CASE COMMENTARIES

CONSTRUCTION

The Tennessee Court of Appeals held that the mode of pre-suit notice set forth in Tenn. Code Ann. § 66-34-602(a)(2) is directory rather than mandatory and requires only substantial compliance. *Aarene Contracting, LLC v. Krispy Kreme Doughnut Corp.*, No. E2016–01155–COA–R3–CV, 2016 WL 7377280 (Tenn. Ct. App. Dec. 20, 2016).

By Derek Terry

In *Aarene Contracting, LLC v. Krispy Kreme Doughnut Corp.*, the Tennessee Court of Appeals addressed whether the notice provision in Tennessee's Prompt Pay Act ("Act" or "Prompt Pay Act"), Tenn. Code Ann. § 66–34–602(a)(2), requires strict compliance. The section provides that "notification shall be made by registered or certified mail, return receipt requested." Tenn. Code Ann. § 66–34–602(a)(2). Upon review, the Tennessee Court of Appeals held that the requirement of the statute is directory rather than mandatory and can be achieved through substantial compliance.

This case arose out of a construction contract executed in November 2013 in which Aarene Contracting, LLC ("Aarene") agreed to renovate a Chattanooga store for Krispy Kreme Doughnut Corporation ("Krispy Kreme"). The agreement provided that Krispy Kreme would make progress payments and hold ten percent of the amount owed as retainage. In September 2014, Aarene sent a letter via Federal Express and e-mail notifying Krispy Kreme of claims it had against them under the Prompt Pay Act. Among other claims, Aarene asserted that Krispy Kreme should not have withheld more than five percent in retainage. Krispy Kreme responded to Aarene by letter on October 8, 2014, rejecting Aarene's claims. Then, on October 13, 2014, Aarene warned Krispy Kreme by letter that the retainage penalty accumulates every day it refuses to comply.

On August 4, 2015, Aarene filed a complaint against Krispy Kreme in Hamilton County Chancery Court, asserting breach of contract and mechanic's lien claims. Additionally, Aarene claimed Krispy Kreme violated the Act by withholding ten percent as retainage and failing to hold the amount in an escrow account. In response, Krispy Kreme asserted that Aarene failed to comply with the statutory notice requirements of the Act

because Aarene used Federal Express and e-mail rather than certified mail. Krispy Kreme then moved for summary judgment, arguing that the claims were barred because Aarene did not strictly comply with the notice requirements of the Act. Aarene responded with its own motion for summary judgment in October 2015. The trial court granted Krispy Kreme's summary judgment motion and denied Aarene's, writing ". . .This [c]ourt is not going to legislate from the bench by expanding this notice statute." Thereafter, the trial court granted Aarene's motion seeking permission to file an interlocutory appeal.

On appeal, the Tennessee Court of Appeals held that the "mode of pre-suit notice set forth in Tenn. Code Ann. § 66-34-602(a)(2) is directory rather than mandatory and requires only substantial compliance." The court of appeals relied on the Tennessee Supreme Court's prior decision in *Presley v. Bennett*, indicating that the issue of compliance with the procedural requirement turned on whether the statute is directory or mandatory. *Presley v. Bennett*, 860 S.W.2d 857, 860 (Tenn. 1993). In *Presley*, the court noted that the object of determining whether a procedural requirement of statute is directory or mandatory is to "ascertain the legislative intent by consideration of the entire statute, including its nature and purpose, and the consequences that would result from a construction one way or the other." *Id.* Further, directory provisions require only substantial compliance, whereas mandatory provisions require strict compliance. *Id.* Finally, the *Presley* court indicated that, "[s]tatutory provisions relating to the mode or time of doing an act to which the statute applies are ordinarily held to be directory rather than mandatory." *Id.*

The court of appeals compared the facts of this case to recent Tennessee Supreme Court decisions involving the pre-suit notice requirements in medical malpractice lawsuits. In those decisions, the supreme court found that certain pre-suit notice requirements were directory, making substantial compliance satisfactory. *See Arden v. Kozawa*, 466 S.W.3d 758 (Tenn. 2015) (holding that notifying a defendant of statutory claims via Federal Express rather than certified mail is sufficient so long as a defendant is not prejudiced by the deviation from the statutorily prescribed method of service); *see also Thurmond v. Mid-Cumberland Infectious Disease Consultants, PLC*, 433 S.W.3d 512 (Tenn. 2014) (holding that substantial compliance satisfied the statutory requirement that an affidavit by the person who sends pre-suit notice by certified mail be attached to the complaint).

On the other hand, the Tennessee Court of Appeals previously dismissed a materialmen's lien claim for failure to deliver the defendant notice of nonpayment for work by hand rather than registered or certified mail as required by the statute at issue. *Vulcan Materials Company v. Gamble Construction Company, Inc.*, 56 S.W.3d 571 (Tenn. Ct. App. 2001). However, that decision did not address whether the defendant suffered any actual prejudice from the plaintiff's method of providing notice. *Id.*

Here, the court of appeals noted that the legislature intended the method of notice provision "to ensure that the party failing to make payment is notified of [the Act] and of the notifying party's intent to seek relief provided for by the Act." Further, "[a] method of notification that accomplishes this intent without prejudice to the party being notified is sufficient." The court of appeals determined that Aarene provided Krispy Kreme with the information required under the Act before filing suit. Because Krispy Kreme received notice and responded, providing the information by letter via Federal Express and e-mail did not prejudice Krispy Kreme.

The court of appeals reversed the trial court's grant of summary judgment for Krispy Kreme, and remanded Aarene's claims for relief under the Act to be determined by the trial court. This conclusion that substantial compliance with a method of notice provision in a statutory claim for relief is sufficient prevents potentially meritorious claims from being barred for failure to strictly comply with notice requirements. The court of appeals indicated that "[w]hile it is tempting to merely write that the statute says what it says and to blame the legislature for the result[,] . . . courts would be abandoning their constitutional role of interpreting statutes using reason and practicality with the intent of the legislature in mind."

To ensure that a claim under the Prompt Pay Act will not be dismissed on a technicality, practitioners should notify parties via certified mail, return receipt requested. However, by stressing practicality in interpreting the statutory notice provision, the court of appeals recognizes the growth of efficient, alternative methods to certified mail for transmitting important information, as well as the primary concern of actual notice. Strict compliance may not be required for a contractor to notify a party of intent to seek relief under the Prompt Pay Act.

CORPORATE

The Tennessee Court of Appeals held that the Delaware Block Method continues to act as the baseline method for judicial valuations in shareholder appraisal rights cases. Further, the court held that utilizing estimates of future performance to determine the value of dissenting shareholders' shares is not appropriate where such estimates are merely speculative. *Athlon Sports Commc'ns, Inc. v. Duggan*, No. M2015-02222-COA-R3-CV, 2016 Tenn. App. LEXIS 773, 2016 WL 6087667 (Tenn. Ct. App. Oct. 17, 2016), *appeal docketed*, No. M2015-02222-SC-R11-CV, 2017 Tenn. LEXIS 170 (Tenn. Mar. 9, 2017).

By Elizabeth Harwood

In *Athlon Sports Communications, Inc. v. Duggan*, the Tennessee Court of Appeals addressed whether an exclusive application of the Delaware Block Method is required by Tennessee courts in determining a fair valuation of shares, when dissenting shareholders sought to use a valuation method considering prospective profits from "plans in place but not yet executed on the valuation date." Pursuant to *Blasingame v. American Materials, Inc.* and its progeny, the trial court utilized solely the Delaware Block Method, which applies three valuation methods—the market value method, the asset value method, and the earnings value method—and assigns an appropriate weight to each of the three methods based on the relevance of the method to the individual circumstances of the case. *Blasingame v. Am. Materials, Inc.*, 654 S.W.2d 659 (Tenn. 1983). On appeal, the Tennessee Court of Appeals held that the trial court adequately considered the unique circumstances of the case and properly applied the Delaware Block Method. The court of appeals declined to modify the method for valuing the shares of dissenting shareholders and held that the Delaware Block Method continues to act as the baseline method for judicial valuations in such cases. Further, the court held that utilizing estimates of future performance to determine the value of dissenting shareholders' shares is not appropriate where such estimates are merely speculative.

This case arose out of a preferred stock transaction between Stephen Duggan ("Duggan"), an experienced investor, and Athlon Sports Communications, Inc. ("Athlon"), a private sports media company. In

2010, Duggan approached Athlon with a plan to turn around the struggling company by distributing a periodical. Athlon hired Duggan to execute the plan and Duggan purchased 15% ownership of Athlon at $6.75 per share. At the time of Duggan's investment, an accounting firm determined that Athlon had a valuation of zero. Duggan agreed that this was a fair valuation. Despite early signs of success, Athlon's finances worsened. In preparation for a merger, Athlon underwent negotiations to squeeze out Duggan and the other minority shareholders, the defendants in this action for judicial appraisal. Athlon offered to convert the defendants' shares into cash consideration at $0.10 per share. The defendants objected, asserting that the shares were worth $6.18 per share. Athlon's valuation was again determined by an accounting firm to be zero at the time of the merger.

At trial, the defendants' expert presented a discounted cash flow valuation and a Delaware Block Method valuation. The trial court was unpersuaded by the defendants' argument that the discounted cash flow was more appropriate because both methods employed by the defendants yielded a comparable valuation. Considering only the defendants' Delaware Block Method application, the trial court rejected the inclusion of net operating losses ("NOLs") in the asset valuation because the "value of NOLs is contingent upon generating future profits against which to apply the NOLs" and here, the unique circumstances of this case could not produce an estimation of future profits that was more than merely speculative. With respect to the earnings valuation, the trial court concluded the defendants strayed from the requirements of the Delaware Block Method by failing to confine the predictor for future earnings to three to five years. Lastly, regarding the market valuation, the trial court held that "[t]he 2010 Duggan preferred stock transaction is not indicative of value [because] Mr. Duggan has testified that he knew . . . Athlon was worthless," and in any event, "market value is usually not weighty in closely held corporations where there is little or sporadic trading."

The plaintiff's expert used the Delaware Block Method of valuation and concluded that the fair valuation of the shares was zero. The trial court determined that "the greater weight and preponderance of the evidence and application of Tennessee valuation law supports [the plaintiff's expert's] determinations." However, the trial court held that the fair value

was $0.10 per share rather than zero, because the court found that Athlon's established brand name, trademark, and wide circulation of its publication carried some value as intangible assets.

Presented with the question of whether the application of the Delaware Block Method should give way to a modified, more liberal method for valuing shares of dissenting shareholders, the court of appeals confined its analysis to the rule of law set forth *Blasingame*. Although the Delaware Supreme Court departed from a strict application of the Delaware Block Method in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the Tennessee Supreme Court, in its opinion on a petition for rehearing in *Blasingame*, recognized that the Delaware court's relaxing of the strict application of the Delaware Block Method was a necessary response to a modification of a Delaware statute, which does not affect the application of the Delaware Block Method in Tennessee. *Blasingame*, 654 S.W.2d at 668 n.1. In addressing the defendants' argument that the circumstances of this case (specifically, Athlon's undertaking of a new venture) call for a different method of valuation that accounts for future performance, the court reemphasized their reasoning from *MS Holdings, LLC v. Malone*: "[T]he estimate of future performance should not be used to determine value where the evidence is entirely speculative. . . . Obviously, the remaining equity owners . . . hoped that their action would result in future profits, but as of the valuation date any future profits were just that, hope." No. W2006-01609-COA-R3-CV, 2008 Tenn. App. LEXIS 225, at *6–7 (Tenn. Ct. App. Apr. 14, 2008).

Overall, the Tennessee Court of Appeals appears to hold tight to the reasoning in *Blasingame* and its progeny: "[w]hile the Tennessee case law . . . in the years since *Blasingame* has refined further the approach to judicial valuation, it never has departed utterly from the Delaware Block Method as a baseline." However, by stating that courts have not "departed *utterly*" from the Delaware Block Method and describing it is a "baseline," the court seems to suggest that the method is a starting point rather than a rule calling for strict adherence. The court appears to leave room for some potential exceptions to the rote and exclusive application of the Delaware Block Method. This perhaps suggests Tennessee courts could embrace the trend toward abandoning the exclusive use of the Delaware Block Method in favor of a more liberal rule permitting the application of methods more tailored to the specific circumstances of a case. Recently,

the Supreme Court of Tennessee granted the defendants' application for permission to appeal. *Athlon Sports Commc'ns, Inc. v. Duggan*, No. M2015-02222-SC-R11-CV, 2017 Tenn. LEXIS 170 (Tenn. Mar. 9, 2017). Thus, a modification to this rule by the Tennessee Supreme Court could be imminent.

To ensure the methods supportive of a favorable valuation are ultimately considered and substantially weighted using the Delaware Block Method, practitioners should attempt to create a record that is more than speculative with respect to the value of future performance. In the documents constituting the agreement to purchase, attorneys should note that the price paid was calculated to reflect a fair valuation considering factors like those used in the Delaware Block Method. Companies should draft memorandum to entice other investors with caution because such memorandum may be used by dissenting shareholders in the event of a merger if it reports slightly inflated valuations. However, while critics of the Delaware Block Method may be gaining supporters, the valuation of a company will likely continue to be unpredictable and inaccurate no matter the valuation method employed by the courts.

DEBTOR-CREDITOR

The United States Court of Appeals for the Fifth Circuit held that a collection letter sent to an unsophisticated consumer offering to settle a time-barred debt without disclosing that the debt is no longer enforceable or revealing any of the pitfalls of a partial payment could violate the Fair Debt Collection Practices Act ("FDCPA"), regardless of whether litigation is threatened. *Daugherty v. Convergent Outsourcing, Inc.*, 836 F.3d 507 (5th Cir. 2016).

By Hilary Magacs

In *Daugherty v. Convergent Outsourcing, Inc.*, the Fifth Circuit addressed whether a collection letter offering to settle a time-barred debt could violate the FDCPA, when the letter did not disclose the debt's unenforceability or expressly threaten litigation. Generally, the FDCPA prohibits the use of "any false, deceptive, or misleading representation or means in connection with the collection of any debt." 15 U.S.C. § 1692e.

Currently, the circuits differ on whether such a letter violates the FDCPA. In *Huertas v. Galaxy Asset Management*, 641 F.3d 28, (3rd. Cir. 2001) and *Freyermuth v. Credit Bureau Services, Inc.*, 248 F.3d 767 (8th Cir. 2001), the Third and Eighth Circuits held that without threatening litigation a debt collector attempting to collect on a time-barred debt that is otherwise valid has not violated the FDCPA. However, in *Buchanan v. Northland Grp., Inc.*, 776 F.3d 393, 397 (6th Cir. 2015) and *McMahon v. LVNV Funding, LLC*, 744 F.3d 1010, 1020 (7th Cir. 2014), the Sixth and Seventh Circuits held that collection letters offering to settle time-barred debts without disclosing the status of the debts can be misleading and, therefore, violate the FDCPA even if the letters do not threaten litigation. Persuaded by *Buchanan* and *McMahon*, the Fifth Circuit here held that a collection letter sent to an unsophisticated consumer offering to settle a time-barred debt without disclosing that the debt is no longer enforceable or revealing any of the pitfalls of a partial payment could violate the FDCPA, regardless of whether litigation is threatened.

This case arose in 2014 when Plaintiff-Appellant Roxanne Daugherty received a debt collection letter from Defendant-Appellee Convergent Outsourcing, Inc. ("Convergent"), proposing that Daugherty make a payment of $3,249.59 to settle a past-due balance of $32,405.91, which was owed to Defendant-Appellee LVNV Funding, LLC ("LVNV"). The applicable statutory period to collect on the debt had expired, but the letter provided that "[LVNV] has advised us that they are willing to settle your account for 10% of your total balance due to settle your past balance." The letter did not indicate that the statute barred any possible litigation to collect on the debt.

Daugherty filed suit against Convergent and LVNV later that year, claiming they had violated two sections of the FDCPA. First, Daugherty alleged that Convergent and LVNV violated 15 U.S.C. § 1692e by using false, deceptive, or misleading representations or means in connection with the collection of her debt. She also claimed that the Defendant-Appellees violated 15 U.S.C. § 1692f by using unfair or unconscionable means when trying to collect her debt. Daugherty attacked Convergent's letter for failing to disclose that her debt was no longer enforceable because the statute of limitations to collect on the debt had expired, that settling the debt through a partial payment would trigger tax liability for Daugherty, and that a partial payment would revive the entire debt.

Convergent and LVNV filed a motion to dismiss for failure to state a claim upon which relief could be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). The district court granted the motion, relying in part on *Huertas* and *Freyermuth*. The court held that a debt collector does not violate the FDCPA by seeking voluntary repayment of time-barred debts as long as the debt collector does not initiate or threaten legal action when seeking to collect those debts.

On appeal, the Fifth Circuit reversed and held that Plaintiff-Appellant Daugherty's claim was plausible. In reaching its conclusion, the court analyzed cases decided in the other circuits. In, *McMahon*, the Seventh Circuit held that while efforts to collect a time-barred debt are not "automatically improper," a debt collector violates the FDCPA when the language used in the collection letter would lead an unsophisticated consumer to believe that the debt is still enforceable. *McMahon*, 744 F.3d at 1020. This is because § 1692e of the FDCPA prohibits the false representation of the character or legal status of any debt. *Id.* In addition, the *McMahon* court held that efforts to settle a debt could be misleading because, if a consumer makes a partial payment, she could reset the statute of limitations and make herself vulnerable to suit on the full amount. *Id.* at 1021. The Sixth Circuit reached a similar conclusion in *Buchanan*. *Buchanan*, 776 F.3d at 397.

In *Huertas* and *Freyermuth*, the Third Circuit and Eighth Circuit held that attempting to collect on a time-barred debt was permissible under the FDCPA because the debt is not erased by the expiration of the statute of limitations. *Freyermuth*, 248 F.3d at 771; *Huertas*, 641 F.3d at 33. Instead, they noted that the statutory bar merely limits the remedies available to collect the debt. *Id.* The courts both concluded that the letters did not violate the FDCPA because they did not include threats to sue. *Id.*

On balance, the Fifth Circuit agreed with the Seventh Circuit's reasoning in *McMahon* that "[t]he plain language of the FDCPA prohibits not only threatening to take actions that the collector cannot take, but also the use of any false, deceptive, or misleading representation, including those about the character or legal status of any debt." *McMahon*, 744 F.3d at 1021. Persuaded by the Sixth and Seventh Circuit's opinions in *Buchanan* and *McMahon*, the Fifth Circuit reversed the district court's grant of the Defendants' motion to dismiss and remanded the case. The court held

that the Plaintiff-Appellant had stated a claim because, although her collection letter did not threaten her with a lawsuit, it offered her an opportunity to settle her debt without disclosing that the statute of limitations for collecting the debt had passed. The court held that a collection letter sent to an unsophisticated consumer offering to settle a time-barred debt without disclosing that the debt is no longer enforceable or revealing any of the pitfalls of a partial payment can violate the FDCPA, regardless of whether litigation is threatened.

In light of this decision, transactional lawyers should be aware that the circuits remain split on the issue of whether a collection letter offering to settle a time-barred debt violates the FDCPA if the debt collector does not disclose the debt's unenforceability or expressly threaten litigation. In the Fifth, Sixth, and Seventh circuits, debt collectors must reveal whether a debt is judicially enforceable and whether there are potential pitfalls when making a partial payment, regardless of whether litigation is threatened. However, in the Third and Eighth circuits, debt collectors can comply with the FDCPA if they send collection letters on time-barred debt, as long as they do not expressly threaten litigation. Therefore, attorneys checking for compliance with the FDCPA must be knowledgeable about which circuit they are in, as compliance with the FDCPA in the Fifth, Sixth, and Seventh circuits is harder to achieve.

REAL ESTATE & CIVIL PROCEDURE

The Supreme Court of the United States rejected federal jurisdiction over all cases involving the Fannie Mae, interpreting the inclusion of "in any court of competent jurisdiction" in the federal charter's sue-and-be-sued clause to permit lawsuits "in any state or federal court already endowed with subject-matter jurisdiction over the suit." *Lightfoot v. Cendant Mortgage Corp.*, 137 S. Ct. 553 (2017).

By Evan Sharber

In *Lightfoot v. Cendant Mortgage Corp.*, the United States Supreme Court addressed whether the Federal National Mortgage Association ("Fannie Mae") has party-based federal subject-matter jurisdiction, derived solely from its statutory sue-and-be-sued clause.

The clause grants Fannie Mae the power "to sue and be sued, and to complain and to defend, in any court of competent jurisdiction, State or Federal." 12 U.S.C. § 1723a(a). The Supreme Court has previously indicated that nearly identical sue-and-be-sued clauses may successfully grant party-based jurisdiction. *See, e.g. Am. Nat'l Red Cross v. S.G.*, 505 U.S. 247, 248 (1992) (authorizing the Red Cross "to sue and be sued in courts of law and equity, State or Federal, within the jurisdiction of the United States"). The Supreme Court rejected federal jurisdiction over all cases involving the Fannie Mae, interpreting the inclusion of "in any court of competent jurisdiction" in the federal charter's sue-and-be-sued clause to permit lawsuits "in any state or federal court already endowed with subject-matter jurisdiction over the suit."

The circumstances of this case arose in 1999, when Beverly Ann Hollis-Arrington refinanced her mortgage with Cendant Mortgage Corporation ("Cendant"). As a part of the transaction, Fannie Mae purchased the mortgage from Cendant, but Cendant continued to service the loan. Unable to make her payments, the home ultimately entered foreclosure and was sold at a trustee's sale in 2001. Hollis-Arrington and her daughter, Chrystal Lightfoot, attempted to undo the foreclosure and sale with two unsuccessful federal lawsuits. Afterwards, Lightfoot and Hollis-Arrington filed this lawsuit in state court, alleging deficiencies in the refinancing, foreclosure, and sale of the home. Fannie Mae, relying on its sue-and-be-sued clause, removed the case to federal court based on 28 U.S.C. § 1441(a), which "permits a defendant to remove from state to federal court 'any civil action' over which the federal district courts 'have original jurisdiction.'" The district court dismissed the claims on claim preclusion grounds and entered final judgment. On appeal, the Ninth Circuit Court of Appeals initially affirmed the district court's decision without considering whether the district court had jurisdiction over the case under the sue-and-be-sued clause. After the issue was raised, the court of appeals withdrew its prior opinion. After a briefing by the parties, a divided panel affirmed the judgment of the district court. The majority based its decision on the ruling from *Red Cross*, concluding that the sue-and-be-sued clause in Fannie Mae's charter confers subject-matter jurisdiction because the clause specifically mentions the federal courts. The court of appeals held that "[w]hen federal charters, like those of the Red Cross and of Fan-

nie Mae, 'expressly authoriz[e] the organization to sue and be sued in federal courts . . . the provision extends beyond a mere grant of general corporate capacity to sue, and suffices to confer federal jurisdiction.'" *Lightfoot v. Cendant Mortg. Corp.*, 769 F.3d 681, 684 (9th Cir. 2014) (quoting *Red Cross*, 505 U.S. at 257).

In 2016 the Supreme Court granted certiorari to resolve a circuit split. Two circuit courts have concluded that the language in Fannie Mae's charter grants it party-based jurisdiction in federal court, while four circuit courts have disagreed.

