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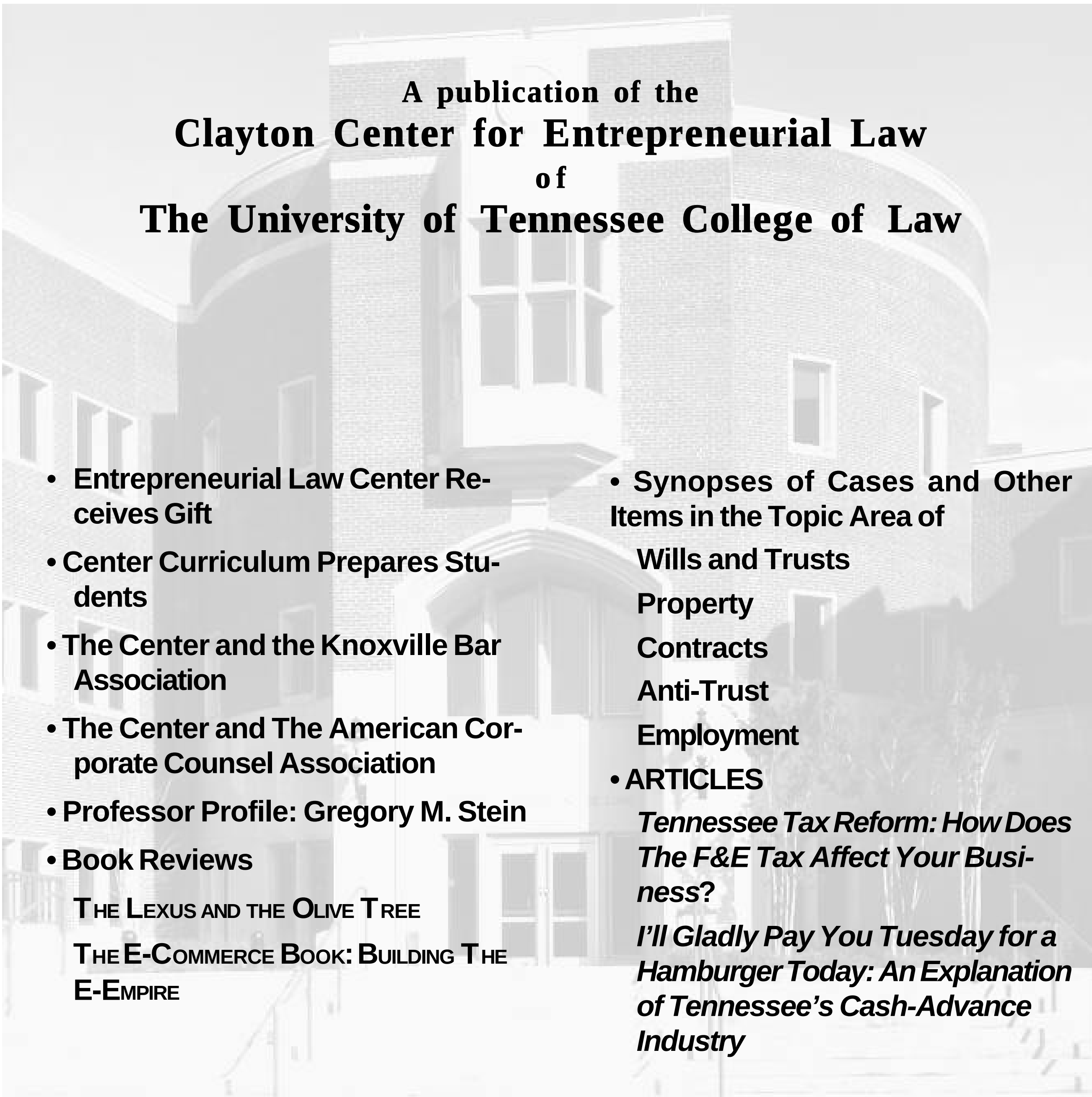
# TransactionS

## Tennessee Journal of Business Law



A publication of the
**Clayton Center for Entrepreneurial Law**
of
**The University of Tennessee College of Law**

# Transactions TENNESSEE JOURNAL OF BUSINESS LAW

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**The University of Tennessee College of Law**

# Contents



## Your Complimentary Copy

Complimentary copies of *Transactions* are being distributed to introduce this new journal to the legal community and, in particular, to regional business practitioners.

*Transactions* is published twice annually by the Clayton Center for Entrepreneurial Law at The University of Tennessee College of Law and will be available as a printed hardcopy delivered by mail or an electronic version delivered by e-mail.

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**Transactions TENNESSEE JOURNAL OF BUSINESS LAW**
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## NEWS & PUBLICATIONS

# Faculty Notes

**Professor Don Leatherman** had two articles accepted for publication in TAX STRATEGIES FOR CORPORATE ACQUISITIONS, DISPOSITIONS, SPIN-OFFS, JOINT VENTURES, AND OTHER STRATEGIC ALLIANCES, FINANCINGS, REORGANIZATIONS AND RESTRUCTURING. The articles are entitled *Shifting of Member Stock Basis Under § 1.302-2(c)* and *Extraordinary Gain and Loss Disallowance*. In March 2000, College of Law faculty granted tenure to Professor Leatherman.

**Professor Robert Lloyd**'s latest work is an article on the new Article 9 of the UCC. The article will appear in the TENNESSEE LAW REVIEW in two parts beginning with the 1999-2000 winter edition.

The TENNESSEE LAW REVIEW published **Professor Colleen Medill**'s article, *HIPAA and Its Related Legislation: A New Role for ERISA in the Regulation of Private Health Care Plans?*, 65 TENN. L. REV. 485-510 (1998). Professor Medill recently addressed the UT College of Law faculty regarding recent trends and legal developments in private, employer-sponsored retirement plans. Additionally, Professor Medill presented "Redesigning Federal Retirement Laws for an Age of Individual Responsibility" at the annual meeting of the Southeastern Association of American Law Schools. Finally, she addressed the annual meeting of the Tennessee Chapter of the Corporate Counsel Association, discussing *Employer Fiduciary Liability Under ERISA for Participant Retirement Savings Education and Investment Advice.*

**Professor Carl Pierce** spoke at the Sixth Annual Tennessee Corporate Counsel Institute in October 1998. His topic was *Current Developments Affecting the Professional Responsibilities of Corporate Counsel*.

**Professor Thomas E. Plank**, who has taught at the UT College of Law for the past five years, was granted tenure by the University of Tennessee Board of Trustees effective August 1, 1999. Professor Plank teaches Contracts II, Debtor-Creditor Law, Commercial Law, and Representing Enterprises.

Professor Plank published two articles in January of 1999. The first, *The Outer Boundaries of the Bankruptcy Estate*, was published in the *Emory Law Journal*. The second, *Why Bankruptcy Judges Need Not and Should Not Be Article III Judges*, was published by the AMERICAN BANKRUPTCY LAW JOURNAL after having been solicited at the suggestion of U.S. Court of Appeals Judge Edith Jones. The MARYLAND LAW REVIEW will publish Plank's article, *Creditors in Possession Under the Bankruptcy Code: History, Text, and Policy*, in the Spring of 2000. He is currently writing a short article entitled, *The Bankruptcy Trust as a Legal Person*, with plans to write two articles entitled, *The Efficiency of Securitization* and *The Secure Legal Foundations of Securitization.* In May of 1999 Professor Plank presented *The Firm Legal Foundations of Securitization* at the American Bar Association, Section of Real Property, Probate and Trust Law in Washington, D.C., and testified for the United States as an expert witness on mortgage-backed securities in a criminal racketeering trial, *United States v. Weiss,* heard by the United States District Court for the Middle District of Florida.

**Professor Gregory M. Stein**'s most recent article, *The Scope of the Borrower's Liability in a Nonrecourse Real Estate Loan*, appeared in the WASHINGTON AND LEE LAW REVIEW (55 Washington & Lee L. Rev. 1207 (Fall 1998)). His next article, *Who Gets the Takings Claim? Changes in Land Use Law Pre-Enactment Owners, and Post-Enactment Buyers*, has been accepted for publication by the OHIO STATE LAW JOURNAL and is slated to appear in the Spring of 2000. He has presented earlier versions of the article to the UT Law Faculty and to the Southeastern Conference of the Association of American Law Schools at its annual meeting. In May of 1999 Professor Stein spoke at the Practicing Law Institute's program on Commercial Real Estate Financing in Atlanta. He was a participant in two panel discussions entitled *Letters of Credit, Participations, Nonrecourse, and UCC Collateral* and *Trouble Ahead: Lender's First Ten Steps Before Acceleration*. His chapter on nonrecourse lending also appeared in PLI's published volume of course materials. Professor Stein is currently co-authoring a book entitled COMMERCIAL REAL ESTATE LAW IN PRACTICE, which is scheduled for publication by Harcourt Brace Professional Publishing in the summer of 2000. In March 2000 the College of Law faculty granted full professorship to Professor Stein.

## Entrepreneurial Law Center Receives $1 Million Gift

One of the nation's most successful entrepreneurs and his wife have made a gift of $1 million to the University of Tennessee College of Law.

Jim Clayton, the CEO and Chairman of the Board of Knoxville (Tenn.)-based Clayton Homes, Inc., and his wife Kay made the gift to the College of Law's Entrepreneurial Law Center, which shall henceforth be known as the Clayton Center for Entrepreneurial Law. Clayton is a 1964 UT law graduate.

"We are extremely grateful for this gift from Jim and Kay Clayton, which will allow our Center for Entrepreneurial Law to flourish," said UT Law Dean Thomas C. Galligan, Jr. "The gift will allow the Center to continue its groundbreaking work in training and informing lawyers, students, and business people about the legal aspects of business. We are proud to claim Jim Clayton as one of our graduates and are eager to work with him and Kay in the years ahead on this exciting project."

The Clayton Center for Entrepreneurial Law provides an academic concentration in business transactions for law students, as well as educational and support programs for legal practitioners, business professionals, and the public.

Reflecting on his gift, Clayton remarked, "Some aspects of legal training encourage some students to leave law school with confrontational, combative, and even in some situations an antagonistic attitude towards business. Too, the students may not recognize fully the opportunity available to assist in the start up and early growth stages of young businesses.

"To encourage positive and pro-active representation of businesses and individuals, the mission of the Clayton Center for Entrepreneurial Law is to educate students and heighten their awareness of the need and opportunity to support and guide entrepreneurs from the start up phase through the transformation into successful, productive enterprises."

In April 1998 Clayton was selected as the College of Law's first Distinguished Entrepreneur in Residence. At that time he shared his views about business lawyers and business law with the law school faculty and student body.

"When Jim Clayton visited the College of Law as the first Distinguished Entrepreneur in Residence nothing was more apparent than his interest in the well-being of our students," said Prof. Carl Pierce, director of the Center. "The Clayton's gift enables us to look forward to an exciting and productive future for the Center."

Clayton opened his first sales center for manufactured homes on Knoxville's Clinton Highway in 1966, and within two years his operation was the largest in the world. Clayton opened the company's first manufacturing plant in 1970, and today 19 plants supply homes to more than 1000-company owned and independent dealers in 28 states.

In addition, Clayton Homes also finances and insures manufactured homes and operates communities in a 27-state market.

Clayton worked his way through the University of Tennessee, Knoxville buying and selling used cars during the late 1950s, while an undergraduate student majoring in electrical engineering. Later, Jim and his brother Joe opened an automobile dealership in Knoxville while Jim was a law student. Jim used a loan from Clayton Motors to found Clayton Homes in 1966.

"I credit much of my success to the UT College of Law," Clayton said in a piece he wrote recently that appeared in a College of Law publication entitled LAWYERS OF THE PRESENT. "There the case studies came alive because I could relate the facts directly to issues in my own business life. The contacts and relationships developed there have given me a networking asset that I have called upon frequently."

## Business Courses Prepare Students for Transactional Practice

The University of Tennessee College of Law has designed an innovative program to prepare students to be transactional attorneys and/or entrepreneurs. The program offers a broad spectrum of classes to appeal to each student's business-oriented interests. Those classes include Income Tax, Corporate and Partnership Tax, Land Finance, Commercial Law, Business Associations, and Intellectual Property. To complement those classes, students concentrating in business are also required to enroll in Contract Drafting and Representing Enterprises. Those classes expose students to "skills-based" learning by teaching students how to deal with real-life business situations.

The Contract Drafting course is highly successful in equipping future transactional attorneys with the tools necessary to draft effective contracts. The course's success can be attributed to several factors. First, the instructors, adjunct professors who are full-time practitioners, bring their unique perspectives and a wealth of experience to the classroom. These attorneys, who have practiced in the legal field for years, provide the students with hands-on training. As a result, the students will be one step ahead of their counterparts when they begin their practices, having already drafted numerous documents and received valuable comments and criticisms concerning their work.

The course also exposes students to situations that they will encounter in practice. Students not only draft contracts but also get an overall picture of what practice is really like. Before any drafting takes place, students interview clients, negotiate with opposing parties, and research the applicable law. Then the students draft contracts based upon their clients' needs. Additionally, students are taught how to be good lawyers, regardless of the type of practice they engage in. Professors share their mistakes so that students may avoid those same mistakes in the future. Very few law school courses provide students with such practical and useful knowledge.

Guest speakers are an integral part of the Contract Drafting course. Loan officers, real estate experts, and other attorneys frequently discuss their experiences and needs concerning the drafting of contracts.

Finally, the various types of contracts students are required to draft provide them with an impressive base of experience to draw upon once they have entered the legal field. Leases, antenuptial agreements, shareholder agreements, and employment agreements are among the documents students draft during a typical semester. Checklists, client letters, and opinion letters are also written. The combination of all of these factors makes Contract Drafting one of the most successful courses in preparing future transactional attorneys for practice.

Representing Enterprises is the course in which students put all of their learning together to plan and draft documents for simulated transactions. In this course,students have the opportunity to take a step back and see "the big picture" by implementing the knowledge they have gained from all of the business-related law courses they have taken. The students plan major business deals and draft all the documents involved in the deals. These future transactional attorneys follow all of the steps in forming a new business, including the tax considerations, filings required, and negotiations. In addition, students acquire experience in dealing with individuals, both as clients and as adversaries. Corporate mergers and acquisitions are addressed in the course, as well as land development agreements, buy-sell agreements, dispute resolution, and estate planning. Much like Contract Drafting, this course is highly successful because the instructors are practitioners who are able to share their experiences with students. Representing Enterprises is the ideal course to prepare students for careers in transactional practice because it integrates classroom learning with real-world experience. As a result, UT College of Law students are better-prepared than their counterparts to practice in the business world.

Success of the Business Transactions concentration can best be measured by the preparedness of new graduates. Shannon Coleman, a new associate at the Knoxville firm of Gentry, Tipton, Kizer & McLemore, says that the classes in the Business Transactions concentration, especially Contract Drafting and Representing Enterprises, helped her tremendously when she began practicing. "My instructor pointed out issues that I would not have thought of just coming out of law school. I learned what to expect from the other side." The first week at her new job, Coleman was involved in two transactions for which she was asked to prepare the governing documents. Normally, a new associate might be apprehensive about the thought of preparing documentation for stock redemption and purchase agreements, but due to her law school experiences, Coleman was able to complete the assignment much more efficiently and knowledgeably than someone who lacked exposure to those facets of the law.

The UT College of Law Business Concentration is innovative, and its future is exciting. The program is teaching students how to practice transactional law, as well as how to generally be better attorneys. In addition, students develop meaningful mentor relationships with their instructors that will last beyond graduation. The UT College of Law is sure to become a national leader in the instruction of future transactional attorneys.

*--Kristi Bernard*

## Clayton Center for Entrepreneurial Law and the Knoxville Bar Association: Managing For Success

Attorneys face endless commitments on a daily basis. There is rarely the time or the energy left at the end of the day to brainstorm about how to improve office management. Ironically, it is the efficient management of the firm which allows the attorney to meet these commitments successfully. A lawyer who spends all of her time dealing with office matters has no time to practice law, which was her purpose for attending law school and opening a firm in the first place.

The University of Tennessee College of Law Clayton Center for Entrepreneurial Law, the Knoxville Bar Association, and the Knoxville Chapter of the Association of Regal Administrators recently cosponsored a CLE entitled "An Insider's Look at Law Office Management." This program was designed to assist attorneys in efficiently and effectively managing their offices. The featured speaker and moderator of the seminar was John Iezzi, CPA, president of the Iezzi Management Group. Mr. Iezzi worked for eight years as an auditor with Price Waterhouse before joining the Richmond-based law firm of McGuire, Woods, Battle & Boothe, LLP. Iezzi assisted the firm as it grew from 52 lawyers in two offices to 300 lawyers in eight offices.

The program focused on three major areas of law office management: Financial Management, Human Resources, and Technology. The Financial Management portion of the program focused on the budgeting and cash flow within the firm ,as well as time and billing practices and structure. It also addressed some compensation considerations.

In the afternoon the Human Resources program focused on the hiring and training of staff. Temporary staffing and conflicts of interest issues were also discussed. Finally, in the Technology portion of the seminar, issues such as e-mail, websites, and the use of computers to produce work products were discussed.

Several members of the Knoxville Bar Association, as well as a representative of Lockheed Martin Energy Systems, participated in panel discussions at the seminar.

There also was a resource kit which was distributed to assist the attorneys in implementing in their own firms some of the ideas discussed at the program.

Participants praised the seminar for both its practical nature and for the informative and lively discussions between the panelists and participants in the seminar. The Clayton Center for Entrepreneurial Law plans to work in conjunction with the Knoxville Bar Association to put on equally useful seminars in the future.

*--Jeffrey Griffin*

## Clayton Center for Entrepreneurial Law and the Tennessee Chapter of the American Corporate Counsel: A Win-Win Partnership

The University of Tennessee College of Law Clayton Center for Entrepreneurial Law has enjoyed a successful relationship with the Tennessee Chapter of the American Corporate Counsel Association ("ACCA"). The relationship, which has benefited both organizations, began with the cosponsorship of a series of Continuing Legal Education seminars.

ACCA is composed of practicing attorneys who are full-time employees of corporations. Members are employed in both small and large corporate legal departments and have a variety of experiences ranging from recent graduates to attorneys with over 40 years of in-house counsel experience.

Carl Pierce, Director of the Clayton Center, states that the goal of the Center is to "foster professional development of in-house counsel." The Center attempts to achieve its goal by focusing on three objectives: to enhance the business transaction curriculum of the University of Tennessee College of Law, to promote scholarship and lifetime learning for corporate attorneys in Tennessee, and to serve the legal profession and the public. The Center seeks to serve the niche market of corporate attorneys by developing a curriculum that will provide students with the skills that corporate legal departments require and by developing a CLE program that will provide corporate attorneys with the education necessary to foster their professional development.

Corporate attorneys spend most of their time in two areas: developing transactions and advising the corporation. In-house counsel provide corporations with a variety of services involving financial transactions, litigation, lobbying, and environmental and other compliance issues. Certainly, a major aspect of the job description is to advise the corporation on the many rules and regulations it must abide by.

In order to meet the needs of the corporate attorney, the Center has teamed with the ACCA to design an impressive CLE program tailored to accomplish the objectives of the ACCA/Center relationship. The program offers 3 hours on ethics and 9 hours on other areas of interest to the corporate attorney. For example, University of Tennessee College of Law Faculty members have taught sessions on ethics, products liability, and pension planning. The focus of the CLE program is to provide corporate attorneys with an opportunity to complete CLE training in areas that are specifically tailored to their needs.

Ed Christenberry, General Counsel for TVA and current president of the Tennessee ACCA, values the contribution of UT professors such as Carl Pierce and Dean Thomas Galligan who conduct the CLEs. Christenberry states that "the CLE attendees benefit immensely from having UT professors conduct CLEs on current issues." However, ACCA is not the only group that benefits from the CLEs. UT professors benefit from their interaction with in-house counsel and this interaction is translated into a richer classroom experience for UT law students. Thus, the professors are able to add value to the business transactions curriculum by educating law students with information that is vital to the practice of corporate law. Christenberry believes that the partnership between the two organizations has been positive for both sides and will only continue to improve in the future as the Center and ACCA's relationship grows.

Mike Vaughn, General Counsel for Willis Coroon in Nashville and past president of the Tennessee ACCA chapter, concurs with Christenberry on the success of the CLE program. Vaughn recognizes the value of the program and believes that attendance for the CLEs will continue to grow each year as word spreads about the program's existence and quality. Vaughn stated that the attendees of the CLEs have been pleased with the educational and networking aspects of the program. In particular, Vaughn stated that the Ethics of Professionalism program is especially helpful because it is focused on in-house counsel instead of attorneys practicing in law firms. He stated that "Professor Pierce does a great job making the information relevant and interesting to in-house counsel."

Vaughn sees a bright future for the Center. Aside from continuing the successful CLE programs for corporate attorneys, he hopes that the programs will attract more students. Vaughn believes that the Center will enable students to gain valuable academic and practical skills. The result of this enhanced instruction will be students who are better prepared to be effective corporate attorneys.

*--Kolin B. Holladay*

## Professor Profile: Gregory M. Stein, Bridging the Gap

As the saying goes, there is no substitute for experience. Recent law school graduates encounter this problem in their initial years of practice as they often have the knowledge but lack the specialized skills necessary to complete sophisticated business transactions. Gregory M. Stein, Professor of Law at the University of Ten-

nessee College of Law, recognizes a significant learning gap for attorneys just emerging from law school into their first years of practice. Specifically, Professor Stein believes new attorneys could have considerable difficulties representing real estate clients without knowledge of the practical applications and intricacies of real estate transactions. "Law schools often do not teach students how to practice law. Then the new lawyer gets to the firm – where they are supposed to learn – and the firm is so busy and cost conscious that they do not have a great deal of time for training," says Professor Stein.

To assist these attorneys in beginning their practice, Professor Stein and two coauthors have teamed with BarBri and Harcourt Brace Publishers to write a book on mortgage and commercial real estate law entitled COMMERCIAL REAL ESTATE LAW IN PRACTICE, tentatively scheduled for publication in July 2000. Professor Stein states that the book, aimed at junior attorneys with basic knowledge, "will serve as a guide for people who have the background but not the experience to conduct real estate transactions."

Professor Stein, a graduate of Harvard University and Columbia University Law School, joined the University of Tennessee College of Law faculty in 1990 after practicing law for four years in the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison, where he specialized in commercial real estate transactions. He currently teaches courses in land acquisition and development, land finance law, land use law, law and economics, property, and advanced property. Professor Stein, a recipient of the Harold C. Warner Outstanding Teacher Award, has published a number of articles on various aspects of real estate law in law journals and other publications across the country.

The commercial real estate law text will be one volume in a series of practice guides coauthored by professors and practicing attorneys. Professor Stein explains that "the idea is to have both academic and practical perspectives in each of the volumes." In further describing the goals of the series, Professor Stein says that "the books are primarily aimed at junior attorneys who come out of law school with basic knowledge but do not know how to draft a contract." This volume and the others in the series will aid in the transition from student to practicing attorney by providing sample language and suggestions for drafting certain provisions of real estate contracts and other instruments.

Professor Stein believes law schools recognize that there is still a rift between education and practice, particularly in the area of business law, which offers fewer clinical opportunities. Currently, a student may complete many excellent business law courses and still lack the ability to put those principles into practice. Law schools such as the University of Tennessee, with its Clayton Center for Entrepreneurial Law, are attempting to address this problem by establishing business transactions centers and offering more "practical" types of courses such as contract drafting.

According to Professor Stein, law firms traditionally taught their new attorneys the practical aspects of real estate transactions, but with firms becoming more thinly staffed, the junior attorneys must have other resources readily available. Professor Stein, like many other professors, tailors his classes to the problems students will face in practice by considering various alternatives and asking how the students could have avoided the problems presented in the case books. He states that "our job is to teach background principles so students can understand where their deal fits into the law."

In addition to his focus on the transactional aspects of real estate and mortgage law, Professor Stein has authored several articles on the Takings Clause. His most recent article, "Who Gets the Takings Claim? Changes in Land Use Law, Pre-enactment Owners, and Post-enactment Buyers," will appear in the OHIO STATE LAW JOURNAL this spring. "What I'm trying to do," Professor Stein states, "is to keep up to date and continue writing in both areas of the law. I want to address important constitutional issues while continuing to help students better understand and engage in the transactional practice of law."

*--Jamie Winkler*

## Book Review:

## GLOBALISM IN THE 21st CENTURY

Thomas L. Friedman, THE LEXUS AND THE OLIVE TREE (1999). Farrar Straus & Giroux. 394 pages. $27.50.

**By R. Todd Bouldin[1]**

In the late 1990s, economies, cultures and businesses around the world witnessed the birth of one of the century's most noteworthy developments: globalism. What does globalism have to do with transactional law? More than it may seem. The lesson of THE LEXUS AND THE OLIVE TREE for law schools and law firms, wherever they may be, is this: they can no longer afford to bypass international law as a practice area for specialists at prestigious firms in large cities. Globalism has brought issues of international trade, and thus international law, to the doorstep of the local business and the local lawyer.

In 1999, the world celebrated the tenth anniversary of the fall of the Berlin Wall, an event that defined international politics of the last decade. Thomas Friedman, THE NEW YORK TIMES foreign affairs columnist and the author of the award-winning FROM HERE TO BEIRUT, argues in his latest book THE LEXUS AND THE OLIVE TREE that the toppling of the Berlin Wall alone triggered the ascendancy of a new and seemingly irreversible system of globalism that now shapes the lives and work of every world citizen. Globalism, as Friedman deems it, is "the dominant international system at the end of the twentieth century." Friedman writes that as international markets and states cope with globalism, they will find themselves strained between the drive for prosperity through the growth of technology and finance on one hand (symbolized by the Lexus) and the traditional values in which local cultures remained rooted on the other (symbolized by the Middle Eastern olive tree). It is this tension which Friedman engages in the pages of this compelling book.

Though the subject of globalism has received much attention in recent journals and books, Mr. Friedman may have written the definitive treatment on the sweeping implications of globalism for the United States and the most remote corners of the globe. Friedman understands the economics of world trade and investment, but his telling of specific examples, many of them amusing, provide the book with its unique contribution to the globalism debate. His use of anecdotes and travelogues like his accountings of the Taco Bell in Qatar and the Burger King on the Champs Elysees personalizes the globalism debate through the eyes of a journalist so that the reader can understand the human dynamics of international economics and politics.

Most importantly, the author spells out the truth of globalism: despite political setbacks and protectionist protest, globalism is inevitable. But, not only is the trend toward international participation inevitable, it is, on the whole, beneficial for every nation and people. Mr. Friedman has spoken the words that our political leaders have been unable or unwilling to speak with effectiveness: globalism properly regulated by the rule of law and mediated by independent panels such as the WTO is good for the rich and the poor, the corporation and the laborer, the developed world and the developing one.

For Friedman, disputes about globalism are irrelevant because the technological revolution and the dynamics of international investments have made globalism irreversible. Governments like the former Soviet Union can no longer control the flow of information within their territories, now that mobile phones, satellite communications, and the Internet allow for international communication irrespective of borders. Government officials who once could influence the economic activities of investors are unable to do so now because markets change with lightening speed as global investors and foreign markets become interconnected. Capital can no longer be contained within borders now that currency can be moved with the click of a mouse. Nonetheless, Friedman believes that these developments do not mean the end of the nation-state or the demise of legal structures. Nations will continue to thrive and respond to globalism with varying degrees of effectiveness; their success or failure depending on whether they succeed in attracting the attention of international investors, or as Friedman calls them, "the Electronic Herd." Because the Electronic Herd is no longer limited by national borders and the Internet is global in its reach, even the poorest of nations may provide grazing ground for the hungry Herd.

However, the Electronic Herd will be particular about where it grazes. To attract global investors, nations will be forced to enact the "Golden Straightjacket": the privatization of state enterprises, the lowering of tariffs, the removal of restrictions on foreign investment and government subsidies, and the balancing of national budgets. Nevertheless, Friedman understands that a nation's economic action will be ineffective in creating an atmosphere for global investment if the legal and ethical prerequisites are not in place to assure investors of reliable, functioning markets: potent securities market regulation, clear shareholder rights, predictable corporate laws, fair bankruptcy procedures that encourage investment, and the acceptance of internationally recognized auditing and accounting standards. A nation must follow the way of the Herd or it will lose its way in the global marketplace. As Friedman illustrates, when France resisted the free use of U.S. encryption technology, the head of Intel's European marketing department used a razor blade to physically remove France from his map of the world. Thus, nations may choose the policies they desire, but they will be subject to the discipline of markets.

Though Friedman states that economies will respond to globalism in varying degrees, he fails to see that his approach allows for little diversity in such responses and fails to offer little more than abstract proposals and vague hopes to the developing world. Instead of recognizing that several forms of government have given rise to flourishing economies, Mr. Friedman's "Golden Straightjacket" seems to reflect the fiscal policies and legal structure of the United States. The author also offers few suggestions to the governments of developing countries for protecting their economies from the harsh effects of international investment. For example, his prescription for International Monetary Fund and World Bank reforms are formulaic and fall short of real proposals to protect poor nations. Though Mr. Friedman limits his foray into policy territory, he succeeds on a grand scale in his analysis of the most significant hope for the reform and economic success of the developing world: the transparency and interconnectedness of markets and states created by the sprawling Internet. This valuable insight alone, and the narratives he offers about the business created in developing countries by those with access to the Web, overshadow his otherwise limited and Americanized counsel for poor nations and those on the brink of international economic disintegration. Mr. Friedman does seem to forget, however, that millions of citizens of developing countries do not have access to a balanced diet, let alone the World Wide Web.

But here in America, even the smallest of Tennessee and American businesses now export goods abroad, many of them selling their wares over the Internet. Therefore, Tennessee attorneys must begin to inform themselves of international law. Otherwise, many clients may risk criminal or civil liability because they conduct their business without the assistance of counsel. Furthermore, some clients may benefit from attorneys who could point them to export opportunities.

Firms whose expertise includes international trade law will possess a valuable business development tool in the 21st century global business environment. Clients may look to larger and more expensive firms in Washington, D.C., or New York for counsel if a local firm is unaware of international trade law. While it heretofore has been acceptable to confine one's expertise to domestic law, Friedman's book opens up the brave new world where only the internationally informed business, or law firm, will survive in the coming age.

THE LEXUS AND THE OLIVE TREE is clear that globalism will leave no stone unturned, no client unaffected. For this reason, the book is an invaluable and accessible read for any lawyer who wants to serve transactional clients comprehensively and ethically in the age of the Internet and globally-connected economies. Friedman vividly communicates his firm, if not elated, belief that the Electronic Herd is coming to a client near you, and only lawyers with global perspectives will help create the conditions that will make the Herd want to stay.

[1] R. Todd Bouldin is a third year law student at the University of Tennessee.

## Book Review:
## A NEW GUIDE TO COMMERCE IN THE 21st CENTURY

Steffano Korper & Juanita Ellis, THE E-COMMERCE BOOK: BUILDING THE E-EMPIRE (2000). London: Academic Press. 284 pages. $39.95.

**By Trevor Smith**[1]

Internet commerce is rapidly becoming a common element of the business world. Although specific estimates vary, experts agree that e-commerce will constitute several hundred billion dollars within 5 years, and will become a major element of the U.S. and global economies. This new online business world creates both an opportunity and a challenge to the legal profession. Within a very short time, concrete knowledge of Internet business practices will be a necessity for all successful business attorneys. In THE E-COMMERCE BOOK, the authors explain how to establish and maintain an online business presence. This work, although not legal in nature, can be a useful resource for the business attorney seeking to understand the fundamentals behind e-commerce.

Korper and Ellis assert that sales of basic consumer goods, which is currently the prime element of Internet commerce, is only the beginning of the e-commerce future. They argue that all businesses, regardless of products sold or markets reached, will be changed by, and forced to adapt to, online commercial practices. According to Korper and Ellis, forty percent of all business to business transactions will be online within seven years. They assert that any company which resists the move into e-commerce will not survive long into the next century. The authors correctly point out that the Internet is littered with new companies, many with market values of millions and even billions of dollars, that are challenging those corporations which have failed to embrace the new electronic medium.

This work discusses every element of building and maintaining a new online business, and creating an online business presence for existing companies. Perhaps one of the most useful elements of this work is the in-depth discussion of online marketing and the list of resources which can be used to generate customers. The authors also discuss business challenges such as globalization and language barriers, hardware and software solutions, online transactions, and online security. Each of these topics is presented clearly, and all necessary elements of online business are discussed.

Lacking in this work is help for the Internet newcomer. The authors assume that the reader already has access to the Internet and a working knowledge of Internet use. Because a web site is the basic element of all Internet business, the authors do not explain to the reader how to set up a presence on the World Wide Web, nor do they discuss other Internet basics such as finding a service provider or choosing software. Such an obvious oversight is understandable, however, given the nature of this book. A simple website can be used to inform the consumer and place the consumer in contact with a company. This work explains how to convert such an existing Internet presence into a vehicle for business transactions. This work also does not discuss the unique legal issues which surround the growth of e-commerce. Such issues include compliance with international laws, liability, jurisdiction, and taxes. In the near future such issues will almost certainly re-define business law in many ways.

The authors correctly assert that the issues surrounding Internet business are quite different from those of bricks and mortar companies. For today's business lawyer, lack of such knowledge will soon prove to be more than a hindrance; it could be a career-threatening liability. On the other hand, a clear understanding of Internet commerce will provide tremendous opportunities for those who seek it.

[1] Trevor Smith is the founder and CEO of Smith Online Entertainment, Inc., which operates HistoryDaily.com and FirstShopping.com.

## SYNOPSES

### WILLS AND TRUSTS

***Battles v. First Union National Bank*, No. 01A01-9809-CH-00497, 1999 WL 675126 (Tenn. Ct. App. Sept. 1, 1999)**

In *Battles v. First Union National Bank*, two heirs under a contested "will" sued a notary public, the notary's bonding company, and a bank for failing to correct their father's belief that the document he signed constituted a validly executed will. The Court of Appeals of Tennessee held that the notary and the bank's employees are not responsible for correcting a testator who mistakenly believes that notarization of his signature in the absence of witnesses validated his will.

In the instant case, Cleon H. Cooke, Jr., traveled to First Union National Bank in Hendersonville, Tennessee, on November 28, 1995 to execute his will. It is uncontroverted that he intended to execute a preprinted will previously completed by the testator by filling in the blanks holographically. Upon his arrival at First Union, one of Cooke's daughters entered the bank to find an individual who would notarize his "will." Cooke waited in his car until his daughter returned with Beverly Pitt, a customer service representative. Pitt watched Cooke sign the document, entitled "Last Will and Testament." She then took the document into the bank and found two bank employees to attest to Cooke's "Last Will and Testament."[1] The witnesses to Cooke's will were bank employees. Neither Pitt nor the bank's employees advised Cooke that the notarized and "witnessed" document failed to meet the due execution requirements mandated by the Wills Act. *See Tenn. Code Ann.* § 32-1-104.[2]

The "testamentary" document signed and notarized in 1995 purported to convey his business, C & S Cleaners of Hendersonville, to his living children. Under this instrument, Cooke also designated the residue of his estate to benefit his widow, Angelina Q. Cooke. But under his formally executed and valid 1976 will, the testator bequeathed all of his real and personal property to his widow. When the decedent's daughters probated the 1995 document, their mother filed a will contest alleging that the 1995 "will" was improperly executed and void. In response, Allison and Leslie Cooke initiated the instant action alleging negligent execution of decedent's will by the notary, the bank, and the notary's bonding company.

Curiously, of the decedent's seven children, only Allison and Leslie attempted to hold the defendant liable for negligent execution of the 1995 "will." In their complaint, the Cooke sisters neglected to explain whether the probate court had actually invalidated the 1995 document pursuant to Angelina Cooke's will contest. Nevertheless, the *Battles* court pressed on to answer the issues presented on appeal.

With regard to the claim of negligent execution asserted against the notary, the *Battles* court held that Pitt acted competently. Adopting a California precedent, the court ruled that a notary does not have an obligation to "give advice about the legal effects of papers to which she witnesses a signature." *Battles*, 1999 WL 675126 at *2 (citing *Vanderhoof v. Prudential Savings and Loan Ass'n.*, 48 Cal.App. 3d 507, 520, 120 Cal. Reptr. 207 (Cal. Ct. App. 1975). The *Battles* court buttressed Tennessee's own case law which required only ordinary care because the notary "is not an ensurer of the truth of [her] recitals." *Figures v. Fly*, 193 S.W.2d 117 (Tenn. 1917).[3]

The court in *Battles* next determined whether the witnesses to Cooke's 1995 "will" violated a duty of care to the testator's daughters. In answering this point of law,[4] the court emphasized that the plaintiff could not claim a vested interest in the decedent's will even if it had been validly executed. The basis for the court's conclusion rested on the well settled notion that "a beneficiary under the will has no property rights in the testator's property until the testator's death." *Dought v. Hammond*, 341 S.W.2d 713, 716 (Tenn. 1960). The court also indicated that the "witness immunity shield" might provide the witnesses to the 1995 "will" with additional protection from tort immunity for false testimony. *Buckner v. Carlton*, 623 S.W.2d 102 (Tenn. Ct. App. 1981). Under *Buckner*'s immunity shield, witnesses receive qualified immunity from testimony taken in open court even when their statements are false or malicious.

In denying the plaintiff's appeal, the court protected witnesses because the court found that they play no part in drafting testamentary instruments. The court distinguished witnesses from those who draft wills that later fail for inadequate due execution. *See Biakanja v. Irving*, 320 P.2d 16 (Cal. 1958). But in *Battles*, the court concluded that the plaintiff's interest in receiving a share of her father's estate comprised a mere expectancy. Thus, like notaries, witnesses are not subject to a duty requiring them to aid putative beneficiaries whose hope for inheritance rests upon unrealized hope. Accordingly, the court held that the bank did not have a duty to train its employees on the due execution of testamentary instruments because witnesses do not have a duty to the testator.

The *Battles* court established that notaries and witnesses shall bear no tort liability for their involvement in the execution of a will unless they drafted the will. However, the court also indicated that even a witness to an invalidly executed will might defend her actions under *Buckner*'s 'qualified witness' exception allowing false or malicious statements in open court. Thus, *Battles* teaches that banks, law firms, and even notary bonding companies in Tennessee need not train their employees in the technicalities of proper testamentary execution under the Wills Act.

--*Justin R. Martin*

1. It is not entirely clear what the witnesses to Cooke's "will" actually signed. It appears that they signed the will's pre-printed attestation clause and self-proving affidavit. Cooke's will would not conform to the requirements of valid execution of Tennessee's Wills Act if the witnesses signed the affidavit but neglected to sign the will itself.
2. The plaintiff attributed the 1995 document's purported invalidity arose from negligent notarization and witnessing of her father's "will." The testator's daughters further alleged that the witnesses committed perjury in signing a false affidavit and that the notary negligently failed to inform the decedent that these procedures did not meet the legal requirements of a valid will execution.
3. The *Battles* court incorporated this position on the notary's innocence, holding that "failure to volunteer information as to the legal effect of the manner of its attestation is not actionable for the reason that she not only had no duty in this respect, but for her to have done so would have been an illegal act. 1999 WL 675126 at *2; 120 Cal.Rptr at 209.
4. The existence or nonexistence of a duty is a question of law for the court. *Glenn v. Conner*, 533 S.W.2d 297 (Tenn. 1976).

***Estate of J.P. Walker v. Tenn. Dept. of Revenue,* C/A No. 03A01-9808-PB-00250, 1999 Tenn.App.LEXIS 447 (Tenn. Ct. App. July 13, 1999)**

Upon death, a decedent's estate is often subjected to federal and state taxes. The issue presented in *Estate of J.P. Walker* is whether federal estate and income taxes have priority over state inheritance taxes when the estate is insolvent. The trial court found the Federal Insolvency Statute applicable in this case, and the court granted priority to the federal tax claim. The Tennessee Department of Revenue appealed the decision.

J.P. Walker died testate in 1991; consequently, his estate was assessed federal estate and income taxes. By 1995, the Estate's aggregate federal tax liability was over four million dollars. The Tennessee Department of Revenue's inheritance tax claims totaled over a half a million dollars. In late 1996, the estate filed a notice of insolvency because it lacked sufficient funds to pay both tax claims in full.

The United States claimed that it was entitled to priority in payment of the tax debts, relying on the Federal Insolvency Statute, 31 U.S.C.A. § 3713. That statute provides, in pertinent part, that "A claim of the United States shall be paid first when . . . the estate of a deceased debtor . . . is not enough to pay all debts of the debtor . . . ." 31 U.S.C.A. § 3713 (a)(1)(B).

The Tennessee Department of Revenue claimed that the Federal Insolvency Statute was inapplicable to this case because the state inheritance tax claim is not a "debt of the debtor" since it arose after the death of Mr. Walker. Tennessee claimed that its tax lien arose at the same time as the federal tax lien—upon Mr. Walker's death. Additionally, the Department of Revenue argued that its competing tax claim should share "pro rata" in the distribution.

The United States Supreme Court has consistently held that in cases of insolvency § 3713 confers an absolute priority to federal tax claims over state claims, allowing no exceptions. *See United States v. Vermont*, 377 U.S. 351, 84 S.Ct. 1267, 12 L.Ed.2d 370 (1964). In various cases, the Supreme Court observed that § 3713 should be construed liberally to favor priority of federal claims. *United States v. Moore*, 423 U.S. 77, 96

S.Ct. 310, 46 L.Ed.2d 219 (1975); *United States v. Key*, 397 U.S. 322, 90 S.Ct. 310, 46 L.Ed.2d 219 (1975). A public policy reasoning, having sufficient revenue to provide for the public welfare and protection of the public fiscal situation, has been employed by the Supreme Court to justify the liberal construction of § 3713.

The Tennessee Court of Appeals held the Federal Insolvency Statute applicable in this case as well. The state inheritance debts are "debts of the debtor" within the meaning of § 3713. Although the Department of Revenue argued that such taxes are debts of the *estate* (not the debtor), the Court of Appeals held that the liberal construction of § 3713 includes state inheritance taxes as "debts of the debtor." Decisions in other jurisdictions are consistent with the Tennessee Court of Appeals determination.

This decision will primarily effect Tennessee tax lawyers and estate planners. Specifically, there should be no doubt when advising clients whether to pay federal tax debts or state tax debts first. Clearly, clients should be advised to satisfy all federal tax estate claims before state claims.

--*South Lewis*

## PROPERTY

### *Graham v. Edmundson*, 1999 WL 476466 (Tenn. Ct. App. July 12, 1999)

For years, lawyers who wanted to place restrictive covenants on property advised their clients to place such restrictions on title to the land when the client owned it as a whole. Lawyers in Tennessee have generally cited *Southern Advertising Co. v. Sherman*, 308 S.W.2d 491 (Tenn. 1957) and *East Sevier County Util. Dist. v. Wachovia Bank & Trust Co.*, 570 S.W.2d 850 (Tenn. 1978). In *Sherman*, The Tennessee Supreme Court held that restrictive covenants would be given effect to the property only as it existed at the time of the covenant. In *Graham*, the Tennessee Court of Appeals reaffirmed the decision not to give restrictive covenants retroactive effect.

In March 1978, Fitts and Johnson Development Company acquired a tract of land that eventually became Bluff Road Acres. On April 7, 1978, two of those tracts were sold to Hasty Construction Company. Then, on September 13, 1978, Fitts and Johnson executed and properly recorded restrictive covenants that purported to cover the entire property. The appropriate parts of the restrictions stated that 1) no trailer homes are to be erected upon the property; and 2) no commercial activities are permitted in the restricted area. The record also states that Hasty Construction never agreed to the restrictions on the two lots it owned. Two months after the restrictions were recorded, Hasty sold part of the land in question to the Thomases, who in October 1981 sold the property to the Edmundsons. In 1991, the property was quitclaimed to Mrs. Edmundson after she and her husband divorced. Edmundson subsequently erected a mobile home, expanded a barn, held rodeos, and opened a beauty parlor. Twenty-one homeowners then filed suit asserting violations of the restrictive covenants and sought injunctive relief.

The trial court granted summary judgment for the defendant stating that "a covenant running with the land must be confined to the property as it existed at the time of the covenant…." In addition, the fact that the defendant had knowledge of the restrictions and even felt bound by them for some time was not pertinent. The grant of summary judgment decreed that there were no issues of material fact and only one conclusion could be drawn from the facts. The plaintiffs appealed, and in a de novo review, the court of appeals addressed the pertinent question. The Court dealt with the power of a developer to bind property it does not own by filing a subdivision plat with restrictive covenants.

Quoting *Sherman*, the court concluded that restrictive covenants will only be valid to the property as it existed at the time of the covenant. The fact that Fitts and Johnson placed the restrictions on the land several months after they sold the land to Hasty (and Hasty never agreed to the restrictions) meant that the restrictive covenants never attached to the property in question. The court then, quoting *East Sevier County*, restated that no covenants should be given general retroactive effect.

This decision reaffirms Tennessee law stating that if a developer (or any other party) wants to bind an entire piece of land, it must place the restrictive covenants on the land while it owns the entire tract. The possibility of placing a retroactive covenant on another's land without the acquiescence of the other party is fiction. Developers must remember to place restrictive covenants on land before any piece is sold. The decision in *Graham* encourages transactional attorneys to identify the needs and desires of their clients and to act upon those needs and desires before any part of the property is sold.

--*Neil Brunetz*

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### *Hathaway v. First Family Fin. Servs., Inc.*, 1999 WL 668786 (Tenn. Aug. 30, 1999)

Prior to 1978, Article 11, Section 7 of the Tennessee Constitution provided a ten percent ceiling on conventional interest rates. Such a ceiling restricted the availability of credit during periods of inflation. In 1978, the General Assembly addressed this problem with the passage of a constitutional amendment and, additionally, with a package of reform legislation enacted in 1979. Part of this reform legislation was the Industrial Loan and Thrift Companies Act (Loan and Thrift Act) which governed the conduct of industrial loan and thrift companies. In *Hathaway*, the Tennessee Supreme Court was asked to decide the formula for calculating a service charge in connection with a refinancing transaction. In addition, the Court was asked to decide the scope of a borrower's remedies for violation of limitations on loan charges imposed by the Loan and Thrift Act.

Joe and Willie Hathaway obtained a loan from First Family Financial Services, Inc. (First Family), the predecessor-in-interest. This loan was secured by a lien on their home. In September 1995 the Hathaways refinanced their loan with First Family. The Hathaways executed, in exchange for the second loan, a promissory note that included the principal amount of the second loan plus precomputed interest thereon over the life of the second loan. The Hathaways used proceeds from the second loan to completely retire the first loan. First Family imposed a service charge on the second loan, which was calculated by subtracting the amount that was used to retire the initial loan balance from the total amount of the refinancing loan and assessing a four percent service charge on the remaining balance.

Thereafter, the Hathaways filed a complaint against First Family in the Chancery Court for Davidson County, on behalf of themselves and "others similarly situated," alleging that the method used by First Family to calculate the four percent service charge had resulted in a charge in excess of the maximum permitted under Tenn. Code Ann. § 45-5-403(1)(A) (Supp. 1998). As a result, the plaintiffs sought "the full array of remedies provided in T.C.A. § 47-14-117 (1995)." Their complaint also alleged that the excessive service charge constituted fraud, negligence, misrepresentation, unjust enrichment, and violated the Federal Truth in Lending Act, the Federal Real Estate Settlement Procedures Act, and the Tennessee Consumer Protection Act.

After First Family removed the case to the United States District Court for the Middle District of Tennessee, First Family filed a motion to dismiss for failure to state a claim. First Family asserted that the service charges at issue were legal pursuant to the Loan and Thrift Act and that this Act provided the Hathaways with their exclusive remedy. As a result of this motion to dismiss, the district judge entered an order certifying to the Tennessee Supreme Court the two questions previously stated, and signifying that these questions were dispositive of First Family's motion to dismiss. The Tennessee Supreme Court accepted certification of these questions.

With respect to the first question, the dispute centered around the determination of the amount that is to be subtracted from the "total amount of the loan" which is "that portion of a loan used to pay any existing loan or part thereof owing by the same borrower." The Hathaways argued that the amount used to pay off their first loan should include the outstanding principal plus any interest on the original loan that would have accrued after the date of refinancing, even though the interest never accrued because the original loan was retired by the refinancing loan. In this manner, the amount on which First Family could have imposed a service charge would have been substantially reduced. The Court rejected the Hathaways interpretation because no portion of the refinancing loan was actually used to pay nonexistent interest. As such, the Court determined that the amount upon which the four percent loan service charge can be imposed is determined by subtracting from the refinancing loan the amount of the original loan that is outstanding as of the date of the refinancing. This latter amount does not include interest on the original loan that has not and will not accrue as a result of the refinancing transaction.

