

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 03-31932

MEDEX REGIONAL LABORATORIES, LLC

Debtor

MEDEX REGIONAL LABORATORIES, LLC

Plaintiff

v.

Adv. Proc. No. 03-3208

PERSHING, YOAKLEY & ASSOCIATES, P.C.

Defendant

MEMORANDUM ON MOTION TO DISMISS

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

This adversary proceeding was commenced by the Complaint filed by the Debtor on December 23, 2003, requesting a judgment against the Defendant in the amount of \$8,200,000.00 for breach of contract and negligence stemming from an employment engagement contract whereby the Defendant recruited and recommended for employment the Debtor's former Chief Financial Officer, Mike Ladd. The Debtor alleges that Ladd caused the Debtor to incur damages in the amount of \$8,200,000.00, for which the Defendant should be liable.

The Defendant filed a Motion to Dismiss on January 9, 2004, requesting that the court dismiss the Complaint for failure to state a claim upon which relief can be granted. See FED. R. CIV. P. 12(b)(6) (applicable in adversary proceedings pursuant to FED. R. BANKR. P. 7012(b)). In support of its Motion to Dismiss, the Defendant asserts that the Debtor has not set forth any basis for the court to find breach of contract and/or negligence or for the requested award of consequential damages.

This is a noncore proceeding that is otherwise related to the Debtor's bankruptcy case. Both parties have consented to the entry of final orders and judgment by the bankruptcy judge, and the Debtor has demanded a jury.¹ 28 U.S.C.A. § 157(c)(2) (West 1993).

¹ Both the Debtor and Defendant have consented to the conduct of the jury trial by the bankruptcy judge. See 28 U.S.C.A. § 157(e) (West 1993 & Supp. 2003).

I

On June 6, 2000, the Debtor retained the Defendant to assist with its recruitment of a Chief Financial Officer. The parties entered into an engagement agreement (Agreement), and pursuant to this Agreement, the Defendant agreed to perform the following services at issue in this action:

identify qualified candidates, prescreen candidates before submission of resumes to Medex, participate in the interview process at your discretion with Medex personnel, perform reference checks on candidates, and attempt to garner any information on a candidate's performance by means other than candidate's listed references.

In connection with the Agreement, the Defendant tendered Ladd as an appropriate candidate for the Chief Financial Officer position, and he was subsequently hired by the Debtor to serve in that capacity.

In its Complaint, the Debtor alleges that while serving as the Debtor's Chief Financial Officer, Ladd obtained approximately \$8,000,000.00 in unauthorized loans and used those funds to expand the Debtor into a regional facility, while falsely representing to the Board of Managers that the company was profitable and without significant indebtedness. Additionally, the Debtor avers that Ladd falsified documents in order to obtain these loans; that he misdirected and misused approximately \$200,000.00 for his personal benefit; that Ladd had a prior criminal conviction for forgery within five years of his employment by the Debtor; and that Ladd had a reputation for producing false and forged documents in a corporate setting and for misleading and misrepresenting his conviction with prior employers.

The Debtor seeks damages against the Defendant stemming from Ladd's alleged actions based upon the Defendant's failure to properly check Ladd's background, references, and records, or in the alternative, for failing to provide such information to the Debtor, including Ladd's criminal background, in breach of the Agreement. The Debtor also avers that the Defendant negligently or recklessly conducted its investigation as required by the Agreement, causing the Debtor to sustain its losses as a direct and proximate cause of Ladd's employment as recommended by the Defendant. Finally, the Debtor argues that it is entitled to consequential damages because it justifiably relied upon the Defendant's recommendations of Ladd under the terms of the Agreement.

