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Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-001412-MR

MICHELE MORGAN;
TAILWIND AVIATION, LLC; AND
TAILWIND PROPERTIES, LLC — APPELLANTS

APPEAL FROM JEFFERSON CIRCUIT COURT
v. HONORABLE MARTIN F. McDONALD, JUDGE
ACTION NO. 03-CI-010459

J. DANIEL LANHAM AND
LANHAM INSULATION, INC. — APPELLEES

AND NO. 2009-CA-001588-MR

J. DANIEL LANHAM — CROSS-APPELLANT

CROSS-APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE MARTIN F. McDONALD, JUDGE
ACTION NO. 03-CI-010459

MICHELLE MORGAN
(INDIVIDUALLY AND IN HER
CAPACITY AS
MANAGING MEMBER OF TAILWIND
FARM, LLC); AND
TAILWIND FARM, LLC — CROSS-APPELLEES

OPINION
AFFIRMING IN PART, REVERSING IN PART,
DISMISSING IN PART, AND REMANDING

** ** ** ** **

BEFORE: MOORE, KELLER, AND STUMBO, JUDGES.

MOORE, JUDGE: This is an appeal and cross-appeal from an April 6, 2009 order and judgment and a subsequent July 14, 2009 order denying a motion to alter, amend, or vacate that judgment. This matter, which involves a series of directed verdicts, contractual and statutory interpretations, and evidentiary rulings relating to three limited liability companies, is the sibling lawsuit of *Morgan v. Lanham*, 2009 WL 2971628 (Ky. App. 2009) (2008-CA-000499-R) (unpublished),[1] a marital dissolution action in Jefferson County Family Court between Michele R. Morgan and James Daniel Lanham.

I. STATEMENT OF THE CASE AND PROCEDURAL HISTORY

We will borrow, briefly, from the facts of *ML I* because they provide this case with a measure of context:

> [Morgan and Lanham] were married May 9, 1998, and a decree dissolving the marriage was entered November 21, 2003. Morgan and Lanham brought considerable assets to the marriage, including real property, commercial property, investments, retirement accounts and an airplane. Morgan had owned and operated a lighting business since 1986, and was its president and chief executive officer. Lanham was likewise the chief executive and sole shareholder in an insulation business ["Lanham Insulation"] operating since 1982. They maintained two joint bank accounts along with separate individual accounts as well as their various business accounts.

[1] Hereafter, we refer to this case as "*ML I*."

> . . . .
>
> Morgan and Lanham entered into a post-nuptial agreement (hereinafter PNA), one month after they married. . . . The PNA also established that any property owned at the time, or acquired thereafter, would be considered their individual property, and not marital property.
>
> . . . .
>
> Additionally, the parties formed three limited liability companies (LLC)[.]

Id. at *1.

The names of the three limited liability companies, referenced above, are "Tailwind Farm," "Tailwind Properties," and "Tailwind Aviation." These entities became the subject of this lawsuit because the Jefferson Family Court declined to rule on matters pertaining to them.

By way of background, Tailwind Farm was formed on January 26, 1998, in order "to acquire, own, develop, train, race, breed and sell thoroughbred horses." Tailwind Farm's operating agreement lists Morgan and Lanham as its members and states that each holds a 50% membership interest.

Tailwind Properties was formed on January 28, 1999, in order to "acquire, own, develop, manage, lease, rent, and sell real property and carry on any and all activities related thereto." Tailwind Properties' operating agreement lists Morgan and Lanham as its members and states that each holds a 50% membership interest. "Exhibit A" to the Operating Agreement reflected that Ms. Morgan made an initial capital contribution of $500.00, and Mr. Lanham made an initial capital

contribution of $500.00. Thereafter, Ms. Morgan transferred, by Deed executed August 25, 1999, her nonmarital commercial office condominium to Tailwind Properties, LLC. Also on August 25, 1999, Mr. Lanham transferred by deed his nonmarital commercial real estate, consisting of two buildings, to Tailwind Properties.

Finally, Tailwind Aviation was formed on January 28, 1999, in order to "acquire, own, lease, operate and sell aircraft and carry on any and all activities related thereto." Tailwind Aviation's operating agreement lists Morgan and Lanham as its members and states that each holds a 50% membership interest. "Exhibit A" to the operating agreement indicates that neither Morgan nor Lanham made an initial capital contribution. Morgan claims that Lanham was to transfer his nonmarital airplane to Tailwind Aviation but did not make that transfer. Lanham acknowledges that when Tailwind Aviation was formed, he was thinking of transferring the airplane to the entity. But, he claims that he did not because the plane was never leased to anyone other than his brother.

Morgan originally filed this suit on December 1, 2003, as an action for a decree of dissolution regarding Tailwind Farm and Tailwind Properties,[2] and for the court to declare her the proper person to wind up the affairs and liquidate the assets of Tailwind Farm, Tailwind Properties, and Tailwind Aviation. Lanham's answer agreed that Tailwind Farm and Tailwind Properties should be dissolved.

[2] Article 11.1(c) of the operating agreements provides that an event of dissolution occurs "Upon the filing of a certificate of dissolution by the Secretary of State of the Commonwealth of Kentucky administratively dissolving the Company." Tailwind Aviation did not request a decree of judicial dissolution because it was administratively dissolved on November 1, 2002. Further, Tailwind Farm was also administratively dissolved prior to when the trial court rendered its opinion in this matter.

Lanham also asserted two cross-claims for breach of fiduciary duty against Morgan.

Thereafter, Tailwind Farm and Tailwind Properties joined as plaintiffs, and Lanham's company, Lanham Insulation, was joined as a defendant. Relevant to this case, Morgan's complaint was amended to assert Tailwind Properties' claims against Insulation for overdue rent and an unpaid loan, and Morgan's additional claim against Lanham for fraud relating to whether he did, or should have contributed his airplane to Tailwind Aviation. On November 17, 2008, Tailwind Aviation was also joined as a plaintiff in this matter.

On April 6, 2009, the trial court directed verdicts 1) in favor of Insulation regarding Tailwind Properties' claims of overdue rent and the unpaid loan; 2) in favor of Insulation regarding a claim for an unpaid $95,000 loan that Tailwind Aviation might have asserted against Insulation; 3) in favor of Lanham regarding Morgan's fraud claim; and 4) in favor of Morgan regarding Lanham's claims against her for breach of fiduciary duty.

Further, the trial court ordered that Tailwind Properties be dissolved, and that the property held by that entity should simply go back to the member who contributed it. In its July 14, 2009 order, the trial court stated:

> The Plaintiffs allege that KRS [Kentucky Revised Statutes] 275.300 requires the Court to distribute assets held by a dissolved LLC. The Court finds that this is not necessary. KRS 275.300(2)(d) permits the LLC to distribute its remaining property to the members according to their respective interests. Again, the operating agreements and the post-nuptial agreement govern the distribution of assets and the Court's

> Judgment is in accordance with those documents. The motion to alter, amend, or vacate will be denied.

These directed verdicts, as well as two evidentiary issues involving the admission of the PNA into evidence and the exclusion of certain expert testimony from evidence, and the trial court's handling of the dissolution of the three Tailwind entities are the subjects of this appeal and cross-appeal. The myriad facts specific to each claim and issue asserted by each party will be stated as they become relevant within the analysis.

II. STANDARD OF REVIEW

The parties of this case appeal from a series of directed verdicts. Many of these directed verdicts, in turn, are based upon statutory construction and the interpretation of several contracts, *i.e.*, three operating agreements and the PNA between Morgan and Lanham. Contract interpretation and statutory construction is a matter of law for the Court to review *de novo*. *Cumberland Valley Contrs., Inc. v. Bell County Coal Corp.*, 238 S.W.3d 644, 647 (Ky. 2007). As to directed verdicts, this Court stated the appropriate standard of review in *Daniels v. CDB Bell, LLC*, 300 S.W.3d 204, 215-16 (Ky. App. 2009):

> When a directed verdict is appealed, the standard of review on appeal consists of two prongs. The prongs are: "a trial judge cannot enter a directed verdict unless there is a complete absence of proof on a material issue or if no disputed issues of fact exist upon which reasonable minds could differ." *Bierman v. Klapheke*, 967 S.W.2d 16, 18-19 (Ky. 1998). "A motion for directed verdict admits the truth of all evidence which is favorable to the party against whom the motion is made." *National Collegiate Athletic Ass'n By and Through Bellarmine College v. Hornung*, 754 S.W.2d 855, 860 (Ky.1988),

> citing *Kentucky & Indiana Terminal R. Co. v. Cantrell*, 298 Ky. 743, 184 S.W.2d 111 (1944).
>
> Clearly, if there is conflicting evidence, it is the responsibility of the jury, the trier of fact, to resolve such conflicts. Therefore, when a directed verdict motion is made, the court may not consider the credibility or weight of the proffered evidence because this function is reserved for the trier of fact. *National*, 754 S.W.2d at 860 (citing *Cochran v. Downing*, 247 S.W.2d 228 (Ky.1952)).
>
> In order to review the trial court's actions in the case at hand, we must first see whether the trial court favored the party against whom the motion is made, including all inferences reasonably drawn from the evidence. Second, "the trial court must determine whether the evidence favorable to the party against whom the motion is made is of such substance that a verdict rendered thereon would be 'palpably or flagrantly' against the evidence so as 'to indicate that it was reached as a result of passion or prejudice.'" If the answer to this inquiry is affirmative, we must affirm the trial court granting the motion for a directed verdict. *Id*. Moreover, "[i]t is well argued and documented that a motion for a directed verdict raises only questions of law as to whether there is any evidence to support a verdict." *Harris v. Cozatt, Inc.*, 427 S.W.2d 574, 575 (Ky.1968). Further, "a reviewing court cannot substitute its judgment for that of the trial judge unless the trial judge is clearly erroneous." *Bierman*, 967 S.W.2d at 18.
>
> Importantly, evidence that is speculative, conjectural, or both is not

sufficient to defeat a motion for directed verdict. *Id*. at 216.

III. ANALYSIS

A. *Tailwind Properties v. Lanham Insulation*; *Tailwind Aviation v. Lanham Insulation*: The trial court's bases for directing verdicts, regarding Tailwind Properties' and Tailwind Aviation's respective claims, in favor of Lanham Insulation

Tailwind Aviation asserted a claim against Insulation for an unpaid loan in the amount of $95,000. Tailwind Properties asserted claims against Insulation for $64,000 in unpaid rent and for an unpaid loan in the amount of $110,000. Insulation moved for directed verdicts on each of these claims. In its April 6, 2009 order, the trial court granted each of Insulation's motions. The trial court's order states, generally, that its reasons for directing a verdict in favor of Insulation are that

> the unambiguous language of the Post-Nuptial Agreement and the various Operating Agreements for the Limited Liability Companies at issue in this matter necessitate judgment in favor of the Defendant Lanham Insulation, Inc. as a matter of law and on the further basis that the evidence presented at trial on said claim was insufficient to sustain a verdict regarding same and that a verdict rendered thereon would be palpably or flagrantly against the evidence in that no reasonable jurors could have found for the Plaintiffs on said claim.

