

## CASE COMMENTARIES

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### CONTRACTS—INTERPRETING THE PARTIES' INTENT

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The Tennessee Court of Appeals held that the State's merger statute, Tenn. Code Ann. § 48-21-108, should not be applied to construe the terms of a contract when the parties expressed a contrary intention in the agreement. *Simmons Bank v. Vastland Dev. P'ship*, No. M2018-00347-COA-R3-CV, 2019 Tenn. App. LEXIS 321, at \*12–13 (June 27, 2019).

*Cal Burton*

The age-old contracts law question of when the parties' intentions in an agreement supersede the statutory law of a jurisdiction was considered again in the 2019 Tennessee Court of Appeals case *Simmons Bank v. Vastland Development Partnership*. In *Simmons Bank*, the Tennessee Court of Appeals examined whether provisions in Tennessee's merger statute should be applied to construe the terms of a renewal option when the parties expressed a contrary intention in their agreement. Under Tennessee Code Annotated § 48-21-108(a)(2), "When a merger becomes effective . . . every contract right possessed by, each corporation or eligible entity that is merged into the survivor shall be vested in the survivor without reversion or impairment." Tenn. Code Ann. § 48-21-108. Thus, any contract right held by a non-surviving entity is transferred "without reversion or impairment" to the surviving entity. Despite this statutory language, the Tennessee Court of Appeals held that § 48-21-108(a)(2) did not apply when "the parties to the contract expressed a contrary intention." *Simmons Bank*, 2019 Tenn. App. LEXIS 321, at \*12.

First State Bank ("First State") entered into a leasing agreement with Vastland Development Partnership ("Vastland") to lease office space in the Nashville area in 2003. The lease provided the following renewal option to First State:

**Provided** that as of the time of the giving of the First Extension Notice and the Commencement Date of the First Extension Term, (x) **Tenant is the Tenant originally named herein**, (y) Tenant actually occupies all of the Premises initially demised under this Lease and any space added to the Premises,

and (z) no Event of Default exists or would exist but for the passage of time or the giving of notice, or both; **then Tenant shall have the right to extend the Lease Term** for an additional term of five (5) years (such additional term is hereinafter called the “First Extension Term”) . . . . Adhering to the same above, the Tenant shall have the right to extend the Lease Term for an additional term of two (2) five (5) year options, hereinafter called the “Second Extension Term” and the “Third Extension Term.”

*Id.* at \*3 (emphasis added by the court). The lease’s default provision further stated that, “First State Bank would be in default if it was ‘dissolved or otherwise fail[ed] to maintain its legal existence,’ or upon ‘any assignment, subleasing, or other transfer of Tenant’s interest . . . except as otherwise permitted in [the] Lease.” *Id.*

First State exercised their first renewal option in May 2011, which extended the lease through August 17, 2016. During this extended period, First State merged with Simmons Bank (“Simmons”). The merger occurred in September of 2015, just shy of a year before the lease was set to expire. Simmons continued as the surviving entity, and First State ceased to exist separately. Simmons operated on the property throughout the duration of the lease and attempted to exercise the second renewal option on January 19, 2016. Vastland refused to renew the lease, stating that the renewal option was conditioned on the renewing tenant being “the Tenant originally named herein.” *Id.* at \*4. As First State was “the Tenant originally named” in the lease, Vastland maintained that Simmons had no right to exercise the second renewal option. *Id.* In response, Simmons filed suit against Vastland seeking injunctive and declaratory relief allowing them to exercise the second renewal option. Vastland responded with an answer and counterclaim pursuing declaratory and injunctive relief prohibiting Simmons from exercising the second renewal option, as well as a claim for unlawful detainer.

Following written discovery, Vastland motioned for summary judgment, arguing that Simmons could not exercise the second renewal option as they were “not the original tenant named in the Lease.” *Id.* at \*5. Further, Vastland argued that even if the court considered Simmons as the original tenant, that the default provision in the lease prevented the option from being exercised. According to Vastland, First Bank had entered default by, “[failing] to ‘maintain its legal existence,’ and [transferring] its interest to Simmons Bank by operation of law.” *Id.*

Simmons cross-motivated for summary judgment and relied on § 48-21-108(a)(2) to support their argument that the second renewal option could be exercised. Simmons made a purely statutory argument that, “every contract right, possessed by [First Bank] . . . vested in [Simmons] without reversion or impairment.” *See* Tenn. Code Ann. § 48-21-108(a)(2) (2012); *Simmons Bank*, 2019 Tenn. App. LEXIS 321, at \*5–6. Thus, First State’s contract rights were acquired by Simmons after the merger, and Simmons should be able to exercise the second renewal option as the original tenant of the lease. Additionally, Simmons argued that even though § 48-21-108(a)(1) stripped First State of its “separate existence,” that First State still legally existed within Simmons Bank. *Id.* at \*6. Further, as the lease’s default provision used the term “legal existence,” Simmons argued that First Bank did not default. *Id.*

The trial court ruled in Simmons’ favor, stating that: “First State bank continues to exist, not separately, but as a part of Simmons Bank.” *Id.* Further, the trial court held that, “the merger statute expressly provides for an automatic vesting of pre-existing contract rights in the surviving corporation, Simmons Bank.” *Id.* at \*7. The trial court found that the provisions of the merger statute, “should not be rendered surplusage by the general language of the Lease, particularly where . . . the result does not appear to disrupt any expressed intention of the parties regarding merger in the language of the lease.” *Id.* Put simply, the trial court held that the provisions of the merger statute applied regarding the second renewal option, as the lease itself did not express any contrary intention. Vastland then appealed the decision. However, the trial court found in favor of applying the merger statute because they did not think that the lease expressed any contrary intention. While Simmons won at the trial level, the foundational doctrine that a statute will be superseded by an agreement when the parties express a contrary intention remained and would be used by the Tennessee Court of Appeals to decide this case.

On appeal, the Tennessee Court of Appeals reversed the trial court’s decision. The Court began their analysis by turning to “[t]he cardinal rule of construction . . . that the court must give effect to ‘the intent of the contracting parties at the time of executing the agreement.’” *Id.* at \*8 (citing *Planters Gin Co. v. Fed. Compress & Warehouse Co.*, 78 S.W.3d 885 (Tenn. 2002)). Next, the Court applied a fundamental canon of contract interpretation, and relied on the plain meaning rule to ascertain the intent of the parties to the lease. Then, the Court cited to recent precedent from the Tennessee Supreme Court and reiterated that: “[O]ne of the bedrocks

of Tennessee law is that our courts are without power to make another and different contract from the one executed by the parties themselves.” *Simmons Bank*, 2019 Tenn. App. LEXIS 321 at \*9 (quoting *Eberbach v. Eberbach*, 535 S.W.3d 467, 468 (Tenn. 2017)). Further, the Court reiterated that absent fraud or mistake, contracts are interpreted and enforced as they are written. Rounding out their discussion of the applicable law, the Court stated that, “with a few exceptions, a statute is not applied to construe the contract when the parties to the contract express a contrary intention.” *Simmons Bank*, 2019 Tenn. App. LEXIS 321, at \*9. One notable exception to this principle is available where the parties’ intentions in the contract are against public policy.

Applying the principles stated above to the case at bar, the Court found in favor of Vastland. The Court held that the original parties to the lease expressed a contrary intention to Tennessee’s merger statute, stating:

The Lease does not state that “Tenant” may renew the Lease. To the contrary, the Lease contains a restrictive provision that expressly restricts the right of renewal to the “Tenant originally named herein,” which is a clear contractual declaration that the right of renewal was restricted to “First State Bank,” not its successors or assigns.

*Id.* at \*10–11. The Court read the above language in conjunction with a specific phrase in the lease’s default provision that triggered an event of default “when ‘there shall occur any assignment . . . or other transfer of Tenant’s interest . . . except as otherwise provided by this Lease,” and found that the original parties’ had intended to limit the right to exercise the lease’s renewal options to First State and not its successors. *Id.* at \*11.

The Court then addressed Simmons’ argument that § 48-21-108(a)(2) transferred First State’s contract rights to them through the merger. As they had foreshadowed in preceding statements, the Court disagreed with Simmons’ arguments, stating that they “failed to appreciate the significance of the parties’ agreement to restrict the right to renew the Lease to the “Tenant originally named herein.”” *Id.* at \*12. The Court found that this phrase provided a contrary intention to Tennessee’s merger statute, and thus, Simmons was prohibited from exercising the second renewal option. Additionally, the Court concluded that:

[R]egardless of whether the Lease was transferred to Simmons Bank by merger pursuant to Tenn. Code Ann. § 48-21-108(a)(2) “without reversion or impairment,” the parties agreed to restrict

the right to renew the lease to one entity, First State Bank, “the Tenant originally named” in the Lease. As a consequence, Simmons Bank does not have the right to exercise the renewal option.”

