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Summary of Cases

By Mike Abelow

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1. Arbitration

Healthmart USA, LLC v. Directory Assistants, Inc., M2010-00880-COA-R3CV, 2011 WL 1314662 (Tenn. Ct. App. Apr. 6, 2011).

{Short Summary}
The Court considered an arbitration provision in a consulting contract that provided for binding arbitration. The provision allowed the party that filed the arbitration demand to select the arbitration service, location, and choice of law. The provision also provided that the other party expressly consented to the choices made by the demanding party so long as the demanding party acted in good faith. The trial court found the provision too ambiguous to be enforced. The Court of Appeals reversed, finding that the provision was not ambiguous. The Court also considered whether the non-demanding party's claim of fraudulent inducement of the contract must be submitted to arbitration and concluded that it must, despite the fact that Tennessee law prohibits the arbitration of fraudulent inducement claims.

{Long Summary}
A Connecticut consulting company and a Tennessee insurance agency entered into a consulting contract to help the Tennessee agency save on its advertising costs. The contract contained an arbitration clause providing:

> Should a dispute arise we both agree to try and resolve it with the other party. If we cannot, we both want to resolve it quickly and cost effectively. To achieve that, we both agree to resolve any dispute arising out of or relating to this contract through confidential binding arbitration and agree to mutually choose an arbitration service, location and choice of law forum. If we are unable to come to a mutual agreement, or if one of us refuses to participate in choosing, the party filing a demand will have the right to make the choices unilaterally, as long as the filing party made a good faith effort to come to a mutual agreement, and the non-choosing/non-participating party expressly consents to and waives any and all objections to the choices made.

A dispute arose and the Connecticut consulting company demanded arbitration. The Tennessee insurance company filed a lawsuit in Chancery Court. The Connecticut company filed a motion to compel arbitration. The Chancery Court denied the motion to compel, finding the good faith requirement ambiguous and subject to multiple interpretations. The Court of Appeals reversed, finding that the contract was unambiguous and was not merely an agreement to agree. The Court of Appeals ruled that leaving the choice of arbitration service, location, and choice of law to the party demanding arbitration made the contract too vague to be enforced. The Court contrasted these particulars of the arbitration with an agreement to agree on price.

The Court remanded for a factual determination of whether the Connecticut company made a good faith effort to come to a mutual agreement on the service, location, and choice of law.

Importantly, the Court also addressed the issue of whether the Tennessee insurance company's claim of fraud in the inducement must be arbitrated. Tennessee law prohibits the arbitration of fraudulent inducement claims, but federal law—the Federal Arbitration Act—allows it. Where the parties have expressly provided which law governs their contract—Tennessee law or federal law—the answer is clear. Here the contract was silent as to whether the law of Tennessee or the FAA was controlling. The Court decided that the Federal Arbitration Act applied, since the contract was between a

Tennessee company and an out-of-state company. Therefore, the fraud in the inducement claims must be arbitrated.

2. Bankruptcy & Judicial Estoppel

Reynolds v. Tognetti, W201000320COAR3CV, 2011 WL 761525 (Tenn. Ct. App. Mar. 4, 2011).

{Short Summary}
Failure to list state court tort lawsuit as asset in bankruptcy did not bar state court lawsuit; trial court should have considered plaintiff's motion to amend the complaint to add the bankruptcy trustee as a party rather than granting defendant's motion for summary judgment.

{Long Summary}
Plaintiff Reynolds was injured in an auto accident, then filed bankruptcy, received a discharge of his debts, and then filed a state court lawsuit. Reynolds failed to list the tort claim as an asset in his bankruptcy. Defendant moved for summary judgment on grounds of judicial estoppel. Reynolds responded by (1) asking the bankruptcy court to reopen his bankruptcy; and (2) moving the state court for permission to amend the complaint to add the bankruptcy trustee as a plaintiff.

The bankruptcy court reopened the bankruptcy case. The bankruptcy trustee filed a motion to intervene in the state court lawsuit or to substitute the trustee as the plaintiff for Reynolds.

The trial court granted the defendant's motion for summary judgment, ruling that Reynolds was judicially estopped from bringing the tort claim by virtue of his failure to list the claim as an asset in his bankruptcy case.

The Court of Appeals reversed. The Court distinguished between the doctrines of standing and judicial estoppel, and distinguished between these two doctrines which courts have sometimes been tempted to apply interchangeably.