Writing for a unanimous Supreme Court, Justice Sotomayor reviewed five previous Supreme Court cases considering the sue-and-be-sued clauses of other federally-chartered entities. In three of those cases, the clauses were held to grant jurisdiction, while two of the clauses were insufficient. The Court considered its most recent decision in *Red Cross*, where it noted that the previous decisions "support the rule that a congressional charter's 'sue and be sued' provision may be read to confer federal court jurisdiction if, but only if, it specifically mentions the federal courts." *Red Cross*, 505 U.S. at 255. The Court differentiated Fannie Mae's charter from the one in *Red Cross*, where the grant of party-based jurisdiction was held to be effective. Because the clause was not "'in all relevant respects identical' to a clause already held to grant federal jurisdiction[,] [the] case [could not] be resolved by a simple comparison." (quoting *Red Cross*, 505 U.S. at 257). Instead, "the outcome . . . turn[ed] on the meaning of 'court of competent jurisdiction' in Fannie Mae's sue-and-be-sued clause." *Id.* The Court considered a court of competent jurisdiction to be any court with an independent source of subject-matter jurisdiction. Therefore, unlike in *Red Cross*, the inclusion of "any court of competent jurisdiction" in Fannie Mae's charter operated "not to grant federal courts subject-matter jurisdiction over all cases involving Fannie Mae" but to "permit suit in any state or federal court already endowed with subject-matter jurisdiction over the suit."

The Supreme Court's decision in *Lightfoot* clarifies the *Red Cross* decision. The mention of "federal courts" does not automatically confer federal subject-matter jurisdiction in sue-and-be-sued clauses.

Additionally, after *Lightfoot*, Fannie Mae will be treated differently from "its sibling rival" – the Federal Home Loan Mortgage Corporation

("Freddie Mac"). Freddie Mac's charter shares the same sue-and-be-sued clause as the one found in *Red Cross* – meaning that it does have the party-based ability to remove cases to federal court, while Fannie Mae does not. Fannie Mae argued that "there is no good reason to think that Congress gave Freddie Mac fuller access to the federal courts than it has" because the entities serve nearly identical functions in the secondary mortgage market. However, the Court brushed aside this argument, noting that "the textual indications [suggest] Congress did just that" and that, when Freddie Mac's sue-or-be-sued provisions were enacted, it was still a government-owned corporation, and Fannie Mae was privately owned at the time. After *Lightfoot*, practitioners should be aware that Freddie Mac will have party-based federal subject-matter jurisdiction and Fannie Mae will not. This will result in fewer federal court cases involving Fannie Mae.

SECURED TRANSACTIONS

The Tennessee Court of Appeals held that the requirement for a commercially reasonable disposition found in Tennessee Code Annotated § 47-9-610 applies only once the secured party has actual or constructive possession of the collateral. *WM Capital Partners, LLC v. Thornton,* No. M2015–00328–COA–R3–CV, 2016 WL 7477738 (Tenn. Ct. App. Dec. 29, 2016).

By Kathryn Zimmerman

In *WM Capital Partners, LLC v. Thornton*, the Tennessee Court of Appeals addressed whether a two-year delay in repossession and sale of collateral by a secured creditor rendered the disposition commercially unreasonable.

The case involved several loans that Tennessee Commerce Bank (the "Bank") extended to Bowling Green Freight, Inc. ("Bowling Green Freight"), a trucking company owned and operated by Anthony and Elizabeth Thornton. As a part of these transactions, Bowling Green Freight granted the Bank a security interest in equipment. The Thorntons also guaranteed payment of the loans to the Bank. Bowling Green Freight defaulted on its loans to the Bank. At the end of multiple forbearance periods, Bowling Green Freight still could not make payments on the loans,

so Mr. Thornton asked the Bank to repossess the collateral. At that time, the value of the collateral exceeded the loan balance, but the Bank declined to repossess. On August 17, 2011, the Bank accelerated the loans. In January 2012, the Bank then filed suit against Bowling Green Freight and the Thorntons. On the same day, the Bank was placed into a receivership with the Federal Deposit Insurance Corporation ("FDIC"). Ultimately, the FDIC-receiver sold the loans involved to WM Capital Partners, LLC ("WMCP"), and the original case, which failed to include a claim against the Thorntons for breach of the guaranty, was dismissed without prejudice.

At some point, WMCP repossessed the collateral and sold it at auction on July 11, 2013, applying the proceeds to the principal owed. By that time, the equipment had depreciated, leaving WMCP undersecured. Thereafter, WMCP filed the present action against Bowling Green Freight and the Thorntons, seeking a deficiency judgment based on the Thornton's personal guarantees. The chancery court found that WMCP's disposition of the collateral was commercially reasonable, granted summary judgment in favor of WMCP, and ordered a deficiency judgment in the amount of $6,507,435.10.