*Id.*

In *Simmons Bank*, the Tennessee Court of Appeals aligned themselves with those who prefer to examine the intent of the parties over those who prefer to apply broad statutory provisions in the interpretation of a contract. *Simmons Bank* provides a modern opinion that stands on the shoulders of the common law rather than blindly following the intent of the legislature. It reinforces the “[bedrock] of Tennessee law . . . that our courts are without power to make another and different contract from the one executed by the parties themselves.” *Eberbach*, 535 S.W.3d at 478. It continues to allow savvy drafters to elude the provisions of the Tennessee Code through clever language and crafty conditions. Some, like Simmons, may prefer that agreements conform to statutory provisions and be interpreted alongside them. But, as the Tennessee Court of Appeals held in *Simmons Bank*, the parties’ intentions will usurp any contradictory statutory provision, and are still the foundation for contractual interpretation.

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### FAMILY LAW—UNIFORM CHILD CUSTODY JURISDICTION AND ENFORCEMENT ACT

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**The Tennessee Court of Appeals held that exclusive, continuing jurisdiction does not exist when all parties presently reside outside of Tennessee and have not resided within the state in the previous six months.** *Hernandez v. Hernandez*, No. W2018-01388-COA-R3-CV, 2019 Tenn. App. LEXIS 371 (Ct. App. July 30, 2019).

*Shane Carey*

In *Hernandez v. Hernandez*, the Tennessee Court of Appeals determined whether a trial court erred by granting a motion to dismiss based on a lack of subject matter jurisdiction under the Uniform Child Custody Jurisdiction and Enforcement Act (“UCCJEA”). According to the UCCJEA, codified at Tenn. Code Ann. § 36-6-217(a), if a Tennessee court has made a child-custody determination, the court maintains jurisdiction unless a Tennessee court or court of another jurisdiction determines that

the child, child's parents, and any person acting as a parent do not currently reside in Tennessee and have not for the previous six months. Also, the court may not modify their original determination unless it has jurisdiction to make an initial determination under Tenn. Code Ann. § 36-6-216. For these reasons, the Court upheld a trial court's decision to grant a motion to dismiss based on a lack of subject matter jurisdiction.

The pertinent facts are as follows: David Alan Hernandez ("Father") and Amber Ada Hernandez ("Mother") married during 2005. The couple had one daughter ("Child") together before they ultimately divorced. It was undisputed that a permanent parenting plan was part of the divorce decree entered on October 26, 2006. The plan specified Mother as the primary residential parent and that Father was to receive co-parenting time each weekend. At the time of divorce, both parties lived in Tennessee. However, Father testified that he relocated to North Carolina in 2014, and Mother testified that she and Child relocated to Alabama at some time during 2015. In 2014, prior to moving to Alabama, Mother was the focus of a criminal investigation in Tennessee involving sexual contact with a minor.

As a result of Mother's criminal investigation, Father filed two petitions in the trial court on November 17, 2016. In the first petition, filed as a "Petition for Temporary Injunction," Father requested to have the Mother's visitation suspended, thus granting him emergency custody of Child. In the second petition, Father claimed that a material change in circumstances had occurred since the original parenting plan was entered in 2006. Father's grounds for both petitions were Mother's criminal investigation, and he alleged that Child was not in a safe environment due to the criminal nature of Mother's charges.

On the same day Father filed the two petitions in the trial court, Mother filed a motion to dismiss both petitions as well as an answer to the petition which sought a temporary injunction. As grounds for her motion to dismiss, Mother stated that the trial court lacked subject matter jurisdiction under the UCCJEA. Although Mother denied all other allegations within Father's petitions, she acknowledged that she was charged in a criminal case but was free on bond and planning to contest the charges against her. In response to Father's allegations that Child was not safe in Mother's care, Mother stated that while in Father's care, Child was placed in situations with a person listed on the Tennessee Sexual Offender Registry.

Following a non-evidentiary hearing regarding the “Petition for Temporary Injunction,” the trial court entered an “Order for Visitation” on December 5, 2016. Within this order, the trial court granted increased co-parenting time to Father, particularly over the holidays. In response to Father’s allegations of Child’s lack of safety, the trial court ordered that Mother’s co-parenting time should be supervised by Mother’s stepmother at all times. Similarly, in response to Mother’s allegations, the trial court ordered that the paternal grandmother must not be around Child unsupervised.

Although she had already filed a motion to dismiss Father’s second petition, Mother filed an answer to the second petition on December 28, 2016. Mother stated in her answer that a material change in circumstance had occurred since the original parenting plan from 2006 (similar to Father’s argument). However, Mother contended that a new plan was necessary since the parties lived a significant distance from one another. In 2017, Mother entered a guilty plea to aggravated statutory rape related to her previous criminal investigation. Subsequently, the parties participated in mediation with regards to the parenting plan but could not reach an agreement. Therefore, the trial court conducted a bench trial and ruled that Father’s second petition and Mother’s counter-petition should both be dismissed because the court did not have subject matter jurisdiction under the UCCJEA.

On July 27, 2018, Father timely appealed the trial court’s decision to the Tennessee Court of Appeals. Father presented three main arguments within his appeal. First, he claimed that the trial court had erred by dismissing on the grounds that the court lacked subject matter jurisdiction because Mother and Child did not live in Alabama for six months at the time the petition was filed. Second, Father argued that, in the event the trial court properly found that Mother and Child did live in Alabama for the statutory minimum of six months, then Mother’s behavior in leaving Tennessee was not justifiable because it was an attempt to avoid jurisdiction of Tennessee courts. Lastly, Father contended that even if the trial court *did* lose exclusive, continuing jurisdiction, the trial court exercised temporary emergency jurisdiction when it entered the “Order for Visitation” and therefore erred by failing to specify a timeframe in which he could obtain an order from an Alabama court.

The UCCJEA, as described in Tenn. Code Ann. § 36-6-217(a), states that when a Tennessee court has made a child-custody determination, the court maintains exclusive, continuing jurisdiction unless a Tennessee court

or court of another state determines that the child, child's parents, and any person acting as a parent do not currently reside in Tennessee. Moreover, a Tennessee court which has made a determination relating to child-custody and does *not* have exclusive, continuing jurisdiction may not modify that determination unless it has jurisdiction to make an initial child-custody determination under Tenn. Code Ann. § 36-6-216. To that regard, Tenn. Code Ann. § 36-6-216 states that, in order for a Tennessee court to make an initial child-custody determination, Tennessee must be the home state of the child on the date of the initial filing or must have been the home state within six months before the initial filing.

First, the Court rejected Father's contention that the trial court erred when it dismissed the modification petition based on a lack of subject matter jurisdiction. In support, the Court referenced several findings of fact from the trial court's ruling. The trial court found that neither the parents nor the Child lived in Tennessee when the petition was filed. Further, according to testimony at trial, none of the parties involved had lived in Tennessee during the previous six months. Thus, the Court stated that, pursuant to Tenn. Code Ann. § 36-6-217(a), the trial court no longer maintained exclusive, continuing jurisdiction and was not able to modify its own initial child-custody determination.

The Court also rejected Father's argument that Mother's behavior in leaving Tennessee was unjustifiable. Father made the argument that Mother was simply trying to avoid the jurisdiction of Tennessee courts by moving to Alabama. Additionally, Father cited Mother's trial testimony and suggested that Mother moved to Alabama as a result of her undergoing criminal investigation in Tennessee. The court disagreed, finding that Mother's behavior was *not* causally related and, by stating these facts in her testimony, Mother was simply trying to provide an accurate timeline rather than reasons for her decision to move to Alabama.

Lastly, the Court rejected Father's argument that the trial court exercised temporary emergency jurisdiction when it entered the December 2016 "Order for Visitation" and therefore erred when it did not provide a specific timeframe in which Father could obtain an order from an Alabama court before the temporary order expired. Based on this argument, Father believed that the December 2016 order remained valid. Upon review, the Court referenced Tenn. Code Ann. § 36-6-219, which states that a Tennessee court has temporary emergency jurisdiction if the child is present within Tennessee and it is necessary in an emergency to protect the child because the child is subjected to mistreatment or abuse. The



Court rejected Father's claim that his statements to the trial court regarding the safety of Child were specific enough to warrant the invocation of temporary emergency jurisdiction. In fact, the Court of Appeals stated that the trial court did not invoke such jurisdiction at any point in the December 2016 order because Child was not present in Tennessee at that time. Further, the Court stated that the trial court did not even mention Tenn. Code Ann. § 36-6-219 within the December 2016 order, and therefore could not have attempted to exercise temporary emergency jurisdiction.

