
By Logan Burnette

In *Goree v. UPS, Inc.*, 490 S.W.3d 413 (Tenn. Ct. App. 2015), the Tennessee Court of Appeals addressed claims of racial discrimination and retaliation made by two employees of the United Parcel Service (“UPS”) under the Tennessee Human Rights Act (“THRA”), codified at Tenn. Code Ann. § 4-21-101, et seq. Specifically, the Court of Appeals decided the proper standard of causation for retaliation claims under the THRA is the “but-for” standard.

Plaintiffs Mitch Goree (“Goree”) and James Wherry (“Wherry”) are both African-American employees for UPS. Prior to the lawsuit, both men worked at UPS for over thirty years. In 2000, Goree was promoted to the position of business manager. Goree was later demoted from his position as business manager and, in 2004, filed a lawsuit against UPS alleging racial discrimination. The suit was eventually dismissed, and Goree continued to work for UPS. In 2006, Wherry was promoted to division manager for UPS and supervised business managers in a given area.

In 2010, Wherry asked Goree to serve as acting business manager at the Walnut Grove packing center until the position could be permanently filled. In August 2010, Goree and Wherry had lunch with Wherry’s superior, James Buchanan, to discuss the still-vacant business manager position at the Walnut Grove facility. Goree alleges that at this lunch, Buchanan assured Goree that he would be promoted to the position of business manager. However, Buchanan later announced that Brian Riley, a white male, would transfer from another facility and become the business manager for the Walnut Grove facility. Goree immediately left UPS and took six months of “stress leave” in order to
deal with the overwhelming embarrassment and humiliation he felt due to not receiving the promotion.

Wherry was demoted to business manager in 2011 when a UPS internal investigation revealed that Wherry was responsible for the improper termination of an employee under the collective bargaining agreement between UPS and the teamsters’ union. In response to these adverse employment actions, Goree and Wherry filed a lawsuit in 2011 claiming that UPS discriminated and retaliated against each of them on the basis of race in violation of the THRA.

Under the THRA, it is an impermissible discriminatory practice for an employer to “discriminate against an individual with respect to compensation, terms, conditions or privileges of employment because of an individual’s race . . . .” Tenn. Code Ann. § 4-21-401(a)(1). Additionally, it is also unlawful for employers to “[r]etaliate or discriminate in any manner against a person because such person has opposed a practice declared discriminatory . . . or because such a person made a charge, filed a complaint, testified, assisted or participated in any manner in any investigation, proceeding or hearing . . . .” Tenn. Code Ann. § 4-21-301(a)(1).

There are four elements to establish discrimination and retaliation claims under THRA. A plaintiff must show that: 1) “he is a member of a protected class;” 2) “he applied and was qualified for a position for which the employer was seeking applicants;” 3) “he was subjected to adverse employment action;” and 4) “the rejection occurred under circumstances giving rise to an inference of unlawful discrimination.” To establish a retaliation claim, a plaintiff must show that: 1) “he engaged in activity protected by the THRA;” 2) “the exercise of his protected rights was known to the defendant;” 3) “the defendant thereafter took a materially adverse action against him;” and 4) there was a causal connection between the protected activity and the materially adverse action.”

The trial court found that both Goree and Wherry had sufficiently proven all the elements of both their discrimination and retaliation claims respectively. Furthermore, the district court dismissed UPS’s motion for directed verdict at the close of trial. UPS appealed to the Tennessee Court of Appeals.
On appeal, the court upheld Goree’s claim of racial discrimination for failure to promote. Goree was able to provide sufficient circumstantial evidence to create an inference of discrimination by demonstrating that he was more qualified than Riley and that the nondiscriminatory reasons for the adverse employment decision provided by UPS were merely pretexts for racial discrimination.

The Court of Appeals also upheld Goree’s claim that UPS’s failure to promote him was in retaliation for his 2005 lawsuit alleging racial discrimination. Goree demonstrated a causal connection between his protected activity of filing a discrimination complaint in 2005 and his failure to be promoted in 2010 by offering direct evidence that the district president of UPS told Wherry that employees with histories of litigation against UPS were not promoted. In an issue of first impression, the court adopted the reasoning set forth in the United States Supreme Court decision of University of Texas Southwestern Medical Center v. Nassar, 133 S. Ct. 2517 (2013), by establishing a “but-for” causation standard for retaliation claims filed under the THRA. Under this standard, the plaintiff must show that the protected activity was the determinative factor in the defendant’s decision to perform the retaliatory adverse employment action.

The Court of Appeals reversed the trial court’s decision regarding Wherry’s claim of racial discrimination based on his demotion. The court held that Wherry could not sustain an inference of discrimination by failing to show an analogous example of a UPS employee in Wherry’s position who engaged in the same conduct, yet was treated more favorably than Wherry.

As a result, the Court of Appeals reversed the trial court’s decision regarding Wherry’s claim for retaliation based on his demotion. Wherry had not previously filed a complaint against UPS, and his only protected activity under THRA was supporting Goree to be the Walnut Grove business manager. While support for Goree was sufficient for Wherry to claim engagement in a protected activity, Wherry did not provide sufficient evidence to sustain the required but-for causal link between his protected activity and his demotion.
In light of this decision, Tennessee labor and employment attorneys should take note of how the Goree court applied the THRA within the retaliation context, especially as it concerns the newly adopted “but-for” causation standard regarding the link between protected activity and adverse employment action in retaliation claims. It is not enough for a plaintiff to simply show that they engaged in a protected activity, and later that they experienced an adverse employment action. Plaintiffs must show that, were it not for their participation in the protected action, they would have been promoted. Finally, the case provides an example of the danger an employer risks when they consider an employee’s litigation history in determining whether or not to promote.

**REAL ESTATE**

The Supreme Court of Tennessee held that notice of a tax sale is not required for parties designated as nominees. *Mortg. Elec. Registration Sys., Inc. v. Ditto*, 488 S.W.3d 265 (Tenn. 2015).

By Kane Shepherd

In *Mortgage Electronic Registration Systems, Inc. v. Ditto*, the Supreme Court of Tennessee addressed—as an issue of first impression—whether due process compelled notice to be given to petitioner Mortgage Electronic Registration Systems, Inc. (‘‘MERS’’). The Hamilton County Chancery Court (‘‘trial court’’) held that MERS did not have an interest in the property sold at a tax sale to defendant purchaser, Carlton Ditto (‘‘Ditto’’), meaning that notice was not required. The Court of Appeals affirmed, albeit for a different reason, holding that MERS had no standing to file suit because it had not suffered any injury. *Mortg. Elec. Registration Sys., Inc. v. Ditto*, No. E2012–02292–COA–R3–CV, 2014 WL 24439, at *5 (Tenn. Ct. App. Jan. 2, 2014). The Tennessee Supreme Court granted certiorari and held that MERS had no interest in the property and thus did not require notice of the sale.

This case arose from a tax sale of property located in Chattanooga, Tennessee. The original owners, Joseph and Gerald Dossett, borrowed approximately $60,000 from Choice Capital Funding, Inc. (‘‘Choice Capital’’) to purchase the property in 2006. The deed of trust (‘‘DOT’’) associated with the loan listed Choice Capital as the lender, and also
described MERS as “a separate corporation that is acting solely as nominee for [Choice Capital].” The DOT also stated that MERS was “the beneficiary under this Security Instrument . . . .” MERS is a national registry system that tracks changes in ownership interests of mortgage loans, allowing lenders to avoid the payment of recording fees each time interests in the loans are transferred.

The Dossetts failed to pay property taxes on the property in 2006, and Hamilton County filed a delinquent tax lawsuit against them in 2008. While Choice Capital received notice of the tax sale, the county made no attempt to give MERS notice of the lawsuit despite it being referenced in the public record. The Dossetts never paid the 2006 property taxes, and the property was sold to Ditto in 2010 at a tax sale. MERS brought suit in 2012, alleging that it had a constitutionally protected right in the property through the DOT and thus should have received notice of the tax sale based on the constitutional requirement of due process. Ditto and Hamilton County argued that the DOT gave MERS no interest in the property, meaning that the notice requirement did not apply, and claimed that MERS’ own policy gave all rights associated with property interests to lenders.

The trial court ruled for Ditto and Hamilton County, holding that the county had complied with the notice requirements of both the DOT and the tax sale statute because neither mentioned the means by which notice should be given to MERS. After reviewing cases from other jurisdictions, as well as the language of the DOT, the trial court also held that MERS had no “interest” in the property because it had no power to lend to, or collect money from, the borrower, and played a limited role. The Court of Appeals affirmed, but on somewhat different grounds, emphasizing MERS’ status as a “nominee,” meaning that it had limited rights with respect to the loan interests that it tracked. Since MERS could only be considered a nominee, the appellate court determined that MERS did not suffer any injury with respect to the tax sale and thus had no standing to file suit.

The Supreme Court of Tennessee affirmed both lower courts’ decisions that MERS did not have a protected interest in the property. In
affirming the decision that MERS did not have an interest in the property, the Supreme Court of Tennessee agreed with the trial court that the question should focus on the “interest” question itself, and not whether MERS suffered an “injury,” as the Court of Appeals did. Looking at the rights granted to MERS by the DOT, the court acknowledged the language seemed to be contradictory. The DOT indicated that MERS acted “solely as the nominee for the lender,” but at the same time labelled MERS as a “beneficiary” and allowed it to “exercise some rights of the lender,” if necessary. Because the issue of MERS’ interest in property had not been decided in Tennessee, the court pointed to Landmark National Bank v. Kesler, 216 P.3d 158, 167 (Kan. 2009), for a case containing similar DOT language. The court observed that there, the Supreme Court of Kansas held MERS to simply be an “agent” or “straw man” for a lender, meaning that it could not have a real interest in property. Likewise, the court cited Culhane v. Aurora Loan Services. of Nebraska, 826 F. Supp. 2d 352, 370 (D. Mass. 2011), in which the court considered it “absurd” for MERS to think it could act both as a mortgagee and an agent for lenders simultaneously.

Considering these and related cases, the court determined that MERS could not be considered a “beneficiary” for purposes of having a protected property interest. The court again emphasized the language of the DOT that deemed that MERS acted “solely as nominee” and found that this language meant that the DOT intended MERS to act in a limited way, given the very definition of the word “nominee.” Furthermore, the court observed that the notice provision of the DOT did not mention MERS, suggesting that MERS acted merely as “an agent with limited powers, akin to a special power of attorney,” and that it could not have a protected interest in the property.

The Tennessee Supreme Court’s decision follows the line of reasoning set forth in other cases involving MERS. While this represents the first case involving MERS’ interest in property in Tennessee, other courts have widely held that MERS does not have the rights of a lender, and instead is a nominee that tracks ownership interests in loans as they change hands.

While the issue of MERS claiming to have a protected interest in property may still be an open issue in many jurisdictions, the supreme
court’s decision should mean that MERS’ role is more clearly defined in Tennessee. Tax sale buyers, holders of mortgage loan interests, and practitioners should not have to be as concerned that MERS may try to exercise the rights of a lender. At the very least, the court’s decision encourages clarity in deeds of trust that involve MERS. It may inspire such documents to be worded in a way that leaves no question that third parties like MERS cannot claim to have an interest in property. Finally, the supreme court’s decision helps promote the increasing fluidity of mortgage loan interests, ensuring that they may be transferred more easily without lenders wondering what interests MERS may attempt to claim.

Utilities


By David Large

In *FERC v. Electric Power Supply Association*, 136 S. Ct. 760 (2016), the United States Supreme Court addressed two distinct issues surrounding the Federal Energy Regulatory Commission (FERC) and its practice of “demand response,” which compensates consumers for conserving electric energy during specific times. First, the Court questioned whether the Federal Power Act (FPA) permits the practice of “demand response,” and second, whether FERC’s decision to compensate demand response providers and electricity producers the same rate was arbitrary and capricious. This action was brought by the respondent Electric Power Supply Association (EPSA), a national trade association representing competitive power suppliers, including generators and marketers, against FERC.

The FPA was passed by Congress in 1935 for the purpose of regulating “the sale of electric energy at wholesale in interstate commerce.” 16 U.S.C. § 824 et seq. The act was passed in response to electric power generation and distribution becoming increasingly national in scope.
The FPA charges FERC with “oversee[ing] all prices for … interstate transactions and all rules and practices affecting such prices.”

FERC has shifted the practice of electric energy sales from a monopolistic model to one driven by markets, though this presents numerous challenges. Electricity cannot be effectively stored so generators of power must produce the exact amount of energy needed every minute. To do this, nonprofit entities were created to manage wholesale markets on a regional basis. These market operators receive demand schedules from load-serving entities (LSEs) “that buy power at wholesale for resale to [end] users” and take “bids from generators specifying how much electricity they can produce at those times and how much they will charge for it.” The market operators then fill the quantity of power demanded by accepting bids in ascending order. The largest bid that is accepted is then “paid to every supplier whose bid was accepted.” This price point is, to use an economic term, the marginal cost, hereafter referred to as the “locational marginal price” (LMP).

Another challenge for FERC is the inelasticity of demand for electric power. When temperatures rise, everyone consumes more power because they have no incentive to refrain from such activity, and there is no reasonable alternative. Approximately fifteen years ago, wholesale market operators, in conjunction with FERC, combatted this problem by employing the practice of “wholesale demand response,” which “pays consumers for commitments to curtail their use of power, so as to curb wholesale rates and prevent grid breakdowns.” Similar to the auction process described above, large individual users “submit bids to decrease … consumption.” The market operators will accept any bid that is under the LMP, because, if the LMP is $40, rather than having to produce one additional unit at $41 they can pay the consumer $40 to refrain from consuming this additional unit. In 2011, FERC issued the “rule under review here” where they required wholesale market operators, “under two specified conditions, to pay LMP for any accepted demand response bid, just as they do for successful supply bids.” These two conditions are simply that the consumer actually be able to reduce consumption by the amount suggested and that paying LMP for a bid will save LSEs money.
At trial, the Court of Appeals for the District of Columbia Circuit vacated the Rule as “ultra vires agency action.” The court held that “FERC lacked authority to issue the Rule,” because the practice of demand response enticed retail consumers into the wholesale market, and as a result, the Rule “engages in ‘direct regulation of the retail market.’” In addition, the Court of Appeals held “that the Rule [was] arbitrary and capricious under the Administrative Procedure Act, because FERC failed to ‘adequately explain’ why paying LMP to demand response providers ‘results in just compensation.’” The court suggested, as others previously had, that by providing full LMP to demand response providers, these providers were experiencing a “windfall by leaving them with ‘the full LMP plus . . . the savings associated with’ reduced consumption.” The United States Supreme Court granted certiorari and reversed both holdings by a count of 6-2.

The Supreme Court undertook a three-part analysis to make a ruling on these issues. First, the Court determined that demand response did, in fact, “directly affect wholesale rates.” The goal of demand response is to lower energy prices by preventing inefficiencies in the context of wholesale markets. There is no indication to the contrary that the goal of demand response is anything other than to lower the wholesale market rate.

Second, the Court determined that this practice did not unjustly interfere with retail electricity sales. The Court conceded that any action taken by wholesale producers and purchasers has some effect on retail markets, but it also stated that “whatever effects at the retail level, every aspect of the regulatory plan happens exclusively on the wholesale market and governs exclusively that market’s rules.” Any effect had on the retail market is an inadvertent result of a practice focused exclusively on the wholesale market.

Finally, the Court held that the decision to compensate demand response providers at LMP was not “arbitrary and capricious.” When determining whether a practice is arbitrary and capricious, “a court is not to ask whether a regulatory decision is the best one possible or even whether it is better than the alternatives.” It is only a matter of whether FERC has
“examine[d] the relevant [considerations] and articulate[d] a satisfactory explanation for its action[s].” In its explanation, FERC stated that the level of profitability of each individual power plant is not relevant to the matter. The purpose of paying LMP to demand response providers is simply to incentivize “more efficient supply and demand decisions.” Additionally, paying LMP can help demand response providers overcome “significant start-up expenses” such as “the cost of installing necessary metering technology and energy management systems.”

At its most basic level, this ruling incentivizes more participation in demand response practices and results in cheaper wholesale electricity costs. Entities situated to benefit from demand response will look to increase participation by continually decreasing energy consumption. A good attorney will also act as a risk manager in determining any potential liabilities that could result from this cutback. For example, big-box grocery stores would potentially open themselves up to food safety issues, or a decrease in electricity consumption by a manufacturing plant could potentially result in a product defect. Finally, an attorney representing either party in a demand response transaction should be aware of how this practice works in order to properly structure any agreement between the parties to avoid any needless legal disputes.

FIDUCIARY DUTIES

The Supreme Court of the United States held that courts must assess a party's current complaint to determine whether a reasonably prudent fiduciary could not conclude an alternative action would do more harm than good. Amgen Inc. v. Harris, 136 S. Ct. 758 (2016).

By Mila Yarbrough

In Amgen Inc. v. Harris, 136 S. Ct. 758 (2016), stockholders in an employee stock ownership plan (ESOP) brought suit against plan fiduciaries for breach of the duty of prudence under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 et seq. The United States Supreme Court clarified its holding in Fifth Third Bancorp v. Dudenhoeffer, 134 S. Ct. 2459 (2014), which set the standard for breach of the duty of prudence. In Amgen Inc., the Court held that a complaint alleging a breach of the duty of prudence must present facts
and allegations that support the proposition that a reasonably prudent fiduciary could not have concluded that the alleged alternative action would do more harm than good.

The case arose out of a class action between stockholders who were former Amgen Inc. employees and Amgen Inc. (“Amgen”) fiduciaries. While employed by Amgen, the stockholders were eligible for and held individual ESOPs, which gave stockholders the opportunity to purchase ownership in Amgen’s stock and were managed by the fiduciaries. In 2007, the value of Amgen stock fell, and, believing the fiduciaries were not protecting their interests, the stockholders filed a class action against the fiduciaries for an alleged breach of fiduciary duties under ERISA.

The district court granted the fiduciaries’ motion to dismiss, holding the fiduciaries did not breach their duties, including the duty of prudence. The Ninth Circuit reversed, and the Supreme Court vacated and remanded the Ninth Circuit’s judgment in light of the Supreme Court’s decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014). On remand, the Ninth Circuit reversed again the district court’s dismissal of the complaint, and the fiduciaries again sought certiorari from the Supreme Court.

*Fifth Third Bancorp v. Dudenhoeffer* detailed three factors for the breach of the duty of prudence. First, there must be alternative action that the defendant could have taken. Second, that alternative action must comply with securities laws. Third, a prudent fiduciary, under the same circumstances, would not view the alternative action as more likely to harm the fund than to benefit it. The *Amgen Inc.* Court clarified the third element by stating that ultimately, the complaint, in its current form, should plausibly allege a prudent fiduciary, in the same position, could not conclude the alternative action would do more harm. There, the complaint was lacking in plausible allegations to that effect, and the Court concluded that the Ninth Circuit had not engaged in proper analysis of the complaint. When applying the facts—as alleged in the complaint—to the rule, the Ninth Circuit only used the first two factors from *Fifth Third Bancorp v. Dudenhoeffer*. Although the first two factors were satisfied, the third factor was not because the stockholder’s
complaint itself did not contain any facts or allegations to show that there was an alternative action that satisfied *Fifth Third*'s standards.

In sum, in *Amgen Inc. v. Harris*, the Supreme Court of the United States clarified the third factor, in conjunction with the first two, that is necessary to allege a breach of duty of prudence; the Supreme Court held that courts must assess a party’s current complaint to determine whether a reasonably prudent fiduciary could not have concluded that the alleged alternative action would do more harm than good.

The Court’s clarification of *Fifth Third Bancorp v. Dudenhoeffer* ultimately places a heavier burden on stockholders or individuals who allege that ERISA fiduciaries have breached their duty of prudence. Although more work for stockholders, the Court has a strong interest in enforcing this policy because Congress strives to encourage employees to purchase ownership in stock. In order for stock-ownership in ESOPs to thrive, stockholders cannot allege a breach of prudence each time the value of stock drops, for stockholders must understand the risk they take on when they agree to purchase ownership of a company’s stock.

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**GOVERNMENT CONTRACTS**

The Sixth Circuit limited the government’s recovery under the False Claims Act to treble the difference between what the government bargained for and what the government received. *United States ex rel. Wall v. Circle C Constr., LLC*, 813 F.3d 616 (6th Cir. 2016).

By Amanda Derryberry

In *United States ex rel. Wall v. Circle C Constr., LLC*, 813 F.3d 616 (6th Cir. 2016), the Sixth Circuit Court of Appeals addressed the proper calculation of damages for claims made under the False Claims Act (FCA), 31 U.S.C. § 3729.

Circle C Construction (“Circle C”) entered into a contract with the United States government for the construction of several dozen warehouses. The warehouses were constructed at the Fort Campbell Army base located on the Kentucky and Tennessee border. The contract required Circle C and any subcontractors to pay employees above market wages pursuant to the Davis-Bacon Act, 40 U.S.C. § 3142.
Circle C was also required to submit a weekly certification of compliance to this wage rate for itself and any subcontractors.

Phase Tec, a subcontractor of Circle C, performed the electrical work throughout the warehouses. During the course of construction, Phase Tec did not comply with the required wage rate and underpaid its electricians a total of $9,916. This underpayment resulted in false certifications of compliance leaving Circle C liable to the government under FCA. Subsequently, a Phase Tec employee brought an FCA case on behalf of the United States against Circle C. Under the FCA, the government may recover three times its actual damages. 31 U.S.C. § 3729(a)(1)(G).

The district court awarded the government damages of $762,894.54, or three times the entire amount that the government paid for the electrical work minus the $15,000 Phase Tec had already paid in a prior settlement over the same issue. The court’s calculation was based on the government’s theory that the entire $259,298 electrical project was tainted by Phase Tec’s underpayment, leaving the warehouses valueless to the government.

On appeal, the Sixth Circuit rejected the lower courts calculation and held the district court’s award of damages to be an abuse of discretion. The court held that damages must be limited to only actual damages, calculated as the “difference in value between what the government bargained for and what the government received.” The court noted that the government bargained for both the buildings and the payment of Davis-Bacon Wages and received the buildings but only part of the wages. Thus, the difference between the two, or the amount to make the government whole amounted to the underpayment of $9,916.

The Sixth Circuit pointed to the obvious contradiction between the “taint theory” and the government’s continued use of the buildings as evidence that the electrical work was not valueless. The court credited the accounting as creative yet inapplicable, because there was no evidence of any taint to the contract or electrical work. The court noted that the taint theory applies to cases where a contractor delivers dangerous goods or goods plagued with some “unalterable moral taint”
which renders them worthless. In cases involving worthless goods, money damages would be insufficient to remedy the breach, yet, in this situation, the difference between the contractually-required payment and the payment actually paid was easily calculable, and the harm to the government could be remedied through money damages.

Additionally, the Court of Appeals dismissed the government’s argument that it would have withheld the entire payment had it been aware of Phase Tec’s underpayment as extraneous. The court explains that FCA damages are not calculated based on a “hypothetical scenario,” but rather the calculated difference between the value received and the value bargained for. As such, the Sixth Circuit Court of Appeals held that the district court’s damage calculation was an abuse of discretion and that the actual damages were $9,916, which totaled to $29,748 when tripled. Less the $15,000 prior settlement payment, the found Circle C’s liability significantly reduced to a total of $14,748.

The Sixth Circuit’s decision limits FCA damages to the calculated difference in value between the goods or services the government bargained for and what the government actually obtained. The court’s decision will have significant implications on future FCA cases by limiting the application of the taint theory to the few situations where money goods would be insufficient to remedy the breach. The precedent set by United States ex rel. Wall v. Circle C. Constr., LLC, standardizes the government’s damage recovery and could dissuade litigants from bringing meritless claims.

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**REAL ESTATE**

The Supreme Court of Tennessee held that proof of an actual or presumptive ouster is not a requirement in establishing title by prescription as between co-tenants. Roberts v. Bailey, 470 S.W.3d 32 (Tenn. 2015).

By Susanne Kozma

In Roberts v. Bailey (Roberts II), 470 S.W.3d 32 (Tenn. 2015), the Tennessee Supreme Court addressed whether, in proving title by prescription, an individual must prove “presumptive ouster.” In Roberts v. Bailey (Roberts I), No. E2013-01950-COA-R3-CV, 2014 WL 3778298
the Tennessee Court of Appeals held that establishing a presumptive ouster was a requirement for title by prescription between co-tenants. In Roberts II, the Tennessee Supreme Court reversed and held that while proof of an actual ouster is required in claims of adverse possession between co-tenants, proof of an actual or presumptive ouster is not required in claims for title by prescription.

The circumstances behind this case began in 1918, when spouses N.B. (“N.B.”) and Pearl Bailey (“Pearl”) acquired two tracts of land during a brief period in Tennessee legal history where the conveyance of real property to spouses created a tenancy in common with no survivorship rights. Presumably, however, N.B. and Pearl thought that they entered a tenancy by the entirety with survivorship rights. After N.B. died intestate, Pearl proceeded to use and treat their property as if she had full title despite the fact that N.B.’s interest in the property had passed under intestacy to his and Pearl’s four children.

Over a period of about forty years, Pearl and her four children operated under the belief that Pearl had obtained complete ownership of the property after N.B.’s death. Pearl transferred certain segments of the property to some of her children, and in turn those children also transferred sections of property to their siblings and children. By 2009, Robert W. Bailey, the son of N.B. and Pearl, believed that he and his two children (“The Baileys”) had complete ownership over one full tract of land (“James Farm”). The Baileys would have been correct if not for the law that made Pearl and N.B. tenants in common with no survivorship rights. In actuality, upon N.B.’s death, fifty percent of the ownership in the two tracts of property, including James Farm, had passed to the four children.

The Baileys learned of the defect in their title to James Farm while defending a suit to establish boundary lines against third parties. After learning of the defect, the Baileys filed a third-party complaint to quiet title for James Farm against the descendants of Naomi Bailey Littleton (the “Littletons”). The Baileys initially argued that they had full ownership of James Farm because it had been the actual intention of N.B. and Pearl to create a tenancy by the entirety. Both the trial court
and the Tennessee Court of Appeals rejected the Baileys’ argument. On remand to the trial court, the Baileys amended their third-party complaint and asserted that they had fee simple title in the land through the doctrine of prescription. The trial court granted summary judgment to the Littletons and held that the Baileys had failed to establish title by prescription because the Littleton’s ignorance of their interest in the property qualified as a “disability” that prevented the Littletons from pursuing their rights. The Baileys again appealed, and the Tennessee Court of Appeals affirmed on different grounds. The court of appeals found that the Littleton’s ignorance of their property interest did not qualify as a disability, but that the Baileys had still failed to establish a presumptive ouster of the Littletons, and therefore had failed to acquire prescriptive title.

The Tennessee Supreme Court granted certiorari and held that the Littleton’s ignorance of their property interest was not a disability and that, in the doctrine of prescriptive title, a showing of actual or presumptive ouster is not required. The court reversed the decision of the court of appeals and remanded the cause to the trial court. In reaching its decision, the court cited Marr’s Heirs v. Gilliam, 41 Tenn. 488 (1860), where the Supreme Court of Tennessee recognized the doctrine of title by prescription between co-tenants. The court also cited England v. England, No.E2011-02094-COA-R3-CV, 2012 WL 4503434, at *5-6 (Tenn. Ct. App. Oct. 2, 2012), in which the Tennessee Court of Appeals articulated that a prescriptive holder acquired prescriptive title when 1) he or she had been in “exclusive and uninterrupted possession of the land for a period of twenty years or more,” 2) the co-tenants had not been under any disability to assert their rights during that period, and 3) the prescriptive holder’s occupancy occurred without the co-tenant’s implied or actual permission.

In applying this test to the Baileys’ case, the court quickly found that the Baileys had satisfied the first element because they had been in exclusive and uninterrupted possession of James Farm for over twenty years. As for the second element, the court agreed with the court of appeals that “disability” did not include ignorance of a property interest, but was limited to incidents of minority or incapacity. Finally, the court found that the Baileys’ possession of James Farm was without the Littletons’ permission, and that therefore the Baileys had established
prescriptive title. In reaching this last point, the court reiterated that the “primary difference” between title by prescription and adverse possession is that “adverse possession requires proof of an ‘actual ouster’ of co-tenants, whereas title by prescription does not.”

The court’s decision in Roberts v. Bailey, 470 S.W.3d 32 (Tenn. 2015), clarifies prior Tennessee case law and firmly establishes that a fundamental difference between the doctrine of adverse possession and the doctrine of title by prescription is that, in the latter, the holder of property need not prove actual ouster of a co-tenant. In future title by prescription claims, a holder of property need only satisfy the elements laid out in England v. England and is not required to prove actual or presumptive ouster of a co-tenant. For practitioners, the court’s decision provides clarity as to the fundamental difference between adverse possession and title by prescription and offers clearer strategic elements in choosing which avenue to pursue.

SECURITIES

The Tennessee Supreme Court adopts the Tooley standard under Delaware law to determine whether a shareholder’s claim is direct or derivative. Keller v. Estate of McRedmond, 495 S.W.3d 852 (Tenn. 2016).

J. Logan Wilson

After a deadlocked vote among sibling shareholders, the Chancery Court for Davidson County, Tennessee, ordered that a closely held corporation, McRedmond Brothers, Incorporated (“MBI”), be dissolved and its assets sold at auction to the highest bidder. Stephen McRedmond (“Stephen”), along with two of his sisters, Anita and Linda (collectively, the “Buyers”), entered into an asset purchase agreement for all of the business’s assets after placing a winning bid at auction. The Buyers also formed and capitalized a new corporation, McRedmond Feed Company, Incorporated (“McRedmond Feed”), to serve as the designated receiver of the business’s assets at closing.
The trial court then entered an order approving the sale of the business’s assets to the Buyers, and ordered all of the current officers and directors of the business’s assets, including Stephen and his brother Louis Anthony McRedmond (“Louie”), to conduct MBI’s business only in the usual, regular, and ordinary course, preserve its organizational structure, and preserve its goodwill and relationships with customers, employees, and all others having business relationships with the firm. However, during the bidding process for MBI’s assets until he surrendered control at closing, Louie began preparations to open a competing business by filing a charter of incorporation for his new business, soliciting employees and customers, and nearly depleting MBI’s entire inventory.