On appeal, the Tennessee Court of Appeals considered "whether the delay between the date the Bank was first asked to repossess its collateral and the date of the auction of the collateral by WMCP rendered the disposition commercially unreasonable." The court considered the statutory requirements set forth in Tennessee's version of Article 9 of the Uniform Commercial Code. Under Tenn. Code Ann. § 47–9–601(A)(1), a secured creditor "[m]ay reduce a claim to judgment, foreclose, or otherwise enforce" its claim or security interest upon default. The court also noted that under Tenn. Code Ann § 47–9–609 "the secured creditor '[m]ay take possession' of any collateral after default." After taking possession, the secured creditor "has the option of proposing to accept the collateral in full or partial satisfaction of the debt or of disposing of the collateral." Under Tenn. Code Ann § 47–9–610(b), "[i]f the secured creditor chooses to dispose of the collateral, then '[e]very aspect of [the] disposition of collateral, including method, manner, time, place and other terms, must be commercially reasonable.'" The court of appeals indicated that under the "Rebuttable Presumption Rule . . . the secured party may be denied a de-

ficiency judgment" if it "fails to conduct a commercially reasonable disposition." Tenn. Code Ann. § 47–9–626(3), (4) (also citing U.C.C. § 9–626 cmt. 3 (2014)).

Bowling Green Freight and the Thorntons argued that the delay in auctioning the collateral was commercially unreasonable. In support of this interpretation, they cited two prior Tennessee Court of Appeals decisions, *Nationsbank v. Clegg,* 1996 Tenn. App. LEXIS 214 (Tenn. Ct. App. 1996), *overruled on other grounds by Auto Credit v. Wimmer*, 231 S.W.3d 896 (Tenn. 2007) and *R & J of Tenn., Inc. v. Blankenship-Melton Real Estate, Inc.*, 166 S.W.3d 195 (Tenn. Ct. App. 2004), *overruled on other grounds by Auto Credit v. Wimmer*, 231 S.W.3d 896 (Tenn. 2007). WMCP "agreed that '[the Bank's] refusal to accept the tender was commercially unreasonable and caused the value of the collateral to plummet due to inescapable depreciation of the equipment in question.'" However, WMCP argued that the Bank's refusal to repossess the collateral did not have to be commercially reasonable. Instead, WMCP insisted that the test of whether the Bank acted in a commercially reasonable manner applies only after the secured creditor accepts possession of the collateral, which it did not do until much later.

The Tennessee Court of Appeals agreed with WMCP. The court of appeals noted that "default engenders rights in the secured party, but these rights are optional." As such, it followed that "no particular sequence for the exercise of the secured party's rights is mandated." In holding that Tennessee's version of Article 9 does not require a secured creditor to repossess collateral after default at the request of the debtor, the court of appeals distinguished the present case from its prior decisions in *Nationsbank* and *R & J of Tenn., Inc.*, noting that the secured party had at least constructive possession of the collateral in both of those cases. The court of appeals held that the Bank did not have actual nor constructive possession of the collateral at the time Mr. Thornton requested repossession. The court went on to specify that "declining to repossess collateral does not, without more, amount to constructive possession." While the Bank gave Bowling Green Freight the instruction to continue using the collateral, the court of appeals indicated that this alone falls short of exercising the dominion or control necessary to form constructive possession.

However, the court held that WMCP failed to satisfy its burden of production on summary judgment because the record did not reveal the date on which WMCP came into possession of the collateral or indicate "any proof showing that the time between [possession] and disposition was commercially reasonable." Therefore, the court reversed the grant of summary judgment.

In light of this decision, transactional attorneys in Tennessee should be aware that secured creditors must act in a commercially reasonable manner with respect to dispositions of collateral only after they have taken actual or constructive possession. This makes the analysis of whether the creditor has exercised any level of control over the collateral critical for purposes of establishing when the creditor must begin to act in a commercially reasonable manner. Commercial reasonableness has no bearing on the effect of delaying possession, if, once the collateral is possessed, it is disposed of in a commercially reasonable manner.