In sum, the trial court held that Insulation was entitled to judgment as a matter of law based upon 1) the PNA, referenced above; 2) the LLC operating agreements; and 3) the general rule, stated above, that a directed verdict is proper where there is a complete absence of proof on a material issue or if no disputed issues of fact exist upon which reasonable minds could differ. *See Daniels*, 300 S.W.3d at 215. But, the trial court's order gives no indication as to why the PNA or any of the LLC operating agreements warranted judgment in favor of Insulation as a matter of law. Thus, before we address the specifics of Tailwind Aviation's and Tailwind Properties' claims, it is necessary at the start to determine the relevance of the trial court's reliance on the PNA and the operating agreements as

its first two bases for directing a verdict in favor of Insulation, and whether these mandated judgment in favor of Insulation.

1. The trial court's first basis: the postnuptial agreement (PNA) between Morgan and Lanham

On June 5th, 1998, Lanham and Morgan entered into their PNA, which referenced schedules of their respective separate properties. Relevant to this case, Lanham's schedule included, but was not limited to, 1) an airplane; and 2) a parcel of commercial property comprised of two buildings, located in Jefferson County, Kentucky, which Lanham used to house his business, Lanham Insulation. From the beginning of this litigation, Insulation has argued that the PNA controls what Tailwind Properties and Tailwind Aviation own. Insulation places special emphasis upon paragraph 13 of that agreement, which states:

> Although each party [*i.e.*, Lanham and Morgan] has the right hereunder to keep his or her individual assets separate from those of the other party, the parties hereto shall have no obligation to keep their individual assets separate. Any commingling of the assets of the parties hereto or other failure to keep their individual assets separate shall not in any way be considered an abandonment of the provisions of this Agreement and shall not affect its enforceability. Each party agrees that neither shall have the right to claim an abandonment of the terms of this Agreement, either by action or implication, and that this Agreement may only be abandoned by the written agreement of the parties.

Insulation argues this paragraph means that any property transferred to or acquired by either LLC, described in the schedule attached to the PNA between Morgan and Lanham, is actually property that has been comingled between Morgan and Lanham and, therefore, Insulation reasons that it does not

owe Tailwind Aviation or Tailwind Properties for any loans or rent traceable to any of these properties.

There are three problems with this argument.

First, property that is validly transferred to a limited liability company or acquired by a limited liability company, such as Tailwind Aviation or Tailwind Properties, is the property of the limited liability company. KRS 275.240(1). It is not the property of either Morgan or Lanham, regardless of their status as LLC members. *Id*.

Second, the plain language of the PNA, quoted above, demonstrates that the PNA only applies to the parties to the PNA: Lanham and Morgan. Indeed, Paragraph 13 only applies in the event that Lanham and Morgan comingle their separate assets with *each other*. The PNA does not apply to Tailwind Aviation or Tailwind Properties because neither of these legal entities were parties to the PNA.

And third, in making this argument, Insulation is attempting to assert contractual rights belonging to Lanham and Morgan, not its own rights. Neither Lanham, nor Morgan, are parties to any of these claims between Insulation, Tailwind Properties, and Tailwind Aviation. In short, to the extent that the trial court granted a directed verdict based upon the PNA between Morgan and Lanham, the trial court erred.

2. The trial court's second basis: The operating agreements of Tailwind Aviation and Tailwind Properties

Next, we turn to the identical operating agreements for Tailwind Properties and Tailwind Aviation. Insulation reasons that all of Tailwind Aviation's and Tailwind Properties' assets were contributed by, or generated from property contributed by, the members of these entities: Morgan and Lanham. Insulation interprets the operating agreements relating to both entities to mean that when a member contributes any property to one of these entities, that property is held in that member's capital account. Insulation reasons, therefore, that each member is entitled to get out exactly what he put in, and that any property transferred to or acquired by either of these entities "essentially remained" property belonging to the members of the entities, *i.e.*, Morgan and Lanham.

Therefore, Insulation further reasons that if it received a loan from Tailwind Properties or Tailwind Aviation, it is not required to repay that loan to Tailwind Aviation or Tailwind Properties. This, it contends, is because the money those entities used to lend Insulation either came from the sale of property contributed by Morgan and Lanham or was generated by that property. Similarly, Insulation argues that it does not owe Tailwind Properties for any overdue rent if the building it was renting from Tailwind Properties was contributed by a member of Tailwind Properties. Instead, Insulation reasons that the loan or overdue rent should go to the member of Tailwind Properties or Tailwind Aviation who contributed the asset that was sold to generate the funds loaned to Insulation or to the member of Tailwind Properties who contributed the building that Insulation leased.

Insulation argues that several provisions contained within those operating agreements support its position. These provisions define what a "capital contribution" is, govern the creation and maintenance of an LLC member's capital account, and determine the proper circumstances in which a member *may* receive a distribution of property in kind:

> **ARTICLE I**
> **Definitions**
>
> For purposes of this Operating Agreement, unless the context clearly indicates otherwise, the following terms shall have the following meanings:
>
> . . . .
>
> *"Capital Contribution"* shall mean any contribution of cash or Property made to the Company by or on behalf of a Member.
>
> . . . .
>
> **ARTICLE VII**
> **Contributions to the Company; Capital Accounts**
>
> *7.1 Initial Capital Contributions*. The initial Capital Contribution of each Member shall be allocated as set forth in Exhibit A attached hereto as his/her initial Capital Contribution and receive the Membership Interest set forth in Exhibit A. No interest shall accrue on any Capital Contribution, and no Member shall have the right to withdraw or be repaid any Capital Contribution except as provided in this Operating Agreement.
>
> *7.2 Additional Contributions.* Except as set forth in Section 7.1 above, no Member shall be required to make any Capital Contributions. If approved by the Members from time to time, the Members and/or other Persons may be permitted to make additional Capital Contributions if and to the extent they so desire.

7.3 Maintenance of Capital Accounts. The Company shall establish and maintain Capital Accounts for each Member. Each Capital Account shall be increased by (a) the amount of any cash actually contributed by the Member to the capital of the Company, (b) *the fair market value of any Property contributed by the Member to the Company* [emphasis supplied] (net of liabilities assumed by the Company or subject to which the Company takes such Property, within the meaning of §752 of the Code), and (c) the Member's share of Net Profits and of any separately allocated items of income or gain (including any gain and income allocated to the Member to reflect the difference between the *book value* [emphasis supplied] and tax basis of assets contributed by the Member). Each Capital Account shall be decreased by (a) the amount of any cash distributed to the Member by the Company, (b) the fair market value of any Property distributed to the Member (net of liabilities of the Company assumed by the Member or subject to which the Member takes such Property within the meaning of §752 of the Code), and (c) the Member's share of Net Losses and of any separately allocated items of deduction or loss (including any loss or deduction allocated to the Member to reflect the difference between the *book value* [emphasis supplied] and tax basis of assets contributed by the Member).

. . . .

ARTICLE XI
Dissolution and Winding Up

. . . .

11.3 Winding Up, Liquidation, and Distribution of Assets. Upon dissolution, an accounting shall be made by the Company's independent accountants of the accounts of the Company and of the Company's assets, liabilities, and operations, from the date of the last previous accounting until the date of dissolution. The Members shall immediately proceed to wind up the affairs of the Company. If the Company is dissolved and its affairs are to be wound up, the Members shall:

> (a) Sell or otherwise liquidate all of the Company's assets as promptly as practicable (*except to the extent the Administrative Member may determine to distribute any assets to the Members in kind* [emphasis supplied]);
>
> . . . .
>
> (d) Distribute the remaining assets to the Members as follows: first, in an amount equal to the positive balance (if any) of the Members' Capital Account (as determined after taking into account all Capital Account adjustments for the Company's taxable year during which the liquidation occurs) and, *to the extent any assets remain, in proportion to their Membership Interests, either in cash or in kind, as determined by the Administrative Member* [emphasis supplied]. Any such distributions to the Members in respect of their Capital Accounts shall be made in accordance with the time requirements set forth in Treas. Reg. §1.704-1(b)(2)(ii)(b)(2). The net fair market value of those assets to be distributed in kind shall be determined as of the date of dissolution by independent appraisal or by agreement of the Members. Those assets shall be deemed to have been sold as of the date of dissolution for their fair market value, and the Capital Accounts of the Members shall be adjusted pursuant to the provisions of Article VIII and Section 7.4 of this Operating Agreement to reflect such deemed sale.

As a preliminary matter, Insulation's argument regarding the operating agreements contains exactly the same problems as Insulation's prior argument pertaining to the PNA: Insulation is attempting to assert contractual rights belonging to Lanham and Morgan, not its own rights; Insulation again ignores KRS 275.240; and, taken objectively, it appears that Insulation is attempting to escape from several debts by attempting to pierce the corporate veils of its creditors. Most glaringly of all, the plain language of these operating

agreements lends Insulation's argument no support. This last point, however, warrants a bit more discussion.

Insulation's argument begins with a fundamental misinterpretation of what a "capital account" is, how the operating agreement directs a capital account to be maintained, and how a member's capital account is affected when that member makes a capital contribution of *property*, rather than *cash*. When a member contributes property, the LLC shall increase his capital account by the *fair market value of that property*. *See* Article 7.3(c). This value is also referred to as the "book value" in Article 7.3, which is commonly defined as "the value at which an asset is carried on a balance sheet." BLACK'S LAW DICTIONARY 177 (7th ed. 1999). Stated differently, when a member contributes property, rather than cash, the members of the LLC determine the fair market value of that property at the time of the contribution and credit the contributing member's account with that value. After the property is contributed, the LLC owns the property. *See* KRS 275.240; *see also* Article I (defining "capital contribution" as "any contribution of cash or Property made to the Company by or on behalf of a Member; also defining "Company Property" as "any Property *owned* by the Company"). The member, on the other hand, is left with the book value of that property credited to his capital account.

Take the following example: In the year 2000, *Member* contributes a car to *LLC*. *Member* and *LLC* agree that the book value of the car is $1,000. In exchange for the contribution, *LLC* credits $1,000 to *Member's* capital account.

Thereafter, *LLC* owns the car. Thus, any appreciation or depreciation of the car's value, following the contribution, belongs to *LLC* because it is the property of *LLC*. If the car's value decreases to $700 in 2001, this decrease has no effect upon the $1,000 credited to *Member's* capital account. If the car's value increases to $1,500, that appreciation is an asset of *LLC* for the same reason: the car belongs to *LLC*, not *Member*. Likewise, if *LLC* allows someone to rent its car, that rent is an asset of *LLC*, not *Member*.

Certainly, the operating agreement provides that the administrative member *may* distribute LLC property to members, in kind. *See* Article 11.3(a) and (d). The operating agreement allows the administrative member to do so, *i.e.*, it is *permissive*, after determining the value of that property as of the date of the LLC's *dissolution* (not as of the date it was *contributed*), and to distribute it in an amount equal to the positive balance of the member's capital account and in proportion to a member's interest in the LLC. *Id*. But, contrary to Insulation's understanding, these operating agreements do not *require* either LLC to return any property contributed by any member.[3] Members are only entitled to receive cash distributions equivalent to the positive balance of their capital accounts. *See* Article 11.3(d). And, Tailwind Aviation and Tailwind Properties have never conducted an accounting to determine the values of the capital accounts belonging to either Morgan or Lanham.

[3] Similarly, Kentucky law provides that no LLC member is entitled to receive a distribution from an LLC in any form other than cash, unless the LLC operating agreement states that LLC members are so entitled. *See* KRS 275.220(1).

In light of the above, the property that Morgan and Lanham contributed to either Tailwind Aviation or Tailwind Properties did not "essentially remain" the property of Morgan and Lanham. Nor, for that matter, can the operating agreements be interpreted to mean that Morgan and Lanham have any right to get out of the LLCs any of the property they put into the LLCs. As such, to the extent that the trial court determined that the operating agreements of Tailwind Aviation and Tailwind Properties supplied a basis for judgment as a matter of law in favor of Insulation, the trial court erred.

That said, it is necessary to determine whether the third basis of the trial court's order justified directed verdicts in favor of Insulation on the claims of Tailwind Aviation and Tailwind Properties. Below, we address whether there was a complete absence of proof on a material issue, or if no disputed issues of fact existed upon which reasonable minds could have differed relating to these claims.

3. The trial court's third basis: the absence of proof to support a claim, or no disputed issue of fact

a. *Tailwind Aviation v. Lanham Insulation*: $95,000 Loan

As noted above, Aviation claims to have loaned Insulation $95,000. The trial court held otherwise, granting a directed verdict in favor of Insulation on this issue. After reviewing the record, we agree with the trial court's decision.

Before delving into the circumstances of this alleged loan, it is first necessary to delve into Aviation's pleadings. A cursory review of its complaint reveals that Aviation never actually asserted a claim against Insulation for the

recovery of any alleged loan. Rather, Aviation's first amended complaint, filed December 6, 2005, states:

> COUNT IV
> TAILWIND AVIATION'S CLAIM AND MORGAN'S ALTERNATIVE CLAIM AGAINST LANHAM FOR RECOVERY OF THE CONSIDERATION FOR HIS MEMBERSHIP INTEREST
>
> 40. In accepting a membership interest from Tailwind Aviation, Lanham promised, and agreed, to transfer title to the Aircraft to Tailwind Aviation.
> 41. Lanham failed and refused to transfer title to the Aircraft to Tailwind Aviation despite his promise and agreement to do so.
>
> 42. Had Lanham transferred the Aircraft to Tailwind Aviation as promised and agreed, it would have become the sole and exclusive property of Tailwind Aviation pursuant to KRS 275.240.
>
> 43. In November, 2001, Lanham sold the Aircraft and received $103,500 in proceeds from such sale. Had Lanham transferred the Aircraft to Tailwind Aviation in consideration for his membership interest as promised and agreed, such sale proceeds would have been the sole and exclusive property of Tailwind Aviation.
>
> 44. Lanham's failure and refusal to transfer the Aircraft to Tailwind Aviation was a breach of his contract with Tailwind Aviation. As a result of such breach, Tailwind Aviation has been damaged in the amount of $103,500, or alternatively, Morgan, as a 50% Member, has been damaged in the amount of $51,750, plus interest thereon from the date of the Aircraft's sale, and Tailwind Aviation or Morgan, as applicable, is entitled to a judgment against Lanham in such applicable amount together with interest from the date of sale.

On November 17, 2008, Tailwind Aviation filed a second amended complaint which reincorporated the above claim and added only one other claim:

B. EQUITABLE ESTOPPEL

> 9. Following the formation of Tailwind Aviation, Lanham continually represented to Morgan by his statements and conduct, including but not limited to the execution of Tailwind Aviation's tax returns, that he had transferred title to the aircraft to Tailwind Aviation.
>
> 10. After Mr. Lanham sold said airplane, it was discovered that he did not transfer title of the Aircraft to Tailwind Aviation.
>
> 11. By virtue of his statements and conduct, and his signing and filing tax returns for Tailwind Aviation, Mr. Lanham is equitably estopped from denying that the aircraft should have been transferred to Tailwind Aviation.
>
> 12. Morgan and Tailwind Aviation have suffered damages in excess of the jurisdictional requirements of this Court as a result of Lanham's statements and conduct.

The first indication that Aviation believed that it had loaned Insulation $95,000 does not appear in the record until December 11, 2008, approximately two months prior to the trial of this matter. In a document styled "PLAINTIFFS' DAMAGE ITEMIZATION DISCLOSURES," Aviation stated that it was asking for "$95,000 in principal owed by Lanham Insulation, Inc., for a loan made on November 8, 2001," and "Interest at 8% per annum from November 8, 2001 through February 24, 2009." In light of the fact that Aviation did not raise any contention in its pleadings that it was entitled to recoup a $95,000 loan from Insulation, and in light of the fact that Aviation made no motion, per Kentucky Rules of Civil Procedure (CR) 15.02, to amend its pleadings to conform to the

evidence presented in this case, it is arguably improper for this Court to review this matter on appeal.

However, even assuming that Aviation's contention had been properly raised at trial, the evidence of record demonstrates only that if Insulation did receive a loan of $95,000, that loan came from Morgan and Lanham, personally, and not from Aviation. Aviation has no record of making any loan to Insulation and the check, which Aviation claims evidences the $95,000 loan, was written from Morgan and Lanham's joint marital account and signed by Morgan in her personal capacity.

Nevertheless, Aviation contends that some evidence of probative value demonstrates that a loan existed between itself and Aviation and that Aviation is entitled to collect upon that loan. In support of its contention, Aviation relies solely upon the testimony of Morgan, who was a non-administrative member of Aviation during the period of time Aviation purports to have made this loan.[4] Morgan's testimony regards an airplane Aviation allegedly owned, the sale of that airplane, and her understanding that $95,000 that she and Lanham received from the proceeds of the airplane's sale and subsequently loaned to Insulation was actually meant to be a loan from Aviation to Insulation:

> Q: Did Tailwind Aviation subsequently sell this airplane?
>
> Morgan: Yes.
> Q: When did that occur?

[4] Tailwind Aviation's operating agreement lists Morgan as its administrative member. However, Lanham and Morgan stipulated that shortly after the inception of this entity, Lanham took over as its administrative member.

Morgan: That occurred in 2001.

Q: And why was the airplane sold?

Morgan: Dan said that his business was cash strapped, and he wanted to sell some of the assets and loan the money to his business. I didn't want to. I didn't want to lose this asset, but he needed it so I agreed.

. . . .

Q: I'll ask you—first of all, is that your handwriting on that check?

Morgan: Yes, it is.

Q: And that check is dated when?

Morgan: 11/7/01.

Q: And that's how long after the sale of the airplane?

Morgan: I think it was the next day.

Q: And again, why was this check written on the joint account, the joint marital account and not on the Tailwind Aviation account?

Morgan: I have no idea. It should have gone into the Aviation account.

Q: Did Tailwind Aviation have a checking account in November of 2001?

Morgan: Yes.

Q: Did Dan [Lanham] tell you that he was having the sale proceeds wired from the sale of the airplane into your joint account as opposed to the Aviation account?

Morgan: No. I was surprised when it showed up there.

Q: Did you agree to have this loan made to [sic] Tailwind Aviation to Lanham Insulation?

Morgan: Yes.

Q: You wrote the check, right?

Morgan: Yes.

Q: And he didn't force you to write it?

Morgan: No.

Q: Was it your intent that this was to be a loan?

Morgan: Yes.

Q: And does, in fact, the check, itself, on the memo portion say "loan?"

Morgan: Yes.

Q: When you wrote this check, what was your understanding as to who was loaning the money to Lanham Insulation, Inc.?

Morgan: Tailwind Aviation was loaning the money to Lanham Insulation.

Q: And has any of that money been repaid to Tailwind Aviation?

Morgan: No.

Q: Have you demanded from Lanham Insulation, or through Dan as the sole owner, that it be repaid?

Morgan: Many times.

Morgan's testimony is not probative of whether Aviation loaned Insulation $95,000 because it tends to prove only that Lanham told Morgan, prior to the sale of the airplane, that *he* was *planning* to loan the sale proceeds to

Insulation. It is not probative of whether *Aviation* actually *made* a loan to Insulation following the sale. For this reason, Morgan's testimony should not be taken in a vacuum; rather, it should be taken in context with the evidence of record demonstrating what *Aviation* believed happened to the proceeds after the sale was completed.

In this regard, the only evidence of record tending to support that Aviation did own the airplane, which was allegedly the source of the funds Aviation claims to have loaned to Insulation, only supports the proposition that Aviation chose to sell the airplane and distribute the sale proceeds to Lanham and Morgan, rather than loan them to Insulation. As Aviation *itself* explains on pp. 2-3 of its appellate brief:

> On November 8, 2001, the day after the sale, *Morgan wrote a check from their* [Morgan and Lanham's] *joint checking account to Lanham Insulation in the amount of $95,000*. Said check specifically noted on its face that it was a "loan." (See Plaintiffs' Trial Exhibit 3, attached hereto as Exhibit 4). . . . Lanham ensured [sic] *Morgan* that either he or his company would repay the loan. (Tr. Trans. p. 114, 11. 1-4). Morgan has since made many demands for repayment on behalf of Tailwind Aviation, but Lanham has failed to repay the $95,000 loan. (Tr. Trans. p. 112, lines 9-16).
>
> Tailwind Aviation's federal tax returns for the years 2000 and 2001, signed by Lanham and filed with the IRS, reflect that the airplane was an asset of the LLC. (See Plaintiffs' Trial Exhibits 4 and 5, 2001 Income Tax Return attached hereto as Exhibit 5). Further, the Tailwind Aviation 2001 tax return attributed half of the profit from the sale of the airplane to Morgan and half to Lanham, consistent with the Operating Agreement and prior tax returns. (See Exhibit 5). *Both Morgan and Lanham received Schedule K-1s with an equal*

> *distribution of $43,623 from the sale of the airplane.* (Tr. Trans. p. 259, 11. 7-15; See Exhibit 5). Each member also paid taxes on the distributions as set forth on the Schedule K-1s. (Tr. Trans. p. 124, 11. 4-9).

(Emphasis added.)

Stated differently, Aviation explains that it not only understood that it owned the airplane, but it also understood that, after selling the airplane, *it distributed the sale proceeds to its members*. Consistent with Aviation's explanation, the check representing the funds loaned to Insulation was written from Morgan and Lanham's joint marital account. And, the K-1s belonging to both Lanham and Morgan, filed with Aviation's 2001 tax return, do reflect that both Lanham and Morgan each received and withdrew from their capital accounts distributions from Aviation in 2001.[5]

Thus, even if the airplane was Aviation's property, the evidence of record is only capable of demonstrating that Aviation believed it distributed all of its assets to Lanham and Morgan, personally. Indeed, Morgan and Aviation make no contention that Aviation's 2001 tax return was in any way erroneous. As such, the proposition that Aviation loaned proceeds from the sale of an airplane to Insulation, after it purported to have distributed those same proceeds to Morgan

[5] Aviation's 2001 tax return demonstrates that these two respective distributions, each in the amount of $43,623, account for the entirety of the $103,500 proceeds realized from the sale of the airplane and all other assets Aviation purported to own prior to that sale. Aviation listed on its 2001 tax return that prior to the sale of the airplane its total assets consisted of "$35,580" which it attributed to its adjusted basis—formerly Lanham's adjusted basis—in the airplane. The $43,623 figure that Aviation distributed to Morgan and Lanham, as its 2001 tax return illustrates, consists of 1) half of the adjusted basis of the airplane; 2) half of the ordinary income realized from the sale of the plane ($48,368); 3) half of Aviation's 2001 gross receipts and sales ($2,000); 4) half of the capital gain realized from the sale of the plane ($19,555); minus 5) half of a $12,648 deduction claimed for hanger fees, charts, and fuel; and minus 6) half of an outstanding member loan in the amount of $5,608, unrelated to the sale of the plane.

and Lanham, results in an absurdity. We find no error with this portion of the trial court's decision.

b. *Tailwind Properties v. Lanham Insulation*: $110,000 loan

As stated above, Lanham is Insulation's sole shareholder and a comember of Tailwind Properties. Morgan, the administrative member of Tailwind Properties, testified that Lanham requested a loan from Tailwind Properties to Insulation. On April 26, 2002, Morgan gave Lanham a blank check from Tailwind Properties. That same day, Morgan noted in Tailwind Properties' checking account register that Tailwind Properties had issued a check to Insulation for "$110,000" and that this amount was a "loan." On April 29, 2002, Lanham signed and dated the check he received from Morgan, making it payable to Insulation in the amount of $110,000. Insulation cashed the check. To date, Insulation has not repaid any part of this amount to Tailwind Properties.

Tailwind Properties asserted a claim to recoup the $110,000 it loaned Insulation. However, Insulation argued that Tailwind Properties had waived its right to collect this loan from Insulation because Tailwind Properties had either assigned Lanham, as Tailwind Properties' member, the account representing Insulation's obligation to repay Tailwind Properties $110,000 or the promissory note representing it.

In support of its argument, Insulation relied upon information contained in Tailwind Properties' 2002 tax return. On October 6, 2003, Tailwind Properties filed its 2002 federal income tax return representing that it had

distributed all of its assets to its two members, Morgan and Lanham. At trial, two certified public accountants, Vicki Buster and Michael Mountjoy, offered expert opinions as to the meaning of Tailwind Properties' 2002 tax return. Both opined that the $176,045 purportedly distributed to Morgan consisted of the value of a building Morgan had contributed to Tailwind Properties ($160,926) and a distribution of half of Tailwind Properties' net operating income ($15,119). Both opined that Lanham's distribution of $260,005 consisted of the value of a building Lanham had contributed ($134,886). Both also opined that the other half of the $260,005, which the 2002 tax return reported as a distribution of "money (cash and marketable securities)" in the amount of $125,119, consisted of half the net operating income ($15,119), and an additional amount of $110,000. Buster and Mountjoy further opined that this $110,000 probably represented a promissory note relating to the loan between Insulation and Tailwind Properties, or the outstanding balance of the account Insulation owed to Tailwind Properties.

Insulation also cited to a protective claim that Tailwind Properties submitted to the IRS on June 19, 2006, apparently under the authority of IRS General Counsel Memorandum (GCM) 38,786, 1981 IRS GCM LEXIS 22 (Aug. 13, 1981).[6] Tailwind Properties believed that it had incorrectly allocated a disproportionate amount of capital gain to Lanham (*i.e.*, it had allocated to Lanham 100% of the capital gain, rather than only 50% as mandated in its operating

[6] IRS General Counsel Memoranda ("GCM's") "function as a body of 'working law'" within the IRS. *Taxation with Representation Fund v. IRS*, 646 F.2d 666, 683 (D.C. Cir. 1981). Although no party cites to GCM 38,786, we find GCM 38,786 persuasive in this matter because it addresses and presents the Service's view of the minimum informational requirements necessary for a valid protective claim.

agreement), and wished to extend the limitations period for Lanham to make a claim for a refund. The protective claim was accompanied with a revised version of the 2002 tax return, which contained a reallocation of capital gain between Lanham and Morgan. Notably, however, this revised 2002 tax return repeated that Lanham had received a "withdrawal" of $260,005 and otherwise contained the same calculations contained in the 2002 tax return. Based upon Insulation's argument and this evidence, the trial court granted a directed verdict in favor of Insulation.

Finally, Insulation also introduced approximately fifty of its checks into evidence. Each check was made out to "J. Daniel Lanham." Of these, approximately forty included notations of "LOAN PMT," "PAYMENT ON LOAN," or "LOAN PAYMENT." Insulation also introduced deposit slips from Morgan and Lanham's joint bank account, reflecting that checks with the same check numbers had been deposited into that account.

On appeal, Tailwind Properties contends that the trial court erred in granting a directed verdict in favor of Insulation, and that the evidence of record does reveal a genuine dispute with regard to whether it divested itself of the right to collect the $110,000 loan from Insulation. After a careful review of the evidence in the light most favorable to Tailwind Properties, we agree.

Insulation's motion for directed verdict was based upon its theory that Tailwind Properties waived its right to collect this loan by assigning it to Lanham,

its member. However, knowledge and intent are the key elements of the law of waiver and the law of assignment. The general rule relating to waiver is that

> a waiver exists only where one with full knowledge of a material fact does or forbears to do something inconsistent with the existence of the right or of his intention to rely upon that right. Knowledge of the existence of the right on the part of the party claimed to have made the waiver is an essential prerequisite to its relinquishment. No one can be said to have waived that which he does not know, or where he has acted under a misapprehension of the facts.

Harris Bros. Const. Co. v. Crider, 497 S.W.2d 731, 733 (Ky. 1973). Likewise, the general rule relating to assignment is that

> a valid assignment is made when the context of the assigning instrument shows the intention of the owner of a chose in action to transfer it to the transferee. But notwithstanding such liberality it is also the rule of universal application that the intention of the parties to a transaction, whether evidenced by writing or resting in parol, must be gathered from what they said 'and not by what they may have intended to say but did not.'

Roberts v. Powers, 303 Ky. 489, 198 S.W.2d 58, 60 (1946).

With these rules in mind, a closer examination of the record demonstrates that an issue of disputed fact does exist regarding whether Tailwind Properties intended to divest itself of the right to collect the loan that it made to Insulation.

Turning first to Tailwind Properties' 2002 tax return, we note at the onset that Buster and Mountjoy were only able to guess at what the 2002 tax return actually meant. Neither could testify to its veracity, and neither assisted in its

creation.[7] And, the record is replete with evidence tending to indicate that Tailwind Properties' 2002 tax return was more a symptom of Tailwind Properties' inept bookkeeping, rather than a reflection of Tailwind Properties' intent.[8]

For example, Tailwind Properties' 2002 tax return reflected that the buildings contributed to Tailwind Properties by Morgan and Lanham had been redistributed to Morgan and Lanham. Yet, to date, those buildings remain titled in the name of Tailwind Properties.

Additionally, Morgan, the administrative member of Tailwind Properties who filed the 2002 tax returns, testified on several occasions that she did not intend to distribute to Lanham the entitlement to recover this loan, did not understand that the 2002 tax returns reflected any kind of agreement to distribute any property from Tailwind Properties to Lanham, and further testified that she had little understanding of what the tax return actually meant when she filed it. In one of several exchanges between Morgan and Insulation's counsel to this effect, she stated:

> Q: And do you recall [Vicki Buster] saying in her deposition that they didn't know anything about this

[7] The accountant who did prepare this return, Diane Medley, did not testify in this matter.

[8] Insulation stops short of arguing that a federal income tax return is irrefutable evidence, but does argue that it is "particularly disingenuous" for Tailwind Properties to claim its 2002 tax return is inaccurate because "they are somehow suggesting that people who file tax returns do not have to be truthful in their representations to the IRS[.]"

Statements contained in income tax returns are made under penalty of perjury. *See* 26 U.S.C.A. § 6065. However, they are entitled to no greater deference than any other evidence of record. *See, e.g., Purchase Transp. Services v. Estate of Wilson*, 39 S.W.3d 816, 819 (Ky. 2001) (holding that an administrative law judge, sitting as fact-finder in its determination of whether an employment relationship existed, was entitled to disregard that decedent considered herself to be an independent contractor for the purpose of her income tax returns, and believe evidence to the contrary).

return being filed and that they were upset at Chilton & Medley?

Morgan: Yeah. Like I said: I didn't know that [the tax returns] were not correct. I was given them by Chilton & Medley. I didn't know that they weren't correct.

Q: And it just so happens that on this return in 2002 that you just happened to file without Chilton & Medley signing it, and you filed it in October of '03, that it allocated Dan [Lanham]'s building back to Dan [Lanham], didn't it?

Morgan: I didn't know that it did that. I'm not a CPA. I didn't know.

Q: Well you've been, you've been testifying here today, Ms. Morgan, about what you believe these do and don't do all up and down these tax returns. Are you telling this jury that you didn't know when you looked at this that what, that what you were doing was allocating [Lanham's] building back to him?

Morgan: I'm absolutely telling you that.

Q: And that you were allocating $125,119 in cash that [Lanham] got from Lanham Insulation, back to him?

Morgan: I don't know anything about that.

We turn next to Tailwind Properties' 2006 protective claim, which appears to reincorporate the 2002 tax return's representations regarding Lanham and Morgan's distributions. However, whether this protective claim reflects Tailwind Properties' intent to distribute the $110,000 loan to Lanham is, at best, questionable. As a rule, it is only necessary for a protective claim to be "clear and definite to apprise the Service of the essential nature of the claim." *See* GCM 38,786, 1981 IRS GCM LEXIS 22, at *2. Vicki Buster, who prepared Tailwind

Properties' 2006 protective claim, testified that the only purpose for filing the protective claim was to allow Lanham additional time to file a claim for a refund of, or credit for, overpayment of capital gains tax as a result of paying 100% of the capital gains tax, rather than only 50%. As such, regardless of whether Tailwind Properties had any intention of distributing the $110,000 loan to Lanham, it would have been a pointless gesture for Tailwind Properties to have readjusted how any distributions were reflected in Lanham's K-1 for the purpose of its protective claim; doing so would not have apprised the IRS of the essential nature of the protective claim, nor would it have had any effect upon Morgan's or Lanham's tax liability; and the operating agreement required Morgan and Lanham to pay 50% of the capital gains tax, respectively, regardless of any distribution either received.

Furthermore, despite Insulation's assertion that Tailwind Properties had assigned its right to collect this loan to Lanham and despite the fact that Lanham was fully aware of this claim between Insulation and Tailwind Properties from the date of its filing, Lanham never sought to intervene as a necessary party in this claim in order to assert any personal interest in the $110,000 loan at issue. And, despite Buster and Mountjoy's suppositions regarding Lanham's receipt of a promissory note representing the $110,000 loan debt, which might have transferred Tailwind Properties' right to collect this loan to Lanham, no such note exists in the record; there is no testimony that any such note ever existed; and Insulation presents no authority or argument to the effect that a tax return, by itself, is capable of conveying such an interest.

Finally, the fifty checks Insulation introduced into evidence are also not dispositive of whether Lanham actually received the right to receive any payments on this loan from Insulation. This is because 1) none of these checks were signed; 2) none of these checks were deposited and cancelled; and, most importantly, 3) in light of Insulation's prior contention that it received a $95,000 loan from Lanham and Morgan, personally, it is just as probable, if not more so, that these checks represented repayments of that loan.

In short, the question is a close one. But, a wavier cannot be inferred lightly. *Valley Const. Co., Inc. v. Perry Host Management Co., Inc*., 796 S.W.2d 365, 367 (Ky. App. 1990). And, taken in the light most favorable to Tailwind Properties, there is some evidence of probative value demonstrating that when Tailwind Properties filed its 2002 tax return - the basis of Insulation's theories of assignment and waiver - it acted without knowledge of the facts, or under a misapprehension of the facts, and did not knowingly and voluntarily divest itself of the right to recoup this loan from Insulation. Accordingly, we reverse the trial court on this issue.

c. *Tailwind Properties v. Lanham Insulation*: $64,000 in overdue rent

Some evidence of record demonstrates that Insulation leased from Tailwind Properties one of the two buildings contributed to Tailwind Properties by Lanham. The terms of Insulation's lease were stated in a "tenant estoppel certificate," signed by Lanham in his capacities as Tailwind Properties' member and Insulation's president. The certificate states that Insulation was required to

pay Tailwind Properties $4,000 in monthly rent throughout the term of the lease, which began January 1, 1999, and ended December 31, 2002. Morgan, the administrative member of Tailwind Properties, testified that Insulation failed to pay rent for a total of sixteen months during the term of the lease. Morgan testified that, in her role as Tailwind Properties' administrative member, she made several demands upon Insulation to pay this rent. Lanham, on behalf of Insulation, testified that Insulation *did* fail to make between twelve- and sixteen-months' worth of rent payments to Tailwind Properties and that, just as Morgan claimed, Insulation could have missed as many as sixteen-months' worth of rent payments. Further, Insulation presented no evidence that it actually paid Tailwind Properties any rent over the course of the sixteen months Tailwind Properties claimed Insulation was in default. As such, some evidence of probative value demonstrates that Insulation could owe Tailwind Properties $64,000 in unpaid rent.

And yet, the trial court granted a directed verdict on this claim in favor of Insulation.

As discussed above, the trial court could not have arrived at this conclusion by relying upon either the PNA between Morgan and Lanham or the operating agreement of Tailwind Properties. However, Insulation also substantially repeated and reasserted the "waiver by assignment" theory it made with respect to the $110,000 loan issue, above, when it moved for a directed verdict on this issue. In its oral motion after the close of the evidence in this case, Insulation argued:

> Mr. Lanham also testified that there was no expectation that those missed rent payments would be repaid, he testified about how the buildings worked together, and we think that his testimony, um, establishes the affirmative defense of waiver; we've entered an instruction to that effect. And in particular, evidence that goes to show that, again, is where's the evidence that [Tailwind Properties] was actively trying to collect this? Or, conversely, is there evidence that the LLC didn't expect to collect this? And we think that the tax returns show that there's evidence that supports Mr. Lanham's testimony that these have been waived because it shows no assets, no account receivable assets on these rents. So we think that, uh, on the rent issue, to the extent that you don't grant our directed verdict, there's the, clearly the issue of waiver has been presented which would, which would, um, prevent a directed verdict on that issue for [Tailwind Properties].[9]

In sum, Insulation claimed to have established, indisputably, that Tailwind Properties had waived its right to collect $64,000 in rent because 1) Lanham testified that it did; and 2) Tailwind Properties' tax returns reflected no account receivable assets on these rents. We disagree.

First, while Lanham's testimony would certainly be probative evidence of whether Tailwind Properties waived its right to collect $64,000 in overdue rent from Insulation, Morgan testified to the contrary. In that regard, a disputed issue remained, and Lanham's testimony did not warrant a directed verdict in favor of Insulation.

Second, a tax return may be probative evidence but, in and of itself, it is not dispositive to any question of law. *See Purchase Transp. Services*, 39

[9] Tailwind Properties also moved for directed verdict on this issue, which the trial court denied. Tailwind Properties does not raise the trial court's decision to deny its motion for directed verdict as an issue on appeal, or argue that it was error for the trial court to do so.

S.W.3d at 819. And, in any event, this Court is further persuaded that Tailwind Properties had no obligation to report these rents as assets on its 2002 tax return.

To begin, "A motion for directed verdict admits the truth of all evidence which is favorable to the party against whom the motion is made." *National Collegiate Athletic Association v. Hornung*, 754 S.W.2d 855, 860 (Ky. 1988). In light of (1) evidence of record demonstrating the existence of a lease between Tailwind Properties and Insulation, and (2) Morgan's testimony that Insulation has refused to recognize and has disputed Tailwind Properties' right to receive the $64,000 in rent Tailwind Properties claims Insulation owes, Tailwind Properties has presented evidence sufficient to present a *prima facie* claim against Insulation for liquidated damages,[10] *i.e.*, for $64,000 in overdue rent owed on a lease.

Insulation fails to articulate why Tailwind Properties was required to include a claim for liquidated damages in its tax return and favors this court with no authority supporting that Tailwind Properties was obligated to do so. Furthermore, the applicable section of the United States Tax Code provides that the

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"Liquidated damages" was defined by the Kentucky Supreme Court in *Nucor Corp. v. General Elec. Co.*, 812 S.W.2d 136 (Ky. 1991):

> When the damages are 'liquidated,' pre-judgment interest follows as a matter of course. Precisely when the amount involved qualifies as 'liquidated' is not always clear, but in general 'liquidated claims' means 'made certain or fixed by agreement of parties or by operation of law.' Examples are a bill or note past due, an amount due on an open account, or an unpaid fixed contract price.

Id. at 141 (internal citation omitted).

"amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period." 26 U.S.C. § 451(a); *see also* 26 C.F.R. 1.451-1, Treas. Reg. § 1.451-1 (general rule for taxable year of inclusion) ("Gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting.") Tailwind Properties has not received the amount of overdue rents it claims Insulation owes and a claim for liquidated damages does not fall into any of the specifically defined exceptions to this rule (*see* 26 U.S.C. § 451(b)-(i)). Nor, for that matter, does it appear that Tailwind Properties' accounting method would have required it to have included any amount of rent that it did not receive in its tax returns: Tailwind Properties' tax returns reflect that it utilized the "cash" method of accounting, and under the "cash" method of accounting, income is not counted until that income is actually received, and expenses are not counted until they are actually paid. *See* 26 C.F.R. § 1.461-1(a)(1).

Additionally, through our own research of this issue, we have found the applicable accounting rules further support that Tailwind Properties was not required to report a liquidated damages claim against Insulation in any of its tax returns. The Financial Accounting Standards Board ("FASB") defines a contingency "as an existing condition, situation, or set of circumstances involving

uncertainty as to possible gain . . . or loss." FASB, Original Pronouncements FAS5-2.[11] Statement of Financial Accounting Standards No. 5 lists "[p]ending or threatened litigation" as an example of a loss contingency, *id*. at FAS5-3, and discusses the factors to be considered "in determining whether accrual and/or disclosure is required with respect to pending or threatened litigation and actual or possible claims and assessments," *id*. at FAS5-8. "Thus, the FAS view a lawsuit as a contingency." *Emerald Coast Finest Produce Co. Inc. v. United States*, 79 Fed. Cl. 466, 473 (Fed. Clms. Ct. 2007) (finding that a lawsuit is a contingent asset, not an accounts receivable); *see also In re Blast Energy Servs., Inc.*, 396 B.R. 676, 706-07 (Bankr. S.D. Tex. 2008) (finding *Emerald* "persuasive" and concluding that a party's claim is not an account receivable, but rather, a contingency). FAS5 ("Accounting for Contingencies") further provides that "[c]ontingencies that might result in gains usually are not reflected in the [company's financial] accounts since to do so might be to recognize revenue prior to its realization." FASB, Original Pronouncements FAS5-17(a).

In short, Insulation's argument, that Tailwind Properties indisputably waived its claim for $64,000 against Insulation for overdue rent simply because Tailwind Properties did not list this claim on any of its tax returns, has no support in the law and is utterly unpersuasive. Beyond the LLC operating agreements and the PNA discussed earlier in this opinion, this argument, along with Lanham's

[11] The Statements of Financial Accounting Standards ("FAS") of the Financial Accounting Standards Board ("FASB") is considered to be "at the top of the GAAP [generally accepted accounting principles] hierarchy." *Emerald Coast Finest Produce Co., Inc. v. United States*, 79 Fed. Cl. 466, 473 (Fed. Clms. Ct. 2007) (citing Jan R. Williams & Joseph V. Carcello, *GAAP Guide Level A: Restatement and Analysis of Current FASB Standards xii* (2007) (GAAP Guide)).

testimony, are the only bases upon which the trial court rendered a directed verdict in favor of Lanham. Consequently, the trial court erred, and this claim must be remanded.

B. *Morgan v. Lanham*: Fraud

Morgan alleges that Lanham is liable to her for fraud in the inducement or misrepresentation. In her complaint, she asserted that Lanham had misrepresented that he had transferred his airplane, discussed above, to Aviation as a capital contribution in order to induce her to become a comember of Aviation, and that she was damaged as a result. At the close of Morgan's evidence, Lanham moved for directed verdict arguing that Morgan had failed to plead fraud with particularity and that, even if Lanham had made such a misrepresentation, Morgan had failed to prove that it had damaged her. The trial court held in favor of Lanham on both bases. We agree with its decision.

A party claiming fraud must establish six elements by clear and convincing evidence: (1) material representation; (2) which is false; (3) known to be false or made recklessly; (4) made with inducement to be acted upon; (5) acted in reliance thereon and, (6) which causes injury. *United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 468 (Ky. 1999); *Wahba v. Don Corlett Motors, Inc.*, 573 S.W.2d 357, 359 (Ky. App.1978). Where the proven facts or circumstances merely show inferences, conjecture, or suspicion, or such as to leave reasonably prudent minds in doubt, it must be regarded as a failure of proof to establish fraud. *Goerter v. Shapiro*, 254 Ky. 701, 72 S.W.2d 444 (1934).

Our analysis of Morgan's claim of fraud focuses upon the sixth element, stated above, and whether Morgan introduced any probative evidence to support that she sustained an injury as the result of any misrepresentation Lanham allegedly made. The general rule with respect to damages is that

> [a]ll recoverable damages are subject to some uncertainties and contingencies, but it is generally held that the uncertainty which prevents a recovery is uncertainty as to the fact of damage and not as to its amount. Where it is reasonably certain that damage has resulted, mere uncertainty as to the amount does not preclude one's right of recovery or prevent a jury decision awarding damages.

Johnson v. Cormney, 596 S.W.2d 23, 27 (Ky. App. 1979), *overruled on other grounds by Marshall v. City of Paducah*, 618 S.W.2d 433 (Ky. App. 1981); *see also Hanson v. American National Bank & Trust Co.*, 865 S.W.2d 302, 309 (Ky. 1993) (to the same effect), *overruled on other grounds by Sand Hill Energy, Inc. v. Ford Motor Co.*, 83 S.W.3d 483, 495 (Ky. 2002). Stated differently, Kentucky law does not require Morgan to provide exact calculations of her damage—an estimation may suffice if it proves damages with "reasonable certainty." However, Kentucky law does not tolerate uncertainty as to the *fact* of damage (*i.e.*, recovery will not be had where there is uncertainty as to whether the damage has in fact occurred).

Morgan asserts that Lanham's misrepresentation relating to the titling of the airplane damaged her in three ways: 1) it caused her to make "monetary contributions" to Aviation; 2) it caused her to pay 50% of the capital gain realized

from the sale of the airplane; and, as she states in her brief, 3) it induced her to agree to loan Lanham Insulation $95,000 from the proceeds of the airplane's sale.

As to the first of these contentions of damage, Morgan failed to provide any evidence at trial supporting that she made monetary contributions to Aviation.[12] The closest that Morgan came to demonstrating what she may have contributed to Aviation was stating, in her complaint, that she contributed "the sum of $7,350 at a minimum[.]" However, this statement cannot sustain Morgan's burden to prove that she was damaged because Lanham denied this in his answer and, in any event, pleadings are not evidence. *Educational Training Systems, Inc. v. Monroe Guar. Ins. Co.*, 129 S.W.3d 850, 853 (Ky. App. 2003).

As to Morgan's second contention of damage, it is true that Aviation's operating agreement obligated Morgan to pay 50% of the capital gain attributable to the sale of property it owned. Nevertheless, even if Morgan had never become a member of Aviation, or if Aviation had never been formed, or if the airplane had remained Lanham's separate, nonmarital property, Morgan still would have been obligated to pay *all* of the capital gain realized from the sale of the airplane because she elected to file a joint tax return with Lanham for 2001, the year the airplane was sold. *See* 26 U.S.C. § 6013(d)(3). Morgan makes no contention that the titling of the airplane induced her to file her taxes jointly with Lanham in 2001. As such, whether Morgan was damaged by paying 50% of the capital gains

[12] Indeed, in a July 30, 2008 order, the trial court directed that "Each party claiming damages of any nature shall submit an itemization of such damages to opposing counsel on or before 60 days before trial." On December 11, 2008, Morgan submitted her itemization, which contained no reference to fraud and included no itemization of any damages relating to fraud.

realized from the sale of the airplane is speculative at best and warrants no recovery.

Finally, we turn to Morgan's contention that Lanham's misrepresentation as to the title of the airplane damaged her because it induced her to agree, as Aviation's member, to loan Lanham Insulation $95,000 from the proceeds of the sale of that airplane. This contention is without merit because Morgan's "consent" on behalf of Aviation to loan $95,000 to Insulation had no value and caused her no injury; as discussed above, nothing in the record supports that Aviation was ever a party to that loan. Rather, the record only supports that Aviation either distributed all of its assets to Morgan and Lanham, and that Morgan and Lanham loaned Insulation that amount shortly after receiving the proceeds from the airplane's sale, or that Lanham never contributed the airplane (*i.e.*, the source of the funds used for the alleged loan) to Aviation at all.

In light of the above, we find no error in the trial court's decision to grant a directed verdict in favor of Lanham on this claim.

C. *Lanham v. Morgan*: Morgan's fiduciary duty

Morgan has always been the administrative member of Tailwind Farm and Tailwind Properties, which, per the operating agreements of those entities, means that she is the managing member. Lanham has only been a member of those entities. Of relevance, Article 5.4 of the operating agreements of each entity provides:

> *Liability for Certain Acts*. The Administrative Member shall perform her managerial duties in good faith, in a

> manner she reasonably believes to be in the best interests of the Company, and with such care as an ordinarily prudent person in a like position would use under similar circumstances. The Administrative Member does not, in any way, guarantee the return of the Members' Capital Contributions. The Administrative Member shall not be liable, responsible or accountable to the Company or to any Member for any loss or damage sustained by the Company or any Member, unless the loss or damage shall have been the result of fraud, deceit, gross negligence, wanton or reckless misconduct, or a wrongful taking by the Administrative Member.

In her role as administrative member, Morgan was charged with the responsibility of managing the business affairs of these entities, keeping their records, and preparing their tax returns. With respect to the tax returns, Article 8.1 of the operating agreements of each entity provides that "Net Profits, Net losses and other items of income, gain, loss, deduction and credit shall be apportioned among the Members in proportion to their Percentage Interests."[13] And, each of these operating agreements states that Morgan's percentage interest is "50%," and that Lanham's percentage interest is "50%." Pursuant to the operating agreements, then, Morgan and Lanham would share all taxable gains and losses equally.

In 2002, Morgan and Lanham filed separate tax returns. Lanham asserted two claims for breach of fiduciary against Morgan, alleging that Morgan, in her role as administrative member, breached the fiduciary duties she owed to him per Article 5.4 when she prepared, approved, and filed the 2002 tax returns for

[13] Tailwind Properties, Tailwind Farm, and Tailwind Aviation elected to become "pass-through" limited liability companies. Accordingly, they were taxed as partnerships, rather than entities, meaning that their taxable income and losses passed through to Morgan and Lanham, who were then entitled to claim their individual shares of these entities' deductible losses to the extent of their adjusted basis in their membership interests. *See* 26 U.S.C. § 704(d).

Tailwind Properties and Tailwind Farm. At trial, Morgan moved for directed verdicts on these claims. The trial court held in favor of Morgan. The specifics of these claims, Morgan's arguments relating to them, and our resolution of each, are addressed below.

1. *Lanham v. Morgan*: breach of fiduciary duty regarding Tailwind Properties

Lanham alleged that on Tailwind Properties' 2002 tax return, Morgan had shifted 100% of Tailwind Properties' capital gains tax liability onto him. In support, Lanham produced Tailwind Properties' 2002 tax returns, which reflect that, while Morgan and Lanham shared the taxable gain attributable to Tailwind Properties' $33,320 in rental income for that year, Lanham was assigned all of the liability for paying state and federal taxes for Tailwind Properties' 2002 capital gains; Tailwind Properties' 2002 tax return reflected a total of $315,849 in capital gains. Lanham's testimony that he paid all of the applicable capital gains tax is also undisputed. In his brief, Lanham contends that it was error for the trial court to direct a verdict in favor of Morgan on this claim.

However, the sole issue Lanham raised in his notice of cross-appeal is a claim of breach of fiduciary duty relating only to "Michelle Morgan, individually and as the managing member of Tailwind Farm, LLC, and Tailwind Farm, LLC." Lanham failed to raise any issue relating to Tailwind Properties, or Morgan's role as the managing member of Tailwind Properties, in his notice of cross-appeal; Lanham failed to list Tailwind Properties or Morgan in her capacity as managing member of Tailwind Properties as parties to any claim in his cross-appeal; and, for

that matter, Lanham has never contended that Morgan, in her individual capacity, has ever owed him any fiduciary duty relating to Tailwind Properties.

Consequently, Lanham's failure to list Tailwind Properties and Morgan, in her capacity as Tailwind Properties' administrative member, as parties to this cross-appeal precludes this Court from reviewing this claim. Both Tailwind Properties and Morgan in her capacity as Tailwind Properties' administrative member were necessary parties in whose absence this court cannot grant Lanham relief. *See Braden v. Republic-Vanguard Life Ins. Co.*, 657 S.W.2d 241, 243 (Ky. 1983); *see also* CR 73.03. Lanham's failure to list these parties on his notice of cross-appeal was fatal to his ability to appeal this claim and, to the extent that this claim has been raised in this matter, it must be dismissed.

2. *Lanham v. Morgan*: breach of fiduciary duty regarding Tailwind Farm

Lanham's prior breach of fiduciary duty claim dealt with the subject of having to pay all of *Morgan's* half of Tailwind Properties' capital gain. This claim of breach of fiduciary duty deals more with Lanham having to pay his own rightful share of Tailwind Properties' 2002 capital gains taxes, without being able to offset Tailwind Farm's net operating losses against them. Lanham alleged that on Tailwind Farm's 2002 tax return, Morgan shifted 100% of Tailwind Farm's net operating losses to herself, preventing him from claiming them as a deduction, and that he was damaged as a result. In support, Lanham produced Tailwind Farm's 2002 tax returns, which reflect that all of Tailwind Farm's net losses, in a total amount of $110,528, had been assigned to Morgan. Morgan does not dispute that

Lanham was unable to deduct any of these losses from his personal tax return. Lanham also testified that his inability to use these losses as deductions in his personal 2002 tax return resulted in an approximate difference of about $20,000 in tax liability.

In response to Lanham's claim that Morgan breached her fiduciary duty as Tailwind Farm's administrative member, Morgan presented two arguments. First, Morgan contended that Lanham failed to present evidence that she had breached any duty. She substantially repeats this argument in her cross-appellee brief:

> Regarding Tailwind Farm, both Morgan and Lanham testified that Morgan contributed the vast percentage of capital to the company in support of its horse business. Morgan testified that she contributed all of the capital to Tailwind Farm in 2002, and Lanham did not offer any testimony disputing her contributions or evidence that he contributed capital to Tailwind Farm in 2002. The capital contributed by Morgan came from loans by her business, Lite Source, and inherited money. Therefore, Lanham did not present evidence that Morgan breached her fiduciary duty to Lanham by accurately reporting 2002 capital contributions[14] and losses for Tailwind Farm.

Second, Morgan contended that Lanham failed to present evidence sufficient to demonstrate that Morgan's alleged breach damaged him and the amount of those damages because Lanham failed to introduce his personal 2002 tax return into evidence.

[14] Lanham also argued that Morgan misrepresented the amount of their respective capital contributions to Tailwind Farm on Tailwind Farm's 2002 tax return. However, this is not an event of damage. Tailwind Farm's operating agreement required Morgan and Lanham to each pay half of the capital gains tax and take half of Tailwind Farm's losses, regardless of either's capital contributions; and, in any event, Tailwind Farm has never conducted a formal accounting to determine, as a final matter, the positive balance of Morgan's or Lanham's capital accounts.

Morgan's first argument is without merit because Tailwind Farm's operating agreement calls for all of its losses to be split equally between its two members, Morgan and Lanham, irrespective of any capital contributions. If Morgan wished to have taken more of the losses, she and Lanham could have amended the operating agreement accordingly. However, the operating agreement was not amended and some probative evidence of record demonstrates that, instead, Morgan made a unilateral decision to claim all of Tailwind Farm's losses without Lanham's consent. Thus, in the light most favorable to Lanham, a reasonable jury could have found that Morgan breached the fiduciary duties she owed to Lanham, imposed upon her by virtue of Article 5.4 of Tailwind Farm's operating agreement.

Furthermore, we disagree with Morgan's second argument, *i.e.*, that Lanham failed to produce evidence sufficiently probative of damage. Tailwind Properties' and Tailwind Farm's tax returns are sufficiently probative of the fact of Lanham's damage. Together, they are capable of demonstrating that, but for Morgan's breach, the share of Tailwind Properties' capital gains taxes, which Lanham was actually responsible for paying, could have been reduced. And, where the evidence of record is capable of proving the fact of damage with certainty, Kentucky law does not require Lanham to provide exact calculations of his damage—an estimate may suffice if it proves damages with "reasonable certainty." *See Johnson*, 596 S.W.2d at 27; *see also Hanson*, 865 S.W.2d at 309. Morgan provides no authority that a jury verdict based upon Lanham's estimate of

an approximate $20,000 difference in his 2002 tax liability would be manifestly against the evidence; the trial court accepted Lanham's testimony to that effect; and some probative evidence of record demonstrates that he paid all of Tailwind Properties' capital gains taxes and took none of Tailwind Farm's losses.

In light of the above, we conclude that the trial court abused its discretion in granting a directed verdict in favor of Morgan on Lanham's second claim for breach of fiduciary duty regarding Tailwind Farm, and remand this claim for further consideration.

D. Evidentiary Issues

We review a trial court's decision as to the admittance or exclusion of evidence under an "abuse of discretion" standard. *Clephas v. Garlock, Inc.*, 168 S.W.3d 389, 393 (Ky. App. 2004). "The test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair, or unsupported by sound legal principles." *Commonwealth v. English*, 993 S.W.2d 941, 945 (Ky. 1999). An abuse of discretion exists only when we are "firmly convinced that a mistake has been made." *Overstreet v. Overstreet*, 144 S.W.3d 834, 838 (Ky. App. 2003) (citation omitted). Appellants[15] argue that the trial court erred with respect to two evidentiary issues, discussed below.

1. Exclusion of Ivan Schell's testimony

[15] Tailwind Aviation, Tailwind Farm, Tailwind Properties, Morgan, and Morgan (in her capacity as the administrative member of Tailwind Farm) collectively assert these two evidentiary findings as the bases of error. Thus, for the purpose of reviewing these two contentions of error, we refer to these parties collectively as "appellants." Conversely, because the trial court ruled upon these issues in favor of Lanham and Insulation, we refer to Lanham and Insulation, collectively, as "Appellees."

The Appellants intended to call Ivan Schell as an expert witness. Schell is an attorney who had consulted extensively with Morgan and Lanham in drafting the operating agreements for Tailwind Aviation, Tailwind Properties, and Tailwind Farm. Schell also drafted the PNA between Morgan and Lanham. Schell's expert disclosure, filed by Appellants pursuant to CR 26.02(4)[16] on January 30, 2009, provided that Schell would offer expert testimony on the following topics:

> 1. The formation of Tailwind Aviation, LLC, Tailwind Properties, LLC and Tailwind Farm, LLC and his drafting of the Operating Agreements for these entities.
>
> 2. The Post Nuptial Agreement entered into by Michele Morgan and J. Daniel Lanham.
>
> 3. The various estate planning documents he prepared for Michele Morgan and J. Daniel Lanham.
> 4. The legal interaction and consequences of the various documents he prepared for Michele Morgan and J. Daniel Lanham; including the corporate documents for Tailwind Aviation, Tailwind Properties and Tailwind Farm; the Post Nuptial Agreement and the various estate planning documents.
>
> 5. That Michele Morgan and Dan Lanham transferred and conveyed their individual ownership interests in certain real property they owned before their marriage to Tailwind Properties, LLC and in exchange, each received a fifty percent (50%) membership interest in said LLC.
>
> 6. That the terms and provisions of the PNA which he prepared did not prevent Michele Morgan or Dan Lanham from conveying and transferring their individual

[16] CR 26.02(4) requires parties to disclose, upon request before trial, "facts known and opinions held by experts," including, "the subject matter on which the expert is expected to testify, and . . . the substance of the facts and opinions to which the expert is expected to testify and a summary of the grounds for each opinion." CR 26.02(4)(a)(i).

ownership interests in certain real property to Tailwind Properties, LLC.

Prior to the trial of this matter, the Appellees moved to exclude any testimony Schell proposed to offer on these topics. The Appellees contended that the testimony that the Appellants intended to elicit from Schell, referenced above, constituted several inadmissible legal opinions. The trial court granted the Appellees' motion and instructed the Appellants that Schell would only be allowed to testify in the capacity of a fact witness. Thereafter, when the Appellants called upon Schell to testify, the appellants asked Schell no questions regarding the meaning of the PNA, the meaning of any of the operating agreements, or how Schell explained the legal effect of any of these documents to Morgan or Lanham. On appeal, Appellants contend that the trial court erred in granting the Appellees' motion to exclude the above-referenced portions of Schell's proposed testimony. We disagree.

The substance of Schell's excluded expert testimony was not "made known to the court by offer," per Kentucky Rules of Evidence (KRE) 103(a)(2). But, the substance and object of that excluded testimony are apparent from his expert disclosure and from the context of the questions the Appellants asked him at trial. Schell was called upon to offer several opinions about the legal significance, interpretation, construction, and consequence of several contracts.

As a general rule, expert testimony is admissible when the expert's specialized expertise will assist the *trier of fact* in understanding the evidence or in determining a fact in issue. *See* KRE 702. However, no party to this action has

ever contended that the PNA or the operating agreements are ambiguous, and a contract which is plain and unambiguous on its face will be interpreted by the *court* as a matter of law. *See First Commonwealth Bank of Prestonsburg v. West*, 55 S.W.3d 829, 835 (Ky. App. 2000); *see also Hibbitts v. Cumberland Valley National Bank & Trust Company*, 977 S.W.2d 252, 254 (Ky. App. 1998). For this reason, as an equally general rule, the opinion of an attorney as to the legal effect, interpretation, and consequence of a document is not admissible. *See* 32 C.J.S. Evidence § 546(86); *see also*, 31A Am. Jur. 2d *Expert and Opinion Evidence* § 357 (2010). Schell's expert testimony was not offered for any valid purpose and the trial court therefore properly excluded his testimony.

2. Admission of the PNA (PNA)

The PNA between Morgan and Lanham, discussed above, was the subject of significant interpretation and litigation before the family court in Morgan's and Lanham's separate divorce proceedings. *See ML I.*
In that matter, Lanham argued that the family court was the best forum for interpreting the application of the PNA to those assets held by Tailwind Properties, Tailwind Aviation, and Tailwind Farm. In its September 27, 2007 findings of fact and conclusions of law, and again in its final order of February 13, 2008, issued in response to Lanham's motion for reconsideration, the family court responded:

> [Morgan's and Lanham's] interest in Tailwind Farm, LLC, Tailwind Properties, LLC, and Tailwind Aviation, LLC arises from the three (3) operating agreements and their capital contributions[.] [T]his Court shall defer to the Circuit Court as to each party's interest in these entities and the remedies available to them in that forum

> as those interests stand independent of the marriage based on their LLC status.

After repeating this statement in its February 13, 2008 order, the family court added:

> Just as they did with their affairs during their marriage, neither party [*i.e.*, Morgan and Lanham] recognized the legal significance of the distinction between an asset belonging to them personally and an asset owned by a LLC.
> . . . .
>
> Had the parties not wished those properties to be handled as a corporate business entity and to retain their 403 status,[17] they would not have formed an LLC. The Court's position has not changed and it will decline to changes [sic] its ruling on this issue. Therefore, Mr. Lanham's motion to reconsider the ruling with regard to the LLCs will be denied.

We have already held that the PNA between Morgan and Lanham does not have any legal effect upon any properties at issue once Morgan or Lanham contributed them to the LLCs. Prior to the trial of this matter, however, the Appellants also moved to exclude the PNA from being introduced into evidence. Curiously, the basis of their motion was not that the PNA was irrelevant to the ownership and disposition of the assets held by the LLCs. Rather, the sole basis of their motion was that a subset of *res judicata*, issue preclusion, barred the trial court from admitting the PNA into evidence. The Appellants argued that the family court in the prior divorce action between Morgan and Lanham had already

[17] In Kentucky, the disposition of property belonging to either spouse or both spouses in a dissolution of marriage action is governed by statute, specifically KRS 403.190.

held, as a matter of law, that the PNA was not relevant to the ownership and disposition of the assets held by the LLCs.[18]

The trial court held that *res judicata* did not preclude admitting the PNA into evidence, and we agree with the trial court's decision. In *Yeoman v. Com., Health Policy Bd.*, 983 S.W.2d 459, 465 (Ky. 1998), the Supreme Court of Kentucky discussed the issue preclusion aspect of *res judicata*:

> For issue preclusion to operate as a bar to further litigation, certain elements must be found to be present. First, the issue in the second case must be the same as the issue in the first case. Restatement (Second) of Judgments § 27 (1982). Second, the issue must have been actually litigated. *Id*. Third, even if an issue was actually litigated in a prior action, issue preclusion will not bar subsequent litigation unless the issue was actually decided in that action. *Id*. Fourth, for issue preclusion to operate as a bar, the decision on the issue in the prior action must have been necessary to the court's judgment. *Id*.

Here, the family court's decision on the issue of the PNA's relevance to the LLCs and any property held by those LLCs could not have been necessary to its judgment in the prior divorce action between Lanham and Morgan because, stated simply, it entered no judgment with respect to the LLCs and any property held by those LLCs. Instead, it deferred those subjects to the trial court in this matter. Thus, issue preclusion could not function to bar the PNA from being

[18] The Appellants' written motion *in limine* regarding this issue only asserted *res judicata* as a basis for exclusion. During the hearing on this motion, Appellants' counsel argued that the family court's order had determined that the PNA was irrelevant, but stated "Whether or not Judge Bowles [the presiding judge in the divorce action] was right or wrong, we're not arguing that."

entered into evidence in this matter because the fourth element of issue preclusion, as stated in *Yeoman*, is not present. We find no error in this respect.

E. Dissolution of Tailwind Aviation, Tailwind Farm, and Tailwind Properties

After entering a decree of dissolution, KRS 275.290(3) requires the court to direct the winding up and liquidation of a limited liability company's business and affairs in accordance with KRS 275.300. In turn, KRS 275.300 mandates that the court wind up and liquidate a limited liability company's business and affairs as provided in that entity's operating agreement. And, Article 11 of the operating agreements for Tailwind Aviation, Tailwind Farm, and Tailwind Properties provide for how each entity is to be dissolved and how each entity's affairs are to be wound up.

Importantly, Article 11.1(b) provides that each entity "shall be dissolved and its affairs wound up . . . upon entry of a decree of judicial dissolution . . . dissolving the [entity]. Furthermore, Article 11.3 requires that

> Upon dissolution, an accounting shall be made by the Company's independent accountants of the accounts of the Company and of the Company's assets, liabilities, and operations, from the date of the last previous accounting until the date of dissolution.

Thereafter, Articles 11.3(a) through (g) prescribe when those assets shall be liquidated; the order in which the entities' liabilities, including members' capital accounts, will be satisfied; how the proceeds of the liquidation, as well as

the entity's losses and profits, should be allocated to each member's capital account per Article 8 (above); and the order in which the entities' liabilities, including members' capital accounts, will be satisfied.

Morgan's pleadings filed in this matter ask for 1) a decree of judicial dissolution for Tailwind Farm[19] and Tailwind Properties; 2) a decree appointing Morgan as the proper person to oversee the winding-up of the affairs and liquidation of the remaining assets belonging to the entities; and 3) a decree directing Morgan to wind up the entities' affairs and liquidate and distribute their assets. Morgan did not ask the trial court to conduct an accounting in equity.

