CASE COMMENTARIES

BANKRUPTCY

A bankruptcy court may not surcharge the homestead exemption of a debtor to pay the trustee's attorney fees (<u>even if it was due to debtor misconduct</u>). *Law v. Siegel*, 134 S. Ct. 1188 (2014).

By Jack Parker

In *Law v. Siegel*, 134 S. Ct. 1188 (2014), the United States Supreme Court held that courts shall not surcharge a debtor's exempt property to pay for expenses not otherwise allowed under the Bankruptcy Code ("the Code"). Chapter 7 of the Code gives an insolvent debtor the opportunity to discharge his debts by liquidating his assets to pay his creditors. 11 U.S.C. §§ 704(a)(1), 726, 727. After filing a bankruptcy petition under Chapter 7, an "estate" made up of all the debtor's property is placed under the control of a trustee, who is responsible for managing the liquidation of the estate's assets and distribution of the proceeds. 11 U.S.C. §§ 541(a)(1), 704(a)(1). However, the Code authorizes the debtor to "exempt" certain kinds of property from the estate, enabling him to retain those assets post-bankruptcy. 11 U.S.C. § 522(b)(1). Except in particular situations, exempt property "is not liable" for the payment of "any [prepetition] debt" or "any administrative expense." 11 U.S.C. § 522(c), (k).

One exemption, commonly known as the "homestead exemption," protects up to $22,975 in equity in the debtor's residence. 11 U.S.C. § 522(d)(1). Some states provide homestead exemptions that are more generous than the federal exemption. 11 U.S.C. § 522(b)(3)(A). These state exemptions sometimes result in debtors claiming the exemptions that are available under applicable state law, as opposed to the exemption provided under federal law.

In *Law v. Siegel*, Alfred H. Siegel ("Siegel") was appointed as trustee in Stephen Law's ("Law") Chapter 7 bankruptcy proceeding. The estate's significant asset was Law's house, valued at $363,348. Law claimed that $75,000 of the house's value was covered by California's homestead exemption. He also reported that the house was subject to two voluntary liens: a note and deed of trust for both Washington Mutual bank and for "Lin's Mortgage & Associates," respectively. Law claimed that there was no equity in the house that could be recovered for creditors, because the sum of the two liens exceeded the house's nonexempt value. If this were true, he would have been able to keep his house, as Siegel would have had no reason to pursue its sale.

A few months after Law filed his petition, Siegel began a proceeding alleging that the lien in favor of "Lin's Mortgage & Associates" was fraudulent.

Two former acquaintances came forward claiming to be Lili Lin, one of whom disclaimed any interest in the house at all. The second "Lili Lin" claimed to be the true beneficiary of the note and deed of trust and spent five years engaged in litigation contesting Siegel's avoidance of the note and deed of trust, as well as the sale of the house.

In 2009, the bankruptcy court concluded that "no person named Lili Lin ever made a loan to [Law] and that "the loan was a fiction, meant to preserve [Law's] equity in his residence beyond what he was entitled to exempt" by perpetrating "a fraud on his creditors and the court." The court determined that Siegel had incurred $500,000 in attorney's fees as a result of Law's fraud and decided to grant Siegel's motion to "surcharge" the entirety of Law's $75,000 homestead exemption (making those funds available to defray Siegel's attorney's fees).

The Ninth Circuit Bankruptcy Appellate Panel affirmed and held that the bankruptcy court's ruling was not erroneous and that the court had not abused its discretion. The appellate panel pointed to *Latman v. Burdette*, 366 F.3d 774 (2004), in which the Ninth Circuit had recognized a bankruptcy court's power to "equitably surcharge a debtor's statutory exemptions" in exceptional circumstances, such as "when a debtor engages in inequitable or fraudulent conduct." The Ninth Circuit then affirmed the ruling of the appellate panel and held that the surcharge was proper because it was "calculated to compensate the estate for the actual monetary costs imposed by the debtor's misconduct, and was warranted to protect the integrity of the bankruptcy process."

Under federal bankruptcy law, a bankruptcy court has statutory authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. 11 U.S.C. § 105(a). It may also possess "inherent power ... to sanction 'abusive litigation practices,'" but in exercising those statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions.

On appeal, the United States Supreme Court held that the bankruptcy court violated the terms of 11 U.S.C. § 522 when it ordered that the $75,000 protected by Law's homestead exemption be made available to pay Siegel's attorney's fees (an administrative expense). The Court noted that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of" the Bankruptcy Code. A bankruptcy court's powers come from statutory directives and prohibitions; and it is unable to order something that contravenes a provision of the Code. Under 11 U.S.C. §§ 522(b)(3)(A) and (k), Law was entitled (through California state law) to exempt $75,000 of equity in his home from the bankruptcy estate, and that amount was "not liable for payment of any administrative expense." Attorney's fees incurred during litigation are considered an administrative expense. Thus, the Court held that the bankruptcy court exceeded the limits of its authority and its inherent powers under 11 U.S.C. § 105(a) when it awarded a surcharge on Law's exemption.

The Supreme Court also overruled the surcharge because no one "timely oppose[d] [Law]'s homestead exemption claim." The Court had previously held that a trustee's failure to make a timely objection prevents him from challenging an exemption; therefore, the Court reasoned, Law's exemption "became final" before the bankruptcy court imposed the surcharge. The Court also focused on the fact that the ultimate determination of what will be exempted rests solely with the debtor. A debtor is not required to invoke an exemption to which the statute entitles him; but if he does, the court may not refuse to honor the exemption absent a valid statutory basis for doing so. Since the bankruptcy court had no statutory basis for denying Law's exemption, it had no authority to grant a surcharge against the exemption once Law designated what was exempted. Siegel argued that courts have disallowed exemptions under state law due to debtor fraud, but the Court pointed out that federal law does not provide for a bankruptcy court to deny an exemption if it is not specified in the Code.

The Supreme Court recognized that the ruling would cause Siegel to suffer financial harm, but asserted that Congress made the decision to allow for exemptions. Therefore, the Court reasoned, courts must respect the intent of Congress and the balance it created among creditors and debtors. However, the Court did provide examples of other ways in which bankruptcy courts could deal with debtor misconduct. Bankruptcy courts could: deny a discharge of debt, impose sanctions for bad-faith conduct, or pursue criminal prosecution of the debtor.

In light of the Supreme Court's decision in *Law v. Siegel*, bankruptcy attorneys should be aware that courts will not be able to surcharge against exemptions in the event of fraudulent misconduct by the debtor. The Code expressly prohibits exempted property from being used to pay administrative expenses, and the courts will not allow it. One thing attorneys could do to avoid this situation is to challenge the homestead exemption as being fraudulent prior to the surcharge litigation. This would help to preserve the claim of fraud at the beginning of the proceedings. However, bankruptcy attorneys who have a fraudulent debtor situation also have other options. The attorney could ask a court to impose sanctions for bad faith litigation conduct, which could result in an order for direct payment of the attorney's fees involved in that litigation. A benefit of this approach is that such a claim would survive the bankruptcy case and would be enforceable through regular collection of judgment actions. While attorneys acting as trustees in bankruptcy cases will not be able to surcharge against exemptions for bad-faith debtors, they will be able to pursue other avenues in order to prevent fraudulent conduct, or alternatively, to be compensated for having to litigate such conduct.

BUSINESS ASSOCIATIONS

Under federal law, whistleblower protection under the Sarbanes–Oxley Act of 2002 extends to employees of private contractors and subcontractors who serve public companies. *Lawson v. FMR LLC*, 134 S.Ct. 1158 (2014).

