right of setoff, the creditor must owe a debt to the debtor, that creditor must have a claim against the debtor, both the debt owed by the creditor and the creditor’s claim against the debtor must have arisen prepetition, and the debt and claim must be mutual obligations.

In *In re Gregg*, before the debtor, Gregg, filed for relief under chapter 11, two events transpired. First, the creditor, Southern Adventist University (“SAU”), obtained a judgment against Gregg for breach of a lease and recorded the judgment in Hamilton County. Second, Gregg brought a claim against SAU in a personal injury lawsuit for injuries sustained when she slipped and fell on property owned by SAU. At the time Gregg filed for relief under chapter 11, the personal injury lawsuit was pending in the Circuit Court of Hamilton County and the amount of damages sought by Gregg was unknown.

When Gregg filed for chapter 11, SAU filed a proof of claim for the amount of the recorded judgment plus post-judgment interest. SAU then filed for relief from the automatic stay in order to setoff any monetary judgment that Gregg might be awarded in the pending personal injury case against the judgment lien amount set forth in SAU’s proof of claim. In order to exercise the right of setoff, the Bankruptcy Code requires four elements to be met: (1) the creditor must owe debt to the debtor; (2) the creditor must have a claim against the debtor; (3) both the debt and the claim must arise before the filing for relief (“timing”); and (4) the debt and claim must be mutual obligations (“mutuality”).

First, the creditor owed a debt to the debtor. The Bankruptcy Code defines “debt” as a “liability on a claim.” SAU has a liability on Gregg’s claim against them for injuries sustained when she slipped and fell on property owned by SAU. Second, the creditor had a claim against the debtor. The Bankruptcy Code defines a claim as a “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.” Applying this definition, SAU had a right to payment from Gregg for the amount of the judgment and post-judgment interest,

and this claim was properly presented by SAU in a proof of claim.

The two elements of setoff that were at issue in *In re Gregg* were timing and mutuality. Regarding timing, while SAU's claim against Gregg was undoubtedly prepetition, as the cause of action giving rise to the claim and the judgment arose before Gregg filed for chapter 11 relief, Gregg claimed that the damages from her personal injury lawsuit should be considered postpetition because the damages would have to be determined after the filing for relief. However, the court disagreed with Gregg and stated that the pivotal point in time in determining whether a claim is pre or postpetition is when the cause of action giving rise to the claim arose, not the awarding of damages. Since Gregg slipped and fell before the petition for relief was filed, her claim was prepetition. Therefore, both the debt owed to Gregg by SAU and the claim by SAU against Gregg arose prepetition and the timing element of setoff was met.

While mutuality is not defined in the Bankruptcy Code, Tennessee bankruptcy courts have held that "[m]utuality of obligations means that the obligations must be between the same parties, . . . and must be 'owing to and due in the same rights and capacity.'" Both the debt and the claim were between SAU and Gregg; therefore, the obligations were between the same parties. Obligations do not have to arise from the same transaction nor even be of the same character to be considered "owing to and due in the same rights and capacity." In other words, a tort claim can be setoff against a contract claim even when the claims arose from different causes of action. Therefore, mutuality existed and all elements of setoff were met.

The decision in *In re Gregg* furthers the broad scope of setoff that a bankruptcy court will allow. A creditor may set off any prepetition debt owed to the debtor against a prepetition claim of the creditor against the debtor as long as there is mutuality between the two. With such a broad interpretation of "mutuality," the scope of setoff is large and aids creditors in obtaining relief from the automatic stay imposed by a bankruptcy filing.

BUSINESS ASSOCIATIONS

Related Business Entities Operating Under Separate Governing Documents May Not Be Related for Purposes of Satisfying Financial Obligations.

Bradshaw v. Chattanooga Railcar Serv., No. E2005-02728-COA-R3-CV, 2007 Tenn. App. LEXIS 234 (Tenn. Ct. App. Apr. 19, 2007).

By Scott Simmons

Two separate companies that are owned by the same majority shareholder and share nearly identical operating agreements may not be “lumped” together for purposes of analyzing cash distributions to shareholders. Each company must abide by the terms of its operating agreement in making payments to shareholders to cover tax liability incurred on company profits and cannot rely on payments made by another company with the same majority shareholder.

In *Bradshaw v. Chattanooga Railcar Services*, Bradshaw was a shareholder in two companies, Chattanooga Railcar Services (“CRS”) and Kingsport Railcar Services (“KRS”) (collectively, the “Defendants”). As a charter member of these companies, Bradshaw claimed he was eligible under the terms of each company’s operating agreement to receive a shareholder distribution sufficient to pay his tax liability incurred as a result of undistributed profits from both companies. He asserted that because no payments were made by either company to cover his liability, disbursements to other shareholders were in direct opposition to the operating agreements.

The operating agreements of both companies are identical in structure, and read in pertinent part, that:

Distributable Cash means . . . all funds of the Company on hand . . . that, in the discretion of the Chief Manager, is available for distribution to the Members after provisions [have] been made for . . . an amount sufficient to pay any Federal or state taxes assessed on Company income taxable to the Members . . . even if the Company must borrow the money to make such payments.

Bradshaw referenced this provision in each operating agreement and argued that he had not received payments to cover his tax liabilities despite the fact that disbursements were made to other shareholders. The trial court found that Bradshaw had received sufficient amounts from KRS to cover his tax liabilities during the years in question, but had not received any payments from CRS. The trial court “lumped” the two companies into one entity, and found that the payments distributed to Bradshaw by KRS “were sufficient to enable him to pay the taxes due on his share”

of the income from both KRS and CRS.

On appeal, Bradshaw averred that the trial court misinterpreted the scope and span of the two companies' operating agreements. Citing *Doe v. HCA Health Services of Tenn., Inc.*, 46 S.W.3d 191 (Tenn. 2001), the Tennessee Court of Appeals determined that interpretation of such agreements is a question of law and thus subject to de novo review.

Upon review, the court upheld the trial court's determination that the language within the respective operating agreements was not ambiguous, noting that "the agreements plainly state[d] that provisions must be made for 'an amount sufficient to pay any Federal or state taxes assessed on Company income taxable to the Members,' before any additional distributions can be made." With respect to the payments received from KRS, Bradshaw argued that the distributions were not specifically designated as amounts paid for the purpose of covering his income tax liability. However, the court, unpersuaded by this line of reasoning, affirmed the lower court's holding that the amounts paid by KRS to Bradshaw were sufficient to pay his taxes.

As to CRS, the appellate court found the trial court erred in treating the two companies as an aggregate, single company. The court held that CRS was a "completely separate entity from KRS." As such, CRS made no distributions to Bradshaw in 2000 or 2001, despite making such payments to other shareholders. In accordance with the plain language of the operating agreement, Bradshaw was owed a distribution from CRS in the amount necessary to pay his tax liability from income attributed to the company. The issue of the amount of Bradshaw's tax liability from 2000-2001 for income attributable to CRS was remanded to the trial court for determination.

As *Bradshaw* distinctly demonstrates, the fact that more than one company contains the same majority owner does not mean that the two firms may be treated as a single, aggregate entity for purposes of determining company distributions related to tax liability of the shareholder. When the terms of separate operating agreements are unambiguous, each agreement should be treated as a separate governing document, even when they are identical in both form and content and each company is under the control of the same majority shareholder.

The Tennessee Banking Act Does Not Mandate the Sale of Trust Assets to a State or Federal Bank of the FDIC; Trust Assets may be Sold to Any Outside Party. *In re Sentinel Trust (Sentinel II)*, No. M2006-01002-COA-R3-CV, 2007 Tenn. App. LEXIS 260 (Tenn. Ct. App. Apr. 26, 2007).

