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Commonwealth of Kentucky

Court of Appeals

NO. 2010-CA-001833-MR

SOHAL PROPERTIES, LLC

APPELLANT

v.

APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE F. KENNETH CONLIFFE, JUDGE
ACTION NO. 09-CI-007869

MOA PROPERTIES, LLC and
MOTELS OF AMERICA, LLC

APPELLEES

OPINION
AFFIRMING IN PART, REVERSING IN PART,
AND REMANDING

** ** * * * * *

BEFORE: CAPERTON, COMBS, AND THOMPSON, JUDGES.

COMBS, JUDGE: Sohal Properties, LLC, appeals from an order of the Jefferson Circuit Court entered on June 17, 2010, granting summary judgment in favor of MOA Properties, LLC, and Motels of America, LLC (the appellees).

Sohal also appeals the order entered August 13, 2010, dissolving Sohal's notice of *lis pendens* as well as the order entered on September 8, 2010, postponing the jury

trial to resolve Sohal's allegations of fraud and making the August 13, 2010, order final and appealable. The summary judgment of June 17, 2010, granted the appellees a right of possession to the disputed property and determined that they were entitled to keep a non-refundable, security deposit in the amount of \$500,000.00 paid by Sohal Properties. Under the circumstances presented in this case, we conclude that the appellees' retention of the security deposit constituted an invalid forfeiture. Therefore, we reverse and remand the judgment of the trial court with respect to the disposition of these funds.

The facts are undisputed. MOA Properties, a Delaware limited liability company, is the owner of the Super 8 Motel located at 4800 Preston Highway in Louisville. On May 3, 2006, Sohal Properties, a limited liability company with offices in Ontario, Canada, agreed to lease the property (including the fixtures, furniture, and equipment) for a term of three years.¹ Throughout the term of the lease agreement, Motels of America, another Delaware limited liability company, also held an interest in the leasehold. Motels of America is a party to a franchise agreement with Super 8 Motel, Inc., and has also described itself as owner of the disputed premises.

The parties' lease agreement required Sohal Properties to deliver to Motels of America a daily activity report and to deposit all receipts derived from the ownership, operation, maintenance, and management of the hotel to certain "lockbox" accounts. Regular and automatic disbursements were to be made from

¹ This arrangement appears to be a typical hotel lease arrangement whereby the lessor essentially contracts for the services of the lessee as operator of the premises.

these accounts to a master account controlled by an independent third party, LaSalle National Bank in Chicago. Funds disbursed from the master account were used to pay the monthly rent, the monthly deposit for property taxes, the monthly deposit for insurance premiums, and a monthly contribution to a capital reserve account. The amount by which the monthly receipts deposited exceeded the monthly disbursements to Motels of America was disbursed to Sohal Properties each month.

Motels of America was to provide to Sohal Properties a monthly summary of the receipts and disbursements related to the “lockbox” accounts as well as a monthly schedule of the deposits and balances of the property taxes, insurance reserve, and capital reserve accounts. Unless Sohal Properties defaulted on the terms of the lease agreement, it was entitled to the return of the accumulated funds in the capital reserve account at the end of the lease term. (Sohal Properties contends that it contributed more than \$209,500.00 over the term of the lease toward the capital reserve.)

Sohal Properties also paid a \$500,000.00 security deposit at the commencement of the lease. The security deposit was described in the lease agreement as non-refundable and was meant to secure performance of the “terms, covenants and conditions of this lease.” Lease at 19. Under the terms of the lease, the security deposit could be used to satisfy any breach of the lease.

The lease agreement between Motels of America and Sohal Properties also included an option-to-purchase provision. Under the terms of that provision, Sohal

Properties had an option to purchase the disputed property for \$2,700,000.00 at any time between May 3, 2006, and February 3, 2009 -- three months prior to the expiration of the lease term. If Sohal Properties elected to exercise the option to purchase, it was required to submit an additional \$5,000.00, non-refundable “option deposit” to secure its further performance. The purchase price was to be credited with the \$500,000.00 security deposit collected at the commencement of the lease and not yet applied to satisfy Sohal Properties’ obligations under the lease – as well as a portion of the monthly lease payments.

