

## CASE COMMENTARIES

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### ARBITRATION

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#### **Arbitration Agreements May Be Enforced Even Within Adhesion Contracts.**

*Chapman v. H. & R. Block Corp.*, No. E2005-00082-COA-R3-CV, 2005 Tenn. App. LEXIS 737 (Tenn. Ct. App. Nov. 28, 2005).

By Holly N. Mancl

Typically, parties to an arbitration agreement are required to resolve disputes within the agreement's scope through arbitration. The Federal Arbitration Act evinces a federal policy of enforcing such agreements. However, a party may allege that the terms of the arbitration agreement are so unfair that the court should either deem the contract unconscionable or determine that a party waived his or her right to arbitration, thus rendering the agreement unenforceable and enabling the parties to seek relief through adjudication. The Tennessee Court of Appeals recently upheld a motion to compel arbitration despite allegations of unconscionability and waiver when the parties signed a stand-alone two-page arbitration agreement.

In *Chapman v. H. & R. Block*, Chapman entered into a loan agreement with H. & R. Block ("Block") on behalf of her daughter, Daniels. Chapman personally guaranteed the loan and offered her home as security in the transaction. Chapman agreed to give Daniels the loan disbursement, and Daniels agreed to make the necessary payments. The loan agreement contained a stand-alone two page arbitration agreement. The loan agreement also reserved a three-day revocability period for the borrower. Chapman did not rescind within the grace period, but later asked if she could be released from the contract. Block refused, and Chapman continued to comply with the terms of the agreement. Daniels subsequently ceased making payments on the loan.

Chapman filed suit seeking rescission of the loan and alleging that Block "engaged in activities, which it knew or should have known were unconscionable, false, and fraudulent and which had the purpose of causing [her] to sign [the] mortgage loan." Block filed a motion to compel arbitration based on the arbitration agreement. The agreement stated that either party could compel arbitration "within 60 days after a complaint, an answer, or an amendment to a complaint has been served." Block filed its motion within 60 days after the amended complaint was served. The trial court ordered arbitration, but required that Block pay all arbitration fees.

Chapman raised two issues on appeal. The first issue was whether the arbitration agreement was unconscionable and unreasonable. Although courts have a policy of enforcing arbitration agreements, courts will not enforce unconscionable

agreements with terms so unfair that enforcement would be oppressive. In adhesion contracts, one party possesses overwhelming bargaining power and controls nearly all terms of the contract. Even though adhesion contracts give the weaker party virtually no bargaining power, the mere fact that a contract is one of adhesion does not unequivocally render the agreement unconscionable. Rather, the court must evaluate the terms of the contract to see if they were “beyond the reasonable expectations of an ordinary consumer.” Therefore, regardless of whether the contract was one of adhesion, it will only be void as unconscionable if the terms are so unfair that they would shock an ordinary consumer.

The second issue presented to the appellate court was whether Block waived its right to compel arbitration. Although motions to compel arbitration are typically initiated after the filing of the original complaint, this agreement enabled the parties to compel arbitration within 60 days of an amended complaint being served. Block compelled arbitration more than seven months after the filing of the original complaint, but within 60 days of the amended complaint being served. If the court adopted a narrow definition of “amendment,” then Block properly moved to compel arbitration within the designated period. However, if the court used the definition that Chapman urged, then an amendment must include “a new set of contentions and denials, [or] a new requirement of proof”; under this definition, Chapman’s amendment to her complaint would not constitute an amendment under the agreement, thus enabling her to pursue her claims in court.

The Federal Arbitration Act preempts state law and governs arbitration agreements. This Act codifies the federal policy of enforcing arbitration agreements. However, unconscionable agreements will not be enforced. Although adhesion contracts are frequently offered to consumers with miniscule bargaining power over the terms, the fact that an agreement is presented as a contract of adhesion will not definitively render the contract unenforceable. In order for any contract, including contracts of adhesion, to be unenforceable, the contract terms must be oppressive to the weaker party and viewed as unreasonable by ordinary consumers. These requirements place a heavy burden on parties seeking to avoid arbitration agreements.

Courts utilize basic contract principles when evaluating arbitration agreements. An assertion that a contract should be void based on a party’s failure to read its terms is unlikely to garner sympathy from a court; enabling a party to succeed on such a claim would directly contradict the contract principle of holding parties to their contracts. In addition, courts enforce severability clauses when only a portion of a contract is deemed unenforceable. Sensitive to fairness concerns, courts evaluating mandatory arbitration agreements may choose to assign all arbitration fees to the party that is in a better position to bear the financial burden. Thus, the *Chapman* court respected the validity of the arbitration agreement and compelled arbitration, but assigned all fees to Block.

Even if an arbitration agreement is found to be valid, parties may waive their rights to enforce the agreement. However, because public policy favors arbitration, a general presumption against waiver exists. A party trying to prove waiver must show that the adverse party knew of its arbitration rights, that it acted inconsistently, and that its inconsistent actions prejudiced the moving party. The placement of such a heavy burden on the moving party emphasizes that courts must resolve any doubts concerning the scope and enforceability of waiver in favor of arbitration.

Transactional attorneys must be cognizant of the strong public policy favoring the enforcement of arbitration agreements. As *Chapman* illustrates, arbitration agreements will be enforced unless an ordinary consumer would deem the terms unreasonable or oppressive, or if the parties have explicitly waived their rights to arbitration. *Chapman* illustrates that courts are likely to follow the federal policy of supporting arbitration, as well as the policy of enforcing the unambiguous terms of written contracts. Transactional attorneys should advise clients to carefully read and review all parts of the contract and warn clients that signing an arbitration agreement will likely result in a waiver of their right to seek judicial relief.

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#### BANKRUPTCY

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**BAPCPA Homestead Cap Equally Applicable in Opt-Out States.** *In re Gaylord Philip Landahl*, 338 B.R. 920 (Bankr. M.D. Fla. 2006).

By Jordan Rae Smith

When filing for bankruptcy, a debtor has the right to claim certain items of property as exempt and, by doing so, protect those items from creditors; such exemptions can include a vehicle or equity in a home. While these exemptions are designed to protect debtors, limitations on these exemptions are designed to protect creditors. In part to protect creditors from the so-called “mansion loophole,” through which debtors in some states could protect all of their equity through home ownership, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).

Although BAPCPA amended the Bankruptcy Code to limit the homestead exemptions in order to prevent consumer debtors from forum shopping, ambiguities in the amendment’s wording made it unclear whether it applied in states where federal exemptions were unavailable. This question came before the United States Bankruptcy Court for the Middle District of Florida, Tampa Division, in *In Re Landahl*.

In *In Re Landahl*, the debtor, Landahl, filed for bankruptcy relief under Chapter 7 of the United States Bankruptcy Code and claimed an exemption for his homestead under Florida law. The Chapter 7 trustee objected to the exemption on

the grounds that its value exceeded \$125,000 and that it was a residence that the debtor had acquired within 1,215 days of the bankruptcy petition date. The case was subsequently converted to a Chapter 13 case, but the court found that the trustee retained standing to continue to pursue the objection.

The debtor made two arguments in his motion for summary judgment. First, he alleged that the equity of the homestead property was less than \$125,000. Second, he argued that the BAPCPA cap did not apply in Florida because of its status as an “opt-out” state. The court focused on whether the application of the BAPCPA cap was valid.

As enacted in 1978, the Bankruptcy Code offers debtors a choice to either exempt certain property under Section 522(d) of the Bankruptcy Code or exempt that property under applicable state law. The state of Florida later adopted legislation that denied its residents the opportunity to use the federal exemptions from the Bankruptcy Code. States with this type of legislation are referred to as “opt-out” states.

The BAPCPA added a new subparagraph (p) to Section 522 of the Bankruptcy Code to remove a debtor’s homestead exemption if the debtor has not owned the homestead for at least 1,215 days before the bankruptcy petition date and if the value of the homestead exceeds \$125,000. Section 522(p) provides:

Except as provided in paragraph (2) of this subsection and section 544 and 548, *as a result of electing under subsection (b)(3)(A) to exempt property under State or local law*, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate \$125,000 in value. [Emphasis added.]

The court noted several prior cases in its discussion of whether the BAPCPA cap applied in Florida; all of these cases focused on the language of Section 522(p), specifically regarding the term “electing.” Ultimately, in determining that the homestead value cap did, in fact, apply in opt-out states like Florida, the court noted that the term “electing” in Section 522(p) is not connected with the term as it is used in Section 522(b)(1), which explains the option to choose between state and federal exemption laws. Instead, the court found that the term relates back to Section 522(b)(3)(A), which contains the provision under which state exemption laws may be used.

The court also cited previous holdings demonstrating that Congress’ purpose in adding Section 522(p) was primarily to close the “mansion loophole.” Thus, the court determined that there was no reason to believe that Congress intended Section 522(p) to apply in some states and not others. Consequently, the court held that the “electing” language can be read as referring to the act of claiming an exemption for a

homestead property under state law. The court held that such a reading is consistent with other provisions within the Bankruptcy Code and is consistent with the legislative history. The court noted that “even if there is an ambiguity, the conclusion from the legislative history is inescapable—there is no expressed intent to make the \$125,000 cap operative in some states, but not others.” The court denied the debtor’s motion for summary judgment and sustained the trustee’s objection to the debtor’s claim of exemption.

The court in *In re Landahl* supported a broad application of Section 522(p) by holding that the cap on homestead exemptions in bankruptcy proceedings applied in all states, not just those that allow their residents to choose between federal and state exemption laws. The court specifically noted that it would be “irresponsible” to rule that the amendment was inoperative in certain circumstances that are not explicitly defined. If the court had found that the cap provision was not applicable in Florida, then the “mansion loophole” would still be open and debtors could protect their assets through exemptions in certain states. Although this was not the first court to come to this conclusion, its holding supports the applicability of the BAPCPA cap, even in opt-out states, and protects the interest of creditors by preventing debtors from shielding extensive assets through exemptions.