By J. Scott Childs

When the Tennessee Commissioner of Financial Institutions (“Commissioner”) liquidates an insolvent trust company, questions arise as to which outside parties the Commissioner can legally sell the trust company’s assets with court approval. In *Sentinel II*, a legal dispute arose regarding whether the Commissioner had the authority to sell seized real estate that was formerly owned by a trust company to a party other than another state or national bank or the Federal Deposit Insurance Corporation (“FDIC”).

In April 1999, the Tennessee Banking Act (the “Banking Act”) was amended to extend its application to trust companies. Later that year, the Commissioner commenced a formal investigation of the Sentinel Trust Company (“Sentinel”) into its business practices and financial situation to ensure compliance with the Banking Act. After a series of annual investigations, numerous violations of the Banking Act were uncovered in 2004. A commissioner-appointed receiver determined that Sentinel was insolvent by at least \$6.2 million. Subsequently, the Commissioner determined that liquidation was necessary and appropriate, and several former officers and directors of Sentinel (“Officers”) filed a petition seeking judicial review of the Commissioner’s decision. The trial court upheld the Commissioner’s actions of taking control of Sentinel and its property. The Tennessee Court of Appeals upheld this determination in *Sentinel I*.

Following *Sentinel I*, the Commissioner proceeded with his efforts to complete the liquidation of Sentinel. The primary asset at issue was the real estate and office building that formerly housed Sentinel’s headquarters, a property that cost Sentinel \$1.1 million to acquire and develop. In 2006, the Commissioner-appointed receiver entered into a purchase and sale agreement for the property in the amount of \$450,000 with Robert and Aiyoung Allen, a married couple from Florida. When the Commissioner filed a Motion for Approval of Sale with the trial court, the Officers filed a petition objecting to the Motion. The trial court granted the Commissioner’s Motion and the Officers’ appealed.

According to section 1502 of the Banking Act, as amended in 1999, the Commissioner has broad authority to manage the affairs of an insolvent trust company over which he has properly taken possession. This power allowed the Commissioner to reorganize or liquidate Sentinel in accordance with section 1504. Section 1502 further provides that the Commissioner may, with approval of the

appropriate court, sell all or part of the assets of the insolvent trust company to a state or national bank or the FDIC. The Officers relied on this provision in challenging the sale of the Sentinel property to the Allens. The Officers argued that section 1502 restricts the Commissioner to selling such property to either a state or national bank or the FDIC.

The court rejected the Officers' argument on two grounds. First, section 1502 was merely permissive in tone rather than mandatory. Section 1502 states that the Commissioner "may" liquidate assets by selling them to a bank or the FDIC. Second, section 1502 allowed the Commissioner to liquidate seized trust company assets in accordance with section 1504. Under section 1504, the Commissioner may sell any trust company asset having a value in excess of \$500 so long as he first obtains court approval. The statute contained no limitation on the Commissioner regarding what categories of parties could legally purchase such assets. Therefore, the court, reading sections 1502 and 1504 together, reasoned that, because the Commissioner had proper court approval, he could sell the Sentinel property to the Allens, a private third party.

This case clarifies the Commissioner's power to liquidate insolvent trust companies. With court approval, the Commissioner can sell a seized trust company asset exceeding \$500 in value to any outside party. The Banking Act has only applied to trust companies since 1999, but it has applied to banks from its inception. Thus, the Commissioner's liquidation powers as articulated in *Sentinel II* also apply to insolvent banks. When representing a bank or trust company under investigation by the Commissioner, it is important to understand the Commissioner's wide latitude in finding potential purchasers of a seized asset, often at a heavily discounted price from what the asset was originally worth.

COMMERCIAL LAW

Uniform Commercial Code Requires the Sending of But Not Necessarily the Receipt of Notification Prior to Disposition of Collateral. *Auto Credit of Nashville v. Wimmer*, 231 S.W.3d 896 (Tenn. 2007).

By Melanie McDavid Lamb

While the Uniform Commercial Code ("UCC") requires creditors to provide notification to the debtor, any secondary obligors, and other interested parties prior to the disposition of collateral, there was still some uncertainty as to whether

creditors were required to take additional steps to determine whether that notification has been received. Previous decisions requiring creditors to take additional action to verify that notice was actually received were overruled by the Tennessee Supreme Court in *Auto Credit of Nashville v. Wimmer*.

In *Wimmer*, Wimmer borrowed money from Auto Credit of Nashville (“Auto Credit”) to finance the purchase of a car, which served as security for the loan. Wimmer subsequently defaulted on this loan and surrendered the car to Auto Credit. Auto Credit mailed Wimmer a letter regarding the disposition of the collateral via certified mail return receipt requested. However, Wimmer never received the notification letter, which was returned to Auto Credit after three unsuccessful attempts at delivery.

On February 7, 2002, Auto Credit sold the collateral and subsequently filed suit against Wimmer to recover a deficiency balance. A judgment was entered in favor of Wimmer and Auto Credit appealed. Wimmer counterclaimed for damages on the theory that Auto Credit failed to comply with mandatory notification requirements under Tenn. Code Ann. § 47-9-625(c)(2), Tennessee’s version of the UCC. The circuit court found Auto Credit’s notification to be reasonable and held that the sale was proper. Auto Credit was granted a deficiency judgment against Wimmer.

Wimmer appealed to address, not the deficiency judgment itself, but his counterclaim for statutory damages that the trial court dismissed. The court of appeals reversed the lower court and awarded Wimmer statutory damages, which were offset by the deficiency judgment previously awarded to Auto Credit.

Auto Credit appealed to the Tennessee Supreme Court, which addressed the requirements for “sending” reasonable notification under Tenn. Code Ann. § 47-9-611(b). The term “send” is explicitly defined in Article 9 of Tennessee’s UCC as “to deposit in the mail . . . with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or to cause the record of notification to be received within the time it would have been received if properly sent” This definition is consistent with the plain meaning of the word “send.”

Receipt of notice is not discussed in the statutory provision requiring notification. However, the introductory provisions of the UCC state that “[w]hen the essential fact is the other party’s receipt of the notice, that is stated.” In addition, Tennessee law presumes that mail was received “upon proof that the letter was properly addressed, properly stamped, and duly deposited with the post office.”

The Court analyzed three possibilities that may arise prior to disposition of the collateral. First, a creditor sends no notification and proceeds to sell the

collateral in clear violation of the statute. Second, a creditor sends notification pursuant to the statute, knows this notice was received, and conducts a valid sale of the collateral. Third, a creditor sends notification, learns that such notification was not received, and proceeds to sell the collateral without attempting to locate the debtor. In *Mallicoat v. Volunteer Finance & Loan Corp.*, 415 S.W.2d 347 (Tenn. Ct. App. 1966), the court of appeals held that it was not reasonable to proceed with the sale without making an additional attempt to provide notification.

In *Wimmer*, the creditor sent notification as outlined in the statute, but did not know whether that notification was received prior to conducting the sale. Applying the plain meaning of the statutory language, the court concluded that the UCC does not require the creditor to take additional steps to determine whether notification was received. The Court reasoned that requiring creditors to take an additional step to verify receipt of the notification in each and every case would place an unreasonable burden on the creditor and would “make secured transactions in this state unduly cumbersome.” There are numerous reasons why debtors do not receive notification, including change of address and lost or misplaced mail. In addition, many debtors may refuse delivery of the notification, causing the creditor further delay.

The court’s decision is fair for both creditors and debtors. It gives creditors the right to sell collateral for which they bargained when entering into the secured transaction. On the other hand, this decision protects the debtor by leaving in place the holding in *Mallicoat* which requires creditors to take additional steps to provide notice to the debtor only when the creditor has actual knowledge that its notification was not received.

