BUSINESS ASSOCIATIONS – LLC MEMBERS

The Tennessee Court of Appeals found support for membership status at formation based on the organizational documents and the conduct of the parties before and after formation of the limited liability company. However, the Court of Appeals vacated and remanded the case back to the trial court because the trial court applied the incorrect statute in determining the inspection rights of the member. *Heatherly v. Off the Wagon Tours, LLC*, No. M2019-01582-COA-R3-CV, 2021 Tenn. App. LEXIS 337, 2021 WL 3722155 (Tenn. Ct. App. Nov. 17, 2020).

Erika Holmes

In *Heatherly v. Off the Wagon Tours, LLC*, the Tennessee Court of Appeals considered whether Rickie Heatherly ("Heatherly") was a member of Off The Wagon Tours, LLC ("Off The Wagon") and thus entitled to have his request to inspect and copy of Off The Wagon's records fulfilled. The case was appealed following a bench trial in which the trial court issued an inspection order based on the finding that Heatherly was a member of Off The Wagon and was therefore entitled to inspect and copy the records as requested. The trial court also awarded Heatherly costs and attorney's fees, reasoning Carney had no reasonable basis to deny Heatherly's request to inspect. The Court of Appeals affirmed the trial court's finding that Heatherly was a member of Off the Wagon at formation; however, the case was remanded back to the trial court for determination of whether Heatherly continued to be a member of Off The Wagon or if his membership status was terminated, and if so, when it was terminated. The determination of membership status impacts whether restrictions apply to Heatherly's request for inspection under the Revised Limited Liability Company Act which was not properly considered[1].

Prior to commencement of this action, Heatherly developed an idea to create a "party vehicle" business comprised of a tractor and custom-built wagon. *Id.* at *3. Carney liked the business idea and began

[1] The trial court improperly relied on the Tennessee Limited Liability Company Act in ordering inspection when the applicable statute was under the Revised Limited Liability Company Act based on the date of the limited liability company's ("LLC's") formation.

work to form Off The Wagon. Initially, in exchange for his idea, Carney offered Heatherly 3% membership interest. Two others were also offered membership interest in exchange for cash contributions. When the potential investors opted out of the business, Carney offered Heatherly 5% membership interest, rather than 3%, in exchange for his idea and to assist in starting the business. Heatherly accepted the 5% offer.

Carney utilized the online legal services platform Legal Zoom to form Off The Wagon, draft and file the Articles of Incorporation (the "Articles"), and draft an operating agreement. Legal Zoom filed the Articles with the Tennessee Secretary of State on February 24, 2016. Although Carney indicated to Legal Zoom that the members were himself, Heatherly, Danny Cage, and Steven Reese, the filed Articles did not specify who the members were. The Articles simply stated Off The Wagon, was manager-managed, Carney was the manager, and that Off The Wagon had four members. The final operating agreement only listed Carney and Heatherly as members and was signed by Carney but not Heatherly. The startup funds were provided by Carney while Heatherly contributed his ideas and labor. Additionally, Heatherly provided money to Off The Wagon's account for the purchase of insurance as well as some membership fees.

On April 8, 2016, Off The Wagon opened for business. The tractor was driven by Heatherly. Carney was responsible for handling the paperwork and customers. As the business continued, Carney presented Heatherly with two additional offers for membership interest. One offer in August 2016 in which Heatherly would receive an additional 5% membership interest in exchange for $10,000 in sweat equity and another offer for an additional 5% interest when a second wagon was purchased for the business.

Eventually, there was a breakdown in relations between Heatherly and Carney. On November 18, 2016, Carney furnished Heatherly with two letters, one regarding an offer to purchase Heatherly's shares, and another, a buyout agreement indicating Heatherly was no longer needed for Off The Wagon because Heatherly did not comply with the agreed upon standards and rules. Carney signed the buyout agreement, and although Heatherly ceased to work for Off The Wagon, he never signed the buyout agreement. Heatherly's membership interest purportedly continued until August 30, 2018, as reflected in documents filed with the Tennessee

Secretary of State. The 2017 annual report for Off The Wagon indicated there were no longer four members, only two. The number of members was further reduced to one in the annual report filed after the case began. Carney indicated discrepancy in the 2017 annual report was the fault of Legal Zoom.

In May 2017, Heatherly demanded payment "for both his membership interest and the work he performed for the LLC." *Id.* at *7. Heatherly also made a written request to access to Off The Wagon's books and records in August 2017. Off The Wagon never complied with this request.

This action was initiated after Off The Wagon failed to make company documents and records available for inspection following Heatherly's written request. Heatherly sought relief under Tenn. Code Ann. § 48-228-104. Off The Wagon contended Heatherly was not entitled to the requested documents and records because he "[was] not, and had never been, an owner or member of Off The Wagon Tours, LLC." *Heatherly,* 2021 Tenn. App. LEXIS 337 at *2.

At trial over the disputed membership status of Heatherly, testimony was heard from both Heatherly and Carney, evidence of the sweat equity proposal was admitted,[2] and testimony of Carney and Heatherly as business partners was presented.[3] The trial court ruled Heatherly was a member of Off The Wagon at the time of formation and as such was entitled to access and inspection of Off The Wagon's records based on Tenn. Code Ann. § 48-228-104. Off The Wagon was ordered to allow inspection; however, Heatherly was restricted in his use of the records. Heatherly was also awarded attorney's fees and costs because the trial court found Carney lacked a reasonable basis to question Heatherly's inspection rights.

