Dated: January 17, 2008
The following is ORDERED:

Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

CHARLES HUNT GALLINA,

Debtor.

Case No. 03-26316-L
Chapter 7

Barbara R. Loevy, Chapter 7 Trustee,

Objector,

v.

Wolf River Investments, Inc.,

Respondent.

ORDER SUSTAINING OBJECTION TO PROOF OF CLAIM

BEFORE THE COURT is the objection of Barbara R. Loevy, Chapter 7 trustee ("Trustee"), to the secured claim filed by Wolf River Investments, Inc. ("Wolf River"). The court heard

testimony on January 10 and 24, 2007, and asked the parties to file proposed findings of fact and conclusions of law. The parties have done so and the objection is ready for decision. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACT

There are substantial factual disputes between the parties. Certain background facts, however, are not in dispute. In 1990, the Debtor, Charles Hunt Gallina, undertook the development of a residential subdivision in Shelby County, Tennessee, known as the Huntington Oaks subdivision ("Huntington Oaks"). Shortly thereafter, David J. Johnson, a licensed attorney, undertook the representation of Gallina in connection with Huntington Oaks. He was the attorney that handled the closing of the original development loan acquired by Gallina from the Bank of Bartlett in 1995, and he was the attorney who handled the closing of a subsequent loan with Citizens Bank that replaced the original development loan. The property was acquired by Gallina from Harrison Wilder. Gallina originally purchased 22 acres, but had discussions from the beginning about purchasing an additional 37 acres from Wilder. According to Gallina, when he went to Johnson's office to close the development loan with the Bank of Bartlett, Johnson was aware that Gallina did not have funds to purchase the adjoining acres and suggested that they go into business together to purchase and develop those acres. Johnson denies this, but it is a fact that the two did go into business together shortly thereafter.

On June 24, 1994, Johnson formed a Nevada corporation, Wolf River Investments, Inc., and in 1999 sought and obtained authority to transact business in the state of Tennessee. Johnson testified that he serves as the president of Wolf River and that its shareholders are his three adult daughters; Wolf River was created as an investment vehicle for them. Both Gallina and Johnson

agree that Johnson formed a new entity, Huntington Oaks, LLC, in late 1995 or early 1996, for the purpose of acquiring and developing the second parcel of land consisting of 37 acres. This project was known as Huntington Oaks, First Addition. Johnson and Gallina agree that the members of Huntington Oaks, LLC, were Gallina and Wolf River. Johnson and Gallina agree that Huntington Oaks, LLC, was eventually converted to a partnership effective January 1, 2000, at Johnson's suggestion for unspecified tax reasons. No books or records were kept for Huntington Oaks, LLC, or the partnership. Neither had a bank account. The parties disagree about who was responsible for record keeping of the limited liability company and partnership. There is some discrepancy about the cost of improvements that were made to the First Addition property. Johnson admits that engineering was obtained, brush was cleared, and fill work was done. Gallina testified that the First Addition received all governmental approvals for development in 1998.

Gallina testified that he was injured in an automobile accident on April 15, 1998. As a result, he began to take pain medication in May 1998. On January 27, 1999, he suffered a stroke and was hospitalized for two weeks. Gallina underwent back surgery in May of 1999, which was not successful in alleviating his pain. After surgery, Gallina increased his use of pain medication. He underwent a second surgery in April of 2000. He testified that he was confined to his bed for an extended period thereafter, and took Oxycontin three times per day until September 2000. He testified that he became addicted to the use of this pain medication and required the support of a physician to wean him off of it. Gallina testified that he was under the care of this physician in October 2000 and was not able to start driving again until November 2000. Gallina hired James Surprise, Johnson's law partner, to represent him in connection with litigation arising from his accident. Surprise, now deceased, represented Wolf River at the hearing before this court.

On April 15, 2003, Gallina filed a voluntary petition under Chapter 11 of the Bankruptcy Code, but it was converted to a case under Chapter 7 on June 22, 2005. Wolf River filed a proof of claim on May 15, 2003, in the amount $147,668.54. The claim was later amended on January 9, 2007, to decrease the amount of the claim to $110,772.22. The claim is evidenced by a series of thirty-two promissory notes dated between September 29, 1999, and January 23, 2001, together with a Collateral Assignment dated October 10, 2000, by which Gallina purportedly assigned his interest in the litigation resulting from his automobile accident to Wolf River. Gallina testified that he first became aware that Wolf River claimed that he owed funds to it when it filed its proof of claim. There is no evidence that Wolf River made demand for payment prior to filing its proof of claim.