LABOR & EMPLOYMENT

Written Corporate Policy: A Company’s Worst Enemy? *Vebar v. Cole Nat’l Group, Inc.*, No. 06-4542, 2007 WL 3129713 (6th Cir. Oct. 26, 2007).

By Jonathan Louis May

Attorneys in the corporate realm are often responsible for drafting and maintaining written policies for their clients. Included in many of these policies are carefully crafted job qualifications and descriptions. Problems arise, however, when the corporate decision-makers do not abide by the written policy. When this occurs, the policy is often turned against the company and makes for damning evidence.

Such was the case in *Vehar v. Cole National Group, Inc.*

In *Vehar*, Wendy Vehar, a former female employee of Cole Vision Corporation (“Cole”) brought suit under the Federal and Ohio Equal Pay Act (“EPA”). Vehar began working for Cole after an eight-year hiatus from computer programming. Vehar had Bachelor’s Degrees in mathematics and computer science, nearly seven years of work experience, and took a number of courses designed to ensure that her education was up to date with the level of current technology. She was hired in February of 2001 as a “Data Analyst,” a position her manager said she was “over qualified” to do, which had a salary of \$46,000. In June of the following year she was transferred to a different section of Cole and promised the title of “Programmer Analyst.” Instead, Vehar was placed in the lower position of “Programmer II” and received a salary of \$46,400, representing a one percent raise. During her time at Cole she received an “E” or “exceeds expectations” on her performance reviews and management viewed her as a leader and capable of making a difference. When Vehar left Cole in November 2004, she was earning \$48,783, \$25,000 less than she was paid when she found new employment.

In contrast, Erich Leipold and Dave Crosley worked in the same division of Cole and were paid substantially more money. Leipold, who had no college degree and nine years of experience in the field, was hired by Cole in 2000 and earned \$60,000 as a “Program Analyst.” Crosley, who also had no college degree and eight years of experience, was hired by Cole in 2000 and earned \$68,500 as a “Systems Analyst.” Both Leipold and Crosley received “M” or “meets expectations” performance reviews, yet continued to advance in title and salary during their time at Cole. When Leipold and Crosley left the company, they were earning \$78,622 and \$73,733, respectively, twenty percent more than Vehar.

The duties held by these three employees were nearly identical despite the difference in pay and title. All three were programmers in the same division of the company, reported to the same manager, and took essentially the same assignments. The three programmers often worked together, and on a number of occasions Vehar was designated as the team leader with the other two employees reporting to her. Vehar complained to the management of Cole about the pay discrepancies, but was told she would not be given a raise. At trial, however, Cole claimed that the pay discrepancy arose from a difference in experience levels, thus Leipold and Crosley were paid more because they had more experience.

To state a claim under the EPA a plaintiff must make a prima facie showing that an employer pays different wages to employees of opposite sexes for equal work on jobs requiring equal skill, effort, and responsibility and performed under similar working conditions. If an employee establishes a prima facie case, the EPA provides four affirmative defenses an employer may use to explain the discrepancy. The four

defenses are: (1) a seniority system; (2) a merit system; (3) a system that measures earnings by quantity or quality of production; or (4) that any factor other than sex was behind the discrepancy. The fourth “catch-all” provision has left courts with little guidance about how to evaluate the affirmative defense.

Vehar filed suit under the Federal and Ohio EPA, as well as Title VII of the Civil Rights Act of 1964 and the corresponding Ohio Civil code. The district court granted Cole’s motion for summary judgment holding that Cole met the “catch-all” affirmative defense. On appeal, Vehar challenged the holding on the basis that a reasonable jury could have found that sex played a role in determining Vehar’s wages.

The Sixth Circuit reversed the trial court’s grant of summary judgment on the basis that Cole failed to meet its heavy burden under the catch-all affirmative defense. Cole was hoisted by its own petard, however, when the court compared the job descriptions, their listed salary grade, and the experience of each employee. The job descriptions indicated that the positions required a Bachelor’s degree or equivalent work experience typically achieved with five, seven, or ten plus years of work experience, depending on the salary of the position. The relative similarity in job experience (almost seven years for Vehar, compared to eight and nine years for Leipold and Crosley, respectively) and the fact that Vehar was the only one of the three with a Bachelor’s degree greatly discredited Cole’s claim that experience caused the twenty percent pay discrepancy.

Further, Cole’s policies and job qualifications left it unclear whether a Bachelor’s degree is interchangeable with work experience and did not clarify the value of having both. The job descriptions used “or” rather than “and” in describing the qualifications, which meant the combination of experience and a college degree could make Vehar the more qualified and experienced candidate. Considering the exemplary performance reviews Vehar received in contrast to the mediocre reviews received by Leipold and Crosley, it was clear that a reasonable jury could find for Vehar on her EPA claim.

Standards emerged that applied to all employers, which proved particularly incriminating for Cole. First, regardless of the title an employee holds, courts will evaluate the relative equivalence of each employee’s job on a case-by-case basis by focusing on the duties, responsibilities, and requirements of each position. Only after such individualized inquiry can a court determine whether the job held by a female employee deserves similar compensation as the male employee with which it is being compared. Second, a company’s own policy and guidelines will be used to measure whether a plaintiff was qualified for the position sought or for a position that is substantially the same but receiving a higher salary. Lastly, the “catch-all” affirmative defense places a heavy burden on the defendant to demonstrate that a legitimate business reason—not sex—led to the pay discrepancy. If a defendant fails

to meet that burden, not only is summary judgment improper, but the defendant will likely lose before a jury.

It is with these lessons in mind that an attorney charged with drafting corporate hiring guidelines, overseeing compliance with those guidelines, or evaluating the liabilities of the company must operate. Only through responsible policy writing, employee education, and diligent oversight can an employer and its counsel hope to avoid expensive and timely employment discrimination litigation.

A Possible Policy-based Exception to the At-will Employment Doctrine in Tennessee and the Framework for Applying Such an Exception. *Little v. Eastgate of Jackson, LLC*, No. W2006-01846-COA-R9-CV, 2007 Tenn. App. LEXIS 242 (Tenn. Ct. App. Apr. 24, 2007).

By Brad Hearne

In *Little v. Eastgate of Jackson, LLC*, the Tennessee Court of Appeals considered, on interlocutory appeal, the issue of whether the plaintiff-employee's complaint stated a claim for retaliatory discharge in violation of a clear public policy. The employee was terminated because he had left the work premises to aid an assault victim. The court held that there was a clearly mandated public policy in favor of such behavior and that this public policy may be the basis for an exception to the at-will employment doctrine. The court proceeded to adopt a framework for applying such policy-based exceptions. This framework required the employee to prove: (1) that the clear public policy exists; (2) that discouraging the conduct in which the plaintiff engaged would jeopardize the public policy; and (3) that the public-policy-linked conduct in fact caused the dismissal. Additionally, as part of the analysis, the employer was permitted to assert the defense of an "overriding justification" for termination.

In *Little*, the plaintiff was an at-will employee of a store doing business as Eastgate Discount Beer and Tobacco. While at work, Little witnessed a woman across the street from the store being physically assaulted by an unidentified man. The employee took a baseball bat from under the work counter, left the work premises, and yelled and gestured at the assailant with the bat, causing him to leave the scene. The employee then brought the woman back to the store, where he called the police. Two days later, the defendant-store terminated the employee because he left the work premises to aid the assault victim. He then sued his employer, asserting that his termination violated public policy. The employer filed a motion to dismiss

the complaint, arguing that the termination did not violate a clearly established public policy. The trial court found that the employee's complaint stated a valid claim for retaliatory discharge and denied the motion to dismiss. The employer filed an interlocutory appeal.

Tennessee has long adhered to the employment-at-will doctrine. However, the Tennessee Supreme Court has recognized that an employer's ability to discharge at-will employees is tempered by the court's recognition of a cause of action for retaliatory discharge. In general, an at-will employee may not be discharged for any reason that violates a clear public policy that is evidenced by an unambiguous constitutional, statutory, or regulatory provision.