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**Economic Substance Determines Whether a Transaction is a True Lease or a Secured Transaction.** *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609 (7th Cir. 2005).

By Whitney Bailey

Section 365 of the Bankruptcy Code uses substance rather than form to distinguish between a lease and a security interest. Thus, only a “true lease” qualifies as a lease under the Code. Because leases and secured loans may be structured to serve similar economic purposes, it is possible to draft leases that work like security agreements and secured loans that work like leases. The distinction becomes important when the lessee-debtor is in bankruptcy, as the Bankruptcy Code imposes different rights and responsibilities on the parties depending on whether the transaction is characterized as a lease or a secured loan. A true lessee must perform its obligations under the lease or forfeit the property. A borrower who has granted a security interest, however, can keep the property without paying the full, agreed upon price; the borrower must give the lender the economic value of the security interest with the difference becoming an unsecured claim. This situation was presented to the Seventh Circuit in *United Airlines, Inc. v. HSBC Bank USA, N.A.*

During the 1990s, United Airlines (“United”) entered into various transactions to finance a series of improvements to its facilities at four airports. One

such transaction was between United and the California Statewide Communities Development Authority (“CSCDA”) in which CSCDA issued \$155 million in bonds to fund improvements at United’s facilities at San Francisco International Airport (“Airport”). United had leased 128 acres for use as a maintenance base, since 1973; the lease was to terminate in 2013 unless an extension was negotiated. The rent depended on an independent estimation of the property’s market value. The 1997 transaction between United and CSCDA involved four aspects: the sublease, the leaseback, the trust indenture, and the guaranty.

First, United subleased twenty of its 128 acres at the Airport to CSCDA for thirty-six years. This term of the sublease matched the debt-repayment schedule instead of the remaining term of United’s lease with the Airport. CSCDA paid \$1 to sublet the twenty acres. Second, CSCDA leased the twenty acres back to United for a rent equal to the interest on the bonds plus an administrative fee payable to the trustee, HSBC Bank (“HSBC”). The lease had a \$155 million balloon payment in 2033 to retire the principal. United could postpone the payment until 2038; if that occurred, the sublease would also be extended. United had the option to prepay, in which case the sublease and the leaseback terminated. If United failed to pay, CSCDA could evict United from the twenty acres. The lease also contained a “hell or high water” clause, meaning that United must pay the promised rent even if some physical or legal event dispossesses United of the use or economic benefit of the premises. Third, CSCDA issued the bonds and released the \$155 million to United against the promises made in the sublease and arranged for HSBC, as trustee, to receive the payments. Finally, United provided a guaranty to ensure repayment of the bonds.

After filing for reorganization under Chapter 11 of the Bankruptcy Code, United argued that none of the four transactions constituted a lease for purposes of Section 365. United proposed to treat each transaction as a secured loan, enabling the company to continue using the airport facilities while paying only a fraction of the promised “rent.” The bankruptcy court ruled that one of the transactions—but not the San Francisco transaction—was a true lease, but the others were not. The district court reversed in part, deciding that all four arrangements were true leases. United appealed to the Seventh Circuit.

The Seventh Circuit ruled that substance, rather than form, determines the nature of the transaction and distinguishes a lease from a secured loan. Only a true lease qualifies as a lease under Section 365 of the Bankruptcy Code. In reaching its decision, the Court of Appeals examined the functional meaning of the Bankruptcy Code, the Uniform Commercial Code (“UCC”), and the legislative history of the Bankruptcy Code.

Reflecting a practical approach to interpretation of Section 365, the Court concluded that it was unlikely that the Bankruptcy Code would make substantial economic effects turn on the parties’ choice of language rather than the substance of their transaction. If the Code allowed form to control, then the distinctions between

the two types of transactions could be “obliterated” at the drafters’ will. While the Code does not expressly define the term “lease,” the UCC and the legislative history demonstrate that whether a lease is a true lease or a lease intended as security depends on the circumstances of each case.

After determining that substance rules over form in distinguishing between a lease and a secured loan, the Court then addressed which law should be used to determine the legal consequences of the particular transactions. The Court turned to California state law, as the Bankruptcy Code is silent on the issue. California had enacted the UCC, and therefore uses a functional approach to separating leases from secured credit with respect to personal property and also takes a similar approach to real property as a matter of common law.

The Court held that the transaction between United and the CSCDA was not a true lease under California law. First, the rent in question was measured not by the market rental value of the twenty acres, but by the debt-repayment schedule for the bonds. The “hell or high water” clause further illustrated the lack of connection between the base’s rental value and United’s financial obligation. Second, CSCDA had no remaining interest at the end of the lease. United retained its full tenancy. Reversion without additional payment is the UCC’s per se rule for identifying secured credit. Third, the balloon payment had no parallel in a true lease, though it is a common feature of secured credit. Finally, the lease and sublease terminated immediately upon prepayment by United. In a true lease, prepayment would ordinarily secure a tenant’s right to occupy the property.

The holding of *United Airlines* does not reflect a divergence from the approach commonly used to separate leases from secured transactions. It does, however, reflect the ever-increasing complexity of lease, security, and financing transactions. In structuring these transactions, a transactional attorney should be aware that if a lease is later held to be a security interest, the secured party could be denied secured creditor status if the appropriate steps are not taken to perfect the security interest. Moreover, *United Airlines* demonstrates, particularly in the bankruptcy context, the importance of determining, during the planning and drafting of the transaction, whether a bankruptcy court will likely classify the transaction as a true lease or as a secured transaction.

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**COMMERCIAL LAW**

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**Actual Loss Must be Proven in a Successful Tennessee Consumer Protection Act Claim.**

*Roberson v. West Nashville Diesel, Inc.*, No. M2004-01825-COA-R3-CV, 2006 Tenn. App. LEXIS 77 (Tenn. Ct. App. Feb. 3, 2006).

By Rachel N. Wright

When a repair shop does work on equipment and the owner neither pays for the work nor tries to pick up the equipment for an extended period of time, is the repair shop entitled to storage fees? If a repair shop is not entitled to such fees, is it a violation of the Tennessee Consumer Protection Act (“TCPA”) to demand such fees? These are some of the major questions addressed by the Tennessee Court of Appeals in *Roberson v. West Nashville Diesel, Inc.*

In *Roberson v. West Nashville Diesel, Inc.*, Mr. Roberson took his equipment, including three trucks and a Cat Loader, to West Nashville Diesel (“WND”) for repair. Mr. Roberson partially paid his debt for the repair work by performing grading work for WND. However, Mr. Roberson still owed WND a balance of \$14,706 after completing the grading work. For approximately the next two years, WND periodically billed Mr. Roberson for the balance owed on the repair work. Mr. Roberson made no attempt to pay the bill, nor did he attempt to pick up his equipment during that time.

After receiving no response from Mr. Roberson regarding payment or pickup of the equipment, WND sent a letter to Mr. Roberson on May 28, 2002, stating that he owed storage fees of \$10 per day per vehicle, totaling more than \$30,000, in addition to the balance still owed for repairs. WND also informed Mr. Roberson that he had until June 10, 2002, to pay the repair bill as well as the storage charges or it would sell all of the equipment at auction on June 27, 2002. On the day the auction was scheduled to take place, WND received a certified letter from Mr. Roberson indicating that he was aware of the upcoming auction and notifying WND that he had filed a warrant to recover the property. The property was sold at auction on the scheduled date. The three trucks were sold to WND for the price owed for the repair work. The Cat Loader had a repair work balance of \$7,141 and was sold to a third party for \$8,500.

Mr. Roberson then filed to recover the vehicles in General Sessions Court. The General Sessions Court ordered WND to return the equipment to Mr. Roberson, and WND then appealed to the Circuit Court (“trial court”). In the trial court, Mr. Roberson alleged that WND was not entitled to storage fees and that the attempt to collect them violated the TCPA. The trial court found that the \$14,706 for repairs on the equipment was a reasonable sum. The trial court also awarded



compensatory damages of \$12,000 to Mr. Roberson, which it determined was the difference between the fair market value of the equipment and the amount for which it was sold.

The trial court found that no authority, statutory or otherwise, allowed WND to charge storage fees and that WND's attempt to collect storage fees constituted an unfair and deceptive act in violation of the TCPA. For violating the TCPA, the trial court awarded Mr. Roberson \$3,000 in damages and \$6,000 in attorney's fees. WND appealed the trial court's decision to the Tennessee Court of Appeals.

On appeal, the Tennessee Court of Appeals examined three main issues: the repair costs, the storage fees, and the alleged violation of the TCPA. First, the court emphasized that the propriety of having an auction to pay Mr. Roberson's debt was not challenged. It also stated that Mr. Roberson was to be awarded any of the proceeds of the sale after the balance for repairs was satisfied. However, the court found that the fair market value of the equipment should be determined by its sale price at the auction. The court found that the three trucks were sold at their fair market price, which, in this case, was also the amount that was owed in repairs. The only piece of equipment with excess sales proceeds was the Cat Loader. The difference in the fair market value and the sale price for the Cat Loader was approximately \$1,359. The court found that the trial court erred in awarding Mr. Roberson \$12,000 for the loss of his property because the only difference between fair market value and the equipment's sale price was the \$1,359 for the Cat Loader. Thus, the court determined that the trial court erred in its calculations and reduced the amount to \$1,359.

Next, the court considered whether storage fees were appropriate in this case. WND argued that it had the right to charge the storage fees relying on a "common law storage lien." However, the court held that "whether or not any general common law lien for storage costs may have survived the enactment of specific statutory liens, any entitlement to such a lien rests on an actual obligation to pay the storage costs." The court agreed with the trial court's finding that there was no evidence indicating any type of agreement between the parties with regard to storage fees. In addition, the court noted that WND never gave Mr. Roberson notice that it intended to charge storage fees, nor did WND include storage fees when it periodically billed Mr. Roberson for the balance owed on repairs. For these reasons, the court held that storage fees were inappropriate in this case.

Finally, the court considered whether WND violated the TCPA when it attempted to charge Mr. Roberson storage fees with no prior notice, and also whether Mr. Roberson was entitled to the damages and attorney's fees he had been awarded. The trial court had found that the attempt to charge the storage fees constituted an unfair and deceptive act under the TCPA. The appellate court, however, held that it did not matter whether a TCPA violation had occurred because Mr. Roberson was not entitled to damages under the TCPA in any case. The court observed that Mr. Roberson did not demonstrate that he had suffered any

“ascertainable loss of money or property” as a result of the alleged unfair or deceptive act. In fact, Mr. Roberson’s loss of money or property occurred because he failed to pay his repair bill for an extended period of time, entitling WND to perform the auction. Consequently, the court reversed the \$3,000 award to Mr. Roberson for the TCPA violation and also the \$6,000 award for payment of attorney’s fees.

*Roberson v. West Nashville, Inc.* demonstrates that for a claim to be successful under the TCPA, there must first be evidence that there has been an actual loss of either property or money. The transactional attorney should remember, when advising clients in a proposed course of action in a contract or lien situation, that a TCPA violation claim may be successful if the other party to the contract can demonstrate actual loss and an unfair or deceptive act. Therefore, before a transaction is commenced, a transactional attorney should caution his or her client to unambiguously provide for additional remedies (fees, charges, etc.) in the contract to avoid potential TCPA claims.

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#### CONTRACT LAW

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#### **“At Will” the De Facto Standard for Oral Agreements of Indefinite Duration.**

*Sun-Drop Bottling Co. v. Herb Helton*, No. M2004-02152-COA-R3-CV, 2006 Tenn. App. LEXIS 157 (Tenn. Ct. App. Mar. 6, 2006).

By Rachel O. Park

Unless the parties’ intentions indicate otherwise, contracts for an indefinite duration are generally terminable “at will” by either party. With regard to oral contracts for an indefinite duration, the best evidence of the parties’ intentions is the conduct of the parties themselves. In addition to the parties’ conduct, the court may also consider a number of other factors, including: (1) the position of the parties and the circumstances surrounding the transaction at the time it was made; (2) the business to which the contract relates; and (3) the subject matter of the contract. The Tennessee Court of Appeals considered these factors in *Sun-Drop Bottling Co. v. Herb Helton* and determined that the contract in question was terminable “at will.”

The relationship between Herb Helton (“Helton”) and the Sun-Drop Bottling Company (“Sun-Drop”) began in 1955 when the parties entered into an oral distribution agreement. This initial agreement was terminated in 1960. However, in 1967 the parties entered into a second oral distribution agreement. Under this agreement, Helton purchased the distribution rights of Sun-Drop products for the distribution area of Lewis County. Most recently, in July 1996, Helton and Sun-Drop entered into a written distribution agreement covering the distribution of all Sun-Drop products.

At some point after the parties signed the 1996 agreement, Helton desired to sell his distribution rights to a third party. Not wanting to allow Helton to sell his distribution interest, Sun-Drop immediately filed a declaratory judgment action seeking a declaration of the respective rights of the company and Helton under the parties' oral and written distribution agreements. Following an evidentiary hearing, the trial court concluded that the contract between Helton and Sun-Drop was "at will." Therefore, either party had the right to terminate the contract without cause upon reasonable notice if the termination was in good faith.

Helton appealed the trial court's decision. On appeal, Helton provided three examples to support his contention that the contract was not terminable "at will." Helton's first example involved two occasions where Sun-Drop merely altered the terms of a distribution agreement without terminating the rights of Helton as a distributor. From this example, Helton argued that if Sun-Drop had the right to terminate its distribution agreements "at will," Sun-Drop would have simply terminated Helton's distribution rights instead of facilitating a compromise agreement between Helton and another distributor. Both the trial and appellate courts concluded that Sun-Drop was motivated by maintaining goodwill with its distributors and protecting its reputation, which could be helpful in the recruitment of distributors in the future. Without more evidence to contradict the trial court's findings, the appellate court concluded that Sun-Drop's conduct in facilitating these two transfers did not necessarily foreclose an ability to terminate the agreements "at will."

Helton next argued that Sun-Drop's past threats to terminate the 1967 agreement, all of which stated a cause for termination, established a precedent that the agreement was not terminable "at will." The appellate court, however, concluded that Helton's own actions demonstrated that the 1967 agreement was "at will." The court determined that Helton's purported conduct of not maintaining income statements, a business bank account, balance sheets, profit and loss statements, or any other business records, coupled with the fact that he never established a business location, was sufficient evidence to support the conclusion that Helton was operating under a non-permanent business relationship. The court further determined that Helton had known of Sun-Drop's policy of treating its contracts as "at will" as early as 1982.

Helton's final argument was that *Marshall County Distrib. Co. v. Sun-Drop Bottling Co.*, Nos. 86-170-II, 86-357-II, 1987 Tenn. App. LEXIS 2710 (Tenn. Ct. App. May 27, 1987), binds the parties in a permanent contractual agreement. In *Marshall County*, the Marshall County Distribution Company sued to enjoin Sun-Drop from terminating an oral distribution agreement. The trial court held that the agreement could only be terminated for cause and that cause did not exist. *Id.* at \*2. The distinction between the facts in *Helton* and that of *Marshall County*, however, is that in the latter, evidence established that Sun-Drop's management had assured Marshall's ownership that "there was no danger of losing the distributorship." *Id.*

Based on this distinguishing fact, the appellate court determined that the holding in *Marshall County* was not applicable. Because all the evidence presented by Helton did not preponderate against the trial court's finding that the distribution agreement was terminable "at will," the appellate court affirmed the trial court's decision.

As *Helton* illustrates, the burden of proof necessary to demonstrate that an oral agreement with an indefinite duration is not terminable "at will" is extremely high. A party seeking to overcome such burden must establish that the parties to the oral contract intended the contract to be something other than "at will." Even though the *Helton* court concluded that the contract was "at will," the case provides examples of the evidence necessary to carry the burden of proving that a contract, oral or otherwise, is not "at will." However, where the parties to a contract fail to provide that the contract is terminable only for cause and fail to act in any manner that would indicate that a contract is anything other than "at will," courts will not hold otherwise.

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**Equitable Relief Remains Unavailable for Contracts Implied in Fact.** *Metro. Gov't of Nashville v. Cigna Healthcare of Tenn., Inc.*, No. M2003-02700-COA-R3-CV, 2005 Tenn. App. LEXIS 732 (Tenn. Ct. App. Nov. 22, 2005).

By Brett T. Smith

When a contract implied in fact exists, equitable relief is not available. Tennessee has long recognized that contracts implied in law and implied in fact are two distinct types of contracts, and equitable relief is only available for contracts implied in law. Additionally, if a party seeks damages because of a breach of contract, actual damages must exist. The injured party may not profit from a breach or be placed in a better position than he would be in had the contract been completed. These two issues were central to the decision in *Metropolitan Government v. Cigna Healthcare, Inc.*

In *Metropolitan*, the Metropolitan Government of Nashville ("Metro") issued a "Request for Proposal to Provide Medical and Dental Services" ("RFP") in 1995. Cigna submitted its proposal and secured the four-year contract in the same year. The two pertinent provisions of the RFP were as follows: first, the successful bidder must execute a performance bond, and second, the successful bidder must introduce any objections to provisions of the RFP upon submission of the bid. Cigna failed to execute a performance bond and did not introduce any objections upon submission of the bid.

Metro first encountered problems in 1998 when it discovered that it did not have a written contract with Cigna. While there was no written contract, Cigna had provided insurance coverage to Metro employees since Cigna was awarded the

contract in 1995. After doing further research, Metro discovered that Cigna had not executed a performance bond. Metro asked Cigna to purchase the performance bond even though the term of the contract was nearing expiration. Metro filed suit when Cigna declined to purchase the performance bond. Metro claimed that Cigna was unjustly enriched by accepting full payments and not executing a performance bond. In addition, Metro claimed that if an implied contract existed, Cigna breached the implied contract by not executing the performance bond.

Cigna moved for summary judgment, and the trial court granted its motion. The trial court found that Metro had not paid a premium for the performance bond, and Cigna had not received extra benefits for failing to execute the performance bond. Cigna demonstrated that the cost of the performance bond was not part of the bid and its cost would not have been passed along to Metro. Additionally, the trial court found a condition precedent excusing Cigna's duty to supply a performance bond. The value of the performance bond was to be for the "negotiated value of the contract" per the RFP. Both parties agreed that a "negotiated value of the contract" did not exist; therefore, Cigna's duty to supply a performance bond was excused. Metro appealed the ruling.

The first issue the Tennessee Court of Appeals was required to resolve was whether Metro could recover under the theory of unjust enrichment. For a party to recover using the equitable theory of unjust enrichment, a true contract between the parties cannot exist, or the contract must have become unenforceable or invalid since the formation. Many often make the mistake of assuming that equitable relief is available for all implied contracts. However, Tennessee recognizes both implied in law and implied in fact contracts as distinct types of implied contracts. Implied in law contracts "are a class of obligations which are imposed or created by law without the assent of the party bound, on the ground that they are dictated by reason and justice." Implied in fact contracts "arise under circumstances which, according to the ordinary course of dealing and common understanding of men, show a mutual intention to contract." Parties can only recover using equitable relief if an implied in law contract exists. In *Metropolitan*, Cigna and Metro performed their respective duties under the contract for over three years as if a fully executed agreement existed. The Court concluded that both parties' actions showed a mutual intention to contract and that a contract implied in fact existed. Thus, Metro could not recover damages under the equitable theory of unjust enrichment.

The second issue the Court had to resolve was whether Metro was entitled to damages because of Cigna's breach of the contract. When the parties acted as if a contract existed for three years, they entered into a fully enforceable contract implied in fact. With a contract in place, Cigna should have executed a performance bond. Cigna's failure to procure the bond was a breach of contract. Under contract law, the goal of assessing damages is to put the injured party in as close a position as possible to the place the party would have been if the contract were completed. A mere breach of the contract does not entitle the injured party to damages; the injured

party must have suffered actual damages because of the breach. In *Metropolitan*, Cigna fully performed all of its duties under the contract except executing a performance bond. Metro would have been in the same position if Cigna had executed the performance bond at the commencement of the deal. While Cigna breached the contract, Metro did not suffer any damages because of the breach and was not entitled to recover damages.

*Metropolitan* provides several reminders for transactional attorneys. First, it is important to make certain that all necessary parties have executed and endorsed, where appropriate, an agreement. Having a fully executed, enforceable contract is better than having to rely on relief available for implied contracts. Second, contracts implied in fact and implied in law are two distinct types of implied contracts. Implied in law contracts are imposed when a party has not assented to a contract, but equity must be done to avoid an injustice. Implied in fact contracts exist when both parties act as if a contract exists, but an actual agreement has not been executed. Equitable relief is only available when the court imposes a contract implied in law. Finally, a party is not entitled to damages simply because a breach of contract occurred. The injured party must suffer damages because of the breach. A party is not entitled to profit from the breach or be placed in a better position than they would have been in had the contract been performed.

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**Inoperative or Inaccurate? It Makes a Difference.** *Edward H. Tenison v. The Penn Warranty Corp.*, No. M2004-02605-COA-R3-CV, 2005 WL 3132356 (Tenn. Ct. App. Nov. 22, 2005).

By John L. Fuller

Imprecise contract language often leads to unintended results. Whether a litigant wins or loses can hinge on the subtle connotations of a single adjective. This is precisely what The Penn Warranty Corporation (“Penn”) discovered in *Tenison v. The Penn Warranty Corporation*. Penn is a warranty company specializing in automobile service contracts. Seeking to fill a niche in the market for automobile warranty service, Penn sells its warranty coverage through used car dealerships and directly to consumers. Penn takes pride in its simple, easy to understand, and no-hassle coverage, but on one occasion its standard terms and conditions fell short—at least as far as Penn was concerned.

In April 2003, Edward Tenison purchased a 1983 Mercedes-Benz 240D from a used car dealership. Though twenty-years-old, the car’s odometer registered only 71,350 miles. Unknown to Mr. Tenison, the car had actually traveled much closer to 250,000 miles. Apparently a third-party had tampered with the odometer, rolling it back prior to its arrival at the dealership. Along with the car, Mr. Tenison purchased

a warranty issued by Penn through the dealership. The dealer notified Penn of the car's age before issuing the warranty. Penn did not object, but allowed the dealership to issue the warranty contract on Penn's behalf. It is unclear whether Penn inquired about the mileage of the car at that time.

The warranty contained language that rendered void any contract for coverage on a car with an "inoperative odometer." The particular application of this clause would become central to the litigation that would follow. Within the warranty period, the car required extensive repairs totaling \$9,552.18. Penn discovered the tampered odometer during the warranty company's review of the repairs and subsequently denied coverage. Penn took the position that Mr. Tenison's rolled-back odometer was "inoperative," excluding the car from warranty coverage. Though the odometer was not correct, there was nothing "inoperative" about its ability to measure mileage. As a result, Mr. Tenison believed that Penn could not deny coverage under the terms of the warranty contract. The General Sessions Court agreed.

Following a General Sessions Court decision in favor of Mr. Tenison, Penn appealed the decision to Circuit Court. The Circuit Court found that Mr. Tenison was not aware that the odometer had been rolled back and had made no misrepresentations to Penn about its condition. Further the court held that while an "inoperative odometer" would indeed void coverage under the warranty, an odometer that was simply inaccurate would not. The Circuit Court then awarded Mr. Tenison \$9,522.18 for the cost of his repairs and \$3,700 in attorney's fees under the Magnuson Moss Warranty Act.

On appeal to the Tennessee Court of Appeals, Penn raised three arguments. First, that the term "inoperative odometer" did in fact exclude coverage for Mr. Tenison's car; second, that the exclusion language was ambiguous, making the contract void; and finally, that the exclusion language was "so ambiguous" as to prevent a meeting of the minds and therefore render the contract void. Following a *de novo* review, the Court of Appeals rejected Penn's arguments and unanimously affirmed the Circuit Court.

The Court of Appeals determined that the contract language was not ambiguous when it referred to an "inoperative odometer." Rather, the phrase was clear and excluded coverage from automobiles whose odometers were not working. Because both parties acknowledged that the odometer in question was working, the Court of Appeals held that the warranty contract was not void and that the Circuit Court correctly awarded Mr. Tenison his repair costs.

A number of lessons can be learned from *Tenison v. The Penn Warranty Corporation*. Primarily, to ensure that a contract means what it says, an insurer should make sure the contract says what it means. The Court of Appeals suggested explicitly that had Penn intended to exclude from warranty coverage automobiles with incorrect odometers, the warranty company could have easily inserted language to that effect in its contract. In essence, Penn failed to shift the burden of

determining an automobile's accurate history to the purchaser of the warranty. Though the facts of *Tenison* are rather simple, its lesson can be quite broad. The insertion of just a few words into its terms and conditions could have saved Penn thousands of dollars in litigation costs.

A second lesson to emerge from *Tenison* suggests that warrantors who allow third parties to enter into contracts as agents on behalf of the warrantor should install safeguards that shift the burden of inaccurate representation to the agent. While extensive due diligence can be cost-prohibitive for some insurers, especially those in the "low-cost" market like Penn, threshold safeguards should be easy to enforce. Contract language that holds an agent liable for inaccurate representation and specifies damages will encourage the agent to discover fraudulent product histories. It will also discourage the agent from issuing warranties for products with suspicious histories or indicia of unlawful tampering. The facts in *Tenison* suggest that the dealer could have reasonably discovered that the odometer had been rolled back. Additionally, a simple matrix of make, model, year, and mileage could have raised a flag on Mr. Tenison's car suggesting that perhaps the odometer had been manipulated.

While accurate contract language clearly protects the warrantor, it also protects the consumer by helping him or her avoid needless litigation. The automobile purchaser, for whom the availability of warranty service may influence his or her decision, will purchase more reliable automobiles when warrantors predict claim probability more accurately. A warrantor will issue warranties on more favorable terms for automobiles less likely to need extensive service in the future. The more favorable the warranty, the more likely a consumer is to purchase. Both parties benefit.

In conclusion, *Tenison* provides all contract attorneys with an important reminder to pay close attention to the language of the contracts he or she drafts. A contract drafter should never rely on a court to give implied meaning to terms, nor to enforce an adjective to the extent of its connotations. An odometer may be inaccurate, but as long as it still counts miles, it is not inoperative.

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**Intent to be Bound by a Contract Will Activate an Arbitration Agreement.**

*God's Battalion of Prayer Pentecostal Church, Inc. v. Miele Assocs., L.L.P.*, 845 N.E.2d 1265 (N.Y. 2006).

By David Goodman

Under the objective theory of contracts, an enforceable agreement requires a manifestation of a willingness to enter into a bargain by one party and the acceptance of that offer by another party. The execution of a contract generally satisfies these



requirements, but other arrangements can also constitute an objective offer and acceptance. Although contract law provides flexibility in allowing parties to enter into binding agreements, courts are increasingly reluctant to enforce arbitration clauses without explicit proof of acceptance. The case of *God's Battalion of Prayer Pentecostal Church, Inc. v. Miele Associates, LLP* arose in the tension between these competing interests.

In *God's Battalion*, God's Battalion of Prayer Pentecostal Church ("Church") hired Miele Associates ("Miele") to renovate and expand its premises. Miele in turn hired Ropal Construction ("Ropal"). Subsequently, the Church and Ropal entered into a signed agreement. Miele also prepared and forwarded a contractual instrument to the Church, where it remained unsigned by both parties. The agreement provided that "all claims . . . shall be decided by arbitration." In addition to this unsigned written instrument, the Church asserted that an additional, overriding oral agreement existed between the parties.

When the Church became dissatisfied with Ropal's performance, it sued Miele for breach of contract alleging that Miele "failed to perform the terms, covenants and conditions of the agreement." However, the Church maintained that some of the contractual terms of the written agreement were included in the oral agreement. As such, the lower court faced the question of whether an arbitration clause is enforceable where the contractual instrument remained unsigned by both parties and where a parallel oral agreement existed. The court sent the Church's claim to arbitration. Both the Appellate Division and the Court of Appeals affirmed.

On one hand, a party seeking to enforce an arbitration clause must show a "clear, explicit and unequivocal" agreement to arbitration by the second party. Otherwise, the second party may instead bring its claims to trial. On the other hand, no requirement exists that a writing must be signed in order for it to be legally binding and enforceable.

In this case, despite the fact that neither party signed the contract, the Church evidently meant to be bound by it. First, the Church failed to refute Miele's claim that the parties operated under the written terms. Second, the Church's complaint explicitly stated that Miele failed to honor those written terms. Thus, the Church relied upon the validity of the underlying contract while it simultaneously sought to avoid the operation of the arbitration clause. Third, the Church did not claim that the arbitration clause would remain unenforceable upon the execution of the contract.

In light of these facts, the court found that both parties had objectively relied on the written instrument, thus giving it legally binding effect. Furthermore, a contract "should be read to give effect to all its provisions" rather than "disclaiming part . . . while alleging breach of the rest." The court affirmed the lower court's decision to send the Church's claims against Miele to arbitration. It held that parties seeking to enforce arbitration clauses must show "clear, explicit and unequivocal" agreement by the other party. Yet, where evidence shows that parties intended to be

bound by an overarching written agreement, the subordinate arbitration clause will be enforced without a signature.

However, the court did not resolve what amount of evidence would be insufficient to establish such intent. An attorney seeking to enforce an agreement without invoking an arbitration clause should emphasize that the controlling agreement was oral and show why the parties did not operate under the terms of the written instrument. Moreover, the complaint should frame the issue solely in terms of the oral agreement. However, from a transactional attorney's perspective, if a client wants to ensure that an arbitration clause will be enforced, it is important to ensure contracts are signed by all parties in a timely fashion. A transactional attorney should also review applicable state and federal law and consider the circumstances under which an arbitration agreement may be invalid even within a signed contractual instrument.

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**When is a Deal Finally a Deal?** *Barnes & Robinson Co. v. OneSource Facility Serv., Inc.*, 195 S.W.3d 637 (Tenn. 2006).

By T. William Caldwell

When parties begin negotiations in furtherance of a final agreement, their intent determines the existence of a contract, the terms of the contract, and the extent to which each party has a duty to perform his or her contractual obligations. Reaching an agreement can be a burdensome process, and oftentimes parties execute letters of intent before signing a contract to memorialize benchmarks in the agreement process. The language used in these letters represents the intent of the parties, and courts use this language to determine the nature of the negotiations and the success or failure of the negotiations in creating a contract.

In the early stage of negotiations for the purchase of janitorial assets from the defendant, the plaintiff in *Barnes & Robinson Co. v. OneSource* executed two letters of intent with the understanding that the letters established the framework for contract negotiations. Both letters unambiguously referred to the execution of a final purchase agreement as a requirement for an agreement between the parties. Barnes & Robinson claimed that after the parties signed both letters they continued negotiations and eventually reached an agreement. However, before a definitive written agreement could be signed by both parties, OneSource requested, among other things, a purchase price more than a million dollars higher than the price named in the letters of intent. Barnes & Robinson rejected this request and negotiations began to dissolve. Eventually, Barnes & Robinson sued OneSource for breach of contract, failure to negotiate in good faith, and promissory estoppel.

The trial court granted OneSource's motion to dismiss all three claims based solely on the intent of the parties as expressed in the language of the two executed letters. After interpreting the letters by the ordinary and natural meaning of the language used, the court made two conclusions that proved fatal to the plaintiff's claims: the letters unambiguously conditioned a final agreement between the parties upon the execution of a definitive, written agreement, and the letters did not contain an express agreement to negotiate in good faith. Thus, the parties never created a contract because they did not sign a definitive, written agreement. In addition, the unambiguous language in the letters vitiated plaintiff's claim of promissory estoppel on the grounds that plaintiff's reliance was unreasonable. Finally, OneSource did not have a duty to negotiate in good faith because Tennessee does not recognize a duty to negotiate in good faith absent an express agreement.

On appeal, Barnes & Robinson asserted that the execution of a written agreement was not a condition precedent to the creation of an enforceable contract. However, the Court of Appeals noted that the letters of intent explicitly stated that no final agreement could be created without a written, definitive agreement between both parties. This language, by its ordinary and natural meaning, excluded the possibility that either the letters of intent or an oral agreement could create an enforceable contract. Thus, the Court of Appeals affirmed the Chancery Court's dismissal of the plaintiff's breach of the contract claim.

Barnes & Robinson also disputed the trial court's finding that the executed letters of intent did not imply a duty to negotiate in good faith. Noting that Tennessee courts do not recognize an implied duty to negotiate in good faith, the Court of Appeals held that a duty to negotiate in good faith is dependent on an express contractual agreement of such a duty and an express agreement on all the essential terms of the contract. If the parties have agreed to the essential terms of a contract, they can rightfully include an express agreement to negotiate the remaining terms of the contract in good faith. If the parties have not already agreed on the essential terms of the contract, any express agreement to negotiate in good faith would be akin to an agreement to make a contract.

In *Barnes & Robinson Co. v. OneSource*, the parties neither agreed on the essential terms of the contract nor did they agree to any express duty to negotiate in good faith. The letters of intent indicated that a final agreement depended on a definitive purchase agreement that was never signed by the parties. Also, the letters of intent did not contain language expressly creating a duty to negotiate in good faith. In fact, the letters of intent indicated that "the parties shall have no liability in the event the transaction [is] not completed for any reason whatsoever." Thus, the defendants' exorbitant increase in purchase price to avoid making a contract did not subject them to liability for the failure of negotiations.

Also at issue was whether plaintiff's actions in reliance on defendants' alleged representations constituted promissory estoppel. Detrimental reliance by a party is an important component of promissory estoppel, but equally important is whether

the reliance by the party claiming promissory estoppel is reasonable. Though on appeal the court did not dispute plaintiff's factual allegations regarding defendants' representations, the court held that plaintiff's reliance was not reasonable as a matter of law. The Court of Appeals affirmed the trial court's decision; because the letters of intent relieved the parties of liability in the event the transaction was not completed, plaintiff's reliance was not reasonable.

Where parties have begun contract negotiations with letters of intent or similar instruments, courts can use those representations to settle contract disputes. However, parties entering negotiations should consider the steps leading to a contract as carefully as the contract itself, and they should not rely on legal safety nets like promissory estoppel or implied duties of good faith. Therefore, a transactional attorney, when drafting a letter of intent that includes all of the essential terms of the proposed contract, should provide for an express agreement to negotiate in good faith if his client wants to ensure that those essential terms will become part of the final contract. Moreover, if the attorney foresees that it may be necessary to rely upon the terms of the letter of intent, such letter should not require a definitive, signed agreement as a condition precedent to formation of a contract between the parties.

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#### ENTERTAINMENT

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**Transfer of Tangible Property Does Not Necessarily Mean That Intangible Rights Follow.** *Polygram Records, Inc. v. Legacy Entm't Group, L.L.C.*, No. M2003-02608-COA-R3-CV, 2006 Tenn. App. LEXIS 41 (Tenn. Ct. App. Jan. 20, 2006).

By Kristy L. Rice

The United States Supreme Court has recognized a distinction between tangible and intangible property rights. Although a person obtains tangible rights in property, the intangible rights associated with that property do not necessarily follow. These ownership concerns become more complicated when recording artists contract with multiple parties to provide different services and several years pass before ownership of the intangible rights is questioned. The Tennessee Court of Appeals in *Polygram Records, Inc. v. Legacy Entertainment Group, LLC* considered the transfer of tangible property rights and its effect on the underlying intangible property rights.

Under the facts in *Polygram*, legendary performer Hank Williams entered into a contract with MGM "for the purpose of making phonograph records." MGM's rights passed to its successor in interest, Polygram Records, Inc. ("Polygram"). Williams also entered into an agreement with WSM radio whereby he and his band, The Drifting Cowboys, performed on the station's "Mother's Best Flour" radio

program. Because Williams and his band traveled to give performances, they made acetate recordings that could be used on the program in their absence. The ownership of these recordings is now in dispute.

Nearly ten years after Williams' band made the acetate recordings, WSM decided to discard them. A station employee, Les Leverett, obtained permission to keep the recordings for himself. After an extended period of time, Leverett sold the recordings to a former member of The Drifting Cowboys, Hillous Butrum. Butrum enhanced the recordings by removing skips and excess noise and adding background music. Butrum filed and received copyrights for the re-mixed recordings, which he then sold to Legacy Entertainment Group ("Legacy"). Legacy expressed its desire to exploit the acetate recordings of the "Mother's Best Flour" program through the production and sale of phonograph records. Polygram insisted that it had exclusive rights to exploit Williams' recordings and brought this action to settle the dispute. Hank Williams' heirs joined the lawsuit claiming they inherited Williams' rights in the recordings. The trial court dismissed the claims of both Legacy and Polygram and concluded that the rights to the recordings belonged to Williams' heirs. Legacy and Polygram appealed.

The court addressed two issues on appeal. The first was whether the trial court erred in finding that Legacy had no right to exploit the recordings. Legacy offered two arguments for its position. First, Legacy claimed that the chain of title passed from WSM to Legacy by way of Leverett and Butrum. However, the court noted that "[p]ossession of a tangible embodiment of a work or performance such as the recordings at issue conveys no rights or ownership interests to the intangible rights embodied therein, especially the right to commercially exploit the performances embodied therein." Thus, although Leverett obtained permission from WSM to take the physical recordings, he did not receive any intangible rights. Therefore, Leverett had no intangible rights in the recordings to pass to Butrum. Moreover, Butrum's copyright for the enhanced recordings he produced did not include the original acetate recordings. When pre-existing material is altered and a new copyright is obtained, the copyright applies only to the "derivative work" and does not extend to the pre-existing material. The subsequent copyright gave Butrum no interest in the underlying recordings. Therefore, Butrum had no intangible rights in the original recordings to convey to Legacy.

Next, Legacy argued that it obtained rights to exploit the name and likeness of Hank Williams because the contract between Williams and WSM was silent on the issue. Tennessee recognizes the property right of publicity, which acknowledges a property interest "in the use of one's name, photograph or likeness." Further, under Tennessee Code Annotated section 47-25-1103, this right does not terminate upon death and is inheritable by the deceased's heirs. The court refused to infer that Williams transferred his right of publicity to WSM based on mere silence in the agreement. Therefore, the court affirmed the trial court's dismissal of Legacy's

claim, holding that Legacy had no interest in the intangible rights attached to the acetate recordings.

The second issue on appeal was whether the trial court erred in finding that Polygram did not obtain the exclusive right to exploit the recordings as phonograph records based on the contract between Williams and MGM. The contract consisted of a letter MGM sent to Williams employing his “exclusive personal services for the purpose of making phonograph records.” Polygram argued that this letter gave it the exclusive right to make phonograph records from any recordings, including the WSM recordings. Polygram relied on the portion of the letter that read, “All recordings and all records and reproductions made therefrom, together with the performances embodied therein, shall be entirely our property, free of any claims whatsoever by you or any person deriving any right or interest from you.” The court, however, relied on the four corners of the entire document and focused on the first page that read, “recordings made for the purpose of making phonograph records.” The disputed recordings were made for the sole purpose of being played on the radio by WSM when Williams and his band were on the road; they were not made for the purpose of making phonograph records. Thus, the acetate recordings were not covered by the contract between MGM and Williams, and neither MGM nor Polygram had the right to exploit the recordings.

As *Polygram* illustrates, thorough legal planning and documentation is essential when dealing with intangible property rights. The interest-holder of intangible rights should carefully evaluate and properly document all assignment and licensing decisions because a performer’s legacy and music often survive the artist’s death. *Polygram* demonstrates that intangible rights do not necessarily accompany the transfer of tangible property. These intangible rights are freely assignable and licensable and do not expire upon death. Thus, when drafting recording contracts, transactional lawyers should consider the possibility that tangible and intangible interests may be vested in different persons or entities, and should ensure that the performer’s publicity rights are held by the intended party.

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#### LABOR AND EMPLOYMENT

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**Tennessee Adopts Class Action Tolling Doctrine.** *Tigg v. Pirelli Tire Corp.*, No. M2003-02118-COA-R3-CV, 2005 Tenn. App. LEXIS 812 (Tenn. Ct. App. December 22, 2005) *appeal granted* No. M2003-02118-SC-R11-CV, 2006 Tenn. LEXIS 859 (Tenn. Sept. 25, 2006).

By Jonathan W. Robbins

Class action suits are allowed and, in many cases, encouraged, in order to promote efficiency and economy in litigation where there are a number of

participants who stand in the same situation. Potential members of such a class must rely upon the named members to press claims on their behalf. But what happens when the class action litigation is dismissed, time has passed, and those potential members are left holding their individual claims? The United States Supreme Court answered that question over twenty years ago in the Federal context. However, Tennessee courts had yet to decide the issue until it was presented to the Tennessee Court of Appeals in *Tigg v. Pirelli Tire Corp.*

In *Tigg v. Pirelli*, Pirelli Armstrong Tire Corporation (Pirelli) had hired non-union replacement workers for its manufacturing plant in Madison, Tennessee while most of its regular workers, members of the United Rubber, Cork, Linoleum and Plastic Workers Union, were on strike. When hired, the replacement workers were told that their jobs would be permanent and they would not be terminated once the union workers returned. However, after the nine-month strike was settled and union workers began returning to Pirelli, the company began to fire the replacement workers under pressure from the national and local unions.

Subsequently, three of the terminated replacement workers filed a class action suit against Pirelli, the Local 670, and the United Rubber Workers Union. They sued Pirelli for breach of contract and retaliatory discharge; they sued the unions for treble damages for procurement of the breach of their employment contracts. On appeal following the grant of a motion pursuant to Tenn. R. Civ. P. 12.02(6), the Tennessee Court of Appeals remanded the case of *Baldwin v. Pirelli Armstrong Tire Corp.*, leaving the breach of contract and procurement of breach of contract claims to be decided. However, on May 9, 2002, over seven years after the occurrence of the events leading to the suit, the named plaintiffs dismissed their complaint, after settling their individual claims, before any attempt to certify the class was made and without giving notice to the other potential class members.

Three months later, eleven replacement workers filed another class action suit asserting breach of contract and wrongful termination claims against Pirelli and the procurement of breach of contract claims against the two unions. Pirelli moved to dismiss, asserting that the complaint was barred by the statute of limitations and the doctrine of laches. The replacement workers claimed that the statute of limitations should have been tolled while the *Baldwin* class action suit was pending and that they were not guilty of sleeping on their rights. The trial court agreed with Pirelli and dismissed the complaint as to all parties, citing the expiration of the relevant statutes of limitations and the doctrine of laches.

On appeal, the workers raised two issues. The first was whether the trial court erred in rejecting the class action tolling doctrine, which would have tolled the statute of limitations during the pendency of the *Baldwin* class action suit. The United States Supreme Court first articulated the class action tolling doctrine. The doctrine tolls the statute of limitations for prospective class members who make timely motions to intervene in the litigation after the court has found the suit inappropriate for class action status and to potential class members who file their

own individual actions after the class action is not certified. The tolling period begins when the class action suit is filed and the clock is restarted when the class is not certified, a class is certified that does not include the individual plaintiff, or when the individual plaintiff opts out of the class. The class action tolling doctrine articulated by the United States Supreme Court, nonetheless, is a federal procedural rule and, while a majority of states addressing the question have incorporated the doctrine into their own procedures, it was not controlling and Tennessee had not previously addressed the issue.

Based upon the favorable commentary given to the benefits of the class action tolling doctrine by the Tennessee Supreme Court in previous cases, the Tennessee Court of Appeals held that the class action tolling doctrine is consistent with Tennessee class action rules and creates no conflict with the policies implicit in statutes of limitations. The court also articulated the four required circumstances that must be present to invoke the doctrine. Thus, the party seeking the benefit of the class action tolling doctrine must (1) have been a member of the purported class, (2) name as the defendant the same defendant in the class action complaint, (3) assert the same claims originally asserted in the class action suit, and (4) file suit on an individual basis because the class action tolling doctrine will not apply to subsequent class action suits. These limitations assure that the named defendant will have received notice of the claim within the limitations period and will have knowledge, at least generally, of potential plaintiffs and their claims in order to preserve evidence, gather witnesses, and otherwise prepare a defense. Therefore, in the *Tigg* case, the claim of breach of contract against Pirelli and the claims of procurement of breach of contract against the unions were not barred by the statute of limitations, but the separate and distinct claim of wrongful termination against Pirelli was barred.

Also at issue was the trial court's application of the doctrine of laches. Laches is a discretionary tool of the courts to dismiss a complaint when there has been neglect or omission to assert a right for such a time that would cause prejudice to the adverse party. However, the Tennessee Court of Appeals reiterated the policy that laches will not be applied where a delay in filing suit can be reasonably explained or justified. In a case where plaintiffs did not file suit individually while a class action suit was pending, those potential class action members may not be accused of sleeping on their rights. Therefore, where the class action tolling doctrine applies, the doctrine of laches does not apply as long as any subsequent claim is timely filed. The Court of Appeals held that the trial court abused its discretion in applying the doctrine to plaintiff's claims.

As illustrated in *Tigg*, the statute of limitations tolling doctrine, as previously articulated by the Supreme Court of the United States, is compatible with Tennessee procedural law and will be applied in relevant situations. Additionally, a defendant will not be able to invoke the doctrine of laches as a means of escaping the class action tolling doctrine. In practice, when a class action suit is pending, a transactional lawyer should advise clients of the possibility of future, similar claims if



the class action is not certified, is certified while excluding some potential members, or if potential members remove themselves from the class.

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**Use of After-Acquired Evidence of Employee Misconduct in Tennessee.** *Teter v. Republic Parking Sys., Inc.*, 181 S.W.3d 330 (Tenn. 2005).

Whitney L. Quarles

Most jurisdictions allow an employer to use evidence of employee misconduct acquired after an employee's termination to bar or limit the employer's liability for breach of an employment contract. To excuse an employer's subsequent breach, an employer must show that it would have immediately terminated the employee had it known of the misconduct. In *Teter v. Republic Parking Systems, Inc.*, the Tennessee Supreme Court addressed the required level of proof an employer must show when it asserts it would have terminated the employee had it known of the workplace misconduct. The Court held that the "evidence of employee misconduct . . . need only be shown by a preponderance of the evidence."

In 1997, two years after he began working as regional vice president for Republic Parking Systems ("RPS"), Eric Teter renegotiated his employment contract. The new contract included a severance pay provision allowing Mr. Teter to recover income for one year if he were "discharged for any reason other than gross misconduct, fraud, neglect of job responsibilities or voluntary termination."

Although the 1997 employment contract contained no expiration date, RPS made several attempts to enter into a new employment contract with Mr. Teter in 2001. Because the proposed contracts contained less-favorable bonus calculations and included no severance pay provision, Mr. Teter refused to accept the proposed contracts, as he wished to continue his employment under his 1997 contract. Mr. Teter received a memorandum in September 2001, notifying him that he was no longer employed by RPS. The memorandum stated that although Mr. Teter was not entitled to severance pay because he terminated his employment voluntarily by not accepting the proposed contracts—a claim the Tennessee Supreme Court later found erroneous—RPS would provide him severance pay for six months. However, RPS became suspicious after Mr. Teter removed his computer's central processing unit from his office, stating that he was removing personal files. An analysis of his computer revealed that Mr. Teter had been viewing pornographic websites from his office computer.

RPS's Chief Executive Officer ("CEO") then sent Mr. Teter a letter stating that because he had engaged in "gross misconduct" and would have been fired immediately had the CEO been aware of the activity, Mr. Teter would no longer receive any severance pay from RPS. Mr. Teter brought suit against RPS in

November 2001 for breach of contract, seeking severance pay under the 1997 employment contract.

The trial court granted Mr. Teter's motion for summary judgment, adopting the reasoning of *Lewis v. Fisher Service Co.*, which required employers to show by clear and convincing evidence that the employee's misconduct was so egregious that he or she would have been fired immediately upon the employer's discovery of the misconduct. The trial court found no such clear and convincing evidence, and therefore, granted summary judgment for Mr. Teter. The Tennessee Court of Appeals affirmed the trial court's decision.

On appeal, the Tennessee Supreme Court noted that "the application of the after-acquired evidence doctrine as a bar to liability presents an issue of first impression in Tennessee." The Court agreed with the lower court's finding that an employer can use after-acquired evidence of employee wrongdoing to limit or bar its liability by showing that the employee would have been terminated had the employer been aware of the misconduct. However, the Court disagreed with the burden of proof required by the lower court. The court noted that in civil cases, the requirement of proving the evidence by a clear and convincing standard is reserved for issues of important public policy. The Court held that after-acquired evidence cases are not a matter of important public policy and should be treated no differently from other contract disputes, which utilize the preponderance of the evidence standard. Because the Court found a material issue of fact as to whether RPS's CEO would have fired Mr. Teter had he been aware of the misconduct, the Court remanded the case for trial.

*Teter v. Republic Parking Systems, Inc.* represents a decision favorable to employers. An employer's obligation under an employment contract can be limited or barred entirely if an employer can show that an employee's misconduct warranted immediate dismissal. Because after-acquired evidence of gross misconduct does not involve a major public policy concern, an employer must only prove certain immediate termination by a preponderance of the evidence, rather than by a clear and convincing standard. An employer is not charged with the difficult task of proving with a high probability that it would have immediately terminated the employee, but instead must simply demonstrate the termination was more probable than not.

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**PROPERTY**

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**Supreme Court Allows Governments to Exercise Eminent Domain Powers and Transfer the Property to Private Developers.** *Kelo v. City of New London*, 545 U.S. 469 (2005).

By Jason J. Isaacson

Although local governments may use the state's police powers to condemn property, this power has constitutional limitations. The Fifth Amendment's "public use" restriction allows the government to condemn property and to give it directly to the public for valid public purposes. However, where the government condemns property and gives it to private entities for a public purpose, the application of the Fifth Amendment is less obvious. This tension especially hits home when a citizen's property becomes subject to governmental condemnation. Such was the situation presented to the United States Supreme Court in *Kelo v. City of New London*.

In *Kelo*, the city of New London, Connecticut, via the New London Development Corporation ("NLDC"), finalized a redevelopment plan to revitalize the city's waning economic health. Fortuitously, a pharmaceutical company had announced plans to build a large research facility adjacent to the Fort Trumbull area, a peninsula that jutted into the Thames River. The plan included, among other things, the construction of a waterfront hotel, a marina, restaurants, and office space. Execution of the plan required the procurement of ninety acres of land. Thus, the city granted the NLDC power to condemn property through eminent domain if necessary. The NLDC was able to purchase much of the property, but nine property owners refused to sell. In response, the NLDC initiated condemnation proceedings.

The nine property owners filed suit seeking a restraining order to prevent the city from condemning the unblighted property. Among other contentions, they claimed that "the takings would violate the 'public use' restriction of the Fifth Amendment." While the suit was pending in the New London Superior Court, the NLDC publicized its intention to lease some of the parcels to private developers to execute the plan. The trial court granted a restraining order as to the condemnation of one of the parcels designated in the plan as "marina support," but denied relief as to other properties designated as "office space." Both sides appealed to the Supreme Court of Connecticut, which held that all of the city's takings were valid. The property owners appealed to the Supreme Court of the United States and certiorari was granted.

In the Supreme Court, the property owners contended that even if the government properly reimbursed private property owners, it could not do so only to turn around and transfer it to other private entities. To this end, the petitioners demanded a literal reading of the words "public use" in the Fifth Amendment.

Alternatively, they asked the Supreme Court to impose a requirement on legislatures to show that the public purpose will be served with “reasonable certainty.”

When the Supreme Court first applied the Fifth Amendment to the states in the late 19th century, they couched the “public use” limitation into a “public purpose” test. In *Strickley v. Highland Boy Gold Mining Co.*, the Court explained that “use by the general public” was “inadequate” as a “universal test.” Therefore, in Justice Stevens’ majority opinion, he rejected the property owners’ literal interpretation of public use, and instead posited the query of whether the city’s plan served a “public purpose.”

The meaning of “public purpose” has also evolved over time. In a mid-20th century case, *Berman v. Parker*, the Supreme Court held that a legislature’s inner-city redevelopment project served a public purpose as a whole. Thus, the Court established a narrow role for federal courts in takings cases. Then, in *Hawaii Housing Authority v. Midkiff*, the Court upheld governmental takings given to private lessees to weaken a land oligopoly. In that case, the Court established that the state possesses broad authority to decide what the public goals are and how they will be achieved. Finally, in *Ruckelshaus v. Monsanto, Co.*, the Court upheld Congressional provisions to publicize trade secrets in order to eliminate barriers to competition in the pesticide market. As a result, legislatures are afforded broad latitude in deciding what constitutes a valid public purpose. Applying this case law, the Supreme Court refused to second-guess New London’s redevelopment plan, holding that it satisfied the “public purpose” requirement of the Fifth Amendment.

Where the government takes property from private individuals and gives it to other private entities for a valid public purpose, Constitutional demands are satisfied. Therefore, whether condemned property is then given to private or public entities is immaterial in takings cases as long as a valid public purpose exists. The applicable case law forecloses any other reading. Moreover, the Supreme Court also held that states are not precluded from placing further restrictions on eminent domain.

The dissent capitalized on the government’s role in securing property. Justice O’Connor warned that all private property is now vulnerable to condemnation in the name of “economic development.” She surmised that the losers are the poor and the winners are the rich with political influence. Justice Thomas emphasized the inability of the government to restore the “subjective value” of property to its owners under this expansive doctrine. He feared that the most affected members of society will be minority communities with less political power.

As *Kelo* illustrates, property owners in the United States must yield to governmental takings done with a public purpose, whether the property is then given to private or public entities. Besides adding a new dimension to the issue of whether private property can be condemned by the government and given to private entities, *Kelo* sends a clear message that federal courts will not second-guess legislatures on this subject. Thus, where governmental condemnation proceedings are in progress, property owners should use every legislative avenue available to address their

grievances. Moreover, if state law places further restrictions on eminent domain, property owners may address their grievances in state courts.

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## TAXATION

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**Charitable Tax Exemption for Nonprofit Family Wellness Centers Held Constitutional in Tennessee.** *Club Sys. of Tenn. v. YMCA of Middle Tenn.*, No. M2004-01966-COA-R3-CV, 2005 Tenn. App. LEXIS 793 (Tenn. Ct. App. Dec. 19, 2005).

By Christopher Riccardi

Deciding that real and personal property used to provide physical exercise opportunities for adults and children without regard to an individual's ability to pay constituted a charitable use, the Tennessee Court of Appeals affirmed the trial court's ruling upholding Tennessee Code Annotated Section 67-5-255 ("Section 67-5-255") as constitutional.

Section 67-5-255 was codified in 2000 and, in relevant part, provides a charitable tax exemption to entities using property for the purpose of a nonprofit family wellness center in connection with certain organizational requirements outlined in the statute. Club Systems of Tennessee, Inc. ("Club Systems") challenged the constitutionality of Section 67-5-255 in a lawsuit brought against the YMCA of Middle Tennessee ("YMCA") soon after the statute was enacted. The trial court heard arguments on the matter and upheld the statute as constitutional. Club Systems appealed this ruling to the Tennessee Court of Appeals.

On appeal, the Tennessee Court of Appeals first considered whether the statute created a *per se* property tax exemption by failing to focus upon the exempted property's use, thus violating Article II, Section 28 of the Tennessee Constitution. Article II, Section 28 allows the legislature to exempt from property taxes all property "held and used for purposes purely . . . charitable." When the legislature exercises this power under the Tennessee Constitution, the court noted that the exemption must be based on the use of the property and not the nature of its owner. Further, the use of the property must be for a purpose that may be properly exempted under the Tennessee Constitution. Therefore, if the statute provides a tax exemption for property used "exclusively for" or "directly incidental to" a charitable purpose, the statute will not run afoul of Article II, Section 28 of the Tennessee Constitution.

Section 67-5-225 specifically provides a charitable tax exemption for property used as a nonprofit family wellness center, defined in the statute as "real or personal property used to provide physical exercise opportunities for children and adults." After emphasizing the plain language of the statute, the Tennessee Court of Appeals

found that the legislature had not overlooked the use requirement embodied in Tennessee Constitution Article II, Section 28. Further, the court applied Indiana and Pennsylvania precedent, along with the Tennessee Supreme Court's definition of charity, to find that providing a nonprofit family wellness center, operated in accordance with the statute, is a charitable use of property. Since Section 67-5-255 only exempts property based on its use, specifically property used as a nonprofit family wellness center which qualifies as a charitable use of property, the court stated that "the statute does not create a per se exemption . . . that bears no relation to the property's actual use." Accordingly, the Tennessee Court of Appeals held that section 67-5-225 did not violate Article II, Section 28 of the Tennessee Constitution.

Next, the Tennessee Court of Appeals used equal protection analysis to determine whether the statute created a property tax exemption for the exclusive benefit of the YMCA, thus violating the Class Legislation Clause of Article XI, Section 8 of the Tennessee Constitution. In its analysis, the court applied *Newton v. Cox* and decided that a rational basis standard was appropriate since the legislative classification at issue did not interfere with the exercise of a fundamental right or operate to the peculiar disadvantage of a suspect class. When equal protection analysis is used under a rational basis standard, the court, quoting *Tennessee Small School Systems v. McWhorter*, stated that "if some rational basis can be found for the classification [in the statute] . . . the classification will be upheld." Consequently, the Tennessee Court of Appeals held that Section 67-5-225 did not violate Article XI, Section 8 of the Tennessee Constitution because: (1) the "physical fitness of its citizens is, at least, a legitimate state interest" and (2) "[t]he fact that T.C.A. Section 67-5-225 provides a tax break for . . . place[s] to exercise and . . . learn about the importance of physical fitness regardless of age, income or ability to pay is . . . rationally related to the legitimate state interest of healthy citizens."

Finally, the Tennessee Court of Appeals addressed the issue of whether Section 67-5-255 is constitutional as applied to the YMCA. After concluding that the statute was enacted to clarify existing law, the court narrowed Club Systems' unconstitutional as applied argument to "whether the YMCA property is being used in a 'purely' charitable manner as required by the Tennessee Constitution." Tennessee precedent calls for a liberal construction of tax exemptions. Therefore, the court rejected a "very strict construction of the constitutional and statutory requirement[s]." Further, the court, quoting *Youth Programs, Inc. v. Tennessee State Board of Equalization*, noted that "the proper test is whether the challenged use is 'directly incidental to or an integral part of one of the recognized purposes of an exempt institution.'" As a result, the Tennessee Court of Appeals held that the YMCA's provision of televisions, sound systems, vending machines, waiting areas, and parking lots qualified as a charitable use because "these amenities are . . . an integral part of the charitable purpose espoused by the YMCA" and "although incidental to the accomplishment of the YMCA's charitable function, nonetheless qualify for tax-exempt status."

*Club Systems of Tennessee, Inc. v. YMCA of Middle Tennessee* affirms the use of liberal construction of tax exemptions in Tennessee, as well as the “directly incidental to or an integral part of test” for determining whether property is used for a purely charitable purpose. Moreover, *Club Systems* formally adopts the views of other jurisdictions in concluding that the provision of a nonprofit family wellness center, as defined in and operated in convention with Section 67-5-255, is a charitable use of property and may be exempted from property taxes by the legislature under the Tennessee Constitution.

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**When is a Sale a “Wholesale” Sale for Tax Purposes?** *Pfizer, Inc. v. Johnson*, No. M2004-00041-COA-R3-CV, 2006 Tenn. App. LEXIS 44 (Tenn. Ct. App. Jan. 23, 2006).

By Nicholas C. Zolkowski

Recently, the Tennessee Court of Appeals held that an additional business tax should not be assessed to all wholesalers, but rather only to wholesalers who are the most directly related to consumers.

In Tennessee, all transactions are assessed a minimum business tax under Tennessee Code Annotated Section 67-4-609(a). However, Tennessee Code Annotated Section 67-4-609(b) requires an additional tax on “wholesale” sales. Under Tennessee Code Annotated Section 67-4-702(a)(22), a “wholesale” sale occurs, in the regular course of business, when a wholesaler sells tangible goods to a retailer for resale, lease, or rental to a user or consumer. Specifically, a wholesaler sells goods to a retailer, a retailer sells goods to a consumer, and a “wholesale” sale is the transaction between the wholesaler and a retailer. In such a transaction, the wholesaler is assessed the additional “wholesale” tax. In *Pfizer, Inc. v. Johnson*, the Tennessee Court of Appeals considered the statutory definition of “wholesale” sales and the associated tax.

Pfizer, Inc. (“Pfizer”) manufactured and sold pharmaceutical drugs as well as other products. Pfizer sold to both wholesalers, such as McKesson Corporation (“McKesson”), and retailers. When Pfizer sold products to retailers, it paid the minimum business taxes and the additional “wholesale” taxes. However, Pfizer paid only the minimum business taxes—but not the “wholesale” tax—on sales to McKesson and other wholesalers. *Pfizer, Inc. v. Johnson* arose following an audit of Pfizer by the Department of Revenue. The Department categorized Pfizer’s sales to McKesson as “wholesale” sales, resulting in the assessment of the additional “wholesale” taxes as well as resulting in delinquency fees against Pfizer in the amount of \$3,495,799.08.

The trial court granted the State's motion for summary judgment as to Pfizer's liability for the additional taxes and delinquency fees. On appeal, Pfizer argued that its sales to McKesson were not "wholesale" sales, as defined by the Tennessee Code Annotated, and thus were not subject to the additional business taxes.

On appeal, the Court noted that taxing statutes are to be strictly construed against the government. Moreover, the Court stated that the definition of a "wholesale" sale was clear, and to interpret it any other way would be impermissibly extending the language.

The Court looked to the legislative intent behind the statute. The State argued that the legislature intended to assess the minimum business tax and the additional "wholesale" tax on all transactions. However, the Court reasoned that this was not the intent of the legislature when it drafted and enacted the statute. Instead, the Court held that the legislature intended "wholesale" sales to include only transactions between wholesalers and retailers. It reasoned that if a buyer purchases goods, but does not thereafter sell the goods to a consumer, then the buyer is not a retailer, but another wholesaler. If only wholesalers are party to a sales transaction, then the additional "wholesale" tax is not intended to be assessed since no retailer is involved.

The Court held that Pfizer's sales fit into the non-"wholesale" category. McKesson did not sell the Pfizer pharmaceuticals to consumers, but rather to retailers who then sold the pharmaceuticals to consumers. Since McKesson had not sold the pharmaceuticals directly to consumers, it was a wholesaler and not a retailer. Pfizer was one step removed from any transaction with a retailer. Therefore, any sales from Pfizer to McKesson were between wholesalers, and did not meet the statutory requirement of a "wholesale" sale. Indeed, the statutorily defined "wholesale" sales occurred later, when McKesson sold the pharmaceuticals to the retailers. As a result, the Court reversed the trial court's decision, and held that Pfizer was not liable for the additional "wholesale" taxes or fines.

The holding of *Pfizer, Inc. v. Johnson* clarified the definition of "wholesale" sales in Tennessee, assisting business parties in determining the scope of potential state tax liabilities. When advising a client concerning sales agreements and potential "wholesale" taxes, a transactional attorney should remain aware of the client's and the other contracting party's relationships with end consumers. Armed with this knowledge, the transactional attorney can advise a client regarding the tax implications—including whether to account for "wholesale" taxes in addition to the minimum business tax—of the sale of a particular product to an identified buyer.



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**TELECOMMUNICATIONS**

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**Telephone Consumer Protection Act of 1991 Regulates Certain Text Messages.** *Joffe v. Acacia Mortgage Corp.*, 121 P.2d 831 (Ariz. Ct. App. 2005).

By Drew H. Reynolds

The Telephone Consumer Protection Act of 1991 (“TCPA”) was enacted to regulate the telemarketing industry’s use of sophisticated equipment to generate automated telephone calls. New advances in technology, however, are continuously altering society’s understanding of what a telephone call actually is. Short Message Service (“SMS”), for example, is a service that makes it possible to send and receive text messages using either a cellular telephone or the Internet. Determining whether SMS messages should be regulated by acts such as the TCPA is problematic because the messages do not constitute traditional calls. With technological advances such as SMS redefining society’s concept of communication, courts now face the dual challenge of interpreting statutes that regulate communication in the face of technological innovation and deciding whether such statutes apply to these innovations. Such was the situation presented to the Arizona Court of Appeals in *Joffe v. Acacia Mortgage Corporation*.

In *Joffe*, Acacia, as part of a marketing campaign, programmed its computers to send e-mail solicitations over the Internet to consumer e-mail addresses. In *Joffe*’s case, Acacia’s computers generated his cellular telephone number, combined it with his cellular telephone carrier’s domain name, and sent the solicitations to the resulting e-mail address. When these emails were sent to his carrier’s domain, the carrier converted their content into a format that could be transmitted to *Joffe*’s cellular telephone number. Consequently, *Joffe* filed a complaint alleging that Acacia had violated the TCPA by sending unsolicited advertisements to his cellular telephone in the form of text messages. Acacia moved twice for summary judgment, but both motions were denied and the trial court held that Acacia had violated the TCPA.

On appeal, Acacia raised several issues. The first was whether the superior court erred in ruling that the TCPA applied to Acacia’s actions. This issue can be further divided into two smaller issues: first, whether Acacia called *Joffe* and, second, whether it used an automatic dialing system to do so. Although the TCPA prohibits making “any call” using “any automatic dialing system” to “any telephone number assigned to a . . . cellular telephone service,” it does not define the word “call.” In order to determine what Congress intended when it used the word “call,” the appellate court applied customary rules of statutory interpretation, considering both the plain and ordinary meanings of the word “call” and the purpose of the statute itself. Because the TCPA was enacted to control automated telephone calls, the

court found that Congress used the word “call” to refer to an attempt to communicate by telephone.

Furthermore, the court found that the potential for two-way real time voice communication, which Acacia argued was an essential component of a call, was irrelevant. Because the TCPA prohibits the act of attempting to communicate with a cellular telephone number using certain equipment—regardless of whether there is a possibility of vocal communication between the parties—the court held that a text message may constitute a call subject to the requirements of the TCPA if the other requirements of the statute are met. The court also rejected Acacia’s argument that it merely sent an e-mail to an e-mail address. Although Acacia used the Internet to send the messages and sent them to an e-mail address, they were meant to reach Joffe’s carrier, where they would be converted into SMS messages, and thus should not be considered e-mail. Because sending a text message from the Internet to a phone achieves the same result as sending it from a phone to another phone, Acacia’s Internet-to-phone messages functioned as attempts to communicate with Joffe by telephone. Consequently, the court held that Acacia called Joffe.

The TCPA, however, only applies to calls made using an automated telephone dialing system, which it defines as “equipment which has the capacity--(A) to store or produce telephone numbers to be called, using a random or sequential number generator; and (B) to dial such numbers.” Acacia asserted that it did not use such equipment, again arguing that it simply used its computers to send e-mail to an e-mail address. Yet, the court found that the definition of automated dialing system includes advances in technology; thus, the fact that Acacia used technology different from that contemplated by Congress when it enacted the TCPA was irrelevant. By utilizing its computers, along with SMS technology, Acacia effectively used an automatic telephone dialing system to call a telephone number assigned to a cellular telephone and, in so doing, violated the TCPA.

Acacia finally argued that the TCPA violated its rights under the First Amendment. A statute that creates a content-neutral time, place, and manner restriction on speech survives Constitutional challenge if it serves “a significant government interest,” “is narrowly tailored” to serve that interest, and leaves “open ample alternative channels for communication of the information.” Acacia argued that Congress did not articulate any governmental interest applicable to its actions because it could not have anticipated the existence of SMS technology when it enacted the TCPA. The court found, however, that protecting the privacy of cellular telephone subscribers, many of whom have completely replaced their “land line” telephones with cellular telephones, serves a significant government interest. Furthermore, because the TCPA prohibits only those calls made with automatic dialing systems, it is narrowly tailored to serve the government’s interest and leaves ample alternative channels for communication of the information. Consequently, the court held that the TCPA did not violate Acacia’s rights under the First Amendment.

As *Joffe* illustrates, the TCPA applies to any attempt to communicate with a cellular telephone number using certain equipment. *Joffe* suggests that businesses will not be able to circumvent the TCPA simply by utilizing new technology, such as SMS, that did not exist when the TCPA was enacted. The TCPA, however, does not completely prevent businesses from communicating with consumers; businesses still have the option of entering calls by hand or making only those calls that consumers have consented to receive. Consequently, to assist clients in avoiding potential liability under the TCPA, an attorney should advise clients to use alternative, legal methods of communication instead of trying to avoid the provisions of the TCPA by utilizing advances in technology.