The promissory notes are interesting for a number of reasons. A summary highlights some of the irregularities in the notes.

	Date	Amount	Footer	Source of Funds
1	09/29/99	$800.00	pkissee/note/gallina, hunt demand note 16	unknown
2	10/18/99	8,000.00	pkissee/note/gallina, hunt demand note 14	Wolf River Investments, Inc. David Johnson
3	11/11/99	797.00	pkissee/note/gallina, hunt demand note 3	David J. Johnson, P.C. Escrow Account
4	11/11/99	20.00	pkissee/note/gallina, hunt demand note 4	David J. Johnson, P.C. Escrow Account
5	12/13/99	5,184.00	pkissee/note/gallina, hunt demand note 5	David J. Johnson, P.C. Escrow Account
6	1/25/00	5,000.00	pkissee/note/gallina, hunt demand note 6	David J. Johnson, P.C. Escrow Account
7	2/2/00	654.65	pkissee/note/gallina, hunt demand note 7	David J. Johnson, P.C. Escrow Account
8	2/25/00	1,000.00	pkissee/note/gallina, hunt demand note 8	David J. Johnson, P.C. Escrow Account
9	3/20/00	5,184.00	pkissee/note/gallina, hunt demand note 9	David J. Johnson, P.C. Escrow Account

10	4/13/00	15,000.00	pkissee/note/gallina, hunt demand note 17	David J. Johnson, P.C. Escrow Account
11	5/8/00	240.00	pkissee/note/gallina, hunt demand note 10	David J. Johnson, P.C. Escrow Account
12	5/11/00	500.00	pkissee/note/gallina, hunt demand note 11	David J. Johnson, P.C. Escrow Account
13	5/12/00	500.00	pkissee/note/gallina, hunt demand note 18	unknown
14	5/24/00	5,500.00	pkissee/note/gallina, hunt demand note 19	David J. Johnson Equity Asset Line
15	6/6/00	5,600.00	pkissee/note/gallina, hunt demand note 20	David J. Johnson Equity Asset Line
16	6/12/00	5,184.00	pkissee/note/gallina, hunt demand note 12	David J. Johnson, P.C. Escrow Account
17	6/23/00	5,000.00	pkissee/note/gallina, hunt demand note 21	David J. Johnson Equity Asset Line
18	7/13/00	1,500.00	pkissee/note/gallina, hunt demand note 22	David J. or Imogene M. Johnson
19	7/31/00	900.00	pkissee/note/gallina, hunt demand note 23	David J. or Imogene M. Johnson
20	8/18/00	960.00	pkissee/note/gallina, hunt demand note 24	David J. or Imogene M. Johnson
21	8/23/00	600.00	pkissee/note/gallina, hunt demand note 25	David J. or Imogene M. Johnson
22	8/25/00	400.00	pkissee/note/gallina, hunt demand note 26	David J. or Imogene M. Johnson
23	9/12/00	1,800.00	pkissee/note/gallina, hunt demand note 27	David J. or Imogene M. Johnson
24	9/25/00	9,832.00	cbrigance/note/gallina demand note 13	Wolf River Investments, Inc. David Johnson
25	9/29/00	800.00	cbrigance/note/gallina demand note 12	Wolf River Investments, Inc. David Johnson
26	10/10/00	896.00	cbrigance/note/gallina demand note 8	David J. Johnson, P.C. Escrow Account
27	10/23/00	201.20	cbrigance/note/gallina demand note 5	unknown
28	10/28/00	12,000.00	cbrigance/note/gallina demand note 6	Wolf River Investments, Inc. David Johnson
29	11/21/00	2,500.00	cbrigance/note/gallina demand note 7	Wolf River Investments, Inc. David Johnson
30	12/21/00	1,300.00	cbrigance/note/gallina demand note 9	Wolf River Investments, Inc. David Johnson
31	1/9/01	700.00	cbrigance/note/gallina demand note 10	Wolf River Investments, Inc. David Johnson

32	1/22/01	964.00	cbrigance/note/gallina demand note 11	Wolf River Investments, Inc. David Johnson
	Total	$99,516.85		

Gallina has no recollection of signing any of the notes, but he did recall signing documents provided to him by Johnson. Gallina indicated that he did not intend to borrow funds from Wolf River. Rather, he linked each of these asserted transactions with a need of the limited liability company or Johnson individually. Gallina testified that Wolf River agreed to fund the expenses of preparing the First Addition for development and that the parties agreed to "settle up" when they obtained a development loan.