By William Lay

In *Lawson v. FMR*, the Supreme Court of the United States reexamined the scope of whistleblower protection afforded to employees of public companies under the Sarbanes-Oxley Act of 2002, codified at 18 U.S.C. § 1514. Congress passed the Sarbanes-Oxley Act (the "Act") following the collapse of Enron Corporation in an effort to promote transparency and trust in the financial system. The Act protects employees of public companies from being subjected to retaliatory action after reporting unlawful business practices, colloquially termed "blowing the whistle." In application, however, questions soon emerged concerning the scope of protection offered by the Act. In *Lawson*, the Supreme Court addressed the issue of whether the whistleblower protection set out in the Sarbanes-Oxley Act was applicable to privately-held contractors and subcontractors of public companies.

In *Lawson*, the Petitioners, Jackie Lawson and Jonathan Zang, were employed by two different subsidiaries of FMR LLC ("FMR"), a privately held firm that provides advisory and management services to a series of Fidelity mutual funds. Lawson and Zang independently filed suit against FMR in the U.S. District Court for the District of Massachusetts, alleging retaliatory action under the Sarbanes-Oxley Act. Lawson alleged that she had suffered a constructive retaliatory discharge after she raised concerns regarding questionable accounting methodologies, such as overstated expenses. Jonathan Zang alleged that he suffered a retaliatory discharge after expressing concern about inaccuracies in a SEC registration statement.

FMR moved to dismiss both causes of action, arguing that a § 1514 action could not be maintained against a privately held company. The district court, however, denied both motions, but certified the question for interlocutory appeal. On appeal, the First Circuit Court of Appeals reversed the decision of the trial court, holding that the Sarbanes-Oxley Act was limited in its scope and did not afford protection to the employees of a private contractor. The United States Supreme Court granted certiorari and reviewed the case in order to determine the proper scope of protection offered under § 1514.

The Sarbanes-Oxley Act of 2002 extends protection against retaliatory action to employees of public companies. Specifically, the Act states that "no company…officer, employee, contractor, subcontractor, or agent of such company or nationally recognized statistical rating organization, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee." The issue in *Lawson* involved the scope of the Act, as employees of public companies were offered protection that was unavailable to the private contractors working alongside them.

On appeal, the Supreme Court held that whistleblower protection under the Sarbanes–Oxley Act extends to employees of private contractors and subcontractors who serve public companies. This holding extended unprecedented protection from retaliatory discharge to private employees under federal whistleblower law. In reaching this decision, the Court applied traditional standards of statutory interpretation, interpreting the terms used in the Act by their ordinary, plain meaning.

In the analysis, Justice Ginsburg, writing for the majority, denoted that nothing in the language of the Sarbanes-Oxley Act confined the class of protected employees to those of a designated employer. Further, the majority opted for a broad construction of the term "employee," essentially classifying employees of a privately held contractor as employees of the public corporation with which it was contracting for the purposes of protection under the Sarbanes-Oxley Act. The Court reasoned that a broad interpretation of the term "employee" better fit the legislative intent of Congress in drafting the legislation: preventing another Enron scandal, promoting transparency, and encouraging workers to report illegal business practices.

The rationale behind this decision is further reflected in Justice Ginsburg's concerns that under the minority's interpretation of the Sarbanes-Oxley Act, a public company would be able to circumvent liability for retaliatory discharge simply by replacing its own employees with private contractors, eloquently termed "ax-wielding specialists," by FMR. A particular example of this can be found by examining the mutual fund industry. As Justice Ginsburg notes, many mutual funds have no personal employees themselves, but instead rely on independent contractors to manage their finances. Before *Lawson*, these private contractors would not have been subject to liability for retaliation under the

Sarbanes-Oxley Act. The majority in *Lawson* chose to remedy this situation by precluding public companies from dodging liability under the Sarbanes-Oxley Act through the practice of hiring private contractors.

Following the Supreme Court's decision in *Lawson*, transactional attorneys should be cognizant when drafting employment or representation contracts that the legal distinction between employees of public companies and private contractors has been greatly diminished in terms of statutory construction. Therefore, corporate attorneys must be vigilant in reviewing their clients' labor practices, as new precedent and ideas of statutory construction affect the private sector. In addition to implementing a broad interpretation of the term "employee," the Court in *Lawson* opened the door to further questions of statutory interpretation. If the Court can construe protection offered to employees of public companies as applicable to those who work for private contractors, then further selections of law may also, by extension, be made applicable to private contractors. In this way, while the instant impact of the Supreme Court's decision in *Lawson* is to extend the Sarbanes-Oxley Act's protection against retaliatory discharge to private contractors of public companies, the legacy of *Lawson* may very well be the elimination of certain legal barriers and distinctions between the regulation of public companies and the private subcontractors who serve them.

CONTRACTS

Under Tennessee law, the risk of loss does not shift to the buyer when the goods tendered by the seller are rejected and immediately returned by the buyer, regardless of whether the goods are insured. *3L Communs., L.L.C. v. Merola*, No. M2012-02163-COA-R3-CV, 2013 Tenn. App. LEXIS 589; 2013 WL 4803532 (Tenn. Ct. App. Sept. 6, 2013).

By Rachel Henry

Under Tenn. Code. Ann. § 47-2-601, if a buyer receives non-conforming goods, the buyer can (a) reject in whole, (b) reject in part, or (c) accept part of the goods and reject the rest. Further, according to Tenn. Code Ann. § 47-2-509, the risk of loss of goods shifts to the buyer when the goods are to be delivered to a particular location and the carrier passes the goods so as to enable a buyer to take delivery. However, the exception to this rule, under Tenn. Code Ann. § 47-2-510(1), states that if the goods fail to conform to the terms of the contract, the risk of loss does not shift to the buyer, but instead remains with the seller until the goods are accepted or cured. In *3L Communs., L.L.C. v. Merola,* the Tennessee Court of Appeals addressed whether the risk of loss shifts to the buyer when non-conforming goods are rejected, returned uninsured, and then lost while in transit back to the seller.

In *3L Communs., L.L.C. v. Merola*, buyer 3L Communications, L.L.C. ("3L") brought suit against seller Jodi Merola, individually, and d/b/a NY Telecom Supply ("Merola"). 3L, a buyer and seller of high-end optical telecommunications equipment, posted an online ad stating it was looking to purchase optical boards. In response to the post, Merola contacted 3L and negotiated to sell five boards for $35,090.60. After confirming that the boards had been "tested and 'were in great shape,'" 3L purchased the boards from Merola on November 21, 2008. However, when the boards were delivered on November 23, 2008, 3L found the boards damaged and "sloppy." After contacting the third party to whom 3L was planning to sell the boards, 3L immediately notified Merola that the boards were unusable and stated that the boards would be shipped back.

On December 12, 2008, 3L shipped the boards via FEDEX Ground, according to Merola's instructions. On December 17, 2008, 3L emailed Merola regarding the refund for the boards, but Merola responded that the boards had not yet been received. Then, Merola sent another email to 3L on December 26, 2008, stating that she still had not received the boards. 3L then researched the FEDEX tracking number and discovered that the boards had been delivered on December 18, 2008. Suspecting something was wrong, 3L researched Merola's business and found that the shipping address was a residential address and that, despite Merola's representations, the address rarely sent or received packages. Upon this discovery, 3L confronted Merola with the information, but Merola immediately stopped all communication.