In reviewing the findings and ruling of the trial court, the Court of Appeals found Heatherly was a member of Off The Wagon; however, the inspection order was not upheld. The Court of Appeals remanded the case

---

[2] "A picture of the proposal [written on a white board] was admitted as an exhibit[.]" *Heatherly,* 2021 Tenn. App. LEXIS 337 at *5.

[3] A competing business owner "understood from conversations with both men that they were 'partners of some kind.'" *Id.* at *7

to the trial court to establish whether Heatherly was still a member or if his membership status was terminated, and if so, when. The status of Heatherly's membership is important for determining restrictions on Heatherly's right to inspection.

The Court of Appeals first reviewed the trial court's finding that Heatherly was a member of Off The Wagon. Carney argued that although he did offer Heatherly membership interest, "there was a condition precedent to becoming a member . . . that Heatherly never completed . . . ." *Heatherly,* 2021 Tenn. App. LEXIS 337 at *9. The Court of Appeals declined to order additional findings regarding the terms of Carney and Heatherly's membership agreement reasoning there was "sufficient findings of fact and conclusions of law" in the trial court's opinion to "determine how the court reached its ultimate conclusion on the inspection of records." *Id.* at *9 n.1.

In Tennessee, the statutes that govern LLCs depend on the LLC's date of formation. The Tennessee Revised Limited Liability Company Act ("Revised Act") applies to LLCs formed after January 1, 2006. *See* Tenn. Code Ann. § 48-249-1002(a)(1)(A). "[T]he Tennessee Limited Liability Company Act applies to domestic LLCs, formed before January 1, 2006, that have not elected to be governed by the Revised Act." *Heatherly*, 2021 Tenn. App. LEXIS 337 at *13 (citing Tenn. Code. Ann. § 48-249-1002(c)). Off The Wagon was formed in 2016; therefore, the Revised Act was applicable to this case.

Under the Revised Act, a member is defined as "a person that has been admitted to an LLC as a member, provided in § 48-249-501." Tenn. Code Ann. § 48-249-102(20). A person may become a member at formation of the LLC or at a later time. *Id.* § 48-249-501(a), (b). An LLC is considered formed when the articles of incorporation are filed. *Id.* § 48-249-201(a). The LLC documents, the articles of organization and the operating agreement, may provide evidence of a person's membership status, but they are not conclusive. *Id.* § 48-249-102(16). *Id.* § 48-249-501(a), (b). Members may, but are not required, to enter into an operating agreement. *Id.* § 48-249-203(a). Additionally, relevant evidence of a person's membership status is the conduct of the parties before and after formation. *See Parigin v. Mills*, No. E2016-00640-COA-R3-CV, 2017 Tenn. App. LEXIS 179, 2019 WL 1032740, at *7–8 (Tenn. Ct. App. Mar. 16, 2017). An individual's membership status is important because LLC members and former members have a statutory right to access records of the LLC, and if the LLC denies access the LLC "may summarily order inspection or copying of the records demanded, at the expense of the LLC." Tenn. Code Ann. § 48-249-308(d).

Despite Carney's claims that Heatherly was not a member of Off The Wagon because the sweat equity condition precedent was not fulfilled, the Court of Appeals found ample support that Heatherly was a member at formation of Off The Wagon. Off The Wagon's filed Articles, which formed Off The Wagon, indicated there were four members, one of whom Carney later identified as Heatherly. The operating agreement for Off The Wagon also listed Heatherly as a member. Furthermore, Heatherly accepted Carney's offer of 5% membership interest in exchange for his idea and labor, which Heatherly provided. The Court of Appeals did not find support in Carney's argument that the agreement for membership interest was solely the agreement of 5% interest in exchange for $10,000 in sweat equity. The Court of Appeals pointed to the picture of the white board proposal as evidence that the sweat equity requirement in exchange for 5% interest was for an *additional* 5% interest.

After determining Heatherly the trial court properly found to be a member of Off The Wagon, the Court of Appeals then assessed the validity of the trial court's inspection order and Heatherly's inspection rights. The Court of Appeals found the trial court applied the incorrect statute when ruling Heatherly was entitled to inspection of the Off The Wagon's records. The trial court relied on inspection rights under the Tennessee Limited Liability Company Act, not the Revised Act which was applicable to Off The Wagon given the date of formation. Because the Revised Act is applicable in this case, it is important to establish whether Heatherly's membership interest was terminated, and if so, when because it will establish the extent of the documents and records Heatherly is entitled to. Differing from the Limited Liability Company Act, both members and former members are explicitly given rights to access LLC's records by the Revised Act; however, the extent of records the requesting party is entitled to is restricted. *Id.* § 48-249-308(a). The Revised Act limits former members' access to records to "proper purposes pertaining to the periods during which they were members." *Id.*

Despite the Court of Appeals holding that Heatherly was a member of Off The Wagon at formation, the Court of Appeals vacated the trial court's inspection order with instructions to establish whether Heatherly was still a member or whether his membership status had been terminated. This finding impacts what records Heatherly is entitled to have access to because the incorrect statute was applied at the trial level.

Considering the ruling in this case, business law attorneys in Tennessee should be careful in their statutory analysis. Attorneys should bear in mind the formation date of the LLC will dictate the applicable statutory inspection rights of members. LLCs should consult an attorney before denying requests for inspection because denying requests for inspection could lead to additional expenses the LLC will incur should a court order inspection or copying. Furthermore, attorneys litigating right to inspection and copying matters should ensure the court applies the proper statute to minimize appealable issues.