After learning of Louie’s actions, the Buyers filed a counterclaim against Louie in the ongoing dissolution proceedings. Their claims can be grouped into three general categories: “(1) Louie’s willful and intentional violation of the trial court’s orders, (2) Louie’s breach of his fiduciary duty to the original MBI, and (3) Louie’s intentional interference with business relations.” The Buyers did not include McRedmond Feed as a plaintiff, nor did they include the original MBI or Louie’s competing business as a defendant. The trial court awarded damages to the Buyers based on Louie’s violation of the court’s orders, intentional interference with business relations, and breaches of fiduciary duty. The Tennessee Court of Appeals then reversed the trial court’s opinion in its entirety, holding that the Buyers’ claims belonged to McRedmond Feed and should be brought on its behalf in a shareholder derivative action (not as a direct private action claim by and for the shareholders themselves).

On grant of the Buyers’ application for permission to appeal, the Tennessee Supreme Court determined the proper standard for deciding whether a claim brought by shareholders of a corporation is direct or derivative in nature. The court first explained that derivative suits by shareholders seek to redress wrongs to the corporation, often by corporate insiders, such as a director or officer’s breach of his or her fiduciary duty. On the other hand, direct suits involve an injury to the shareholder as an individual, such as the deprivation of voting rights or the right to inspect corporate books, as well as wrongful inducement to selling stock or direct victimization by fraud.
The court expressly rejected its previous standard for determining whether a claim is derivative or direct. That prior standard had come from *Hadden v. City of Gatlinburg*, 746 S.W.2d 687 (Tenn. 1988). The court explained that the *Hadden* standard was confusing to many practitioners and judges and chose to instead adopt the standard used by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004). *Tooley* states that the direct versus derivative determination turns solely on two questions: “(1) who suffered the alleged harm (the corporation or the suing stockholders, individually); and (2) who would receive the benefit of any recovery or other remedy (the corporation or the stockholders, individually)?” The *Tooley* standard also requires that the claimed direct injury must be independent of any alleged injury to the corporation. The court also approves of the use of other jurisdictions’ guidance regarding and analysis of the *Tooley* standard in determining cases under Tennessee law.

The court then analyzes the Buyers’ three general categories of claims under the *Tooley* standard. Under the *Tooley* standard, the Buyers must demonstrate that the duty breached was owed to them and that they can prevail without showing an injury to the corporation.

First, the court held that the Buyers have a valid direct action for Louie’s willful and intentional violation of the trial court’s orders. The court explained that the trial court order violation claim was essentially an action for civil contempt or breach of contract because the order was entered expressly for the benefit of the Buyers. McRedmond Feed was only a third-party beneficiary of the order, so the claim rightfully belonged to the Buyers.

Next, the court held that claims originating from Louie’s alleged breach of his fiduciary duty to the original MBI belonged to the corporation, not the Buyers, and could only be asserted directly by the corporation or derivatively by its shareholders. The court explained that the Buyers essentially claimed that Louie engaged in management and self-dealing at the expense of the corporation, rather than the Buyers themselves. As a result, any claim resulting from a breach of fiduciary duty from
mismanagement or self-dealing belongs to the corporation, not its shareholders.

Finally, the court held that the claims originating from Louie’s intentional interference with business relations belonged to McRedmond Feed and could only be asserted derivatively. Because Louie’s operation of his new corporation did not begin until after the closing of the purchase, the court found that any interference must be related to the interruption of McRedmond Feed’s business relations.

The court also denied the claim from the Buyers that they should be treated like partners instead of shareholders due to the corporation’s closely held, subchapter-S status. Unlike corporate shareholders, partners in a partnership are harmed individually when the partnership is harmed, and thus may assert any claim for injury to the partnership as a direct action. Citing Hadden, the court explained that the Buyers could not disregard the corporate form at their convenience, even as a closely held corporation. As a result, the court affirmed in part and reversed in part the decision of the court of appeals and remanded the case to the court of appeals.

Generally, this case serves as a lesson that all attorneys need to be attentive as to what parties will be entitled to seek a remedy in the event of noncompliance with contractual terms or court orders. Commercial litigators should take note of the importance of the adoption of the Delaware standard in determining direct versus derivative standing for shareholders’ claims under Tennessee law. Under this opinion, Delaware law, as well as other states’ court opinions interpreting the Tooley standard, will serve as more persuasive authority in Tennessee courts than previous Tennessee decisions in the area (which were decided under a different legal standard). Litigators should also make sure that the correct plaintiffs and defendants are named in their cases based on this decision. Additionally, transactional attorneys should note that the many years of litigation in this case could have been avoided had the original shareholders’ agreement included an appropriate deadlock provision. Transactional attorneys should also ensure that court orders issued pursuant to an asset sale are expressly entered for the benefit of the buyers and their designees, and that the buyers and their designees are parties to any contract they wish to later enforce.