Each of the notes is dated and each of them carries at the bottom a footer indicating a drive path and a number. The summary comparison shows that the footer numbers are out of sequence in many cases. Cynthia Brigance, a paralegal employed by Johnson who prepared nine of the notes, testified that she could not explain why the footer numbers would be out of sequence. She said that it was her practice to pull up the last note prepared, change the date of the note to the current date, make the changes directed by Johnson, and rename the document, numbering them sequentially. The sources of funds are also of interest. Only eight of the thirty-two notes are drawn on accounts in the name of Wolf River.

Other irregularities are not apparent from the summary. Each of the notes is a demand note, payable together with interest. Although each of the notes was prepared on a word processor, in every case the original interest rate, "fifteen percent (15%)," has been stricken and "ten (10%)" typewritten underneath the stricken language. Johnson testified that the notes were prepared at his

office by his staff, but he could give no explanation for why, in every case, over a period of time spanning many months, it was necessary to alter the interest rate on every note.

Each of the notes states that it is secured by a "Collateral Assignment" with no further description. Johnson asserts that there were three Collateral Assignments given by Gallina over the course of this relationship: the first assigned Gallina's membership interest in Huntington Oaks, LLC; the second, his partnership interest in Huntington Oaks Partnership; and the third, his interest in the litigation arising out of his automobile accident. This third Collateral Assignment, relied upon by Wolf River, is dated October 10, 2000, the date of the twenty-sixth note, a date when Gallina testified he was unable to conduct business because of his treatment for addiction to prescription pain medication. UCC-1 Financing Statements were prepared and filed with the Tennessee Secretary of State and the Shelby County Register.

The signature of Gallina on the Collateral Assignment was acknowledged before Cynthia Brigance as notary. She testified that she had no recollection of the transaction, but was sure that she never notarized Gallina's signature outside of Johnson's office. She testified that if she notarized his signature on October 10, then Gallina was in Johnson's office on October 10. Gallina testified that he was unable to drive on that date and could not have been in Johnson's office. Ms. Brigance testified that she does not keep a log of documents for which she serves as notary.

Johnson's testimony was also of interest. Johnson is a licensed attorney for and has represented banks since 1969. In that capacity, he has handled many closings of real estate transactions, including the preparation and funding of promissory notes. He had no specific recollection of any of the transactions with Gallina, including the signing of the Collateral Assignment. He testified that Wolf River, an investment vehicle for his daughters, had funds on

hand in his attorney escrow account that he was authorized to use in his discretion, and that these were the source of loans to Gallina. Johnson testified that Wolf River paid its share of partnership debts as the parties went along, but there was no evidence of this.

The only records kept by Wolf River consisted of its checkbook and some handwritten calculations performed by Johnson. Johnson testified that he prepared an operating agreement for Huntington Oaks, LLC, and a partnership agreement for Huntington Oaks Partnership, but neither of these was made part of the trial record. Johnson acknowledged that nothing in the agreements indicated that Gallina would serve as the bookkeeper for the limited liability company or partnership, but that he did not feel that it was his responsibility to do so. According to Johnson, there is no record of advances made by either Wolf River or Gallina to make the note payments due to Wilder for the purchase of the First Addition property, other than canceled checks. Johnson testified that the primary partnership asset was foreclosed in 2001 and thereafter the partnership terminated. Although he believed that the partnership agreement called for a full and complete accounting upon termination, no accounting was ever prepared by him or anyone else. Although the partnership terminated in 2001, Johnson testified that Wolf River never made demand upon Gallina for repayment of the notes. No demand was made until the original proof of claim was filed on May 15, 2003.

During the trial, Johnson introduced a list that Gallina acknowledged to have written himself. At the top of the document appear the words, "Hunt owes David Johnson as of 3/20/2000." There follows a list of 15 numbered items. Gallina had no recollection of creating the document and thought that it might have been created during a telephone call to reflect allegations made by Johnson. The document is undated, but reflects transactions listed as late as June 23, 2000.

ANALYSIS

The parties have very different conceptions of the issues in this case. Wolf River takes the position that it is merely attempting to collect the notes, which are secured by Gallina's interest in his personal injury lawsuit. Wolf River characterizes the transactions between Johnson and Gallina as "routine lending transactions," with which Gallina was familiar, and thus that no conflict of interest arose between Johnson and his client.

The Trustee points to the numerous irregularities in the transactions between Johnson and Gallina, and the ongoing relationship of attorney and client between them. The Trustee asserts that business transactions between an attorney and client must be carefully scrutinized for fairness, and thus that the court should not treat the claim of Wolf River as a simple one to collect a series of notes. The Trustee asserts that she has successfully controverted the proof of claim filed by Wolf River, and thus that the burden has shifted to Wolf River to prove its claim.

It is true that in bankruptcy cases, a claim or interest, proof of which is timely filed, is deemed allowed unless a party in interest objects. 11 U.S.C. § 502(a). If an objection is made, the bankruptcy court, after notice and hearing, is to determine the amount of the claim and allow the claim except under certain circumstances, including the circumstance that the claim is unenforceable against the debtor under any agreement or applicable law. 11 U.S.C. § 502(b)(1). The party objecting to a claim bears the initial burden of production to discredit the creditor's proof of claim and "produce evidence which, if believed would refute at least one of the allegations that is essential to the claim's legal sufficiency, [at which point], the burden reverts to the claimant to prove the validity of the claim . . . by a preponderance of the evidence." *In re Cleveland*, 349 B.R. 522, 527 (Bankr. E.D. Tenn. 2006) (internal citations omitted) (alterations in the original).

It is likewise true that transactions between an attorney and client are subject to heightened scrutiny: "The level of good faith [required of an attorney engaged in business with a client] is significantly higher than that required of other business transactions where the parties are dealing at arm's length." *Alexander v. Inman*, 974 S.W.2d 689, 694 (Tenn. 1998). In order to enforce a contract with a client, the attorney must demonstrate:

> (1) that he or she provided the client with the same information and advice that an attorney would have provided the client had he or she not been personally interested in the transaction;
> (2) that the client fully understood the meaning and effect of the contract;
> (3) that the client's understanding of the contract was the same as that of the attorney's; and
> (4) that the contract was just and reasonable.

Alexander v. Inman, 903 S.W.2d 686, 694 (Tenn. Ct. App. 1995). Although attorneys are not precluded from engaging in business transactions with their clients, such transactions may occur only in limited circumstances due to the attorney's influence over his client. *Hager v. Fitzgerald*, 934 S.W.2d 668, 670 (Tenn. Ct. App. 1996). The fear is that an attorney's self-interest will interfere with his judgment on behalf of his client. *Id.* at 670-71 (explaining that an attorney must show that he used no undue influence and that he gave his client all "all information and advice which it would have been his duty to give if he had not been interested.") (citation omitted). Consequently, business dealings between attorneys and their clients are strongly discouraged by the Tennessee Rules of Professional Conduct and the prior Tennessee Code of Professional Responsibility. *See* Rule 1.8, Tennessee Rules of Professional Conduct, Tennessee Supreme Court Rule 8; DR 5-104(A), Tennessee Code of Professional Responsibility, Tennessee Supreme Court Rule 8 (2000).

There is little question that all of the activities of Wolf River were controlled by Johnson. Johnson testified that he created Wolf River as an investment vehicle for his daughters, and that he,

as agent for Wolf River, advanced funds to Gallina. There is no indication that Johnson's activities were scrutinized by any other person. Checks to Gallina were drawn upon Johnson's escrow account and his personal checking account. As a result, the court views the activities of Wolf River as the activities of Johnson. Johnson and his law firm served as attorneys for Gallina. Accordingly, the transactions between Wolf River and Gallina must be viewed as transactions between a lawyer and his client. Johnson does not dispute this.