Additionally, attorneys should stress to clients the importance of clear establishment of who members of the LLC are and members' inspection rights, specifically for those LLCs formed after January 1, 2006 and governed by the Revised Act. In the event there is a breakdown in relations among members, documentation should clearly establish the departing member's membership interest has been terminated. Otherwise, despite a member's departure, they could continue to be entitled to access to the LLC's records and documents based on a member's statutory right to access records under Tennessee Code Annotated § 48-249-308(a).

CONTRACTS – ENFORCEABILITY OF AN OPTIONS CONTRACT

The Tennessee Court of Appeals held that when an option agreement provides that the option price is to be mutually agreed upon by the parties after the option to purchase is exercised, the contract is unenforceable because the price is not reasonably ascertainable, despite the option agreement including parameters for the purchase price. In addition, under Tennessee law, when an essential element, like price, remains to be negotiated, a duty to negotiate in good faith does not arise absent an express contractual agreement. *LVH, LLC v. Freeman Inv., LLC*, No. M2020-00698-COA-R3-CV, 2021 WL 1943370, 2021 Tenn. App. LEXIS 188 (Tenn. Ct. App. Sept. 22, 2021).

Alex Sosnowski

In *LVH, LLC v. Freeman Investment, LLC*, the Tennessee Court of Appeals addressed whether an option agreement was enforceable between a professional development company and a property owner. The plaintiff, LVH, LLC ("LVH"), sought specific performance and unjust enrichment for an option agreement ("the Agreement") entered into with Freeman Investment, LLC ("FI"), the owner of the property at issue. FI took the position that the Agreement was not an enforceable contract because the option price remained open to negotiation after LVH exercised their option. The court agreed with FI that the price was not reasonably ascertainable by a court and held that the Agreement is merely an agreement to agree, which is not enforceable under Tennessee Law. Due to the court's determination that the Agreement was not an enforceable contract, the court remanded the unjust enrichment claim to the trial court.

FI is the owner of a twelve-acre parcel of property ("the Property") which LVH identified as a possible site for a multi-family real estate development. After negotiations, LVH and FI entered into an option agreement in February 2018. The Agreement granted LVH an exclusive option to purchase the Property by March 15, 2019. In paragraph 2 of the Agreement, the parties set out parameters for a purchase price. The Agreement stated that the option price was to be based on a minimum of 125 residential units, at a price of $20,000 per unit. However, paragraph 2 also states that the option price is "[t]o be mutually agreed upon by Buyer and Seller." *LVH*, 2021 Tenn. App. LEXIS 188, at *14. Further, paragraph 3 covers the deposit amount upon execution of the Agreement and provides that the deposit amount is to be returned to the buyer in the event the buyer and seller cannot agree on a price.

On February 26, 2019, LVH exercised its option to purchase the Property. LVH calculated that 119 residential units could be developed on the Property and applied the option price of $20,000 per unit at a minimum of 125 units; therefore, in a draft contract of sale, LVH set forth a price of $2,500,000. In response to LVH's intent to exercise the option for $2,500,000, FI informed LVH that it was willing to sell the Property for $9,975,000.

In April 2019, LVH sued FI for specific performance and unjust enrichment. Both parties moved for summary judgment on whether the Agreement was an enforceable contract. The trial court determined that the option price in the Agreement was "sufficiently ascertainable to be enforceable" and that FI breached the contract. *Id.* at *5. Due to the trial court finding the Agreement unenforceable, they did not address the unjust enrichment claim except for denying both parties' motions for summary judgment because "there are genuine issues of material facts as to whether a benefit was conferred on FI and whether FI accepted that benefit." *Id.* at *17–18.

The Court of Appeals reversed the trial court's holding. The court concluded that the Agreement was not enforceable because the Agreement is merely an agreement to agree, which is unenforceable in Tennessee.

The Court of Appeals began its analysis by discussing the principles governing the enforceability of a contract. For any contract to be enforceable, including an option contract, "the parties must agree on the material terms."[1] In addition, the terms of the contract must be "sufficiently definite to enable a court to give it an exact meaning." *United Am. Bank of Memphis v. Walker*, 1986 Tenn. App. LEXIS 3368, at *1 (Tenn.

[1] *Abbott v. Abbott*, No. E2015-01233-COA-R3-CV, 2016 Tenn. App. LEXIS 512, at *4 (Tenn. Ct. App. July 20, 2016)). The court in Abbot further states that "[p]rice is generally considered an essential term in a sales contract. *Id.*

Ct. App. Oct. 10, 1986). If the contract is clear and unambiguous, the literal meaning of the contract governs.

The Court of Appeals then turned to *Fourth Eights, LLC v. Salem*, a similar case decided by the appellate court involving the enforceability of an option agreement granting a party the right to purchase property. 194 S.W.3d 484, 484 (Tenn. Ct. App. 2005). The option agreement in *Four Eights* granted a tenant the option to purchase the property at "its then fair market value" and that "Fair Market Value must be determined by the lessor and Lessee, negotiating in good faith, within thirty days … of the election to purchase the Premises." *Id.* at 486. The Court of Appeals concluded that because the parties must determine the fair market value, the "parties basically made an 'agreement to agree' to something in the future, and such agreements have generally been held unenforceable, both in this jurisdiction and others." *Id.* In the present case, the court asserts that their holding in *Four Eights* follows the general principle that "in order for a contract to be binding it must spell out the obligation of the parties with sufficient definiteness that it can be performed." *See Id.* at 487 (*citing United Am. Bank of Memphis*, 1986 Tenn. App. LEXIS 3368, at *4).