Prior to *Little*, Tennessee courts addressed retaliatory discharge claims in different contexts, but there were no decisions addressing the viability of such a claim under circumstances similar to this case. Therefore, the court turned to *Gardner v. Loomis Armored*, 913 P.2d 377 (Wash. 1996), a factually similar case decided by the Washington Supreme Court. In determining whether to recognize a policy-based exception to the at-will doctrine, the Tennessee Court of Appeals adopted the framework set forth in *Gardner* and shown above.

To support its holding that there is a clearly-mandated public policy in favor of encouraging citizens to rescue others, the Tennessee Court of Appeals cited several Tennessee statutes. For example, Tenn. Code Ann. § 39-11-612 absolves citizens from criminal liability for using force to rescue a third person when the citizen reasonably believes that the intervention is immediately necessary to protect the third person. The court also cited Tenn. Code Ann. § 39-11-504 (duress), Tenn. Code Ann. § 39-11-621 (use of deadly force by a private citizen), and Tenn. Code Ann. § 39-17-1322 (defenses to prosecution for an offense against public health, safety, and welfare). According to the court, these statutes show an unambiguous legislative intent to pronounce the public policy of encouraging citizens to rescue a person reasonably believed to be in imminent danger of death or serious bodily harm, and to protect a citizen who undertakes such heroic action from negative repercussions.

To the relief of employers, the court did not go so far as to adopt a broad "Good Samaritan" doctrine that would protect all conduct undertaken in aid of another. Rather, the public policy demonstrated in the statutes extends only to situations in which the employee took action to rescue or protect another person reasonably believed to be in imminent danger of death or serious bodily harm. Additionally, the framework adopted by the court permits the employer to assert the defense of an "overriding justification" for termination. In *Little*, the employer asserted concerns that the employee's behavior could expose them to potential liability. The determination of whether this potential liability was an overriding

justification for dismissal was left to the trial court on remand.

In summary, absent an overriding justification, employees cannot generally be terminated for any reason that violates a clear public policy that is evidenced by an unambiguous constitutional, statutory, or regulatory provision. A practitioner should keep in mind provisions that encourage and/or protect certain behaviors. Finally, the public policy in favor of encouraging citizens to rescue others reasonably believed to be in imminent danger of death or serious bodily harm may be the basis for an exception to the at-will employment doctrine if no overriding justification for dismissal is present.

PROPERTY LAW

Who Foots the Bill for Moving Utility Lines on Public Rights-of-Way . . . Utility Companies or Local Government? *Metro. Gov't v. Bellsouth Telecom*, 502 F. Supp. 2d 747 (M.D. Tenn. 2007).

By Amber Becton

In *Metropolitan Government v. Bellsouth Telecom*, the District Court for the Middle District of Tennessee addressed the question of who bears the burden of relocating utility lines on public rights-of-way. A municipal government has authority to require utility companies to relocate lines and equipment to accommodate public works that are reasonably necessary to benefit public welfare. Unless an applicable reimbursement statute exists, the cost of relocating such equipment lies with the utility company.

The Metropolitan Government of Nashville and Davidson County (“Metro”) provided several municipal functions including maintenance of public properties. As a result of Metro’s Public Square redevelopment project, several utility lines needed to be relocated. These lines were placed and maintained in their current location by Bellsouth Telecommunications (“BST”). A dispute arose over whether Metro or BST was responsible for the costs associated with relocating the lines. BST refused to move the lines and equipment unless Metro agreed to pay, in advance, the costs associated with the relocation. In order to keep the Public Square project on schedule, Metro agreed to pay the fees in advance. Metro then brought suit against BST seeking recovery of the costs to relocate the lines and equipment and an injunction and declaration concerning responsibility to relocate utility lines in the future. Both parties filed motions for summary judgment.

The threshold issue in this case was which party bore the cost of relocating utility lines and equipment on public rights-of-way. At common law, a utility bore the cost of relocating from public rights-of-way “whenever requested to do so by state or local authorities.” However, an exception existed when the costs were otherwise allocated by contract or statute. Thus, Tennessee requires utilities to bear the burden of relocating utility lines and equipment unless a valid reimbursement statute exists.

Metro asserted that no applicable reimbursement statute existed and that BST should bear the relocation cost. However, BST argued that the Public Square project fell within the definition of a redevelopment project and thus fell under a Tennessee reimbursement statute which requires reimbursement for relocation of utility lines and equipment necessary to a “redevelopment or urban renewal project.” The court agreed with BST and held that the reimbursement statute was applicable to the Public Square project. Although the Metro’s housing authority was not directly involved in the planning for the Public Square project, the court determined the reimbursement statute still applied because a substantial portion of the Public Square project fell within a redevelopment district and was governed by a redevelopment plan.

Because the relocation was necessary and fell within the development area, the court held that Metro was responsible for the costs of relocating the BST lines under the Tennessee reimbursement statute. Thus, the court denied Metro’s motion for reimbursement for its advance payment to BST for relocation of the utility lines.

In addition to reimbursement, Metro sought a permanent injunction barring BST from refusing to relocate lines, at BST’s cost, after a reasonable request from Metro. The court applied a four-factor test to determine whether to grant a permanent injunction. For a permanent injunction to be granted, the plaintiff must prove (1) that he has suffered irreparable injury, (2) that monetary damages are an inadequate remedy, (3) that a remedy in equity is warranted, and (4) that an injunction is not contrary to public interest. The court found that Metro did not meet its burden of showing it suffered irreparable injury or lacked an adequate remedy. Thus, the court ruled that a permanent injunction was not warranted.

Metro also sought a declaration stating BST was required, at its own cost, to relocate lines when Metro deemed it necessary absent valid reimbursement statutes. The court considered five factors in determining whether to issue a declaration, including whether the action would settle the dispute, whether the action would clarify a legal issue, and the presence of a more effective remedy. The court determined that a limited declaration was useful to clarify legal issues between the parties in their case given their continued relationship with each other.

The court declared that although Tennessee had adopted reimbursement statutes allowing utility companies to recover costs associated with relocation, utility companies were not permitted to refuse to relocate equipment when a municipality reasonably requested. The court also stated that the utility was not allowed to demand payment from the municipality prior to relocating the equipment because such demands can unnecessarily delay public works projects. As such, the burden was on the utility company to provide the relocation services and then sue the municipality for reimbursement if the utility felt a statute required reimbursement and the municipality refused. In this instance, BST's refusal to relocate the lines until they were paid was a violation of the reimbursement statute even though Metro was obligated to pay for the relocation of the lines.

BST also argued that the Telecommunications statute gave BST the power to refuse to relocate any of its facilities if the relocation was a result of any purpose other than to benefit the traveling public. The court found that this argument was without merit and held that a state has the police power to compel utility companies to remove lines from public rights-of-way. This followed the common law rule that a utility company's use of public rights-of-way was always subordinate to the rights of the public.

In issuing a declaration on the state of public utilities law, the court also rejected BST's argument that the issue of who bears the cost of relocation was a fact-specific issue that must be determined on an individual basis. When, as in this case, the burden was properly allocated to the municipality, the court determined that a declaration was necessary to clarify Metro and BST's legal relationship and to prevent future disputes. Therefore, the court issued a declaration.

For transactional lawyers in Tennessee, those representing municipalities, and those representing utility companies, this case provides a statement of the law regarding who bears the burden of relocation. It also reinforces the right of the municipality to exercise its police power to require utilities to relocate equipment from public rights-of-way when doing so is necessary to benefit the public welfare. Where relocation of utilities is likely to be in dispute, the transactional lawyer should advise clients that the initial cost of relocation lies on the utility company, which has a right to be reimbursed for such expenses if a reimbursement statute applies to the situation. If a municipality fails to reimburse the utility, then the burden is on the utility to sue for reimbursement.