The Collateral Assignment is Not Enforceable

The Collateral Assignment upon which Wolf River relies now is the third in a line of collateral assignments. The first allegedly pledged Gallina's interest in Huntington Oaks, LLC, and the second, in Huntington Oaks partnership. The third collateral assignment is substantially different from the prior two in that it purports to pledge an interest in an asset unrelated to the subject of the alleged loans to Gallina. It purports to pledge an interest in a lawsuit for which a partner of Johnson was engaged to represent Gallina.

Johnson offered no proof that he or anyone else in his firm provided Gallina with any information or advice about entering into this transaction or that Gallina had an understanding of the transaction. Gallina testified that on October 10, 2000, he was suffering symptoms of withdrawal from prescription pain medication, he was not able to drive a car, and was having trouble writing. He has no recollection of having signed the document and believes that the signature on the document does not match that of a check that he admittedly signed on the same day. Gallina testified that he could recall no discussion with Johnson concerning assigning an interest in the litigation to Wolf River and that he did not intend to give Wolf River a security interest in the lawsuit.

Further, the contract is neither just nor reasonable given the relation between the parties. An attorney who has an interest in his client's lawsuit could not objectively evaluate settlement options for that client. His financial interest would incline him to urge his client to accept a settlement in whatever amount would pay his claim rather than undertake the risks of trial. This is a different situation than that of a contingency fee contract, in which the lawyer shares an interest in the outcome of his client's lawsuit, but his incentive is to maximize the recovery for his client. The fact that Johnson *could have* improperly interfered with the settlement of the lawsuit, rather than the suggestion that he actually did do so, renders the collateral assignment unjust and unreasonable.

As Johnson has failed to satisfy any of the *Inman* factors, the Collateral Assignment is unenforceable and may be avoided by the Trustee.

The Notes are Likewise Unenforceable

Under Tennessee law, the right of a party to enforce a negotiable instrument is as follows:

> (a) Except as stated in subsection (b), the right to enforce the obligation of a party to pay an instrument is subject to the following:
>
> > (1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings; . . .
>
> (b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to the defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

Tenn. Code Ann. § 47-3-305. The defenses set forth in subsection (a)(1) are "real" as opposed to "personal" defenses. Personal defenses are not defenses to a note, but arise from the underlying

transaction, such as lack of consideration. *See Fed. Deposit Ins. Corp. v. Turner*, 869 F.2d 270, 273 (6th Cir. 1989). Personal defenses are allowed as defenses to the original wrongdoer, but not to a subsequent holder in due course. *Id.* The Trustee, a party in interest, raised the following defenses to payment of the notes: (i) lack of legal capacity; (ii) illegality of the transaction; and (iii) fraud in the inducement. Wolf River does not assert the rights of a holder in due course. As with the Collateral Assignment, the burden of proof to demonstrate that the lending transactions between Wolf River and Gallina were fair rests upon Wolf River, the alter ego of Johnson.

(A) Lack of Legal Capacity

The Trustee asserts that as the result of his automobile accident and subsequent surgeries, Gallina became addicted to pain medication and was rendered incapable of carrying out normal business transactions. In support of this defense, the Trustee relies upon the testimony of Gallina. Gallina testified to the severe pain that he suffered from his back injury, to periods of time when he was hospitalized for surgery and was confined to bed rest, to his addiction to pain medication and to the medically supervised withdrawal from the use of this medication. He testified that he had no recollection of asking for loans from Johnson or Wolf River, or of executing the notes and Collateral Assignment. Gallina acknowledged that he did sign documents presented to him by Johnson. The Trustee offered no corroborating medical proof of Gallina's incapacity. Wolf River offered the testimony of Mrs. Haggerty, who said that she and her husband had business dealings with Gallina in 1999 and 2000 and that he appeared to her to be fine, but she admitted on cross examination that she did not see Gallina on a regular basis.

The question of competency to contract is a question of law. The Tennessee Court of Appeals has summarized the capacity to contract as follows:

> Competency to contract does not require an ability to act with judgment and discretion. All that is required is that the contracting party reasonably knew and understood the nature, extent, character, and effect of the transaction. Thus, persons will be excused from their contractual obligations on the ground of incompetency only when (1) they are unable to understand in a reasonable manner the nature and consequences of the transaction or (2) when they are unable to act in a reasonable manner in relation to the transaction, and the other party has reason to know of their condition.

