

***ARC LIFEMED, INC. V. AMC-TENNESSEE, INC.: IMPLICATIONS  
FOR THE APPLICATION (OR LACK THEREOF) OF THE INTERNAL  
AFFAIRS DOCTRINE***

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**I. INTRODUCTION**

In the mid 1990s, Tennessee began experiencing a boom in the construction of assisted living facilities.<sup>1</sup> ARC Lifemed, Inc. (“ARC”) was a large company that for many years had been a leader in the construction of nursing home facilities in the eastern and southeastern regions of the United States.<sup>2</sup> ARC wished to enter the assisted living facility market, and in 1997, it embarked upon a business plan with the ultimate goal of opening forty assisted living facilities.<sup>3</sup> By the fall of 1998, ARC had twenty assisted living facilities built and in operation.<sup>4</sup>

Despite having no prior experience managing assisted living facilities, LifeTrust, Inc. (“LifeTrust”), a company created in 1996, owned and operated thirty assisted living facilities by the end of 1998.<sup>5</sup> LifeTrust began contemplating ways to increase the revenues generated by assisted living facilities through means other than merely providing residents with room and board.<sup>6</sup> Believing that it could obtain increased revenues by entering the pharmacy market, LifeTrust began discussions regarding entering into “a joint venture with ‘The Pharmacy,’ an institutional pharmacy serving skilled nursing facilities and assisted living facilities primarily in Tennessee.”<sup>7</sup> Shortly thereafter, American Medserve Corporation acquired The Pharmacy, which was

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<sup>1</sup> See *ARC Lifemed, Inc. v. AMC-Tennessee, Inc.*, No. M2003-02640-COA-R3-CV, 2005 Tenn. App. LEXIS 460, at \*3 (Tenn. Ct. App. Aug. 2, 2005).

<sup>2</sup> *Id.* at \*2-3.

<sup>3</sup> *Id.* at \*3.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* The Pharmacy, owned and operated by Buddy Stephens, “had profitably concentrated its business in the long-term care market.” *Id.*

renamed AMC-TN.<sup>8</sup> In 1997, LifeTrust and AMC-TN entered into a joint venture, forming LifeMed, LLC (“LifeMed”)<sup>9</sup> as a Delaware limited liability company qualified to conduct business in Tennessee.<sup>10</sup> LifeMed was established to operate as a “pharmacy within a pharmacy,” running its operations out of AMC-TN’s facilities and supplying pharmaceutical supplies to LifeTrust’s assisted living facilities.<sup>11</sup>

ARC learned of LifeTrust’s and AMC-TN’s joint venture in 1997 while searching for ways to increase its own revenues.<sup>12</sup> ARC had prior experience managing a pharmacy in Richmond, Virginia,<sup>13</sup> and expressed an interest in joining LifeMed as a member of the joint venture. ARC contributed \$300,000 to LifeMed in 1998 and received a one-third ownership interest.<sup>14</sup> According to LifeMed’s Management Agreement, AMC-TN would manage the business’s daily operation.<sup>15</sup> As manager, AMC was entitled to a management fee.<sup>16</sup>

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<sup>8</sup> *Id.* American Medserve Corporation itself was eventually acquired by Omnicare, Inc., “the leading institutional pharmacy in the nation.” *Id.* at \*3-4. Although ownership of the business changed for a second time, the name AMC-TN was retained. *Id.* at \*4.

<sup>9</sup> *Id.* at \*4. LifeTrust initially contributed \$200,000 to the joint venture in exchange for a forty percent ownership share. *Id.* AMC-TN contributed \$300,000 to the joint venture and received a sixty percent ownership share. *Id.*

<sup>10</sup> *Id.* at \*33. Both the plaintiff’s complaint and AMC-TN’s counter-complaint affirmatively asserted that LifeMed was organized under the laws of Delaware. The Court of Appeals did not question these assertions. *Id.* at \*29, \*33.