SECURITIES REGULATION

Securities Law Implicitly Precludes Antitrust Claims. *Credit Suisse Securities (USA) LLC v. Billing*, 127 S. Ct. 2383 (2007).

By Stephen D. Hargraves

What legal remedies are available to buyers of newly issued securities, where the underwriters have allegedly undertaken coordinated efforts to collect excessive commissions through unlawful practices, including laddering, tying, and pledges regarding later sales of the issued shares? In *Credit Suisse Securities (USA) LLC v. Billing*, the United States Supreme Court granted certiorari to determine whether securities law precludes claims stemming from such antitrust law violations.

In *Credit Suisse*, the underwriting practices at issue took place during the course of an initial public offering (“IPO”) of shares in a company. In conjunction with the IPO, ten investment banks (“petitioners”) formed a syndicate to market the company shares. After both investigating and estimating the likely market demand for the shares at various prices, the petitioners agreed to buy all the newly issued shares from the issuing firm at a discounted price. After purchasing the shares, the petitioners then resold them at an increased price to investors. Traditionally, this increased resale price of the shares over the discounted syndicate price amounts to the syndicate’s commission.

However, according to the IPO investors, the petitioners unlawfully agreed that the syndicate would not sell shares of the IPO to a prospective buyer unless that buyer committed (1) to buy additional shares of the IPO at escalating prices (“laddering”), (2) to purchase from the petitioners other less desirable securities (“tying” arrangements), and (3) to pay unusually high commissions on subsequent offerings from the petitioners (“pledging”). These alleged marketing activities amounted to additional charges over and above the petitioners’ traditional IPO commissions. Moreover, the investors alleged that the concerted efforts of the petitioners artificially inflated the share prices of the securities in question.

In January 2002, a group of sixty investors brought class-action lawsuits against the underwriting firms, alleging that the firms violated antitrust laws by engaging in laddering, tying, and the collection of excessively high commissions. The petitioners moved to dismiss the investors’ complaints on the ground that federal securities law impliedly precluded application of antitrust laws to the conduct in question. In agreement with the motion, the United States Court for the Southern District of New York dismissed the action. On appeal, the Court of Appeals for the Second Circuit vacated the lower court’s decision and remanded the actions to the

lower court.

In *Credit Suisse*, the United States Supreme Court noted that where regulatory statutes, such as securities law, are silent with respect to antitrust, courts must determine whether, and in what respects, the regulatory statutes preclude the antitrust laws' application. In previous decisions specifically addressing the relation of securities law to antitrust law, the Court made clear that §§ 77p(a) and 78bb(a) may not be interpreted as savings clauses so broad as to preserve all antitrust actions. In determining the preclusion issue, the Court must apply a "clearly incompatible" standard in concluding whether the antitrust complaint may coexist with securities law. Under this standard, to warrant an implication of preclusion, the following criteria must be present: (1) the existence of regulatory authority under the securities law to supervise the activities in question; (2) evidence that the responsible regulatory entities exercises that authority; (3) a resulting risk that the securities and antitrust laws, if both applicable, would produce conflicting guidance, requirements, duties, privileges, or standards of conduct; and (4) the possible conflict affects practices that lie squarely within an area of financial market activity.

Applying each of the foregoing criteria to the facts in *Credit Suisse*, the Court found that the respondents could not reasonably dispute the existence of several of the conditions necessary in determining implied preclusion. First, general marketing efforts, such as road shows and book-building efforts, to promote and sell securities during the IPO process are considered by financial experts, as well as securities regulators, as essential to the successful marketing of an IPO. As such, the petitioners' general marketing practices qualify as lying squarely within an area of financial market activity.

Second, under securities law, the Securities and Exchange Commission ("SEC") enjoys the legal authority to forbid, permit, encourage, discourage, tolerate, limit, and otherwise regulate virtually all aspects of the IPO marketing process. Additionally, private individuals may recover damages for harm resulting from securities law violations. As a result, regulatory authority exists under securities law to supervise the IPO marketing activities exercised in the instant case.

Third, the Court noted that the SEC has continuously exercised its legal authority to supervise the IPO marketing efforts at issue. One example of such involvement in this area of financial market activity can be seen in the SEC's detailed definitions stating how underwriters, such as the petitioners, may interact with customers during road shows. Moreover, the SEC has brought actions against underwriters who violate SEC regulations relating to marketing activities. Therefore, the Court found satisfactory evidence that the responsible regulatory entity, the SEC, exercises its authority.

Given that the first, second, and fourth criteria for finding implied preclusion had been easily satisfied, the Court focused its attention on the last, more complicated, question: is the antitrust claim presented in the instant case likely to prove practically incompatible with the SEC's administration of the securities laws? The Court determined that while the SEC has disapproved the conduct that the antitrust complaints attack, seemingly obviating any conflict between the two bodies of law, other considerations led the Court to find that simultaneous application of securities law and antitrust law would produce conflicting guidance, requirements, duties, privileges, or standards of conduct.

First, a fine, complex line separates activity that the SEC permits from activity that it forbids. As such, evidence tending to show unlawful antitrust activity and evidence tending to show lawful securities marketing activity may overlap, or prove identical. This blurred demarcation of legally permissible activities, coupled with the possibility of antitrust plaintiffs bringing lawsuits in dozens of different courts with different non-expert judges and non-expert juries, would open the door to widely different legal results. Therefore, the threat of likely antitrust mistakes and inconsistencies, and the resulting unpredictability of what may constitute legally permissible marketing activities, could alter underwriter conduct in undesirable ways. As a result, antitrust lawsuits would threaten serious harm to the efficient functioning of the securities markets.

Furthermore, in determining whether antitrust law and securities laws may coexist, the Court found that the enforcement-related need for an antitrust lawsuit is unusually small, given the active involvement of the SEC in this arena. Together, the potential harm to the securities markets and the small need for antitrust lawsuits in this particular sphere indicate that a serious conflict exists, satisfying the third criteria for finding implied preclusion. Consequently, the Court reversed the Second Circuit's decision, holding that the securities laws are "clearly incompatible" with the application of the antitrust laws in the instant case.

Although the petitioners' joint efforts to collect "excessive" commissions could be independently viewed as violations of antitrust laws, the Court's holding in *Credit Suisse* resolved that where such activities are governed by securities law, those statutory regulations implicitly preclude the application of antitrust laws. A transactional lawyer should advise underwriters of newly issued securities that their marketing activities, with regard to such securities, are effectively immune from claims arising out of antitrust violations. In addition, a transactional lawyer should advise investors in newly issued securities that any suffered damages stemming from marketing activities, such as laddering and tying, may only be remedied under securities law. Failure to file a claim limited to securities law violations will result in the claim's dismissal on a motion for summary judgment.

Requirements for Pleading “Strong Inference” of Scier in a Private Action Under the Securities Exchange Act of 1934. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499 (2007).

By Taylor Williams

The Securities Exchange Act of 1934 provides individuals with a private right of action to enforce federal antifraud securities laws. To prevent the flood and abuse of private litigation in this area, Congress enacted the Private Securities Litigation Reform Act of 1995 (the “PSLRA” or the “Act”). One safeguard included in § 21D(b)(2) of this Act requires plaintiffs bringing such an action to include in the complaint each statement alleged to have been misleading, the reasons why the statement is misleading, and any facts giving rise to a “strong inference” of scier. Scier exists if the defendant acted with the intent to deceive, manipulate, or defraud investors. However, in enacting the PSLRA, Congress failed to address the requirements or definition of the term “strong inference.” After differing interpretations of “strong inference” appeared among the circuits, the Supreme Court resolved the dispute by establishing the meaning “strong inference” in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.* The Court ultimately held that the plaintiff must set forth sufficient, specific facts to create an “inference of scier . . . more than merely plausible or reasonable – it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”

In *Tellabs*, investors who purchased Tellabs’s stock between December 11, 2000, and June 19, 2001 (“Shareholders”), accused Tellabs and its chief executive officer, Richard Notebaert, (collectively the “Defendants”) of “engaging in a scheme to deceive the investing public about the true value of Tellabs’[s] stock.” The Shareholders pointed to four particular acts by Defendants between December 2000 and spring 2001 that misled the investing public into purchasing Tellabs’s stock. First, Notebaert indicated that demand for Tellabs’s flagship product was increasing when in fact, demand was waning. Second, Notebaert indicated that Tellabs’s new flagship product was ready for production and demand for the product was high, though neither statement was true. Third, Defendants falsely represented Tellabs’s financial results for the fourth quarter of 2000. Fourth, Defendants overstated projected future revenue streams based on false demand projections of Tellabs’s products. Over the next few months, the poor performance of Tellabs’s products slowly became apparent to the public and ultimately culminated on June 19, 2001, when Tellabs disclosed significantly lower demand projections for its flagship product. As a result, the company lowered its revenue projections, causing the company’s stock to plunge from \$67 to \$15.87 a share.

Shortly after Tellabs’s stock plummeted, the Shareholders filed a class action in the District Court of Illinois. The complaint stated that Defendants “had engaged

in securities fraud in violation of § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 [and] that Notebaert was a ‘controlling person’ under § 20(a) of the 1934 Act and therefore derivatively liable for the company’s fraudulent acts” (citations omitted). Following a motion by the Defendants, the district court held that the Shareholders had not pleaded their case with particularity as required by the PSLRA, and dismissed the complaint without prejudice. In response, the Shareholders amended their complaint to include specific references to twenty-seven confidential sources in an attempt to show the existence of Notebaert’s scienter. After considering the new references, the district court determined that Notebaert’s statements were misleading; however, the Shareholders had still failed to plead with sufficient particularity that Notebaert had acted with scienter. The complaint was again dismissed, but this time it was dismissed with prejudice.

Upon the second dismissal, the Shareholders appealed the decision to the Seventh Circuit Court of Appeals. The Seventh Circuit agreed that the Shareholders had sufficiently pleaded that Notebaert’s acts were misleading, but unlike the district court, the court of appeals concluded that the complaint created a “strong inference” of Notebaert’s scienter. In making this determination, the Seventh Circuit concluded that a complaint will survive “if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.” The Seventh Circuit adopted this rather lax standard for pleading out of fear that a stricter standard would violate the Shareholder’s Seventh Amendment right to a jury trial. This interpretation created a stark disagreement between the Sixth and Seventh Circuits as to pleading requirements to establish a “strong inference” of scienter. The Sixth Circuit required plaintiffs to plead the requisite scienter with such particularity that no other competing inferences could plausibly be drawn. The United States Supreme Court granted certiorari to resolve this disagreement among circuits.

In reaching its decision, the Supreme Court first looked at the legislative intent behind § 21D(b)(2) of the PSLRA, which requires heightened pleading for private actions under the securities fraud laws. In enacting the PSLRA, Congress adopted the Second Circuit’s “strong inference” language to describe the standard for pleading such actions. However, Congress did not adopt the Second Circuit’s interpretation of “strong inference.” As a result, the Supreme Court left great leeway in defining the term. In *Tellabs*, the Supreme Court set forth to establish a standard of pleading which would promote the two goals of the PSLRA: “to curb frivolous, lawyer-driven litigation, while preserving investors’ ability to recover on meritorious claims.”

In determining the level required to create a “strong inference,” the Supreme Court stated that a court must take into account all plausible opposing inferences in deciding scienter. The Court noted that the Seventh Circuit had not done this

because it only applied a “reasonable person” standard, which failed to take into consideration any other inferences. The Court held that while a “reasonable person” standard does create an inference of scienter, it fails to create a “strong inference” of scienter. A court must look to all “plausible nonculpable explanations” for the defendant’s conduct. Accordingly, a “complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.” Ultimately, the Supreme Court found that the Shareholders had pointed to questionable actions on the part of the Defendants, but the Shareholders had failed to set forth unambiguous circumstances, which would unequivocally indicate an inference of scienter.

Importantly, *Tellabs* sets forth the standard for pleading securities fraud violations under the Securities Exchange Act of 1934 § 10(b). Any attorney wishing to bring such an action must plead with particularity: (1) the specific statements or acts of deception and why they were misleading and (2) facts creating a “strong inference” of scienter. To create a “strong inference,” the plaintiff must set forth enough specific allegations so that the inference of the existence of scienter is at least as strong as any other opposing inference. As a result, an attorney could either set forth facts proving scienter *or* set forth facts disproving all other possible mental states or motives for the misleading acts. Although this holding does not require a plaintiff to prove the inference of scienter in *the* most plausible manner, the challenge of proving that the inference of scienter is as likely as any other opposing inference will be a significant obstacle for a plaintiff alleging securities fraud violations under the Securities Exchange Act of 1934 § 10(b).

TAX LAW

If Title Ownership Is Unclear, Attorneys Must Send Notice To Every Possible Owner. *Keisler v. Wallace*, No. E2006-00276-COA-R3-CV, 2007 Tenn. App. LEXIS 488 (Tenn. Ct. App. July 31, 2007).

By Martha McRee

Keisler v. Wallace demonstrates that lawyers must find the correct title holders of property and ensure adequate notice is given to these individuals to complete a valid tax sale. The result in *Keisler v. Wallace* depended on whether there was common ownership of property in Campbell County, Tennessee. The Tennessee Court of Appeals determined that there was a genuine issue of material fact as to whether there was common ownership of this property, and, because ownership was

unclear, it was also unclear whether notice was adequate.

Mr. Keisler filed a complaint to quiet title to and partition 600 acres of land in Campbell County. Keisler successfully purchased this property from all but one of the heirs of Z.D. Baird. However, he did not own the underlying mineral rights on the land. Campbell County owned the mineral rights. Campbell County purchased these rights at a tax sale that was held when taxes dues on the mineral rights were not paid for several years. These tax notices were sent to Lendon Baird.

Keisler sought to set aside the tax sale, arguing that his predecessors in interest, the heirs of Z.D. Baird, and the individual who received notice, Lendon Baird, did not have common ownership of the property. Without common ownership, the notice sent to Lendon Baird was inadequate.

Several deeds pertained to the property at issue. First, a 1920 deed documented the conveyance of three tracts of land to Z.D. Baird. These three tracts are the same 600 acres owned by Keisler. In addition, a 1921 deed documented the conveyance to Z.D. Baird of property identical to the third tract included in the 1920 deed. However, there was also a different and separate line of title that appeared to describe the same property. A 1964 deed documented a conveyance of a portion of four tracts of land from heirs of Winston Baird to Lendon Baird. Three of these tracts are those described in the 1920 deed to Z.D. Baird. These appeared to be the same 600 acres now owned by Keisler. To complicate things further, the sole surviving heir of Lendon Baird conveyed her interest in the combined four tracts to Bart Montanari. Montanari filed a successful motion to intervene.

The central issue in the case was whether there was commonality of ownership between the heirs of Z.D. Baird and the heirs of Winston Baird to support a joint assessment of taxes and a sale when the taxes were not paid. The plaintiff argued there was not a commonality of ownership; therefore, the notice was not sufficient. Campbell County argued there was joint ownership of the property, and thus the notice was sufficient and the county legally owned the mineral rights. The court of appeals determined that a genuine issue of material fact remained and vacated the grant of summary judgment.