Rawlings v. John Hancock Mut. Life Ins. Co., 78 S.W.3d 291, 297 (Tenn. Ct. App. 2001) (internal citations omitted). An individual seeking to invalidate a contract on the basis of mental incapacity bears the burden of proving that one or both parties to the contract were mentally incompetent at the time the contract was formed. *Id.* at 297 (citations omitted). In order to prove mental incapacity, the individual must show, "in light of all the surrounding facts and circumstances, that the cognitive impairment . . . rendered the contracting party incompetent to engage in the transaction at issue . . . ." *Id.* (citations omitted). Evidence of the mental impairment alone does not prove lack of legal capacity to contract. *See Id.* at 297, n. 3*; Street v. Waddell*, 3 S.W.3d 504, 505-06 (Tenn. Ct. App. 1999).

Even though Gallina did not recall signing the various notes relied upon by Wolf River, he acknowledged engaging in a number of business transactions at or about the date of each note. That is, in every case, or nearly every case, Gallina was able to match the note and check relied upon by Wolf River with some transaction that he said created an obligation on the part of Wolf River or Johnson. For example, he testified that the check that Johnson identified as the funding check for the note dated October 18, 1999, in the amount of $8,000.00, was actually intended to reimburse Gallina who hired a subcontractor on Johnson's behalf to do some work at Johnson's personal residence. As another example, Gallina testified that the check identified by Johnson as the funding

check for the note dated January 25, 2000, was for dirt and dirt work on lots owned by Wolf River. As a third example, Gallina explained that the check identified as the funding check for the final note, dated January 25, 2001, in the amount of $964.00, was to reimburse Gallina for a sprinkler system put into one of the houses being sold. Without deciding whether to credit Gallina's specific testimony about the purpose of each check, the court is able to determine that over the period of time covered by the notes, Gallina was able to conduct business, at least some of the time.

The issue of capacity to contract is clouded, however, by the fact that there is conflicting evidence about when the various notes were actually signed. Gallina did not recall executing any of the notes and did not recall asking for loans. Johnson gave only vague testimony to the effect that Gallina would call to ask for money and that Johnson would have a note drawn at or near the time that he caused a check to be issued for Gallina's benefit. Johnson did not give specific testimony about when the notes were signed, except that he did say that he never asked Gallina to sign a note while he was in the hospital. Gallina was able to identify at least one note, however, that was dated on a day when Gallina was in the hospital – the note dated April 20, 2000, in the amount of $15,000.00. Based upon this testimony and the irregularities in the notes (i.e., the footers that are out of sequence), the court finds it difficult to credit Johnson's testimony to the effect that the notes were signed at or near the dates of the funding checks. Indeed, it is impossible for the court to determine when the notes were signed rendering it equally impossible for the court to gauge the mental capacity of Gallina at the time of signature. Gallina has raised a substantial question about his capacity to contract at the time these notes were signed. Johnson admitted knowing of Gallina's illnesses and has failed to prove when the notes were actually signed. Thus, Johnson has failed to

prove that Gallina reasonably knew and understood the nature, extent, character, and effect of the transactions.

(B) Illegality of the Transaction

The defense of illegality of the transaction with respect to a negotiable instrument implicates the underlying transaction that gives rise to an obligation for payment. A transaction is illegal if it violates state or federal law or is against public policy. *See Alexander v. Inman*, 903 S.W.2d 686, 694 (Tenn. Ct. App. 1995) (explaining that courts will not enforce contracts for attorneys' fees if those contracts are contrary to public policy). Neither business transactions by and between an attorney and his client nor loans from an attorney to his client are per se illegal. 7A C.J.S. *Attorney & Client* § 291 (2007). They are, nevertheless, strictly scrutinized for fairness. *See Inman*, 903 S.W.2d at 693. Johnson bears the burden of demonstrating that his transactions with Gallina did not violate public policy. Public policy prohibits an attorney from engaging in business dealings that are detrimental to his client's interests. *See Hager v. Fitzgerald*, 934 S.W.2d 668, 670 (Tenn. Ct. App. 1996). The relationship between an attorney and his client is one of trust and confidence. *See, e.g., Inman*, 903 S.W.2d at 693; *Cooper & Keys v. Bell*, 153 S.W. 844, 846-47 (Tenn. 1913). Transactions between such persons have been said to be presumptively invalid unless evidence is provided to establish their fairness. *See Sec. Fed. Sav. & Loan Assoc. v. Riviera, Ltd.*, 856 S.W.2d 709, 714 (Tenn. Ct. App. 1993).

