
By Christie M. Weaver

A conflict can arise between arbitration clauses and state laws that assign jurisdiction of a particular issue to a judicial or administrative forum. In *Preston v. Ferrer*, the Supreme Court held that when parties contractually agree to arbitration, the Federal Arbitration Act (“FAA”) overrides any state law that assigns primary jurisdiction to another arena.

Arnold M. Preston (“Preston”) and Alex E. Ferrer (“Ferrer”) entered into a contract (the “Contract”) whereby Preston, a California-based entertainment attorney, would render legal services to Ferrer, a former Florida trial court judge who appeared as “Judge Alex” on a television program of the same name. The Contract allowed for arbitration of any dispute arising from “the terms of [the Contract] or the breach, validity, or legality thereof.” Preston invoked the arbitration clause and submitted the case to the American Arbitration Association (“AAA”) seeking fees allegedly due to him under the Contract. Ferrer challenged the validity of the contract under the California Talent Agencies Act (“TAA”), claiming that Preston illegally acted as a talent agent. The TAA provided that disputes be referred to the California Labor Commissioner; thus, a conflict emerged between state law and the terms of the Contract’s arbitration clause. Ferrer filed suit in state court requesting an injunction to postpone arbitration and seeking a determination that the controversy was not subject to review by an arbitrator. Preston moved to enforce the arbitration clause, asserting that he acted as a “personal manager” and not as a talent agent as defined by the TAA. The California Superior Court partially granted Ferrer’s request, enjoining arbitration until the Labor Commissioner accepted jurisdiction over the dispute. While Preston’s appeal was pending, the Supreme Court decided *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006), holding that an arbitrator—not the state court—must decide whether a contract containing an arbitration clause was illegal. The California Court of Appeal found that *Buckeye* was inapplicable to the *Preston* case and affirmed the lower court’s decision, holding that the TAA vested exclusive jurisdiction with the Labor Commissioner. Preston’s petition for review was denied by the California Supreme Court, but the United States Supreme Court granted a writ of certiorari. The sole question before the Supreme Court was whether the California Labor Commissioner or an arbitrator
would determine if Preston acted as a personal manager or a talent agent.

The Supreme Court reversed the decision of the California Court of Appeal, holding that the FAA preempts state law when parties agree to arbitrate disputes arising from a contract. Section 2 of the FAA sets forth a national policy favoring arbitration by providing that an agreement to settle disputes by arbitration in a contract “shall be valid, irrevocable, and enforceable” unless the entire contract is void. In contrast, the TAA authorized arbitration of disputes only if both parties agreed to participate and allowed the Labor Commissioner to be present. The Court found that TAA procedures conflicted with the FAA in two respects: first, the TAA gave the Labor Commissioner exclusive jurisdiction over a dispute that the parties agreed to arbitrate; and second, the TAA’s prerequisites to enforcement of an arbitration agreement contradicted the legislative intent that disputes be resolved quickly.

The Supreme Court disagreed with the California Court of Appeal’s determination that Buckeye was inapposite because it did not involve an administrative agency and found the Buckeye decision to be controlling. Ferrer attempted to differentiate the case by asserting that the TAA merely delayed arbitration, as opposed to the state court’s outright prohibition of arbitration in Buckeye. In rejecting this argument, the Court explained that arbitration would likely be long delayed if the dispute initially went before the Labor Commissioner, which is contradictory to Congress’s intent to expedite alternative dispute resolution. Additionally, the Court believed Ferrer would not surrender substantive rights afforded to him by the TAA or California law if the dispute was directed to arbitration. The Court could find no reason to distinguish Buckeye, where adjudicatory authority was vested in a state court, from Preston, where an administrative agency was given jurisdiction. Accordingly, state laws that allow for administrative review prior to arbitration are preempted by the FAA, as are state laws that divert the dispute to an initial court review.

The Preston decision is an important endorsement of the FAA’s stated “federal policy favoring arbitration” and reinforces that the FAA preempts contradictory state laws. Transactional attorneys negotiating contracts must consider the impact of the FAA if parties agree to arbitrate disputes, especially in industries where individuals may rely upon specialized and administrative agencies to protect their rights. Further, the states’ ability to monitor and regulate those industries could be threatened by precursory submission of disputes to an arbitrator. In light of Preston, parties to a contract will be able to avoid administrative adjudication in favor of arbitration, but may also risk surrendering protections offered by state statutes and agencies that are preempted by the FAA.

By Bryan C. Hathorn

A transitory action is an action that can be brought wherever personal service of process can be made on the defendant, as opposed to a local action, which must be brought where the subject matter of the controversy exists. Multiple possible venues exist for transitory actions in Tennessee. Tennessee Code Annotated § 24-4-101(a) provides that the proper venue for a transitory action is “where the cause of action arose or where the defendant resides or is found.” In *Federal Express v. American Bicycle Group, LLC*, the Tennessee Court of Appeals held that, for the purpose of determining venue, an LLC can be found at the location of its registered agent and office.

Federal Express (the “Plaintiff”) filed a complaint against The American Bicycle Group, LLC (the “Defendant”) in Knox County Chancery Court. The summons was served on the Defendant’s registered agent located in Knox County. The Defendant moved to dismiss the case for improper venue. The Defendant asserted that the Knox County venue was improper because the transitory action arose in Shelby County and the Defendant’s place of business was in Hamilton County. The Plaintiff responded that for the purpose of venue, the Defendant was found in Knox County because its registered agent was in Knox County. The trial court denied the motion, and the Defendant made an interlocutory appeal to the Court of Appeals to determine if the Knox County venue was permitted.

Corporations can be found in counties where they have an “office, agency or resident director.” Although LLCs are not incorporated, Tennessee courts often apply corporate law to LLCs. Thus, an LLC can be found in any county where it

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1 When the plaintiff and the defendant both reside in the same county, the “common county” exception to this rule provides that the action can only be brought where the cause of action arose or in the common county of residence, eliminating the venue where the defendant is “found.”

2 Redman v. DuPont Rayon Co., 56 S.W.2d 737, 739 (Tenn. 1933).
maintains “an office for furtherance of its business activities.”

Tennessee Code Annotated § 48-208-101 provides that an LLC must have a registered office and a registered agent in the state, and that the “registered agent must maintain a business office that is identical with the registered office.” Moreover, under Tennessee Code Annotated § 48-208-102, if the LLC changes its registered office or registered agent, “the street address of its registered office and the business office of its registered agent will be identical.” Thus, the registered agent must maintain a business office at the LLC’s registered office. Because an LLC can be found at a business office, it can be found at the location of its registered agent and office.

The Defendant’s registered agent maintained its business office at a street address in Knox County. As such, the court found that the Defendant had a business office in Knox County and was found there for the purpose of venue in a transitory action.

The court’s decision reaffirms that the appropriate venues for a plaintiff to bring a transitory action against an LLC or corporation in Tennessee are (i) where the cause of action arose, (ii) where the defendant does business (i.e., where it resides), and (iii) where it maintains a business office (i.e., where it can be found— including the location of its registered agent and office). A plaintiff may bring an action in any of these venues.

As a result, an LLC must defend a lawsuit in any venue where the LLC has a registered agent and office. As a practical matter, if an LLC wishes to avoid a particular venue, it is necessary to avoid being found there. While an LLC may not be able to eliminate a place of business in an unfavorable venue, it is possible to choose the location of the LLC’s registered agent and office.

When counseling an LLC, Tennessee attorneys should advise the LLC that it will be required to defend a civil action anywhere that the LLC maintains a registered agent and office. If an LLC already has its registered agent and office in a venue where it does not wish to appear, it can change the location of its registration. The procedure for doing so is provided by Tennessee Code Annotated § 48-208-102 (b). To change its registered agent and office, the LLC must deliver to the secretary of state a statement which provides the name of the LLC, the name and address of the current registered agent and office, and the name and address of the new registered

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agent and office. After changing the location of its registered agent and office, the LLC will only be found for the purpose of venue either where it has its new registered agent or where it maintains business offices. However, suit can still be brought where an action arose.

## CONTRACT LAW

A party cannot enforce an ambiguous contract provision where the party knew or should have known that the other party had a substantially different interpretation of that provision. *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810 (Del. Ch. 2007).

By Christopher M. Smith

When a contract provision is ambiguous, the Delaware Court of Chancery will use extrinsic evidence to find an objectively reasonable interpretation. If the extrinsic evidence plausibly suggests two reasonable interpretations, the court will construe the provision in light of the “forthright negotiator principle,” which looks at “the subjective understanding of one party that has been objectively manifested and is known or should be known by the other party.” Under this principle, the court will not enforce an ambiguous provision where one party knew or should have known of the other party’s differing interpretation of that provision.

The directors of United Rentals, Inc. (“URI”), a multi-billion dollar equipment rental company, solicited bids for a leveraged buyout of the company. Investment group Cerberus Capital Management, L.P. (“Cerberus”), entered into negotiations to buy the company. To limit its potential liability, Cerberus created the shell corporations RAM Holdings, Inc. and RAM Acquisition Corp. (collectively “RAM”) to merge with URI. Because RAM had practically no assets, Cerberus used one of its investment funds to guarantee RAM’s obligations to URI. Although they operated in different states, all entities were incorporated under Delaware law.

The parties negotiated the merger for months and sent nine drafts back and forth before reaching the final Merger Agreement (“Agreement”). Throughout negotiations, the parties fundamentally disagreed on URI’s remedies in the event that RAM (i.e., Cerberus) backed out of the merger. RAM maintained that URI’s sole remedy in the event of breach was a $100 million “termination fee” constituting liquidated damages. In contrast, URI wanted the right to demand specific performance of RAM’s obligations under the Agreement, but was unclear in communicating that requirement to RAM. The Agreement itself contained two contradictory provisions regarding URI’s remedies: the first provision granted URI
the right to “enforce specifically the terms and provisions of this Agreement,” subject to the second provision, which stated that the termination fee was the “sole and exclusive remedy . . . and in no event shall [URI] seek equitable relief . . . from [RAM or Cerberus].”

RAM backed out of the merger, admitting that it breached the Agreement but maintaining that it was only liable for the $100 million termination fee. URI argued that a plain reading of the Agreement expressly protected the “right to specific performance” subject to the “sole and exclusive remedy” language. URI maintained that the breach was not a “termination” (a defined term in the contract) that would give rise to the $100 million termination fee, but rather a breach allowing for the remedy of specific performance. RAM, on the other hand, argued that it expressly rejected URI’s right to specific performance through the second provision, just as it had forcefully rejected that remedy in previous drafts and negotiations.

The Delaware Court of Chancery denied URI’s petition for specific performance because URI knew or should have known that RAM interpreted the ambiguous provisions to preclude the remedy of specific performance. Because the contractual provisions were ambiguous, the court looked at extrinsic evidence found in Agreement drafts, notes of meetings, and witnesses’ recollections of discussions. When extrinsic evidence offered no “obvious” objective interpretation and each party offered a different reasonable interpretation, the court utilized the “forthright negotiator principle” to settle the meaning of the ambiguous provisions. Under this principle, the court focused on how effectively each party had communicated its understanding of the Agreement to the other party. The court held that “URI knew or should have known what Cerberus’s understanding of the Merger Agreement was, and if URI disagreed with that understanding, it had an affirmative duty to clarify its position in the face of an ambiguous contract with glaringly conflicting provisions.”

The court relied chiefly on evidence that RAM had repeatedly and forcefully insisted through draft edits and oral communication that URI’s only remedy was the $100 million termination fee. In contrast, URI’s negotiating attorney wavered on the issue and seemingly acquiesced to RAM’s interpretation: “Testimony indicated that [URI’s attorney] put up no fight on this issue.” In response to RAM’s uncompromising stance, he “replied, ‘I get it.’” In doing so, he “categorically failed to communicate” URI’s understanding of its right to specific performance.

The lawsuit could have been avoided if RAM had deleted the specific performance provision rather than making it “subject to” the termination fee provision. The court noted that while Delaware law allows for such hierarchical organization of contract provisions, simply deleting the specific performance language would have been the superior and “seemingly obvious” approach. Instead,
both sides allowed the ambiguity to remain in the Agreement.

Citing one of Judge Richard Posner’s articles on law and economics, the court acknowledged that a certain amount of ambiguity is sometimes necessary to close a deal. In *United Rentals, Inc. v. RAM Holdings, Inc.*, however, the ambiguity resulted in an expensive lawsuit without the possibility of summary judgment because a material fact was in dispute. In addition, although it ultimately won the lawsuit, Cerberus paid a reputational cost. After noting “the importance of reputation in the private equity field,” the court criticized Cerberus for “walking away from this deal, for favoring their lenders over their targets, [and] for suboptimal contract drafting” and quoted a New York Times article calling Cerberus “the ultimate flighty, hot-tempered partner.”

For transactional attorneys, this decision illustrates two principles of contract negotiation and drafting: First, and especially in transactions with numerous contract drafts, it is far better to delete an obsolete provision than to attempt to nullify it by making it “subject to” a separate provision. Contradictory provisions create ambiguity, and ambiguity allows the court to consider extrinsic evidence. Second, at all stages of negotiation, a transactional attorney should be forthright, clear, and relentless in advocating his client’s interpretation of provisions and his client’s goals. Mixed messages may lead to trouble, especially where the court utilizes the “forthright negotiator principle” to resolve ambiguous provisions.


By Ryan Hoffman

Prevailing litigants often incur substantial expenses in the form of attorney’s fees. In Tennessee and other jurisdictions that follow the traditional American rule, litigants must pay their own attorney’s fees absent a statute or contract that provides otherwise. When a prevailing party in a contractual dispute seeks to recovery attorney’s fees, courts must determine whether the contracting parties intended that the prevailing party be entitled to recover attorney’s fees from the breaching party. In *Cracker Barrel Old Country Store, Inc. v. Epperson*, the Tennessee Court of Appeals held that a declaration of easements and restrictions that provided that all “costs and expenses” of any suit arising from a violation of the declaration would be assessed against the defaulting party did not provide for recovery of attorney’s fees.
Cracker Barrel v. Epperson concerned a Declaration of Reciprocal Rights and Easement and Restrictive Covenants (the “Declaration”) involving neighboring properties owned by Cracker Barrel and Richard Epperson and Timothy Causey (the “Defendants”). Paragraph nine of the Declaration stated that the agreement created mutual benefits and servitudes that ran with the land, and that if an owner violated the declaration’s provisions, any party with an interest in the property was entitled to legal and equitable remedies. Paragraph nine stated: “All costs and expenses of any suit or proceeding shall be assessed against the defaulting party.”

Cracker Barrel initiated suit against the Defendants, claiming that their plan to expand a building violated the Declaration. In its complaint, Cracker Barrel sought attorney’s fees, a request that also appeared in the Defendants’ counterclaim. The trial court found that the expansion plan violated the Declaration and issued an agreed judgment and permanent injunction in January 2006. This judgment provided that Cracker Barrel could renew its motion for an award of “Plaintiff’s attorneys’ fees, costs and expenses incurred in connection with obtaining [the] Permanent Injunction” if the parties were unable to resolve their dispute through nonbinding mediation. After the parties failed to settle the dispute, the trial court awarded Cracker Barrel court costs, but found that the Declaration did not provide for an award of attorney’s fees.

The sole issue raised on Cracker Barrel’s appeal was whether the trial court properly denied Cracker Barrel’s request for attorney’s fees. The Tennessee Court of Appeals affirmed the decision of the lower court, holding that no language in the Declaration compelled the Defendants to pay Cracker Barrel’s attorney’s fees. The court concluded that Tennessee follows the American rule, which requires parties to pay their own attorney’s fees unless a statute or contract provides otherwise or there is some equitable basis for awarding attorney’s fees. Additionally, the court noted that an award of attorney’s fees, absent one of the above exceptions, is against public policy in Tennessee.

The American rule does not apply when parties to a contract agree to a fee shifting provision. According to the majority in Cracker Barrel v. Epperson, Tennessee case-law supports the presumption that contracting parties do not intend to deviate from the American rule unless a contract “specifically provid[es]” for the recovery of attorney’s fees. Thus, the court reasoned that the drafter of the Declaration could have “specifically” or “expressly” provided that the prevailing party in an enforcement action may recover attorney’s fees. Because the Declaration did not specifically provide for the shifting of “attorney’s fees,” the court refused to interpret the phrase “costs and expenses” as encompassing attorney’s fees. Based on Tennessee’s adherence to the American rule, public policy considerations, and the lack of express language unequivocally shifting attorney’s fees, the majority denied
Cracker Barrel’s request for attorney’s fees.

The dissent argued that the majority’s construction of the American rule was too strict. According to the dissent, Tennessee allows recovery of attorney’s fees “under an express contract ‘if the language of the agreement is broad enough to cover such expenditures.’” The dissent argued that the phrase “all costs and expenses of any suit or proceeding” was broad enough to include attorney’s fees. Conversely, the majority focused on the phrase “costs and expenses” and disregarded the preceding word, “all,” in declining to award attorney’s fees. Yet, attorney’s fees are certainly either a “cost” (although they are distinguished from court costs) or “expense” associated with a lawsuit. Since the Declaration provided that “all costs and expenses” shifted to the defaulting party, it is not difficult to imagine that the contracting parties contemplated the payment of attorney’s fees at the Declaration’s formation. The majority, however, determined that this language did not constitute an “express” and “specific” manifestation of the contracting parties’ intent as required under Tennessee law.

The court’s message in Cracker Barrel v. Epperson is clear: parties to contract must explicitly provide for the shifting of “attorney’s fees” if they wish to recover such fees. Contract drafters should be mindful of this requirement. In addition, attorneys may find it necessary to modify pre-existing fee-shifting agreements to conform to the explicit language required in Cracker Barrel v. Epperson.

**EMPLOYMENT LAW**


By Melissa Hughes

The growing popularity of retirement security plans administered by a participant’s employer has resulted in confusion regarding legal liability when such plans are mismanaged. Over twenty years ago, the United States Supreme Court held that a participant in a fixed benefit disability plan did not have a separate cause of action under § 502(a)(2) of the Employee Retirement Income Security Act (“ERISA”), 29 U.S.C. §§ 1001-1461 (1974), for injury to the participant’s individual account. The Supreme Court recently reexamined its previous decision and held that, in the case of defined contribution employee benefit plans, an individual claiming breach of fiduciary duty does have standing to bring suit under § 502(a)(2) for injuries distinct from the entire plan.
As an employee at DeWolff, Boberg & Associates (“DeWolff”), James LaRue contributed to an ERISA-regulated 401(k) retirement savings plan administered by DeWolff. This type of retirement plan, categorized as a “defined contribution plan” or an “individual account plan,” operates by investing a participant’s contributions, so that, at the point of retirement, the participant will receive the value of the individual account. The value of the account is determined by the financial success of the invested contributions. While defined contribution plans are more popular in recent years, “defined benefit plans” were once the standard type employee benefit plan. Unlike the defined contribution plan, a defined benefit plan uses the participant’s years of service and quantity of compensation to calculate a fixed level of retirement income to which the participant is entitled.

In 2004, LaRue filed suit against DeWolff, alleging that DeWolff failed to follow LaRue’s directions to make certain changes on his individual 401(k) account. LaRue claimed that DeWolff’s mismanagement, which depleted $150,000 from LaRue’s interest, was a breach of the fiduciary duty owed under ERISA § 409(a). Although § 502(a) of ERISA provides six ways in which various parties and individuals may bring a civil cause of action, LaRue chose to assert claims under § 502(a)(2) and § 502(a)(3). The district court denied LaRue’s original claim under § 502(a)(3) and granted DeWolff’s motion for judgment on the pleadings. The district court concluded that Plaintiff sought money damages rather than the equitable relief available under § 502(a)(3).

LaRue appealed to the Third Circuit, this time asserting a claim under both § 502(a)(2) and § 502(a)(3). Under § 502(a)(2), the Secretary of Labor, plan participants, beneficiaries, and fiduciaries are authorized to bring an action “on behalf of a plan” to recover for violations provided in § 409(a) of ERISA, which subjects fiduciaries who breach any responsibility, obligation or duty imposed by statute to personal liability. In denying the § 502(a)(2) claim, the Third Circuit relied on an older Supreme Court decision, Massachusetts Mutual Life Insurance Co v. Russell, 473 U.S. 134 (1985). In Russell, an individual participant of a defined benefit plan sought recovery under § 502(a)(2) for damages resulting from her employer’s delay in processing her claim. The Supreme Court rejected the participant’s right to bring an individual claim, holding that § 502(a)(2) provided a remedy only for injury to the entire plan and not for distinct participant injuries.

Applying the Supreme Court’s rationale in Russell, the Third Circuit denied LaRue’s claim under § 502(a)(2). The Third Circuit classified LaRue’s remedy as “personal” and held that his “remedial interest” was unable to “serve as a legitimate proxy for the plan in its entirety.” In addition to rejecting LaRue’s § 502(a)(2) claim, the Third Circuit also denied his argument under § 502(a)(3).
The Supreme Court granted LaRue’s writ of certiorari for the sole purpose of addressing the Third Circuit’s interpretation of § 502(a)(2). The Supreme Court distinguished *Russell* and held that although § 502(a)(2) does not offer relief for individual injury different from injury to the entire plan, § 502(a)(2) does offer relief for breaches of fiduciary duty that harms an individual participant’s plan assets. In making this distinction, the Supreme Court declared that the “former landscape of employee benefit plans . . . has changed.” At the time of ERISA’s enactment, the predominant type of employee benefit plan was the defined benefit plan formerly at issue in *Russell*. A participant in a defined benefit plan does not acquire an individual account. Rather, at the time of retirement the participant receives a fixed benefit amount based on the percentage of salary formerly received. As explained by the Supreme Court, the holding in *Russell* “speaks to the impact of § 409 on plans that pay defined benefits.” With defined benefit plans, an administrator’s violation of ERISA would not affect an individual participant’s benefits without also affecting the plan as a whole. The Supreme Court recognized that for defined benefit plans, fiduciary misconduct would not create participant injury distinct and separate from injury to the entire plan. Thus, the need for an available cause of action to individual participants was unnecessary, because bringing suit on behalf of the plan as a whole would serve the ultimate concern in passing ERISA, to prevent “misuse and mismanagement of plan assets by plan administrators.”

In the modern economy, defined contribution plans are more predominant than defined benefit plans. Unlike defined benefit plans, fiduciary misconduct involving a defined contribution plan can threaten participants’ individual interests without causing harm to the entire plan. Because the benefit received under a defined contribution plan is largely the result of the performance of invested contributions, a participant can stand to gain or lose without affecting the entire plan. Relying on this distinction, the Supreme Court decided that its holding in *Russell*, which allowed a cause of action only if the injury is to the “entire plan,” was limited to defined benefit plans. On the other hand, a participant in a defined contribution plan is entitled to recovery for harm to the value of the participant’s individual plan as a result of fiduciary misconduct. Accordingly, LaRue had a cognizable breach of fiduciary duty claim under ERISA § 502(a)(2) for the alleged injury to his 401(k) interest because he claimed injury to his individual defined contribution plan.

In practice, an attorney should consider the possible liability a client might be subject to while managing, or choosing another entity to manage, a defined contribution plan as opposed to a defined benefit plan. A transactional attorney should advise an employer-client to consider the interests and suggestions of the employee and the expected success of plan management decisions before making any changes to the plan. The potential liability of failure to make certain changes
should also be discussed with an employer-client. Poor administration of employees’ requests to change their defined contribution plans can result in a breach of fiduciary duty and significant liability.


By George Green

If a general agent exceeds his actual authority, the principal remains liable for any action taken by the agent within the scope of the agent’s apparent authority. In *BellSouth Advertising & Publishing Corp. v. Primary Residential Mortgage, Inc.*, the Tennessee Court of Appeals held that a principal’s failure to disclose a general agent’s authoritative limitations to a third party is sufficient to establish that party’s good faith belief in the agent’s apparent authority.

Craig Daliesso (“Daliesso”) was the branch manager for Primary Residential Mortgage, Inc. (“PRMI”) at its Franklin, Tennessee facility. The “Branch Manager Agreement” (the “Employment Agreement”) between Daliesso and PRMI outlined Daliesso’s responsibilities as branch manager, which included overseeing the day-to-day operations of the office and supervising all of the employees. The Employment Agreement provided that Daliesso could not enter into binding contracts on behalf of PRMI without the company’s written consent. However, Daliesso authorized a series of advertising contracts with BellSouth Advertising and Publishing Corporation (“BellSouth”) to market PRMI in the Nashville, Tennessee Yellow Pages and an internet directory. Daliesso assured BellSouth’s sales representative that he had authority to bind PRMI to the advertising contracts, and BellSouth was unaware of the Employment Agreement or of any restrictions on Daliesso’s authority. PRMI breached the advertising contracts, and BellSouth sued PRMI for the remaining balance and moved for summary judgment. The trial court granted BellSouth’s motion for summary judgment, holding that Daliesso had apparent authority to bind PRMI to the advertising contracts. PRMI appealed solely on the ground that Daliesso did not have actual authority to bind them to the contracts with BellSouth pursuant to the terms of the Employment Agreement.

On appeal, the Tennessee Court of Appeals affirmed the trial court’s ruling, holding that (i) there was sufficient basis to conclude that BellSouth possessed a
good-faith belief in Daliesso’s apparent authority to bind PRMI to the advertising contracts, and thus, (ii) PRMI was liable for the remaining balance. Apparent authority may exist when a principal has not granted its agent actual authority, but the principal’s behavior—either intentionally or through carelessness—induces detrimental reliance by a third party. Significantly, the principal’s actions lead to apparent authority, not the acts of the individual agent. In discussing this concept, the court determined that three elements must be present to establish apparent authority: “(1) the principal either actually or negligently acquiesced in the agent’s exercise of authority; (2) the third party had knowledge of the fact and a good faith belief that the agent possessed such authority; and (3) the third party detrimentally relied on the apparent authority.”

The court determined that the circumstances satisfied the first and third elements. Regarding the first element, PRMI placed Daliesso in a position of authority as branch manager of its Franklin, Tennessee office. Accordingly, PRMI fostered the appearance that Daliesso had authority to manage the office and make decisions that promoted the livelihood of the branch. Similarly, the court found that the third element was satisfied because it was clear that BellSouth detrimentally relied on Daliesso’s apparent authority as branch manager.

Regarding the second element, the court discussed several factors in finding that BellSouth had a good faith belief in Daliesso’s apparent authority to represent PRMI. Initially, the court analyzed the facts to determine what authority PRMI had actually conferred to Daliesso. The Employment Agreement established that Daliesso had the authority to represent PRMI in a general fashion. Daliesso was responsible for originating loans, completing credit and background checks on prospective clients, and making personnel decisions within the branch. Relying on the Tennessee Supreme Court’s decision in O’Shea v. First Federal Savings & Loan Ass’n, 405 S.W.2d 180 (Tenn. 1966), the court noted that when an agent’s authority and power is expressed in a limited scope, a third party is fully justified in implying any authority which is reasonable and customary under similar circumstances. If the principal has limited the general agent’s authority, the principal is responsible for disclosing the limitations to a third party because of the broad authority the title encompasses. Although PRMI had contractually limited Daliesso’s authority to enter into contracts on its behalf, the record does not indicate that PRMI communicated those limitations to BellSouth.

Although PRMI’s actions gave rise to apparent authority, Daliesso’s actions and behavior still could have eliminated BellSouth’s good-faith reliance on his authorization. The court noted that if Daliesso had been apprehensive or skeptical about approving the advertising contracts, then BellSouth would have lost the requisite good faith belief necessary to satisfy the second element. Conversely, the
court acknowledged that Daliesso explicitly and without hesitation affirmed to BellSouth’s sales representative that he had authority to approve the contracts. Moreover, the circumstances did not reveal any motive or substantial benefit evidencing that Daliesso stood to personally gain from the contracts, nor was BellSouth aware of any such agenda.

The court also inquired into whether it was reasonable under the circumstances for BellSouth to believe that Daliesso possessed the necessary authority to enter into the advertising contracts. The contracts were presumably intended to generate business for the mortgage office. Because the mortgage business is usually oversaturated, firms typically rely heavily on advertising to increase market share; thus, Daliesso’s actions were intended to benefit PRMI. The court found that BellSouth was reasonable in believing that that the manager of a mortgage office would be authorized to enter into advertising contracts.

Ultimately, the court held that (i) Daliesso’s position as branch manager made Daliesso a general agent of PRMI; (ii) neither PRMI nor Daliesso expressed limitations on Daliesso’s authority; and (iii) Daliesso possessed the apparent authority to bind PRMI to the advertising contracts.

The Tennessee Court of Appeals’ decision in BellSouth v. Primary Residential Mortgage reinforces the agency law notion that to avoid liability for the unauthorized acts of their general agents, principals must notify third parties of limitations to the agents’ authority. A contract between a principal and agent that limits the agent’s authority will not necessarily shield the principal from liability if the agent exceeds that authority. Although an employment contract is an important step in limiting an agent’s authority, attorneys should advise business entities that additional measures should be taken to expressly notify third parties of the limits on their employees’ authority.

By Natasha W. Campbell, Esq. *

The doctrine of *respondeat superior* subjects employers to liability for the negligent acts of employees. However, the Tennessee Court of Appeals recently held in *Huber v. Marlow* that where an employer’s only liability rests on the actions of a “nonparty employee,” the employer cannot be held vicariously liable after the statute of repose has run against that employee.

Elizabeth Chenoweth was treated by Dr. Douglas Marlow and Dr. David Rankin at Baptist Hospital of East Tennessee. While under Dr. Rankin’s care, Ms. Chenoweth fell down and sustained a head injury which caused an intracranial hemorrhage. Ms. Chenoweth underwent surgery to relieve pressure caused by the hemorrhage, but died two days later.

In a subsequent malpractice action brought by Ms. Chenoweth’s daughters, Internists of Knoxville, PLLC—the employer of Dr. Marlow and Dr. Rankin—argued that it could not be held liable under *respondeat superior* because Dr. Rankin had not been sued within the three-year statute of repose. The trial court granted summary judgment, and Plaintiffs appealed.

On appeal, the court restated the premise that a principal may not be held vicariously liable for the negligent acts of its agent “(1) when the agent has been exonerated by an adjudication of non-liability, (2) when the right of action against the agent is extinguished by operation of law, or (3) when the injured party extinguishes the agent’s liability . . . .”*1 The *Huber* court found the second circumstance present in this case—i.e., that the right of action against the agent, Dr. Rankin, had run.

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1 Huber, 2008 WL 2199827 at *3 (quoting Johnson v. LeBonheur Children’s Med. Ctr., 74 S.W3d 338, 345 (Tenn. 2002)).
Statutes of repose extinguish the right to sue. Thus, because the medical malpractice statute of repose had run while the litigation was pending against Dr. Rankin, the court stated that the harm was *damnum absque injuria*—a wrong for which the law allows no redress.” The court thus affirmed partial summary judgment in favor of Internists of Knoxville.

The court’s decision in *Huber v. Marlow* may affect litigation far outside the context of medical malpractice actions because the doctrine of *respondeat superior* is not limited to the healthcare setting. In Tennessee, “[a]n employer is liable for the negligent acts of an employee if the employee is on the employer's business and acting within the scope of his employment at the time the negligent act occurs.”

Tennessee attorneys should be mindful that under *Huber v. Marlow*, lawsuits brought against an employer under the doctrine of *respondeat superior* must be filed within the statute of repose applicable to the tortious employee.

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**PATENT LAW**


By James Cline

In a patent infringement action, the district court may award permanent injunctive relief to the patent holder. Traditionally, a federal court may grant such relief only after a patent holder has demonstrated:

(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.