Previously, the Tennessee Supreme Court had stated that a taxpayer must be before the court by actual or constructive service of process for a valid suit to collect delinquent taxes. This taxpayer must be the proper title owner of the property. When a taxpayer is not properly before the court, the sale is a nullity to him and it can be attacked at any time. Furthermore, if the tax sale is void, the statute of limitations providing a three year limit to challenge a tax sale does not apply.

Keisler argued that the tax assessment and sale of the mineral rights were

invalid for two reasons. First, the county did not have the authority to combine property owned by Z.D. Baird and his successors with property owned by Winston Baird and his successors. According to Keisler, there was no evidence to support a finding that the two parties jointly owned the property. Second, the heirs of Z.D. Baird from whom Keisler acquired the property did not receive sufficient notice because notice was only sent to Lendon Baird.

Campbell County and Montanari disagreed and claimed that several items in the record established commonality of ownership in the four tracts. These items included a copy of the final settlement of the estate of Z.D. Baird, a complaint filed in the trial court by the heirs of Z.D. Baird, and a copy of a 1988 court of appeals opinion. Campbell County and Montanari asserted that these items supported a finding that the heirs of Z.D. Baird and the heirs of Winston Baird co-owned the four tracts of land.

The Tennessee Court of Appeals determined that it was clear the Baird family owned a large amount of land in Campbell County at some point in time. In addition, the heirs of Z.D. Baird and the heirs of Winston Baird jointly owned some 800 or 900 acres. However, there was no definitive answer about whether the 800 or 900 acres owned jointly by the heirs of Z.D. and Winston Baird included the 600 acres that were the subject of this lawsuit. Thus, a genuine issue of material fact existed as to whether there was joint ownership and consequently adequate notice.

This case is very important for transactional lawyers, particularly real estate lawyers. Lawyers should ensure that they verify all of the owners of property to whom they send tax assessments. If ownership is unclear, notice should be sent to all potential owners. In addition, lawyers should complete a thorough title search to ensure that the land to be purchased includes any underlying mineral rights.

WILLS AND ESTATES

Illegitimate and Omitted Children Can No Longer Arrange Their “Legal Birth” to Avoid the Established Rules of Will and Statutory Construction.
Lanier v. Rains, 229 S.W.3d 656 (Tenn. 2007).

By Emily Cleveland

The failure of a testator to explicitly disinherit any known or unknown children can significantly complicate the probate process and may cause the testator

to risk judicial interpretation that runs contrary to the testator's intent. In *Lanier v. Rains*, the Tennessee Supreme Court was forced to decide if a child, *born before* the testator executed his will but *legitimized after*, qualified as a pretermitted heir under Tenn. Code Ann. § 32-3-103 and was thus entitled to a share of the estate. With the widespread availability and use of sophisticated paternity tests today, the holding of the Court has significant implications, because it is now scientifically possible to extract DNA from a deceased testator and determine paternity posthumously.

Dexter Rains (the "Decedent") died on July 30, 2004. Less than three weeks later the only named beneficiaries in the Decedent's will, his wife and son ("Beneficiaries"), filed a petition to admit the will into probate. The Decedent had executed his will on June 30, 1998, and his estate included, among other assets, a bank and insurance agency. After the will was approved for probate, Elizabeth Lanier ("Lanier") filed suit to establish paternity and simultaneously filed a claim for a one-third share of the estate under the pretermitted child statute.

Tenn. Code Ann. § 32-3-103 protects a pretermitted child *born after the making* of a will, by providing that a child, "born after the making of a will, either before or after the death of the testator, . . . not provided for nor disinherited . . . shall succeed to the same portion of the testator's estate as if the testator had died intestate." Lanier, born December 23, 1961—almost forty-three years before the Decedent's death and thirty-seven years before his will was executed—claimed the Decedent was her biological father. However, during his lifetime, the Decedent never supported Lanier nor sought a declaration of legitimization and made no mention of Lanier in his will. However, to support her claim that she should be considered "born after the making of the will," Lanier relied on the unreported opinion from the case *Rose v. Stalcup*, No. 140, 1988 WL 69501 (Tenn. Ct. App. July 8, 1988), where the Tennessee Court of Appeals held that the "legal birth" date for the purposes of Tenn. Code Ann. § 32-3-103 was established on the date of a judicial decree of paternity or legitimization, regardless of the *actual* birth date of the claimant.

The Beneficiaries had no personal knowledge of whether the Decedent was Lanier's biological father, but admitted that during the Decedent's lifetime, the Decedent knew that Lanier claimed she was his daughter. To defend Lanier's claims, the Beneficiaries challenged the propriety of the *Rose* opinion and argued that, under the plain language of the statute, Lanier did not qualify as being "born after the making of the will." Additionally, the Beneficiaries asserted that even if *Rose* applied, the Decedent had implicitly disinherited Lanier by the terms of his will.

The chancellor granted the Beneficiaries' motion to dismiss and observed that "the Legislature never intended to allow the court to birth children by legitimization and use this fiction to place them within the meaning of the pretermitted child's statute." The chancellor concluded that the Decedent knew

Lanier might be his daughter, and based on the ruling in *In re Estate of Eden*, 99 S.W.3d 82 (Tenn. Ct. App. 1995), where the court held that a testator who specifically left his property to *named* individuals disinherited his other heirs by implication, Lanier was not entitled to inherit from Decedent. The court of appeals affirmed the chancellor's judgment, specifically declined to follow the holding in *Rose*, and ruled that Lanier did not qualify as a pretermitted heir. Lanier appealed to the Tennessee Supreme Court.

Following the applicable standard of review, the Tennessee Supreme Court noted that because all allegations of fact must be taken as true, the court had to assume that the Decedent was Lanier's biological father. Next, applying the rules of statutory construction to interpret the pretermitted heir statute, the court looked to the legislature's intent in passing the statute. The Tennessee General Assembly enacted Tenn. Code Ann. § 31-2-105 to combine the separate paternity and legitimization statutes and define the parent-child relationship. The statute provides that an action to establish the paternity of a child can be brought before or after the birth of the child and until three years after the child reaches the age of majority. However, the statute provides an exception if the statute is being invoked to determine inheritance through intestate succession. If such a situation exists, a person born out of wedlock is a child of the mother and also a child of the father if: (1) the paternity is established by an adjudication before the death of the father or (2) is established *after* the death of the father *by clear and convincing proof*. Interpreting this statute, the court has held that a child born out of wedlock, whose paternity was not established before the father died, can still establish the right to inherit by intestate succession if that right is asserted within the applicable statute of limitations and the child establishes paternity by clear and convincing evidence.

The first issues addressed by the Tennessee Supreme Court was whether the holding of *Rose* was binding in this case and whether it was appropriate for a child legitimized after a decedent's death to qualify under the pretermitted heir statute. Agreeing with the court of appeals, the court declined to follow *Rose* and rejected Lanier's argument that her "legal birth" occurred at the time of legitimization, and therefore after her father wrote his will. Agreeing with the Beneficiaries and applying a central concept of probate law, the court noted that statute was designed to effectuate the actual intent of the testator by supplying an "omitted intention on behalf of after born children *inadvertently excluded*." Following the rules of statutory construction, the court declined to force its own interpretation into the term born. Because the legislature expressed no intent to allow a liberal construction of the word "born," the court held Lanier was simply *not* born after the will was written.

