

IN THE CHANCERY COURT FOR THE STATE OF TENNESSEE
TWENTIETH JUDICIAL DISTRICT, DAVIDSON COUNTY, PART III

LESLIE NEWMAN, Commissioner of the)
Tennessee Department of Commerce and)
Insurance, (Marie Murphy, Special Deputy)
Commissioner of Commerce and Insurance)
for the State of Tennessee))
))
Petitioner,))
))
VS.))
))
SMART DATA SOLUTIONS, LLC, a)
Tennessee limited liability company, et al.,)
))
Respondents.))

NO. 10-507-III

Damages Petitioner Against
Evans/Petree PC and
William L. Hendricks, Jr.

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MEMORANDUM AND ORDER

This lawsuit was filed by the State of Tennessee in March of 2010 to liquidate companies conducting insurance business. The petition for liquidation was granted by this Court in May of 2010. The status of the case is that the Liquidator is presently marshaling assets of the companies. Part of that process is the assertion by the Liquidator of claims on behalf of the liquidated entities pursuant to Tennessee Code Annotated section 56-9-313(b)(1).

One such claim is a Petition to recover damages on behalf of one of the liquidated entities, Smart Data Solutions, LLC ("SDS"), from Evans/Petree PC, a Memphis law firm, and William L. Hendricks, an attorney of the firm, (collectively referred to herein as the "Attorneys"), for alleged acts of legal malpractice the Attorneys are claimed to have committed in their representation of SDS beginning in February of 2008.

The Attorneys filed a Tennessee Rule of Civil Procedure 12.02(6) motion that the Petition should be dismissed for failure to state a claim. The motion was argued before the Court on August 25, 2011, and taken under advisement.

In a September 1, 2011 Memorandum and Order, the Court granted the Attorneys' motion with the determination that the Petition did not contain allegations sufficient to support any of the Petitioner's legal malpractice theories, but the Court did not dismiss the case. The Court provided the Petitioner an opportunity to amend.

On September 30, 2011, an Amended Petition was filed. The Attorneys are now back before the Court, renewing their motion to dismiss on the grounds that the Amended Petition, like its predecessor, fails to allege facts sufficient to state a claim of legal malpractice. Additionally, with respect to one claim, the Attorneys assert that it is time-barred.

After reviewing the Amended Petition, argument of counsel and the law, the Court grants the motion to dismiss, both on the grounds of failure to state a claim and that one claim is also barred by the statute of limitations. The Court's reasoning is as follows.

In its amended pleading, the Petitioner maintains the same theories of malpractice liability against the Attorneys:

1. The Attorneys are liable, under Tennessee Code Annotated section 48-249-306, for not preventing SDS from making distributions to SDS's owner, Bart Posey, or his family in 2009 and 2010.

2. The Attorneys are liable for not preventing SDS from making certain premium payments for sham insurance.
3. The Attorneys are liable for advocating SDS' position that it was not an insurance company after some states had made that determination and by not making SDS comply with state regulations or cease doing business.

These are the theories which the Court determined in its September 1, 2011 Memorandum and Order had insufficient factual allegations. Although the Petitioner has added factual allegations, for the reasons explained below, the amended pleading fails to state a claim.

Unlawful Distributions

Paragraphs 30-31, 50, 52, 54-67, of the Amended Petition allege unlawful distributions violative of Tennessee Code Annotated section 48-249-306 and that the Attorneys' liability for knowing or that they should have known of the distributions. The Court dismisses this claim (1) as a matter of law and (2), with respect to some conveyances, for insufficient factual allegations.

In terms of the law, the Petitioner has cited no authority for its claim that an attorney can be liable for an LLC's unlawful distributions. Tennessee Code Annotated section 48-249-307 limits its list of those who are liable for unlawful distributions to: member, manager or director under specific circumstances. Attorneys are not listed. As a matter of

law, then, the Petitioner has failed to state a legal malpractice claim for unlawful distributions.

Additionally, in terms of factual allegations, with the exception of the \$144,000 distribution to Mr. Posey for a home alleged at paragraphs 54-61, the remaining alleged transfers do not contain any factual allegations that:

- The Attorneys knew about any transfer of funds from SDS to Mr. Posey;
- The Attorneys opined on the advisability of the alleged fraudulent transfers;
- The Petitioners were involved in the day-to-day business operations; and
- The only fact alleged of the Attorneys' knowledge is that their fees were being paid slowly and with delay. That fact is insufficient to state a claim of knew or should have known.

For these reasons, both factual and legal, the Court dismisses the legal malpractice claims derived from unlawful distributions.

Sham Insurance and Regulatory Advice

Turning now to the Petitioner's claim of legal malpractice with respect to SDS' purchase of sham insurance and failure to heed state regulatory agency notices and decisions, in its September 1, 2011 Memorandum and Order, the Court found the original petition insufficient on this claim because of insufficient facts to establish duty. This Court found

in its September 1, 2011 Memorandum and Order that the original petition did not contain allegations that SDS had asked the Attorneys to investigate the purported insurance provider, to advise SDS on whether to make any particular premium payments or to advise SDS on whether it was itself an insurer and, if so, what it needed to do to comply with applicable regulations.

In its amended pleading, the Petitioner now uses the label "general counsel" when referring to the Attorneys as well as allegations of specific matters on which SDS requested the Attorneys to provide legal services such as: responding to several state agency investigations and lawsuits; future contemplated work including a possible restructuring and a lawsuit against one of the insurers; handling customer complaints and drafting indemnity language; communicating with one of the insurers regarding its coverage in response to various state investigations. *See* paragraphs 38-39, 41, 42, 69, 83-84. Nevertheless, the Amended Petition still fails to contain allegations that state a claim of duty in terms of SDS requesting the Attorneys to advise SDS on how to comply with applicable regulations, investigate potential insurers or advise SDS on whether to make any particular insurance premium payment. Absent these, dismissal is required.

As to whether the Attorneys had a duty to prevent SDS from continuing to pay premiums once the North Carolina Department of Insurance entered its August 15, 2008 administrative order stating that a particular insurer was "bogus," the Court concludes that this fact does not establish a duty on the part of the Attorneys. First, as SDS and its owner

were named parties in the North Carolina investigation and orders, they already had knowledge and had been put on notice that North Carolina considered the insurance product a sham and posed a risk of nonpayment for member claims.

Additionally, at paragraph 76 of the Amended Petition it states that SDS knew, no later than February 2009, that the Bema/SAA insurance product was a sham. Accordingly any associated malpractice claim was time-barred (a one-year statute of limitations) before the receivership liquidation was filed in March 2010. Accordingly to *Woods & Woods v. Lewis*, 902 S.W.2d 914, 917-18 (Tenn. Ct. App. 1994), a client has one year from discovery of the negligence to sue the attorney. Combined with that is Tennessee Code Annotated section 56-9-304 and 313(c)(1) that indicates that rehabilitation and liquidation orders do not revive claims on which the limitations period has already expired by the time the rehabilitation and/or liquidation petition was filed.

Based upon the foregoing reasoning and authorities, the Court grants the Attorneys' motion, and the Amended Petition is dismissed in its entirety with prejudice. Court costs are assessed against the Petitioner. It is so ORDERED.



ELLEN HOBBS LYLE
CHANCELLOR

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