In another case, the Court of Appeals held that the operative provision, "Purchase price to be mutually agreed upon based on [independent] appraisal at time of notice to sell" made the option agreement unenforceable. *Huber v. Calloway*, No. M2005-00897-COA-R3-CV, 2007 Tenn. App. LEXIS 435, at *1 (Tenn. Ct. App. July 12, 2007). In *Huber*, the court noted that if the phrase "based on [independent] appraisal" stood alone, it would be conceivable for the agreement to be enforceable. *Id.* at *5. However, in the context of the entire agreement, specifically, "[P]rice to be mutually agreed upon[,]" the only possible meaning is that the parties agreed to negotiate price and that a sale would only occur if the parties made an agreement. *See Id.*

In the present case, LVH argues that the price parameters in paragraph 2 set forth a specific formula for calculating the option price; therefore, the purchase price is not left open for future negotiations. The Court of Appeals disagreed with LVH's interpretation, because the Agreement "also states that the option price is to be mutually agreed upon by the parties within 30 days of the end of the option period." *LVH*, 2021 Tenn. App. LEXIS 188, at *16–17. In addition, the court noted that even if paragraph 2 can be construed to provide a definite price term, paragraph

3 provides that the buyer's deposit is to be returned if an agreement on price cannot be made. In the context of the entire Agreement, the Agreement contemplates that the option price will be determined after future negotiations, to which the parties may not agree. Therefore, the option price is not reasonably ascertainable by a court, and due to that price being an essential element of the Agreement, the Agreement is unenforceable and is no more than an agreement to agree.

In an important footnote, the court addressed the issue of whether an agreement with essential terms remaining to be negotiated subjects the parties to negotiate those terms in good faith. The court stated that in Tennessee, the duty of good faith does not arise in future negotiations "absent an express contractual agreement." *Barnes & Robinson Co. v. OneSource Facility Servs., Inc.*, 195 S.W.3d 637, 644 (Tenn. Ct. App. 2006). Therefore, in this case, LVH and FI have no duty to negotiate in good faith because the Agreement is silent on the matter.

Finally, for LVH's unjust enrichment claim, the trial court denied LVH's motion for summary judgment and did not address the claim at trial because their holding on the enforceability of the Agreement pretermitted the unjust enrichment claim. Now that the appellate court has held the Agreement unenforceable, they remand the unjust enrichment claim to be further addressed.[2]

This case demonstrates three crucial factors for transactional practitioners. First, if a contract sets out parameters for a purchase price, those parameters will likely not hold legal weight if the contract also provides that the parties shall mutually agree upon the price. Second, practitioners should be careful of provisions covering security deposits. The court here expressed that even if paragraph 2 of the Agreement did not provide that the parties will mutually agree on the option price, paragraph 2 could be construed as sufficiently definite on price, paragraph 3 provides that the buyer's deposit is to be returned if an agreement on price cannot be agreed upon. Third, if it is necessary to have a contract where essential elements are left open for negotiations, it is essential to consider that in Tennessee, the duty of good faith does not arise in future negotiations "absent an express contractual agreement." *Id.*

[2] On remand, the trial court will address whether FI received a benefit and whether they accepted that benefit. If a benefit was conferred on FI and they accepted that benefit, the trial court will address the value of the benefit received.

CONTRACTS – ORAL & STATUTE OF FRAUDS

The Tennessee Court of Appeals held that an admission by a party claiming to be a party to an oral contract is a legal conclusion that is not required to be taken as true and which requires a determination by the court. By continuing under a revenue-sharing agreement following an alleged material breach, the alleging party waives the right to assert the material breach as a bar to a breach of contract claim. In such a case, when an enforceable contract exists, it is proper to deny requests for quasi-contract damages under the theories of unjust enrichment and money had and received. *Old Hickory Coaches, LLC v. Star Coach Rentals, Inc.*, No. M2020-COA-R3-CV, 2021 Tenn. App. LEXIS 455 (Tenn. Ct. App. Nov. 15, 2021).

S. Chase Talbot

In *Old Hickory Coaches, LLC v. Star Coach Rentals, Inc.,* the Tennessee Court of Appeals determined that the oral contract formed between the parties was enforceable and not a violation of the statute of frauds, as it potentially could be completed within a year. In addition, the Court of Appeals addressed whether James Copeland's, the CEO and President of Star Coach Rentals, Inc. ("Star Coach"), admission of being a party to the suit made him an individual defendant or only a party to the suit in his official capacity. The court found that when a party admits to being a party to an oral contract, the admission is not binding because it is a legal conclusion, the determination of which rests with the court. Upon determining the oral contract was valid and Mr. Copeland was a party to the lawsuit only in his official capacity, the court determined that continuing under the revenue-sharing agreement following an alleged material breach waived the right to assert the material breach as a bar to a breach of contract claim. Finally, the court found that quasi-contract damages under the theories of unjust enrichment and money had and received were improper as the oral contract was enforceable.

