
By Aaron Lay

Generally, arbitration agreements are enforceable except upon the grounds as exist at law or in equity for the revocation of any contract. The United States Court of Appeals for the Sixth Circuit in *Cooper v. MRM Inv. Co.* reversed a decision of the Tennessee district court that held an employment-contract arbitration agreement invalid on five grounds.

MRM, a Kentucky Fried Chicken (“KFC”) franchisee, required Cooper to sign a document providing that all claims against KFC would be arbitrated within the rules of the American Arbitration Association (“AAA”). Her assent to this clause was a prerequisite to being hired as an assistant manager. Cooper later quit as a result of alleged sexual harassment and filed a complaint. The Tennessee district court held the arbitration agreement invalid.

Noting that the Supreme Court has roundly endorsed arbitration and explained its benefits in the employment law context, the United States Court of Appeals addressed each issue the district court raised when invalidating the agreement.

The court first addressed the issue of whether under Tennessee law, the arbitration agreement was a contract of adhesion. In Tennessee, a contract of adhesion is created when 1) a standardized form is offered on a “take it or leave it” basis and 2) the party in the weaker bargaining position has no meaningful alternatives if they do not sign. The court found that the agreement met the first element, but that Cooper did not show that she would be unable to find suitable employment if she did not sign.

The second issue is whether the arbitration agreement was unconscionable. Tennessee recognizes two types of unconscionability: substantive and procedural. To prove procedural unconscionability, a party must show that it did not have the opportunity to understand the terms of the contract. The district judge made no such finding. Additionally, no finding was made that Cooper had far inferior bargaining power when the agreement was signed. Without this finding, there was no substantive unconscionability.
The third issue presented is whether the district court erred in finding that the agreement lacked sufficient bilateralism. An arbitration agreement is bilateral if it requires both parties to arbitrate claims arising in their relationship, which this agreement did.

The fourth issue under consideration is whether the lack of express waiver of right to jury trial would render the agreement invalid. According to the appellate court, the loss of a jury trial is a “necessary and fairly obvious” consequence of the arbitration agreement. Further, the Seventh Amendment does not confer the right to a jury trial per se, but only the right for a jury to hear the case if it proceeds to a court of law. The agreement in this case was simple and embodied on a separate document, being one of four presented for signing. Cooper most likely knew that by signing, she was waiving her right to a jury trial.

The district court’s final ground for finding the arbitration agreement invalid was that arbitration would be prohibitively expensive. The court of appeals determined that this claim had potential merit based on AAA rules. MRM’s offer to pay the costs of the arbitration was not dispositive.

The AAA has since amended its rules and now requires employers to pay for all up-front costs, except for a small filing fee and the costs of an employee's witness. The appellate court remanded to the district court to review the agreement under the new AAA rules.

We can surmise from Cooper that arbitration will be legitimately accepted as a tool for dispute resolution for employment conflicts. An arbitration agreement will be analyzed under the same invalidating factors as contracts are analyzed. Cooper resolved whether unequal bargaining power alone would invalidate an arbitration agreement as well as the need for an express agreement. We can conclude from this case, that as a precaution, arbitration agreements should contain a severability clause, so that terms that would otherwise invalidate the agreement could be removed. It is likely that the question of prohibitive costs has been resolved by the change in AAA rules, making arbitration agreements a likely fixture in future employment agreements.

By Laura M. Williams

Individual Retirement Accounts (“IRAs”) can be exempted from a bankruptcy estate pursuant to Section 522(d)(10)(E) of the Bankruptcy Code. Upon filing for bankruptcy, all interests in the debtor’s property are transferred to the bankruptcy estate. However, Section 522 of the Bankruptcy Code allows the debtor to retain certain interests in property. Section 522(d)(10)(E) exempts from the bankruptcy estate a “right to receive ... a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of ... age.” The United States Supreme Court granted certiorari in *Rousey v. Jacoway* to discuss this very issue.

In *Rousey*, Richard and Betty Jo Rousey (“the Rouseys”) were terminated by their employer and were required to collect the sums from their pension plans. The Rouseys deposited the sums into two separate IRAs. Several years later, the Rouseys filed a Chapter 7 bankruptcy petition. The Rouseys asserted that the IRAs were exempt from the bankruptcy estate under Section 522(d)(10)(E) of the Bankruptcy Code. Jill Jacoway (“Jacoway”), the Court-appointed Trustee, objected to the Rouseys’ claim for exemption of the IRAs and moved to have the IRAs included in the bankruptcy estate. The Bankruptcy Court granted Jacoway’s motion.

On appeal, the Bankruptcy Appellate Panel agreed with the Bankruptcy Court that the Rouseys’ IRAs could not be exempt under the Bankruptcy Code. The BAP held that the IRAs were not similar plans or contracts to stock bonuses, pensions, annuities, or profit-sharing plans. Further, the Bankruptcy Appellate Panel also held that because the Rouseys had unlimited access to and control over the accounts, the IRAs were not conditioned on account of any factor listed in Section 522(d)(10)(E).

The Court of Appeals for the Eighth Circuit affirmed the BAP’s decision. The Court of Appeals held that even if IRAs were similar plans or contracts, they were not conditioned on any factor found in Section 522(d)(10)(E) of the Bankruptcy Code. Also, the Court of Appeals held that the IRAs were accessible to the Rouseys, much like savings accounts, which are not exempt from the bankruptcy estate. The United States Supreme Court granted certiorari to review the issue.
IRAs must meet three requirements under the Bankruptcy Code to be exempt from the bankruptcy estate. First, the right to receive payment must be from “a stock bonus, pension, profit-sharing, annuity, or similar plan or contract.” Second, the right to receive payment must be “on account of illness, disability, death, age, or length of service.” Finally, the right to receive payment is only exempt to the extent necessary to support the accountholder or the dependents.

The Supreme Court first examined whether the Rouseys’ IRAs provided a right to payment on account of age. The Court interpreted “on account of” to mean “because of.” Thus, Section 522(d)(10)(E) requires that the right to receive payment be because of “illness, disability, death, age, or length of service.” Although the Rouseys’ have a “non-forfeitable right to the balance” of the IRA accounts, this right is subject to a ten percent tax for any withdrawal before the age of fifty-nine and one half years. The Court, finding that the Rouseys’ right to payment of the IRAs was on account of age, held that the ten percent penalty was significant and substantial.

Next, the Supreme Court addressed whether the Rouseys’ IRAs were similar to plans or contracts within the meaning of Section 522(d)(10)(E) of the Bankruptcy Code. To qualify as similar, the IRAs must contain “common characteristics” to the plans or contracts listed in Section 522(d)(10)(E), which provide a substitute for wages earned during employment. The Court held that the Rouseys’ IRAs are similar and thus, exempt from the bankruptcy estate.

As Rousey illustrates, IRAs not only receive favorable tax treatment, but also favorable treatment in bankruptcy proceedings. The Internal Revenue Code allows tax to be deferred on an IRA until the sum is withdrawn. Also, IRAs similar to the Rouseys’ (those that meet the requirements of Section 522(d)(10)(E) of the Bankruptcy Code) will be exempt from the bankruptcy estate. Debtors will thus be able to keep income in an IRA that might otherwise become part of the bankruptcy estate and be distributed among creditors. A transactional attorney is well advised to counsel his clients to accumulate money in IRAs and other Section 522(d)(10) qualified instruments to receive positive tax and bankruptcy treatment while still maintaining control over the investment of these funds.

By Caitlin E. Shockey

Fiduciaries have a duty to disclose company information to employees participating in a pension benefit plan, despite their fears of insider trading liability. In *Gee v. UnumProvident Corp.*, UnumProvident Corporation (“UnumProvident”), a large provider of disability insurance, provided a pension benefit program called UnumProvident 401(k) Retirement Plan (“The Plan”) to give employees the opportunity to save and invest for retirement. Gee and Scanlon, along with others, owned UnumProvident stock and participated in The Plan.