On the second question, the Court very succinctly decided that the remedies prescribed by Tenn. Code Ann. §§ 47-14-101, *et seq*. are the exclusive remedies of borrowers with respect to a violation of the limitations on loan and interest charges that are imposed by the Loan and Thrift Act. In reaching this decision, the Court relied upon *Hodges v. S.C. Toof & Co*., 833 S.W.2d 896, 899 (Tenn. 1992), in which the Court stated that if a statute creates a new right and prescribes a remedy for its enforcement, then the prescribed remedy is exclusive.

This decision clarifies the amount on which an Industrial Loan and Thrift Company may impose a service charge. However, on the issue of remedies under the Loan and Thrift Act, the Court held that the only remedies open to borrowers are exclusive with respect to interest and loan charges under the Loan and Thrift Act. This does not mean that Industrial Loan and Thrift Companies are not under any circumstances subject to the provisions of the Tennessee Consumer Protection Act, but the Court specifically declined to adopt such a broad exemption. As such, each case must be examined on its own facts because it is unclear to what extent an Industrial Loan and Thrift Company could be held subject to the Tennessee Consumer Protection Act on matters unrelated to loan and interest charges.

--*John R. LaBar*

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**Nesmith v. Alsup, 1999 WL 557620 (Tenn. Ct. App. Aug. 2, 1999)**

When documents are not written clearly, attorneys and clients must think of creative arguments to produce the result that the original documents intended. The case of *Nesmith v. Alsup* did this when confusing language in a will led a client to make an argument of adverse possession against another co-tenant. To successfully raise this argument, the *Nesmith* court states that the ejection of a tenant from the property must be clear.

In his Last Will and Testament, John Alsup named his wife, Blanche Alsup, as trustee in charge of providing for their son's education. If necessary, the trustee was given the right to sell the family farm to finance the education of John Alsup II, with the remainder to be equally divided between Blanche, John Alsup II, and Betty, Blanche's daughter. After the testator's death, John Alsup II ("John"), was able to attend college without selling the farm. While John was in college, his mother moved to Georgia to live with Betty, leaving John to attend to the maintenance and upkeep of the family farm. During this time, John exercised sole control over the property. John rented the property, took rents, and paid the property taxes. In addition, John negoiated with the City of Murfreesboro for an easement and he dealt with a number of parties interested in purchasing the property.

Following the death of Blanche, Betty brought suit claiming that language in Blanche's will granting "to my two children, Betty Alsup Mavity Nesmith and John A. Alsup II, in fee simple, share and share alike" created in her an undivided one-half interest in the farm. John challenged Betty's claim, and through litigation, the trial court determined that John Alsup's will created a tenancy in common between John, Betty, and Blanche. Following the death of Blanche, the trial court held that John and Betty held an undivided one-half interest in the farm.

On appeal, John raised a number of issues, including that of adverse possession.

A claim of adverse possession by one cotenant against another co-tenant is inherently complicated. In order to sustain a claim of adverse possession in Tennessee, a party must maintain possession for at least seven years, and the possession must be open, actual, continuous, exclusive, adverse, and notorious. It is theoretically impossible, therefore, for a co-tenant to adversely possess against another co-tenant in that, by definition, possession by one of the co-tenants is equated with possession by all of the co-tenants. In addition, the Court of Appeals notes that, since each co-tenant retains the right to enter the property, possession of the property by one of the co-tenants is generally not considered adverse to the claim of the other co-tenants.

Acknowledging the need for a possibility of adverse possession as against co-tenants, Tennessee courts recognize an exception to the usual requirements for adverse possession in the event that one of the co-tenants ousts the other co-tenants. Short of physical removal from the property, an ouster, as defined by the court, involves "some act that makes it clear to [the] co-tenant that she is being excluded from ownership." Previous opinions have held that constructive notice will not constitute an ouster. See *Drewery v. Nelms*, 177 S.W. 946, 948 (1915) (holding that "[t]he mere silent, sole occupation by one of the entire property, though he be claiming the whole estate, and appropriating the whole rents, without an accounting to or claim by others, without notice of his co-tenant that his possession is adverse, and unaccompanied by some act which can amount to an exclusion and ouster of the co-tenant, cannot be construed into an adverse possession"). From previous opinions and the literal reading adopted by the court, it seems clear that in order for a co-tenant to adversely possess property against other co-tenants, there must be a positive act on the part of the possessor that unequivocally informs the other co-tenants that they are excluded from the property.

In this case, the court held that Alsup's actions and representations as sole owner of the farm did not constitute an ouster. The fact that John did not offer an accounting of the income of the property to either his mother or sister did not constitute what the court views as actual notice of exclusion from the property. In addition, the fact that John represented himself as the sole, exclusive owner to the City of Murfreesboro, potential buyers, as well as tenants on the property did not afford Betty the degree of notice required by the court. The Court of Appeals held against John despite Betty's knowledge that John was representing himself as sole owner of the property and that her name was not on any of the documents involved in these representations.

The implication of this case for transactional attorneys is clear. If a client wishes to posses adversely against a co-tenant, the client must, by a clear, unmistakable act inform the co-tenant of the client's intentions to possess adversely. Mere constructive knowledge, or even actual knowledge on the part of the co-tenant, will not satisfy the strict requirement articulated by the court of appeals unless the client has issued some affirmative act in effort to inform the co-tenant.

*--Thomas Dykstra*

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### ***Bullard v. Scott*, 1999 WL 486818 (Tenn. Ct. App. July 13, 1999)**

Transactional attorneys in commercial real estate business have long used the tenancy in common as a way of granting a single piece of property to multiple parties. A tenancy in common permits co-tenants to convey their share of the property to another without risking the loss of the advantages a tenancy in common provides. Very few restrictions are placed upon a co-tenant's right to convey his or her share of the property to another. *Bullard v. Scott*, 1999 WL 486818 (Tenn. Ct. App.), creates a new and unexpected restriction upon that right.

The controversy in *Bullard* surrounds a lot in the Thatcher Shore Acres Subdivision. Thatcher Shore Acres is a 40-lot subdivision located adjacent to a lake. The lot in question was conveyed to 38 of the 39 property owners of Thatcher Shore Acres as tenants in common so that each property owner in the subdivision would have water access. As a result of the conveyance, each grantee owned a $1/39^{th}$ interest in the lot. The Scotts obtained one of these $1/39^{th}$ interests. In an effort to provide the property owners of two adjacent subdivisions with lake access, the Scotts conveyed a $1/7800^{th}$ interest in their $1/39^{th}$ interest to the property owners of these two adjacent subdivisions. (Their deed did not prohibit such a conveyance.) By the conveyance, the water access lot in the Thatcher Shore Acres Subdivision was subject to the additional use of over 40 new property owners. Bullard and the other property owners of the Thatcher Shore Acres Subdivision sued to invalidate the conveyance.

In Tennessee, co-tenants of a piece of property held by a tenancy in common enjoy the right to possess and use the entire piece of property. However, each co-tenant stands in a confidential relationship to the other co-tenants. The same duties are imposed upon them as though "a joint trust was created by contract between them." Thus, each co-tenant must "put forth their best exertions to protect the common interest" and cannot assume a "hostile attitude" toward the rest of the co-tenants. Each co-tenant also has a right to convey his share of the property to another. The new owner of the interest in the property enjoys the same right to possess and use the entire piece of property as the original owner.

In *Bullard*, the court recognized that a co-tenant has a right to convey his or her interest in a piece of property. The court also recognized that the Scotts had lawfully conveyed their interest in the property. The court stated, however, that a lawful conveyance may have such adverse effects upon the other co-tenants' known use of the property that it can only be considered as "a 'hostile' act against the co-tenancy." The court held that "under the unique circumstances of this case," the Scotts' conveyance constituted an "assumption of a hostile attitude." Because the number of potential users of the property was increased by over 40, the conveyance was a violation of the Scotts' duty "to put forth his or her best interest of the co-tenancy." Thus, the court invalidated the conveyance.

How should lawyers interpret *Bullard*? Interpreted broadly, the decision in *Bullard* would seem to be a significant change in property law. Normally, the lawful conveyance of an interest in a piece of property by a co-tenant would not be considered an assumption of a hostile attitude toward the other co-tenants. The difficulty in interpreting *Bullard* so broadly is the uncertainty of where one would draw the line. Can a conveyance be considered hostile for other reasons? For example, what if a co-tenant conveys his or her entire interest to a person that he or she knew was planning to make an improper use of the property. Could the other co-tenants win a suit to invalidate the conveyance based upon the Bullard decision? Because the court qualified its holding by stating "under the unique circumstances of this case," the more likely approach is to interpret *Bullard* narrowly. But even if given a narrow interpretation, *Bullard* presents problems. For example, how does a co-tenant determine, before the transaction occurs, the allowable number of parties to which he may convey his interest? *Bullard* does not provide much guidance to lawyers making this determination. Thus, whether interpreted broadly or narrowly, transactional lawyers would serve their clients well by being aware of *Bullard* and its possible implications.

*--Chris Trump*

## Contracts

***Chattanooga Associates, Limited Partnership v. Cherokee Warehouses, Inc.*, No. 03A01-9901-CH-00021, 1999 WL 907653 (Tenn. Ct. App. Oct. 18, 1999)**

This case examines the scope of the implied covenant of good faith and fair dealing in certain provisions of a lease agreement. It also provides a definition of the contract terms "maintenance" and "repairs." Chattanooga Associates, Limited Partnership ("Plaintiff") leased a warehouse to Cherokee Warehouses, Inc. ("Defendant"). The lease agreement provided Defendant would be responsible for paying its proportionate share of any maintenance or repairs on the building or land surrounding the building. In 1994, Plaintiff performed what it believed to be necessary construction projects on the parking lot of the storage warehouse and charged Defendant its proportionate share of the costs. When Defendant refused to pay the bill within the time specified in the lease terms, Plaintiff sued Defendant in the Chancery Court of Hamilton County and was awarded costs of construction on the parking lot of the warehouse property, plus a 15 percent late charge pursuant to a provision in the lease, and attorney's fees. Defendant appealed the chancellor's decision to the Tennessee Court of Appeals.

On appeal, Defendant argued that the chancellor erred in refusing to bar recovery because Plaintiff breached the implied covenant of good faith and fair dealing. More specifically, Defendant contended that Plaintiff had a duty to disclose to Defendant any plans to perform construction work on the property and that those plans were not disclosed. The court of appeals discussed the duty of good faith analyzed in *Wallace v. National Bank of Commerce*, 938 S.W. 2d 684 (Tenn. 1997), which held that the common law duty of good faith does not extend beyond the agreed upon terms in a contract. After discussing *Wallace* the court stated that in order for Defendant "to prevail on this issue, it must prove that the Plaintiff's actions were not a performance of the contract according to its terms. This is particularly true in this case where the parties to the contract are two experienced commercial entities." *Chattanooga Associates, Limited Partnership v. Cherokee Warehouses, Inc.*, No. 03A01-9901-CH-00021, 1999 WL 907653, at *6 (Oct. 18, 1999 Tenn. Ct. App.). The terms of the lease agreement did not require any prior notice before beginning maintenance or repairs. The court stated: "The contract gave the Plaintiff the option to elect to perform 'any maintenance or repairs . . .' as it saw fit. The contract placed no requirement on the Plaintiff to notify the Defendant before undertaking any such 'maintenance or repairs.'" *Id.* at *7. The court then reasoned that "[i]f Defendant wished such a requirement be placed on Plaintiff, it could have negotiated that issue with the Plaintiff and insisted that such a provision be included in the contract. No such provision requiring notice was included." *Id.* Therefore, the court of appeals found that Plaintiff did not breach an implied duty of good faith and fair dealing and that the chancellor did not err in refusing to bar recovery on such basis. *Id.* at *7.

Although the court of appeals found in favor of Plaintiff on this issue, the case was reversed and remanded in order to determine what parts of the construction constituted "maintenance or repairs" under the lease agreement. The court indicated that some of the purported repairs may have actually been capital improvements, for which Defendant would not be financially responsible. The court stated that it did not have enough evidence to decide which expenses of the construction were for "maintenance or repairs." However, the court did provide the chancellor with some guidance, defining expenses as "necessary to keep the premises in as good as a condition as they were in when the lease was entered into by the parties." *Id*.

In light of their holding, the court of appeals found that the chancellor's award of the late fee was in error. *Id.* at *9. Although the lease agreement provided that Plaintiff could charge Defendant a 15percent late fee, the court reasoned that some of the expenses charged were not actually repairs under the lease. *Id.* The

### *In re Estate of Harold Jenkins*, No. 01-A-01-9707-CH-00348, 1998 Tenn. App. Lexis 375 (Tenn. Ct. App. June 12, 1998)

It is well established in Tennessee that an oral contract is enforceable under most circumstances. Difficulties arise, however, when one of the parties to the contract dies before fulfilling his part of the bargain. Throw in a country music superstar, a bitter bus driver, not to mention a large estate, and a simple contracts case takes on a life of its own. Such was the case of *In re Estate of Harold Jenkins.*

In *In re Estate of Harold Jenkins*, Billy Parks was employed as a driver, valet, and general handyman by Harold Jenkins, a/k/a Conway Twitty. Joining the entourage in 1972, Parks was employed by the country music sensation until Twitty's death in 1993. Throughout his 21 years of service with Twitty, Parks received a regular salary, medical benefits, and a pension.

Following Twitty's death, Parks filed a claim against the estate, seeking enforcement of a binding oral contract to pay a $20,000 bonus to Parks after twenty years with his employer. Specifically, Parks claimed that Twitty had promised to pay a $20,000 bonus to members of his crew that stayed with him twenty years, that Twitty had made bonus payments to other employees, and that Parks was entitled to the bonus in 1992. The probate court denied the claim, holding that Twitty's promise to "take care of Billy Parks" was too vague and uncertain to be legally enforceable. On appeal, the appellate court reversed and remanded for a hearing and disposition. On remand, Parks' claim was denied, indicating that "there was absolutely no bonus . . . no contract. There was no offer, acceptance, consideration."

On appeal, Parks argued that he was entitled to the $20,000 bonus based on a unilateral contract offer that may be accepted by performance. Citing *Hutchinson v. Dobson-Bainbridge Realty Co.*, 31 Tenn. App. 490, 217 S.W.2d 6 (Tenn. App. 1946), the court noted that while "a binding contract is not formed until acceptance, the promisor may lose the power to withdraw the promise where the promisee has partly performed in reliance on the promise." Ultimately, the case of Billy Parks lacked a promise. Nowhere was it established that Twitty had said, implied, or otherwise promised Mr. Parks that "if you work for me for twenty years, I will pay you $20,000."

Rather, the most the court could conclude was that "at one point," Twitty intended to pay his crew a $20,000 bonus. Nevertheless, a mere intention "to do something on the happening of a particular event does not amount to an offer that can be accepted by the other party." As a result, the court held that Parks failed to establish his claim for the bonus.

As the decision in Estate of Jenkins indicates, no matter how good the relationship between the employee and employer, the terms and conditions of a bonus should always be in writing. This not only protects the employee, but the employer and the employer's estate from false claims. Just as employment can be terminated at will, so can a promise to "take care of" an employee. Where an employer intends to provide a system of bonuses for employees, it is vital to provide written documentation of this program, or in the alternative, establish a standard practice and timeline for granting bonuses. While this will not entirely preclude the frivolous litigation surrounding the administration of a celebrity's estate, it is a step in the right direction.