II

When faced with a motion to dismiss pursuant to Rule 12(b)(6), the court must "construe the complaint in the light most favorable to the plaintiff, accept all the factual allegations as true, and determine whether the plaintiff can prove a set of facts in support of its claims that would entitle it to relief." *Bovee v. Coopers & Lybrand, C.P.A.*, 272 F.3d 356, 360 (6th Cir. 2001). Although all factual allegations are accepted as true, the court "need not accept as true legal conclusions or unwarranted factual inferences." *Mich. Paytel Joint Venture v. City of Detroit*, 287 F.3d 527, 533 (6th Cir. 2002) (quoting *Morgan v. Church's Fried Chicken*, 829 F.2d 10, 12 (6th Cir. 1987)). The focus is on "whether the plaintiff has pleaded a cognizable claim." *Marks v. Newcourt Credit Group, Inc.*, 342 F.3d 444, 452 (6th Cir. 2003). The complaint should not be dismissed "unless it appears beyond doubt that the plaintiff can

prove no set of facts in support of [its] claim which would entitle [it] to relief.” *Buchanan v. Apfel*, 249 F.3d 485, 488 (6th Cir. 2001) (quoting *Conley v. Gibson*, 78 S. Ct. 99, 102 (1957)).

The Defendant argues that the Complaint does not set forth adequate facts under which the court may find that the Defendant breached the Agreement with the Debtor in its recruitment and recommendation of Ladd. Additionally, the Defendant avers that the Debtor has pled no set of facts under which the court could find that the Defendant’s conduct was negligent. Finally, the Defendant argues that under no set of facts could the court award the Debtor the consequential damages it seeks.

III

The Debtor’s Complaint first asserts that the Defendant breached the Agreement, and therefore, the Debtor is entitled to damages for breach. In response, the Defendant argues that it did not breach the Agreement because the Agreement did not require it to perform any criminal background check on prospective candidates. Under Tennessee law,

[w]hile a contract may be either expressed or implied, or written or oral, it must result from a meeting of the minds of the parties in mutual assent to the terms, must be based upon a sufficient consideration, free from fraud or undue influence, not against public policy and sufficiently definite to be enforced.

Johnson v. Central Nat’l Ins. Co., 356 S.W.2d 277, 281 (Tenn. 1962); *Klosterman Dev. Corp. v. Outlaw Aircraft Sales, Inc.*, 102 S.W.3d 621, 635 (Tenn. Ct. App. 2002).

When resolving disputes concerning contract interpretation, [the court’s] task is to ascertain the intention of the parties based upon the usual, natural, and ordinary meaning of the contractual language. All provisions in the contract

should be construed in harmony with each other, if possible, to promote consistency and to avoid repugnancy between the various provisions of a single contract.

Guiliano v. Cleo, Inc., 995 S.W.2d 88, 95 (Tenn. 1995) (citations omitted).

While intent is generally expressed in the body of the contract, “the object to be attained in construing a contract is to ascertain the meaning and intent of the parties as expressed in the language used and to give effect to such intent if it does not conflict with any rule of law, good morals, or public policy.” *Planters Gin Co. v. Fed. Compress & Warehouse Co., Inc.*, 78 S.W.3d 885, 890 (Tenn. 2002). However, if a provision may be susceptible to more than one reasonable interpretation, it may render the terms of the contract ambiguous. *Planters Gin Co.*, 78 S.W.3d at 890. “Where the terms of the contract are ambiguous, the intention of the parties cannot be determined by a literal interpretation of the language, and the courts must resort to other rules of construction.” *Planters Gin Co.*, 78 S.W.3d at 890.

The Agreement expressly states that the Defendant will provide the following services in connection with the search for a Chief Financial Officer for the Debtor:

identify qualified candidates, prescreen candidates before submission of resumes to Medex, participate in the interview process at your discretion with Medex personnel, perform reference checks on candidates, and attempt to garner any information on a candidate’s performance by means other than candidate’s listed references.

Although the Agreement does not expressly state that the Defendant will conduct criminal background checks, the provision providing for performance of reference checks and attempting to garner information by means other than listed references could be construed as including background checks that would have disclosed Ladd’s criminal background.

Because the Agreement is ambiguous, it is necessary to ascertain the parties' intent when the Agreement was executed. Therefore, taking the pleadings in a light most favorable to the Debtor, the court finds that the Debtor has stated a claim upon which relief could be granted, and the Motion to Dismiss cannot be granted as to the breach of contract claim.