In 2000, Sherry Wise of Old Hickory Coaches, LLC ("Hickory Coaches") agreed to a revenue-sharing agreement with Mr. Copeland of Star Coach Rentals, Inc. via a "handshake deal." Per the agreement,

> (1) Old Hickory would provide the trailers and trucks; (2) Star Coach would lease the trailers and trucks to

> production companies; (3) the parties would split the rental income 50/50; (4) Star Coach would be responsible for routine maintenance and storage; and (5) Old Hickory would be responsible for major repairs and renovations.

To start, Old Hickory sent Star Coach six trailers and six trucks. In 2007, a production company informed Mr. Copeland that new trailers would be needed to maintain the contract with Star Coach. Mr. Copeland contacted Ms. Wise, who purchased two new trailers and delivered them to Star Coach; however, no new trucks were provided. The testimony surrounding the need for new trucks was conflicting. Ms. Wise stated there were no discussions involving the need for new trucks, while Mr. Copeland testified that the current trucks were not adequate to pull the new, bigger trailers. To accommodate the new trailers, Mr. Copeland leased one of the trucks already in his possession and purchased another to haul the second trailer. Ms. Wise testified that she was not informed that Mr. Copeland was leasing his personal trucks, that the Old Hickory trucks were insufficient, and that had she known, she would have purchased the new trucks.

Later, in 2010, Ms. Wise discovered Star Coach's failure to make eleven weeks of payments per the revenue-sharing agreement. In June 2011, Ms. Wise sent a letter to Mr. Copeland regarding the money owed. Within the letter, she specifically addressed the agreement was between Star Coach and Old Hickory. Thereafter, the parties altered the agreement to split the income 75/25 until the missed payments by Star Coach were caught up, according to Ms. Wise. In actuality, Mr. Copeland retained the seventy-five percent, citing "renovations" Star Coach had made to the trailers in 2010 as a reason to keep the money and claiming that the eleven weeks of missed payments was to help recover the costs. Realizing around this time that Star Coach was still paying Old Hickory for both the trucks and trailers, Mr. Copeland reduced the payments being made to Ms. Wise to only include the rental profits of the trailers. After 2010, Mr. Copeland continued to make major repairs and renovations to the trailers, claiming Ms. Wise did not have the money. He estimated the total cost of repairs to be $42,965.00. By the middle of 2015, the relationship between Star Coach and Old Hickory terminated. In the fall of 2015, Ms. Wise picked up the trailers and continued trying to settle the 2010 payment discrepancies to no avail.

In August 2016, Old Hickory sued Star Coach and Mr. Copeland for breach of contract and promissory estoppel. The trial court awarded damages to Old Hickory pursuant to the revenue-sharing agreement in the amount of $101,529.00 and awarded damages to Star Coach for the repairs and renovations in the amount of $12,415.00. In addition, the trial court found Mr. Copeland acted strictly in his professional capacity, refusing to name him as an individual defendant.

On appeal, the trial court's decision was affirmed. The Court of Appeals held that Mr. Copeland was not bound by his alleged admission of being a party to the contract, as it was a legal conclusion that was not required to be taken as true and necessitated a determination by the court. In addition, upon determining that the revenue-sharing agreement was a valid contract, the appellate court affirmed the denial of quasi-contract damages under the theories of unjust enrichment and money had and received.

The Court of Appeals began by discussing whether Mr. Copeland had admitted that he was personally a party to the contract with Old Hickory. While Old Hickory's brief argued that Mr. Copeland's use of "Defendants" in his answer indicated that he was a party in his individual capacity, the court noted in the same paragraphs that Mr. Copeland used "it" in reference to "Defendants." In *Nichols v. Blocker,* No. 87-110-II, 1988 Tenn. App. LEXIS 262 (Tenn. Ct. App. Apr. 29, 1988), the court explained that a party is bound by admitting the existence of a contract; however, admitting the contract is binding and enforceable is a legal conclusion. Furthermore, having discussed the law involving admissions within an answer in *Sakaan*, the court reiterated that while facts confessed in pleadings are binding on the party, an "inadvertent assent" to a legal assertion is not controlling. *Sakaan v. Fedex Corp., Inc.,* No. W2016-00648-COA-R3-CV, at *4 (Tenn. Ct. App. Dec. 21, 2016). Thus, even if Mr. Copeland had admitted to being a party in his individual capacity, the admission would not have been required to be taken as true.

In determining that the alleged admission by Mr. Copeland was a question of law requiring a legal determination, the court moved to discuss whether he was a personal defendant. The court found this issue to lack merit. While the trial court found Mr. Copeland was only operating in his professional capacity, even if he had been found to be a personal defendant, Old Hickory did not prove any personal liability against Mr.

Copeland. Old Hickory also failed to raise this issue of Mr. Copeland's personal liability on appeal.

Next, the court addressed whether an enforceable contract had been formed. In *Tolliver v. Tellico Vill. Prop. Owners Asss'n, Inc.,* 579 S.W.3d 8, 28 n. 12 (Tenn. Ct. App. 2019), the court previously held that the statute of frauds does not bar the enforcement of an oral contract if it is possible for the defendant to complete performance within one year. Supported by Mr. Copeland's statements that the contracts "ran from year to year," the appellate court affirmed the trial court's decision that it was possible for the agreement between the parties to be fully performed within one year. Because the contract was found to be enforceable, the court determined unjust enrichment and quasi-contract damages were improper. It is only where there is no enforceable contract, and the court must impose a contractual obligation, that a party may benefit from quasi-contract damages. *B&L Corp. v. Thomas & Thorngren, Inc.,* 162 S.W.3d 189, 217 (Tenn. Ct. App. 2004).