In *eBay Inc. v. MercExchange, L.L.C.*, the United States Supreme Court held that

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2 Craig v. Gentry, 792 S.W.2d 77, 79 (Tenn.Ct.App.1990)(citation omitted); see Parker v. Vanderbilt Univ., 767 S.W.2d 412, 416 (Tenn. Ct. App. 1988) (“To hold the master/principal liable, it must be established ‘that the servant or agent shall have been on the superior’s business, acting within the scope of his employment.’”) (quoting Nat’l Life & Accident Ins. Co. v. Morrison, 162 S.W.2d 501, 504 (Tenn. 1942)).
district courts must apply this general “four-factor test” to disputes arising under the Patent Act and thus, an injunction does not automatically follow a finding of patent infringement.

MercExchange, L.L.C., held a business method patent for an electronic marketplace operated by a trustworthy, central authority and structured to facilitate the exchange of goods between private buyers and sellers. The technology company attempted to license its patent to eBay Inc. and Half.com, Inc., both of which operated websites that displayed listings of goods for sale by private sellers. Negotiations failed, and the websites continued business as usual.

MercExchange filed suit against eBay and Half.com in the United States District Court for the Eastern District of Virginia, alleging patent infringement. A jury found that MercExchange’s business method patent was valid and had been infringed by eBay and Half.com. The district court awarded damages but denied the patent holder’s motion for permanent injunctive relief. In supporting its decision, the court found that MercExchange would not suffer an irreparable injury if an injunction was not awarded. The district court reached this conclusion based on MercExchange’s “willingness to license its patents” and “its lack of commercial activity in practicing the patents.”

On appeal, the United States Court of Appeals for the Federal Circuit reversed in part, holding that the district court had abused its discretion by not awarding permanent injunctive relief. The Federal Circuit relied on its “general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances.” Finding the district court’s analysis unpersuasive, the Federal Circuit saw no reason to depart from this standard practice.

The United States Supreme Court vacated the judgment of the Federal Circuit, holding that both lower courts had failed to properly apply equitable principles. Specifically, the Court held that the traditional four-factor test for permanent injunctive relief must be applied to disputes arising under the Patent Act. The district court erred by denying injunctive relief based on the patent holder’s desire to license its patent and its decision not to commercially practice the invention. Such broad classifications avoid the detailed analysis required by the principles of equity. The Federal Circuit erred by applying its “general rule” for permanent injunctions and ignoring the traditional equitable principles altogether. Consequently, the Supreme Court remanded so that the district court may correctly apply the four-factor test in determining whether permanent injunctive relief is appropriate.
In reaching its decision, the United States Supreme Court relied on “well-established principles of equity.” The Court noted that a significant departure from these principles should not be merely implied by the courts. Accordingly, the Supreme Court reasoned that absent clear congressional intent to the contrary, the general four-factor test applies to disputes arising under the Patent Act. The Act contains no indication that Congress intended to create a unique rule governing permanent injunctions in patent disputes. Moreover, the Patent Act states that courts “may grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent . . . .” Therefore, the Federal Circuit’s “general rule” for permanent injunctions has no apparent statutory basis in the Act, and the traditional four-factor test applies to disputes arising under the Act.

The Supreme Court’s comparison of patents and copyrights lends further support for the application of the four-factor test to patent disputes. Both patents and copyrights, as defined by their respective acts, are forms of personal property. As such, patent holders and copyright holders possess the “right to exclude others” from interfering with their property. Both the Patent Act and the Copyright Act state that courts may award injunctive relief according to traditional equitable principles when that right has been violated. Thus, mirroring its past treatment of injunctions under the Copyright Act, the Supreme Court held that the four-factor test similarly applies to disputes arising under the Patent Act.

The eBay decision marks an end to the longstanding presumption that a permanent injunction automatically follows a finding of patent infringement. The Supreme Court’s unanimous ruling makes it clear that injunctions in patent disputes will be more difficult to obtain under the traditional four-factor test. The two concurring opinions, however, suggest that the application of the test is somewhat uncertain in the context of modern patent enforcement. After eBay, the possibility of obtaining a permanent injunction remains, but the likelihood of doing so has been significantly reduced. Patent holders, alleged infringers, and the attorneys who represent them must understand the practical effects of eBay and plan their patent strategies accordingly.

By Kevin Hartley

In Gore v. Stout, the Tennessee Court of Appeals analyzed the elements necessary for the creation of a public road by implication and the elements needed to establish a prescriptive easement. The court also addressed the difference between a prescriptive easement and the acquisition of property by adverse possession. In doing so, the court held that creation of a public road necessitates dedication by public use. The court also stated that a party may tack on the adverse use of land under a predecessor’s title to meet the twenty-year period necessary to establish a prescriptive easement. Moreover, the court explained that adverse possession differs from a prescriptive easement in that adverse possession is asserted to acquire title in or possession of land while a prescriptive easement is claimed for the right to use land.

In 1980, Jon Johnson purchased land in Putnam County, Tennessee, where he and his friend, Willard Gore, spent time hunting. To access this property, Johnson often used a route that crossed land owned by Tony Stout. In 1996, Gore purchased a piece of this land from Johnson. Because the land was not easily accessible, Gore accessed the property via the route across Stout’s land. Gore had used this route from 1980 through 1996 on his hunting trips with Johnson, and he continued to use the route from his purchase of the land in 1996 until July 2001. In July 2001, Stout confronted Gore about his use of the route. In 2003, Stout informed Gore that he planned to block the route leading across his land to Gore’s land, an act that would essentially prevent Gore from accessing his land.

Gore filed suit in an attempt to preserve access to the route across Stout’s property. The trial court ruled that the route was a public road by implication, that Gore had a prescriptive easement to use it, and that Gore had an easement by adverse possession. Stout appealed.

On appeal, the Tennessee Court of Appeals held that the route was not a public road by implication. To create a public road by implication (i) the landowner must express an intent to dedicate the road to the public and (ii) the public must
either expressly or impliedly accept the road. The court determined that the
evidence presented by Gore did not establish Stout’s intention to dedicate the route
to public use. Thus, the court reversed the trial court and held that the route was not
a public road by implication.

Additionally, the court ruled that Gore did not have a right to use the route
as a result of adverse possession. The court reasoned that an easement is not an
interest in the ownership of real property, but a claim for the use of property. Further, the court recognized a difference between the exercise of possession and
amount of control necessary to establish adverse possession and the continuous use
element of a prescriptive easement. Thus, the court also reversed the trial court’s
holding that Gore had the right to use the route based on adverse possession.

However, the court affirmed the trial court’s ruling that Gore acquired a
prescriptive easement to use the route crossing Stout’s land. Under Tennessee law,
the creation of a prescriptive easement occurs when “the use and enjoyment of the
property [is] adverse, under a claim of right, continuous, uninterrupted, open, visible, exclusive, with the knowledge and acquiescence of the owner of the servient
tenement, and [ ] continue[s] for the full prescriptive period.” In making its
determination, the court addressed three issues: (1) whether use of the route had
occurred for the full prescriptive period; (2) whether Gore’s possession
was adverse, hostile, and under a claim of right; and (3) whether use of the route had been
sufficiently continuous.

The first issue was whether Gore could add Johnson’s prior adverse use of
the route onto his adverse use to satisfy the required twenty-year period. The court
held that Gore could do so. Tennessee law allows a buyer to use parol evidence to
prove that he or she reasonably relied on representations made by the seller that the
transfer of land includes the right to use property that the seller previously used
adversely. The court reasoned that because the route across Stout’s land represented
the only reasonable way for Gore to access his property, he and Johnson understood
that when he purchased the land he would retain a right to use the route.

The second issue was whether Gore’s possession had been adverse, hostile,
and under a claim of right. The court reasoned that Gore adversely used the route
because he had neither requested nor received permission to use the route. Further,
the court found it persuasive that Gore or Johnson maintained the route and used it
regularly and visibly for twenty-three years with no objection by Stout. The court
deemed this use sufficient to put Stout on notice that Gore and Johnson asserted a
hostile claim on his land. As such, the court stated that if Stout wanted to prevent
Gore from attaining a prescriptive easement over the route, he should have objected
to Gore’s use at an earlier time.
The third and final issue the court addressed was whether Gore's use of the route was continuous. Stout conceded that Gore's use since 1996 was continuous; thus, the court only needed to determine whether Johnson's use from 1980-1996 had been continuous. The court stated that determinations of continuous use must be based on the unique circumstance of each case. The court held that even though the frequency of Johnson's use fluctuated, the use was continuous given the circumstances of the case.

Based on its determination of these three issues, the court affirmed the trial court's holding that Gore had a prescriptive easement to use the route crossing Stout's land. In view of Gore v. Stout, landowners should remain vigilant of hostile claims to their land. Lawyers should advise landowners to object to hostile claims against their land in a timely manner to prevent the claim from rising to the level of a prescriptive easement. If landowners do not object to such hostile claims, they may forfeit their right to control access to their land.

**Tax Law**

Because ordinary investment advisory fees incurred by a trust or estate are also commonly incurred by individuals, such fees are only tax deductible to the extent that they exceed 2% of the adjusted gross income, as mandated in § 67(a) of the Internal Revenue Code. Knight v. Comm'r, 128 S. Ct. 782 (2008).

By Jennifer Simons

Investment advisory fees are considered “miscellaneous itemized deductions” under I.R.C. § 67(a) and are deductible only to the extent that they exceed 2% of the adjusted gross income (the “2% floor”). Under § 67(e)(1), costs incurred in the administration of trusts or estates are not subject to the 2% floor. In Knight v. Commissioner, the Supreme Court addressed whether investment advisory fees incurred by a trust or estate are subject to the 2% floor of § 67(a) or exempt as administrative costs under § 67(e)(1). The Court held that investment advisory fees incurred by a trust or estate are subject to the 2% floor if they are fees for advisory services commonly rendered to individuals; but that additional advisory fees specific to fiduciary accounts may be fully deductible as administrative costs.

Michael Knight, trustee of the William L. Rudkin Testamentary Trust (the “Trust”), hired Warfield Associates, Inc., an investment advisory firm, in 2000 to advise him concerning investing the assets of the Trust. The Trust, which held approximately $2.9 million in marketable securities at the beginning of the tax year, paid Warfield Associates $22,241 for the services. On its 2000 income tax filing, the
Trust reported an income of $624,816 and deducted the full amount of Warfield Associates’ advisory fees. The Commissioner of Internal Revenue conducted an audit and found that the fees were subject to the 2% floor, resulting in a tax deficiency of $4,448.

The Trust petitioned the United States Tax Court, arguing that a trustee’s duty to act as a “prudent investor” under the Uniform Prudent Investor Act requires the trustee to obtain investment advisory services, and such fees are therefore unique to trusts and fully deductible. The Tax Court rejected this argument and ruled in favor of the Commissioner, holding that such fees are subject to the 2% floor because full deduction under § 67(e)(1) applies only to expenses that are uncommon outside the area of trusts. On appeal, the Second Circuit affirmed the Tax Court’s decision, holding that costs are fully deductible only if individuals are “incapable” of incurring them. The Trust appealed the Second Circuit’s decision to the United States Supreme Court.

The Supreme Court affirmed, holding that the investment advisory fees incurred by the Trust were subject to the 2% floor because they were fees for the same type of services commonly obtained by individuals and that Warfield Associates had not charged fees for any special fiduciary services that were subject to the § 67(e)(1) exemption. However, the Supreme Court determined that the test for deciding whether expenses are fully deductible is not whether such costs are “incapable” of being incurred by individuals, but instead whether they are “commonly” or “customarily” incurred by individuals. In adopting this test, the Court looked primarily to the language of the statute.

I.R.C. § 67(e)(1) states that the exemption from the 2% floor applies only to costs incurred in the administration of an estate or trust “which would not have been incurred if the property were not held in such trust.” The Court rejected the Trust’s interpretation of the statute as a causation test of whether the cost was incurred due to the property being held in trust, noting that such interpretation would allow full deduction of all costs incurred by a trust. The Court also found that the question is not whether an individual could have incurred the cost, as stated by the Second Circuit, because Congress used the word “would” instead of “could” in the statute. After closely examining the statutory language, the Court found that the best interpretation of the statute was the test previously adopted by the Fourth and Federal Circuits: “Costs incurred by trusts that escape the 2% floor are those that would not ‘commonly’ or ‘customarily’ be incurred by individuals.”

Individual taxpayers commonly hire investment advisers and incur their fees. As such, the Court concluded that the fees incurred by the Trust in this case do not qualify for exemption from the 2% floor of § 67(a). If Warfield Associates had
charged a special additional fee for fiduciary-related advisement, such a fee would be fully deductible under § 67(e)(1). However, the record in *Knight v. Commissioner* indicated that the fees charged by Warfield Associates were for common investment advisory services—not for fiduciary-specific services. The Court also noted that a trust with an unusual financial objective or abnormal circumstances could require expert advice, and that the incremental cost of such advice beyond the cost of ordinary services offered to individuals would be exempt from the 2% floor of § 67(a).

Prior to the Supreme Court’s decision in *Knight v. Commissioner*, the Federal Circuit Courts were divided on this issue, with the Sixth Circuit holding in 1993 that investment advisory fees incurred by trusts and estates are fully deductible. *Knight v. Commissioner* overturns the Sixth Circuit’s 1993 ruling and settles the discrepancy, while also providing statutory interpretation and a test for determining which costs are deductible. The case also spells out a loophole for trusts, providing that the 2% floor of § 67(a) of the Internal Revenue Code can be avoided by obtaining fiduciary-specific investment advisory services. The Court complicates the loophole, however, by indicating that fees for specialized services will only be fully deductible in the amount that they exceed “what would normally be required for the ordinary taxpayer.”

In evaluating the reasonableness of treasury regulations, Third Circuit Federal Courts will apply the Supreme Court’s deferential *Chevron* analysis rather than its stringent *National Muffler* analysis. *Swallows Holding, Ltd. v. Comm’r*, 515 F.3d 162 (3d Cir. 2008).

By Jennifer Neal

When a statute is ambiguous, the court must determine whether an agency’s regulations are reasonable in light of the statutory language. The United States Supreme Court developed tests in both *National Muffler Dealers Ass’n v. United States*, 440 U.S. 472 (1979), and *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984), to determine whether federal administrative agency rules and regulations are reasonable in light of their enabling statute. However, the Court has not resolved apparent discrepancies between the two tests. In *Swallows Holding, Ltd. v. Commissioner*, the United States Court of Appeals for the Third Circuit confronted inconsistencies inherent in the tests and adopted the *Chevron* deference for agency regulations.
Swallows Holding, Ltd. v. Commissioner involved a Barbados corporation ("Swallows Holding") that owned rental property in San Diego from 1993-1996 but neglected to file United States tax returns for the relevant tax periods until 1999. When Swallows Holding filed its tax returns for 1993-1996, the corporation claimed deductions for real property activities. The statute allowing business expense deductions for real property activities was silent as to time limitations but included the term "manner." In a treasury regulation, the Secretary of the Treasury proscribed that returns falling under the statute must be filed within eighteen months or the deductions would be disallowed. Treas. Reg. 1.882-4(a)(3)(i). Because Swallows Holding failed to file its tax return within eighteen months of the due date, the Commissioner assessed tax deficiencies for 1994-1996.

Following the assessment, Swallows Holding filed suit in the United States Tax Court. The Tax Court determined that the Supreme Court did not intend for Chevron to supplant National Muffler. Therefore, the court considered the six-part inquiry from National Muffler and concluded that the treasury regulation was unreasonable. Because Congress failed to include the term "time" in the statute in question, the court looked to similar statutes involving "manner" that also included "time." The court concluded that the legislature included the term "time" in statutes where it intended the term to apply. Therefore, the court found the statute unambiguous on its face but nonetheless applied the National Muffler test.

In its analysis, the Tax Court determined that National Muffler and Chevron involved the same essential inquiry. National Muffler involved a six-part test which required the court to consider the following:

1. whether the regulation is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent; 2. the manner in which a regulation dating from a later period evolved; 3. the length of time that the regulation has been in effect; 4. the reliance placed upon the regulation; 5. the consistency of the Secretary’s interpretations; and 6. the degree of scrutiny Congress has devoted to the regulation during subsequent reenactments of this statute.3

Because the regulation failed several parts of the National Muffler test, the Tax Court concluded that the regulation was an unreasonable exercise of power and ruled in favor of Swallows Holding.

3 Swallows Holding, 515 F.3d at 166 (citing Nat'l Muffler Dealers Ass'n v. United States, 440 U.S. 472 (1979)).
The Court of Appeals considered whether the Tax Court erred in concluding that *Chevron* and *National Muffler* produced the same result. Essentially, the *Chevron* analysis involved a two-part inquiry that affords federal agencies broad discretion when the statute is ambiguous. Under the first prong of *Chevron*, the court must determine whether a statute is ambiguous. Under the second prong, the court considers whether the agency’s interpretation is a “permissible construction” of the statute; the interpretation does not have to be the only interpretation or the interpretation the court would have selected if confronted with the question. Ambiguities within statutes are considered “implicit congressional delegation” of authority. If the court determines that the statute is unambiguous, then the court never considers the second prong of the test; the agency’s actions are deemed unreasonable and an impermissible exercise of authority.

To determine whether the statute in *Swallows Holding, Ltd. v. Commissioner* was ambiguous, the court considered the fact that other courts had “struggled over whether ‘manner’ included[d] a timing element.” Additionally, other sections of the code involving the term “manner” lacked the term “time.” In some instances, the statutes were interpreted to imply a time element, but in other instances, the court reached the opposite conclusion. Consequently, the statute contained ambiguities, requiring the court to consider the second prong of *Chevron*.

Regarding the second prong of *Chevron*, the court confronted several inconsistencies in the *National Muffler* and *Chevron* tests. The Court of Appeals found that the Tax Court relied heavily on factors that were not dispositive or mandatory under *Chevron*; therefore, it conducted its own analysis of the *Chevron* factors. Applying the second prong of *Chevron* to the facts of the case, the Court of Appeals concluded that the treasury regulation was a reasonable, permissible construction of the enabling statute. *Chevron* deference becomes more appropriate in cases involving complex areas of the law, and tax law undoubtedly falls within the category. Because the regulation allowed a reasonable timeline for filing a tax return and the treasury regulation was a valid exercise of the Secretary’s rule-making authority, the Third Circuit vacated the Tax Court’s order and remanded the case.

The decision in *Swallows Holding, Ltd. v. Commissioner* clarifies that courts in the Third Circuit will defer to a federal agency’s rules when a statute is ambiguous as long as the agency’s interpretation is reasonable. Such a result implies that treasury regulations and similar administrative rules will carry greater weight in the future unless they are clearly inconsistent with their enabling statutes. In light of *Swallows Holding, Ltd. v. Commissioner*, attorneys challenging federal administrative rules or regulations should be aware that a court will not invalidate regulations simply because the court would have interpreted the statute differently.