Following these events, 3L filed suit against Merola for breach of contract and violation of the Tennessee Consumer Protection Act of 1977. After amending the complaint to include NY Telecom and Network Supply, L.L.C. as a party-defendant, Merola filed an answer denying all of 3L's claims. In addition, Merola filed a counterclaim and asked the trial court to dismiss the amended complaint, claiming that 3L assumed the risk of loss when it returned the boards. After discovery, Merola's counsel entered a motion to withdraw and asked for a continuance. The trial court granted the continuance and Merola proceeded as a *pro se* litigant. Following a hearing, the trial court entered judgment in favor of 3L, finding (1) the risk of loss remained with Merola throughout the transaction, (2) 3L was entitled to the full purchase price of the boards ($35,060.90), (3) 3L was entitled to prejudgment interest in the amount of $7,799.05, and (4) 3L was entitled to attorney's fees.

In its analysis, the court looked to the holding in *Moses v. Newman*, 658 S.W.2d 119 (Tenn. Ct. App. 1983), which stated that the risk of loss had not shifted to the buyer when the plaintiff's mobile home had not been properly set up according to the contract and was subsequently destroyed by a wind storm. The *Moses* court held that, in order for the risk of loss to shift to the buyer, the seller's actions must conform to all of the conditions set forth in the contract. Further, the *Moses* court cited *William F. Wilke, Inc. v. Cummins Diesel Engines, Inc.*, 252 Md. 611, 250 A.2d 886 (1969), where the court held that, despite the fact that the goods had been delivered to the buyer, the risk of loss had not shifted away from the seller because the seller had not tested or inspected the goods as required by the contract.

On appeal, the Tennessee Court of Appeals applied the *Moses* and *Wilke* holdings and found that because Merola was a merchant and 3L was a buyer as defined under the Uniform Commercial Code ("UCC"), the UCC applied to the transaction of goods between the parties. Further, the court held that Tenn. Code Ann. § 47-2-510 applied because the risk of loss had not shifted from Merola to 3L when the goods did not conform to the agreement between the parties. Although Merola argued that the risk of loss shifted to 3L because the package had not been insured, the court held that this fact was irrelevant and did not relieve Merola from the risk of loss, since the goods were rejected and did not conform to the agreement. Thus, because the UCC applied to the non-conforming goods and the lack of insurance did not relieve Merola of the risk of loss, the Tennessee Court of Appeals held that the trial court properly found that the risk of loss remained with Merola.

Merola next argued that, as a *pro se* litigant, the trial court gave her unfair treatment. The appellate court stated that, while *pro se* litigants are entitled to fair and equal treatment, they must comply with the same rules that represented parties are required to follow. Therefore, Merola was not entitled to special treatment simply because she represented herself. After reviewing the evidence from the transcript of the trial court, the Tennessee Court of Appeals held that the trial court did not erroneously hinder Merola's ability to litigate.

Next, Merola argued that the trial court erroneously awarded prejudgment interest. Reviewing the prejudgment interest under the abuse of discretion standard, the appellate court found that awarding prejudgment interest is appropriate when a party has lost its use of money for a period of time due to actions by the breaching party. Thus, the court quickly dismissed this issue because 3L was deprived of the money it paid for the boards ($35,060.90) for a period of time, and therefore the trial court did not abuse its discretion in awarding prejudgment interest to 3L.

Finally, the court reviewed whether the trial court erroneously awarded attorney's fees to 3L under a clear showing of abuse standard. The appellate court acknowledged that Tennessee follows the "American Rule," which states that parties are generally required to pay for their own attorney's fees unless there is an express provision in a contract stating otherwise. 3L asserted that attorney's fees were appropriately awarded based on a provision in the Tennessee Consumer Protection Act ("TCPA"). However, the trial court specifically held that Merola had not violated the TCPA. Therefore, because the trial court did not state its reason for awarding attorney's fees, the appellate court held that this award was erroneous and thus the case must be reversed on this issue alone.

Under the decision set forth in this case, transactional attorneys should be aware that the risk of loss remains with the seller when a buyer rejects and promptly returns non-conforming goods. This increases the burden of the seller to make sure that precautionary measures are taken in order to have the goods successfully returned. In addition, a buyer's decision not to insure the non-conforming goods will not relieve the seller of liability under risk of loss. Thus, transactional attorneys should advise clients to always require insurance on any return shipment of non-conforming goods to make sure the goods and the interests of their clients are protected. In sum, buyers, sellers, and transactional attorneys alike should make sure that they are aware of who bears the risk of loss during business transactions in order to avoid issues like those addressed in *3L Communs., L.L.C. v. Merola*.

CONTRACTS

Under Tennessee law, an individual who signs an agreement on behalf of a corporate entity will be held personally liable for the contract obligations when the clear intent of the contract is to bind the representative. *Creekside Partners v. Scott*, No. M2012-00623-COA-R3-CV, 2013 WL 139573, 2013 Tenn. App. LEXIS 14 (Tenn. Ct. App. Jan. 10, 2013).

By Lindsay Johnson

The statute of frauds requires that before an individual may be held liable for another's debt, there must be a writing evidencing the guarantee, signed by the guarantor. This requirement becomes particularly relevant in commercial contracts that contain a guarantee provision. If it is unclear whether the signer solely executed the contract on behalf of a corporation, or whether the signer also provided written assent to personally guarantee a corporation's obligations, there remains the question of whether the debt may be enforced against the signer personally. The Tennessee Supreme Court addressed this very issue in *Creekside*

Partners v. Scott, when it considered whether a corporate representative may be held personally liable for obligations arising under a commercial agreement when the agreement contains a guarantee provision and the representative signs the agreement a single time.

On September 28, 2007 Creekside Partners ("Creekside") and NTS Enterprises, Inc. ("NTS"), an entity owned by Albert Nathan Scott ("Mr. Scott"), entered into a commercial real estate lease agreement (the "Lease"). Creekside drafted the Lease, naming itself "Landlord" and NTS the "Tenant." Mr. Scott, in his capacity as president signed the Lease a single time on behalf of NTS. The lease did not include a "signature line separately or specifically designated for a guarantor to execute the lease."

In 2010, NTS breached its lease obligation when it failed to make rent payments as the Lease required. As a result of this breach, Creekside terminated the Lease and instituted a breach of contract action against Mr. Scott and NTS on June 6, 2011. Creekside sought to hold Mr. Scott personally liable for NTS's rent obligation arising from its breach of the Lease. Creekside alleged that Mr. Scott signed the Lease in both his representative capacity as NTS's president and as an individual guarantor. Mr. Scott contested the assessment of personal liability for the damages, arguing that he "did not execute the Lease as a guarantor of NTS's obligations."

The trial court held that Mr. Scott was not personally liable as a guarantor for NTS's lease obligations. Two findings were determinative in this holding. First, "[t]he court found that Mr. Scott's signature—which was preceded by the corporation's name and followed by a designation of Mr. Scott's corporate capacity as its president—created a presumption that he acted solely as a corporate representative." Second, "[t]he court … found that there was 'no indication anywhere in the form of his signature … indicating that Mr. Scott intend[ed] to be signing as a guarantor or intend[ed] to be signing as an individual' to negate the presumption." Accordingly, the court assigned all damages to NTS and found Mr. Scott free of any personal liability.

Creekside appealed, arguing that the trial court incorrectly interpreted the Tennessee Supreme Court's recent decision in *84 Lumber Co. v. Smith*, 356 S.W.3d 380 (Tenn. 2011). In *84 Lumber*, the trial court held the debtor corporation's president personally liable as guarantor when the corporation failed to pay for the products it acquired on its line of credit because the "express language of the application … bound both [the corporation] as the credit applicant and [the president] as an individual guarantor." After being reversed by the court of appeals, the Tennessee Supreme Court again reversed and reaffirmed the holding of the *84 Lumber* trial court, stating that while "[i]n most cases, a representative who signs a contract is not personally bound to the contract," a representative may be held personally liable for the contract obligations "when the clear intent of the contract is to bind the representative." Creekside contended that, as in *84 Lumber*, the "clear and unambiguous" language of the Lease demonstrated that the parties intended to bind Mr. Scott in both a representative capacity and as a personal guarantor.