As such, the Court held that (1) Tennessee did not maintain exclusive, continuing jurisdiction, (2) Mother's behavior when she moved to Alabama was not unjustifiable, and (3) the trial court did not invoke temporary emergency jurisdiction with regards to the December 2016 order. For these reasons, the Court ultimately found that the trial court did not err in dismissing the motion based on a lack of subject matter jurisdiction and thereby affirmed the trial court's ruling. However, the court made one distinction from the trial court's ruling by clarifying that the December 2016 order had no effect following the entry of the final order, which stated the trial court lacked exclusive, continuing jurisdiction. Thus, as the December 2016 modification order was no longer in effect, the original parenting plan order from 2006 remained valid until a court with proper jurisdiction modified the original determination.

Tennessee practitioners should be aware of the court's interpretation of the UCCJEA when determining the proper court for matters related to initial or modified child custody determinations.

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## LLCS—VALUATION OF MEMBERSHIP INTEREST IN LIMITED LIABILITY COMPANIES

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The Tennessee Court of Appeals held that, in the context of Tenn. Code Ann. § 48-249-505–506, (1) “fair value” is determined by the member’s proportionate interest in the company as a going concern, and is distinguished from “fair market value”, which consists of the price at which property would change hands between a willing buyer and a willing seller; (2) discounts for lack of control and marketability are not necessary for appraising a membership interest; and (3) tax affecting is relevant in assisting the court’s determination of the fair value of the going concern value of an S corporation. *Raley v. Brinkman*, No. M2018-02022-COA-R3-CV, 2020 Tenn. App. LEXIS 341 (Tenn. Ct. App. July 30, 2020).

*Issam Babour*

In *Raley v. Brinkman*, the Tennessee Court of Appeals addressed multiple issues including the meaning of the “fair value” of a membership interest in termination and purchase under Tenn. Code Ann. § 48-249-503(a). Under the statute, “if the existence and business of the LLC are continued following the termination of a membership interest under § 48-249-505(a) . . . regardless whether such termination of membership interest was wrongful, any member whose membership interest has so terminated . . . is entitled . . . to receive from the LLC the fair value of the terminated membership interest . . . calculated as set forth in § 48-249-506.” Tenn. Code Ann. § 48-249-505(c).

This case arose out of a business dispute between two members of a Tennessee limited liability company. Plaintiff Terrel Raley (“Raley”) and Defendant Cees Brinkman (“Brinkman”) opened the restaurant the Pharmacy Burger Parlor & Garden (“The Pharmacy”) under their joint venture, 4 Points Hospitality, LLC (“4 Points”). Brinkman owned Brinkman Holdings, LLC (“Brinkman Holdings”) separately from Raley. Brinkman Holdings and 4 Points entered into a lease agreement for the property which specified that Brinkman Holdings would provide the restaurant building and parking. Each member owned a 50% interest in 4 Points. 4 Points chose to be taxed as an S Corporation. The terms of the operation agreement required Raley to contribute \$30,000 in labor and Brinkman to contribute \$175,000 in cash with an even split of net profits. Raley was the managing member and oversaw the administrative duties

and day-to-day operations including payroll and profit disbursement. The parties disputed the terms of the salary agreement, as Raley alleged they agreed that he would receive up to eight percent of the gross sales and Brinkman would receive four percent, while Brinkman claimed Raley would receive eight percent gross sales and he would receive four percent gross sales with an additional four percent set aside for the development of other restaurants. By its fifth year, The Pharmacy had a gross income of around \$3.4 million. Raley opened another restaurant on his own, and the business relationship between Raley and Brinkman subsequently deteriorated due to allegations of breach of contract and misappropriation of funds.

Raley filed a complaint against Brinkman in February of 2016. Raley brought suit individually and on behalf of the LLC alleging, *inter alia*, that Brinkman breached the operating agreement by failing to contribute \$175,000 in capital. Brinkman asserted counterclaims for breach of contract and breach of fiduciary duty, alleging that Raley had misappropriated funds for personal use and that Raley had improperly withheld a portion of Brinkman's distributions and salary. Brinkman alleged conversion and sought punitive damages. Furthermore, Brinkman sought to terminate Raley's membership interest. The trial court ultimately found against Raley in breach of contract, breach of fiduciary duty, and conversion and against Brinkman for breach of contract. The trial court ruled that Brinkman had breached the operating agreement by failing to make a \$175,000 capital contribution; Raley was liable for breach of fiduciary duty, breach of contract, and conversion for underpaying Brinkman's distributions and salary and for using 4 Points' funds to satisfy unrelated, personal expenses; Raley was not liable for punitive damages because his conduct was not egregious; and Brinkman was not entitled to attorneys' fees. The trial court also terminated Raley's membership interest in 4 Points and calculated the value of Raley's membership interest. The trial court decided to exclude any testimony or evidence pretraining to discounts for marketability or lack of control. In addition, the court held that the application of a corporate income tax rate to 4 Point's stream of income was not appropriate. Brinkman delivered the first payment to buy out Raley's membership interest and appealed the decision.

The Court of Appeals first denied Raley's motion to dismiss the appeal after concluding that Brinkman had not waived his right to appeal. In an email, Brinkman's counsel clearly stated that a wire-transfer for the first payment was not to be construed as a waiver of Brinkman's issues

with respect to the trial court's valuation of Raley's membership interest or any of the other proceedings in the trial court.

The Court allowed Raley's membership interest to be terminated pursuant to Tenn. Code Ann. § 48-249-503(a)(6)(A) and (C), finding that Raley was engaging in wrongful conduct that adversely and materially affected the LLC's business and engaging in conduct relating to the LLC's business that makes it not reasonably practicable to carry on the business with the member.

The Court then considered the value of Raley's membership interest. The Court held that the membership interest should be determined at "fair value", and that "fair value" was distinct from "fair market value". However, the meaning of "fair value" was unclear due to the lack of definition provided in the operating agreement, LLC Act, and the general ambiguity surrounding the plain language of the term. The Court noted that the term did not have a commonly accepted meaning in ordinary usage or in the business industry, and that considering the meaning of "fair value" in the LLC Act was an issue of first impression. The Court attempted to ascertain the legislature's intent and ultimately found that "fair value" is determined based on the value of the business as a going concern and not the market price. The Court adopted the Delaware Supreme Court's definition of "fair value" as the shareholder's proportional interest in the business, valued as a going concern. The going concern value assumes the company will remain in business indefinitely and continue to be profitable.

The Court next addressed Brinkman's argument that discounts for lack of control and marketability should be applied to determine the value of Raley's membership interest. The Court held that the value appraisal was not simulating a pro forma sale. Rather, it assumed that the interest holder was willing to maintain his interest and to benefit from that interest. The Court reasoned that discounts for lack of control and marketability would be contrary to underlying principles of "fair value". Furthermore, these discounts were only pertinent to a valuation based on a theoretical sale to a third party, and in this case, the company itself was the one purchasing Raley's membership interest. The Court also noted that when valuing the entity in its entirety, courts and valuation experts account for the company's lack of marketability.

The Court next considered whether tax affecting was relevant for determining the "fair value" of Raley's membership interest. Pursuant to Tennessee Rule of Evidence 401 and Tenn. Code Ann. § 48-249-50, the

Court found that tax affecting was relevant for the trial court to determine the going-concern value of the membership interest. Under Tenn. Code. Ann. § 48-249-506, the recommendations of any of the appraisers of the parties to the proceeding constitutes relevant evidence of fair value. Additionally, the Court found it relevant that Brinkman's expert established tax-affecting is a generally accepted practice for determining the fair value of an S corporation.

The Court next held that contractual rights are not waivable. The Court reiterated that waiver applies primarily to conditions which may be thought of as procedural or technical, or to instances in which the non-occurrence of a condition is comparatively minor. The Court found that Brinkman's obligation to make a capital contribution of \$175,000 was a material part of the agreed exchange. As such, the obligation could not be waived by an act or omission of Raley.

Tennessee adheres to the American rule for attorney fees. In Tennessee, litigants are responsible for their own attorney fees unless a contractual or statutory provision create a right to recover attorney fees or some other exception applies. The Court recapitulated that in the context of contract interpretation an exception to the rule occurs only when a contract specifically or expressly provides for the recovery of attorney fees. Pursuant to Tenn. Code Ann. §§ 48-249-804 and -805, courts may award attorney fees. It is within the trial court's discretion whether to award attorney fees. Under Tenn. Code. Ann. §48-249-804(a), a court may require the plaintiff to pay the defendant's reasonable expenses, including attorneys' fees, incurred in defending the proceeding, if it finds that the proceeding was commenced without reasonable cause. A plaintiff acts without reasonable cause if the plaintiff's claims in the lawsuit are not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; or the plaintiff's allegations in the suit are not well grounded in fact after reasonable inquiry. Under Tenn. Code. Ann. §48-249-804(b), the court is given discretion in awarding attorney fees in derivative proceedings. Tenn. Code. Ann. §48-249-805 gives the trial court the discretion to award attorneys' fees and expenses in the event one of the members of the LLC violates a provision in the LLC Act.

Additionally, the Court refused to award punitive damages to Brinkman despite Raley's conduct, pursuant to T.C.A. § 48-249-505 which demonstrates that punitive discounts are not acceptable "regardless whether such termination of membership was wrongful". Punitive

damages are intended to punish the defendant. The Court noted that in order to recover punitive damages Birkman had to prove by “clear and convincing evidence that [Raley] acted intentionally, fraudulently, maliciously, or recklessly” and that his conduct was “egregious.” Raley, 2020 Tenn. App. LEXIS 341 at \*28.

This case clarifies the definition of “fair value” under Tennessee’s LLC Act. The Court differentiates between the significance of “fair value” versus “fair market value”. Tennessee’s LLC Act was first enacted in 1994 and there appears to be no other applicable rulings providing “fair value” clarification. The precedent set is an important one for transactional attorneys and their clients. In the state of Tennessee, there are more active LLCs than all other business entities combined. If a dispute were to result in the termination of an LLC membership, attorneys and their clients may find some clarity from this case in how termination will affect their LLC’s valuation. Attorneys would also be well served by explaining to their clients that post-judgement interest accrues from the day a verdict is returned. This is true regardless of any motion for new trial or pending appeal. The Court recognized that parties can comply with judgements while still preserving their right to appeal the decision.

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### ARBITRATION—CHALLENGING A DELEGATION PROVISION

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**The Tennessee Court of Appeals held that a delegation provision within a mandatory arbitration clause may not be enforced if the validity of the clause is challenged with sufficient specificity.** *Gibbs v. Capital Resorts Grp., LLC*, No. E2019-00295-COA-R3-CV, 2020 Tenn. App. LEXIS 78 (Ct. App. Feb. 24, 2020).

*Jonathan Russell*

In *Gibbs v. Capital Resorts Grp., LLC*, the Tennessee Court of Appeals addressed whether a delegation provision requiring the parties to submit the issue of arbitrability to an arbitrator instead of the courts was specifically challenged by the Plaintiff’s, Brenda Gibbs (“Plaintiff”), claim of fraudulent inducement. When parties agree to arbitrate the issue of arbitrability through a delegation clause, the Plaintiff must challenge the validity of the delegation clause specifically, not just the validity of the contract as a whole. Upon review, the Court of Appeals found that even

though the Plaintiff only challenged the validity of a paragraph of the agreement containing the mandatory arbitration and delegation agreements, it was sufficient to satisfy the specificity requirement for a delegation clause challenge given the lack of clarity in the agreement itself.

In August of 2018, Plaintiff entered into the “Capital Resorts Club Purchase Agreement” (the “Contract”) with Capital Resorts Group, LLC (“Defendants”) through its sales representative to purchase a timeshare. Paragraph thirty-eight of the contract included a mandatory arbitration provision. The provision required the parties to participate in at least three hours of mandatory mediation prior to filing a lawsuit. Additionally, the mandatory arbitration clause contained the following provision: “Disputes under this clause shall be resolved by arbitration in accordance with Title [Nine] of the US Code (United States Arbitration Act) and the Commercial Arbitration Rules of the American Arbitration Association.” *Id.* at \*4.

On October 19, 2018, Plaintiff filed a complaint against Defendants alleging fraudulent inducement. Plaintiff claimed she “intended to sell her interest in a Capital Resorts timeshare due to financial concerns and the rising cost of maintenance fees,” and that Defendants offered to place her timeshare on the sales “Marketplace.” *Id.* Defendants told Plaintiff “she should act quickly and that [Defendants] needed to file the documents that day.” *Id.* Defendants presented Plaintiff with documents for her signature and did not give her sufficient time to read the documents. While Plaintiff believed she was selling her existing timeshare, the documents she signed actually “traded her existing timeshare as an ‘equity credit’ toward the purchase of another timeshare.” *Id.* at \*7. Plaintiff alleged that when she discovered she had agreed to purchase another timeshare, she attempted to meet with Defendants during the statutorily prescribed ten-day recession period, but the representative refused to meet with her.

Defendants filed a Motion to Dismiss and Compel Mediation and Arbitration, arguing that the arbitration provision of the Contract was “valid, irrevocable, and enforceable.” *Id.* at \*8. According to Defendants, due to the agreement’s reference to the Commercial Arbitration Rules of the American Arbitration Association, which require the arbitrator determine the validity and enforceability of the arbitration agreement, the court should not determine the validity. Defendants further asserted that Plaintiff had not “specifically challenged the delegation provision of the arbitration agreement.” *Id.* at \*9. Plaintiff filed an amended complaint alleging that Defendants made false and material representations and

“[t]hese representations specifically induced Plaintiff to enter into the ‘Mandatory Arbitration’ clause at paragraph [thirty-eight] of the Contract.” *Id.* at \*11. The trial court denied Defendants’ motion to compel arbitration finding the amended pleading sufficiently challenged the arbitration provision.

On appeal, the Court of Appeals affirmed the trial court’s ruling that Plaintiff had plead with sufficient specificity regarding the mandatory arbitration clause and the delegation provision, citing multiple decisions of the United States Supreme Court.<sup>1</sup> According to the Supreme Court’s ruling in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, a claim of fraud in the inducement regarding the arbitration clause itself may be heard in court, but courts may not consider “claims of fraud in the inducement of the contract generally” where there is a clause delegating the issue of arbitrability. 388 U.S. 395, 403–04 (1967). The Supreme Court ruled the plaintiff had challenged the contract as a whole and not the arbitration agreement, therefore the arbitration agreement remained valid.

The Court of Appeals cited *Rent-A-Ctr., W., Inc. v. Jackson*, in which the Supreme Court enforced a delegation provision in the arbitration agreement because the plaintiff had not challenged the delegation provision specifically. 561 U.S. 63, 71–72 (2010). Additionally, the Court of Appeals cited the Supreme Court’s holding in *Buckeye Check Cashing, Inc. v. Cardegna*, which affirmed that a challenge to the validity of the contract as a whole, and not specifically the arbitration clause, cannot be heard by the court and must go to the arbitrator. 546 U.S. 440, 449 (2006).

In the present case, the Court of Appeals held Plaintiff had sufficiently challenged the delegation clause of the arbitration agreement with specificity. The Court noted that Plaintiff’s amended complaint alleging fraudulent representations induced her into signing the Contract, and “these representations specifically induced Plaintiff to enter into the ‘Mandatory Arbitration’ clause at paragraph [thirty-eight] of the Contract.” *Gibbs*, 2020 Tenn. App. LEXIS 78 at \*23. Defendants argued that paragraph thirty-eight contained the delegation clause, but that the complaint only mentioned the general paragraph and failed to mention the delegation clause. However, the Court rejected Defendants’ argument because the lack of clarity and specificity within Plaintiff’s allegation was

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<sup>1</sup> On appeal, Plaintiff raised the issue of whether the Court of Appeals had subject matter jurisdiction under the Tennessee Uniform Arbitration Act, but the Court quickly resolved this issue pursuant to T.C.A. § 29-5-319 which gives jurisdiction to hear appeals from denials of motions to compel arbitration. *Id.* at 15.



a result of the clause itself. The delegation provision was buried in a long paragraph, and the Court held it was “incredibly unclear that this clause is an agreement to delegate arbitrability issues to an arbitrator.” *Id.* at \*23. Therefore, the specificity in Plaintiff’s challenge to the provision was limited by the vagueness of the provision itself.

The Court did acknowledge Defendants’ argument that the parties had agreed to adopt the American Arbitration Association’s rules which “provide for arbitration of the issue of arbitrability.” *Id.* at \*24. The Court also reasoned that the adoption of these rules could be proof that the parties agreed to delegate the issue of arbitrability to an arbitrator. However, in this case, Plaintiff was not provided with a copy of the rules. Also, the agreement used unclear language by referencing “disputes under this clause” but not explicitly stating that “this clause” referred to the issue of arbitrability and that those issues would be delegated to an arbitrator. *Id.* at \*28. Thus, Plaintiff could not be expected to challenge the agreement with more specificity due to the lack of clarity within the language of the agreement itself.

The Court of Appeals distinguished this holding from the Supreme Court’s holding in *Rent-A-Ctr.* In *Rent-A-Ctr.*, the Supreme Court found the plaintiff had not specifically challenged the delegation provision because the contract contained a separated delegation provision within the arbitration agreement and the plaintiff had only challenged the contract as a whole, not the specific delegation provision. *Id.* at \*27 (citing *Rent-A-Ctr.*, 561 U.S. at 71–72). However, according to the Court in the present case, “Defendants choose to bury the delegation clause in paragraph [thirty-eight] concerning the arbitration agreement, and they must deal with the repercussions of their action.” *Id.* at \*28. Because the clause was unclear and buried in the agreement, Plaintiff could not be expected to challenge the provision with greater specificity.

Ultimately, the Court of Appeals decided Plaintiff had sufficiently and specifically challenged the delegation provision in the mandatory arbitration clause because the provision was unclear on the issue it was delegating, it was buried within a long paragraph, and Defendants did not provide a copy of the rules it was attempting to enforce. Thus, Plaintiff’s challenge to the paragraph as a whole, without specifically mentioning the delegation clause, was appropriately specific and the trial court did not err in denying Defendants’ motion to compel arbitration.

In light of this holding, transactional attorneys in Tennessee should ensure clarity when drafting arbitration agreements, particularly in drafting

delegation clauses. First, validity concerns should be resolved at the time of contracting. Additionally, parties should be given time to thoroughly read the documents. If the agreement references external rules such as the American Arbitration Association's rules, provide a copy of those rules with the contract. Further, in anticipating challenges to the validity of drafted arbitration agreements, separate the provisions of the arbitration agreement into sections, so that if a specific arbitration issue is in question, particularly the issue of delegation, the court uses lack of clarity as a factor in refusing to enforce the provision.

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### BANKRUPTCY—CREDITOR'S MOTION FOR RELIEF FROM AN AUTOMATIC STAY

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**The Supreme Court of the United States held that a bankruptcy court order resolving a creditor's motion for relief from an automatic stay is a distinct proceeding, final and immediately appealable.** *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582 (2020).

*Jonathan Davis*

In *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, the Supreme Court of the United States addressed whether denial of a creditor's motion for relief from an automatic stay is a distinct proceeding, final and immediately appealable upon the ruling of a bankruptcy court. Typically, as understood within civil proceedings, a final court order is one that resolves an entire case. However, bankruptcy cases are different in that they often involve multiple resolutions that might resemble independent cases outside the context of bankruptcy. *Ritzen Grp., Inc. v. Jackson Masonry, LLC*, 140 S. Ct. 582, 586 (2020) (citing *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015)). This is an important distinction between bankruptcy and civil cases because the designation of an order as final can affect when and how it can be appealed. 28 U.S.C. § 158(c)(2) and the Federal Rules of Bankruptcy Procedure 8002(a) allow fourteen days for a party to appeal a final order from a bankruptcy court. The Supreme Court held that a bankruptcy court order denying a creditor's motion for relief from an automatic stay is a distinct proceeding, final and immediately appealable. The primary ramification of this holding is that creditors hoping to appeal an order denying relief from an automatic stay must do so within 14 days of the

order to prevent being barred from pursuing claims outside of the bankruptcy forum.

Ritzen Group, Inc. (“Ritzen”) contracted to buy land in Nashville, Tennessee from Jackson Masonry, LLC (“Jackson”). The sale never happened and Ritzen sued for a breach of contract in Tennessee state court. The breach-of-contract case lasted for over a year, and days before trial Jackson filed for Chapter 11 bankruptcy. 11 U.S.C. 362(a) states that filing for Chapter 11 bankruptcy acts as an automatic stay. An automatic stay requires all claims against a debtor to be resolved within the bankruptcy forum.

In the Federal Bankruptcy Court, Ritzen filed a motion for relief from the stay which would allow it to resume claims against Jackson in Tennessee state court. Ritzen argued that “relief would promote judicial economy and that Jackson had filed for bankruptcy in bad faith.” *Id.* at 587. However, the Bankruptcy Court denied the motion for relief and instead of appealing the court’s order, Ritzen sought a proof of claim against Jackson’s bankruptcy estate based on the initial breach-of-contract claim. The court found for Jackson and dismissed the claim. Without objection, the Bankruptcy Court then confirmed Jackson’s reorganization plan, permanently preventing new or continued proceedings brought by creditors outside of the forum of bankruptcy.

Ritzen filed notices of appeal in the Middle District of Tennessee for both denial of relief from the automatic stay and the initial breach-of-contract claim. The District Court held that the appeal for relief from the automatic stay was made outside of the 14-day period allowed for “final orders” under 28 U.S.C. § 158(c)(2) and the Federal Rules of Bankruptcy Procedure 8002(a). *Id.* The District Court held that Ritzen would have had to appeal within fourteen days of the Bankruptcy Court’s order denying relief from the automatic stay. It also ruled against Ritzen on the merits of the breach-of-contract claim.

Ritzen then appealed to the Court of Appeals for the Sixth Circuit. The Court affirmed each of the District Court’s dispositions, holding that “[a]djudication of Ritzen’s motion for relief from the automatic stay qualified as a discrete ‘proceeding,’ commencing with the filing of the motion, followed by procedural steps, and culminating in a [dispositive] decision based on the application of a legal standard.” *Id.* (quoting *In re Jackson Masonry, LLC*, 906 F.3d 494, 499–500 (2018)). Therefore, under 28 U.S.C. § 158(c)(2) and the Federal Rules of Bankruptcy Procedure 8002(a), Ritzen had 14 days to appeal, starting with the denial of its motion for

relief. In agreement with the Middle District of Tennessee, the Court of Appeals held that Ritzen's appeal was untimely.

The Supreme Court of the United States then granted certiorari to resolve whether a creditor's motion for relief from an automatic stay is a distinct proceeding, final and immediately appealable upon the ruling of a bankruptcy court. The Court first reviewed "finality" by recalling *Bullard v. Blue Hills Bank*, 575 U.S. 496 (2015), a previous Supreme Court case. *Id.* at 558. In *Bullard*, the Court held that an order rejecting a bankruptcy payment plan proposal was not final because the process of creating a bankruptcy payment plan typically "involves back and forth negotiations." *Id.* In contrast to payment plan proposals that typically involve "back and forth negotiations," most circuits treat a denial for relief of stay as "final, immediately appealable decisions." *Id.* at 589.

Ritzen claimed that an order denying relief from an automatic stay is simply a small step towards resolving a creditor's claims within the bankruptcy case, while Jackson argued that it is a "distinct proceeding." *Id.* However, the Court agreed with the Sixth Circuit and Jackson, the resolution of a motion for relief from an automatic stay is "an independent 'proceeding' within the meaning of 28 U.S.C. § 158(a)." *Id.*

The Court reasoned that there is an entirely separate process for determining whether a creditor may obtain relief from an automatic stay. Often, this process is even governed by state law. Further, separate sections of the United States Code, while not directly applicable to the issue at hand, reference motions relating to automatic stays as "core proceedings," an indication of congress's intent. *Id.*; 28 U.S.C. §§ 157(b)(2)(G), 158(a).

Ritzen argued that if the Court were to adopt Jackson's view, it would be dividing the case into too many parts. Further, Ritzen argued that its motion would ultimately decide the forum for the case, making it merely one step in the resolution of its claims against Jackson. The Court agreed that a bankruptcy case should not be divided into too many parts, but the issue was already addressed in *Bullard*. The Court found that "[t]he concept of finality cannot stretch to cover, for example, an order resolving a disputed request for an extension of time." *Id.* (citing *Bullard*, 575 U.S. at 496). However, the Court also pointed out that Ritzen underestimated the impact of a motion for relief from an automatic stay, finding that it is not merely one step in the resolution of its claims. The denial of such a motion impacts not only the claims of the creditor but also the resolution of claims by other parties against the debtor.

The fact that the motion will determine the forum for the case is also not persuasive in determining the finality of a ruling on the motion. Orders denying use of a forum, such as one denying personal jurisdiction, are final.

Additionally, some parties file a motion for relief from an automatic stay without the ability to pursue claims outside of the bankruptcy forum. Therefore, the reason for filing the motion does not always concern forum. The Court noted that “motions for stay relief may, for example, seek permission to repossess or liquidate collateral, to terminate a lease, or to set off debts.” *Id.* at 591. The Court concluded that there would be “no good reason to treat stay adjudication as the relevant ‘proceeding’ in only a subset of cases.” *Id.*

Ritzen then argued that the order should not be treated as final based on its allegation that Jackson filed for bankruptcy in bad faith. Therefore, the bankruptcy court’s decision “turns on a substantive issue that may be raised later in the litigation.” *Id.* However, the Court found that “[U.S.C.] [s]ection 158(a) asks whether the order in question terminates a procedural unit separate from the remaining case, not whether the bankruptcy court has preclusively resolved a substantive issue.” *Id.*

Finally, Ritzen argued that dividing bankruptcy cases into different parts is inefficient. However, the Court disagreed, holding that “[c]lassifying as final all orders conclusively resolving stay-relief motions will avoid, rather than cause, ‘delays and inefficiencies.’” *Id.* (citing *Bullard*, 575 U.S. at 504). The Court pointed out that the present case is actually indicative of inefficiencies that could result if appeals were not required to be brought soon after a motion for relief of an automatic stay was rejected. Each party has engaged in extensive litigation, Jackson’s reorganization plan has been finalized, and “Ritzen seeks to return to square one . . . to relitigate the opposing contract claims in state court.” *Id.*

Ultimately, the United States Supreme Court unanimously affirmed the decisions of both the Middle District of Tennessee and the Court of Appeals for the Sixth Circuit. The Court held that a bankruptcy court order denying a creditor’s motion for relief from an automatic stay is a distinct proceeding, final and immediately appealable.

The primary ramification of this holding is that upon denial of a motion for relief from an automatic stay, creditors should immediately appeal if warranted. Creditors will have 14 days from the time of a bankruptcy court’s order denying relief from an automatic stay. Failure to

appeal an order denying relief from an automatic stay is will ensure that a creditor will be limited to pursuing claims within the forum of bankruptcy.

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### COVENANTS—WHEN A SUCCESSOR CAN MODIFY A RESTRICTIVE COVENANT

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**The Arizona Court of Appeals held that a successor to a declarant of a deed cannot modify a restrictive covenant that requires the operating of a golf course.** *Swain v. Bixby Village Golf Course, Inc.*, 450 P.3d 270 (Ariz. Ct. App. 2019).

*Robert Fristche*

The Arizona Court of Appeals affirmed both (1) the trial court’s judgment that defendant TTLC Ahwatukee Lakes Investors, LLC (“TTLC”) (a) was not entitled to modify the declarant’s deed, (b) had breached the Conditions, Covenants, and Restrictions (CCRs), and (c) had breached the implied covenant of good faith and fair dealing; and (2) the grant of the injunction. The Court of Appeals focused its discussion on the interpretation of the 1992 deed restriction, the modification of the declaration, and the granting of the permanent injunction. The Plaintiffs, Linda W. Swain and Eileen T. Breslin (“Plaintiffs”), own property that borders or features the Lakes Golf Course. Defendant, TTLC (“TTLC”), was an investment company that bought the Lakes Golf Course Property from Defendant, Bixby Village Golf Course Inc., (“Bixby”), in 2015, intending to convert it into a residential community.

The Declarant, Chicago Title Agency of Arizona, Inc. (“Declarant”), is the original owner of the Lakes Golf Course and the Country Club Golf Course. In November 1992, the Declarant recorded a Declaration of Covenants, Conditions, Restrictions and Easements (“CC&R”) covering both golf courses for mutual benefit of the “Declarant and all present and future owners” and “any owner of property located within the Ahwatukee master planned community”—the “Benefitted Persons.” *Swain*, 450 P.3d at 272. Through this transaction, the Declarant intended to comply with requirements of the covenants to gain the benefits of Arizona Revised Statute § 42-146. Bixby purchased the golf courses in June 2006 and subsequently leased them to Ahwatukee Golf Properties, LLC (“AGP”), a limited liability company owned by Bixby’s president and

his wife. Included in the lease was a provision that AGP operate the golf courses. Despite attempting to restore the golf course, Bixby later closed and dismantled the Lakes Golf Course, placed a barbed wire fence around it, and discontinued certain maintenance procedures; leaving the property behind the homes “a dead, desolate ‘wasteland’” in Swain’s opinion. *Id.* at 274. Bixby then entered into a contract to sell the Lakes Golf Course to TTLC in May 2015. TTLC intended to convert the property into a residential community and acknowledged that it was aware Bixby had stopped using the property as a golf course and that litigation was pending.

The trial court granted the motion to dismiss all claims against Bixby without prejudice. The Plaintiffs then amended their complaint to name TTLC as the defendant and to add claims for injunctive relief, breach of contract, and breach of the covenant of good faith and fair dealing. The trial court denied TTLC’s motion for summary judgment and granted Plaintiffs’ cross motion, finding “that the Declaration requires the operation of a golf course for the benefit of those the Declaration described as benefitted persons and that the covenant did not violate the Thirteenth Amendment.” *Id.* at 273. Finally, the trial court declared that TTLC was not entitled to modify the covenant, and that it had breached both the CC&Rs and the implied covenant of good faith and fair dealing. TTLC appealed the final judgment, and the Court of Appeals reviewed de novo the trial court’s grant of summary judgment and the interpretation of restrictive covenants and other covenants.

In its decision, the Court of Appeals first addressed the construction of restrictive covenants. This was not a novel issue of law for the Arizona Court of Appeals, as earlier decisions prior to *Powell* stated that restrictive covenants must be strictly construed in favor of free use of the land and against any restriction, but this is not the case after *Powell*. *Powell*, 125 P.3d 373, 376 (Ariz. 2006). The Court noted that *Powell v. Washburn* established that restrictive covenants in Arizona should be construed “to give effect to the intentions of the parties ascertained from the language used in the instrument, or the circumstances surrounding creation of the servitude, and to carry out the purpose for which it was created.” *Powell v. Washburn*, 125 P.3d 373, 376-77 (Ariz. 2006) (quoting Restatement (third) of Property § 4.1(1)).

Applying the *Powell* holding to the facts of this case, the Court of Appeals asserted that the covenant in question was intended to require the continuous operation of a golf course on the property, and thus TTLC could not continue to remain idle and leave the property barren. A golf

course was an important amenity for the homeowners, and the restriction in the covenant providing for the operation of a golf course was intentionally included in the CC&Rs in 1992 to benefit homeowners. These CC&Rs and the implied covenant of good faith and fair dealing required that TTLC “not impair the rights of the others to receive the benefit of a golf course in the community per the agreement.” *Swain*, 450 P.3d at 275. The Court recognized that the agreement had two equally important purposes: first, to maintain the property so that it qualified under A.R.S. §§ 42-125.01; and second, to protect the benefitted persons’ interest in living next to or having views of a golf course. Thus, the Court decided not to construe the covenant in TTLC’s favor as such a determination would impair the rights of the plaintiff homeowners. The Court of Appeals rejected TTLC’s construction of the covenant as an inequitable solution after finding that a deteriorating greenway did not have the same value to homeowners as a golf course.

The Court of Appeals next addressed whether TTLC had the contractual right to make a modification of the covenant because TTLC argued that a material change in the conditions or circumstances had occurred. TTLC asserted that *Tierra Ranchos Homeowners Ass’n v. Kitchukov*, should apply to this case, but the Court distinguished the facts in the present case from *Tierra* by noting that there was a clear difference in the status and authority of the parties attempting to modify the covenant. *See Tierra Ranchos Homeowners Ass’n v. Kitchukov*, 216 Ariz. 195, 165 P.3d 173 (App. 2007).

The Court of Appeals rejected TTLC’s argument that the terms of the contract gave TTLC unfettered discretion to determine whether a material change in conditions or circumstances had occurred. The holding of *Tierra* did not govern this contract because the *Tierra* case involved a CC&R that specifically gave a party to the original covenant, the community association, the sole and absolute discretion to determine whether modification of property within the community was appropriate. *Swain*, 450 P.3d at 277 (citing *Tierra*, 216 Ariz. at 197). In contrast, TTLC was not an original party to the CC&Rs and attempted to modify the covenant itself, not property subject to a covenant. Thus, it was clear to the Court that the community association in *Tierra* had sole and absolute discretion to determine whether a modification violated or satisfied the Declaration’s guidelines, while TTLC did not possess that sole discretion for modification and declaration under the terms of its CC&Rs.



The Court held that in order to allow TTLC to modify the covenant, TTLC must prove that the redevelopment of a golf course was so economically unstable that it justified a material change so fundamental or radical that it defeated the covenant's purpose. *Swain*, 450 P.3d at 277. Before considering the evidence in support of material change, the Court also rejected the argument that TTLC could rely on unprofitability to prove material change, as those economic conditions were known to TTLC at the time of the purchase. Both the Plaintiffs and TTLC had presented evidence regarding whether the redevelopment of the golf course was economically feasible; however, the trial court found that the Plaintiffs' experts' assertion that the development was not only economically feasible but also likely profitable was more persuasive. Therefore, the Court of Appeals accepted the trial court's determination, holding that the necessary redevelopment of the golf course did not constitute a material change.

The third issue on appeal dealt with the trial court's granting a permanent injunction. The Court of Appeals found that *Flying Diamond Airpark, LLC v. Meienberg* was relevant to whether the injunction was appropriate in determining "whether a covenant should be enforced depends on equitable considerations" through the weighing of factors "such as the parties' relative hardships, the parties' misconduct, public interest, and adequacy of other remedies." 156 P.3d 1149, 1152 (Ariz. Ct. App. 2007). The Court of Appeals also addressed TTLC's argument that an injunction in this case would violate the 13<sup>th</sup> amendment of the United States Constitution by citing *Butler v. Perry* with respect to involuntary servitude. *See* 240 U.S. 328, 322 (1916).

The Court of Appeals applied the equitable considerations factors from *Flying Diamond Airpark* and determined that the trial court did not err in its determination that an injunction was appropriate. The evidence demonstrated that the Plaintiffs would continue to suffer considerable hardship if the injunction was denied, as the Plaintiffs relied on the fact that the owners of the Lakes Golf Course property would continue to maintain and operate it as a golf course. A golf course in close proximity to their property provided certain benefits to the Plaintiffs, and if the injunction was not granted, the Plaintiffs would instead be forced to suffer the hardship of living next to a now fenced-off "stench-filled wasteland." *Swain*, 450 P.3d at 278. TTLC's hardship in comparison was a minor and merely economic struggle. The Court of Appeals particularly noted that beyond the fact that TTLC had failed to prove economic hardship, the

court in *Shalimar Ass'n v. D.O.C. Enters., Ltd.* held that “economic hardship alone cannot serve as a basis for abrogating a restrictive covenant and rendering its enforcement inequitable.” 688 P.2d 682, 691 (Ariz. Ct. App. 1984).

In conclusion, The Court of Appeals did not permit TTLC to avoid its restrictive covenant because this was the exact risk it had bargained for in the transaction. Throughout the proceedings, there was no doubt TTLC knew that a lawsuit might prevent it from converting the golf course property to a retirement community. Thus, given the trial court’s emphasis on seeking an equitable solution and TTLC’s failure to provide adequate evidence that the circumstances for the redevelopment of a golf course were enough to warrant materially changing the declaration and covenants, the Court of Appeals affirmed the trial court’s ruling.

This particular case will likely impact attempts to modify restrictive covenants in Arizona as the Arizona Court of Appeals clearly disfavored TTLC’s argument that economic hardship warrants modification of an agreement. A defendant who did not have the same level of knowledge as TTLC, or one with far stronger evidence demonstrating economic hardship, may be able to escape such a restrictive covenant, but this case should serve as a warning to parties who try to do so. The terms of the declaration were clear in this case, and as successor owner, TTLC needed to comply with the restrictive covenants that established that the property should be operated as a golf course.

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## BANKRUPTCY—INTERNATIONAL COMITY

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The United States District Court for the Southern District of New York held that dismissal on the grounds of international comity is particularly appropriate when the claim is based on foreign bankruptcy proceedings, so long as affording comity does not violate fundamental standards of procedural fairness or violate any laws or public policies of the United States. *EMA GARP Fund v. Banro Corp.*, No. 18 Civ. 1986 (S.D.N.Y. Feb. 21, 2019).

*Andrew Gaither*

In *EMA GARP Fund v. Banro Corp.*, the Southern District of New York (“S.D.N.Y.”) addressed whether it was appropriate to dismiss EMA GARP Fund’s (“EMA”) claims alleging securities fraud against Banro Corporation (“Banro”) and Banro’s CEO, John Clarke (“Clarke”), based on the grounds of international comity for Canada’s bankruptcy proceedings. Banro is a corporation headquartered and incorporated in Canada. Under established Second Circuit precedent it is appropriate for U.S. courts to afford deference to foreign courts when the claims at issue are part of parallel bankruptcy proceeding. *Royal & Sun Alliance Ins. Co. of Can. v. Century Int’l Arms, Inc.*, 466 F.3d 88, 92–93 (2d Cir. 2006). Even though comity is particularly appropriate for foreign bankruptcy proceedings, the Court must first perform a multi-factor analysis to determine whether the foreign court’s bankruptcy proceedings satisfies “fundamental concepts of procedural fairness.” If the court finds that the foreign court’s proceedings do satisfy the “fundamental concepts of procedural fairness”, the court should then determine “whether affording comity would ‘violate any laws or public policies of the United States’”. *Allstate Life Ins. Co. v. Linger Group Ltd.*, 994 F.2d 996, 1000 (2d Cir. 1993). The S.D.N.Y. held that dismissal of EMA’s claims against both Clarke and Banro on the basis of international comity was appropriate, because the proceedings satisfied fundamental standards of procedural fairness and did not violate United States law or policy.

On December 22, 2017, Banro began reorganization proceedings pursuant to Canada’s Companies’ Creditors Arrangement Act, R.S.C. 1985, c. C-36 (“Banro CCAA Proceeding”). The CCAA court issued a bar date deadline of March 6, 2018, by which all claimants must have filed claims with the court. The CCAA court did not receive any claims from

EMA by the bar date. EMA conceded that it was aware of the Banro CCAA Proceedings and deadlines. On March 5, 2018, EMA decided to file suit in the S.D.N.Y. rather than participate in the CCAA proceedings. On March 27, 2018, the CCAA court approved Banro's reorganization plan and issued the Sanction Order, releasing all equity claims against Banro and its directors, including those of EMA. The CCAA court barred EMA's claim against Clarke because of "non-compliance with the Claims Procedure Order." On May 18, 2018, Banro and Clarke moved to dismiss the claims pending in the S.D.N.Y. based on grounds of international comity.

The Court began by acknowledging that in the Second Circuit dismissal of actions based on international comity for bankruptcy cases is particularly appropriate under *Allstate Life Insurance Company v. Linger Group Limited*, 994 F.2d 996 (2d Cir. 1993). The court assessed whether the Banro CCAA Proceeding satisfied fundamental standards of procedural fairness applying the eight factor *Allstate* test. The eight factors to consider are:

- (1) Whether creditors of the same class are treated equally in the distribution of assets;
- (2) whether the liquidators are considered fiduciaries and are held accountable to the court;
- (3) whether creditors have the right to submit claims which, if denied, can be submitted to bankruptcy court for adjudication;
- (4) whether the liquidators are required to give notice to the debtors potential claimants;
- (5) whether there are provisions for creditors meetings;
- (6) whether a foreign country's insolvency laws favor its own citizens;
- (7) whether all assets are marshalled before one body for centralized distribution; and
- (8) whether there are provisions for an automatic stay and for the lifting of such stays to facilitate the centralization of claims.

*Allstate*, 994 F.2d at 999.

The Court held that the Banro CCAA Proceeding did satisfy fundamental standards of procedural fairness because it "treat[ed] creditors equally within separate classes; provide[d] for a monitor, satisfying the fiduciary requirement; permit[ted] creditors to submit claims and appeal denials of those claims; and provide[d] a court imposed stay." Further, the court determined that the CCAA Proceedings were particularly fair to EMA because EMA had ample knowledge of the ongoing proceedings, the stay imposed by the Banro CCAA Proceedings, the claims and objections procedures, and the hearing on the extinguishment of their claims.

Next, the Court determined that the Banro CCAA Proceeding was a parallel proceeding because it was “a forum in which Plaintiffs could have and should have pursued their claim.” The Court held that the “Banro CCAA Proceeding was a parallel proceeding that extinguished Plaintiff’s claims independent of any conduct taken by Defendants after the filing of this action.”

EMA then asserted that the Canadian court lacked personal jurisdiction over them and thus the stay issued in the Banro CCAA Proceeding did not bind them. The Court dismissed EMA’s personal jurisdiction argument noting that the Canadian court’s lack of personal jurisdiction was irrelevant to the issue of whether to grant comity. Further, the Court reasoned that the dismissal would not cause undue prejudice to EMA, because it chose not to participate in the Banro CCAA Proceeding.

Next the Court determined that dismissal of the action would not violate U.S. law or public policy, because under *DiRenzo v. Phillip Services Corporation*, Canadian courts are still adequate forums despite differences in security law. 232 F.3d 49, 58-60 (2d Cir. 2000), *vacated on other grounds*, 294 F.3d 21 (2d Cir. 2002). The Court further held that the Banro CCAA Proceeding had provided an adequate forum for EMA to raise their claims.

The Court then pivoted to the dismissal of EMA’s claims against Clarke. Banro and Clarke argued that the claims against Clarke related to his role as CEO of Banro and thus should have been adjudicated as part of the CCAA Proceedings. Banro and Clarke further argued that allowing the claims against Clarke to proceed despite their dismissal in the CCAA Proceedings would severely interfere with the CCAA reorganization plan and thus defeat the purpose of granting comity in the first place. The Court adopted this line of reasoning and held that permitting EMA’s claims against Clarke to continue would interfere with the Banro CCAA Proceedings and defeat the purpose of granting comity to the CCAA court.

However, EMA argued that there was no parallel proceeding in Canada for the claims asserted against Clarke and that there was no relationship between the restructuring of Banro and Clarke. The Court dismissed EMA’s argument holding that permitting the claims against Clarke to proceed would “undoubtedly interfere with the implementation of the CCAA reorganization plan because that plan encompassed a release of claims against Clarke.”

Ultimately, the Court dismissed both claims against Banro and Clarke on grounds of international comity. The Court determined that the

proceedings in the Canadian court satisfied fundamental standards of procedural fairness by meeting the standard set forth in *Allstate* and did not violate U.S. law or public policy because, under Second Circuit precedent, the differences in U.S. and Canadian securities law do not render Canadian courts an inadequate forum. Therefore, the appropriate forum for EMA's claims was the CCAA court and granting international comity was appropriate.

EMA appealed the S.D.N.Y.'s decision to the Second Circuit Court of Appeals where the Court affirmed the district court's decision. *EMA Garp Fund, L.P. v. Banro Corp.*, 783 F. App'x 82 (2d Cir. 2019).

These decisions illustrate that in the Second Circuit there is a strong preference for granting dismissals based upon international comity when the claims at hand arise out of foreign bankruptcy proceedings so long as the foreign proceedings satisfy fundamental standards of procedural fairness and do not violate U.S. law or public policy.

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### COMMERCIAL LEASES—RIGHT OF FIRST REFUSAL FOR A TRANSFER TO A RELATED PARTY

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**The Tennessee Court of Appeals held that a lessee's 'right of first refusal' was not triggered when it was transferred by quitclaim deed to a partnership consisting of the lessors. The offer must be bona fide and from a third party.** *Kingston Springs Medical, LLC v. Francis*, No. M2018-01617-COA-R3-CV, 2020 WL 897977 (Tenn. Ct. App. Feb 25, 2020).

#### *Samuel Rule*

In *Kingston Springs Medical, LLC v. Francis*, the Tennessee Court of Appeals addressed whether or not a lessee's right of first refusal was triggered by the execution of a quitclaim deed conveyed to a partnership that consisted of the lessors. The lessee, Kingston Springs Medical ("Kingston Springs Medical"), claimed that it should be able to exercise the purchase provision in the lease to match a "bona fide offer from an unrelated third party" and purchase the property. However, the lessors, Karl and Pamela Francis ("the Francises"), claimed that the transfer via quitclaim deed did not trigger the lessee's right of first refusal, and even if it did trigger the provision, the transfer of the property was not to an

“unrelated party”. Upon review, the Court concluded that the trial court properly granted summary judgement in favor of the Francisces.

In March 2001, the Francisces purchased property in the Indian Pointe Subdivision in Kingston Springs, Tennessee. While the deed only conveyed the property to the Francisces, they split the property with a good friend, Jason West, (“Mr. West”). Mr. West paid half of the down payment, half of the interest on the loan, and shared expenses that ran with the property in consideration for half of the property via handshake agreement. In 2001, Dr. Reggie Anderson, (“Dr. Anderson”), approached the Francisces and Mr. West about investing in a proposed medical office building in Kingston Springs. Although they both declined the investment opportunity, Mr. Francis did suggest that the Indian Pointe property could be the site of the building. Dr. Anderson wanted to purchase the property, but the Francisces were only interested in leasing the property. Dr. Anderson agreed to lease the property but crafted a provision in the lease that gave himself the right to match any “bona fide offer from an unrelated third-party to purchase the fee simple interest in the Leased Premises.” Mr. West was not a party to the lease, and it is unclear whether or not Dr. Anderson knew of Mr. West’s involvement. The lease was between the Francisces and Kingston Springs Medical, LLC, an entity Dr. Anderson formed to develop and operate the medical office building.

In the fall of 2011, Dr. Anderson went to the bank to inquire about refinancing his loan and learned that the property was no longer owned by the Francisces. The Francisces had transferred the property to Indian Pointe General Partners in 2008 for tax and estate planning purposes. The deed was granted for “TEN DOLLARS, cash in hand paid, and other good and valuable considerations.” Indian Pointe General Partners included two partners, AAA Family Limited Partnership and JKW Family Limited Partnership, each with fifty-percent share in the partnership. AAA Family Limited Partnership consisted of the Francisces and their children, and JKW Family Limited Partnership consisted of Mr. West, his wife, and their children. Dr. Anderson believed that this transfer of ownership triggered his option under his lease to purchase the property. Therefore, he sued the Francisces, Mr. West, Indian Pointe General Partnership, AAA Family Limited Partnership, and JKW Family Limited Partnership seeking specific performance to purchase the property or damages. Dr. Anderson claimed “misrepresentation by concealment” by the Francisces for failing to notify him of the transfer so that he could exercise his option to purchase the property.

The Francisces moved for summary judgement, claiming that this transfer of land did not trigger the ‘right of first refusal’ provision in the lease. Even if the court found that this transaction was a “bona fide offer”, Indian Pointe General Partners could not be considered an “unrelated third party” because the Francisces owned half of the partnership that was receiving the land in the transfer. Further, there was only nominal consideration for the transfer of the land. The deed said that the consideration for the transfer was “TEN DOLLARS, cash in hand paid, and other good and valuable considerations,” and so this could not be a “bona fide offer.” The trial court agreed with the Francisces and granted their motion for summary judgment. The trial court reasoned that that the parties intended to create a ‘traditional garden-variety type of first refusal’ where the price and offer were determined by the offer of a third party.

On appeal, the Court agreed with the trial court and affirmed their decision to grant the Francisces motion for summary judgement. The Appellate Court’s standard of review for a summary judgement on a lease interpretation is *de novo*; thus, the trial court’s decision is not presumed to be correct. When interpreting contracts, the Court must give effect to the intention of the parties at the time of the contract, and they must ascertain the plain language of the agreement. Applying these rules for contract interpretation, the Court found that the first right of refusal required a proposed sale of the property to an “unrelated third party”. While Kingston Springs Medical argued that the provision is triggered by any transfer besides those upon death, the Court used the plain language of the agreement to conclude that the right of first refusal was only triggered by an offer from a third party. To agree with Kingston Springs Medical’s position, the Court would need to ignore the latter part of the provision, which defined the right of first refusal as the right to “match the purchase offer of the third party.”

Kingston Springs Medical further argued that the final sentence in the provision made the transfer by the Francisces trigger the right of first refusal. The provision reads: “[a]ny transfer of the fee simple interest in the Leased Premises (except to Lessee) shall be a conveyance subject to the terms and conditions of this agreement.” Kingston Springs Medical argued that the word “agreement” in the provision referred only to the right of first refusal, and so the transfer made by the Francisces triggered the right of first refusal provision. However, the word “agreement” appeared multiple times in this provision of the contract, and the Court found that the parties intended it to mean the entire lease. Even Kingston



Springs Medical acknowledged that the word “agreement” stated elsewhere in the provision referred to the entire lease, and not just to the right of refusal. Therefore, the last sentence of the provision did not substantiate the assertion by Kingston Springs Medical that the right of first refusal applied to all transfer of land.

The holding in this case is relevant to help practicing real estate and estate-planning attorneys assist clients needing to transfer property into a partnership for tax and estate planning purposes. If a client owns a leased property with a tenant’s ‘right of first refusal’ provision for a bona fide offer to buy the property, this property can be transferred to the owner’s partnership without triggering this provision of the lease. However, the lease can specify that it includes all transfers, in which case this does not apply.

This case also affects attorneys who negotiate and draft commercial leases. Practicing attorneys should be aware of the importance of this case if they are negotiating on behalf of their client who wishes to enter into a commercial lease and would like to add an option to purchase the property. The lessee must specify that they would like the option to purchase the property if there is any transfer of land, not just a bona fide offer from a third party. Further, if a lessee wants to add a catch-all provision clarifying that the right of first refusal is triggered by any transfer of the property, there must be specific language at the end of the provision to that extent.