<sup>11</sup> *Id.* at \*4. The parties believed that the “pharmacy within a pharmacy” concept would allow LifeMed to share overhead costs with AMC-TN and to utilize AMC-TN’s services without causing the overcapitalization of LifeMed. *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* This pharmacy was used to serve ARC’s nursing home facilities. *Id.* at \*11.

<sup>14</sup> *Id.* at \*4-5. Half of ARC’s \$300,000 investment went to AMC-TN in the form of a distribution. *Id.* at \*5. Under the Amended and Restated LLC Agreement executed by ARC, LifeTrust, and AMC-TN, each member could appoint two members of LifeMed’s Board of Directors; no member could withdraw capital funds without the approval of all three members; and each member’s capital account would be distributed upon termination of the LLC. *Id.* The Agreement further provided that any member could withdraw from the venture “and receive a return of its positive capital account balance.” *Id.* at \*5-6.

<sup>15</sup> *Id.* at \*6. The Management Agreement stated in part that AMC-TN would provide “management, consulting and advisory services to Owner in connection with the operation of the Pharmacy, and

Although both ARC and AMC-TN had experience providing pharmaceutical services to nursing homes, none of the members had experience providing these services to assisted living facilities.<sup>17</sup> Though all the members hoped that ARC's and AMC-TN's experience in the nursing home pharmaceutical market would translate easily into the assisted living facility pharmaceutical market, they would soon find that this would not be the case.<sup>18</sup> AMC-TN, member and managing partner of LifeMed, supplied its pre-existing pharmaceutical clients with pharmaceutical products separately from supplying those products to LifeMed.<sup>19</sup> This practice created inventory control problems because the two pharmacies were not physically separated until early 2000.<sup>20</sup> These inventory control problems, along with an overestimation of the market for assisted living facilities, ultimately led to LifeMed's demise.<sup>21</sup> On August 15, 2000, all three members agreed to dissolve LifeMed.<sup>22</sup> From that point forward, the members' relationship deteriorated to the point that, on October 12, 2001, LifeTrust, ARC, and LifeMed "brought suit against AMC-TN, ...alleging breach of contract, breach of fiduciary relationship, negligent representation and fraudulent misrepresentation."<sup>23</sup> AMC-TN countersued, claiming that LifeMed owed it unpaid management fees under the Management Agreement.<sup>24</sup> Relying on expert testimony, the trial court held that AMC-TN was liable to all

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shall devote such time, expertise, and resources as may be appropriate to properly manage the Pharmacy." *Id.* at \*7.

<sup>16</sup> *Id.* at \*9. This management fee was to be "equal to [AMC-TN]'s actual costs incurred in providing the services to be performed by [AMC-TN under the Management Agreement], plus ten percent (10%)." *Id.*

<sup>17</sup> *Id.* at \*11-12.

<sup>18</sup> *Id.* at \*12.

<sup>19</sup> *Id.* at \*15-16.

<sup>20</sup> *Id.* at \*18-19.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at \*23.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at \*28-29.

plaintiffs on all claims asserted.<sup>25</sup> Additionally, the trial court dismissed AMC-TN's counterclaim.<sup>26</sup>

On appeal, the Tennessee Court of Appeals affirmed the trial court's decision in part and reversed in part.<sup>27</sup> The court noted that the fiduciary duty of a manager-member of a Tennessee LLC is generally owed to the LLC itself, rather than to the LLC's individual members.<sup>28</sup> However, a breach of a fiduciary duty constitutes a breach of contract if the actions constituting the breach of duty also constitute violations of the provisions of the LLC agreement or the management agreement.<sup>29</sup>

## II. FIDUCIARY DUTY AND THE TENNESSEE LLC

In *McGee v. Best*,<sup>30</sup> the Tennessee Court of Appeals recognized the principle that in Tennessee, "there is no fiduciary duty between, or among, individual members of a Limited Liability Corporation."<sup>31</sup> McGee, a founding member and employee of an LLC, was terminated from his position as chief manager of the LLC, and the remaining LLC members purchased his interest in the LLC pursuant to a contractual purchase option.<sup>32</sup> McGee brought suit against the remaining members of the LLC, claiming that they had violated the LLC's operating agreement and their fiduciary duties to the LLC.<sup>33</sup> The Court of Appeals concluded that, based on

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<sup>25</sup> *Id.* at \*1-2.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at \*2.

<sup>28</sup> *Id.* at \*49 (quoting *McGee v. Best*, 106 S.W.3d 48, 64 (Tenn. Ct. App. 2002)).

<sup>29</sup> *Id.* at \*45.

<sup>30</sup> 106 S.W.3d 48 (Tenn. Ct. App. 2002).

<sup>31</sup> *Id.* at 63.

<sup>32</sup> *Id.* at 51, 54.

<sup>33</sup> *Id.* at 55. Specifically, McGee alleged

that the defendants violated the Operating Agreement, and the Tennessee Limited Liability Act by purporting to terminate him without a meeting or the waiver of a meeting...[and] that the defendants breached the agreement and their fiduciary duty to the LLC and the covenant of good faith and fair dealing by purporting to

Tennessee statutory law, members of a Tennessee member-managed LLC have a fiduciary duty to “*account to the LLC*” for any benefit received and to act as trustee of any profits the member derives from any transaction to which the other members of the LLC did not consent.<sup>34</sup> The court found the statutory language important and emphasized that courts should not discount the intent of the legislature as expressed in the wording of the legislation itself.<sup>35</sup> The court dismissed McGee’s cause of action for breach of fiduciary duty because it was clear that the legislature intended for LLC members to owe a fiduciary duty only to the LLC itself and not to the other members.<sup>36</sup>

The rule espoused by the *McGee* court—that members of a Tennessee LLC owe a fiduciary duty to the LLC itself and not to its members—appears to be contradicted by the ruling in *Anderson v. Wilder*.<sup>37</sup> Similar to *McGee*, the plaintiff LLC members were expelled from FuturePoint Administrative Services, LLC, by vote of the other members.<sup>38</sup> The plaintiffs filed suit, alleging that the defendants breached the fiduciary duty they owed to the rest of the members.<sup>39</sup> Applying principles of Tennessee corporation law, the Tennessee Court of Appeals found that members

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terminate his employment for ‘cause’ when no cause existed and by attempting to acquire his membership interest, without having any right to do so.

*Id.*

<sup>34</sup> *Id.* at \*63-64 (quoting TENN. CODE ANN. § 48-240-102 (2002)) (emphasis added).

<sup>35</sup> *McGee*, 106 S.W.3d at 64; *see also* Worrall v. Kroger Co., 545 S.W.2d 736, 738 (Tenn. 1977) (providing that “legislative intent or purpose is to be ascertained primarily from the natural and ordinary meaning of the language used, when read in the context of the entire statute, without any forced or subtle construction to limit or extend the import of the language”); *State ex rel. Rector v. Wilkes*, 436 S.W.2d 425, 427 (Tenn. 1968) (providing that “[t]he prime purpose of statutory interpretation is to ascertain and give effect to the legislative intent and all rules of [statutory] construction yield to achieve this end”); *Mangrum v. Owens*, 917 S.W.2d 244, 246 (Tenn. Ct. App. 1995) (providing that “[t]he rule of statutory construction to which all others must yield is that the intention of the legislature must prevail”); *Plough, Inc. v. Premier Pneumatics, Inc.*, 660 S.W.2d 495, 498 (Tenn. Ct. App. 1983) (providing that “[t]he rule of statutory construction to which all others must yield is that the intention of the legislature must prevail”).

<sup>36</sup> *McGee v. Best*, 106 S.W.3d 48, 64 (Tenn. Ct. App. 2002).

<sup>37</sup> No. E2003-00460-COA-R3-CV, 2003 Tenn. App. LEXIS 819 (Tenn. Ct. App. Nov. 21, 2003).

<sup>38</sup> *Id.* at \*1.

<sup>39</sup> *Id.* at \*2.

holding a majority interest in a Tennessee LLC owe fiduciary duties to holders of minority interests in the LLC.<sup>40</sup> The defendants argued that the court should follow *McGee* and find that members of an LLC owe fiduciary duties only to the LLC and not to other LLC members.<sup>41</sup> The *Anderson* court rejected this argument, however, distinguishing the *McGee* case by characterizing it as merely “an employment dispute” not involving any “allegation of oppression by a majority shareholder group.”<sup>42</sup>

#### A. ARC Lifemed, Inc. v. AMC-Tennessee, Inc., and the Application of the Fiduciary Duty of LLC Members to Other LLC Members

In *ARC Lifemed, Inc. v. AMC-Tennessee, Inc.*,<sup>43</sup> the Tennessee Court of Appeals ruled that AMC-TN owed no fiduciary duty to the other members of LifeMed, LLC, thus reversing the ruling of the trial court that such duties existed and were breached by AMC-TN.<sup>44</sup> The *ARC Lifemed* court relied heavily on *McGee* in reaching its conclusion.<sup>45</sup> The *ARC Lifemed* court acknowledged the conflict between the *McGee* and *Anderson* decisions.<sup>46</sup> However, the *Anderson* court’s ruling was limited to those

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<sup>40</sup> *Id.* at \*8-9. In so finding, the Tennessee Court of Appeals specifically referenced *Nelson v. Martin*, 958 S.W.2d 643 (Tenn. 1997), a Tennessee Supreme Court case cited in the plaintiff’s brief. *Id.* at \*8. In *Nelson*, the Tennessee Supreme Court stated that in the corporate context, “majority shareholders owe a fiduciary duty to minority shareholders.” *Nelson*, 958 S.W.2d at 647; *see also* *Mike v. Po Group, Inc.*, 937 S.W.2d 790, 793 (Tenn. 1996) (providing that “Tennessee courts have stated that majority shareholders owe a fiduciary duty to minority shareholders”); *Nelms v. Weaver*, 681 S.W.2d 547, 549 (Tenn. 1984) (providing that majority stockholders have “a fiduciary relationship” with minority stockholders); *Dale v. Thomas H. Temple Co.*, 208 S.W.2d 344, 352 (Tenn. 1948) (providing that a “controlling stockholder...owe[s] a fiduciary duty to other stockholder[s]”).

<sup>41</sup> *Anderson*, 2003 Tenn. App. LEXIS 819, at \*16.

<sup>42</sup> *Id.* The *Anderson* court emphasized that the *McGee* court “noted that ‘this case boils down to a rather uncomplicated dispute controlled by the employment contract and the Operating Agreement[;]...[t]he only issue involved is whether termination of the employment was for cause.’” *Id.* (quoting *McGee v. Best*, 106 S.W.3d 48, 67 (Tenn. Ct. App. 2002)).

<sup>43</sup> No. M2003-02640-COA-R3-CV, 2005 Tenn. App. LEXIS 460 (Tenn. Ct. App. Aug. 2, 2005).

<sup>44</sup> *Id.* at \*54.

<sup>45</sup> *See id.* at \*49-53. The *ARC Lifemed* court quoted extensively from *McGee* and took steps to closely associate the case at bar with *McGee*. *Id.*

<sup>46</sup> *See id.* at \*50.

situations in which majority shareholders had wronged minority shareholders.<sup>47</sup> Because LifeMed, LLC, had no majority member, the *Anderson* decision did not apply, and the defendant had no fiduciary duty to the other members of the LLC.<sup>48</sup> Instead, the court stated that the case at bar resembled *McGee* in that it involved nothing more than “uncomplicated contractual duties under an operating agreement and a management agreement.”<sup>49</sup>

### III. INTERNAL AFFAIRS DOCTRINE

If the *ARC Lifemed* court’s ruling regarding the duty owed by members of a Tennessee LLC to other LLC members were the only, or even the most significant, issue implicated, the case, while interesting, would be simply another appellate court case upholding Tennessee precedent. However, the most significant issue implicated by the *ARC Lifemed* case concerns choice of law, an issue not readily apparent to one not specifically looking for it. Couched within the opinion, and seemingly glossed over by the appellate court, is the fact that LifeMed, LLC, was organized under Delaware law.<sup>50</sup> Despite this “key fact,” the Tennessee Court of Appeals adjudicated the case based on Tennessee statutory and case law.<sup>51</sup>

*ARC Lifemed* is not the first case in which a state has attempted to apply its own law to entities organized in Delaware. In *VantagePoint Venture Partners 1996 v. Examen, Inc.*,<sup>52</sup> the Delaware Supreme Court was faced with the issue of whether a California statute<sup>53</sup> provided shareholders with rights in addition to those provided under Delaware law or whether the California statute preempted Delaware law.<sup>54</sup>

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<sup>47</sup> *Anderson v. Wilder*, No. E2003-00460-COA-R3-CV, 2003 Tenn. App. LEXIS 819, at \*8-9 (Tenn. Ct. App. Nov. 21, 2003).

<sup>48</sup> *ARC Lifemed*, 2005 Tenn. App. LEXIS 460, at \*50.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* at \*33.

<sup>51</sup> *See, e.g., id.* at \*47-53.

<sup>52</sup> 871 A.2d 1108 (Del. 2005).

<sup>53</sup> The California statute in question was section 2115 of the California Corporations Code, which provides that the articles of incorporation of foreign corporations having contacts with California must comply with California law, regardless of the foreign corporation’s state of incorporation. CAL. CORP. CODE § 2115(a)-(b) (West 2006).

<sup>54</sup> *VantagePoint*, 871 A.2d at 1112, 1114 & n.22.

Examen provided legal expense management solutions throughout the United States.<sup>55</sup> Examen was contemplating a merger with LexisNexis, but the merger required the approval of a majority of the holders of Examen common stock and Series A Preferred stock, voting together as a single class.<sup>56</sup> VantagePoint owned approximately eighty-three percent Examen's common stock and wanted a separate class vote instead of the two classes voting together as one class because a separate vote would have given VantagePoint the power to block the merger.<sup>57</sup> VantagePoint wanted the California statute to apply because its application would allow a separate class vote, whereas the application of Delaware law would not.<sup>58</sup>

Examen filed a complaint in Delaware seeking a declaration that Delaware law applied, while VantagePoint filed an action in California seeking "a declaration that Examen was a quasi-California corporation...and therefore subject to" California's corporate law statutes.<sup>59</sup> The California Superior Court stayed its action to allow the Delaware court to rule on Examen's choice of law action.<sup>60</sup> The Delaware Court of Chancery held that Delaware law governed, which meant that the shareholder vote on the proposed merger of Examen and LexisNexis would entail common stock and Series A Preferred Stock voting as a single class.<sup>61</sup> VantagePoint appealed the decision to the Delaware Supreme Court, which affirmed the Court of Chancery.<sup>62</sup>

In ruling that only Delaware law applied in the *VantagePoint* case, the Delaware Supreme Court invoked the internal affairs doctrine.<sup>63</sup> Courts have long accepted that the only state that should have the authority to regulate a corporation's

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<sup>55</sup> *Id.* at 1110-11.

<sup>56</sup> *Id.* at 1111.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.* at 1109-10.

<sup>60</sup> *Id.* at 1110.

<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 1109.

<sup>63</sup> *Id.* at 1117-18.



internal affairs is the state of incorporation.<sup>64</sup> This principle, known as the “internal affairs doctrine,” developed from the notion that in order to prevent corporations from being subjected to inconsistent regulations from different states, the authority to regulate a corporation’s internal affairs should reside with only one jurisdiction.<sup>65</sup> The internal affairs doctrine protects the expectations of parties with an interest in a corporation by providing a sense of certainty and predictability regarding the law that will govern the corporation.<sup>66</sup> Indeed, the uniform treatment of those associated with a business entity is only possible if the laws of a single state govern the entity.<sup>67</sup> Individuals that may be affected by the choice of laws applicable to a business entity expect that the laws of the entity’s state of incorporation will govern, as this state is easily identified.<sup>68</sup> However, the internal affairs doctrine is more than merely a conflict of laws principle. It also protects the right of business entity actors to know which laws will govern their and the entity’s actions.<sup>69</sup> This right to know which laws will apply to a given situation is guaranteed by the Due Process Clause of the

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<sup>64</sup> See, e.g., *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) (providing that “only one State should have the authority to regulate a corporation’s internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders—because otherwise a corporation could be faced with conflicting demands”); *Rogers v. Guar. Trust Co.*, 288 U.S. 123, 130 (1933) (providing that “[i]t has long been settled doctrine that a court—state or federal—sitting in one state will, as a general rule, decline to interfere with, or control by injunction or otherwise, the management of the internal affairs of a corporation organized under the laws of another state but will leave controversies as to such matters to the courts of the state of the domicile”).

<sup>65</sup> See *Edgar*, 457 U.S. at 645.

<sup>66</sup> See *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 91 (1987). The Restatement (Second) of Conflict of Laws posits that

[a]pplication of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate...system[ ], certainty, predictability and uniformity of result, protection of the justified expectations of the parties and ease in the application of the law to be applied.

RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. e (2005).

<sup>67</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 cmt. e (2005).

<sup>68</sup> *Id.*

<sup>69</sup> *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1113 (Del. 2005).

Fourteenth Amendment.<sup>70</sup> The internal affairs doctrine is now a well established doctrine that is recognized by both federal and state courts.<sup>71</sup>

In *Edgar v. MITE Corp.*,<sup>72</sup> a Delaware corporation initiated a cash tender offer for all of the outstanding shares of an Illinois corporation.<sup>73</sup> MITE Corp., the offeror, had not registered the offer with the Illinois Secretary of State as required by Illinois statute mandating registration of any takeover offer for the shares of an Illinois target corporation.<sup>74</sup> On the same day that MITE Corp. initiated the tender offer, it also commenced litigation to challenge the registration requirement.<sup>75</sup> The United States Supreme Court affirmed the lower courts' rulings, finding that the Illinois statute in question was "a substantial burden on interstate commerce" and, thus, "invalid under the Commerce Clause."<sup>76</sup> The Illinois Secretary of State raised the internal affairs doctrine issue, arguing that because the tender offer occurred in Illinois, the Court should apply the internal affairs doctrine and hold that Illinois law governs the transaction.<sup>77</sup> The United States Supreme Court stated that, because the Illinois statute applied not only to transactions involving Illinois corporations but also to transactions in which ten percent of the target corporation's shares are held

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<sup>70</sup> *Id.* The Due Process Clause provides in part that

[n]o State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. CONST. amend. XIV, § 1.

<sup>71</sup> *See, e.g.*, *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 91 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982); *McDermott Inc. v. Lewis*, 531 A.2d 206, 208-09 (Del. 1987).

<sup>72</sup> 475 U.S. 624 (1982).

<sup>73</sup> *Id.* at 626-27.

<sup>74</sup> *Id.* at 626-28.

<sup>75</sup> *Id.* at 628.

<sup>76</sup> *Id.* at 646.

<sup>77</sup> *Id.* at 645.

by Illinois residents, regardless of the target company's state of incorporation, the internal affairs doctrine could not apply to the statute.<sup>78</sup>

In *CTS Corp. v. Dynamics Corp.*,<sup>79</sup> Dynamics Corp., which was attempting to acquire a significant amount of CTS Corp. stock, challenged the validity of a segment of the Indiana Business Corporation Law,<sup>80</sup> alleging that the federal Williams Act<sup>81</sup> preempted the Indiana Act.<sup>82</sup> The District Court found in favor of Dynamics Corp., and the Seventh Circuit affirmed.<sup>83</sup> The United States Supreme Court reversed the two lower courts, stating that the Williams Act did not preempt the Indiana Act<sup>84</sup> and reiterating that “[i]t...is an accepted part of the business landscape...for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.”<sup>85</sup> The Court went on to state one of the most important rationales underlying the internal affairs doctrine, namely, to “promot[e] stable relationships among parties involved in the corporations [a state] charters.”<sup>86</sup>

In *McDermott Inc. v. Lewis*,<sup>87</sup> upon which the *VantagePoint* court relied heavily,<sup>88</sup> the Delaware Supreme Court applied the internal affairs doctrine in deciding that

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<sup>78</sup> *Id.*

<sup>79</sup> 481 U.S. 69 (1987).

<sup>80</sup> IND. CODE §§ 23-1-17-1 *et seq.* (2005).

<sup>81</sup> 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2005).

<sup>82</sup> *CTS Corp.*, 481 U.S. at 75.

<sup>83</sup> *Id.* at 76.

<sup>84</sup> *Id.* at 86. The Court opined that “[t]he longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly” and that “[t]he regulatory conditions that the [Indiana] Act places on tender offers are consistent with the text and the purposes of the Williams Act.” *Id.* at 86.

<sup>85</sup> *Id.* at 91.

<sup>86</sup> *Id.*

<sup>87</sup> 531 A.2d 206 (Del. 1987).

<sup>88</sup> *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1110-16 (Del. 2005).

Panamanian law governed a Delaware company's voting of its shares in a Panamanian corporation.<sup>89</sup> In *McDermott*, a Delaware subsidiary of a Panamanian corporation wanted to vote its shares in the parent company in a way prohibited by Delaware law.<sup>90</sup> The plaintiffs filed suit to rescind the reorganization under which McDermott Delaware became a subsidiary of McDermott International (the Panamanian company).<sup>91</sup> The trial court ruled in favor of the plaintiffs, finding that Panama would not apply its laws to the facts of the case.<sup>92</sup> On appeal, the Delaware Supreme Court reversed based on the fact that there was no relationship between McDermott International and the State of Delaware and because the issues raised by the plaintiffs did not involve the internal affairs of McDermott Delaware.<sup>93</sup> Therefore, based on the internal affairs doctrine, Panamanian law applied to the manner of voting shares in McDermott International; thus, McDermott Delaware was allowed to vote its shares in the parent company in a manner prohibited by Delaware law.<sup>94</sup>

Quoting from *McDermott*, the *VantagePoint* court noted that the application of "local internal affairs law...to a foreign corporation is 'apt to produce inequalities, intolerable confusion, and uncertainty, and intrude into the domain of other states that have a superior claim to regulate the same subject matter.'"<sup>95</sup> To avoid these potential problems, the *VantagePoint* court followed Delaware precedent and applied the internal affairs doctrine.<sup>96</sup> The internal affairs doctrine was relevant in *VantagePoint* because the controversy being adjudicated clearly involved the relationship of a corporation to its shareholders.<sup>97</sup> It was this relationship between

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<sup>89</sup> *McDermott Inc.*, 531 A.2d at 208-09.

<sup>90</sup> *Id.* at 208.

<sup>91</sup> *Id.* at 209.

<sup>92</sup> *Id.* at 209, 212.

<sup>93</sup> *Id.* at 209.

<sup>94</sup> *Id.* at 209, 219.

<sup>95</sup> *VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1114 (Del. 2005) (quoting *McDermott*, 531 A.2d at 216).

<sup>96</sup> *Id.* at 1116.

<sup>97</sup> *Id.* at 1115-16.

the shareholders, some of whom lived in Delaware, and Examen, Inc., a Delaware corporation, that demanded that the internal affairs doctrine deem Delaware law controlling.<sup>98</sup>

Notwithstanding the Tennessee Court of Appeals' decision in *ARC Lifemed*, in the past, Tennessee courts have applied the internal affairs doctrine. In *Bayberry Associates v. Jones*,<sup>99</sup> the Tennessee Court of Appeals ruled that Maryland corporate law applied to litigation involving a Maryland corporation.<sup>100</sup> In *Bayberry*, Comdata was a Maryland corporation with its principal place of business in Tennessee.<sup>101</sup> After attempts to negotiate a merger with more than one company, Comdata finally reached a tentative agreement to merge with Welch, Carson, Anderson & Stowe IV, a New York limited partnership. Bayberry, a New Jersey limited partnership that owned a large amount of Comdata stock, filed a class action suit in Tennessee, seeking damages and an injunction to prevent the merger.<sup>102</sup> In deciding the case, the Tennessee Court of Appeals was first required to determine which state's law would apply.<sup>103</sup> The court interpreted the internal affairs doctrine as requiring that "[c]laims involving the 'internal affairs' of a corporation should be resolved in accordance with the law of the state of incorporation."<sup>104</sup> The Court also looked to the Tennessee corporation statutes, which contain a provision addressing the internal affairs doctrine.<sup>105</sup> The court concluded that, by enacting legislation that codifies the internal affairs doctrine, the Tennessee legislature "implicitly recognized and approved the internal affairs doctrine as a choice of law rule for Tennessee."<sup>106</sup>

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<sup>98</sup> *Id.* at 1116.

<sup>99</sup> 1988 WL 137181 (Tenn. Ct. App. Nov. 9, 1988).

<sup>100</sup> *Id.* at \*4.

<sup>101</sup> *Id.* at \*1.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.* at \*4-5.

<sup>104</sup> *Id.* at \*4.

<sup>105</sup> *Id.* at \*4-5. The Tennessee Code provides that "[c]hapters 11-27 of this title do not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state." TENN. CODE ANN. § 48-25-105(c) (2005).

<sup>106</sup> *Bayberry*, 1988 WL 137181, at \*5.

#### IV. IMPLICATIONS OF *ARC LIFEMED V. AMC-TENNESSEE*

Both Tennessee case law and Tennessee statutory law clearly indicate that, under the internal affairs doctrine, Tennessee courts should apply the corporate law of the state under which a business entity that is a party to litigation is incorporated.<sup>107</sup> The *ARC Lifemed* court, however, applied Tennessee LLC law to an LLC organized in Delaware.<sup>108</sup> The Tennessee Court of Appeals' failure to apply the widely recognized and often-applied internal affairs doctrine is likely due to the fact that neither party in the *ARC Lifemed* case sought the application of Delaware law, as the court made no mention of either party raising the choice of law issue. It is possible that both parties' attorneys examined Delaware law and neither concluded that the use of Tennessee law would be disadvantageous or would lead to a result different from the result that would be obtained under Delaware law. In any case, attorneys representing business entities in litigation in Tennessee courts should be mindful of the state in which the entities they represent are incorporated. This information will allow attorneys to include the choice of law issue implicating the internal affairs doctrine in their complaints or answers to complaints, as the case may be.

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<sup>107</sup> See *id.* at \*4-5; § 48-25-105(c).

<sup>108</sup> See *ARC Lifemed, Inc. v. AMC-Tennessee, Inc.*, No. M2003-02640-COA-R3-CV, 2005 Tenn. App. LEXIS 460, at \*47-53 (Tenn. Ct. App. Aug. 2, 2005).