In his answer, Lanham agreed that Tailwind Properties and Tailwind Farm should be dissolved. However, Lanham denied that Morgan was the proper person to wind up the affairs of the entities, and he also contended that it would be unnecessary to liquidate any assets or wind up any affairs because Lanham reasoned that any liquidation or distribution of assets in property should be done in accordance with the terms and conditions of the parties' PNA and pursuant to the orders entered by the Jefferson Circuit Court in connection with the dissolution of marriage proceedings between Morgan and Lanham.

However, as it relates to any issue of dissolution, the trial court's order states, in its entirety:

> IT IS FURTHER ORDERED AND ADJUDGED, in that the parties have agreed that Tailwind Properties, LLC should be dissolved, that the request of the parties to do so is hereby GRANTED. The parties shall within ten

[19] As noted earlier, Tailwind Farm was administratively dissolved prior to the trial court's opinion and order in this matter.

> (10) days of the entry of this Order and Judgment take all necessary steps, including, without limitation, the execution of any necessary documents, to effectuate the dissolution of said entity with the office of the Secretary of State for the Commonwealth of Kentucky and any other jurisdiction, as necessary.
>
> IT IS FURTHER ORDERED AND ADJUDGED, in that the only actions necessary to effectuate a winding-up of Tailwind Properties, LLC is for the entity to transfer the real estate owned by the entity to the member who owned said property prior to the formation of said entity, that, within ten (10) days of the entry of this Order and Judgment, Michele Morgan in her capacity as administrative member for Tailwind Properties, LLC shall take all necessary steps, including, without limitation, the execution of any necessary documents, effectuate a transfer of the real estate at issue from Tailwind Properties, LLC to the appropriate member as described above by means of Quitclaim Deed in a form to be agreed upon by the members. In the event that Tailwind Properties, LLC fails or refuses to act in accordance with this Order and Judgment within the allotted time, the Jefferson County Commissioner is hereby authorized to take all necessary steps to effectuate this Order and judgment in its stead.

In sum, after the trial court granted directed verdicts on every claim in this matter, the trial court only ordered that Tailwind Properties be dissolved; it did not appoint any person to wind up the remaining business or liquidate and distribute any of the remaining assets of Tailwind Aviation, Tailwind Farm, or Tailwind Properties. Instead, the trial court simply determined that the assets held by Tailwind Properties should return to Morgan and Lanham. Consequently, the trial court only ruled on one of several issues presented by these parties regarding dissolution, and resolved a new issue it created itself, *i.e.*, how the property held by each entity should be distributed.

Perhaps, the trial court arrived at this erroneous result because it believed that the PNA between Morgan and Lanham determined the disposition of the assets held by Tailwind Properties. In any event, the trial court's directive does not comport with Article 11 of Tailwind Properties' operating agreement. One of the more glaring examples of this is that, prior to ordering the distribution of Tailwind Properties' assets, the trial court gave Tailwind Properties no opportunity to conduct an accounting with its independent accountants, per Article 11.3, to determine: 1) the fair market value of any of the property held by Tailwind Properties; and 2) the value that property added to the contributing member's capital account at the time the property was contributed; 3) the appreciation of that property at the time of dissolution; and 4) the value of each member's capital account, factoring in any loans or distributions that member may have taken. Indeed, Article 4.1(e) in each of these operating agreements, as well as KRS 275.185(c)(1), requires that each LLC maintain a record of each member's capital contributions to each LLC, and neither Morgan, nor Lanham, placed those records into evidence in this matter.

In light of the above, the trial court erred when it purported to dissolve Tailwind Properties and distribute its assets in contravention of Tailwind Properties' operating agreement. Furthermore, because the trial court failed to make determinations as to who should oversee the winding-up of the affairs and liquidation of the assets of the respective LLCs, these claims must also be

remanded to the trial court for further proceedings. *See Drake v. Drake*, 721 S.W.2d 728, 730 (Ky. App. 1986).

IV. CONCLUSION

With respect to Tailwind Aviation's claim against Insulation for the recoupment of a $95,000 loan, we affirm the trial court's decision.

With respect to Morgan's claim of fraud and misrepresentation against Lanham, we affirm the trial court's decision.

With respect to Morgan's contentions of error regarding the testimony of Ivan Schell and the admission of the PNA, we affirm the trial court's decisions.

With respect to Tailwind Properties' claim against Insulation for the recoupment of a $110,000 loan and $64,000 in overdue rent, we reverse those decisions and remand those claims to the trial court.

With respect to Lanham's claim against Morgan and Tailwind Properties for breach of fiduciary duty, we dismiss due to Lanham's failure to list Tailwind Properties and Morgan, in her capacity as Tailwind Properties' administrative member, in his notice of cross-appeal.

With respect to Lanham's claim against Morgan, and Tailwind Farm for breach of fiduciary duty, we reverse the trial court's decision and remand that claim to the trial court.

And, with respect to the trial court's decisions regarding the dissolution and winding up of Tailwind Aviation, Tailwind Farm, and Tailwind Properties, we reverse the trial court's decision to dissolve Tailwind Properties and

distribute its assets, and remand this matter, as well as the matters relating to the dissolution of Tailwind Farm and Tailwind Aviation, for further findings. On remand, the trial court will 1) appoint a person to oversee the winding-up of the affairs and liquidation of the remaining assets belonging to Tailwind Aviation, Tailwind Farm, and Tailwind Properties; and 2) enter a decree directing that person to wind up each entity's affairs and liquidate and distribute its assets pursuant to each entity's operating agreement.

Finally, as *dicta*, we note that it would certainly be the better practice for the parties herein to abate this matter, following remand, in order to allow the independent accountants of Tailwind Aviation, Tailwind Farm, and Tailwind Properties to conduct an accounting of the assets of each entity and the final balance of Morgan's and Lanham's respective capital accounts.

STUMBO, JUDGE, CONCURS.

KELLER, JUDGE, CONCURS IN PART AND DISSENTS IN PART BY SEPARATE OPINION.

KELLER, JUDGE, CONCURRING IN PART AND DISSENTING IN PART: For the reasons set forth below, I respectfully dissent, in part, from that portion of the majority's opinion that denies appellate relief to Lanham with regard to a portion of his cross-appeal. I concur with the results reached by the majority on the remaining issues raised, but write separately to clarify what I believe will be the net result of this litigation.

First, the reasons for my dissent. Lanham claims that Morgan violated her fiduciary duty to Tailwind Farm and Tailwind Properties with regard to the allocation of losses and capital gains. The majority states that Lanham is foreclosed from pursuing his appeal of the trial court's finding regarding Tailwind Properties and Morgan as managing member because Lanham did not name either as a party to this appeal. The majority correctly cites CR 73.03. However, the majority ignores the Supreme Court of Kentucky's holding in *Blackburn v. Blackburn,* 810 S.W.2d 55, 56 (Ky. 1991), that "the principal objective of a pleading [is] to give the opposing party fair notice." When "[t]he conduct of the parties leaves . . . no doubt that [they] . . . fully understood the identity of all of the parties to the appeal throughout the course of the appeal[,]" failure to identify one of the parties is not fatal to the appeal. These parties have been involved in litigation, either in family court or circuit court, since 2003. There is no doubt that they were aware of the identity of the parties and the issues involved in this appeal. Therefore, this court should address all of the issues raised by Lanham on cross-appeal.

Next, I address those findings by the majority with which I agree. As a preface to doing so, I believe this matter involves the simple dissolution of a business relationship. Morgan and Lanham may have been husband and wife; however, that relationship has no bearing on their business relationship. When they formed the LLCs, Morgan and Lanham entered into operating agreements that provided for the operation and dissolution of those business entities. As members

of those LLCs, Morgan and Lanham are bound by the terms of the operating agreements. Morgan and Lanham did not always operate the LLCs pursuant to those agreements and they did not always keep or maintain acceptable business records. However, neither shortfall exempts them from the provisions of the operating agreements.

While not particularly relevant to their business relationship, I believe Morgan and Lanham's marital relationship will likely prove relevant in the future. During the course of their marriage, Morgan and Lanham entered into the PNA. I believe that they are bound by that contractual relationship and, once the LLCs are dissolved and the property and money is distributed according to the operating agreements, Morgan and Lanham may very well be required to redistribute that property and money pursuant to the PNA. Based on my review, it appears that, although the trial court skipped a step, it placed Morgan and Lanham in the same position they will be in once property and money in the LLCs is distributed to them as members and then redistributed pursuant to the PNA. In hindsight, I believe that the parties would have been better served to complete litigation of matters involving the LLCs before concluding the family court proceedings. However, since the parties did not choose that path and since we cannot go back in time, we must deal with the parties where they are.

Having noted the preceding, I agree with the majority's finding that the trial court should not have granted Lanham Insulation's motions for directed verdict regarding the issues of past rent, the alleged $110,000.00 loan from

Tailwind Properties to Lanham Insulation, and Lanham's cross-claim against Morgan. There is evidence of record that Lanham transferred commercial real estate to Tailwind Properties and that Lanham Insulation entered into a lease agreement with Tailwind Properties. It is undisputed that Lanham Insulation did not pay all the rent it owed. Therefore, the trial court should have permitted the jury to determine if a lease agreement existed and if Lanham Insulation violated the terms of the agreement.

As to the alleged $110,000.00 loan from Tailwind Properties to Lanham Insulation, there is evidence that Lanham wrote a check from Tailwind Properties' account payable to Lanham Insulation. The records indicate that the check was a loan by Tailwind Properties to Lanham Insulation. Tailwind Properties' 2002 tax return contains calculations from which one could infer that Tailwind Properties assigned the loan to Lanham. However, Morgan, the managing member of Tailwind Properties, denied any knowledge of such an assignment. Therefore, there was sufficient evidence that the loan was from Tailwind Properties to Lanham Insulation and that no assignment had been made, warranting submission of this issue to the jury.

Finally, I agree with the majority that there was sufficient evidence to submit the issue of Morgan's violation of her fiduciary duty as managing member of Tailwind Farm. The evidence, viewed in the light most favorable to Lanham, reveals that Morgan disproportionately took credit for losses by Tailwind Farm to

the exclusion of Lanham. Thus a jury question existed and the trial court erred by taking this matter from the jury.

I concur with the majority's holdings affirming: the trial court's findings regarding the alleged loan of $94,000.00 from Tailwind Aviation to Lanham Insulation; the trial court's directed verdict on the issue of fraud; and the trial court's evidentiary rulings.

On remand, I would instruct the court to conduct, if requested to do so, a new trial on the issues of rent owed by Lanham Insulation to Tailwind Properties; the alleged loan from Tailwind Properties to Lanham Insulation; and the alleged breach of her fiduciary duty by Morgan. Once a jury determines if rent is owed and if the loan was made and must be repaid, the court should order the dissolution of Tailwind Properties and disposition of its assets pursuant to the operating agreement. If a jury determines that Morgan breached her fiduciary duty and that Lanham was damaged thereby, the court should enter an appropriate judgment.

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