As the end of the lease term approached, Sohal Properties indicated to Motels of America that it intended to exercise the option to purchase. Since Sohal Properties was having difficulty securing adequate financing to close the transaction, the parties agreed to extend the period for exercising the option until June 30, 2009. Ultimately, Sohal Properties was unable to secure adequate financing for the purchase, and Motels of America demanded possession of the property pursuant to the terms of the lease agreement.

When Sohal Properties refused to surrender the hotel premises, Motels of America initiated a forcible detainer action in Jefferson District Court. Following a hearing conducted on July 23, 2009, the district court ordered possession of the disputed property to Motels of America. Sohal Properties appealed to the Jefferson Circuit Court. The Jefferson Circuit Court determined that the district court lacked jurisdiction to adjudicate the matter and remanded for an order dismissing the petition and writ.

On August 5, 2009, MOA Properties and Motels of America initiated this action against Sohal Properties in Jefferson Circuit Court. MOA Properties and Motels of America alleged: that the lease agreement had ended by its express terms; that Sohal Properties had failed to remit hotel receipts (as required by the terms of the lease) since June 14, 2009; that Sohal Properties had refused to vacate the premises; and that the bond of Sohal Properties (posted as a result of the district court action) was grossly insufficient to cover the damages incurred as a result of the holdover. MOA Properties and Motels of America sought: an accounting of all revenue accruing from the operation of the hotel; recovery of that revenue; and the appointment of a receiver to manage and operate the hotel during the pendency of the action. Over the objections of Sohal Properties, a receiver was appointed by the Jefferson Circuit Court.

On August 24, 2009, Sohal Properties filed its answer and a counterclaim. In Count One of its counterclaim, Sohal Properties alleged that its written agreement with Motels of America was a “purchase arrangement” whereby Sohal Properties agreed to lease the hotel with an option to purchase the Super 8 franchise together with the real property, buildings, furniture, fixtures, and equipment. In the event that Sohal Properties elected to exercise the option to purchase, Sohal Properties understood that the \$500,000.00 security deposit and a portion of the monthly rent were to be credited toward the purchase price. However, if Sohal Properties did not exercise the option, the parties’ agreement provided that the amount of the security deposit would not be refunded. Sohal

Properties contended that this part of the agreement amounted to a forfeiture provision that violates public policy and that, therefore, it is unenforceable.

In Count Two of its counterclaim, Sohal Properties alleged that MOA Properties and Motels of America had wrongfully withheld disbursement of its share of hotel revenue in June 2009 and that MOA Properties and Motels of America held excessive sums in the tax reserve account. In Count Three of its counterclaim, Sohal Properties alleged that Motels of America had induced Sohal Properties to enter into the lease agreement and to pay the required security deposit by fraudulently misrepresenting the amount of annual gross revenue generated by the hotel. Finally, in Count Four of its counterclaim, Sohal Properties alleged that it held an equitable interest in -- or lien against -- the disputed property by virtue of the substantial security deposit and the purchase price credit portion of the rent. MOA Properties and Motels of America denied the allegations.

On May 12, 2010, Sohal Properties filed a motion for partial summary judgment. It argued that the lease provision providing for the forfeiture of the security deposit should be declared void and unenforceable. It conceded that some portion of the security deposit could be applied *pro tanto* to offset any actual damages.

MOA Properties and Motels of America responded to the arguments of Sohal Properties and filed a cross-motion for partial summary judgment. MOA Properties and Motels of America contended that the terms of the lease were valid, that the term of the lease had expired, and that they were entitled to judgment as a

matter of law. MOA Properties and Motels of America challenged the contention of Sohal Properties that it had obtained some equitable interest in the property beyond the lease term. However, they did not address the nature of the substantial, non-refundable security deposit.

