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Commonwealth of Kentucky
Court of Appeals

NO. 2009-CA-002198-MR
AND
NO. 2009-CA-002284-MR

LI AN CHOU

APPELLANT/CROSS-APPELLEE

APPEAL AND CROSS-APPEAL FROM JEFFERSON CIRCUIT COURT
v. HONORABLE MITCHELL PERRY, JUDGE
ACTION NO. 05-CI-000197

RICHARD C. CHILTON,
MARK O. CHILTON AND
WILLIAM W. CHILTON, III

APPELLEES/CROSS-APPELLANTS

OPINION
REVERSING IN PART, AFFIRMING IN PART
AND REMANDING

** ** * ** * ** *

BEFORE: ACREE, CHIEF JUDGE; STUMBO AND THOMPSON, JUDGES.

STUMBO, JUDGE: Li An Chou seeks our review of the trial court's decision to dismiss, without prejudice, his claims against Richard, Mark and William Chilton.

The Chiltons cross-appealed asserting that all claims should have been dismissed

with prejudice. Upon our review, we hold that the trial court erred when it dismissed a portion of Chou's claims, and also erred when it failed to dismiss other claims with prejudice. We therefore reverse in part the decision of the Jefferson Circuit Court and remand to that trial court for further proceedings consistent with this opinion.

Li An Chou was born in China and raised in Taiwan. He came to the United States and operated several companies importing and exporting products between China, Taiwan and the United States. Because of his nationality of birth, Chou was familiar with and utilized the benefits of operating his business ventures as Minority Business Enterprises (MBE). One advantage of operating as an MBE is that certain preferences are given to those companies when bidding on public projects.

Richard C. Chilton and his brother Mark Chilton formed RAM Engineering and Construction, Inc. They were later joined by their nephew William W. Chilton, III and engaged in the business of large-scale public construction projects. The Chiltons owned all of the stock in RAM and each held a position on the board of directors.

Mark Chilton and Chou knew each other through their church. Mark approached Chou with a request to assist RAM in its attempts to import a certain piece of construction equipment from South Korea to the United States. Although Chou did not normally do business in South Korea, he was able to introduce Mark to a business acquaintance in Chicago who regularly traded with South Korean

companies. During this initial business contact, Mark Chilton introduced Chou to the methods RAM used during construction of a stadium at the University of Louisville and introduced Chou to Richard Chilton and William Chilton.

In 1998, Richard Chilton approached Chou with the proposition of forming a new construction company that would be able to secure MBE status. The Chiltons offered to teach Chou the construction business with Chou being responsible for obtaining MBE certification for the new company. In September 1998, Ram.Chou Construction was formed as a limited liability company. The “First Amended and Restated Operating Agreement” of Ram.Chou was signed by the parties on March 9, 1999. In order to qualify as an MBE, Chou was granted a fifty-one percent ownership stake in Ram.Chou and he was appointed as president/managing member of the corporation. He received a draw against future profits of \$4,000 per month as well as company-provided health insurance. The Chiltons owned the remaining forty-nine percent of the company among the three of them.

Initially, because of their experience in the construction business, the Chiltons were to guide the operation of the company but were supposed to teach Chou so that he could ultimately assume the role of being in charge of Ram.Chou’s operations. However, the reality was a much different story. RAM and Ram.Chou both operated in the same construction business environment. Ram.Chou used RAM employees and equipment for its work. RAM’s accounting department handled both RAM and Ram.Chou’s finances, accounting and payroll. In turn, it

was to reconcile all transactions between the two companies. However, the Chiltons wired funds or wrote checks between the two companies without authorization or documentation. The Chiltons professed they did this because Chou was not capable of running the business and did not want to learn. Chou argues that he was shut out of the operations of the company and existed only as a figurehead for the Chiltons to secure MBE-related contracts.

In 2002 Ram.Chou attempted to renew its MBE certification but its application was denied and Ram.Chou was decertified as an MBE. One of the problems with certification involved the lack of documentation reflecting that Ram.Chou was a separate entity and not merely a conduit for RAM transactions. The Chiltons then had the RAM accounting office send Chou a notice of termination advising him of his COBRA rights to continue insurance coverage under the Ram.Chou insurance plan. After the decertification and Chou's termination, the Chiltons signed checks moving money from Ram.Chou to RAM. Chou asked for copies of the financial records related to Ram.Chou but was denied access.

Chou filed an action in 2005 naming himself individually as the plaintiff with the Chiltons named individually as defendants. He sought relief on grounds of fraud (misrepresentation), breach of loyalty, breach of fiduciary duty, breach of the duty of good faith and fair dealing implied in the Operating Agreement, misappropriation of funds from Ram.Chou and a complete accounting of the financial aspects of Ram.Chou including funds owed by Ram.Chou to him

along with a formal dissolution of Ram.Chou as a corporate entity. The Chiltons filed a motion to dismiss in June 2009 alleging among other arguments that Chou was not a real party in interest and lacked standing to file suit against the Chiltons and that only Ram.Chou was a proper party. The trial court denied Ram.Chou's motion to intervene and on August 18, 2009, dismissed Chou's complaint without prejudice. The trial court determined that Ram.Chou but not Chou individually was the real party in interest and that Chou as an individual lacked standing to seek relief. This appeal followed.

Pursuant to the trial court order, Chou then re-filed the action naming himself, the Chiltons, Ram.Chou and RAM as parties. That action has been stayed pending the outcome of this appeal. On cross-appeal, the Chiltons argue the original dismissal should have been with prejudice.

At issue is the amended complaint filed by Chou on April 25, 2005. In that pleading, Chou listed eight counts alleging that he personally had been harmed individually by the Chiltons in their individual capacity. That complaint first sought recovery for dissolution of the limited liability company Ram.Chou. It also sought an accounting determining Chou's share of the assets of the company. Chou then alleged a breach of loyalty, misappropriation of funds, breach of fiduciary duty, breach of a covenant of good faith and fair dealing, and misrepresentation. Finally, there was a request for punitive damages.

While perhaps at some points ambiguous, the complaint was sufficient to provide notice of Chou's claims and requested relief. *See* Kentucky Rules of

Civil Procedure (CR) 8.01(1). To clarify the issues, the trial court's pretrial order instructed Chou to provide a list of itemized damages. Chou there claimed damages of \$1,306,548 for breach of the operating agreement, fraud, misappropriation and breach of fiduciary duty and as gain taken by the defendants. He then claimed damages of \$312,000 for breach of the operating agreement caused by his improper termination. He also sought punitive damages in the amount of \$7,000,000.

Our review of the dismissal of Chou's claims is similar to appellate review of a granted motion for summary judgment. We must view the facts in a light most favorable to Chou and any doubt is to be resolved in his favor.

Steelvest, Inc. v. Scansteel Service Center, Inc., 807 S.W.2d 476, 480 (Ky. 1991).

CR 17.01 provides, "Every action shall be prosecuted in the name of the real party in interest[.]" The trial court held that Chou was not the real party in interest for each claim. We disagree. "The real party in interest is the one who is entitled to the benefits of the action upon the successful termination thereof."

Brandon v. Combs, 666 S.W.2d 755, 759 (Ky.App. 1984). The real party in interest is the one "who has the right to control and receive the fruits of the litigation[.]" *Taylor v. Hurst*, 186 Ky. 71, 216 S.W. 95 (1919) (citation omitted).

The question then becomes whether Chou individually was a real party in interest as it relates to the claims made in the complaint. It is not our role to determine the merits of those claims but merely whether Chou has standing to bring them. *City of Louisville v. Stock Yards Bank & Trust Co.*, 843 S.W.2d 327, 328 (Ky. 1992).

At the outset we must note that the Chiltons have raised issues in their brief concerning the amount of compensatory damages Chou is seeking. We decline to rule on these arguments. The judgment being appealed from concerned only whether or not Chou had standing to bring his claims. The trial court did not address whether the amounts Chou is seeking to recover are reasonable or supported by the evidence. This opinion will focus solely on the issue of standing.

Chou's first claim requests dissolution of the limited liability company Ram.Chou. One method of achieving that would be for all members of the company to agree and file appropriate documents for dissolution with the Secretary of State. Kentucky Revised Statutes (KRS) 275.285. Since he alleges the Chiltons continued to operate Ram.Chou, it appears that such an agreement was not an option. Another option would be for "a member" to seek a judicial dissolution of the company. KRS 275.290(1). That is exactly what Chou's complaint does. As a member of the company, he is entitled to seek dissolution in court. He has standing to seek that relief and he is a real party in interest. The Chiltons argue that Chou abandoned this claim; however, the trial court only ruled that Chou lacked standing. We decline to make any findings as to whether Chou abandoned this claim and rule solely on the issue of standing. Dismissal of this claim was in error.

Next, Chou sought an accounting concerning the limited liability company Ram.Chou. On a request for dissolution, the assets and liabilities of the company must be accounted for prior to distribution. *See* KRS 275.300(2). As this

would be the natural next required step in the dissolution of the company, Chou as a member of the company seeking the dissolution is a real party in interest to request an accounting. Again, the Chiltons argue that Chou abandoned this claim; however, the trial court only ruled that Chou lacked standing. We decline to make any findings as to whether Chou abandoned this claim and rule solely on the issue of standing. Dismissal of this claim was error.

Chou also claimed breaches of the duty of loyalty and the breach of fiduciary duty that arose from the Operating Agreement. These are essentially the same claim. *Patmon v. Hobbs*, 280 S.W.3d 589, 593-594 (Ky. App. 2009). The trial court did not err as to this claim. A breach of fiduciary duty generally occurs between a principle and an agent. *Id.* Chou argues that *Patmon, supra*, holds that every member of a limited liability company owes a duty of loyalty and fiduciary duty to every other member of the company. If this is true, Chou would have standing to bring this claim against the Chiltons. This is not an accurate reading of *Patmon*. In that case, a previous panel of this Court held that managing members of a limited liability company have a fiduciary duty to other members of the company. *Id.* at 595. In this case, the Operating Agreement indicates that Chou is the managing member. The Chiltons did not owe a fiduciary duty to Chou; therefore, he has no standing to bring these claims.

We next examine Chou's claim for misappropriation of funds and opportunities. Ram.Chou and not Chou himself would benefit from any recovery for the misappropriation of funds and opportunities. This cause of action is also

similar to the breach of fiduciary duty claim discussed in the preceding paragraph. While Chou may or may not receive funds from Ram.Chou on dissolution of that company, any wrongs for misappropriation perpetrated by any of the Chiltons would be wrongs against Ram.Chou and not Chou individually.

We next review Chou's claims for breach of the covenant of good faith and fair dealing. "In every contract, there is an implied covenant of good faith and fair dealing." *Ranier v. Mount Sterling Nat. Bank*, 812 S.W.2d 154, 156 (Ky. 1991). The contract in question is the Operating Agreement. To put it another way, Chou is claiming that the Chiltons breached their contract with him. Here, the Operating Agreement specifically allows members to sue other members for "fraud, gross negligence, an intentional breach of this Agreement, or as otherwise required by the act." The breach of the covenant of good faith and fair dealing would be a breach of the Agreement. Whether or not it was an intentional breach would be up to the fact finder at trial. The Operating Agreement that was signed by all the parties allows Chou to bring a suit based on this claim. Chou has standing to bring this claim and the trial court erred in holding otherwise.

Chou also brought a claim for misrepresentation. This is a claim alleging fraud. *Bear, Inc. v. Smith*, 303 S.W.3d 137, 142 (Ky. App. 2010). Because the Operating Agreement allows members to bring claims for fraud against other members, Chou has standing to bring this claim.

Finally, we examine Chou's claim for punitive damages. A claim for punitive damages cannot survive when an underlying claim for compensatory

damages is absent. *Ammon v. Welty*, 113 S.W.3d 185, 188 (Ky. App. 2002). We have held that Chou has standing for his claims of breach of the covenant of good faith and fair dealing (breach of contract) and misrepresentation. Those claims seek compensatory damages and should Chou be successful, he is entitled to seek punitive damages. Dismissal of the claim for punitive damages was error.

The judgment of the Jefferson Circuit Court is reversed in part and affirmed in part. This matter is remanded to that court for proceedings consistent with this opinion.

ACREE, CHIEF JUDGE, CONCURS.

THOMPSON, JUDGE, CONCURS IN PART, DISSENTS IN PART, AND FILES SEPARATE OPINION.

THOMPSON, JUDGE, CONCURRING IN PART AND DISSENTING IN PART: Respectfully, I must dissent from that portion of the majority opinion which holds Chou does not have standing to assert his claim for breach of fiduciary duties against the Chiltons. In all other respects, I concur.

Initially, I point out Chou's appointment as president and managing member of Ram.Chou was nothing more than a formality done for the sole purpose of qualifying the company as an MBE. In reality, Ram.Chou had no independent existence from RAM and Chou did not manage Ram.Chou. It was operated and managed by the Chiltons. Based on this alone, the majority's reasoning is flawed.

Additionally, I do not interpret the rule espoused in *Patmon v. Hobbs*, 280 S.W.3d 589 (Ky. App. 2009), to apply only to managers of a limited liability

company. In fact, KRS 275.170 extends fiduciary duties to each member *or* manager when its states:

(2) The duty of loyalty applicable to *each member and manager* shall be to account to the limited liability company and hold as trustee for it any profit or benefit derived by that person without the consent of more than one-half (1/2) by number of the disinterested managers, or a majority-in-interest of the members from:

.....

(b) Any use by the *member or manager* of its property, including, but not limited to, confidential or proprietary information of the limited liability company or other matters entrusted to the person as a result of his or her status as *manager or member*. (Emphasis added.)

The *Patmon* Court did refer to the duties of managing members throughout its opinion and, logically so, because the defendant was the managing member of the company. However, it did not exclude the members of a limited liability company from the same duties. Just as partners owe the utmost good faith to each and every other partner, members of a limited liability company owe a fiduciary duty to fellow members and the company. *Patmon*, 280 S.W.3d at 595.

I would reverse.

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