--*Heather Flory*

## ANTI-TRUST

***Jo Ann Forman, Inc., v. National Council On Compensation Insurance, Inc.*, No. 01-A-01-9805-CH-00260, 1999 WL 767799 (Tenn. Ct. App. Sept. 29, 1999)**

Business contracts may contain clauses which regulate or set the prices respecting goods and/ or services of one or both of the parties. Whether these business arrangements operate in restraint of trade, and are hence unlawful, is governed by state and federal antitrust legislation. Tennessee's state antitrust statutes, the Tennessee Trade Practices Act, govern intrastate commerce agreements: "[a]ll arrangements, contracts, agreements, trusts or combination between persons or corporations made with a view to lessen, or which tend to lessen, full and free competition [respecting sale or importation of articles in the marketplace, and those] designed, or which tend to advance, reduce, or control the price or the cost to the producer or consumer of any such product or article, are declared to be against public policy, unlawful and void." Tenn Code Ann. §47-25-101 (1995). The statutory language has remained unchanged since 1903. Cases turn entirely on whether or not the pricing arrangements in dispute concern a "product or article" within the meaning of the statute, and reported cases dealing with this subject have been few and far between. The Tennessee legislature "intended to prohibit trusts, combinations, and agreements affecting all commerce not covered by the federal statute, and upon which it had a right to legislate." However, when an agreement between business entities regulates or controls *intangible* contract rights or services, establishing unreasonably high prices in the market for the services which are its subject, Tennessee's Trade Practices Act does not apply. Such was the decision in an appeal presented to the Tennessee Court of Appeals in *Jo Ann Forman, Inc., v. National Council On Compensation Insurance, Inc.*

Forman concerned a dispute whether workers' compensation insurance premiums were an "article or product" within the purview of the act or whether they constituted an "intangible" so that the antitrust statutes did not apply. Tennessee Workers' Compensation Law requires all employers, with limited exceptions, to purchase workers' compensation insurance or to qualify to self-insure in order to provide benefits and pay compensation for death, disablement, or injury to their employees. These insurance policies are contracts between the employer and the insurer, and they are purchased in either a voluntary market or in an assigned risk context (also called the "residual market"; it covers those employers who typically have adverse loss experience and are therefore unable to obtain coverage in the voluntary market). The employer who is classified as an assigned risk obtains insurance according to a state plan which, *inter alia*, requires all insurance companies to participate and provide insurance as insurers of last resort. Clearly, the residual market mandate poses significant risks for insurers, so many insurance companies minimize these risks and satisfy their obligations by forming cooperative contractual arrangements (referred to in this case as "the Pool") which pay the assigned servicing carriers an allowance as reimbursement for their obligatory expenses, and assure them a reasonable profit.

In *Forman*, the plaintiffs comprised various corporations who had purchased workers' compensation insurance. They brought suit to complain that the defendants, specified members of "the Pool" containing workers' compensation insurers doing business in Tennessee, entered into one such agreement to inflate workers' compensation insurance rates by charging excessive servicing carrier allowances which, in fact, had the effect of raising the rates in both the residual and the voluntary markets. Plaintiffs sought recovery for the full amount of the allegedly excessive premiums that they paid for their insurance policies on the ground that the contractual arrangement between the members of "the Pool" was designed, or tended to control, the price of their insurance in violation of Tennessee's antitrust statute, Tenn. Code Ann. §47-25-101. The trial court denied the defendant's motion to dismiss for failure to state a claim, and the defendants appealed, still insisting that because the express language of the provision uses the words "products or articles," insurance premiums do not fall within the purview of the statute.

The Tennessee Court of Appeals determined that the instant case turned entirely on whether or not increased costs of workers' compensation insurance involves a "product or article" within the meaning of the Tennessee antitrust statutes. The plaintiffs' argument relied heavily on language in the opinion of the Tennessee Supreme Court in *Standard Oil Co. v. State*, 117 Tenn. 618, 643, 100 S.W. 705, 711 (1907), which stated: "The Legislature clearly intended to prohibit trusts, combinations, and agreements affecting all commerce not covered by the federal statute, and upon which it had a right to legislate. It did not intend to stop short of its power to exceed it."

Defendants asserted that this language was mere dicta and, instead, that the Tennessee Supreme Court case, *McAdoo Contractors, Inc. v. Harris*, 222 Tenn. 623, 439 S.W.2d 594, 597 (1969) was determinative. *McAdoo* concerned a claim filed against the county, its architect, and the county judge, alleging that they all fraudulently conspired to deprive the complainant of a contract, in combination of restraint of trade contrary to Tenn. Code Ann. §69-101 (now codified at §47-25-101). The *McAdoo* court decided (1) that it was impossible to bring a contract award under the statute because the express terms applied to "articles of foreign and domestic origin," and (2) that the only plausible construction may be to outlaw efforts to control the price of the building material, but that such was not the case.

The Court of Appeals found that insurance premiums do not qualify as "product(s) or article(s)" within the meaning of Tennessee Code Annotated section 47-25-101, in keeping with the holding of the supreme court in *McAdoo*. To paraphrase Justice Humphreys therein: it was clear that the Tennessee Trade Practices Act expressly applies to articles of foreign and domestic origin so that it would be virtually impossible to bring workers' compensation insurance under the statute, which is an intangible contract right or service.

In addition, the *Forman* court agreed with the defendant that the specific language in *Standard Oil* upon which plaintiffs' relied was "obiter dictum." As such, comments in an opinion do not control when the point which was dictum is presented for decision in a subsequent case. Statements in a decision are authority only on the point in judgment which arises in the particular case before the court. The Court of Appeals further quoted Justice Green of the United States Supreme Court where he said: "Doubtless the doctrine of stare decisis is a salutary one and to be adhered to on all proper occasions; but it only arises in respect of decisions directly upon the points in issue."

Since *McAdoo* was decided in 1969, numerous attempts have been made in the General Assembly to amend the Trade Practices Act and expand its scope. None have been successful. Although thwarted attempts at legislation are not the keenest guides to uncover legislative intent, the Court of Appeals determined that these amendment efforts would be unnecessary if the present Trade Practices Act indeed covered "every conceivable . . . agreement or contract to lessen or destroy competition and control prices" as asserted in the Attorney General's brief in *Standard Oil*. Further, the court stated "[c]ourts have held that nonaction by a legislative body may be a dubious guide but may become significant where proposals for legislative change have been repeatedly rejected."

*Forman* tells us generally what types of agreements and contracts in restraint of trade will not violate the Tennessee Trade Practices Act. Clearly, business arrangements which control pricing should be planned so that they cover only services and other intangibles which do not fall within the purview of the Act. Although numerous legislative efforts have been aimed at expanding the scope and include other kinds of economic activity, this has not yet occurred.

--*Cheryl Davis*

## EMPLOYMENT

***King v. TFE, Inc.*, 1999 WL 675132 (Tenn. Ct. App. Sept. 1, 1999)**

In 1982, the Tennessee Court of Appeals in *Hamby v. Genesco*, 627 S.W.2d 373 (Tenn. App.1982) held that an employment handbook can become a part of the employment contract. Thus, it becomes imperative that attorneys who have employers as clients inform them of the possibility of their employee handbook being considered contractually binding. *King v. TFE, Inc.* sets forth the steps an employer should take to maintain a non-binding handbook. In *King*, the court determined whether an employee was terminated in violation of contractually binding provisions of an employment manual.

TFE, Inc. ("TFE") gave Michael King ("King") an employee manual when they employed him as a truck driver in 1988. In 1993, King was involved in a driving accident during the course of his employment. Having sustained injuries, he was paid worker's compensation disability benefits while he was treated and recovering.

When King returned to work, he was informed that his employment was being terminated because of his involvement in a "major preventable accident." Thereafter, King requested a driver committee review his termination, which is the initial avenue for review of disciplinary action according to the "Employee Handbook." The committee recommended that his accident be deemed "unpreventable," but King was not reinstated. He then sued TFE for breach of an alleged employment contract. The trial court granted summary judgment to TFE holding that the "employee handbook distributed by TFE did not constitute an employment contract." The court reasoned that the relevant provisions in the manual did not employ specific language binding TFE. King appealed.

In its opinion, the Tennessee Court of Appeals restated the well-established rule that a "contract for employment for an indefinite term is a contract at will and can be terminated by either party at any time without cause." In Tennessee, there is a presumption that an employee is an employee at will. Nevertheless, "an employment contract can still exist with regard to other terms of employment."

An employee handbook can be a part of an employment contract in Tennessee. However, it "must contain specific language showing the employer's intent to be bound by the handbook's provisions." The court further stated that, "The language used must be phrased in binding terms, interpreted in the context of the entire handbook, and read in conjunction with any other relevant material, such as an employment application." Courts generally will not interpret provisions as contractual between the employer and employee if the employer reserves within the handbook the unilateral right to modify such provisions.

King admits that he was an employee at will when hired but argues that this status changed when TFE issued its employee manual. The appellate court limited its review to the manual provisions that governed TFE's "Disciplinary Procedures," "Rules and Regulations," and "Involuntary Termination." Under the "Disciplinary Procedures" section, the manual states that TFE "has developed a guideline of violations of professional performance standards and reasonable disciplinary penalties." It further states, "The company retains the right to modify, add to or eliminate work rules at any time as it deems necessary." In the "Rules and Regulations" provision, the handbook explains that the "rules and regulations and the penalties. . . are set forth as guidelines," and that the "list of violations is not inclusive and the company may add to or modify it at any time." It also states that TFE will only "give every consideration to their [the driver committee's] recommendations and findings." Under "Involuntary Termination," the manual states that TFE will "consider submitting the matter to an Arbitrator." The Court then determined that the language used clearly reflected TFE's intent not to be bound either by particular procedures set forth or by the "recommendation" of the driver committee. It also added that the provisions in the handbook must be considered together with any other relevant material. Consequently, the Court found relevance in a document that King signed when he received his employee manual expressing that the manual did not create or establish an employment contract.

This case reminds transactional attorneys of the importance of using non-binding language in documents not intended to be contractual. As the court noted, it is a good idea to take two other steps to prevent a manual from becoming a part of the employment contract. First, the employer should expressly retain the right to amend manual provisions. Secondly, the employer should have the employee sign a document acknowledging that the handbook is not a contract between the employer and employee when delivering the manual to the employee.

--*Sarah H. W. Davis*

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ARTICLES

# Tennessee Tax Reform: How Does The F & E Tax Affect Your Business?

*T.J. Gentle**

## I. INTRODUCTION

In the midst of a fierce debate over tax reform, the Tennessee General Assembly enacted legislation that would relieve the $400 million budget deficit for the upcoming year.[1] Though a state individual income tax was proposed,[2] as well as several other revenue generating alternatives,[3] the result was House Bill No. 1676.[4] Effective July 1, 1999,[5] this legislation shifts much of the burden of the state's revenue deficiencies to limited liability entities (LLEs) by levying a state franchise and excise tax ("F & E tax") on LLEs.[6] Although the longevity of the F & E tax is uncertain,[7] businesses and their lawyers are scurrying to find alternatives that limit this new tax liability.[8]

The F & E tax, which primarily taxed corporations (both "C" and "S" corporations) prior to the new law, will now levy a tax on limited partnerships (LPs), limited liability partnerships (LLPs), limited liability companies (LLCs), and business trusts.[9] Business organizations not protected under the state's limited liability statutes, such as sole proprietorships and general partnerships, remain exempt from the F & E tax.[10] Corporations will be subject to the same F & E tax as before.[11]

The new tax[12] adds a significant factor for new and pre-existing businesses organized in Tennessee in making choice-of-entity decisions as well as whether to organize in Tennessee altogether. Since their enactment,[13] the laws governing LLEs have enticed many out of state businesses to organize in Tennessee.[14] Also, an overwhelming number of Tennessee businesses have elected to organize as LLCs rather than corporations.

The purpose of this article is to provide practitioners with an analysis and explanation of the F & E tax so that it can be properly weighed against the traditional factors (*e.g.*, liability exposure, free transferability of interest, *etc.*) when making a choice of entity decision. In Section II, this article begins with a brief discussion of the causes behind the F & E tax reform. Section III

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1. Governor Don Sundquist, *An Outdated Tax System Meets the 21st Century*, 9 TENNESSEE'S BUSINESS 17 (1999).
2. H.B. 8002, 101st Leg., 2d Spec. Sess. (Tenn. 1999).
3. *See House, Senate Agree on Elements of Budget-Tax Solution*, TENN. J., May 24, 1999, at 2 (providing other tax reform proposals).
4. Tax Revision and Reform Act of 1999, 1999 Tenn. Pub. Acts 406 (current version at TENN. CODE ANN. § 67-4-2001 (1999)).
5. If there are any questions about any of these provisions, contact the Tennessee Department of Revenue, Taxpayer Service Division at 1-800-397-8395.
6. *See* Andree Sophia Blumstein, *Temporary Tennessee Excise, Franchise Tax Fix Signed Into Law*, STATE TAX TODAY, June 25, 1999, at 122 (discussing the F & E tax's scope and effective date).
7. *House, Senate Agree on Elements of Budget-Tax Solution*, *supra* note 3, at 3.
8. *Businesses Scramble to Figure Tax Hit*, TENN. J., June 7, 1999, at 2 (discussing the response of Tennessee businesses to the F & E tax).
9. TENN. CODE ANN. § 67-4-2004(16) (1999) (listing all entities subject to tax).
10. *Cf*. Governor Don Sundquist, State of the State Address (Feb. 8, 1999), *in* STATE TAX TODAY, Feb. 17, 1999, at 31.
11. TENN. CODE ANN. § 67-4-2004 (1999).
12. Both the excise tax and franchise taxes are actually extensions of the prior law; however, the recent amendment will be referred to as the "new excise tax" or the "new franchise tax" in order to distinguish between the original tax and the extension.
13. The Tennessee LLC Act was enacted in 1994. Tennessee Limited Liability Act 1994 Tenn. Pub. Acts 868 (current version TENN. CODE ANN. § 48-201-101 (1999)).
14. Stanley M. Chervin, *The Impact of LLCs on Tennessee Revenues*, STATE TAX TODAY, Feb. 16, 1999, at 30, 34. Over 16,000 LLCs have organized in the state since 1994. Of those 16,000, 77.3%, or 8,206, were not previously engaging in business within the state. *Id*.

explains the intricacies of the new legislation. Section IV provides examples of the impact thatthe new tax will have on LLCs that engage in different business activities in Tennessee.

## II. GROUNDWORK FOR TAX REFORM

The 101st General Assembly entered the 1999 Session with the task of responding to Governor Sundquist's request to "meet the challenges of the 21st Century."[15] Throughout the regular session and both special sessions, legislators fiercely debated potential sources and solutions to the budget deficit. While most of the nation, including Tennessee, was experiencing an economic surplus, Tennessee legislators struggled to cut spending and increase tax revenues.[16] Although actively lobbying for a personal income tax, Sundquist ultimately agreed with legislators that a "fair business tax" would be the answer to the budget deficit. Thus, House Bill No. 1676 was the legislative response to the budget crisis.

The "fair business tax,"[17] which was originally proposed by Sundquist at the 1999 "State of the State Address," targets businesses that benefit from the statutory liability protections of the state, but escape state taxation. One of the most cited examples is the so-called "Kroger Loophole."[18] This structure exploited a Tennessee Department of Revenue (DOR) position that "the mere ownership of [a LLE] interest did not establish sufficient nexus for Tennessee to impose its taxes on the owner."[19] Businesses (such as Kroger) began organizing LLPs and LLCs in Tennessee, while the corporate interest holder, organized outside of the state, would retain up to a 99% interest in the LLE.[20] The businesses would generate profits within the state and the funds would pass through the LLE to the corporate interest holder outside the state. Thus, Tennessee was providing businesses with liability protection while the businesses were passing profits generated in Tennessee to their owners in another state. If the corporate parents were organized within Tennessee, the income would have been subject to the corporate F & E tax.[21]

Due to the increased expenses that Tennessee was incurring from the newly formed LLE businesses and the lack of tax revenue collected[22] from these businesses,[23] the DOR had an economic foundation for sponsoring the new F & E tax.[24] Considering the fierce opposition to the personal income tax by many legislators and their constituents, the F & E tax provided politicians with a political safe haven while temporarily remedying the budget problem.

## III. ANALYSIS OF THE F & E TAX

The F & E tax is basically an extension of the corporate franchise and excise tax to any Tennessee pass-through entity that benefits from limited liability protection under the Tennessee Code ("T.C.A."). In order to understand how the F & E tax will affect Tennessee businesses, the details of these new taxes must be clearly understood. Thus, the intricacies of each tax are discussed below.

### A. *Excise Tax*

The excise tax is imposed upon an entity for "the privilege of doing business . . . in Tennessee."[25] The excise tax is levied upon the net earning of an entity,

15. Sundquist, *supra* note 10, at 31.
16. According to John. G. Morgan, Comptroller of the Treasury of State of Tennessee, $81 million in cuts were accepted by the legislature in the 2000 budget. John Morgan, *Tax Reform Options and Implications*, 9 TENNESSEE'S BUSINESS 17 (1999).
17. Sundquist, *supra* note 10, at 34.
18. J. Leigh Griffith, *Taxing Tennessee New Business Taxes*, TENN. BAR J., Aug. 1999, at 13.
19. *Id.* at 16.
20. *New Taxes: Who, What , When, How, Where*, TENN. J., July, 5, 1999, at 1.
21. *Id.*
22. Sundquist, *supra* note 10, at 24. For example, one business in Tennessee reorganized itself in 1997 and cut its tax liability from $195,000 to $10 merely by changing from a corporation to an LLC. *Id.*
23. Chervin, *supra* note 14, at 30-32.
24. Elizabeth C. McNichol, *Governor Sundquist's Revised Tax Proposal Would Address Long-Standing Problems with Tennessee's Tax System* (Apr. 1, 1999) <http://www.cbpp.org/4-1-99sfp.htm> (providing research results from the Center on Budget and Policy Priorities).
25. Cook Export Corp. v. King, 652 S.W.2d 896, 900 (Tenn. 1983).

and therefore has characteristics similar to a business income tax.[26] The new excise tax broadens the tax base in terms of the types of entities that are subject to the tax and to some degree the activities of those entities that bring the entities within the scope of the tax.[27]

The excise tax provides that all "taxpayers" or "persons,"[28] "doing business in Tennessee,"[29] "shall, without exception other than as provided herein, pay to the Commissioner of Revenue, annually, an excise tax, in addition to all other taxes, equal to six percent (6%) of the net earnings for the next preceding fiscal year for business done in this State during that fiscal year."[30]

1. Defining "Taxpayer"

This provision contains several details that must be examined. First, the definition of "taxpayer" has been amended to include LLEs. Specifically, these entities include: LLC's (T.C.A. section 48-201-101), LLP's (T.C.A. section 61-1-143), and LP's (T.C.A. section 61-2-101). In addition, T.C.A section 67-4-2004 includes within its definition of "[p]erson" or "taxpayer" "every corporation, subchapter S corporation, . . . cooperative, joint-stock association, business trust, regulated investment company, real estate investment trust, state-chartered or national bank, state- or federally-chartered savings and loan association and any other organization or entity engaged in business."[31] However, specifically excluded from the definition of "person" or "taxpayer" are sole proprietorships and general partnerships.[32]

By including LLEs within the definition of "taxpayers," Tennessee has negated many of the pass-through characteristics that made them attractive business structures.[33] Prior to the new law, a business could organize as an LLC (or any other non-corporate LLE) without incurring an F & E tax at the entity level.[34] The income would "pass-through" to the individual partners or members of the entity.[35] The income received by that individual would then be subject to a federal income tax but not a state level tax. However, the new excise tax will levy a six percent (6%) tax on net earnings at the entity level, thereby creating the effect of a dual-tax. Although this revenue will be taxed by Tennessee at the entity level, the pass-through status will still be respected for federal income tax purposes.[36]

2. Closing the Loopholes

The definition of "doing business"[37] within the state has been amended to exclude certain exemptions, like "the Kroger Loophole."[38] The T.C.A. provided that an interest holder that merely owned an interest in an LP was not "doing business" within the state if the "limited partner's

26. *See* James Overstreet, *Real Estate LLCs brace for Tax Hike*, MEMPHIS BUS. J., July 30, 1999, at 2 (comparing the tax free status on LLCs prior to the new law with the entity level excise tax).
27. *See* discussion *infra*, Section III.A.2.
28. TENN. CODE ANN. § 67-4-2004(16) (1999).
29. *Id.* § 67-4-2004(7).
30. *Id.* § 67-4-2007.
31. *Id.* § 67-4-2004(16).
32. *Id.*
33. *See* Overstreet, *supra* note 26, at 1-3 (discussing how businesses utilized the tax free status of LLEs and providing how the new law may cause some businesses to change structures).
34. Under the Federal "check-the-box" regulations, a partnership, LLC, or any other LLE may elect to be taxed as a corporation even if the entity would qualify as a partnership. Treas. Reg. § 301.7701-3(a). Thus, an entity taxed as a corporation under the I.R.C. will calculate its Tennessee excise tax liability as a corporation. TENN. CODE ANN. § 67-4-2006 (1999).
35. For a detailed explanation of the pass-through characteristics of LLEs, see Stuart Levine, *Limited Liability Companies, Limited Liability Partnerships, Limited Liability Limited Partnerships, And Other Novel Entities*, 86 ALI-ABA 501, 507 (1996).
36. *But see* Dania Leatherman & Marie A. Nelson, *The Race Is On: Choosing a Business Entity*, TENN. BAR J., Dec. 1999, at 24, 26 (providing federal income tax consequences of converting from an LLE to traditional pass-through entities).
37. TENN. CODE ANN. § 67-4-2004(7). Other than repealing a short list of exceptions, the new definition of "doing business" is essentially the same. Under the new law, "doing business" is defined as "any activity purposefully engaged in, within Tennessee, by a person with the object of gain, benefit, or advantage, consistent with the intent of the General Assembly to subject such persons to the Tennessee franchise, excise tax to the extent permitted by the United States Constitution and the Constitution of the State of Tennessee." *Id*.
38. *See supra* notes 18 through 21 and accompanying text.

only business activity in Tennessee is the holding of a limited partnership interest in a partnership located in or doing business in Tennessee; and . . . [t]he limited partner has no right to exercise any power, management or control over the partnership . . . ."[39]

Arguably, the removal of exempt status indicates the legislature's intent to subject the interest holders outside of the state to the excise tax. Conversely, the intent of the legislature may not be important because the previously exempt parties now must pay the excise tax at the entity level (rather than the interest holder level). However, the DOR has responded to this dilemma. The DOR's official response is as follows:

> The Department will continue to follow its longstanding policy not to attribute franchise and excise tax nexus to a limited partner or the limited partner equivalent limited liability company member in a partnership or limited liability company doing business in Tennessee, where that is its only contact with this state.
>
> In addition, when a limited partnership or limited liability company is subject to franchise and excise taxes, the Department does not believe that it was the intent of Chapter 406 of the Public Acts of 1999 to attribute Tennessee franchise and excise tax nexus to a partner or limited liability company member solely because of its interest in the taxable entity.[40]

Therefore, the DOR intends to enforce the excise tax at the entity level first; however, the new excise tax models the federal income tax treatment of multi-level organization structures.[41] Thus, if a Tennessee business is the sole owner of another Tennessee LLE, only the ultimate owner would be subject to the tax.[42]

### 3. Calculating Net Earnings

The tax is levied at a rate of six percent (6%) on *net earnings*.[43] The provisions defining net earnings are found at T.C.A. section 67-4-2006. Under that section, a taxpayer determines its net earnings depending upon its "entity status." There are six categories: "C" corporations, "S" corporations, "unitary businesses,"[44] partnerships (or entities taxed as partnerships for federal income tax purposes), single-member LLCs (or entities taxed as individuals for federal income tax purposes), or business trusts.[45]

The characterization of each class of entity relies heavily on how the Internal Revenue Code (IRC) treats them for federal tax purposes. For the purposes of this article, only the calculation for entities taxed as partnerships will be analyzed.[46]

An entity taxed as a partnership calculates "net earnings" as follows:

- Ordinary income (or loss) under the I.R.C[47]
- *Plus* any specifically allocated items of income
- *Less* any specifically allocated items of expense
- *Less* amounts subject to self-employment tax[48]

39. 1998 Tenn. Pub. Act. 1092, *repealed by* 1999 Tenn. Pub. Acts 406 ("except such powers or capacities outlined in § 61-2-302 that limited partners may exercise without participating in the management or control of the partnership, and the limited partner, in fact, exercises no such power, management or control over the partnership").
40. Tennessee Department of Revenue, *Frequently Asked Questions Under the New Franchise and Excise Law* (visited Nov. 14, 1999) <http://www.state.tn.us/revenue/faq.htm>.
41. Tenn. Code Ann. § 67-4-2008(7)(D) (1999) (providing exemption for certain LLEs that are part of a multi-level structure).
42. For a detailed discussion of tax treatment of multi-level structures, Griffith, *supra* note 18, at 17.
43. Tenn. Code Ann. § 67-4-2007 (1999).
44. Unitary Business is defined at Tenn. Code Ann. § 67-4-2004(25) (1999).
45. The final category also includes estates, "other than a decedent's estate." *Id.* § 67-4-2006(a)(6).
46. Since an overwhelming number of new businesses in Tennessee are organized as LLCs, it seems appropriate to focus on the possible treatment of LLCs.
47. Tenn. Code Ann. § 67-4-2006(a)(4) (1999). This subsection provides that any amount of ordinary income or loss, as defined under the I.R.C., "increased or decreased by additional items of income or expense specifically allocated to partners or members under the provisions of Sections 701-761." *Id.*
48. *Id.* This amount includes the amount *subject to self-employment tax*, and "*distributable or paid* to each partner or member." *Id*. (emphasis supplied).

- *Less* amounts contributed to qualified pension plan
- *Equals* Net Earnings

T.C.A. section 67-4-2006(b) provides a laundry list of items to both add to and subtract from the net earnings calculation. This provision provides the items that distinguish the Tennessee excise tax on net earnings and ordinary income under the borrowed federal income tax provisions. Examples of items that would increase net earnings (above ordinary income of an I.R.C. partnership) include gains from the sale of assets held in investment, business assets, and rental income.[49] Conversely, items that would reduce net earnings include charitable contributions, loss from the sale of assets held for investment, and loss from the sale of business assets.[50]

Also, the new excise tax limits the use of a net operating loss for LLEs. Specifically, an LLE cannot carry forward any net operating loss from prior years if the LLE was not subject to the excise tax during those years.[51]

4. Exemptions

The new excise tax retains many of the corporate exemptions provided in the prior law.[52] In addition, certain exemptions specifically cover LLEs. These exemptions include LLCs, LLPs, and LPs engaged in the business of venture capital funds,[53] farming,[54] and others.[55] Another exemption exclusively for LLEs existing as of May 1, 1999, exempts businesses "engaged in the business of acquiring notes, accounts receivable [etc.]"[56]

5. Allocating Net Earnings

The allocation and apportionment provisions attempt to maximize the tax base, without infringing upon any U.S. Constitutional provisions.[57] The apportionment statute states that a taxpayer who conducts "business activities" in Tennessee and outside of the state "shall allocate or apportion its net earnings."[58] The rules for apportionment are in T.C.A. sections 67-4-2010 through 67-4-2012. Because of the intricacies of these rules, they will be discussed only as appropriate in Part IV.

B. *Franchise Tax*

The Tennessee franchise tax is imposed at a rate of $.25 per $100.00 (or .25%) of the *greater* of (1) the entity's "net worth" (or apportioned net worth) as determined in accordance with generally accepted accounting principles (GAAP);[59] or (2) the value of property

49. *Id.* § 67-4-2006(a)(4).
50. *Id.*
51. *Id.* § 67-4-2006(c)(1).
52. *Id.* § 67-4-2008. The retained exemption includes: (i) Tennessee corporations meeting specific industrial development requirements; (ii) corporations that actively operate or build more than fraternal organizations (*e.g.*, Mason Lodges); (iii) investment companies or funds organized as "a unit investment trust taxable as a grantor trust;" and (iv) credit unions meeting specific requirements.
53. TENN. CODE ANN. § 67-4-2008(5) (1999). The venture capital funds must be "formed and operated for the exclusive purpose of buying, holding and/or selling securities, including debt securities, primarily in non-publicly traded companies on its own behalf and not as a broker." *Id.*
54. *Id.* § 67-4-2008(6). Other requirements must be fulfilled in order for a farming LLE to qualify for exempt status (*i.e.* substantially all of the businesses are related to farming as well as other requirements).
55. *Id.* There is another exemption for an LLE: "holding of one or more personal residences." However, this exemption requires that "one or more of the members or partners reside" in the personal residence and "[a]t least ninety-five percent (95%) of the voting rights, capital interest or profits of the entity are owned either by natural persons who are relatives of one another or by trusts for their benefit." *Id*.
56. *Id.* § 67-4-2008(7).
57. *See, e.g.*, Geoffrey, Inc. v. South Carolina, 437 S.E. 2d 13, 14 (S.C. 1993), *cert. denied* 114 S. Ct. 550 (1993) ("Imposition of state income tax on foreign corporation engaged in ownership, licensing and management of trademarks, trade names, and franchises of its corporate parent, satisfied due process clause requirement of a link or connection between state and corporation").
58. TENN. CODE ANN. § 67-4-2010(a) (1999).
59. *Id.* § 67-4-2106(a).
60. *Id.* § 67-4-2108(a)(1).

owned and used in Tennessee.[60] The minimum franchise tax also has been increased from $10 to $100.[61] Like the excise tax, the franchise tax now includes LLEs within its definition of taxpayer, thereby subjecting these entities to a new tax.[62] In addition to including LLEs within the scope of the franchise tax, the legislature also provided a new definition for "net worth," thereby changing the base of the tax.

The new definition is intended to create a more uniform application of the law by requiring taxpayers to use GAAP. The new definition requires that a taxpayer calculate net worth as the "difference between the value of a taxpayer's *total assets, less its total liabilities,* determined in accordance with [GAAP] for the tax year covered by the required return."[63] The law also provides that "[p]roper reductions of asset and liability accounts used to determine net worth for franchise tax purposes will be allowed if they are in accordance with [GAAP]."[64]

In an attempt to head off any future miscalculations, the DOR issued a public notice providing that regulation 1320-6-1-16 is no longer valid.[65] This regulation provided: "All reserves and allocations of surplus which do not represent definite and accrued legal liabilities or proper reductions in asset accounts must be included in determining the measure of the franchise tax."[66] By repealing this regulation, the DOR is promoting a uniform application of franchise tax in an attempt to conform with GAAP.

One potentially devastating characteristic of the franchise tax is included in T.C.A. section 67-4-2108(a)(1). This section provides: "The measure of the tax hereby imposed shall in no case be less than the actual value of the property owned, or property used, in Tennessee, excluding exempt inventory."[67] As will be discussed below, this provision may prove troublesome for some business types (*e.g.*, real estate LLPs and LLCs).[68]

Apparently, the franchise tax is not intended to subject a Tennessee corporation or LLE to multiple levels of state franchise tax liability. Stated differently, a bisomess organization consisting of multiple levels of wholly owned subsidiaries, all of which are organized under Tennessee law, is only expected to pay the franchise tax at the ultimate interest holder level. T.C.A. section 67-4-2107 provides: "The value of an interest . . . held by the taxpayer in any other taxpayer paying the tax herein levied and actually doing business in this State shall be deducted from the measure of the tax of the first taxpayer." One commentator noted that since LLEs are pass-through structures under the I.R.C, "the income of most LLEs would automatically be included in the income of their owners. If one or more owners are pass-through entities, the income of the first LLE and the second LLE would also be included with the income of the ultimate owner."[69]

This provision, along with the apportionment provisions[70] of the franchise tax, appears to reduce the likelihood of multiple levels of taxation.[71] However, if a Tennessee franchise taxpayer holds an interest in an entity organized in another state that taxes the out-of-state entity for income generated within its borders, the income will be taxed twice since Tennessee will tax the income to its ultimate holder.[72] This dual taxation would not occur if the out-of-state business was considered to be "doing business"[73] in Tennessee because of the apportionment rules.[74]

However, the apportionment rules do not provide for the allocation of income to entities

61. *Id.* § 67-4-2119.
62. *Id.* § 67-4-2004(16).
63. *Id.* § 67-4-2106(b) (emphasis supplied).
64. *Id.*
65. Tennessee Department of Revenue, *Frequently Asked Questions Under the New Franchise and Excise Law* (visited Nov. 14, 1999) <http://www.state.tn.us/revenue/faq.htm.>.
66. Tenn. Comp. R. & Regs. tit. 13, ch. 1320-6-1-16 (repealed 1999).
67. TENN. CODE ANN. § 67-4-2108(a)(3) (1999).
68. *See* Overstreet, *supra* note 26, at 1 (discussing the potential impact of the franchise tax on real estate LLEs).
69. Griffith, *supra* note 18, at 17.
70. TENN. CODE ANN. §§ 67-4-2107 to 67-4-2109, 67-4-2110 (1999).
71. It is possible that such a system could violate the dormant commerce clause. *See* Barclays Bank PLC v. Franchise Tax Bd., 512 U.S. 298 (1994), *cited in* Steve Christensen, Note, *Formulary Apportionment: More Simple--On Balance Better?*, 28 LAW & POL'Y INT'L BUS. 1133, 1142 n.50 (1997).

not doing business within the state. Possibly to remedy the due process questions that may emerge, the legislature provided an alternative franchise tax base.[75]

C. *Other Provisions*

1. Enforcement

The DOR "may disregard any entity created or transaction made which has no business purpose or is created or made with the primary purpose of evading either the federal income tax or the franchise tax."[76] The legislature added another incentive to prevent businesses from purposefully evading the F & E tax: "It is a Class E felony for any person willfully to attempt in any manner to evade or defeat any tax due the State of Tennessee. Each act done in violation hereof is a separate offense."[77]

2. Estimated Payments

Taxpayers that have a combined franchise and excise tax liability of $5000 are required to make quarterly estimated franchise and excise tax payments.[78]

IV. IMPACT OF THE F & E TAX

According to a survey conducted by the DOR, since 1994, 16,000 LLCs were organized in Tennessee.[79] Due to the popularity of the LLC structure, this analysis will focus on the use of LLCs in transacting business. According to the DOR, businesses engaged in real estate, retail, and manufacturing accounted for nearly one-half of all Tennessee LLCs.[80] Of these business types, the F & E tax will have varying implications.