The court then turned to the issues of whether Star Coach breached the contract and whether damages were proper to Old Hickory. Star Coach argued that even if they did breach the contract, it was preceded by Old Hickory's material breach of failing to supply new trucks. The court noted that in *McClain v. Kimbrough Constr. Co.,* 806 S.W.2d 194 (Tenn. Ct. App. 1990), they held that the defaulting party must be notified of the breach in order to allow it to be corrected. The trial court found no evidence that Ms. Wise was informed that Star Coach would keep all the rental income for the trucks and only remit half of the income from the trailers. As the trial court can observe and assess the credibility of the parties, the appellate court did not find by clear and convincing evidence that Star Coach satisfied the notice requirement outlined in *McClain*. Furthermore, a party to a contract that accepts the benefits with knowledge of a breach waives the right to assert the material breach as a bar to a breach of contract claim. *Madden Phillips Constr. v. GGAT Dev. Corp.,* 315 S.W.3d 800, 815 (Tenn. Ct. App. 2009). Thus, by continuing under the agreement, Star Coach waived its right to assert Old Hickory's material breach.

In addition to reiterating foundational contract law, the decision by the Court of Appeals emphasized the importance of separating assertions of fact from legal conclusions. While it may not always be clear

– especially in an oral agreement – any purported legal conclusions are not required to be true and will fall under the determination of the court. Thus, attorneys need to be diligent in separating what must be taken as true and what must be determined by the court when analyzing and crafting their pleadings.

GENERAL CONTRACTORS – PRIVATE RIGHT OF ACTION

The Tennessee Supreme Court held that Tenn. Code Ann. § 56-7-111 does not provide a private right of action for general contractors against insurance companies for failure to comply with the statute. *Affordable Constr. Servs., Inc. v. Auto-Owners Ins. Co.*, 621 S.W.3d 693 (Tenn. 2021).

Alyx Thompson

In *Affordable Construction Services, Inc. v. Auto-Owners Insurance Company*, the Tennessee Supreme Court considered whether a general contractor has a private right of action against an insurance company for a violation of T.C.A. § 56-7-111. The court determined that the statute does not expressly provide a private right of action to a general contractor. The court also concluded that the plaintiff failed to prove the legislature's intent was to imply a private right of action.

Affordable Construction Services, Inc. ("Plaintiff"), a general contractor, sued Auto-Owners Insurance, Co. ("Defendant"), an insurance company, for violating T.C.A. § 56-7-111. The statute states that when insurance losses accrue to insured property owners, the insurance company shall include the general contractor of any uncompleted construction or building contracts as a payee. Grand Valley Lakes Property Owners Association (the "Property Owner") owned the property at issue, which was protected through a property and casualty insurance policy insured by the Defendant. When the property was damaged due to a severe weather event, the Property Owner hired the Plaintiff to repair the property. When the Defendant paid the Property Owner the insurance proceeds by check, the Defendant did not include the Plaintiff as a payee. Subsequently, three lawsuits were filed concerning the payment of insurance proceeds.

First, the Property Owner filed suit against the Defendant to claim insurance proceeds as a result of the property damage. The Defendant eventually issued a check payable only to the Property Owner. Second, the Plaintiff sued the Defendant and the Property Owner to recover payment for repairs made to the property, but the court dismissed the case because the court found that the Plaintiff did not have an enforceable contract. Lastly, in this case, the Plaintiff sought a declaratory judgment against the

Defendant and claimed that the Defendant violated T.C.A. § 56-17-111 by failing to name the Plaintiff as a payee on the insurance proceeds check to the Property Owner.

In a certified question from the United States District Court for the Western District of Tennessee, the Tennessee Supreme Court addressed whether general contractors have a private right of action for violations of T.C.A. § 56-7-111. Two additional questions were certified to the court: (1) whether there must have been a contract between the general contractor and the insured for the insurance company to be obligated to include the general contractor as a payee under T.C.A. § 56-7-111, and (2) if a contract is necessary, whether the contract must be unfinished when the check is written. However, the court did not answer the additional questions, as they proved to be unnecessary inquiries after the court determined that T.C.A. § 56-7-111 did not provide a private right of action for general contractors.

The Tennessee Supreme Court began by discussing who has the authority to create a private right of action for violation of a statute and how to determine if there is one, as set out in *Inc. Brown v. Tenn. Title Loans, Inc.*, 328 S.W.3d 850 (Tenn. 2010). The court noted in *Brown* that the legislature, not the courts, has the power to create a private right of action. *Id.* at 855. Determining whether a statute provides for a private right of action is a question of law and statutory construction. *Id.* Either a private right of action is expressly provided by the language of the statute or implicitly provided by the structure and legislative history of the statute. *Id.* The Tennessee Supreme Court found that the language of the statute did not expressly provide for a private right of action.