In an order entered June 17, 2010, the Jefferson Circuit Court denied the motion of Sohal Properties for summary judgment and granted the cross-motion of MOA Properties and Motels of America. The court determined that MOA Properties and Motels of America were entitled to possession of the disputed premises and to the entirety of the security deposit as a matter of law. The trial court rejected any notion that Sohal Properties had retained any equitable interest in the property following termination of the lease. The court did not address whether the lease term providing for a \$500,000.00, non-refundable deposit constituted an invalid penalty rather than a viable agreement for liquidated damages.

In a motion filed June 30, 2010, MOA Properties and Motels of America requested that the notice of *lis pendens* filed by Sohal Properties be dissolved; that the receivership be terminated; and that the owner of record be awarded control of the premises.²

In an order entered August 13, 2010, the court ordered that the notice of *lis pendens* be dissolved and directed the appointed receiver to file a final report and

² MOA Properties and Motels of America argued that the only remaining issue, the fraudulent inducement action, could not support the continued existence of the notice of *lis pendens* since it did not involve a lien or interest in the real property. Sohal Properties disagreed and challenged the motion, arguing that it retained a substantial interest in the hotel premises.

accounting of its activities upon the disputed premises. The court concluded as follows:

Inasmuch as this Court has previously resolved the issue relating to the title to the property at issue in its Order of June 17, 2010, and this Order dissolves the *lis pendens*, then both this Order and the June 17, 2010 Order are both final and immediately appealable.

FINAL AND APPEALABLE

On August 20, 2010, Sohal Properties filed a notice of appeal. It sought to appeal the order entered on August 13, 2010, and the order entered on June 17, 2010. On August 27, 2010, Sohal Properties filed a motion with the Jefferson Circuit Court. It asked the court for an order remanding the case from the court's trial docket and for inclusion of language reciting that the court's order of "August 13, 2010 is final and appealable and that there is no just reason for delay."

In an order entered September 2, 2010, this court directed Sohal Properties to show cause why the appeal should not be dismissed as interlocutory. In the order, we observed that the trial court's order of June 17, 2010, determined an issue related to the title to property and that the trial court's order of August 13, 2010, dissolved the notice of *lis pendens* and ordered the receiver to file a final report and accounting before it determined whether the receivership should be terminated. We observed that the order of August 13, 2010, "recites that both orders are final and appealable but does not recite that there is no just cause for delay, as required by CR 54.02."

In its response, filed on September 13, 2010, Sohal Properties acknowledged that there were claims left unresolved following entry of the August 13, 2010, order being appealed and that the order did not contain the full recitals necessary for application of Kentucky Rule[s] of Civil Procedure (CR) 54.02. The appeal was dismissed.

In an order entered September 8, 2010, the Jefferson Circuit Court declared that “[t]his order and Court’s Order entered on August 13, 2010 are final and appealable and there is not just reason for delay.” This appeal followed.

In that order of September 8, 2010, the circuit court did not refer directly to its order of June 17, 2010. As a result, there may be some arguable concern that the last order did not affect the interlocutory status of its order entered June 17, 2010. Nevertheless, in light of the specific circumstances outlined above, it is readily apparent that the trial court had concluded that there was no just cause for a delay in granting final judgment with respect to all the claims addressed and that it had intended to make the necessary certification. Consequently, we do not find it necessary to abate the appeal for an additional order.

Sohal Properties contended that Motels of America was precluded by the resolution of the district court proceedings from denying that Sohal Properties had acquired an equitable interest in the hotel property beyond the lease term. However, in its order of December 2009, the Jefferson Circuit Court concluded that the complex contract issues presented by the parties **did not fall within the subject matter jurisdiction of the district court**. Since the circuit court’s

dismissal of Motel of America's petition and the writ of forcible detainer were not an adjudication on the merits because of lack of subject matter jurisdiction by the district court, we hold that the doctrine of *res judicata* did not come into play.

Thus, the appellees were not barred from denying the claims of Sohal Properties to an interest in the hotel premises. *See Clemmer v. Rowan Water, Inc.*, 277 S.W.3d 633 (Ky.App. 2009).