A. *Real Estate Market*

In the case of a real estate company organized as an LLC, since the franchise tax is calculated by determining the value of the taxpayer's assets less liabilities, it would appear that the real estate business would not incur any substantial tax liability. However, the franchise tax contains a limitation: "The measure of the tax hereby imposed shall in no case be less than the actual value of the property owned . . . in Tennessee . . . ."[81] Therefore, an LLC that owns a $2 million dollar shopping mall (with a $1.5 million mortgage) would calculate its tax as follows:[82]

*The greater of*

<u>Net Worth</u>

shopping mall -- $2,000,000 (value)

mortgage -- 1,500,000 (liabilities)

Net worth = The greater of the difference of assets less liabilities ($500,000)

Calculation of Tax

$500,000 x .0025 = **$1,250**

*or*

<u>Actual Value of the Property within the State</u>

shopping mall $2,000,000 (value)

Calculation of Tax

$2,000,000 x .0025 = **$5,000**

In this case, the LLC would be forced to pay $5,000 in franchise tax because the shopping mall is located within Tennessee. Although the LLC should arguably only have to pay the tax on the difference between the actual value and liabilities, the Code specifically requires that the

72. TENN. CODE ANN. § 67-4-2106 (1999).
73. *Id.* § 67-4-2106(b).
74. *Id.* §§ 67-4-2107 to 67-4-2109, 67-4-2110.
75. *Id.* § 67-4-2112.
76. *Id.* § 67-4-2112(c)(3).
77. *Id.* § 67-1-1440.
78 . *Id.* § 67-4-2015. Generally, each quarterly payment must be the lesser of 25% of combined franchise/excise liability for the preceding tax year, or 25% of 80% (*i.e.*, 20% )of combined franchise/excise liability for the current year. For tax years beginning on or after July 1, 1999 and before July 1, 2000, quarterly payments must be the *greater* of 25% of combined franchise/excise liability for the preceding tax year, or 25% of 50% (*i.e.*, 12.5%)of combined franchise/excise liability for the current year. *Id*.
79. *See* Chervin, *supra* note 14, at 2.
80. *Id.* at 4. The percentages were as follows:

| | |
|---|---|
| real estate | 26.5% |
| retail | 12.7 |
| manufacturing | 10.0 |

81. TENN. CODE ANN. § 67-4-2108(a)(1) (1999).
82. This example is a simplification for the sake of clarity and does not include other factors that would affect the LLC's tax liability.

tax base be no less than the actual value of the property. In this case, the LLC is required to pay seventy-five percent (75%) more ($3750) solely because the shopping mall is within the state. In addition to the franchise tax, the LLC would still be subject to the excise tax. Thus, a developer who chose to organize as an LLC in order to avoid liability must now pay an unexpected tax.

The same developer may choose another structure if the burden of the franchise tax outweighs the benefit of limited liability. For example, *if* the developer could arrange non-recourse financing for the shopping mall, the developer may not be as concerned about personal liability. Assuming that the developer is not very concerned about potential tort or environmental liability, a sole proprietorship or general partnership (if the developer is accompanied by another party) may be a better alternative.

Conversely, the F & E tax may seem insignificant to another group of developers. If the developers pursue a risky venture in which they were not able to obtain non-recourse financing ,or if there was a high risk of other liabilities (*e.g.*, environmental or tort), the potential that each partner could be held personally liable would weigh heavily in their choice of entity decision. Although the general partnership is exempt from both the franchise and excise taxes,[83] the benefits of the protection from liability in cases such as this appear to outweigh the exempt status of the general partnership.[84]

Also, there are other provisions that may be applicable to a particular real estate transaction. For example, one provision excludes the value of any property from the net worth determination for the franchise tax while construction is in progress.[85]

B. *Retail Market*

According to the DOR, twelve percent (12%) of the Tennessee LLCs are in the retail market. With the exception of businesses like Kroger, a large number of these retail businesses are believed to be the classic "Mom and Pop" stores. Although these smaller retailers clearly benefit from liability protection, many businesses operated as general partnerships and sole proprietorships before 1994.[86] Therefore, many of these businesses may be tempted to waive the liability protection if the F & E tax burden is too high.

Assume that the Mom & Pop store is valued at around $750,000 and Mom and Pop share the interest in the LLC that owns the store (which includes inventory, machines, land, a building and others items of value). If Mom and Pop do not receive a salary as owner-employees, but rather receive a share of self-employment income generated by the store each year, they are allowed to reduce the excise tax base by the amount of income subject to self-employment tax.[87] Thus, self-employment income is deductible for excise tax purposes. This factor may encourage some LLC members to stick around.

C. *Manufacturers*

The DOR estimates that ten percent (10%) of Tennessee LLCs are in the business of manufacturing.[88] In a study conducted by the DOR, approximately seventy-two percent (72%) of Tennessee LLCs provided that protection from liability was their primary reason for choosing LLC status.[89] Manufacturers face liabilities that are unique to their business activities; therefore, some owners would not be willing to drop limited liabil-

83. TENN. CODE ANN. § 67-4-2004(16) (1999) (listing all entities subject to tax).

84. *See* Overstreet, *supra* note 26, at 4.

85. TENN. CODE ANN. § 67-4-2108 (1999). The statute states: "There shall not be included within the meaning hereof the value of any property while construction of same is in progress and, in addition thereto, there is no actual utilization of such property by the taxpayer either in whole or in part." *Id.*

86. 40.3% of the Tennessee LLCs operated as proprietorships before electing to organize as an LLC and 25.8% were previously general partnerships. Chervin, *supra* note 14, at 30-32.

87. Self-employment tax is the Social Security and Medicare tax for individuals who work for themselves, like Mom and Pop.

ity status. For manufactures that are not in a position to forgo limited liability, the F & E tax will be eminent.[90] However, the impact of the F & E tax may not be significant depending on the type of product manufactured.

For example, a company that manufactures computer software may have little F & E tax liability compared to manufacturers of traditional goods. The software manufacturer ("Software LLC") is a moderately sized business with around 20 employees. Software LLC's primary assets are its intangible assets, which include several trademarks and patents.[91] Software LLC's most valuable equipment includes several computers, CD-rewriters, and several peripherals. The business does not need a lot of space, so it leases a modest sized office building. Like many software companies in the industry, Software LLC generates high revenues; however, Software LLC will have virtually no net earnings.[92] Even if Software LLC's revenues are high, it reduces net earnings by all of the deductions available to partnerships provided in I.R.C. sections 701 to 761.[93] Given the nature of the software business, Software LLC should be able to significantly reduce its net earnings by its operating costs, such as amortizing research and development, compensating its staff, and depreciating its computer equipment.[94] Thus, software LLC's excise tax liability will not be significant. Likewise, Software LLC's franchise tax liability will be negligible. The tax base for the franchise tax will likely be the value of the property owned and used within the state (instead of the company's net worth). This value will be mostly comprised of computer hardware, trademarks, patents, and a factor[95] for rental property.[96] Due to the short useful life of computers and software, the book value of these assets will deteriorate rapidly.[97] Thus, Software LLC would not have a high net worth (in relation to its earnings) and would not pay much franchise tax. LLCs like Software LLC will not be dramatically affected by the F & E tax. Therefore, the new tax will have little impact on companies like Software LLC when making a choice of entity. Conversely, manufacturers in more traditional markets will not escape the F & E tax so easily.

For example, a manufacturer of household furniture ("Furniture LLC") has about 25 employees. Its primary assets are industrial woodworking machines, delivery trucks, land (lumber yard), and a building (where the factory is located).[98] Unlike Software LLC, most of Furniture LLC's assets are tangible property.[99]

Furniture LLC's market share is similar to Software LLC (relative to their industries); therefore, Furniture LLC has a healthy amount of revenue. For the purposes of calculating net earnings, its revenue will primarily be offset by items such as depreciation of the building and trucks, payroll deductions, and lumber purchases. After reducing its revenue by those amounts,

88. Chervin, *supra* note 14, at 4.
89. *Id*. at 3. Note that all LLCs did not respond to this question, but of the 9,839 that did respond, 7,101 provided that protection from liability was the primary reason for choosing LLC form. *Id*.
90. TENN. CODE ANN. § 67-4-2004(16) (1999).
91. This example is fairly typical for new businesses in the technology industry. For a discussion of the tax and non-tax benefits relevant to high tech business in making a choice of entity decision, see John M. Cunningham, the Limited Liability Company: Entity Of Choice For High-Tech Start-Ups?, 4 COMPUTER LAWYER 11 (1996).
92. *See No Margin For Error*, COMPUTER BUS. REV., Jan. 3, 1994, at 8 (providing examples of the typical computer and software manufacturer's balance sheets).
93. *See* TENN. CODE ANN. § 67-4-2006(a)(4) (1999).
94. *See* Cary B. Edgar, *The Taxation Of Franchise, Trademark And Trade Name Licenses And Sales*, 3 COMPUTER LAWYER 1, 2-3 (1990) (discussing the rapid depreciation and amortization of technology asset).
95. The rent value included in the tax base is calculated by using the amount paid in annual rents multiplied by factors, which differ based on the type of property used (the factor for real property is eight; equipment and machinery is three; furniture is two; and mobile equipment is one). For example, if Software LLC pays $2,000 per month to rent its office, the rent value would be calculated as follows:

Annual Rent equals $2,000 x 12 (months) = $24,000
Rent Value equals $24,000 x 8 (factor for real property) = $192,000

The rent value would be included in the tax base for the franchise tax.
96. *See* Timothy J. Kenesey, *Simplifying The Tax Treatment Of Intangibles: It's About Time—But Let's Not Forget Computer Software*, 1992 ILL. L. REV. 853, 855 (discussing the value of intangibles and other assets in high tech industries).
97. *See* Edgar, *supra* note 96, at 2-3.

Furniture LLC would typically have more net earnings than Software LLC. Even if it did not, Furniture LLC's franchise tax liability would be substantially higher due to its higher asset base. Even after depreciation, Furniture LLC's assets would have a higher book value considering that the useful life of its assets are much longer.

Although these two companies may have similar revenues, the characterization of their assets are largely the base of their tax liability (specifically franchise tax liability). Between these two manufacturers, the more traditional company will have more tax liability. However, neither company would be in a position to forgo limited liability status based on the F & E tax. Note that both companies may be able to reduce their excise tax burden if they qualify for an "industry machinery" credit provided in T.C.A. §67-4-2009(4).

## V. Conclusion

As the income tax debate continues, proposals for repealing the Hall Tax and the F & E tax continue to surface. Although the longevity of the F & E tax is in question, it clearly presents an issue that businesses now have to face. Although some businesses may elect to drop LLE status until the F & E tax is repealed, many have indicated that they will weather the storm. Although the end may be soon for the F & E tax, the legislature may find it difficult to repeal the law considering the broad base of taxable revenue it has tapped. Regardless, the debate continues and, at least for now, the legislature has placed the state's tax burden on the business community.

98. *See* Bonnie Arnett, *Change Comes To The Furniture Dealer*, ADVANTAGE, March 1, 1987, at 77 (discussing the operations of a traditional furniture manufacturer and providing how technology has changed the industry).
99. Jerry B. Williams, *Lipscomb "Lip" Davis III: Can't Get The Sawdust Out Of His Blood*, ADVANTAGE, Jan. 1, 1988, at 106 (discussing the major startup costs associated with furniture manufacturing).

# I'll Gladly Pay You Tuesday for a Hamburger Today: An Explanation of Tennessee's Cash-Advance Industry

Lawrence M. Magdovitz II*

## I. Introduction to Cash Advances

In the 1990s, Tennessee witnessed the proliferation of a new financial institution - the cash-advance business. This new enterprise allows customers to get cash advances that they normally would not be able to secure through traditional lending institutions. While this type of lending is usually referred to as a cash advance, this term is often used interchangeably with "payday lending, delayed deposit checking, check-deferral transactions, cash-advance loans, or check-cashing."[1] Many simply refer to businesses that make cash advances as "check-cashers" because, on the surface, the transaction involves merely exchanging a customer's personal check for money. However, the actual financial workings involve much more than cashing a check.[2] Consequently, "check-cashing" is a misleading term for describing these businesses.[3] Traditionally, check-cashing stores cashed welfare, social security, or company checks for a fee or sold money orders to customers without checking accounts.[4] Today these "true" check-cashing businesses have found it profitable, if not necessary, to move from cashing checks to making cash advances.[5]

This new sector of the financing industry is particularly relevant to the Tennessee legal community because, as of April 1999, there were almost 700 cash-advance businesses, run by approximately 300 different companies, operating in Tennessee.[6] In total, these cash-advance operations loaned more than $200 million in 1998.[7] Spurred by the success of such lending, Tennessee is currently home to two of the nation's biggest cash-advance companies: Check into Cash, Inc. and National Cash Advance, both based in Cleveland, Tennessee.[8]

A more accurate name for cash advance businesses is "deferred presentment services" - the name the Tennessee legislature chose in regulating these businesses.[9] In a typical deferred presentment service, a business accepts a personal check from a customer, dated as of the date the

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1. *See generally* Rodney Ho, *Fees of Quick-Cash Chains Draw Scrutiny*, WALL ST. J., June 10, 1997 at B1, *available in* 1997 WL-WSJ 2423635.

2. While this lack of precision in a descriptive term is somewhat trivial, it is necessary to point this inaccuracy out to the uninitiated. However, even the senior divisional vice-president of Check Into Cash, Inc., one of the nation's largest cash-advance businesses, said, "For a flat fee, we cash a customer's personal check and hold it until their next payday." *Check-Cashing Chain Opens Office in Rock Hill, S.C.*, KNIGHT-RIDDER TRIB. BUS. NEWS, Aug. 7, 1998, *available in* 1998 WL 16331253.

3. The media continues the mischaracterization of this type of transaction as "cash[ing] a customer's personal check" even two years after the Deferred Presentment Services Act was enacted. *Check Into Cash, Inc. Checks Into New Location*, TENNESSEAN (Nashville), Apr. 21, 1999, at 1E, *available in* 1999 WL 17427178.

4. Ho, *supra* note 1, at B1.

5. *Id.*

6. *See* Sheila Wissner, *Thriving Loan Industry's Secrecy Worries Officials; These High-Profit, Quick Cash Business esAttractive to Organized Crime, Mob Specialist Says*, TENNESSEAN (Nashville), Apr. 18, 1999, at 1A, *available in* 1999 WL 5764723.

7. *Id.*

8. Rebecca Ferrar, *Cash-Advance Law Coming up for Renewal; Who Cares About 391% Interest on 14-Day Loan?* KNOXVILLE NEWS-SENTINEL, Jan. 24, 1994, at D1, *available in* 1999 WL 9154051.