The court is faced with a series of transactions between an attorney and his client who were engaged in business together. Neither of them kept business records for Huntington Oaks, LLC, or for the subsequent partnership. Various checks were given by Johnson to Gallina, which Johnson characterizes as loans and Gallina characterizes as expense reimbursements. Thus the mere fact that

Gallina received and retained the benefit of funds paid by Johnson does not establish an obligation owed by Gallina to Wolf River. The fact that promissory notes were created and signed would indicate that loans were intended to be made but for the fact that Gallina has no recollection of signing the notes and the notes are facially irregular. No independent witness testified concerning any of these transactions. Wolf River admits that there never was a final reconciliation of the limited liability company and partnership expenses.

Johnson is an experienced attorney who has represented banks in any number of lending transactions. He demonstrated his familiarity with various forms of business entities in that he was the one who recommended the original organization as a limited liability company and the subsequent conversion to a partnership. He prepared the operating agreement for Huntington Oaks, LLC, and the partnership agreement for the partnership. He is apparently the one who made whatever year-end calculations were necessary for preparation of tax returns. He was familiar with the fact that the partnership agreement called for a final reconciliation, but took no steps to prepare one or have one prepared when the partnership property was foreclosed in 2001. The fact that he did not expect Wolf River to be repaid is evidenced by his failure to make demand upon Gallina during the period between the foreclosure and the filing of Gallina's bankruptcy case.

All of these factors lend credence to Gallina's insistence that loans were never intended. More importantly, all of these factors indicate that it is unfair to characterize these transactions as loans given the relationship between the parties. Johnson failed to overcome the presumption that his transactions with Gallina are invalid. Therefore, the Trustee's defense of illegality of the transaction is sustained.

(C) Fraud in the Inducement

Fraud in the inducement is fraud in the consideration for or the negotiations leading up to the execution of a negotiable instrument. It is a personal defense and is distinguished from fraud in fact, which is fraud with respect to the character or essential terms of an instrument. *See Fed. Deposit Ins. Corp. v. Turner*, 869 F.2d 270, 273 (6th Cir. 1989). Fraud in the inducement exists when the following five elements exist:

> (1) a false statement concerning a fact material to the transaction;
> (2) knowledge of the statement's falsity or utter disregard for its truth;
> (3) intent to induce reliance on the statement;
> (4) reliance under circumstances manifesting a reasonable right to rely on the statement;
> (5) an injury resulting from the reliance.

Lamb v. MegaFlight, Inc., 26 S.W.3d 627, 630 (Tenn. Ct. App. 2000) (citations omitted).

Gallina had no specific recollection of signing the notes in question. He did say, however, that on the third day of his hospitalization in April of 2000, Johnson asked him to sign a lot of papers. He said that this upset him because he had no clue what he was signing. He said that he signed the papers because he trusted Johnson. Gallina generally indicated that he signed whatever Johnson asked him to sign. It is difficult for the court to evaluate the defense of fraud in the inducement when Gallina is unable to point to any particular representations made by Johnson to induce him to sign the notes. In essence, Gallina indicated that as a result of the relationship between himself and Johnson, the mere fact that Johnson asked him to sign papers amounted to a representation by Johnson that Gallina *should* sign the papers. The Trustee need not rely upon any one particular defense, however, because it is incumbent upon Johnson to show that the transactions between Wolf River and Gallina were fair, and he has failed to do so.

CONCLUSION

For the foregoing reasons, the court concludes that the Trustee's objection to the claim of Wolf River should be sustained. The claim is disallowed in its entirety.

cc: Debtor
Attorney for Debtor
Chapter 7 Trustee
Attorney for Chapter 7 Trustee
Wolf River Investments, Inc.
Attorney for Wolf River Investments, Inc.
United States Trustee