The court then turned to examine whether a private right of action was implicitly established by the structure and legislative history of the statute, utilizing the framework set out in *Brown*. *Id.* In *Brown*, the Tennessee Supreme Court weighed three factors in determining whether the statute at issue created a private right of action: (1) whether the party asserting the cause of action is an intended beneficiary of the statute's protection; (2) whether there is an indication of the legislature's intent to or not to create a private right of action, either expressly or impliedly; and (3) whether implying a private right of action would be consistent with the purpose of the statute. *Id.* The *Brown* court noted additional considerations, such as stating that it will not imply enforcement of a provision if the act as a whole provides for a means of enforcement unless the legislative intent is clear. *Id.* at 856. Additionally, the *Brown* court noted that nonaction by the legislation is relevant when a legislature repeatedly rejects a proposal to introduce a private right of action, even though it is not usually a consideration. *Id.*

In analyzing the language, structure, and legislative history of the statute, the Tennessee Supreme Court began by determining whether T.C.A. § 56-7-111 is part of a larger regulatory scheme. Although it is part of Title 56, which "broadly regulates the insurance industry," it was not found to be part of a larger regulatory scheme.

The court then applied the factors from *Brown*. First, the plaintiff had the burden of proving that it was an intended beneficiary of T.C.A. § 56-7-111. As a general contractor and not an insurance company or an insured owner, the plaintiff would benefit the most from a requirement for an insurance company to name the general contractor as an additional payee on an insurance proceeds check to the insured. Practically, the statute protects general contractors by requiring them to endorse the check before the insured cashes it, which would mean that general contractors would likely not do so unless they had been paid. Statements from Representative Jack Bowman, who introduced the House Bill that became T.C.A. § 56-7-111, indicated that the purpose of the statute was to ensure that there were no delays in payments to general contractors for repairs. Therefore, the Court found that the Plaintiff was an intended beneficiary of the statute.

Second, the Plaintiff had the burden of showing an indication of a legislative intent to provide a private right of action through the statute. The Plaintiff failed to do so, as there was nothing in the statutory structure or legislative history to indicate that the legislature, either expressly or impliedly, intended to provide a private right of action to general contractors under this statute. Therefore, the court found that the Plaintiff did not prove the second factor.

Last, the Plaintiff had to show that a private right of action would be consistent with the purpose of the statute. The court found that although the legislature intended for the statute to avoid delays in payments, the statute did not provide a specific penalty. Under T.C.A. § 56-1-801, when the legislature does not provide a specific penalty for a violation under chapters 2-4, 7, 11, and 32 of Title 56, the penalty is a class

C misdemeanor. T.C.A. § 56-7-111 falls under T.C.A. § 56-1-801. Therefore, as set out in *Brown*, the implication of a private right of action for a regulatory statute with a governmental remedy would be incompatible with the legislature's intent. Therefore, the Plaintiff failed to prove the last factor.

The Tennessee Supreme Court concluded that T.C.A. § 56-7-111 did not expressly or impliedly provide a private right of action for general contractors against insurance companies for violations of the statute and answered the first certified question in the negative, consistent with the framework set out in *Brown* for determining whether a statute provides a private right of action. Business law practitioners should be aware that when they represent general contractors or insurance companies, a suit against an insurance company for a violation of T.C.A. § 56-7-111 is not viable. Additionally, they should note that Tennessee courts will continue to apply the factors from *Brown* in determining whether a statute provides a private right of action and will specifically weigh the existence of an alternative governmental remedy heavily in their determination.

CASE COMMENTARIES

REAL ESTATE – RESTRICTIVE COVENANTS

The Supreme Court of Tennessee held that restrictive covenants, enacted in 1955, that restricted land to residential use did not apply to land bought by the Defendant because the restrictive covenants were retroactively enacted when the original owners did not own all of the land. *Phillips v. Hatfield* 624 S.W.3d 464 (Tenn. 2021).

Zachary Webber

In *Phillips v. Hatfield*, the court considered whether a restrictive covenant executed in 1955 ("1955 Covenant") applied to property purchased decades later in 2016 and 2017 by Mark Hatfield ("the Defendant"). The 1955 Covenant restricted the land to residential use. The Defendant sought to use the land for non-residential purposes. Plaintiff contests that the 1955 Covenant should apply because the covenants stated that the restrictions ran with the land and the Defendant's deed stated "[t]his conveyance is made subject to valid restrictive covenants and easements, if any, appearing of record." The trial and appellate courts found for the plaintiff, stating that it was their finding that there was an implied negative reciprocal easement. However, the Supreme Court of Tennessee found for the Defendant, holding that the 1955 Covenant did not apply in this case. The decision hinged on the fact that the original owners enacted the 1955 Convents when they did not own the entire plot of land the covenants were intended to control.

The Defendant is the current owner of land purchased in 2016 and 2017. The Defendant purchased said land for the purpose of opening a retail business. Richie and Roma Phillips ("the Plaintiffs") own land and reside in a home that shares a property line with the Defendant's property. Both properties are a part of what was previously known as a subdivision called Sunnybrook Addition. J.C. and Mary Virginia Chambers ("the Chambers") were the original owners of that land and recorded a plat for their land in 1953 dividing it up into sections or blocks, which ranged in size. This plat did not restrict the land to residential use. Over the course of the next year, the Chambers began to sell their land. Of the seventy-nine lots the Chambers platted, sixty-seven were sold. Included in the deeds of sale were restrictive covenants ("the Original Covenants") that stated, among other things, that "the property was to be used for residential purposes only." The deeds additionally provided that the covenants ran with the land and were binding for twenty years. These lots were resold numerous times since their initial selling in 1953–54.