9. Deferred Presentment Services Act of 1997, 1997 Tenn. Pub. Acts ch. 255, § 2.

check is written, with the face amount payable to the business. The business then writes one of its own checks to that customer, payable immediately, for an amount less than the face value of the customer's personal check. The difference between the amount given the customer and the face value of the customer's personal check is the fee that the deferred presentment business takes for its services.[10] When the time for repayment arrives, usually fourteen or thirty days later, the business either cashes the customer's check or the customer pays the amount of the check in cash to the business. In a nutshell, the business defers presentment of the customer's check to the customer's bank for a certain amount of time in return for a fee.

This article does not weigh the social costs and benefits of the cash-advance business. This article's purpose is to educate and inform the legal community by explaining the cash-advance business, how it works in Tennessee, the statutory limitations the state has placed on cash advances, and legal issues that arise for both customers and operators of these businesses.

## II. The Deferred Presentment Services Act of 1997

In Tennessee, cash advances are governed by the Deferred Presentment Services Act ("Act").[11] When a customer enters a licensed cash-advance business ("licensee"), she must first be given a written agreement that explains in "clear, understandable language, the fees to be charged by the licensee," and the date on which the customer's check will be deposited by the licensee.[12] After the customer has "read" and signed the deferred presentment agreement, the customer writes a check for a certain amount made payable to the licensee. The check cannot be postdated; it must be dated the day it is written,[13] although both parties know that the customer most likely has insufficient funds in her bank account to cover the check at that time. In return for the customer's check, the licensee gives the customer a check or cash in the amount of the face value of the customer's check less the fee charged by the licensee.[14] The licensee may not charge a fee that exceeds the lesser of 15% of the face value of the customer's check or $30.[15] Within thirty-one days of the transaction, either the customer must pay the face amount of the

10. The fee charged is essentially interest. *See infra* text accompanying notes 14-16. However, the Tennessee state legislature was deliberate in classifying the amount charged as a fee rather than interest, and the reason is set forth in the section describing the Act that follows below. *Id.*; Wissner, *supra* note 6, at A1.

11. Deferred Presentment Services Act, 1997 Tenn. Laws Pub. Acts ch. 255, §§ 2-20 (codified at Tenn. Code. Ann. §§45-17-101 to –119 (1999). The Act, passed in 1997, was originally slated to expire on October 1, 1999. *Id.* However, in March of 1999, the Tennessee legislature amended the Act by deleting the expiration provision, thus allowing the Act to remain in effect. Act of March 17, 1999, 1999 Tenn. Laws Pub. Acts ch. § 14 (S.B. 49) (repealing the October sunset date of the Act and extending the term of the law indefinitely).

12. TENN. CODE ANN. §§ 45-17-102(4), 45-17-112(d), 45-17-112 (g). This agreement is a product of the Tennessee legislature's attempt to keep these cash advances arm's-length transactions and to provide fair notice to the customer of the cost of the cash advances. However, cash-advance customers rarely, if ever, read the terms of the written agreement.

13. TENN. CODE ANN. § 45-17-112(j) (Supp. 1999); *see, e.g.*, Ferrar, *supra* note 8 at D1.

14. *Id.* § 45-17-112(m).

15. *Id.* § 45-17-112(b). If a customer receives a $100 cash advance for fourteen days, the customer would write a check for $115 which, if held (or renewed each month) for a year, is an annual percentage rate of 449%. While on its face the fee may appear to be usurious interest, the Act specifically exempts cash advances from Tennessee's usury laws by saying the "fees" are not interest. Deferred Presentment Services Act, 1997 Tenn. Laws Pub. ch. 255, §§ 3(d), 13(b) (codified at TENN. CODE. ANN. §§ 45-17-102(4), 112(b)(2) (1999)).

check to the licensee or the licensee must present the check to the bank for payment or deposit.[16]

To protect consumers from the lure of easy money, customers may have no more than two checks outstanding with any licensee and the aggregate amount of those checks may not exceed $500.[17] To this end, each licensee must question the customer regarding any outstanding checks to other licensees. In response, the customer is obligated to state, in writing, "(1) that [she has] no more than two checks outstanding to any licensee, and (2) that the aggregate face value of such checks does not exceed the statutory limit."[18] Although the legislature had good intentions in limiting the number of a customer's outstanding cash advances, the statute does not have its intended effect. Since the Act applies to the cash-advance business and not the customer,[19] so long as the licensee "inquires" whether the customer has multiple outstanding cash advances and the customer lies, the customer can obtain as many cash advances as she desires.[20]

The commissioner of financial institutions for the State of Tennessee possesses broad powers to enforce the Act.[21] Anyone wishing to operate a deferred presentment business must have a license, granted by the commissioner, for each location.[22] In order to effectively investigate possible violations by licensees the commissioner is "empowered to inspect the business premises, books and records of any business licensed under the Act," at a cost to the licensed business of $200 per day.[23] In addition, the commissioner may also summon witnesses for examination under oath concerning matters related to the deferred presentment services provided by a licensee, or someone reasonably suspected of providing such services.[24]

A cash advance business must comply with several notice requirements and information filings. It must maintain the books, records, and accounts specified by the commissioner and retain them for at least the preceding two years.[25] The business must conspicuously display its de-

16. *Id.* § 45-17-112(d). In practice, most cash-advance businesses do not make the advances for longer than fourteen days because they can advance the same money twice in one month rather than only once a month, thereby increasing their collective rate of return. *See also infra* text accompanying notes 37-40.

17. *Id.*

18. *Id.* § 45-17-112(p). Without any further investigation, the licensee can rely on the customer's written representation regarding outstanding checks to other licensees. *Id.* In practice, this written representation is made a part of the written agreement concerning the terms of the cash advance and is rarely read by the customer. An even rarer occurrence is a customer who accurately states to a licensee how many outstanding deferred presentment checks they have with all other licensees. *See, e.g.*, John Hendren, *More States Allow Triple-Digit Loan Rates Despite Consumer Complaints*, ASSOCIATED PRESS, Jan. 9, 1999, at *, 1999 WL 2230035. As Hendren and other authors suggest, most cash-advance customers go to several cash-advance businesses every week. These customers carry out a juggling act, "robbing Peter to pay Paul" every month. *See id.*

19. Deferred Presentment Services Act, 1997 Tenn. Laws Pub. ch. 255, §§ 3-4 (codified at Tenn. Code. Ann. §§ 45-17-102(5), 103 (1999)).

20. *See, e.g.*, John Hendren, *Lobbying Money Helping to Persuade Legislators to Legalize Payday Loans*, ASSOCIATED PRESS NEWSWIRES, Feb. 22, 1999; Hendren, *supra* note 18, at *; Ho, *supra* note 1, at B1.

21. TENN. CODE ANN. § 45-17-105 (1999).

22. *Id.* § 45-17-103. Potential licensees must file an application for a cash-advance license with the commissioner, who is responsible for granting, denying, suspending, and revoking licenses in certain situations. *Id.* §§ 45-17-105, 45-17-114(a), 45-17-114(b). To apply for a license, a potential licensee must demonstrate that it has a minimum net worth of $25,000, and that it has the financial responsibility, experience, and general capability to conduct the business in a fair and lawful manner. *Id.* § 45-17-104(a). The application fee is $500 for each license; if the license is granted, the fee is used as the license fee for the first license year. *Id.* § 45-17-106. A license lasts until September 30th of the following year. *Id.* § 45-17-110. On or before September 1 of the following year, each license may be renewed with payment of a $500 renewal fee and a renewal application showing continued compliance with the requirements of Tennessee Code Annotated § 45-17-104.

23. *Id.* § 45-17-111(b) (inspection fees cannot exceed $1,200 per year).

24 . *Id.* § 45-17-111.

25. *Id.* § 45-17-112(a).

ferred presentment license and a notice describing the charges imposed by the licensee.[26] A licensee must also file a written report with the commissioner after certain, significant events affecting the cash-advance business's financial position or reputation.[27] Finally, each licensee must file an annual report with the commissioner by September 1 of each year for every location that a licensee operates.[28]

## III. Selected Legal Matters Commonly Arising from Cash Advances

In discussing legal matters arising from operating a cash-advance business, a hard look must be taken at the remedies available to licensees when a deferred presentment check is refused or, more simply, not repaid.[29] In general, if a person writes a check and fraudulently stops payment on the check or allows the check to be dishonored because of insufficient funds, a closed account, or lack of an authorized signature, the holder of the check is entitled to civil remedies[30] and the issuer could be subject to criminal penalties.[31] However, if a cash advance customer's check is returned from a bank "due to insufficient funds, closed account or a stop payment order," [32] the licensee's remedies are limited to "all civil means available and allowed by law to collect the check."[33] Unlike the typical creditor,[34], a cash-advance business cannot recover attorney's fees or interest in a suit to collect payment of a check.[35] Furthermore, no person who issues a personal check to a licensee under the Act may be charged with the crime of issuing a worthless check under Tennessee Code Annotated § 39-14-121.[36]

One scheme that arose in the cash-advance industry is "loan splitting."[37] A cash-advance business has an incentive to make fourteen-day loans for small amounts, because it receives the greatest return on a fourteen-day loan with a principal amount of $170 or less.[38] Loan splitting may be illustrated as follows. If a licensee makes

26. *Id.* § 45-17-112(n).
27. *Id.* § 45-17-109. These events include the following: bankruptcy filing or reorganization by the licensee; the institution of revocation or suspension proceedings against the licensee by any state or governmental authority; the denial of the opportunity to conduct deferred presentment services business by any state or governmental authority; a felony indictment or conviction of the licensee or any of its directors, officers, or principals; and any other events identified by the commissioner. *Id*.
28. *Id.* § 45-17-119. The report must provide the commissioner with financial reports, including a balance sheet and an income statement. *Id.* These annual reports are used to gather information concerning the effectiveness of the Act's restrictions on the cash-advance industry and its overall economic effect. *See, e.g.*, Ferrar, *supra* note 8, at D1.
29. Ho, *supra* note 1, at B1. Typical cash-advance businesses have a 10% default rate, while credit cards have a lower default rate of 6.5%. *Id.*
30. TENN. CODE ANN. § 47-29-101(a) (Supp. 1999). Specifically, the holder may recover the face amount of the check; ten percent interest per annum on the face amount of the check; or any unpaid balance from the date of execution until full payment is made, including reasonable service charges incurred in attempting to collect on the check, civil court costs, and reasonable attorneys fees. *Id*.
31 *Id.* § 39-14-121. It is a misdemeanor to issue a check when the issuer knows there are insufficient funds to cover the check; the account on which the check is drawn is closed; or the issuer stops payment on the check issued for money, goods, credit, or services. *Id*.
32. *Id.* § 45-17-112(i).
33. Tenn. Op. Att'y Gen. No. 98-070 (1998).
34. *Cf.* TENN. CODE ANN. § 47-29-101 (1999).
35. Tenn. Op. Att'y Gen. No. 98-070 (1998).
36. TENN. CODE ANN. § 45-17-112(i) (Supp. 1999).
37. Ferrar, *supra* note 8, at D1.
38. *Id*. A licensee can only charge 15% of the face amount of the check or $30, whichever is less, so that a customer's check with a $200 face-value 15% equals $30. Because the maximum amount that a cash-advance business can charge is $30, the business has a strong incentive not to advance amounts to the customer greater than $170.

a $340 cash advance for 30 days, it can charge a fee of no more than $30, or a 107% annual percentage rate ("APR").[39] If the licensee makes two cash advances of $170 for 14 days to the same customer, it will receive total fees of $60, a 460% APR on each check. While loan splitting is not expressly proscribed by the Act, the Act seems to prohibit this action as a device used by the licensee with the intent to obtain greater charges than authorized by the Act.[40]

Another common scheme of which both customers and cash-advance businesses should be aware is the "loan rollover" or "renewal."[41] In a loan rollover, the licensee accepts a new deferred presentment check immediately after the customer pays off the earlier deferred presentment check.[42] In essence, the licensee accepts payment for the old check and gives the same money back to the customer under the guise of a new deferred presentment check, in direct violation of the Act.[43] The Act states that "a licensee shall not renew a deferred presentment transaction with the proceeds of a deferred presentment transaction previously made by the same licensee."[44] If the cash-advance business violates this provision, its second cash advance is void, making it unenforceable in law or equity,[45] even if the customer takes the second cash advance and then reports the transaction to the commissioner of financial institutions as a loan rollover, defrauding the cash-advance business in the process.[46] A "cooling-off" period between cash advances may limit rollovers, but a cash-advance customer remains free to patronize other cash-advance businesses so a "cooling off" period would probably be ineffective in the long run.[47]

## IV. Conclusion

This article set out to explain how cash advances work in Tennessee as well as to delineate the Deferred Presentment Services Act while highlighting some of the more practical, non-statutory aspects of the cash-advance business. With the phenomenal growth of the cash-advance industry in Tennessee, the legal community must

39. The annual percentage rate (APR) is calculated by dividing the fee charged by the cash advance received by the customer. The resulting figure is then multiplied by the result of dividing 365 days by the number of days of the cash advance, thus giving the APR. Speaking in terms of APR is important, yet potentially misleading. Some cash-advance customers do get cash advances constantly throughout the year and, in effect, are borrowing at an annual rate. However, APRs are misleading and somewhat alarmist because a customer who, once a year, gets a cash advance of $170 for a fee of $30 for two weeks, is not really concerned that the APR is 460%; Hendren, *supra* note 18, at *.

40. TENN. CODE ANN. § 45-17-112(r) (Supp. 1999) (stating that a licensee shall not use any device or agreement with the intent to obtain greater charges than otherwise would be authorized by this chapter). For example, a licensee who takes two $170 checks on the same day would seem to violate this provision because the licensee is getting two fees for two transactions when the licensee could consolidate the two cash advances for one fee. Whether loan splitting violates the provision is less clear where the two $170 cash advances are made over the course of a week or within a few days of each other, for that matter. Would a second cash advance three days after the first cash advance qualify as a violation of § 45-17-112(r)? The answer would seem to be "no," but no authority has addressed this specific question.

41. Ferrar, *supra* note 8, at D1.

42. Rebecca Ferrar, *Check-Advance Regulation Slowed But Passage Likely*, KNOXVILLE NEWS-SENTINEL, Feb. 3, 1999, at B6, *available in* 1999 WL 9154643.

43. However, rather than paying off the entire amount of the deferred presentment check, the cash-advance business usually accepts the amount of the fee in cash from the customer and agrees to hold the customer's check for another fourteen- or thirty-day period. For instance, a customer who received a $100 cash advance has a $115 check in the possession of the cash-advance business. If the customer cannot pay the entire $115, he can pay the $17.25 fee and delay repayment of the entire amount for another fourteen- or thirty-day period. The Act forbids any such transaction, deeming it void and unenforceable against the customer, regardless of whether the customer did this with the intent to defraud. TENN. CODE ANN. § 45-17-112(q) (Supp. 1999).

44. *Id.*

45. *Id.*

46. *Id.* It seems rather draconian when the Act would look the other way in the face of intentional fraud.

47. Ferrar, *supra* note 8, at D3.

keep up with this burgeoning market in order to adequately serve their clients, whether they are customers of cash-advance services or are in the business of providing cash advances. Since October 1997, the commissioner of financial institutions reported that of 677 offices operating as cash-advance businesses in Tennessee, over half had violated the Deferred Presentment Services Act in some fashion.[48] However, only 23 written complaints were made to the commissioner among an estimated 1.2 million transactions.[49]

While the cash-advance industry is a useful and highly-regulated sector in Tennessee, the businesses that engage in this service require constant supervision to avoid the dangers inherent to the short-term loan industry, such as loan splitting and loan rollovers. The legal community in Tennessee must be ready and able to handle the problems that arise from the cash-advance industry because the short-term loan market shows no signs of slowing down in Tennessee. By increasing the legal community's awareness of the risks involved, the Deferred Presentment Services Act should more effectively be followed and enforced, benefiting cash-advance businesses and their customers alike.

48. Ferrar, *supra* note 38, at B6.
49. ds *Id.*

# Article Submissions

The Editorial Board of *Transactions* is soliciting articles and papers for upcoming issues. Anyone wishing to submit an item that would be of interest to an attorney practicing business, tax, or transactional law in Tennessee is encouraged to contact the journal at any of the addresses below.

The recommended length for articles is 1500 to 6500 words; however, any length article would be acceptable if the topic is appropriately developed. Citations should follow Bluebook format, and articles may be submitted either by e-mail or on floppy disk.

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