We next consider the merits of this appeal. Summary judgment is proper only where "the pleadings, depositions, answers to interrogatories, stipulations, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." CR 56.03. On appeal, we must decide whether the trial court correctly determined that the moving party was entitled to judgment as a matter of law. *Scifres v. Kraft*, 916 S.W.2d 779 (Ky.App. 1996). There is no requirement that the appellate court defer to the trial court since factual findings are not at issue. *Goldsmith v. Allied Building Components, Inc.*, 833 S.W.2d 378 (Ky. 1992).

Liquidated damages are an agreed sum of money to be paid in lieu of actual damages in the event of a breach of contract. A provision providing for liquidated damages will ordinarily be enforced if the amount agreed upon is not greatly disproportionate to the potential injury and if damages may be difficult to ascertain within reason (as of the time of execution of the contract). *Mattingly Bridge Co. Inc. v. Holloway & Son Constr. Co.*, 694 S.W.2d 702 (Ky. 1985);

United Services Auto. Ass'n v. ADT Security Services, Inc., 241 S.W.3d 335 (Ky. App. 2006). However, when these conditions are not met, such a clause may be interpreted as providing for a mere penalty or forfeiture. *Id.* In that case, the provision will not be enforced, and the injured party will be entitled to recover only the actual damages suffered. *Id.* The validity of a liquidated damages clause is a question of law. *Man O War Restaurants, Inc. v. Martin*, 932 S.W.2d 366 (Ky.1996).

Under the particular circumstances of this case, we conclude that the \$500,000.00 non-refundable security deposit is grossly disproportionate to any anticipated loss flowing from a breach of the parties' lease agreement. The stipulated amount was nearly 20% of the initial asking price for the entire enterprise. It does not appear to have been calculated merely to compensate for anticipated damages. Additionally, we note other contract terms that tended to minimize the risk for damages. These terms required Sohal Properties to make its own substantial investments to capital, to render a daily accounting of the hotel's operations, and to turn over all receipts derived from those operations.

In addition, the lease agreement specifically provided that Motels of America could deduct any amounts from the security deposit necessary to satisfy Sohal Properties' obligations under the lease. This provision rendered the amount of damages to be readily ascertainable. It also indicates or strongly suggests that Motel of America's true motive in requiring forfeiture of the security deposit was

to induce performance rather than to liquidate in advance its damages for breach of the lease agreement.

Under these circumstances, the security deposit provided for in this lease must be construed as an impermissible penalty or forfeiture rather than as a valid liquidated damages clause. Although the parties were properly at liberty to fashion a mutually beneficial business transaction, we conclude that it would be unconscionable to allow the forfeiture provided for in this agreement to be enforceable. Since the provision is unenforceable, Sohal Properties was entitled to the summary judgment that it sought.

However, the trial court did not err by concluding that MOA Properties and Motels of America were entitled to possession of the premises pursuant to the plain language of the lease agreement. The parties did not enter into a land sale contract; Sohal Properties did not exercise its option to purchase the property; the lease clause providing for a portion of rent to be credited to the purchase price if the option were exercised did not convert the agreement to a purchase money mortgage; the security deposit was not an equitable mortgage on the property. Sohal Properties acquired no interest whatsoever in the premises beyond the term of the lease, and the appellees were not required to seek a judicial sale of the property by means of any foreclosure action.

Finally, as Motels of America properly observes, a notice of *lis pendens* is applicable only to actions in which right, title, interest in, or claim to real property is involved or affected. KRS 382.440. And, while we have

determined that Sohal Properties has asserted no valid right, title, interest in or claim to the disputed premises, we nonetheless conclude that it had the right to maintain its notice of *lis pendens* throughout the pendency of the action. The action remained “pending” while the appeal was being prosecuted. Consequently, the notice of *lis pendens* should not have been dissolved by the trial court.

Based upon the foregoing, we remand this matter to the trial court for a determination relative to the actual damages, if any, suffered by MOA Properties and Motels of America.

ALL CONCUR.

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