In 1955, the Chambers recorded new covenants that were intended to cover the entire subdivision. These new 1955 Covenants were stated to run with the land and included restrictions on land use and building type. These restrictions limited the lots to residential use. However, none of the deeds that conveyed the Defendant's property mention the 1955 Covenants. The closest the deeds come to referencing the covenant is the language that "the conveyance is subject to valid restrictive covenants and easements, if any, appearing of record." *Phillips*, 624 S.W.3d at 471. Using this evidence, the trial and appellate courts found for the Plaintiffs, holding that the facts established an implied negative reciprocal easement. As such, the Defendant's lot would be subject to the residential use restriction. The case was then granted permission to be heard at the Supreme Court of Tennessee.

The Court began its analysis by identifying that the only potential restriction to the Defendant's land would be the 1955 Covenants. The Original Covenants do not apply because, per the language, the restrictions expire after twenty years. This would place the expiration of the Original Covenants at around 1970, well before the sale at issue in 2016–17. As such, the Court analyzed the validity of the 1955 Covenants to determine if the land purchased by the Defendant had a residential use restriction.

The Supreme Court of Tennessee first identified that landowners have the ability to "sell portions thereof and make restrictions as to the use for the benefit of himself as well as those to whom he sells other portions of the land." *Laughlin v. Wagner*, 244 S.W. 475, 476 (1922). However, the Court went on to identify that "restrictive covenants are in derogation of the right to free use and enjoyment of property." As such "Tennessee courts construe them strictly." *Phillips*, 624 S.W.3d at 475; *Hughes v. New Life Dev. Corp.*, 387 S.W.3d 453, 475. Thus, "if the right to enforce the covenant as to other property is doubtful such right will be denied." *Shea v. Sargent*, 499 S.W.2d 871, 874 (Tenn. 1973) (quoting *S. Advert. Co. v. Sherman*, 308 S.W.2d 491, 493 (1957)). Additionally, the Supreme Court of Tennessee noted that other courts held that "a person cannot restrict the use of another's land simply by recording restrictive covenants that purport to apply to that land." *Birdwood Subdivision Homeowners' Ass'n v. Bulotti Constr. Inc.*, 175 P.3d 179, 183 (2007).

Here, the Court notes that the language of the 1955 Covenants attempted to cover all of the lots of Sunnybrook Addition. However, the Chambers did not own the lots that later became the Defendant's land when the 1955 Covenants were put into place. Thus, the Supreme Court of Tennessee deemed them ineffective. But, even so, the Court noted that a future "grantor obviously would have had the authority to burden the property." As such, the Court then went on to see if any of the numerous conveyances of the Defendant's land contained language that would have subjected the land to the restrictions of the 1955 Covenants.

The Court found that none of the conveyances after the 1955 Covenants applied. The Court found that some of the deeds had no restrictions mentioned at all. Even a deed by which the Chambers themselves resold lots in 1960 did not contain restrictive language. The Court did acknowledge that the specific deed by which the Defendant came to acquire the property did say that it was subject to "valid restrictive covenants, if any, appearing on record." *Phillips*, 624 S.W.3d at 476–77. Even so, the Supreme Court of Tennessee reasoned that "under the circumstances of this case, however, we do not believe this general language reflects sufficient intent on the part of any grantor subsequent to the recording of the 1955 Restrictive Covenants to subject the property to the unnamed restrictions." *Id.* at 477.

Finally, the Supreme Court of Tennessee addressed the previous courts' finding the 1955 Covenants were implied negative reciprocal easements. The Court first stated that Tennessee recognizes implied negative reciprocal easements describing them to occur "when a property owner subdivides land and sells lots with deed restrictions in accordance with a general plan, the restrictions may be enforced by any grantee against any other grantee." *Land Developers, Inc. v. Maxwell*, 537 S.W.2d 904, 912 (Tenn. 1976). However, the Supreme Court of Tennessee found issue again because the Chambers did not own all of the land that they attempted to control with the 1955 Covenants. The Court referred to a Michigan Supreme Court case in which the court reasoned that "[An implied negative reciprocal easement] must start with a common owner. Reciprocal negative easements are never retroactive." *Sanborn v. McLean*, 206 N.W. 496, 497 (1925). The Supreme Court of Tennessee agreed, noting that Tennessee law also recognized that covenants should not be given retroactive effect. *See E. Sevier Cnty. Util. Dist. v. Wachovia Bank & Tr. Co.*, 570 S.W.2d 850, 853 (Tenn. 1978). The Court stated that since the Chambers did not own all of the property when they created the 1955 Covenants, to apply the covenants would be applied retroactively, which is improper.

Finally, the Court briefly addresses the argument that, since the Chambers briefly reacquired the Defendant's lots in 1956, the 1955 Covenants should apply. The Supreme Court of Tennessee found that argument unpersuasive as well, stating that they do "not believe that the implied negative reciprocal easement doctrine can be stretched to impose a restriction upon property when the grantor parted ways with it before attempting to impose the restriction, simply because the grantor reacquired it a year after recording the purported restriction." *Phillips*, 624 S.W.3d at 480.

For all the reasons above, the Supreme Court of Tennessee sided with the Defendant and held that the Defendant's property should not be restricted by the 1955 Covenants. This case highlights two important takeaways. The first is that the Supreme Court of Tennessee will not apply covenants, especially restrictive covenants, retroactively. What this means, practically, is that lawyers must ensure that their clients' wants are represented at the outset and ensure that, if the client wants to enact an implied negative reciprocal easement, it is done correctly. Secondly, this case further highlights the necessity to thoroughly check land records.