Plaintiffs claim that UnumProvident had discretionary power over The Plan and its assets, and thus had a fiduciary responsibility to The Plan’s participants. By making false public statements of its financial situation through press releases, financial reports through the Securities and Exchange Commission (“SEC”), and their annual report to the SEC, UnumProvident imprudently encouraged participants to invest in UnumProvident stock that looked more attractive than it truly was. The complaint alleges UnumProvident’s net aggregate income between 2000 and 2002 was overstated by $29.1 million. Plaintiffs allege Defendants knew or should have known that a UnumProvident stock investment was “inaccurate, incomplete, and materially misleading.” By failing to disclose this to Plan participants, Defendants breached their fiduciary duty.

Defendants moved to dismiss for failure to state a claim upon which relief can be granted, claiming that sharing knowledge of material, nonpublic information would constitute insider trading in violation of federal securities laws. Further, Defendants state that they have no duty under the Employee Retirement Income Security Act of 1974 (“ERISA”) to disclose actual or potential events that could affect the value of the stock. 29 U.S.C. § § 1001 – 1461. Defendants point out that they are not accused of making any affirmative misrepresentations in accordance with The Plan.

ERISA promotes and protects employee benefit plans by imposing obligations and restricting the discretionary powers of those that assume fiduciary responsibilities. These duties are breached when a fiduciary provides materially
misleading information, regardless of intent. The complaint alleges, and the court agrees, that Defendants are ERISA fiduciaries.

Defendants claim that sharing inside information to Plan participants would violate insider trading laws, but the Court held that “the potential liability for violations of securities laws cannot shield a fiduciary from suit over his alleged failure to perform his ‘quite separate and independent ERISA obligations.’” Duties under one federal statute will not preclude duties of another.

The Gee court requires company officials and plan fiduciaries to disclose private, material information to the investing public generally, which includes Plan participants. ERISA allows Plan participants and beneficiaries to bring a cause of action against fiduciaries who, despite actual knowledge of information questioning an investment’s prudence, fail to share this knowledge with those whose financial future depends on The Plan. Although complying with ERISA may subject Defendants to liability for insider trading, it is not enough to negate their fiduciary obligations. By not disclosing information to both the participants and the public, UnumProvident is therefore subject to both ERISA and federal securities laws.

Defendants argue that no affirmative misrepresentations were made in the management of The Plan. Defendants also claim that all statements were made in a corporate, not a fiduciary, capacity. The court, however, held that an ERISA fiduciary cannot give misleading information in any form, including SEC filings. Because UnumProvident was to provide Plan participants with SEC information, Plaintiffs sufficiently alleged that the Defendants, acting in their fiduciary capacity, disseminated materially misleading information to them.

The District Court’s sole issue was whether the Plaintiffs alleged sufficient facts for a cause of action. The court found that the Plaintiffs had met their burden, and thus, denied Defendants’ motion to dismiss.

Gee illustrates the importance of a fiduciary’s duty to act in the best interests of those he or she represents. Fiduciaries are expected to follow the laws and not to undermine them. As this case demonstrates, a fiduciary duty requires a representation of the best interests of Plan participants, even if this representation is not in the company’s best interest.
S Corps and Child Support: What the Majority Shareholder Needs to Know.

By Emily Tumbrink Brackstone

When a married couple decides to divorce, financial issues inevitably become important. Not only must the couple’s assets be divided, but child support payments must be determined. Because child support payments are based on a specific percentage of income, they are easily calculable when the obligor has a fixed salary. However, when the obligor is self-employed, particularly when he or she is the sole or majority shareholder of a closely-held corporation, the calculation becomes increasingly more difficult.

In *Taylor v. Fezell*, the Tennessee Supreme Court resolved the issue of “whether the retained earnings of an S corporation should be treated as income to the sole or majority shareholder of the corporation for the purposes of calculating child support.” Mr. and Mrs. Fezell had two children when they divorced in 1999. Mrs. Fezell received primary custody of the children, and Mr. Fezell was required to make child support payments. He was the sole shareholder of Professional Vending Services (hereinafter “PVS”) at the time the suit was instituted. PVS was registered with the state as an S corporation until 2001, at which time it was converted to a C corporation. While PVS was an S corporation, Mr. Fezell’s taxable income included the company’s retained earnings. When Mr. Fezell converted PVS to a C corporation, his taxable income no longer included PVS’s retained earnings.

After converting PVS to a C corporation, Mr. Fezell filed a post-divorce action seeking a reduction in his child support payments. The trial court used Mr. Fezell’s tax returns from the three years prior to trial to determine his income for the purposes of calculating his payments. Two of those tax returns were from years that PVS was an S corporation, and included PVS’s retained earnings as part of Mr. Fezell’s taxable income. The third return reflected the salary paid to Mr. Fezell from PVS as a C corporation. Based on these returns, the trial court increased Mr. Fezell’s monthly child support payments. He appealed. The Court of Appeals affirmed the trial court.

Mr. Fezell appealed to the Tennessee Supreme Court, arguing that the retained earnings of an S corporation should only be imputed as income in determining child support payments when “the retention of earnings is excessive or there is evidence that the obligor is actually manipulating his or her income.” The Supreme Court agreed, reasoning that this approach would base the child support payments on the shareholder’s actual income while protecting the corporation’s status as an independent entity.
In determining whether the retained earnings of an S corporation is excessive, the Supreme Court instructed lower courts to use the amount of earnings retained by the corporation prior to the divorce as a baseline. Any suspicious or unexplained post-divorce corporation activities should be considered. Expert testimony may be relevant to determine whether the amount of retained earnings is appropriate.

In determining whether the obligor is manipulating his or her income, “the court should closely examine personal expenses and economic benefits provided to the obligor by the corporation and should include the value of those extraordinary benefits in the obligor’s income calculation.” Other relevant factors may also be taken into consideration at the discretion of the trial court.

Because there was no showing that Mr. Fezell manipulated his income or that PVS’s retained earnings were excessive, the Supreme Court held that the trial court erred in imputing PVS’s retained earnings as Mr. Fezell’s income.

*Taylor’s* holding lessens the burden on sole or majority shareholders of closely-held S corporations who are paying child support. Because the retained earnings of the corporation are no longer imputed to shareholders as part of their income, child support payments may decrease as a result of this decision. However, in return for these lower payments, the corporation’s post-divorce activities will be closely scrutinized by courts. Therefore, any changes affecting retained earnings should be fully documented.

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**COMMERCIAL**


By Douglas M. Elkins

Disposition of a debtor’s collateral presents several pitfalls for unwary secured creditors. Under Tennessee’s version of Article 9 of the Uniform Commercial Code, a secured party may dispose of any or all of the debtor’s collateral in a commercially reasonable manner after default. Unfortunately for lenders, the phrase “commercially reasonable manner” provides little guidance. Indeed, where debtors challenge the commercial reasonableness of a disposition, the court engages in a fact specific inquiry that may deprive the secured party of a deficiency judgment.
In *R & J of Tennessee*, the president of Blankenship-Melton Real Estate, Inc. (“Blankenship”), entered into a loan agreement with the Bank of Henderson County (“the Bank”). In the loan agreement, Blankenship granted the Bank a security interest in personal property. Additionally, guarantee agreements were executed, making Blankenship and two associates liable on the loan.

Blankenship defaulted on the loan. The Bank foreclosed on some of the personal property and sold the remaining balance of the note to *R & J of Tennessee* (“R & J”) in November of 2001. R & J permitted continued use of the remaining personal property. Finally, in June 2002, R & J began foreclosure proceedings by notifying Blankenship that the remaining collateral would be sold at a public sale. Blankenship, however, never received the notice because he moved without notifying the Bank. Even though R & J never received a return receipt, they proceeded with the foreclosure sale and later sued Blankenship for the deficiency.

The Circuit Court entered a deficiency judgment against Blankenship. On appeal, Blankenship raised the issue of whether R & J gave Blankenship statutorily sufficient notice regarding the public sale under section 47-9-611(b) of the Tennessee Code Annotated. Under Tennessee's Article 9, the secured party shall send an authenticated notification of disposition to any secondary obligor, such as Blankenship. The official comment to the notice provision states that “the notification must be reasonable as to the manner in which it was sent, its timeliness (i.e., a reasonable time before the disposition is to take place), and its content.” Blankenship argued that the Code requires secured parties to prove that the secondary obligor actually received notice. The Court of Appeals held more narrowly that R & J’s notice was insufficient as a matter of law, based largely upon the fact that R & J proceeded with the sale without any indication as to whether Blankenship received notice.

The second issue was whether R & J conducted the sale in a commercially reasonable manner. Under Tennessee Article 9, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing. In carrying out the sale, the obligations of good faith and commercial reasonableness bind secured creditors and govern every aspect of the disposition. Also, the disposition should be in accordance with prevailing trade practices among reputable and responsible commercial enterprises. Consequently, the court determines compliance on a case by case basis.

In this case, Blankenship argued that the timing of the sale demonstrated that R & J failed to conduct the disposition in a commercially reasonable fashion. R & J
failed to act reasonably by delaying the sale for seven and one-half months after purchasing the note. The Court of Appeals agreed, noting that the comments to section 46-9-610 state that where a secured party holds collateral for a long period of time without disposing of it, a sale may not be commercially reasonable. The continued use of depreciable assets, moreover, not only failed to conform to sound trade practices, but also increased the amount of the deficiency. In addition, R & J failed to provide adequate public notice by either advertising in a public newspaper or utilizing an experienced auctioneer.

Upon determining that Blankenship did not receive adequate notice and that R & J failed to act in a commercially reasonable manner, the Court remanded the case to determine whether R & J was entitled to a deficiency judgment. R & J could recover the deficiency by virtue of the “rebuttable presumption rule,” which applies when a secured creditor fails to conduct a commercially reasonable sale. Under this rule, a presumption arises against the creditor, who must prove what amount should have been realized from a commercially reasonable sale. Failure to rebut the presumption results in denial of the secured creditor’s deficiency judgment and possible liability to the debtor. If the creditor sustains the presumption, however, then the rule offsets the deficiency.

R & J of Tennessee should put secured lenders on notice. The secured party, while granted broad rights concerning default and disposition, nonetheless remains subject to liability for failing to proceed in accordance with part six of Tennessee Article 9. While R & J of Tennessee sheds some light upon the steps that secured lenders in Tennessee should follow to provide notice to debtors and to dispose of collateral, the fact specific nature of such determinations remains risky.

**Contracts**

**Employment Contract Ambiguities Construed against the Employer.**


By Jennifer Rowlett

When an employment contract contains ambiguities regarding an executive compensation plan, the ambiguities will be construed against the employer, as the contract drafter. This was the situation presented in *Hopmayer v. Aladdin Industries*.

Hopmayer signed an employment agreement with Aladdin as Vice President of Sales. The agreement included a phantom unit plan in addition to the base salary.
A phantom unit plan essentially allocates shares in the company to an executive employee without offering voting rights or corporate dividends. Hopmayer’s contract specified that a phantom unit plan would be adopted by the Board of Managers in which he would receive 4,000 phantom units with an initial value of $40.00 per unit. In the agreement Aladdin stipulated that if Hopmayer were terminated, his severance package would include the amount of his last 12 months’ salary and bonus. After approximately eleven months of employment, Hopmayer was terminated as a result of corporate restructuring. Aladdin then informed Hopmayer that his phantom units had neither vested nor appreciated.

Hopmayer filed suit against Aladdin for breach of contract. The trial court held that the phantom unit plan included in the employment agreement was a valid contract and that the mutually agreed-upon plan did not provide for appreciation or vesting requirements. The court awarded Hopmayer $160,000.00, which was the amount equal to the 4,000 units at the initial value of $40.00 per unit, as well as prejudgment interest.

Aladdin raised three issues on appeal. The first issue was whether the trial court erred in holding that the offer of 4,000 phantom units to Hopmayer was sufficiently definite to be enforceable. In order to have a valid contract, there must be mutual assent of the parties to the terms. Adequate consideration, without fraud or undue influence, is also required. The terms must not contradict public policy and must be sufficiently definite to be enforced. The determination of mutual assent centers not on the subjective intent of the parties, but on whether the outward expression of assent by the parties is sufficient to form a contract.

Aladdin argued that the agreement was not sufficiently definite with regard to the phantom unit plan because many details were yet to be determined. Aladdin contended that the plan in Hopmayer’s agreement had not been adopted and thus the previous phantom unit plan applied. The earlier plan included vesting and appreciation requirements. The court determined, however, that Hopmayer had no knowledge of a phantom unit plan with vesting and appreciation requirements. Instead, Hopmayer’s knowledge was that he would receive $160,000.00, the value of the phantom units. The appellate court agreed with the trial court’s determination that the agreement constituted an enforceable contract. The outward expression of the parties’ assent was evidenced by the terms of the signed agreement. Therefore, there was mutual assent to the sufficiently definite terms.

The second issue before the court was whether the trial court erred in holding that the 4,000 phantom units were not subject to vesting requirements, and, if so, whether Hopmayer failed to meet those vesting requirements prior to his termination. The drafter of an employment agreement is responsible for avoiding
any ambiguity in the provisions. The court reasoned that Aladdin could have easily included vesting requirements within the language of the employment agreement to avoid ambiguities. Thus, the court affirmed the trial court’s decision that the agreement between Aladdin and Hopmayer was not subject to vesting requirements.

The third issue on appeal was whether the trial court erred in holding that Hopmayer was to receive the initial value, $160,000.00, rather than the appreciation value of the phantom units. Once again, ambiguities in a contract will be construed against the drafter. Just as with the vesting requirements, Aladdin could have included provisions regarding appreciation value in the employment agreement, but it did not. There was no evidence that Hopmayer had any other understanding of the phantom unit plan other than what was specified in the agreement. Therefore, the court affirmed the trial court’s holding that Hopmayer was to receive 4,000 phantom units with a value of $40.00 each without any appreciation requirements.

As Hopmayer illustrates, an employer, as the drafter of an employment agreement, must take responsibility for ambiguous provisions. The parties will be held to the terms of an employment contract determined by the outward expression of assent, even if one of the parties’ secret intent differs from the terms of the agreement. A court will not impose vesting or appreciation requirements onto an executive compensation plan where there is no evidence of such stipulations in the agreement or by the conduct of the parties. In order to avoid potential liability, transactional attorneys should advise employers to utilize sufficient clarity in the drafting of employment agreements.


By Scott Griswold

Where a buyer and a seller enter into an oral agreement for the purchase of real property, Tennessee’s statute of frauds is satisfied when only the seller, as the “party to be charged,” signs a writing that details the essential terms of the understanding. Tennessee’s statute of frauds, like most other jurisdictions, states that “no action shall be brought, . . . upon any contract for the sale of lands, . . . unless the promise or agreement, upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged . . . .” However, Tennessee’s Supreme Court, along with only one other
state, has construed that the “party to be charged” is always the seller and never the buyer. The Eastern Section of the Court of Appeals recently upheld this minority view in *Blair v. Brownson*.

In *Blair*, the plaintiff sold a parcel of real property with improvements to the defendant at an auction conducted by a local attorney. Following the sale, the attorney drafted a deed conveying the property in fee simple to the defendant. The plaintiff then signed the deed, but did not deliver it to the defendant. Subsequently, the defendant had the property appraised; however, the appraiser’s report stated the house was worth significantly less than the purchase price. As a result, the defendant responded with a substantially reduced offer for the property. The plaintiff demanded the original purchase price, but the defendant refused, announcing that he no longer wanted the property.

The plaintiff sued, seeking specific performance of the sale. In his answer, the defendant asserted the statute of frauds as an affirmative defense. Specifically, the defendant claimed that since the agreement was for the sale of real property and no writing or memorandum was executed by both parties, the oral agreement was unenforceable. The trial judge granted the plaintiff’s request for specific performance. The defendant appealed the order and raised the following issue for review: “whether the deed, which was drafted after the foreclosure sale and signed only by [the plaintiff], suffices to satisfy the statute of frauds.”