Additionally, the court concluded that even if Lanier was considered legally born after the will was written, she was not a pretermitted heir because she was disinherited by implication. Because pretermitted means an unintentional omission,

the court reasoned that the purpose of Tennessee's pretermitted heir statute was to prevent the *unintentional disinheritance* of an unborn child who was clearly not within the contemplation of the testator at the time the will was written. If the testator intended to omit the child from the will, the pretermitted heir statute is inapplicable, regardless of whether the child is legitimate, born out of wedlock, or adopted. The pretermitted heir statute only operates when the testator's intention is not expressed or is not necessarily implied from the will. As a final blow to Lanier's argument that the pretermitted heir statute applied, the court chastised Lanier's attempt to manipulate the statute to circumvent the Decedent's intent. The court concluded that because the Decedent was fully aware of his relationship to Lanier and made no effort to adopt or formally legitimize her after executing his will, Lanier was disinherited, "by implication so . . . that no intention to the contrary could be supposed."

Finally, court explicitly overruled *Rose*. Not only did *Rose* misapply Tenn. Code Ann. § 32-3-103, but an adherence to that ruling would allow a child born out of wedlock and omitted from a will to orchestrate his "legal birth" and avoid the established rules of will and statutory construction.

The *Lanier* case serves to remind probate attorneys of an important theme reiterated throughout probate case law. Simply executing a will does not guarantee that disinherited beneficiaries will not challenge the will. When drafting a will, an attorney needs to exercise the upmost care to ensure that anyone the testator does not desire to provide for is *explicitly* disinherited. It is the job of the drafting attorney to probe deep into the testator's life to determine who the potential heirs are and who might challenge the will. While admitting an extra-marital affair or illegitimate child might have been embarrassing for the Decedent in this case, had the drafting attorney included a clause explicitly disinheriting Lanier, someone almost guaranteed to challenge the will, this costly, time-consuming, and embarrassing litigation could have been avoided.

A Presumption of Undue Influence Arises Where One Possessing an Unrestricted Power of Attorney, Both Executes Such Power and Benefits from Transactions Involving the Deceased's Funds. *Basham v. Duffer*, 238 S.W.3d 304 (Tenn. Ct. App. 2007).

By Russ Blair

In Tennessee, a normal relationship between a mentally competent parent and adult child, with or without powers of attorney, does not constitute a per se confidential relationship, nor does it raise a presumption of impropriety or undue

influence. In fact, assertions of undue influence in a relationship between an elderly parent and adult child with *no powers of attorney* must be supported by evidence of coercion, fraud, deception, or clear dominion over the will of the elderly parent. On the other hand, where the adult child is acting as an attorney-in-fact, a confidential relationship *is* established where the agent *having powers of attorney*, executes such power to his or her own benefit. Consequently, only clear and convincing evidence of the fairness of the transactions will rebut the confidential relationship presumption.

In *Basham v. Duffer*, the Appellants, serving as the decedent's attorneys-in-fact brought a lawsuit against three persons previously responsible for taking care of the decedent prior to her death. The decedent, Estelle Ray, was an elderly widow of minimal education who had been completely dependent upon her husband Fred Ray in all financial and business affairs during his life. Upon Mr. Ray's death, the frugal couple owned a small farm and home, a car, and had amassed nearly \$200,000 in joint bank accounts. While Mrs. Ray remained competent following her husband's death, she first relinquished control of her business affairs and bill-payment to her eldest step-son Martin Ray *without* appointing him power-of-attorney. Martin proceeded to withdraw significant sums of money and, after being gifted Fred Ray's Ford vehicle by Mrs. Ray, subsequently sold it back to the decedent for \$2,500.

Six months later, Mrs. Ray appointed her other two stepchildren, Diane and James, her attorneys in fact. During the twenty-two months that Diane and James served as the decedent's attorneys-in-fact, Diane received approximately \$36,000 and James received \$48,110 in respective gifts from Mrs. Ray's coffers. Also during this time, Mrs. Ray sold the farm and home to her neighbor for \$84,000, but retained a life estate in the house. The Appellants further alleged that while holding the Mrs. Ray's power of attorney, Diane and James "drained the account" into which the proceeds from the home sale were deposited.

Nearly two years after appointing Diane and James as attorneys-in-fact, Mrs. Ray executed yet another power of attorney appointing the Appellants, Ray's niece and grandson, as her attorneys-in-fact. By this time, however, Mrs. Ray had only \$10,000 remaining in her bank accounts. The Appellants subsequently filed a Complaint on Mrs. Ray's behalf alleging that the Appellees unduly misappropriated the decedent's funds. The lawsuit was filed six months before Mrs. Ray died from complications resulting from a stroke. By all accounts, the evidence suggested that the decedent remained mentally alert and competent until suffering the stroke one month prior to her death. The chancery court dismissed the case, finding no breach of duty by the Appellees and declaring Mrs. Ray competent during the time her funds were dissipated.

On appeal, the Appellants argued that the trial court erred in failing to find

that a confidential relationship arose between Mrs. Ray and Martin Ray thereby resulting in a presumption of undue influence and shifting the burden to Martin Ray to show the fairness of the transactions regarding Mrs. Ray's funds. The normal relationship between a mentally competent parent and a child is not per se a confidential relationship and raises no presumption of undue influence in the absence of elements of dominion and control, a showing of physical and mental deterioration of the donor, evidence of fraud or undue influence, or other evidence indicating that the free agency of the donor was destroyed and the will of the donee substituted. Consequently, even where motive or opportunity to exert undue influence may exist in a parent-child relationship, the elderly parent's avowed competence, signatures on checks, and the absence of specific evidence of coercion, fraud, or deception are fatal to establishing a confidential relationship resulting in a presumption of undue influence. Thus, the appellate court affirmed the trial court's holding as to Martin Ray where both parties testified as to Mrs. Ray's competence at the time of the disbursements and Ray had signed the checks with no evidence of coercion or deception.

Appellants also argued on appeal that the trial court erred in failing to find that Diane and James breached a fiduciary duty to Mrs. Ray where they possessed an unrestricted power of attorney. A presumption of undue influence arises where the possessor of an unrestricted power of attorney: (1) executes such power and (2) benefits from transactions involving the funds. This presumption can be rebutted by clear and convincing evidence of the fairness of the transaction.

In the case of Appellee James, the record suggested that he had signed numerous withdrawal slips on the decedent's bank accounts in addition to signing a motor vehicle transfer as an exercise of his power of attorney. There was also little question as to whether James benefited from the transactions where several of the checks he signed were made out to James and his immediate family. The appellate court found that the trial court erred in failing to recognize the existence of a "confidential relationship" which shifted the burden of proof to Appellee James. Consequently, the appellate court reversed because James failed to satisfy his burden when he offered no explanation of the fairness of the transactions but simply testified that the money used by him had been "given away" by Mrs. Ray or "used to pay bills."

On the other hand, no confidential relationship arose when an unrestricted power of attorney was executed but not exercised by the attorney-in-fact. Thus, the appellate court affirmed the trial court's release of Diane from liability because there was no evidence on record that she actually executed any transactions as the Ray's attorney-in-fact. Regardless of the clearly suspicious surface implications surrounding the gradual diminution of Mrs. Ray's money, the court was in no position to cast doubt on the trial court's findings in the absence of competent

evidence and testimony. Accordingly, the Appellants' assertions of undue influence by Diane, without substantial proof, were insufficient to shift the burden of proof.

As illustrated by *Basham*, estate planners, elder law and family law attorneys, and general practitioners should be prepared to discuss the implications of the relationship between an elderly parent and an adult child acting as agent. While such normal relationships do not, in and of themselves, create a confidential relationship or raise a presumption of undue influence, the existence of an unrestricted power of attorney combined with transactions benefiting the "dominant" party creates a confidential relationship as a matter of law. This creates a presumption of undue influence, which can be rebutted only by clear and convincing evidence of the fairness of the transactions executed on behalf of the principal. Tennessee practitioners must be prepared to offer competent evidence and testimonial proof when alleging undue influence by an adult child acting as fiduciary for an elderly parent.

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