However, aside from the language of the contract, the form of the signer's signature can presumptively determine the parties' intent. In *Cone Oil Co. v. Green*, 669 S.W.2d 662 (Tenn. Ct. App. 1983) the Tennessee Court of Appeals stated that when "the name of the corporation appears first followed by the word, 'by' or 'per' and the name of the corporation," a presumption that the representative signed solely in a representative capacity arises. The signature's form creates a presumption that the signer did not intend to be personally bound because the "intention of the parties is self evident" from the signature alone. *Cone Oil Co.* also provides that "it is possible for an officer of a corporation to avoid personal liability by signing his name and adding his title and the name of the corporation." To prevail under this construction, however, "additional evidence, such as test of the instrument or evidence of the joint intent of the parties [is] required to establish that only the corporation was to be bound." Thus, the initial form of the signature guides the court's inquiry into the parties' intent.

In *Creekside*, the court determined that the first type of signature, giving rise to a presumption that the party signed in a representative capacity only, was present "where Mr. Scott's only signature appears immediately after the word 'BY' and immediately before 'Its: President.'" The court distinguished *Creekside* from *84 Lumber* on this basis. Accordingly, the court affirmed the decision of the trial court, holding "the intent of the parties is self evident from the form of the signature: Mr. Scott signed only in his representative capacity, not as a personal guarantor, and as a result, only the corporation, NTS, is obligated under the Lease."

Following this analysis, the court further distinguished *Creekside* from *84 Lumber* in dicta by citing two additional factors that were indicative of the conclusion that Mr. Scott did not intend to sign the Lease as a personal guarantor. The first factor was the location and visibility of the guarantee provision. The guarantee provision in the *Creekside* contract was "the same size font as all the other provisions in the lease" and was "separated from Mr. Scott's signature by two pages," whereas the guarantee provision in *84 Lumber*, was in "all capital letters, set off from the rest of the text, and [was] immediately followed by the president's signature on the same page of the credit application."

The second factor the court considered was the guarantee provision's consistency with the rest of the contract. The court reasoned that if the parties intended to bind Mr. Scott personally as guarantor, the guarantee provision would have been in "contradiction to other provisions in the lease." Specifically, the Lease specified NTS as "*the* tenant," and only mentioned Mr. Scott's name "in relation to the words 'guarantee' or 'co-tenant'" one time, buried in the middle of the document. The Lease also failed to provide a space for Mr. Scott to sign as a guarantor, and did not list the guarantor's address. In contrast, the personal obligation was explicit in the *84 Lumber* contract, where the guarantee provision referred to the president and the corporation separately using the language "I" and "the above business." This distinction divorced the president from the corporation in relation to that provision, indicating that he was assenting to the obligation in his individual capacity.

Accordingly, even if the parties' intent had not been manifest from the form of the signature alone, due to the inconspicuous format of the text of the guarantee provision, as well as the provision's language in the context of the entire contract, insufficient evidence existed to negate the presumption that Mr. Scott signed purely as a representative of the corporation.

The holding in *Creekside* follows Tennessee's jurisprudence concerning corporate representatives' personal liability under guarantee provisions, as informed by the statute of frauds. This decision reaffirms the analytical framework and factors that will be considered when determining the intent of parties to a contract. Practitioners should remember that the parties' intent is critical to determine personal liability when an individual signs an agreement on behalf of a corporate entity, and form is an important aspect of memorializing such intent in written documents. Corporate attorneys drafting an agreement that is intended to bind the signer as a guarantor should ensure the language used clearly distinguishes between the corporate entity and the individual signer, the guarantee provision has a strong visual presence, and the guarantee provision is consistent with the overall contract. Additionally, the signature line should not be designed to have the individual sign "by" or "per" the agreement. Taking these steps in the contract drafting stage will help the client avoid costly disputes if a breach occurs.

EMPLOYMENT LAW

Under Tennessee law, an intentional interference with employment claim requires a separate third-party who steps-aside and acts in furtherance of his own interest. *Davis v. Shaw Indus. Group*, No. M2012-01688-COA-R3-CV, 2013 WL 1577642, 2013 Tenn. App. LEXIS 252 (M.D. Apr. 12, 2013).

By Samuel Chitrit

In *Davis v. Shaw Indus. Group*, the Tennessee Court of Appeals addressed whether a corporation or an agent of the corporation can be liable for intentional interference with its own employment relationship. Keith Davis ("Plaintiff"), a former employee, brought suit against Shaw Industries Group, Inc. ("Shaw"), and Shaw's plant manager, Andrew Plisko ("Mr. Plisko"). Shaw company policy prohibited employees in managerial positions from being romantically involved with any employee under their authority. In 2008, a former employee notified Mr. Plisko that Plaintiff was having an affair with the human resources manager, Katherine Brinkley ("Ms. Brinkley"). Mr. Plisko opened an investigation and notified Ms. Brinkley's supervisor, David Masters ("Mr. Masters"), the director of human resources. Mr. Masters conducted two initial investigations, found no evidence of a company violation, closed the investigations, and asked Mr. Plisko to forward any new information to him.

In mid-2009, Ms. Brinkley resigned from Shaw after accepting employment elsewhere. After Ms. Brinkley began her new employment, she and Plaintiff began openly dating. Soon thereafter, several current Shaw employees filed reports that Ms. Brinkley and Plaintiff were romantically involved while she was still employed at Shaw.

Upon conducting a third investigation, Mr. Masters requested Plaintiff's phone records, requested a list of people who had been at Plaintiff's house in the past year, and discovered that Plaintiff had changed his company life insurance beneficiary to be Ms. Brinkley. Plaintiff provided phone records, but refused to provide a list of the people who had been at his home in the past year.

Mr. Masters informed Plaintiff that he would need to resign for violating company policy. Shaw company policy allows for an investigation to be made where violations of company policy may exist. The pertinent company policy provides: "Any [employee] who refuses to participate in an investigation or is found to not be truthful and complete in his/her responses will be subject to corrective action, up to and including termination." Plaintiff refused to resign and was terminated."

Following these events, Plaintiff filed suit against Shaw and Mr. Plisko. Plaintiff alleged that Mr. Plisko intentionally, maliciously, and without justification procured his termination from Shaw, and that Mr. Plisko was motivated by his own personal interests rather than the interests of Shaw. Plaintiff also alleged that Shaw was vicariously liable as Mr. Plisko's employer (collectively "Defendants"). Later, Defendants filed a motion for summary judgment arguing that, as a matter of law, Shaw could not be held liable for interfering with its own employment, and that Mr. Plisko was acting on behalf of Shaw by following Mr. Masters' instructions.

At trial, the Franklin County Circuit Court found that Shaw could not be liable for intentional interference with its own employment relationship and granted the Defendants' motion for summary judgment. The trial judge applied Tennessee law, requiring a plaintiff who asserts a claim for intentional interference to assert facts showing that the defendant stood as a third-party to the employer-employee relationship. The trial judge found that neither Shaw, nor Mr. Plisko, stood as a third-party to the employment relationship, and granted Defendants' motion for summary judgment.

Tennessee is an employment-at-will state. Under the employment-at-will doctrine, an employer may terminate an at-will employee with or without cause. However, even an at-will employee has an actionable right to continued employment without unjustified interference by a third-party that stands outside of the employment relationship. To prove a claim of intentional interference with at-will employment, a plaintiff must establish that the defendant intentionally and without justification procured the discharge of the employee in question.