IV

Conversely, with respect to the negligence cause of action, the Debtor has failed to state a claim upon which relief can be granted, and the Motion to Dismiss shall be granted as to that claim. In Tennessee, “[i]t is well settled that a tort cannot be predicated on a breach of contract. A tort exists only if a party breaches a duty which he owes to another independently of the contract.” *Calipari v. Powertel, Inc.*, 231 F. Supp. 2d 734, 736 (W.D. Tenn. 2002); *see also Mid-South Milling Co. v. Loret Farms, Inc.*, 521 S.W.2d 586, 588 (Tenn. 1975) (“A contract may be negligently or fraudulently breached and the cause of action remain in contract rather than in tort.”).

If a duty to conform to a standard exists between the parties irrespective of contract, and the defendant is negligent, the damaged plaintiff, generally speaking, may sue in tort. However, if the only source of duty between a particular plaintiff and defendant is their contract with each other, then a breach of that duty, without more, ordinarily will not support a negligence action. Ordinarily, it is not a tort for one of the contracting parties to breach the contract. Conduct constituting breach of contract becomes tortious only when it also violates a duty, independent of the contract, arising from wider principles of social responsibility. Short of that, a party's breach of contract remains enforceable as a contract action - not as a tort action - regardless of whether the breach was an intentional one or an unintentional one caused by carelessness.

Thomas & Assocs., Inc. v. Metro. Gov't of Nashville & Davidson County, No. M2001-00757-COA-R3-CV, 2003 Tenn. App. LEXIS 425, at *17-*19 (Tenn. Ct. App. June 6, 2003) (citations omitted).

The Debtor correctly argues that “[i]t is often the case . . . that the same wrong is both a breach of contract and a tort.” *W. Union Telegraph Co. v. Green*, 281 S.W. 778, 782 (Tenn. 1925). However, that same case, which concerned the measure of damages to be imposed for a tort as opposed to breach of contract, also reiterates that to fall within that dual category, “[a] person voluntarily binds himself by a contract to perform some duty *which already lies upon him independently of any contract.*” *Green*, 281 S.W. at 782 (emphasis added).

Here, the Complaint alleges that the Defendant was negligent in its investigation of Ladd, in particular, in its failure to check Ladd’s background. In order to maintain a successful claim for negligence, a plaintiff must satisfy the following elements:

- (1) a duty of care owed by the defendant to the plaintiff;
- (2) conduct by the defendant falling below the applicable standard of care that amounts to a breach of that duty;
- (3) an injury or loss;
- (4) causation in fact; and
- (5) proximate, or legal, causation.

Staples v. CBL & Assocs., Inc., 15 S.W.3d 83, 89 (Tenn. 2000). As all elements must be satisfied, the first issue in the court’s analysis is whether the Defendant owed an independent duty of care to the Debtor beyond the terms set forth in the Agreement.

A duty is defined as “the legal obligation owed by defendant to plaintiff to conform to a reasonable person standard of care for the protection against unreasonable risks of harm.”

McCall v. Wilder, 913 S.W.2d 150, 153 (Tenn. 1995).

The existence of a duty is a question of law for the court which requires consideration of whether “such a relation exists between the parties that the community will impose a legal obligation upon one for the benefit of others-- or, more simply, whether the interest of the plaintiff which has suffered invasion was entitled to legal protection at the hands of the defendant.” The imposition of a legal duty “reflects society’s contemporary policies and social requirements concerning the rights of individuals and the general public to be protected from another's act or conduct.”

Turner v. Jordan, 957 S.W.2d 815, 818 (Tenn. 1997) (quoting *Bradshaw v. Daniel*, 854 S.W.2d 865, 870 (Tenn. 1993)). In making the assessment of “whether a duty is owed in a particular case, courts must apply a balancing approach, based upon principles of fairness, to identify whether the risk to the plaintiff was unreasonable.” *Staples*, 15 S.W.3d at 89. “A risk is unreasonable and gives rise to a duty to act with due care if the foreseeable probability and gravity of harm posed by defendant's conduct outweigh the burden upon defendant to engage in alternative conduct that would have prevented the harm.” *McCall*, 913 S.W.2d at 153.