The statute of frauds requires that the writing must be “signed by the party to be charged therewith.” In *Blair*, the Court of Appeals held that the deed had been signed by the “party to be charged:” the seller. The Tennessee Supreme Court noted “that the rule is designed to ‘protect the owners of land from being drawn into hasty or inconsiderate agreements’ and to guard ‘against misunderstanding as to the nature and extent of such agreements.’” Thus, the Tennessee Supreme Court found that the legislative intent was to protect the owners of real property.

The defendant argued that although the requirement that only the seller sign the writing was intended to be used as a shield against claims from unscrupulous buyers, it should not be used as a sword against unsuspecting buyers. The Court of Appeals acknowledged that there was sparse case law governing this unique situation. Ultimately, the court found that, regardless of how logical the defendant’s argument was, any change in the law had to come from either the state Supreme Court or the General Assembly. Therefore, the writing was “signed by the party to be charged” and the deed satisfied the statute of frauds. Accordingly, the Court of Appeals affirmed the trial court’s order granting the plaintiff’s prayer for specific performance.
Blair offers many practical take-away points for transactional attorneys. First, while not applicable to parties purchasing real property at auction, in the traditional real property transaction involving an executory contract, buyers’ attorneys should insist on a provision in the executory contract expressly disclaiming any deeds not signed by both parties. By taking this precaution, attorneys should be able to deflect any fatal thrusts from sword-wielding sellers.

Second, if clients are considering purchasing real property at an auction, attorneys should advise them to obtain permission to enter the property beforehand and to have qualified persons inspect and appraise the property. Third, once the inspection and appraisal are in-hand, the clients should get pre-approved for financing from a lending institution, if needed. The clients will be able to bid with confidence that they are making an offer they can afford. Additionally, if any subsequent problems arise, the clients have legal recourse against the inspector and the appraiser.

As Blair illustrates, planning, clearly articulating protective clauses, and written agreements go a long way towards preventing future problems. Furthermore, the Court of Appeal’s decision is significant because it reaffirms Tennessee’s unique interpretation of the statute of frauds where only the seller of real property is required to sign a writing. It is important to note that on August 22, 2005, the Tennessee Supreme Court accepted the defendant’s application for permission to appeal. It is quite possible that the state Supreme Court accepted this case to review the continued validity of Tennessee’s minority interpretation. Considering that 48 states disagree with Tennessee’s current reading of the Statute of frauds, it is certainly possible that the Court of Appeals will be overturned, and Tennessee will fall in-line with the majority of states.


By Anica Conner

The parol evidence rule prevents a party from introducing extrinsic evidence of negotiations that occurred between the parties that were not included in a final, written form. However, in some circumstances the court may look beyond the final writing to interpret an ambiguously written agreement. This occurs when the only documentation between the parties is deficient and the parties’ conduct confirms the existence of additional terms.
In Office Furniture & Related Servs., Inc. v. United Construction Corp., a tornado ripped seventy-five percent of the tin off of the roof of a warehouse leased by Office Furniture & Related Services, Inc. (“Office Furniture”). Office Furniture’s insurance company (“Hartford”), contacted United Construction Corporation (“United”) to assess the damage, and to provide a repair estimate. According to United, it was instructed by Hartford to provide an estimate of the repairs necessary to put the roof back in the condition it was in before the tornado. In addition to the insurance funded repair work, the owner of the warehouse, Jesse Mayo (“Mayo”), requested a “change order work” to repair the roof beyond the tornado damage. Because the change order work exceeded the insurer’s responsibility, Mayo agreed to pay United the cost of the additional work.

The roof began to leak substantially just days after United completed the work. United was initially responsive to Office Furniture’s calls to rectify the problem, but later stopped responding. Office Furniture and Mayo filed suit against United alleging breach of contract, negligence, and violation of the Tennessee Consumer Protection Act (“TCPA”). The only documentation executed between the parties was the work authorization, which did not contain a description of the actual work, pricing, method of payment, or time limitations on the performance. It did not apply to the change order work, and no written agreement governing the change order work was ever signed. Mayo testified about conversations with the president of United, in which Mayo agreed to pay for the additional change order work.

Evidence showed that the roof leaked more after United’s repairs than it did before the tornado struck. The trial court found that United breached its contract by violating the warranty of workmanlike performance and made negligent representations under the TCPA. The plaintiffs were entitled to recover the amount paid to United for the roof, additional damages for furniture injured by the leaks, and attorney’s fees.

On appeal, United raised two issues. The first was whether the trial court erred in allowing parol evidence to expand the terms of the agreement, since United never agreed to produce a leak-proof roof. The second issue was whether United violated the TCPA.

The parol evidence rule prohibits extrinsic evidence which might contradict or alter the meaning of a complete, written agreement. If ambiguities in the agreement are evident, then parol evidence is admissible to explain the actual agreement. Because the only documentation governing the transaction between Office Furniture, Mayo, and United was deficient, the trial court admitted parol
A breach of contract and a violation of the TCPA are two separate causes of action. To violate TCPA, deception, misrepresentation, or unfairness must be proven, regardless of any breach of contract. While there was disagreement between the parties regarding the scope of work and warranty, a violation of the TCPA was not identified here. Because the appellate court was unable to find deception or unfair action, the trial court’s findings of a violation of the TCPA were reversed.

With regard to the plaintiff’s compensation, the work was so defective that the contract was found to be worthless. Therefore, the appellate court affirmed the judgment requiring United to pay the plaintiffs the cost of having the job redone and compensation for the damaged furniture.

As Office Furniture illustrates, if a written and signed contract lacks certainty it may not be sufficient to protect each party’s interests. To avoid this situation, transactional attorneys should encourage clients to reduce all oral negotiations and agreements to a final writing. Both parties should sign the contract, and if additional terms are discussed subsequent to the execution of the initial contract, the contract should be redrafted to integrate new terms. Thus, the final, unambiguous writing will completely define the transaction.

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By Elena Babaeva

Often when negotiating a multi-document transaction, the main document incorporates several other documents by reference. The Tennessee Supreme Court previously held that when a document is incorporated by reference in another document, those documents should be construed together and that a written contract does not have to be signed to be considered binding on the parties. In Staubach Retail Services-Southeast, LLC v. H. G. Hill Realty Co., the Tennessee Supreme Court affirmed those previous holdings and decided that an unexecuted brokerage agreement, incorporated by reference into an executed lease, constitutes an enforceable contract.
In Staubach, H.G. Hill Realty Company (“H.G. Hill”) retained a broker, Southeast Venture, LLC (“Venture”) to find a tenant for H.G. Hill’s property. Staubach Retail Services-Southeast, LLC (“Staubach”), a brokerage firm for dekor, Inc. (“dekor”) a home improvement retailer, contacted Venture expressing interest in the property. Subsequently, H.G. Hill and dekor entered into a “Built-to-Suit Retail Lease” (“lease”), where H.G. Hill agreed to construct dekor’s retail store on H.G. Hill’s property. A clause in the lease declared that the landlord, H.G. Hill, agreed to pay a brokerage commission to the brokers in accordance with an unexecuted separate agreement, which was attached to the lease as an exhibit and incorporated by reference into the signed main document. This agreement stated that the owner, H.G. Hill, agreed to pay half of the commission to the brokers upon execution of the lease and half upon occupancy by the tenant, dekor.

After the lease was signed, H.G. Hill paid the first installment of the leasing commission to the brokers. Once the building was built, dekor prepared it for retail use, but shortly before the first month’s rent was due, defaulted on the lease. Afterwards, H.G. Hill and dekor agreed to terminate the lease. However, Staubach believed it was owed the remainder of its commission and filed an action against H.G. Hill. Both the trial court granted and the Court of Appeals affirmed Staubach’s motion for summary judgment. H.G. Hill appealed, and raised issues as to whether an unexecuted brokerage agreement incorporated into an executed lease constituted an enforceable contract and whether the term “occupy” was synonymous with the payment of rent.

In Staubach, the parties never executed the separate agreement referenced in the lease, but they did sign the main agreement expressly incorporating the agreement. H.G. Hill argued that they did not assent to the unexecuted brokerage agreement and that the second installment of the commission was due only when dekor would “occupy” the building, which meant paying rent. Staubach and Venture, however, argued that H.G. Hill showed their assent to the brokerage agreement by paying the first installment of the commission.

The Tennessee Supreme Court agreed with Staubach and concluded that the brokerage agreement was a binding contract. They further held that if H.G. Hill disagreed with the terms of the brokerage agreement, they should not have signed the lease. Also, the court held that dekor indeed occupied the building, by defining “occupancy,” as “to occupy or take actual possession of the premises.” The court deemed dekor’s acts of hiring employees, changing locks, and installing fixtures to be sufficient for establishing dekor’s occupancy.

The Staubach decision did not extend the law markedly from previous holdings. The court combined and slightly altered previous holdings, concluding
that an unexecuted brokerage agreement is a valid contract when it is incorporated into an executed lease. Therefore, this decision reiterates the necessity of reading legal documents thoroughly, and, if a document is referenced determining whether that document was truly agreed to in the preliminary negotiations. Another issue that arose out of this decision was the dispute that H.G. Hill raised over the definition of the word “occupy.” If H.G. Hill genuinely counted on the word “occupy” to be synonymous with the words “to pay rent,” then H.G. Hill should have included that interpretation in the lease. Cautious practitioners should enumerate all of their desired conditions before fulfilling their contractual obligations to ensure that the court will recognize their interpretation of the terms.

In conclusion, following the decision of Staubach, transactional lawyers should warn their clients that any expressly referenced agreements are going to be effective even if unexecuted. They should also warn their clients that if they would like certain conditions to occur prior to their contract performance, then they should enumerate those conditions exactly rather than relying on general terminology.

**INSURANCE**

**Seventh Circuit Upholds Anti-Stacking Clauses.** *Grinnell Select Insurance Co. v. Baker*, 362 F.3d 1005 (7th Cir. 2004).

By Leland C. Abraham

In the insurance context, an anti-stacking clause is a provision prohibiting multiple coverage for one incident. Absent ambiguity, an anti-stacking clause on the declarations page of an insurance policy will be upheld by courts. Some Illinois courts have held, however, that when the declarations page of a policy contains the language “insurance is provided where a premium is shown,” the policy is ambiguous because an insured might interpret the language “insurance is provided” to allow stacking of policy limits. Most other courts have enforced clear anti-stacking clauses. These courts have generally conceded that the anti-stacking clause in the policy is unambiguous. This was the situation in *Grinnell Select Insurance Co. v. Baker*.

In *Grinnell*, Martha Baker (“Baker”) and Sheena George (“George”) were involved in an automobile accident. Baker sued George in an Illinois court following the accident. George was insured by a policy underwritten by Grinnell Select Insurance Co. (“Grinnell”). The policy insured two of the Georges’ cars. The policy set $100,000 as the per-person, per-accident maximum coverage. Baker and the Georges contend that Grinnell’s insurance exposure is $200,000 instead of the
$100,000 limit. They contend that each of the Georges’ two cars contributed its own limit which may be “stacked” for double coverage.

After removal to a federal district court, summary judgment was entered in favor of Baker and the Georges. On appeal, Grinnell relied on two anti-stacking clauses in the insurance policy. The first clause states that one injured person is matched against the limit of liability shown in the declarations as opposed to multiple limits. The second clause states that $100,000 is the most the insurance company will pay - no matter the number of insureds, claims made, premiums or vehicles involved. Taken together, these clauses prohibit the stacking of limits to provide double coverage.

In Grinnell, the Seventh Circuit anticipated how the Illinois Supreme Court would dispose of this issue. The policy that Grinnell issued, including the anti-stacking clauses, is the standard liability form devised by the Insurance Services Office and is used across the nation. All states, with the exception of Illinois, have interpreted these clauses to foreclose stacking.

If the assumption that the declarations page is ambiguous is correct, it still does not justify stacking unless the anti-stacking clause is to be read out of the policy. The purpose of the anti-stacking clause is to state that even if some other clause suggests the possibility of stacking, that is not what the policy means. The clause serves as a “disambiguator.” To see ambiguity does not justify overriding the anti-stacking clause.

The Seventh Circuit found that if a policy covers two cars and multiple drivers, it is twice as likely to be called upon as a policy covering one car and one driver. The separate premium compensates the insurer for this marginal risk. Further, the anti-stacking clause makes clear that adding a car to the policy increases the number of vehicles covered, but not the limits for any one car or accident.

As Grinnell illustrates, a clear and explicit anti-stacking clause will prohibit the stacking of insurance coverage limits. Illinois stands as the lone jurisdiction to hold an anti-stacking clause ambiguous. While Grinnell does not create any new law, it reinforces that courts are reluctant to overrule anti-stacking clauses.
Cybersquatting: The Effect Trademarks Have On Domain Names.

*DaimlerChrysler v. The Net, Inc.*, 388 F.3d 201 (6th Cir. 2004).

By Jessica Webb

“Cybersquatting” occurs when a person registers an internet domain name that is similar to a trademarked name or phrase and intends to profit from that name. The Anti-Cybersquatting Consumer Protection Act (ACPA), an amendment to the Trademark Act of 1946 (“Lanham Act”), sets forth five elements that a trademark owner asserting a claim must establish. The trademark holder often has trouble establishing two of these elements: that the trademark holder is entitled to protection and that the defendant registered the domain name in a bad-faith attempt to profit. Other issues, like whether the scope of an injunction may be too broad or whether an unlawful taking without compensation occurred, arise after a court has ruled in favor of a trademark holder. These were the issues presented to the Sixth Circuit Court of Appeals in *DaimlerChrysler v. The Net, Inc.*

In *DaimlerChrysler*, the plaintiff, DaimlerChrysler, had used its registered DODGE trademark since 1939. In 1995, the plaintiff registered the domain name, “4ADODGE.com,” and established a website. In 1996, defendant Sussman registered the domain name “foradodge.com” on behalf of defendant Mydak, a federal prisoner. Sussman listed the registrant as The Net, Inc., which was an “unincorporated association” between Sussman and Maydak. The defendants also registered the domain name “foradodge.net,” along with a dozen other domain names that were very similar to other trademarks. For at least eight months, the defendants’ “foradodge.com” domain name directed users to a link to a pornographic website. The plaintiff filed suit on an ACPA claim and moved for summary judgment, claiming that there was no genuine issue of material fact as to whether the defendants violated the ACPA. The district court granted summary judgment for the plaintiff and ordered that the domain name be transferred to the plaintiff and permanently enjoined the defendant from any further use of the “foradodge” name.

On appeal, the defendants raised three issues. First, they argued that the district court erred in holding the 4ADODGE mark a protected trademark under the ACPA because it was not registered. Under the Lanham Act, a trademark is “any word, name, symbol, or device, or any combination thereof . . . used by a person . . . to identify and distinguish his or her goods . . . .” However, under the ACPA, a trademark does not have to be registered to be entitled to protection. Courts often
use a “confusingly similar” test to determine whether an unregistered trademark is entitled to protection. A domain name is “confusingly similar” to a trademark if consumers might think that the trademark holder used, approved, or permitted the use of the domain name.

The Sixth Circuit held that the plaintiff’s name, “4ADODGE,” was entitled to protection under the ACPA. The Court noted that the plaintiff advertised and used the telephone number 1-800-4-A-DODGE as early as 1994 and used the 4ADODGE.COM website since 1995. Thus, the court agreed with the district court’s conclusion that the defendants’ “foradodge.com” domain name was confusingly similar to the plaintiff’s protected trademark.

Whether the defendants registered the domain name with a “bad intent to profit” was the second issue. The ACPA lists nine nonexclusive factors that a court may consider to determine whether a defendant possessed a bad-faith intent to profit. The Court determined that no reasonable trier of fact could conclude that the defendants did not act in bad faith and with an intent to profit. To support its determination, the court found that all but one of the enumerated factors supported a finding of bad faith by the defendants. Factors such as the defendants’ lack of intellectual property rights, the lack of the defendants’ names in the domain name, the lack of use of the domain name to offer goods and services or any other legitimate noncommercial use, and the defendants’ clear attempt to divert customers from the plaintiff’s website were prominent in the court’s decision. Moreover, the court found the DODGE mark highly distinctive.

The third issue raised by the defendants was whether the scope of the district court’s injunction was overly broad by completely disallowing their use of “foradodge” because the plaintiff failed to show that it suffered any harm after the defendants registered “foradodge.com.” A court reviews the grant of a permanent injunction for an abuse of discretion, giving great deference to the lower court’s decision. The Sixth Circuit determined that the injunction issued was “entirely appropriate” under the circumstances. The court found the district court to be correct in concluding that there was a presumption that the plaintiff suffered irreparable harm from the defendants’ infringement on the plaintiff’s trademark.

As DaimlerChrysler illustrates, trademarks have extended into the field of computer technology and the internet. Today, registering for a domain name may require research into several issues, such as the ACPA and the registrant’s intentions. A transactional attorney should advise clients seeking to register a domain name to make sure they are not infringing upon another’s trademark or acting in a manner that could be interpreted as having a bad-faith intent to profit.

By Aaron Belville

Where unionized employees exercise their right to strike, employers cannot retaliate with threats, coercion, unjustified lockouts, and withholding of accrued bonuses. According to the National Labor Relations Act ("NLRA"), an employer is prohibited from firing employees for exercising their right to strike. However, the NLRA is silent in regards to situations where, prior to a strike, an employer has already notified specific employees that they will be laid off. This was the situation presented to the United States Court of Appeals for the Sixth Circuit in *Dayton Newspapers, Inc. v. NLRB*, 402 F.3d 651 (6th Cir. 2005).

*Dayton Newspapers, Inc.* ("DNI") and the local Teamsters-affiliated Union, who represented DNI’s distribution drivers, were negotiating a new collective bargaining agreement in the fall of 1998. While still in negotiations in January of 1999, DNI informed the Union that it was building a new and more efficient facility and, therefore, DNI would be laying off its thirteen least senior drivers. Seniority was the sole factor used in determining which drivers would be laid off. However, to ensure that the soon to be laid off drivers would continue working until the new facility was operational, DNI offered a “Stay-to-the-End Bonus” that was contingent on the affected employees staying at work until their release date.

To strengthen its position in the negotiations, the Union decided to call a one-day strike. DNI’s Operations Manager became aware of the planned strike and warned the drivers that if they were to strike, their jobs would be in jeopardy. Despite this warning, the Union commenced the strike on June 26, 1999. The following day DNI locked out the drivers when they attempted to return to work. Subsequently, DNI, without notifying the Union, met with the eighteen most senior drivers who were going to work at the new facility. At these meetings DNI attempted to receive assurances from the drivers that, if they were allowed to return to work, they would not strike again. Additionally, based in part on a lack of drivers, DNI decided to expedite its move to the new facility. Because of this move, DNI no longer needed the thirteen least senior drivers and, thus, laid them off. DNI then refused to pay the laid off drivers their bonus on the grounds that they had not stayed until released. After reaching individual agreements with DNI, nine of the senior drivers were allowed to return to work. In December of 1999, the Union
offered an unconditional return to work for the remaining drivers with the same terms as those who had returned earlier. DNI refused.

In November of 2000, after the Union charged DNI with numerous unfair labor practices, an Administrative Law Judge found DNI had violated multiple provisions of the NLRA. In July of 2003, the National Labor Relations Board (“NLRB”) upheld the judge’s findings. DNI appealed the NLRB’s ruling to the Sixth Circuit Court of Appeals. The court affirmed the NLRB’s findings that DNI violated the NLRA when it: (1) coerced its employees with threats of lost jobs; (2) dealt directly with the union members without notifying the Union; (3) refused to reinstate the drivers after their unconditional offer to return to work; and (4) failed to pay the laid off drivers the bonus.

In contrast, the Sixth Circuit reversed the NLRB’s holding that the lay off of the least senior drivers was improper. According to the court, the basis for the layoffs was DNI’s move to its new facility, rather than retaliation for the Union’s strike. Although the strike expedited the transition to the new facility, the court found that pure business judgments necessitated the move. The court further stated that DNI could not be punished for doing what it had already planned to do simply because the strike caused it to act more quickly than it would have had there not been a strike.

Despite finding that DNI was allowed to lay off the least senior drivers, the court agreed with the NLRB’s finding that the employees were still entitled to the bonus. The court rejected DNI’s argument that the Union’s strike was essentially a breach of the “Stay-to-the-End” agreement which relieved DNI of its obligation to pay the bonus and cited DNI’s admission that, had the employees been allowed to return after the one-day strike, they still would have been entitled to the bonus. Because of this admission, the employees could not be denied the bonus simply because DNI refused to allow them to return to work after the strike. Since the drivers, with the exception of the one-day strike, remained at work until DNI laid them off, they were entitled to the bonus.

*Dayton Newspapers* demonstrates that when a strike occurs in the absence of a collective bargaining agreement employees who have been notified that they will be laid off prior to a strike can be treated differently than those employees who an employer plans to retain. First, an employer who has already notified employees that they will be laid off, and then does so while the employees are on strike, will be given deference by the courts when a legitimate business justification supports the lay offs. *Dayton Newspapers* highlights the analysis that the Court of Appeals for the Sixth Circuit uses to determine whether a legitimate business justification exists. Second, an employer cannot choose to lay off its employees and then attempt to use a
Union’s strike as a justification for refusing to pay compensation to which the employees were entitled. Although courts tend to allow companies to exercise discretion in making business decisions, there is still an important interest in protecting employees who exercise their right to strike under the NLRA. *Dayton Newspapers* is a good example of the balance that courts attempt to reach between safeguarding the rights of employees and employers.

### Property


By Matthew Petrie

The improper subdivision of property, while severely hampering the value of the land, does not necessarily render title unmarketable. When a landowner improperly subdivides and sells land, the new owner may face serious obstacles to realizing the full use and value of the property. Economic lack of marketability differs from title marketability. The former has no guaranteed legal recourse, whereas the latter protects against subsequent claims of ownership to the same property. The Tennessee Court of Appeals drew a distinction between these two types of rights in *Whaley v. First American Title, Co.*

Forrest and Margaret Whaley (Appellants) purchased a two-acre plot of land which had been subdivided by a previous owner from a larger 74-acre tract. They subsequently purchased title insurance from First American Title Insurance Company (Appellee) to protect against unmarketability of title. Appellants later discovered that their property had been improperly subdivided in violation of a local regulation requiring the approval of the regional planning commission before the division of land into parcels of four acres or less. As a result, neither they nor any subsequent purchaser would be able to obtain a building permit to improve the property. Appellants notified Appellee that they believed the improper subdivision gave rise to a claim under the policy, but their claim was denied.

Appellants filed suit for breach of contract and negligence. The trial court found that the title policy’s purpose was to address issues relating to legal ownership as opposed to value, and thus denied Appellants’ claim.

On appeal, the Appellants raised two issues. The first issue was whether the trial court erred in finding that the policy’s scope extended only to legal ownership of
the Plaintiffs’ property, and not to its value. The court agreed with the Appellants’ argument that ambiguous terms should be construed favorably to the insured. However, the court found that the only possible ambiguities involved technical terms such as “defect in title” and “unmarketability of title,” – legal concepts that may be unfamiliar to average consumers. The court found that the terms were not ambiguous merely because they were unfamiliar to the average consumer. Therefore, the court held that the title policy was unambiguous.

The court then determined whether the improper subdivision fell within the scope of the policy. Title refers to legal ownership, which allows one having title to withstand assertions of others claiming a right to that title. Title does not, however, characterize property as valuable, merchantable, or usable. The court recognized a difference between economic lack of marketability and title marketability. The former refers to physical conditions affecting the use of the property, while the latter relates to defects affecting legally recognized rights of ownership.

In Whaley, because only the value had been affected, the land’s lone defect was in its physical condition, which prevented improvements and made the land difficult to sell. The insurance policy held by the Appellants only covered title marketability, not economic lack of marketability. Although the Appellants were unable to realize the full use and value of their property, no one disputed that the Appellants were the property’s legal owners. Therefore, the court held that title was not rendered unmarketable by the improper subdivision.

The second issue raised by the Appellants was whether the trial court erred by granting summary judgment on the negligence claim. Under Tennessee law, the plaintiffs must prove each of the five elements of a negligence claim. In Whaley, only the first two elements – duty and breach of duty – were at issue. The Appellants were required to prove that the Appellee owed a duty to them, and that they breached that duty. Tennessee Code Annotated section 56-35-129 (2003) creates a duty of care requiring the title insurer (here, the Appellee) to conduct a reasonable examination of the title to property and disclose any defects found. Thus, the duty of a title insurer only extends to discovering and disclosing defects in the chain of title affecting ownership. Because no dispute existed concerning the Appellants’ ownership of the property, the court held that the Appellee was not negligent.

The difference between economic lack of marketability and unmarketability of title had been distinguished in other courts, but the topic had not yet been addressed in Tennessee. The Whaley Court drew the primary distinction between defects in the physical condition which affect the value of property (economic lack of marketability) and defects in title which affect the ownership of property (unmarketability of title). Whaley demonstrates that transactional attorneys should
ensure that clients receive good title to property as well as ensure that the property is economically marketable. In the alternative, attorneys should confirm that any title insurance policy held by the client will cover economic lack of marketability in addition to title unmarketability.

**Securities**


By A. Nikki Jones

In *Werne v. Sanderson*, the Tennessee Court of Appeals held that subsequent shareholders are entitled to the same fiduciary duty standards and recognition as the original owner. The plaintiff (“Werne”) inherited 51 shares of Certificate No. 8 (“stock”) from her father. However, the defendants refused to recognize her ownership rights. Although Werne successfully established her interest in the stock, the trial court held that she failed to prove evidence of monetary damages or to establish her claims of willfully outrageous conduct, fraud, conspiracy or breach of fiduciary duty. In response to these findings, Werne filed an appeal to the Tennessee Court of Appeals (“Court”).

Werne raised three issues: (1) whether the trial court erred in dismissing the individual defendants; (2) whether she had carried her burden of proof in establishing monetary damages; and (3) whether the trial court erred in failing to grant her motion for continuance. The Appellees presented the issues of whether the trial court erred in failing to find that the doctrine of laches applied and that the action should be barred by the statute of limitations.

The Court affirmed the trial court’s determination that Werne’s cause of action was not barred by the statute of limitations because she was not notified within the applicable statute of limitations, of the defendants’ intention to deny her stock’s validity. Although the defendants failed to prevail on the statute of limitations issue, they successfully established the applicability of the doctrine of laches to Werne’s allegations of outrageous conduct fraud, conspiracy and breach of fiduciary duty.
The defense of laches provides that “equity will not intervene on behalf of one who has delayed unreasonably in pursuing his rights.” Hannewald v. Fairfield Communities, Inc., 651 S.W.2d 222, 228 (Tenn. Ct. App. 1983). Laches requires an unreasonably delay that prejudices the opposing party. Id. (quoting Brister v. Estate of Brubaker, 336 S.W.2d 326, 332 (Tenn. Ct. App. 1960)). Because the pivotal players were either deceased, too ill to travel, or did not remember the details of the stock transaction that began in 1977, the Court agreed with the trial court’s determination to dismiss the individual defendants.

The Court next addressed whether the trial court erred in holding that Werne failed to establish damages. According to the trial court’s order the hearing would be on the merits regarding the stock certificate’s authenticity and ownership. At the hearing, Werne failed to appear with counsel, requested a continuance, but was forced to proceed pro se. Then, the trial court required Werne to present evidence regarding damages, too.

The Court determined that the combination of denying Werne’s motion for a continuance and requiring her to precede pro se with issues not scheduled for the hearing inhibited her ability to establish damages. Therefore, the Court remanded the proceedings to determine the amount of damages, if any, resulting from the defendants’ failure to transfer the stock to Werne in 1983.

As Werne demonstrates, disputes regarding the transferability of stock can be avoided if the directors or shareholders of a corporation plan with foresight and abide by their fiduciary duties. This is especially true for corporations whose shareholders may participate in the corporation’s business. An attorney advising clients on such issues should suggest that restrictions be placed on the transfer of shares via the charter, bylaws, an agreement among the shareholders, or an agreement between the shareholders and the corporation. A second option would be to create a class or series of stock with limitations or preferences for employees given stock as a service reward. If the corporation is small, however, it may choose to address stock transferability on a case-by-case basis. If the board of directors authorizes shares in exchange for services performed, the stock recipient could be required to enter into a stock transferability agreement. These mechanisms are simple ways to avoid potential litigation.

By Richard White

In *Commissioner v. Banks*, the United States Supreme Court examined whether fees paid to a plaintiff’s attorney under a contingent-fee agreement constitute taxable income to the plaintiff. Reversing the Courts of Appeals’ decisions, the Court held that because a client completely controls the legal claim, the entire recovery is income to the client, even if state law provides an attorney with a lien or special property interest in the litigation proceeds.

*Banks* and its consolidated case, *Banaitis*, involved employment discrimination claims. Banks settled his claim, while Banaitis proceeded to trial and was awarded damages. Both respondents failed to include the contingent fee portion of the award as taxable income on their federal income tax returns.

For the tax years applicable in *Banks* and *Banaitis*, legal expenses were deductible as a miscellaneous itemized deduction. However, this deduction was unavailable to the respondents because they recovered a sizable income from the litigation, and the Alternative Minimum Tax (“AMT”) establishes a minimum tax liability floor. A present law, the American Jobs Creation Act of 2004, allows a taxpayer to deduct all legal expenses in unlawful discrimination cases regardless of the AMT, but this law was not enacted prior to *Banks*.

In *Banks*, the United States Tax Court ruled that the full amount recovered, including attorney’s fees, was taxable to each plaintiff as ordinary income. On appeal, the Court of Appeals for the Sixth Circuit reversed in part, holding that a contingent-fee agreement was “more like a partial assignment of income-producing property than an assignment of income.” Similarly, in *Banaitis*, the Court of Appeals for the Ninth Circuit held that Oregon law, which provides an attorney with a lien on a client’s litigation recovery, operated as “a partial transfer to the attorney of some of the client’s property in the lawsuit.” Thus, in both cases, the Courts of Appeals ruled that the contingent-fee portion of recovery did not constitute taxable income to the client.

On appeal to the United States Supreme Court, the Commissioner argued that a contingent-fee agreement should be treated as an anticipatory assignment of
income from client to attorney, making the full recovery taxable to the client. However, respondents argued that a contingent-fee agreement should be treated as a joint venture or partnership, with income divisible and taxable to attorney and client according to the terms of the partnership agreement.

The Internal Revenue Code defines income as “all income from whatever source derived.” Further, the Anticipatory Assignment of Income Doctrine provides that one cannot exclude a gain from taxable income by assigning the gain to another, making all gains taxable to the one who earns them. Thus, the primary consideration for proper taxation is control over the income-producing asset. In litigation, such asset is the cause of action, which remains under the plaintiff’s control throughout litigation. Rejecting the respondents’ argument, the Court stated that the attorney-client relationship is similar to the “principal-agent relationship,” where the principal (client) retains control, and the agent (attorney) acts in the best interest of the client. Thus, the Court concluded that because the client completely controls the claim, the entire recovery is the client’s income.

As Banks illustrates, taxation issues must be carefully considered with contingent-fee agreements. Under Banks, the entire recovery is taxable to the plaintiff because the plaintiff owns the income-producing asset — the cause of action. Although recent federal legislation allows a tax deduction for attorney’s fees in unlawful discrimination cases, notwithstanding the AMT, plaintiffs with different claims will still be taxed on the full amount of the recovery. Thus, Banks and recent federal legislation highlight the importance of tax planning for contingent-fee arrangements to ensure sufficiency of the litigation recovery, even after taxation and attorney’s fees.


By Brian L. O’Shaughnessy

Modern manufacturing processes require components that do not fit the traditional concept of “machinery.” At issue in Eastman Chemical Company v. Johnson, is whether the exemption for industrial machinery found in Tennessee Code Annotated section 67-6-102(13)(A) (1998) may be extended to include components not fitting the traditional concept of machinery, such as the catalysts used by Eastman Chemical Company (“Eastman”).
Eastman utilizes catalysts to manufacture various chemical products. These catalysts, which are necessary for production, accelerate chemical reactions without being consumed or otherwise affected in the process. Eastman paid use tax for catalysts from 1995 to 1997. On January 1, 1998, Eastman stopped paying these taxes. Citing the exemptions for industrial machinery and industrial materials, Eastman filed a claim with the Tennessee Department of Revenue (“Department”) seeking a refund for tax paid in 1995, 1996, and 1997. The Department denied Eastman’s claim for a refund.

Eastman filed a complaint in Chancery Court, alleging that the catalysts used to manufacture chemical products were exempt from the use tax. Eastman again sought a refund for taxes previously paid. The Chancery Court granted Eastman’s motion for summary judgment. The Court of Appeals reversed the lower court and held that the catalysts were not exempt from the use tax under Tennessee’s definition of industrial machinery.

In Eastman Chemical, the Tennessee Supreme Court began by addressing rules of statutory interpretation. If the statute is ambiguous as to whether industrial machinery encompasses apparatus such as the catalysts used by Eastman, the court must determine the legislative intent behind the statute by looking at the statute in its entirety, valuing the legislature’s word choices, and considering the context. If, however, the statute is unambiguous, the court must apply a plain meaning interpretation. Finally, when evaluating tax exemptions, the statute must be construed strictly against the taxpayer. Tennessee’s statutory definition of industrial machinery reads:

Machinery, apparatus and equipment with all associated parts, appurtenances and accessories,…which is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale consumption off the premises, . . . where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one’s principal business . . . .


As noted by the court, the catalysts used by Eastman are necessary to and primarily for the fabrication of tangible personal property for resale and consumption off premises. However, the issue remained as to whether the catalysts qualified as “[m]achinery, apparatus or equipment with all associated parts, appurtenances and accessories,” as required by the statute. Id.
The court looked to *AFG Indus. Inc. v. Cardwell*, 835 S.W.2d 583 (Tenn. 1992) (holding that, under a totality of means test, tin ingots melted to create a molten tin bath on which molten glass was floated and shaped qualified as an accessory and associated part of the tin bath apparatus). Where a component is an integral part of the equipment and apparatus used in manufacturing or processing, such component falls under the “industrial machinery” exemption to the Tennessee sales and use tax statutes. The catalysts used by Eastman, like the tin ingots at issue in *AFG Indus.*, are utilized in conjunction with various other items of equipment and apparatus. These equipment and apparatus, which could not function without the catalysts, create industrial machinery when viewed in their totality.

In *Eastman Chemical*, the Tennessee Supreme Court refines and clarifies an existing definition of industrial machinery for purposes of exemption to the use tax. This ruling will have a noticeable impact on tax planning where the taxpayer utilizes sophisticated manufacturing apparatus that would have been previously overlooked for tax exemption status. Additionally, attorneys may advise their clients that Tennessee’s tax law is favorable to the manufacturing industry, thus potentially attracting more manufacturers to the state.

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By Kevin A. Dean

When a Marital Dissolution Agreement (“MDA”) does not specifically classify a payment made after a divorce, complications can arise regarding the deductibility of the payment on the payor’s income tax return. Section 215 of the Internal Revenue Code (“Code”) permits a deduction for alimony paid and references the four tests of Code section 71(b) to define “alimony.” One of the requirements, specified in Code section 71(b)(1)(D), requires that payment liability end upon the death of the payee spouse. Due to Congress’s softening of this provision in 1986, an express provision that the payment end at the death of the payee spouse is not required if state law would end the payment at death.

In *Rogers v. Commissioner*, the U.S. Tax Court interpreted Tennessee law to determine whether such a payment would end at the death of the payee spouse. In this case, Paul Rogers and his wife negotiated an MDA that was adopted by the Circuit Court as part of divorce proceedings in March 1992. The MDA required Mr. Rogers to pay “$225 per week beginning immediately and continuing each week...
hereafter through July 2002.” The MDA also provided that “should the husband die prior to the full payment of this alimony, the Wife shall continue to receive said payment . . . through the term of the contract.” In 2000, Mr. Rogers and his current wife deducted the payment on their income tax return. The Commissioner disallowed the deduction because he concluded that the payment obligation would not end if Mr. Rogers’s former wife (the recipient) died.

Some states define “alimony” as either property settlements or period support payments. However, when the U.S. Tax Court examined Tennessee divorce law, three categories of alimony were recognized.

The first, alimony in solido, is roughly the same as property settlements. The Commissioner argued that the alimony in Rogers fit this category because the MDA did not specify that the alimony would end upon the death of the payee spouse; the MDA only specifically mentioned that the payment would not end on the husband’s (payor spouse’s) death. The Commissioner cited that, as a general rule, an obligation to pay alimony in solido does not end upon the death of the payee spouse. Therefore, the Commissioner concluded that the payments should be considered part of the nondeductible property settlement between the Rogers.

The second category, alimony in futuro, is roughly equivalent to Code section 71 alimony, which would be deductible on the payor spouse’s tax return because under Tennessee law, alimony in futuro ends at the death of the payee spouse. Mr. Rogers argued that the court should use parol evidence, consisting of the language of the order pendente lite that recognized that his ex-wife was in a position of relative financial disadvantage, to reason that the parties intended the payment to be classified as alimony in futuro. However, the U.S. Tax Court disagreed with this position, emphasizing language added to the MDA that referred to the weekly payments as “lump sum alimony,” which the Commissioner argued was a synonym for alimony in solido under Tennessee law.

The third category, rehabilitative alimony, was created by statute in 1984 for the purpose of providing an economically disadvantaged spouse temporary support and maintenance so that they may be rehabilitated. Mr. Rogers also argued that the weekly payment to his ex-wife should be classified as rehabilitative alimony and as such, would end upon his ex-wife’s death by express command of Tennessee law that states, “rehabilitative support and maintenance shall terminate upon the death of the recipient.” Tenn. Code Ann. § 36-5-101(d)(2) (2005). However, the statute cited by Mr. Rogers was not part of Tennessee law until 1993, and as such, was not effective in 1992 when the Rogers’s divorce proceedings were completed. 1993 Tenn. Pub. Acts 243. At the time of the divorce in 1992, Tennessee law classified payments similar to those in the Rogers case (fixed in amount and for a definite term)
as alimony *in solido* even if the purpose was to rehabilitate an economically disadvantaged spouse.

Given that parol evidence supported the Commissioner’s finding that the $225 payment was alimony *in solido* as defined under Tennessee law, and that even if the court were to find the payment to be rehabilitative, Tennessee law in 1992 at the time of the divorce would classify such a payment as alimony *in solido*, the U.S. Tax Court concluded that the payments did not meet the requirement of section 71(b)(1)(D) as they would not end upon the payee spouse’s death. Therefore, the payments were not deductible as alimony on Mr. Rogers’s 2000 income tax return.

The *Rogers* case demonstrates the importance of properly classifying divorce payments. Transactional lawyers should be aware of the applicable state law and how that law defines various forms of alimony so that the client’s intent is matched to the proper type of alimony.
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