As to standing, Reynolds did lack standing to bring the state court lawsuit —because the lawsuit arose from an accident that occurred prior to his filing of a bankruptcy petition, only the trustee had standing to pursue the lawsuit. When a bankruptcy debtor fails to schedule a tort claim as an asset, if the bankruptcy court permits the trustee to reopen the bankruptcy case and administer the asset, then the bankruptcy trustee has standing in Tennessee courts to pursue that claim. Thus, while Reynolds lacked standing, the trustee had standing, and the trial court should have considered the trustee's motion to intervene or substitute rather than dismissing the case on summary judgment.

As to judicial estoppel, in Tennessee that doctrine requires that the party sought to be estopped must have made a willfully false statement of fact (i.e. perjury). To apply this doctrine, the trial court must find that the plaintiff's previous statement was not made inadvertently or by mistake.

In cases where the failure to list the potential tort claim on the bankruptcy schedules is an omission, as opposed to a conscious and deliberate perjury, the Court of Appeals ruled that the bankruptcy trustee may proceed with the lawsuit. While the bankruptcy debtor lacks standing, the trustee does not, and the doctrine of judicial estoppels has no application because the omission was inadvertent.

The Court of Appeals reversed the grant of summary judgment and remanded to the trial court to consider whether to substitute the bankruptcy trustee as the plaintiff.

3. Civil Procedure

Webb v. Nashville Area Habitat for Humanity, Inc., 346 S.W.3d 422 (Tenn. 2011).

{Short Summary}
The Supreme Court declined to adopt the federal pleading standard for complaints to survive a motion to dismiss, abrogating a prior Court of Appeals decision that had applied the federal standard.

{Long Summary}
Starting in 2007, the United States Supreme Court issued a series of decisions formulating the pleading standard for complaints to survive a motion to dismiss in federal court. The U.S. Supreme Court emphasized that a complaint must contain enough facts to show that the complaint is "plausible."

The Tennessee Supreme Court unanimously declined to adopt the United

States Supreme Court's plausibility requirement. The Tennessee Supreme Court was of the view that the plausibility requirement was a major change in pleading practice. The Tennessee Supreme Court saw no need to alter pleading principles that had existed in Tennessee for over forty years, following the adoption of the Tennessee Rules of Civil Procedure in 1970. The Tennessee Supreme Court also believed that the plausibility standard required an evaluation of the merits at too early a point in the litigation, and was unfair to plaintiffs who might not have the information needed to survive a motion to dismiss under the plausibility standard and could only obtain that information through discovery.

In declining to adopt the federal plausibility standard, the Tennessee Supreme Court restated the standard that would be applied in Tennessee. The complaint need not contain detailed allegations of fact, but it must contain allegations on every material point necessary to sustain a recovery on some legal theory.

The Tennessee Supreme Court also clarified a statement from a 1997 Tennessee Supreme Court decision. In the 1997 decision, the Court stated that courts are not required to accept as true "legal conclusions" which are couched as facts. In the 2011 case, the Court said that this "legal conclusions" doctrine has been rarely invoked in Tennessee. The 1997 case involved an allegation that a statute was unconstitutional. The 2011 Court said that such an allegation is really a legal conclusion that is not entitled to be taken as true. In the 2011 case, the Court suggested that an allegation that the federal courts might consider to be conclusory—for example that a defendant discriminated against the plaintiff on the basis of race—would not be considered as conclusory in Tennessee. Instead, such an allegation would instead be considered a factual allegation that must be considered true for purposes of a motion to dismiss.

4. Contracts/Evidence

Johnson v. Tanner-Peck, L.L.C., W2009-02454-COA-R3CV, 2011 WL 1330777 (Tenn. Ct. App. Apr. 8, 2011).

{Short Summary}
Breach of contract action by former employee for breach of alleged agreement granting employee option to purchase 5% of business. Former owner, now deceased, refused to adhere to terms of alleged option. Court of Appeals upheld grant of summary judgment against owner's estate, but reversed grant of summary judgment against LLC that took over business operations. Court also reversed trial court's ruling excluding affidavit on basis of dead-man's statute.

{Long Summary}
Salesman claimed he had an oral agreement with owner of company. Under the agreement, owner granted salesman option to purchase 5% of company. Salesman tried to exercise option but owner refused. Company sold for over $70 million. Salesman sued owner and owner's companies in its various corporate forms. Owner died. Trial court granted summary judgment in favor of salesman.

The Court of Appeals considered the trial court's application of the dead-man's statute. The Court of Appeals decided that the statute prevented either the salesman or representatives of the estate from testifying about the discussions between the salesman and the owner concerning the option. Thus, neither the salesman nor the wife (who was the executor of the estate) would be permitted to testify as to discussions between the salesman and the owner. However, the salesman could prove the terms of the option through the testimony of other employees. Since the estate had no evidence to rebut the employees' testimony, summary judgment for the salesman was proper. The Court of Appeals also ruled that the trial court went too far in excluding, based on the dead-man's statute, portions of the wife's testimony that did not concern conversations her husband had with the salesman but that related more generally to the business.

The Court of Appeals reversed the trial court's grant of summary judgment in favor of the salesman against an LLC the owner had created to take over the operations of the business, which he had previously run as a sole proprietorship. The Court of Appeals saw no evidence in the record that the LLC had agreed to take on the option contract between the owner and the salesman. Normally, the Court emphasized, an LLC is not responsible for the liabilities of its predecessors.

The Court of Appeals also clarified how damages should be calculated in a case for breach of an option contract. Damages are measured as the difference between the buy-in price (the price at which the salesman would have purchased his shares, had the owner not breached the option contract by refusing to sell the shares) and 5% of what the company was sold for years later. The Court of Appeals reversed the trial court's calculation of damages for a number of reasons, including the trial court's failure to reduce the damages by the amount of bank debt that was paid off when the company was sold. There was over $21 million dollars in bank debt in this case; that bank debt should have been deducted from the over $70 million purchase price, as the salesman was entitled to 5% of the net proceeds of the sale, not the gross.

5. Corporate law

Baugh v. Novak, 340 S.W.3d 372, 375 (Tenn. 2011).

{Short Summary}
Overruling Court of Appeals, Supreme Court decided that stock purchase agreement and indemnity agreement were not void as contrary to public policy. Court of Appeals had decided that the agreements were nothing more than attempt to circumvent restrictions on transfer of stock, and that such restrictions are authorized by statute.

{Long summary}
Plaintiffs acquired company from non-parties. Non-parties provided seller financing. Transaction included limitation on right of company to transfer or issue stock, and plaintiffs agreed not to change their ownership interest without obtaining non-parties' consent.

Three years later, plaintiffs agreed to sell defendants half of plaintiffs' interest in the company. Defendants agreed to indemnify plaintiffs for 50% of company's liabilities, including liability on non-party seller note. Because non-parties would not consent to this transaction, plaintiffs' counsel drafted the documents to give defendants a 50% interest without the non-parties' consent.

Company failed, and plaintiffs sued defendants for contribution on note to non-parties. Court of Appeals ruled that indemnity agreement was void as contrary to public policy under TCA § 48-16-208 because it was drafted to circumvent the stock transfer restrictions in the seller financing agreement with the non-parties.

The Supreme Court reversed. Neither the non-party sellers nor the public were harmed by any violation. If the agreement was void, the only benefit would be to defendants, who participated in the alleged public policy violation and had shared in the benefits of owning 50% of the company. Moreover, although plaintiffs and defendants operated the business as 50/50 owners, it did not appear that plaintiffs actually transferred any stock to defendants. The non-party sellers could still enforce the stock restrictions, which was the purpose of the statute.

6. False Claims Act

Knox County ex rel. Envtl. Termite & Pest Control, Inc. v. Arrow Exterminators, Inc., 350 S.W.3d 511 (Tenn. 2011).

{Short Summary}
Company suspected that its competitor was overbilling county. Company conducted investigation, obtained public records, and presented detailed report to county detailing overbilling. Company brought qui tam lawsuit and county moved to dismiss, arguing that company was not original source because lawsuit was based on records previously in county's possession showing overbilling. Supreme Court held that company was original source, as county was previously unaware of overbilling, and while some documents were in county's possession, only company did investigation to connect the dots.

{Long Summary}
Termite control company became convinced that its competitor was overcharging the Knox County School System. The company requested that Knox County provide it with information concerning the payments the county had made to the competitor. The company coupled that information from the county with measurements it took of each of the county's schools. It determined that, for each school, the competitor's bills showed treatment of a larger surface area than actually existed at the school.

When county refused to act, company sued on behalf of county under the qui tam provisions of Tennessee's False Claims Act. County moved to dismiss, arguing that company was not an "original source" as required by the Act.

The Supreme Court ruled that company was an original source. While company relied in part on public records, only its investigation and coupling of those records with measurements of the area to be treated at each of the schools revealed that the seemingly innocuous public records of the competitor's billing of the county in fact showed fraud. The Court emphasized that the

False Claims Act was to be liberally construed, to encourage whistleblowers to uncover fraud.

7. Fiduciary duty/estate litigation

In re Estate of Storey, W2010-00819-COA-R3CV, 2011 WL 2174901 (Tenn. Ct. App. May 31, 2011), appeal denied (Oct. 18, 2011).

{Short Summary}
Statute of limitations for breach of fiduciary duty does not begin to run until fiduciary fulfills affirmative duty to inform beneficiary of all matters pertaining to the fiduciary relationship. Thus, the “discovery rule” applies differently to claims against a fiduciary.

{Long Summary}
Daughter, who was personal representative of her mother’s estate, alleged that her brother improperly used his authority as attorney-in-fact for mother and signatory on mother’s bank accounts to make gifts from mother’s bank accounts to himself.

Brother moved for summary judgment based on the three-year statute of limitations of TCA § 28-3-105, which provides that a claim for injury to personal property or conversion must be commenced within 3 years “from the accruing of the cause of action.”

The trial court granted summary judgment as to all of brother’s acts that occurred three years or more before mother’s death. Daughter appealed.

The Court of Appeals reversed the trial court’s grant of summary judgment. Although the claim was brought more than 3 years after the brother’s acts, this statute of limitations is subject to the “discovery rule” – the rule that the statute of limitations is tolled during the period in which the plaintiff did not know, or have reason to know, of the wrongful conduct and the injury.

The Court of Appeals first clarified that the person whose knowledge mattered was the mother, not the daughter, since the daughter brought her claim as the representative of the mother’s estate.

The Court next addressed which party bears the burden of proof as to the discovery rule. The Court concluded that since the discovery rule was part of an affirmative defense—the statute of limitations—the brother bore the burden to show that the mother should have discovered the wrongful conduct and the injury more than 3 years before suit was brought.

Importantly, the Court addressed an issue that appears to be one of first impression under Tennessee law. The Court clarified that courts must consider what the beneficiary knew, or should have known, in light of the fiduciary relationship between the beneficiary and the defendant. A fiduciary has an affirmative duty to inform the beneficiary of all matters pertaining to the fiduciary relationship. In this case, this included all facts relating to the brother’s expenditures and withdrawals. If that fiduciary relationship did not exist, perhaps someone in the mother’s position would have been on inquiry notice—for example by reviewing bank account statements—that something was wrong. But, because of the fiduciary relationship, the brother had an affirmative duty to disclose to his mother. As the Court put it, “facts which might ordinarily require investigation may not excite suspicion when a fiduciary relationship is involved.” In light of this holding, absent full disclosure by the fiduciary to the beneficiary, it may be very difficult for the statute of limitations to begin running.

8. Medical Malpractice

Shipley v. Williams, 350 S.W.3d 527 (Tenn. 2011).

{Short Summary}
The Supreme Court clarified the standards that trial courts should use when deciding whether a medical malpractice plaintiff has offered expert testimony that is admissible under the locality rule.

{Long Summary}
The Court clarified the application of the locality rule—T.C.A. § 29-26-115—which requires a medical malpractice plaintiff to prove by expert testimony the recognized standard of acceptable professional practice in the community where the defendant practices or a similar community.

The Court held that a medical malpractice plaintiff’s expert who has demonstrated familiarity with the standard of care in the community may testify that there is a broad regional standard or a national standard of medical care to which the defendant must adhere. Justice Koch dissented, arguing that nothing in the plain language of the statute or the Court's prior decisions supported reliance on a national or regional standard of care.

The Court and Justice Koch also parted company on the interplay of the locality rule and the Tennessee Rules of Evidence. The Court held that a trial court commits reversible error if it fails to view the expert's testimony in the light most favorable to the party opposing summary judgment. Justice Koch maintained that that Court had substantially altered the standard of review of summary judgments based on the inadmissibility of evidence. Justice Holder separately concurred to address the dissent, arguing that "the sky has not fallen," and that the Court had simply applied long-standing precedent that a trial court abuses its discretion when it applies an incorrect legal standard to exclude expert testimony.

The Court was unanimous in rejecting two Court of Appeals decisions from 2006 and 2007 that required that the plaintiff's expert have personal, firsthand or direct knowledge of the standard of care in the defendant's community.

9. Products liability

Nye v. Bayer Cropscience, Inc., 347 S.W.3d 686 (Tenn. 2011).

{Short Summary}
The Supreme Court unanimously declined to extend the learned intermediary doctrine—which allows a seller in a failure to warn case to rely on an intermediary to convey warnings about a dangerous product—beyond cases involving pharmaceuticals and medical products. The Court, over a dissent, also decided that the distributor could be sued for product liability because the manufacturer was not subject to service of process due to the manufacturer's bankruptcy filing.

{Long Summary}
The plaintiff was the widow of a worker at a DuPont plant in Chattanooga. The worker died from mesothelioma caused by exposure to asbestos over more than three decades at the plant. The widow sued a number of defendants, including the distributor that sold the asbestos-containing products to DuPont. The distributor asserted that DuPont was aware of the danger of asbestos, and therefore the distributor's failure to warn was not the proximate cause of the worker's injuries. The trial court gave a jury instruction that the distributor could not be liable for failure to warn if DuPont was already aware of the danger of asbestos or if DuPont failed to provide a safe workplace. The Supreme Court unanimously ruled that these jury instructions were erroneous. The Court found that these instructions were a misapplication of the learned intermediary doctrine, and declined to extend that doctrine beyond the pharmaceutical or medical arena. The Court did indicate that a products liability defendant may still argue that a party between the defendant and the injured consumer was an intervening cause of the injury. To make this argument, the defendant must show that the party in the middle of the chain took some conscious act of negligence—an example is a car salesman who is informed of a defect in the car, offered a fix for the defect, rejects the fix and then sells the car to a consumer who is injured by the defect. But, the mere knowledge of the intermediary, without more, is insufficient outside of the medical and pharmaceutical fields.

The Court divided on whether the distributor was subject to products liability claims at all. T.C.A. § 29-28-106 insulates distributors and retailers from products liability unless one of five exceptions applies. One of the exceptions is that the manufacturer is not subject to service of process. The asbestos manufacturers had all filed for bankruptcy, and the Court split on whether they were nonetheless subject to service of process. This issue required the Court to examine the Bankruptcy Code and, more particularly, the precedent of the United States Court of Appeals for the Third Circuit, since the asbestos manufacturers filed bankruptcy in Pennsylvania. The majority ruled that under Third Circuit precedent the manufacturers could not have been served.

10. Shareholder derivative actions

In re Healthways, Inc. Derivative Litig., M2009-02623-COA-R3CV, 2011 WL 882448 (Tenn. Ct. App. Mar. 14, 2011).

{Short summary}
Shareholder brought a derivative action against officers and directors of company, alleging they breached their fiduciary duties by, among other things, alleged insider selling and misrepresentations. Shareholder did not demand that company's board of directors pursue the claims. Court of Appeals concluded that shareholder had not pled facts with required particularity to excuse demand, as complaint did not show that majority of board engaged in insider trading.

{Long summary}
Shareholder brought derivative action on behalf of company against officers and directors for breach of fiduciary duty. Shareholder did not demand that company pursue the claims. Instead, shareholder claimed that any demand would be futile. Company was incorporated in Delaware, and Court of Appeals therefore applied Delaware law to determine whether complaint sufficiently alleged facts to show demand was futile.

The Court concluded that the complaint sufficiently alleged facts to show that demand would have been futile as to three of eleven directors. As to the three directors, the Court of Appeals determined that the allegations that the company was not succeeding in meeting cost savings targets; that the company's earnings would be negatively impacted once the truth came out; that these three defendants were aware of the company's true financial condition; and that they traded on the basis of inside information, were sufficient. However, demand was not excused because the complaint did not include detailed allegations as to a majority of the board.

The Court also considered the effect of an exculpatory provision, which relieves directors of liability for breach of the duty of care. The Court determined that, if a company has such a provision, a director cannot be held liable for breach of the duty of care, and therefore an allegation that a director breached the duty of care would not excuse demand, as the director could be disinterested in determining whether to authorize the company to pursue the claims.