On appeal, the Tennessee Court of Appeals held that Plaintiff's claim against Shaw and Mr. Plisko was without merit. First, the court found that Plaintiff's claim against Shaw was without merit because Shaw cannot interfere as a third-party with its own employment relationship. Second, the court found Plaintiff's claim against Mr. Plisko to be without merit because Mr. Plisko was acting in furtherance of Shaw's interest by following Mr. Masters' orders.

Under Tennessee law, a corporation may only act through its agents; consequently, an agent cannot be individually liable for tortious conduct as long as they act in furtherance of the corporation's interest. The Tennessee Supreme Court has held that when an agent or employee acts within the general range of his authority, and he acts with an intent to further the interest of the corporation, the action is considered to be the action of the corporation and the employee is entitled to the same immunity from liability that the corporation enjoys. However, an agent may be liable for intentional interference if the agent or employee steps aside, acting outside the scope of his employment, in order to serve his own interests. In determining the agent's interests, courts should look to the agent's motive and the means used by the agent. Any manner of intentional interference may be sufficient to support a claim if the underlying purpose is improper.

In this case, the court of appeals first noted that it was undisputed that Mr. Masters, not Mr. Plisko, made the decision to terminate Plaintiff's at-will employment based on Plaintiff's violation of Shaw company policy. Additionally, the court found that there was no question that Mr. Plisko's actions were in furtherance of Shaw's interest, due to the fact that Mr. Plisko was following Mr. Masters' request in handling the investigation of the potential company policy violation. Accordingly, the court determined that Mr. Plisko did not step aside and act in furtherance of his own interest by initiating the investigation or submitting further information to Mr. Masters. As such, the Tennessee Court of Appeals affirmed the trial court's grant of summary judgment for the defendants.

In light of this decision, transactional attorneys should be aware that an agent of a corporation cannot be liable for intentional interference with an employment relationship unless the agent steps aside from his role within the corporation and acts to further his own interest. This grants agents of a corporation the same immunity from intentional interference suits that the corporation enjoys. Also, when faced with a situation where an employee has acted both in furtherance of his own interest as well as in the interest of the corporation, transactional attorneys should look to the underlying purpose of the agent's actions to determine the predominating interest served.

FRANCHISE LAW

If a covenant not to sue is issued in a trademark infringement suit between two competitors, it is the manufacturer's burden to show it could not reasonably be expected to resume its enforcement efforts against its competitor to moot the alleged claims. *Already, LLC v. Nike, Inc.*, 133 S.Ct. 721 (2013).

By Hayley Scheer

In *Already v. Nike,* the United States Supreme Court addressed whether a covenant not to sue issued by a moving party is sufficient to render the case moot. Already, LLC ("Already") and Nike, Inc. ("Nike") are competing shoemakers and distributors. Nike filed a trademark infringement claim against Already after Already refused to comply with Nike's demands to cease and desist the sale of its "Sugars" and "Soulja Boys" shoes. Nike alleged that these specific shoes designed and marketed by Already infringed on Nike's trademarked "Air

Force 1" shoes. As a result of Nike's initial claim, Already filed a counterclaim against Nike, claiming that the Air Force 1 shoe trademark was invalid.

Approximately eight months after Nike filed its initial claim against Already, Nike issued a "Covenant Not to Sue," promising that it would "not. . . raise against Already or any affiliated entity any trademark or unfair competition claim based on any of Already's existing footwear designs or any future Already designs that constituted a 'colorable imitation' of Already's current products." Subsequently, Nike moved to dismiss its initial claim and Already's counterclaim based on the contention that there was no longer an actual controversy between the two parties. Already opposed dismissal of its trademark validity counterclaim against Nike.

At trial, the district court granted Nike's motion to dismiss, and declared the case moot, determining that there was no longer a controversy between the two parties because of the covenant. According to Article II of the Constitution, a case becomes moot "when the issues presented are no longer 'live' or the parties lack legally cognizable interest in the outcome." The district court determined that there is almost no shoe that would fall outside the range of the covenant, and thus, Already was protected from future trademark suits with Nike. Therefore, the covenant presented a remedy between Nike and Already, and there was no longer a substantial controversy between the two parties.

On appeal, the Second Circuit Court of Appeals affirmed the district court's decision that the case was moot, and concluded that Already could not show any continuing injury and that no justiciable controversy remained. Further, the court noted that when a court determines whether a covenant not to sue eliminates the controversy between the two parties, it must look to the covenant's language, the time span included within the covenant, and evidence of whether the receiving party intends to engage in conduct that falls outside the provisions of the covenant. The court could not think of a shoe design from the past or present that Already had marketed that was not covered by the covenant. Additionally, Already had not expressed any intent to market such a shoe that would fall outside the realm of the covenant. Thus, because Nike's covenant not to sue included all necessary provisions and it covered all of Already's apparent shoe designs, the court determined that there was no longer a controversy between the two parties. Already appealed the Second Circuit's decision, and the United States Supreme Court granted certiorari.

The Supreme Court applied the voluntary cessation doctrine test, originating from the *Friends of the Earth, Inc. v. Laidlaw Environmental Services(TOC), Inc.,* 528 U.S. 167, 190, 120 S.Ct. 693, 145 L.ed.2d 510 (2000) decision. Under the voluntary cessation doctrine, the court determines whether the "allegedly wrongful behavior [would] reasonably be expected to recur" by the moving party. If the court finds that the allegedly wrongful behavior would not be expected to recur, then there is no longer an actual controversy, and the case is considered moot. In the present case, the Court looked to Nike's covenant not to sue and applied the test to the language and provisions of the covenant. The Court read the covenant as unconditional and irrevocable, prohibiting Nike from making any claim or demand against Already. Additionally, the Court determined that the covenant protected Already's distributors and customers, and all shoe designs of the past, present, and future. Based on this interpretation, the Court held that Nike's covenant not to sue satisfied the voluntary cessation doctrine, and thus the Court held that it was "absolutely clear" from the facts that this case is moot.

Already attempted to make the argument that because of the covenant, its products would constantly be in the shadow of Nike's trademarks, and investors would be apprehensive to invest in Already's designs. Further, Already argued that as a competitor of Nike, it has a right to challenge any of Nike's intellectual property. The Court rejected all of these arguments, noting that the covenant not to sue actually benefitted Already and their designs, as they were now the only competitor with Nike that had protection from being sued for trademark reasons.

In light of this decision, transactional attorneys should be aware that a covenant not to sue is an available remedy between two competitors, if the issuing party meets the voluntary cessation doctrine test. So long as the manufacturer issuing the covenant shows, with clear and concise language, that it does not reasonably expect to resume its enforcement efforts against its competitor, a covenant could be a more efficient remedy for trademark suits. On the other hand, for companies competing against large corporations, a covenant not to sue could be detrimental to the company's future trademarks. As Already attempted to argue, future investors may not be as likely to invest in smaller companies' designs if a larger competing company, such as Nike, issues a covenant. Additionally, it is also important to consider the potential competitive effect Nike could have if they issued out covenants not to sue to all of their competitors. If this were the case, competition would likely dwindle between companies, which could have negative effects on investors and consumers. Ultimately, *Already v. Nike* is likely one of many trademark cases to come that illustrates the potential effects of covenants not to sue between competing companies.

INTELLECTUAL PROPERTY

In the United States, naturally occurring segments of deoxyribonucleic acid (DNA), or genes, and the information they encode, are not patent eligible merely because they have been isolated from the surrounding genetic material. *Ass'n for Molecular Pathology v. Myriad Genetics, Inc.,* 133 S.Ct. 2107, 186 L.Ed.2d 124 (2013).

By William Dunlap

Under section 101 of the United States Patent Act (the "Act"), "[w]hoever invents or discovers any new and useful…composition of matter, or any new and useful improvement thereof may obtain a patent[,]" subject to any other relevant requirements provided for under the Act. Beyond the enumerated requirements, however, the United States Supreme Court has consistently interpreted section 101 as containing three additional, implied exceptions. Pursuant to the Court's jurisprudence, it is well established that "[l]aws of nature, natural phenomena, and abstract ideas are not patentable." Furthermore, "[g]roundbreaking, innovative, or even brilliant discovery does not by itself satisfy the section 101 inquiry." The Supreme Court has previously addressed the distinction between products of nature and patentable products or processes, specific to biotechnological inventions (e.g. the patenting of living micro-organisms). This jurisprudence laid the groundwork for *Ass'n for Molecular Pathology v. Myriad Genetics, Inc.,* the most recent Supreme Court decision regarding the patentability of various biotechnological inventions.

The *Myriad* case arose out of a lawsuit filed by Dr. Harry Ostrer, along with medical patients and advocacy groups seeking a declaration that Myriad Genetics, Inc.'s ("Myriad") patents, relating to its discovery of the BRCA1 and BRCA2 genes, were invalid. In discovering their location and sequence, Myriad had been able to develop medical tests useful for detecting any mutations in the BRCA genes. The patents, if valid, would give Myriad the exclusive right to isolate the BRCA genes and the exclusive right to artificially manufacture BRCA genes. In reviewing the claims, the United States Supreme Court addressed two issues. First, the Court asked whether artificially manufactured DNA, consisting of exons-only strands of nucleotides (referred to as "cDNA"), is patent eligible subject matter under section 101 of the Act. Second, the Court asked whether isolating a native DNA segment is sufficient to render the isolated genes themselves patent eligible subject matter.

In *Funk Brothers Seed Co. v. Kalo Inoculant Co.*, 333 U.S. 127 (1948), the United States Supreme Court held that a single inoculant created by merely combining a mixture of several naturally occurring strains of bacteria, without any enlargement in its range of utility, is not patent eligible subject matter. Despite the inoculant's enhanced usage for improving soil nitrogen levels, the Court held that the composite bacterium itself was not patent eligible subject matter because combining the strains of bacteria did not cause them to function any differently than how they already functioned individually. In its holding, the Court remarked that "[t]here is no way in which we could call the bacteria mixture a product of invention unless we borrowed invention from the discovery of the natural principal itself."

Later, in *Diamond v. Chakrabarty*, 447 U.S. 303 (1980), the United States Supreme Court held that genetic material is only patent eligible subject matter under section 101 when it is "a non[-]naturally occurring manufacture or composition of matter." Additionally, the genetic material must possess "a distinctive name, character and use." The *Chakraharty* Court held that a new composite bacterium was not a product of nature, because the live, human-made microorganism possessed "markedly different characteristics from any [other bacterium] found in nature[,]" and possessed the newfound capacity for efficiently degrading crude oil.

In the *Myriad* case, the District Court for the Southern District of New York denied Myriad's motion to dismiss for lack of standing, and then granted summary judgment to the parties opposing Myriad's patent claims, on the basis that Myriad's claims fell squarely within the "products of nature" exception, making them ineligible for patent protection. On appeal, the Federal Circuit Court of Appeals reversed the district court's decision. The United States Supreme Court granted the petition for certiorari, vacated the Federal Circuit's judgment, and remanded the case.

On remand, the Federal Circuit affirmed the district court's holding that Dr. Ostrer had Article III standing to bring the claim, but reversed the district court's holding that the two patent claims were invalid. First, the court unanimously held that the BRCA cDNA was patent eligible subject matter under section 101 because cDNA must be artificially created or manufactured. Second, the majority held that the isolated BRCA gene was also patent eligible subject matter. While the majority's rational on this second issue was not uniform, it essentially stated that: (1) the DNA isolation process itself (e.g. severing the covalent bonds at both ends of the DNA strand) technically creates new molecules with unique chemical compositions, and (2) despite the fact that the United States Patent and Trademark Office ("USPTO") lacks substantive rulemaking authority as to what is patent eligible subject matter, deference should still be given to the USPTO's practice of granting gene patents such as those claimed by Myriad. The dissent remarked that: (1) the process of isolating DNA (e.g. severing the covalent bonds) is not inventive, (2) isolated DNA is too structurally similar to naturally-occurring DNA to be sufficiently distinctive, and (3) courts should not defer to the USPTO's past practice of awarding gene patents.

On further appeal, the United States Supreme Court affirmed in part and reversed in part the decision of the Federal Circuit Court of Appeals. It affirmed the decision of the Federal Circuit with regard to the cDNA issue, reasoning that the artificially manufactured DNA is patent eligible to the extent that its manufacturing requires the removal of some native genes (e.g. the introns), making it distinctive from naturally occurring DNA segments. However, the Supreme Court reversed the Federal Circuit on the issue of whether isolating native DNA renders the isolated genes patent eligible subject matter.

The Supreme Court held that in attempting to patent the genetic information encoded in the isolated DNA, Myriad was simply trying to patent a natural occurrence that did not involve any invention. The Court stated that Myriad neither created, nor altered any of the genetic information or structure of the DNA encoded in the isolated genes. The Court also noted that the location and order of the nucleotides naturally pre-existed Myriad's discovery of them.

Next, the Court observed that the facts of *Myriad* more closely paralleled those of *Funk Brothers*, rather than those of *Chakrabarty*. Similar to *Funk Brothers*, Myriad discovered a pre-existing natural occurrence that did not involve any invention, and the discovery, by itself, did not render the BRCA genes new or inventive compositions of matter under section 101. In both *Funk Brothers* and *Myriad*, neither party created or altered any of the actual genetic information or structure of the discovered genetic material. Further, whereas the modified bacterium in *Chakrabarty* was artificially manufactured and possessed distinctive characteristics from any naturally occurring organisms, Myriad merely isolated a natural gene from its surrounding genetic material. Unlike the artificially manufactured BRCA cDNA, the isolated BRCA DNA was not markedly different from the native DNA, because both forms preserved the same protein coding sequences.

The Court also remarked that while Myriad may have expended considerable time and efforts in locating and isolating the native genes, "extensive [research] effort alone [is] insufficient to satisfy the demands" for patent eligibility under section 101. Finally, the Court held that no deference is owed to the USPTO's past practice of awarding gene patents, where "Congress has not endorsed the views of the USPTO in subsequent legislation."

Based on the Supreme Court's holding in *Myriad*, genetic information encoded on isolated DNA, without more, is not considered patent eligible subject matter, while an artificially manufactured gene, cNDA, is. Whether genetic material is patent eligible as a composition or as manufactured material continues to depend, in part, on whether it pre-exists in nature and is markedly distinctive from naturally occurring phenomena. It is important to note, however, the questions that were not addressed by the *Myriad* decision. First, if Myriad's efforts to isolate the BRCA DNA had not been commonplace, then those methods may have been patentable. Second, the Supreme Court did not consider whether isolated DNA with an altered order of the naturally occurring nucleotides would be considered patent eligible subject matter. As these questions point out, the effects of the *Myriad* decision are sure to be felt in in the field of biotechnology, and the contours of what constitutes a patent eligible method patent or product patent, rather than mere discovery, is continually evolving.

SECURED TRANSACTIONS

In Tennessee, a plaintiff's second voluntary dismissal of a supplemental state-law claim in federal court does not preclude him from later refiling the same claim in a Tennessee court. *Cooper v. Glasser*, M2012-00344-SC-R11CV, 2013 WL 6174469 (Tenn. Nov. 26, 2013).

By Jarrod Casteel

The issue presented in *Cooper v. Glasser* is one of a conflict of laws. Federal Rule of Civil Procedure 41(a)(1)(B) codifies the two dismissal rule, stating that a voluntary dismissal by the plaintiff will result in a dismissal without prejudice so long as "the plaintiff [has not] previously dismissed any federal–or state-court action based on or including the same claim." Alternatively, Tennessee Rule of Civil Procedure 41.01(2) codifies a three dismissal rule, stating that a voluntary dismissal will result in adjudication upon the merits if the plaintiff has twice dismissed in any court an action including or based on the same claim. In *Cooper v. Glasser*, the Tennessee Supreme Court addressed whether the second voluntary dismissal of a plaintiff's supplemental state-law claim, filed in federal court, precluded the plaintiff from refiling the same state-law claim in a Tennessee state court.

In *Cooper v. Glasser*, Jeffrey Cooper ("Cooper") filed suit against Phillip, David, and Richard Glasser (collectively "Glasser") in the Superior Court for Los Angeles County, California, alleging fraud, breach of contract, conversion, promissory estoppel, tortious interference with contractual relations, and violation of California securities law. Before Glasser answered the complaint, he moved to dismiss based on a forum selection clause. Without opposing Glasser's motion, Cooper voluntarily dismissed his claims without prejudice on September 15, 2010.

Within two months of voluntarily dismissing, Cooper refiled his previous complaints and alleged three new complaints in the United States District Court for the Middle District of Tennessee. The three new complaints were based on federal securities law violations and were invoked under federal-question jurisdiction. The federal court exercised supplemental jurisdiction over Cooper's original state-law tort claims. Glasser moved to dismiss the federal action, arguing that the statute of limitations had run on the securities law violation claims. On February 15, 2011, before the court could rule on Glasser's motion to dismiss, Cooper again voluntarily dismissed his claims.

On October 5, 2011, Cooper brought a third and final action in the Circuit Court for Davidson County, Tennessee. This complaint alleged three of the state-law claims that he had brought in the previous suits. Glasser moved for summary judgment stating that Cooper's second voluntary dismissal precluded him from filing a lawsuit based on the same or related claims. Cooper argued that his claims were not precluded from being brought again due to Tennessee's three-dismissal rule.

At trial, the court determined that Federal Rule of Civil Procedure 40(a)(1)(B) controlled the claim-preclusive effect of Cooper's previous voluntary dismissals and granted Glasser's motion for summary judgment. The decision was affirmed by the Tennessee Court of Appeals, and the Tennessee Supreme Court granted Cooper permission to appeal.

This was an issue of first impression in Tennessee courts, and the supreme court found that only Georgia had dealt with an issue similar to that which was presented in this case. *Austin v. Coca-Cola Co.*, 458 S.E.2d 409 (1995) provided a situation in which the defendants twice removed claims to federal court, and both times the plaintiffs dismissed the claims voluntarily. The plaintiffs filed a third time in Georgia state court, relying on a Georgia statute which allowed a plaintiff to refile his complaint following two voluntary dismissals. Without stating whether state or federal law controlled, the Georgia Court of Appeals held that the plaintiff's claims had been resolved on the merits in federal court and as a result were barred. Furthermore, the *Austin* decision came prior to the United States Supreme Court's ruling in *Semtek Int'l Inc. v. Lockheed Martin Corp.,* 531 U.S. 497 (2001), which held that a federal district court exercising diversity jurisdiction should apply the claim-preclusion law of the state in which the federal court sits.

In *Semtek*, the plaintiff filed tort claims in California state court which the defendant removed to federal court based on diversity jurisdiction. The defendant moved to dismiss the claims, stating that the California statute of limitations had run, and the district court granted his motion. The district court stated that the claims were dismissed in their entirety, on the merits, and with prejudice. The plaintiff then refiled the same claims in Maryland state court, which imposed a three year statute of limitations. The defendant moved for summary judgment, which was granted at the trial court, and affirmed by the Maryland Court of Special Appeals. The Maryland high court refused to review the case, but the United States Supreme Court granted the plaintiff's petition for certiorari.

The *Semtek* Court recognized that the phrase "adjudication on the merits," as it appears in Federal Rule of Civil Procedure 41(a)(1)(B), was being widely used in judgments that did not pass upon the substantive merits of the claim. Moreover, the *Semtek* Court established three clear points. First, it stated that state claim-preclusion law controls the preclusive effect of a federal dismissal in a diversity case, unless applying state law would sufficiently undermine federal interests. Second, the Court found that imposing Federal Rule of Civil Procedure 41(a)(1)(B) on the state courts may violate the jurisdictional limitation of the Rules Enabling Act as well as the federalism principle which was raised in *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). Finally, the Court held that state courts must give judgments in cases based on federal-question jurisdiction the claim-preclusive effect that federal law commands. *Semtek* did not state, however, whether state or federal law controls the preclusive effect of voluntary dismissals in cases in which the claims are based on supplemental jurisdiction.

The Tennessee Supreme Court found that the reasoning of *Semtek* applied and controlled in *Cooper*. The *Semtek* Court recognized that the nature of a federal court's jurisdiction is a relevant factor in determining which claim-preclusion law applies, but it was not in and of itself outcome determinative. The Court further stated that the phrase "adjudication on the merits" should be narrowly interpreted so as to avoid overstepping the limitations imposed by the Rules Enabling Act. Furthermore, *Semtek* required a determination as to whether the application of state claim-preclusion law would be incompatible with federal interests.

In *Cooper v. Glasser*, the Tennessee Supreme Court recognized that there are some similarities between supplemental and diversity-of-citizenship claims. Both categories of jurisdiction require the federal court to apply and interpret state substantive law. Additionally, the court noted that the United States Supreme Court has recognized the equal application of *Erie* to state-law claims brought under supplemental and diversity statutes. The supreme court reiterated the fact that Cooper voluntarily dismissed his claims before any responsive pleadings had been filed, and therefore, his case had not passed on the substantive merits of its claims. Furthermore, the court found no reason why permitting the claims to be refiled in Tennessee court would be incompatible with federal interests. Therefore, the Tennessee Supreme Court held that Tennessee claim-preclusion law determines the effect of a federal court's judgment following a voluntary dismissal of supplemental state law claims, and reversed the Tennessee Court of Appeals decision.

Cooper v. Glasser makes two important points. First, the Tennessee Supreme Court recognizes that an "adjudication on the merits" under Federal Rule of Civil Procedure 41(a)(1)(B) prevents a plaintiff from refiling in federal court a supplemental state-law claim that has been twice dismissed. Second, in Tennessee, state claim-preclusion law determines the effect of a federal court's judgment following a second voluntary dismissal of a supplemental state-law claim. This gives plaintiffs bringing supplemental and diversity-of-citizenship claims in Tennessee, and likely in other states recognizing a "three dismissal rule," a solid basis to argue the legitimacy of bringing that claim a third time in state court. *Cooper* is noteworthy because the court takes a step toward clarifying the application of Federal Rule of Civil Procedure 41(a)(1)(B) to supplemental state-law claims.

WILLS & ESTATES

Under Tennessee law, a court will focus on the intent of the grantor when determining the meaning of a contested trust. *Frye v. Kimball,* No. CH-10-0141-3, 2014 WL 495340, at *1 (Tenn. Ct. App. Feb. 6, 2014), No. W2013-00636-COA-R3-CV, 2014 Tenn. App. LEXIS 57, at *1 (Tenn. Ct. App. Feb. 6, 2014).

By Jon Parrett

In *Hall v. Hall*, 604 S.W.2d 851, 853 (Tenn. 1980), the Tennessee Supreme Court held that the purpose of a court's interpretation of a trust is to determine the intent of the grantor. The Tennessee Supreme Court later held, in *Daugherty v. Daugherty*, 784 S.W.2d 650 (Tenn. 1990), that a grantor's intent can be ascertained by examining the words the grantor uses in the trust, their context, taken together with the general scope of the trust. In *Frye v. Kimball*, the Tennessee Court of Appeals applied the rules set forth in *Hall* and *Daugherty* to interpret the meaning of a trust.

In 1996, Orion Frye and his wife, Elisabeth Frye ("Elisabeth"), executed two separate trusts benefiting their children, Conrad Frye ("Conrad") and

Fredericka Smith ("Fredericka"), and their grandchild, Katrina Kimball ("Katrina"). Each of the trusts had a one-half interest in Orion and Elisabeth's real estate assets. Orion was the grantor and original trustee of the Orion F. Frye Trust (the "Orion Trust"), and Elisabeth was the grantor and original trustee of the Elisabeth E. Frye Trust (the "Original Elisabeth Trust").

Both of the trusts provided that upon the death of the original trustee, the successor trustee would be designated in the following order: (1) surviving spouse; (2) Conrad; (3) Fredericka. Collectively, the trusts granted a 70% interest in the estate to Conrad, a 20% interest to Fredericka, and a 10% interest to Katrina, Fredericka's daughter.

Orion died in January of 2005, and Elisabeth became the trustee of the Orion Trust. In November of that same year, Elisabeth modified the terms of the Original Elisabeth Trust. Elisabeth modified her trust to change the distribution of assets to grant a 70% interest to Fredericka, a 20% interest to Conrad, and a 10% interest to Katrina (the "Modified Elisabeth Trust").

On January 27, 2010, Conrad filed a petition to remove Elisabeth as trustee of the Orion Trust. In April of 2011, while the litigation was ongoing, Elisabeth died, and Conrad became the successor trustee of both the Orion Trust and the Modified Elisabeth Trust. Fredericka died on August 12, 2010, leaving Katrina the sole inheritor of her share of the estate.

Conrad filed a second petition in July 2011, in which he alleged that he had reached a settlement agreement with Elisabeth on January 25, 2011. According to the petition, the alleged agreement provided that: (1) Conrad would act as co-trustee of the Orion Trust and the Original Elisabeth Trust with Elisabeth; and (2) Elisabeth would renounce and declare void the Modified Elisabeth Trust (the "Settlement"). As evidence of the Settlement, Conrad provided the court with an unsigned memorandum of the Settlement, which Elisabeth's attorney sent to Conrad's attorney in April 2011. However, the parties never executed the Settlement, due to the fact that Elisabeth died less than a week after her attorney sent it. Regardless of this fact, Conrad asked the court to give effect to the drafted memorandum, because he claimed that each of the parties acted in accordance with it prior to Elisabeth's death.

Katrina answered the second petition, contending that any testimony or unsigned memorandum of the Settlement is barred by the statute of frauds. She argued that in the absence of such an agreement, the Modified Elisabeth Trust was made irrevocable by Elisabeth's death. Thus, Katrina contended, the Orion Trust and the Modified Elisabeth Trust governed the distribution of the trusts' property.

At trial, Conrad argued that the Settlement should be legally binding. Alternatively, Conrad argued that if the Settlement was not legally binding and if the Modified Elisabeth Trust governed the distribution of assets, the Modified Elisabeth Trust should be interpreted as only granting life estates, and not gifts. Finally, Conrad also contended that each of the trusts required its beneficiaries to survive both Orion and Elisabeth in order for their share to vest. Accordingly, Conrad argued, because Fredericka did not outlive Elisabeth, Fredericka's share never vested, and thus Katrina was not entitled to it as Fredericka's heir.

The Chancery Court of Shelby County held that because the Settlement was not signed prior to Elisabeth's death, it was not enforceable. The court also held, after reviewing all of the provisions found in the Modified Elisabeth Trust in context, that the "for lifetime" language in the Modified Elisabeth Trust did not intend to create a life estate, but instead intended for the trust assets to be distributed as gifts upon Elisabeth's death.

On appeal, the Tennessee Court of Appeals held that the meaning of a trust is determined by the intent of the grantor. Prior to addressing the meaning of the trust, the court first had to determine whether the Settlement or the Modified Elisabeth Trust was the controlling document. The court stated that a trust must be signed in order for it to be valid. It then looked at the language of the Modified Elisabeth Trust, which provided that any amendment to the trust must be in writing. Because Elisabeth never signed the Settlement, the court found that it never took legal effect, and the Modified Elisabeth Trust was still the valid and controlling document.

Having established that the trial court properly ruled that the Modified Elisabeth Trust was still the focus of the case, the court went on to resolve the legal issue of its interpretation. The court, exercising *de novo* review, held that the purpose of the interpretation of a trust is to determine the grantor's intent, and the intent of the grantor is determined by examining the words and context of the trust, taken in their entirety. First, the court reaffirmed the holding of *Estate of Burchfiel v. First United Methodist Church of Seviervill*e, 933 S.W.2d 481, 483 (Tenn. Ct. App. 1996), stating that the interpretation of a trust agreement is a question of law. Next, the court looked to *Hall v. Hall*, 604 S.W.2d 851, 853 (Tenn. 1980), where the Tennessee Supreme Court held that the overriding purpose of a trust's interpretation is to determine the grantor's intent. The court looked further at another Tennessee Supreme Court ruling, *Daugherty v. Daugherty*, 784 S.W.2d 650 (Tenn. 1990), which established that the grantor's intent is ascertained by examining the words the grantor used, their context, and also the general scope of the document. Finally, the court, relying on *Marks v. Southern Trust Co.*, 310 S.W.2d 435, 438 (Tenn. 1958), held that where clauses in a trust are inconsistent or contradict each other, the court must determine the grantor's intent in order to determine which clause will prevail.

After establishing that the proper test for determining the meaning of a trust is determining the intent of the grantor, the court reviewed the trial court's interpretation of the Modified Elisabeth Trust. The appellate court, exercising *de novo* review, agreed with the trial court's determination that the Modified Elisabeth Trust granted outright gifts, not life estates. The court examined the "for lifetime" language of the Modified Elisabeth Trust and determined that the clause that followed this language discussed an estate outright and free of further trust, which indicated that the grantor intended to create an outright gift, not a life estate.

The appellate court then reviewed the trial court's determination that the Orion Trust did not intend to establish a condition precedent that Fredericka outlive Elisabeth. The court, using *de novo* review and again applying the standards set forth in *Hall* and *Daugherty*, found that the Orion Trust clearly contemplated a situation where the deceased parent's share would go to the grandchild, even if the parent predeceased the grantor. Accordingly, the Tennessee Court of Appeals affirmed the ruling of the trial court.

Based on this decision, transactional attorneys should be aware that when they draft a trust document, they have to be supremely conscious of their client's intentions. Attorneys have to be careful to word the document in a way that correctly expresses their client's wishes. If the document is reviewed by a court of law, its entire meaning will hinge on how the court interprets the words on the document. Additionally, attorneys must take note of provisions in trusts which they are attempting to amend, and they must get any amendments or agreements in writing as soon as possible. As evidenced by *Frye v. Kimball*, there may not be another chance to get such documentation, the absence of which could potentially lead to costly litigation for all parties involved.