Several factors must be considered in determining whether a risk is an unreasonable one. Those factors include the foreseeable probability of the harm or injury occurring; the possible magnitude of the potential harm or injury; the importance or social value of the activity engaged in by defendant; the usefulness of the conduct to defendant; the feasibility of alternative, safer conduct and the relative costs and burdens associated with that conduct; the relative usefulness of the safer conduct; and the relative safety of alternative conduct. Stated succinctly, a duty of reasonable care exists if defendant's conduct poses an unreasonable and foreseeable risk of harm to persons or property.

McCall, 913 S.W.2d at 153 (citations omitted). If the court determines that a duty was owed, the focus then shifts to whether the party's standard of care fell below that of a reasonably prudent person under the same or similar circumstances. See *McCall*, 913 S.W.2d at 153.

In this case, absent the Agreement, there was no independent duty owed to the Debtor by the Defendant "arising from wider principles of social responsibility." *Thomas & Assocs., Inc.*, 2003 Tenn. App. LEXIS 425, at *18. These parties were not inter-related in any way other than by the Agreement. There was no other type of relationship which could be construed as giving rise to a greater duty than those set forth in the terms of the Agreement. As such, the Debtor cannot maintain a cause of action for negligence against the Defendant. Accordingly, the Debtor has failed to state a claim therefor upon which relief can be granted.

V

Finally, the Defendant argues that the Debtor has failed to state a claim upon which the damages that it seeks can be awarded. Having already determined that the Debtor has stated a cause of action for breach of contract, the issue is whether the damages sought are the type for which they may be awarded.

"The purpose of assessing damages in breach of contract cases is to place the plaintiff as nearly as possible in the same position [it] would have been in had the contract been performed, but the nonbreaching party is not to be put in any better position by recovery of damages for the breach of the contract than [it] would have been if the contract had been fully performed." *Cantrell v. Knox County Bd. of Educ.*, 53 S.W.3d 659, 662 (Tenn. 2001)

(quoting *Lamons v. Chamberlain*, 909 S.W.2d 795, 801 (Tenn. Ct. App. 1993)). “Generally speaking, damages for breach of contract include only such as are incidental to or directly caused by the breach and may be reasonably supposed to have entered into the contemplation of the parties.” *BVT Lebanon Shopping Ctr., Ltd. v. Wal-Mart Stores, Inc.*, 48 S.W.3d 132, 136 (Tenn. 2001) (quoting *Simmons v. O’Charley’s, Inc.*, 914 S.W.2d 895, 903 (Tenn. Ct. App. 1995)). This “expectation interest” is “measured by (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform.” *BVT Lebanon Shopping Ctr.*, 48 S.W.3d at 136 (citing RESTATEMENT (SECOND) OF CONTRACTS § 347 (1979)).

The Debtor seeks consequential damages arising from the Defendant’s alleged breach of the Agreement. This type of damages is the kind generally awarded by Tennessee courts in breach of contract cases. Therefore, the Debtor has stated a claim upon which the damages sought could be recoverable.

VI

In summary, the Motion to Dismiss shall be denied as to the Debtor’s claim for breach of contract and any damages sought thereunder. The Motion shall be granted as to the Debtor’s claim for negligence.

An order consistent with this Memorandum will be entered.

FILED: February 27, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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Defendant

ORDER

For the reasons stated in the Memorandum on Motion to Dismiss filed this date, the court directs the following:

1. To the extent the Motion to Dismiss filed by the Defendant on January 9, 2004, seeks the dismissal of the Debtor's claim grounded on breach of contract and damages related thereto pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, made applicable to this adversary proceeding by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, for failure to state a claim upon which relief can be granted, the Motion to Dismiss is DENIED.
2. To the extent the Motion to Dismiss filed by the Defendant on January 9, 2004, seeks the dismissal of the Debtor's claim grounded on tort pursuant to Rule 12(b)(6) of the

Federal Rules of Civil Procedure, made applicable to this adversary proceeding by Rule 7012(b) of the Federal Rules of Bankruptcy Procedure, for failure to state a claim upon which relief can be granted, the Motion to Dismiss is GRANTED. The Complaint filed December 23, 2003, is, to the extent the Debtor's claim against the Defendant sounds in tort, DISMISSED.

SO ORDERED.

ENTER: February 27, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE