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Commonwealth of Kentucky

Court of Appeals

NO. 2013-CA-001723-MR

FIFTH THIRD BANK APPELLANT

v.

APPEAL FROM MARION CIRCUIT COURT
HONORABLE DAVID L. WILLIAMS, JUDGE
ACTION NO. 08-CI-00051

ANN SIMMS ROGERS,
CARRIE LYNN BALL,
MARIE MICHELLE PHILLIPS AND
SARA LALLIE DAVIS AS CO-EXECUTRIXES
OF THE ESTATE OF WILLIAM GARLAND BALL;
STATEWIDE ENVIRONMENTAL SERVICES, INC.;
BALL DEVELOPMENT CORPORATION, INC.;
JOHN RUDOLPH BALL, SR. A/K/A RUDY BALL;
THOMAS NELSON BALL A/K/A NELSON BALL;
JAMES DONALD BALL, SR. A/K/A DONALD BALL;
JOSEPH BERNARD BALL A/K/A BERNARD BALL;
SPRINGFIELD STATE BANK;
SUBWAY REAL ESTATE CORP.;
JERRY FERGUSON D/B/A SUBWAY;
KATHY FERGUSON D/B/A SUBWAY;
THE CATO CORPORATION;
GRACE CHEN D/B/A GOLD STAR BUFFET;
THY LON D/B/A K-NAILS;
BITTERSWEET ASSOCIATES, LLC
D/B/A H & R BLOCK TAX SERVICE;
U.S. BANK;

HOUCHENS FOOD GROUP, INC. D/B/A SAV-A-LOT;
CITIFINANCIAL, INC. D/B/A CITIGROUP;
BONITA LEATHERS D/B/A ORIGINALS BY L & S;
BARBARA SMITH D/B/A ORIGINALS BY L & S;
HIGHBAUGH'S FITNESS, LLC D/B/A CURVES;
CHECK INTO CASH OF KENTUCKY, LLC
D/B/A CHECK INTO CASH;
STOTT'S INCORPORATED D/B/A
DISCOUNT TOBACCO CENTER;
RODERICK D. COXON, D.C., P.S.C.;
VICKY CHILDERS D/B/A BUCK & DOE BARBERSHOP;
CONNIE SMITH D/B/A BUCK & DOE BARBERSHOP;
JERRY STINE D/B/A BUCK & DOE BARBERSHOP;
UNKNOWN TENANTS OF LEBANON TRADE CENTER;
COMMONWEALTH OF KENTUCKY,
COUNTY OF MARION;
CITY OF LEBANON;
J & M MONITORING, INC.;
CITICAPITAL COMMERCIAL CORPORATION;
SANTA BARBARA BANK & TRUST,
A DIVISION OF PACIFIC BANK, N.A.;
AND LEAF FUNDING, INC. APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: ACREE, CHIEF JUDGE; D. LAMBERT, AND NICKELL, JUDGES.

NICKELL, JUDGE: Fifth Third Bank (Bank) challenges the Marion Circuit Court's award of summary judgment to the Estate of Garland Ball (Estate) in its quest to determine the priority of creditors following default on a $2,500,000.00 promissory note.[1] Bank also appeals from an order denying its motion to alter,

[1] This is not the first time this Court has reviewed portions of this record. In *Statewide Environmental Services, Inc. v. Fifth Third Bank,* 352 S.W.3d 927 (Ky. App. 2011), another panel of this Court affirmed the Marion Circuit Court's grant of Bank's motions for default judgment and summary judgment against both the corporate and individual defendants.

amend or vacate the grant of summary judgment and the award of a $256,912.00 judgment to Estate, finding that to be the value of an equitable loan created by stock purchase agreements. Upon careful review of the briefs, the law and the record, we affirm.

FACTS

Five Ball brothers—Bernard, Donald, Garland, Nelson and Rudy—launched several joint business ventures in and around Lebanon, Kentucky, most notably for purposes of this appeal, Ball Development Corporation, Inc. (Ball), in 1971, and Statewide Environmental Services, Inc. (Statewide), in 1991. The five brothers were equal shareholders in, and directors of, both entities.

On or about November 19, 2001, each brother signed a stock purchase agreement for Statewide and a separate one for Ball[2] detailing future disposition of corporate shares of stock. Under the terms of the agreements, when a shareholder dies, his shares are to be offered for sale by his Estate to the corporation within sixty days of death. If, within thirty days of the offer, the corporation declines to purchase the shares, they are to be offered to the surviving shareholders. Forty–five days later, if no purchase has occurred, and no other agreement has been

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[2] Only the agreement pertaining to Statewide was produced despite a search for the Ball agreement. Estate asserts the brothers executed a similar agreement for each business and relies on testimony from two of the brothers that such an agreement exists for Ball, as well as a letter dated April 27, 2005, stating a similar agreement exists pertaining to Ball. Bank only mildly disputes existence of a stock purchase agreement for Ball because none has been produced and Kentucky Revised Statutes (KRS) 411.170 has not been used to prove the existence of a lost document. At oral argument, counsel for Bank admitted an agreement was likely executed for Ball.

reached between the Estate and the remaining shareholders, the corporation is to be liquidated and dissolved.

Garland died April 3, 2005. On April 27, 2005, Garland's shares were formally offered, first to the corporations, and then to the remaining shareholders. According to correspondence between attorneys Hon. Joseph H. Mattingly, III and Hon. William M. Hall, dated June 29, 2005, the remaining brothers elected to purchase "their proportionate share of the ownership of the Estate of William Garland Ball, Sr." in any of the Ball businesses. However, no purchase occurred. Garland's Estate was opened May 12, 2005. When neither corporation was liquidated and dissolved as required by the stock purchase agreements, Estate filed suit to dissolve the corporations on December 8, 2005.[3] Estate filed no *lis pendens* notice with any county clerk alerting the world to its claim against Ball, and filed no financing statement with the Kentucky Secretary of State announcing its claim against Statewide.

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[3] *Estate of Garland Ball, Sr. v. Statewide Environmental Services, Inc.,* et al., Marion Circuit Court, Civil Action No.: 2005-CI-00420. The complaint named as defendants Statewide, Ball, and the four surviving Ball brothers in their individual capacities. Count I of the first amended complaint, filed on July 5, 2006, alleged in part: the "Individual Defendants and [Estate] were parties to certain Stock Purchase Agreements"; the individual defendants "elected to exercise their option to purchase [Estate's] interest in the Corporate Defendants"; Estate "is entitled to have the Stock Purchase Agreements enforced and be paid for the value of [Estate's] interest in the Corporate Defendants by the Individual Defendants." Count II alleged in part: "The directors or those in control of the Corporate Defendants have acted, are acting, or will act in a manner that is illegal or fraudulent and the corporations must be liquidated and dissolved, pursuant to KRS 271B.14-300-320." The Complaint demanded appraisal of the corporations pursuant to the Stock Purchase Agreements and judgment for Estate "against the Individual Defendants for [Estate's] share of the Corporate Defendants." Alternatively, Estate asked that the corporations be dissolved and a receiver appointed to liquidate corporate assets and wind up any business affairs.

In early 2006, months after Garland's death, the four surviving Ball brothers approached Bank about executing a promissory note in the amount of $2,500,000.00. This inquiry followed on the heels of successful negotiations for a $100,000.00 loan.[4] As part of the approval process, Bank collected information from and about Ball, Statewide and the four surviving Ball brothers. By searching the Kentucky Secretary of State's website, Bank learned Statewide had been incorporated on July 29, 1991, was in good standing, and had filed its last annual report in December 2005—a report listing Garland as treasurer despite his death the previous April.

Bank has a manual[5] for processing commercial loans. Multiple pages within that manual are devoted to "Due Diligence Work." Bank's internal lending policy requires collection of specific information about a borrower when Bank's aggregate exposure exceeds $1,000,000.00—in this case, the amount of the loan was to be $2.5 Million. Some of the required searches, which are to span ten years, are: *state civil litigation, both suits and judgments for defendants*; federal civil litigation; state and federal tax liens; Secretary of State tax liens; bankruptcy; and, a corporate search for a Certificate in Good Standing or Articles of Incorporation.

[4] The $100,000.00 loan was part of Statewide's acquisition of a company named Envirodata Group, LLC. In addition to Bernard and Rudy, Tim Hurst, Joe Ford and Harry Kruger, originators of Envirodata, guaranteed this loan. Bank's inquiry into the Ball brothers and their businesses began with this loan which was for Statewide alone, but quickly transitioned to the $2.5 Million loan to Statewide and Ball.

[5] Version 1.0 of the manual was released August 15, 2006.

Bank engaged HireRight, Inc., an outside vendor, to perform a due diligence check in anticipation of the $2.5 Million loan. HireRight's search of "live" criminal records, federal criminal dockets, prohibited parties, federal bankruptcy dockets, tax liens, civil judgments, corporate affiliations and fictitious business names pertaining to Statewide—completed as of March 23, 2006—yielded "no records found," with one exception—a judgment for $5,447.00 dated August 11, 1993, discovered in Greensburg District Court records reflecting Statewide[6] was a successful plaintiff against James W. Anderson, the debtor. HireRight's search of corporate affiliations showed Statewide's status as "inactive" and its company standing as "bad"; it also showed Garland—although deceased—was a registered agent. HireRight's search did *not* reveal the dissolution lawsuit filed by Estate. Neither did it reveal the opening of Garland's estate.

Before making the loan, Nathan Mack, Bank's loan officer, and Hon. Jamie Brodsky, Bank's outside legal counsel, traveled to an office maintained by the Ball brothers in Lebanon, Kentucky, on one or two occasions. There is no indication they visited the Marion County Courthouse to check court records during either of these visits. When deposed on December 5, 2008, Mack—who is now a private consultant and no longer employed by Bank—testified to these points: when contemplating a loan, it is important for a lender to know the officers of the entity to whom it is considering making a loan; Bank was aware "Garland

[6] It is unclear whether a separate search was performed on Ball and on each Ball brother in addition to the search on Statewide. As explained in footnote 4 of this Opinion, the relationship between Bank and the Ball brothers began with a loan to Statewide alone that quickly moved to a second transaction involving both Statewide and Ball.

Ball" was listed as Statewide's treasurer; "due diligence" means one has verified information provided by a potential borrower; searches performed by Bank and HireRight revealed no pending litigation; Bank would want to know of any competing creditors before making a loan; as part of its due diligence, Bank requested a copy of Statewide's Articles of Incorporation; and, Bank also required the brothers to execute a "borrowing resolution."

Bank received a copy of Ball's by-laws requiring a minimum of five directors and a maximum of nine directors at all times. On August 28, 2006, the four surviving Ball brothers signed two corporate resolutions—one for Statewide and one for Ball—entitled "Unanimous Written Consent of the Directors of the Board of Directors Ball Development Corporation, Inc."[7] The opening line of each resolution reads, "[t]he undersigned, being *all* of the Directors of the Board of Directors of Ball Development Corporation, Inc. [or Statewide Environmental Services, Inc.]. . . ." (Emphasis added). Thereafter, the resolutions granted Bank "a first priority security interest in and to all of its assets" and "a first priority mortgage lien against certain real property in Lebanon, Kentucky." The resolutions further stated, "any one of the executive officers of the Company be, and each of them hereby is, authorized and directed, for and on behalf of the Company, to execute the Note, Loan Agreement, Security Agreement, Mortgage, and the other Loan Documents to which it is a party." Both resolutions were

[7] The resolution executed on August 28, 2006, substantially parroted a resolution signed by all four surviving brothers on March 6, 2006, making possible the $100,000.00 loan to Statewide for purchase of Envirodata.

signed by Bernard, Donald, Nelson and Rudy, the four surviving shareholders. Ball pledged a shopping center and office building as collateral, with Nelson signing as Ball's President. Statewide pledged a security interest in all of its general business assets, with Rudy signing as Statewide's President. Mack did not question the identity or whereabouts of the fifth director required by the corporate by-laws.

Mack further testified to these facts: Bank typically inquires about any dissolution plan when there are multiple borrowers involved; on March 5, 2006, a copy of a stock purchase agreement pertaining to Statewide was faxed to Bank; and, Brodsky would have given a legal opinion on the stock purchase agreement. Mack testified, while in Lebanon, he and Brodsky generally discussed existence of the stock purchase agreement with the four surviving Ball brothers. However, just how general that discussion was is debatable given the following testimony by Mack indicating he knew far more than that the agreement existed:

> Q. Did you ever inquire or have any discussions with anyone either within the bank or with the Ball brothers themselves as to whether or not his – Mr. Garland Ball's estate had any interest in the assets of the corporations?
>
> [Mack] A. No. I was told that – I mean, and that was part of the discussion – that we – [Brodsky] and I met with all four of the living brothers and we had – it was all four plus Jamie Brodsky and myself, and we had the discussion about – well, we just had a discussion about the transaction. But what I was told is that, you know, we have your purchase agreement and the way it works is when one was deceased that, you know, that they were paid, and so then the next – you know, so then the brothers inherit a larger share. And which of course, I,

> you know, my comment to them was like that doesn't seem – that doesn't seem fair so – so the last guy living gets – gets stuck with everything and stuck with paying everybody. He's still got to go to work everyday.
>
> Q. But this Stock Purchase Agreement was discussed between you and the – Donald and Nelson and Bernard and Rudy Ball and with Jamie Brodsky at some point?
>
> A. Yeah, I mean just – just in general – just the fact that it did in fact exist.

The foregoing exchange establishes Mack knew more than that stock purchase agreements existed—he was able to recite specific terms of those agreements. Mack also testified: when the $2.5 Million loan was being contemplated, Mack knew one of the Ball brothers was deceased—but he did not know which one;[8] he believed the brother had died several years before in a plane crash; he was unaware an estate had been opened; he did not ask whether the deceased brother had been replaced as a corporate director; and, he never inquired about whether the deceased brother's Estate had any current interest in the businesses. In Mack's view, HireRight's investigation should have revealed the Estate's dissolution lawsuit.

Mack admitted a pending lawsuit would have been a significant piece of information relative to evaluating the loan application and the borrower's liability, but he saw no indication of any such lawsuit. In fact, he testified the surviving brothers had represented to him that Garland's interest in the businesses

[8] Mack's testimony on this point vacillated. Initially, he testified he did not know which brother had died, but later in his testimony responded, "Yes," when asked if he knew Garland was deceased when he prepared his credit write-up.

had already been resolved. The following exchange occurred between Mack and the Estate's attorney toward the end of Mack's direct testimony:

> Q. Well, let me ask it as a question. If – if you knew that there was litigation on behalf of the estate of Garland Ball against the other shareholders –
>
> [Mack] A. Uh-huh.
> Q. – and against – well, against the corporate entities –
>
> A. Uh-huh.
>
> Q. – wherein the estate was alleging that it was entitled to certain value from the companies based on this buy-sell agreement that we've already looked at –
>
> A. Uh-huh.
>
> Q. – would that be an issue that would concern the bank so far as making this loan is concerned?
>
> A. Yes.
>
> Q. And part of the due diligence of the bank is to find these issues that might be lurking and might not be real visible on the surface –
>
> A. Uh-huh.
>
> Q. – to know that you are secure in loaning somebody two and a half million dollars.

When questioned about contradictions in the corporate bylaws requiring agreement of a minimum of *five* directors, and the corporate resolution being unanimously executed by only *four* directors on August 28, 2006, Mack testified he made no attempt to reconcile the two documents and relied solely on the resolution stating the four signatories were the sole directors of the corporations and any one of them

was authorized to bind the corporations. Mack also acknowledged he had reviewed tax returns for Ball and Statewide in making his financial determination. While he admitted seeing documentation indicating as recently as 2005 the corporations paid a share to Garland, Mack could not say whether that money was paid directly to Garland or to his Estate. Mack noted he did not include Garland in the guarantor analysis he prepared as part of his credit write-up.

Believing Ball and Statewide were good credit risks, Brodsky prepared a 24-page, single-spaced loan agreement stating in pertinent part:

> Section 4.06 Litigation. *There are no actions, suits, proceedings or investigations pending or threatened against any of the Obligors at law or in equity* before any court or before any federal, state, municipal or any governmental department, commission, board, agency or instrumentality, whether or not covered by insurance, which, individually or in the aggregate, may result in any materially adverse effect on the business, property or assets or the condition, financial or otherwise, of any of the Obligors or impair any of the Obligors' ability to perform their obligations under the Loan Documents. None of the Obligors are in violation of or in default with respect to any order, writ, injunction or any decree of any court or any federal, state, municipal or other governmental department, commission or bureau, agency or instrumentality which may result in any such materially adverse effect or impairment.
>
> Section 4.07 No Liens and Encumbrances on Collateral. *There are no security interests, liens, claims, or encumbrances upon or against the Collateral except the Liens in favor of Bank granted herein.* Assuming Bank receives all of the Loan Documents which have been properly executed, duly authorized and properly recorded, Bank shall possess a valid and duly perfected first priority security interest in the Collateral. Further, the Collateral is not and shall not be subject to

any other security interest or Lien of any kind whatsoever without the prior written consent of Bank.

[Emphasis added]. The agreement was signed by Rudy as Statewide's President and by Nelson as Ball's President. The document was then signed by Rudy, Bernard, Nelson and Donald in their individual capacities.

The loan was completed on August 28, 2006. On August 30, 2006, Bank recorded the mortgage pertaining to Ball with the Marion County Clerk and a financing statement pertaining to Statewide with the Kentucky Secretary of State.

Ball and Statewide defaulted on the loan, prompting Bank to demand payment and file a foreclosure lawsuit. Estate filed an intervening complaint in the foreclosure action claiming a one-fifth interest in the collateral pledged for the mortgage—a shopping center and an office building—and asking the circuit court to determine the priority of creditors. The Marion Circuit Court entered an agreed order in the foreclosure suit allowing the real estate and general assets to be sold, but allowing the Estate to continue asserting its claim against Bank.

In June 2009, Ball sold the shopping center privately for $1,157,999.44 with the proceeds being disbursed to Bank. In December 2009, Bank bought Ball's office building at a Master Commissioner's sale for $126,564.51. Statewide's general business assets have not been sold.

In April 2011, Estate moved for summary judgment in the foreclosure suit arguing: the stock purchase agreements signed by all five brothers created an equitable lien—of which Bank had actual notice—superior to Bank's mortgage

and security interests; Bank's mortgage was fraudulent[9] and/or a preferential transfer;[10] and, Bank failed to search for suits naming the surviving Ball brothers—the proposed borrowers—as defendants; otherwise, Bank would have found the dissolution lawsuit. Estate again asked the trial court to determine the priority of creditors.

In response to Estate's motion, Bank argued a court may recognize an equitable lien, but cannot create one. Since the stock purchase agreements did not even mention a lien, Bank maintained they did not expressly create a lien by contract. Bank theorized if Estate's argument were correct, an equitable lien would be created in favor of shareholders every time a corporation is dissolved. Citing *Cox v. Guaranty Bank & Trust Co.,* 199 Ky. 115, 250 S.W. 804, 805 (1923), Bank argued no equitable lien had been created, but if it had been, Bank had no actual notice of that lien because it had nothing in its file to cause a "reasonably prudent person under like circumstances to inquire into the matter and discover the existence of [the] mortgage." *State Street Bank & Trust Co. of Boston v. Heck's, Inc*., 963 S.W.2d 626, 630 (Ky. 1998). Bank also argued it had no constructive notice of an equitable lien because Estate did not file a *lis pendens* notice. *Id.*

In May 2011, Bank filed its own summary judgment motion. In support, Bank argued: Mack knew Garland was dead when the loan was negotiated, but did not know an estate had been opened or that Estate was asserting

[9] KRS 378.010.

[10] KRS 378.060.

an interest in the corporations; Bank relied on a written representation from the four surviving brothers stating there was no pending material litigation—a statement included in the loan agreement drafted by Brodsky on behalf of Bank; Bank had not relied on Ball's corporate by-laws in extending the loan, but instead relied exclusively on two corporate resolutions signed by the four brothers on August 28, 2006, stating they constituted all the corporate directors; and, Bank's outside vendor, HireRight, had searched records and found no pending litigation—only a 1993 action in which Statewide had won a judgment for $5,447.00 against a man named Anderson.

Citing *Cox*, Bank acknowledged actual notice may include inquiry notice, but argued that requires proof of two elements—1) possession of facts that would lead a reasonably prudent person to inquire further; and, 2) an existing encumbrance that is discoverable. Bank argued there was nothing it could have done to learn of Estate's interest while negotiating the promissory note. Specifically, Bank maintained the corporate bylaws and stock purchase agreements said nothing about Ball's and/or Statewide's assets and did not reference any encumbrances upon those assets in favor of shareholders. Furthermore, Bank argued, even if its litigation search had uncovered Estate's dissolution lawsuit, nothing in the complaint in that action stated or hinted Estate was asserting an interest in Ball's and/or Statewide's assets, and Estate could have easily asserted a lien in the complaint, but did not. Thus, while Bank admitted having certain documents in its possession, it argued thorough inspection of those documents

would not have allowed it to discover Estate was asserting an equitable lien and claiming superiority over Bank's interest in proceeds from the sale of Ball's shopping center and office building. Bank maintains Estate did not assert a claim to corporate assets with priority until December 8, 2009, when it filed an amended intervening complaint—but even then it did not characterize its interest as an "equitable lien" or even a "lien."

As an aside, we take issue with Bank's characterization of the record on this point. Count I of the first Amended Complaint filed by Estate in the dissolution action on July 5, 2006—nearly two months before the loan was made—a copy of which is included by Bank as an exhibit to its brief—alleges stock purchase agreements were executed in which the four surviving Ball brothers "elected to exercise their option to purchase [Estate's] interest in the Corporate Defendants" and Estate "is entitled to have the Stock Purchase Agreements enforced and to be paid for the value of [Estate's] interest in the Corporate Defendants by the Individual Defendants." Furthermore, the Complaint demanded "the Corporate Defendants be appraised pursuant to the Stock Purchase Agreements and [Estate] have a judgment against the Individual Defendants for [Estate's] share of the Corporate Defendants." From our reading of the first amended complaint, had Bank searched for and found it, Bank clearly would have known something was afoot.

On November 22, 2011, in an eight-page opinion, the Marion Circuit Court awarded summary judgment to Estate, finding the stock purchase

agreements executed by the five brothers had created equitable liens of which Bank had actual notice. The trial court found: Estate asserted a one-fifth interest in Ball and Statewide by letter soon after Garland's death in April 2005 and filed suit to dissolve the corporations in December 2005;[11] Bank's due diligence policy required a background check covering ten years of state civil litigation for defendants, both suits and judgments, for all commercial loans exceeding $1,000,000.00, but this particular search was not performed on the Ball/Statewide application; and, Bank's loan officer knew stock purchase agreements had been executed and one of the Ball brothers was deceased, but did not ask whether the decedent or his estate had any current interest in the corporations.

Finding no case on all fours, but citing *Best v. Jenkins,* 260 S.W.2d 653, 655 (Ky. App. 1953), the trial court concluded equitable liens may result from either a contract showing "an intention to charge property with a debt or obligation," or one may be "implied by a court of equity out of general considerations of right and justice." The trial court concluded the stock purchase agreements executed by the five Ball brothers created a "debt" and an equitable lien on the assets of Ball and Statewide under both theories.

Having decided Estate had an equitable lien, the trial court turned its attention to whether that equitable lien had priority over Bank's subsequent valid

[11] The trial court referenced a letter dated April 27, 2005, from attorney William Hall, Jr. to Nelson Ball formally offering Garland's "interest in each of the Ball Brothers entities first to the respective Corporations or partnership, and then to the surviving shareholders or partners of each respective entity at the price established in section (4) of each of the various [stock purchase] agreements on the terms established pursuant to Section (6) of same."

and recorded mortgage. Applying *Cox's* definition of "actual notice," the trial court determined Mack's deposition established Bank had sufficient factual knowledge that would lead a "reasonably prudent person" in its shoes to inquire further. *Cox,* 250 S.W.2d at 805. Specifically, the trial court determined Bank knew Garland had been a shareholder in 2005; knew one of the Ball brothers was deceased; and, knew stock purchase agreements had been executed; but did not ask whether Garland had any current interest in the corporations. Additionally, the court noted Bank had in its possession corporate bylaws requiring five directors to take action, but acted on corporate resolutions bearing only four signatures—without inquiring about the missing fifth signature. The trial court held, while there may have been no direct evidence of Bank's knowledge of Garland's interest, under *Heck's*, 963 S.W.2d at 630, circumstantial evidence of actual notice was sufficient.

Finally, the trial court cited *Tile House, Inc. v. Cumberland Federal Savings Bank,* 942 S.W.2d 904, 906 (Ky. 1997), for the proposition, "as between innocent parties he must suffer who, by his acts or laches, has made a loss possible" and "equity aids one who has been vigilant and will refuse relief to one who has been dilatory. . . ." The trial court then found Bank would not have extended the loan knowing of Estate's interest in the corporate assets had it followed its own due diligence policy. Thereafter, the trial court granted summary judgment in favor of Estate; denied Bank's request for summary judgment; and,

withheld ruling on Estate's request for the trial court to assign a value to its equitable lien until proof had been submitted.

Bank moved the trial court to alter, amend or vacate the award of summary judgment to Estate to correct factual errors pertaining primarily to Mack's testimony[12] and one omission—that Estate had not filed a *lis pendens* notice. Bank argued neither it nor Estate had been vigilant, and stressed its lending policy was for its own benefit and did not create an interest in a stranger. Bank also argued the trial court's failure to establish the equitable lien's value meant the summary judgment order was not final and appealable—a point with which Estate agreed and asked the trial court to establish a procedure for valuing the equitable lien—suggesting the proper date of valuation was April 27, 2005—the date Estate had offered Garland's shares to the remaining shareholders. Without ruling on either motion, Judge Allan Ray Bertram recused and Judge David L. Williams was assigned to hear the case as a special judge.

After more pleadings were filed, the motion to alter, amend or vacate was heard and the trial court found insufficient grounds existed to grant the motion. In the same order, entered September 26, 2013, the trial court determined the value of Estate's equitable lien was one-fifth of the net proceeds of the sale of the shopping center and the office building or $256,912.00—coincidentally, the

[12] We have read Mack's testimony—some 110 pages—in its entirety. We deem his testimony to be equivocal requiring no need for factual corrections or additions by the trial court.

maximum amount Bank had acknowledged the value of the lien could be. This appeal follows.

ANALYSIS

When evaluating the propriety of a trial court's award of summary judgment, we consider:

> "whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." The trial court must view the evidence in the light most favorable to the nonmoving party, and summary judgment should be granted only if it appears impossible that the nonmoving party will be able to produce evidence at trial warranting a judgment in his favor. The moving party bears the initial burden of showing that no genuine issue of material fact exists, and then the burden shifts to the party opposing summary judgment to present "at least some affirmative evidence showing that there is a genuine issue of material fact for trial." The trial court "must examine the evidence, not to decide any issue of fact, but to discover if a real issue exists." While the Court in *Steelvest*[*, Inc. v. Scansteel Service Center, Inc.* (Ky.1991)] used the word "impossible" in describing the strict standard for summary judgment, the Supreme Court later stated that that word was "used in a practical sense, not in an absolute sense." Because summary judgment involves only legal questions and the existence of any disputed material issues of fact, an appellate court need not defer to the trial court's decision and will review the issue *de novo.*

Community Trust Bancorp, Inc. v. Mussetter, 242 S.W.3d 690, 692 (Ky. App. 2007) (quoting *Lewis v. B & R Corp.,* 56 S.W.3d 432, 436 (Ky. App. 2001).

To reach our ultimate conclusion, Bank asks us to consider three questions, the first of which is a matter of first impression—whether the stock

purchase agreements executed by all five Ball brothers created in Estate an equitable lien in the assets of Ball and Statewide. For the reasons that follow, we hold they did.

There are two types of equitable liens:

> (1) those that may be implied and declared by a court of equity out of general considerations of right and justice as applied to the relations of the parties and circumstances of their dealings, and (2) those that arise from a contract which shows an intention to charge some particular property with a debt or obligation (*Carpenter v. Dummit*, 221 Ky. 67, 297 S.W. 695; *Jones v. Carpenter*, 90 Fla. 407, 106 So. 127, 43 A. L. R. 1409); and such liens will be enforced not only as between the parties, but as against one who takes with notice, or, like an assignee or receiver, stands in the shoes of the debtor (*In re Interborough Consolidated Corporation* (C. C. A.) 288 F. 334, 32 A. L. R. 932).

McFerran v. Louisville Title Co.'s Receiver, 254 Ky. 362, 71 S.W.2d 655, 657 (1934). We begin our analysis with the second type of equitable lien—those that arise from a contract.

Neither party disputes the stock purchase agreements in the present case were in fact contracts. Each contained the three elements of a valid contract —"offer and acceptance, full and complete terms, and consideration." *Energy Home, Div. of Southern Energy Homes, Inc. v. Peay,* 406 S.W.3d 828, 834 (Ky. 2013) (internal citations omitted).

The terms were complete in that they were "definite and certain" and specified the "promises of performance to be rendered by each party." *Kovacs v. Freeman,* 957 S.W.2d 251, 254 (Ky. 1997). Under the terms of the agreement,

upon the death of a shareholder, his interest was to be offered first to the corporation, then to the shareholders, and if not purchased by one or the other, the corporation was to be dissolved and liquidated. No one disputes the language of the agreement.

There was an offer and an acceptance in the stock purchase agreements as evidenced by subsequent correspondence. On April 27, 2005, by letter from William Hall, Jr. to Nelson Ball, Estate formally offered Garland's interest under the agreements "first to the respective Corporations or partnership, and then to the surviving shareholders or partners of each respective entity." That offer was accepted by letter dated June 29, 2005, in which attorney Joseph Mattingly wrote to Hall in pertinent part,

> First, I have been directed by the other shareholders of the Ball Companies, including Ball Development Company, Inc., Statewide Environmental Services, Inc., Ball Brothers Oil Company, Horseshoe Bend River Farms, Inc., B-Five, Inc., Ball Properties and any and all other business entities in which William Garland Ball, Sr. shared an ownership interest with his brothers which is covered by a stock purchase agreement that the remaining shareholders do hereby elect to purchase their proportionate share of the ownership of the Estate of William Garland Ball, Sr. in any of these entities. It is my understanding that financial information has already been shared and that additional information may be necessary in order to value the share of William Garland Ball, Sr. in these entities and to thereafter effectuate this purchase. I look forward to working with you in this matter.

Finally, the agreements were based on consideration. These were family businesses created by five brothers for their mutual benefit and protection.

Each brother agreed to restrictions on how and to whom stock could be transferred —first to the corporation, and then to the other brothers, so they could retain tight control of the businesses. If neither the corporation nor another brother chose to purchase the shares, each corporation was to be dissolved and liquidated rather than being allowed to fall into the hands of a stranger. By mutually agreeing to these restrictions, the brothers ensured the corporations would continue along a path charted by the family, and the brothers could be confident the shareholders with whom they were dealing were likeminded and had the best interests of the family businesses at heart.

Having shown the stock purchase agreements contained all three elements required for a valid contract, we hold a stock purchase agreement can, and in this case did, create a contractual equitable lien. A stock purchase agreement need not specify it is creating an "equitable lien" to establish a lien.

Bank argues nothing in the stock purchase agreement evinced a desire to create a lien and, therefore, did not create a contractual lien. We disagree. By its very nature, a stock purchase agreement creates contractual rights, interests and obligations between the parties thereto. In this case, the language chosen by the brothers could not be clearer as to what they were binding themselves to do. Thus, the stock purchase agreement created a contractual equitable lien in Estate. When Bank loaned the surviving brothers $2.5 Million on August 28, 2006, Estate still had a contractual one-fifth interest in Ball and Statewide, but no one bothered to inform the Estate of the loan or ask for its input.

We turn now to the second way an equitable lien is created. Had we not concluded Estate had a *contractual* equitable lien in Ball and Statewide, we would conclude it had a *non-contractual* equitable lien in the corporations due to equitable principles of justice and fair play. Garland died on April 3, 2005, but his one-fifth interest in the corporations did not evaporate when he drew his last breath. Estate formally offered Garland's interest to the corporations and then to the shareholders by letter dated April 27, 2005. The surviving brothers recognized Garland's interest in a letter dated June 29, 2005, agreeing to purchase his shares. No explanation has been proffered as to why the sale was never completed. At oral argument, counsel for Estate suggested there may have been disagreement over the price.

Bank faults the trial court for not delving deeper into the relationship between the parties and the nature of their dealings, and argues summary judgment was wrongly awarded without that factual basis. While the trial court could have addressed the relationship more deeply before awarding summary judgment to Estate, we are convinced sufficient detail was provided. From the trial court's order we know the five Ball brothers started numerous companies and executed stock purchase agreements for each of them. When Garland died in 2005, the surviving brothers maintained the *status quo* in contravention of the stock purchase agreements which required a purchase of Garland's shares or dissolution and liquidation of the corporations. When the brothers executed a promissory note with Bank in 2006—without consulting Estate—and subsequently defaulted on

that note, this litigation erupted and Estate intervened to assert its claim to one-fifth of the corporate assets, having previously filed suit to dissolve the corporations in accordance with the stock purchase agreements. Had Bank exercised reasonable due diligence—as reflected in its own lending policy—Bank would have realized Estate's interest and would have proceeded accordingly, rather than just ignoring the existing interest of a now-deceased shareholder. As noted by the parties, a trial court cannot *create* an equitable lien. Here, the trial court did not create an equitable lien—but it properly recognized one Bank did not find, overlooked, or ignored.

While we have been cited no case directly on point,[13] and have discovered none through our own research, we are convinced a stock purchase agreement can, and in this case did, create a non-contractual equitable lien. As a matter of first impression, we realize our holding represents a revelation in or clarification of the law, but it is mandated by the facts presented. Any other interpretation of the law would allow Garland's death to extinguish his interest, a result wholly unjustified and unacceptable. Thus, to answer Bank's first question, the stock purchase agreements executed in this case created both a contractual and a non-contractual equitable lien.

[13] Parties and the trial court cite *Jones v. Cabinet for Human Resources,* 710 S.W.2d 862 (Ky. App. 1986); *Geddes v. Reeves Coal & Dock Co.,* 20 F.2d 48 (8th Cir., 1927); *Ingersoll v. Coram,* 211 U.S. 335, 29 S.Ct. 92, 53 L.Ed. 208 (1908); and, *Barnes v. Alexander*, 232 U.S. 117, 34 S.Ct. 276, 58 L.Ed. 530 (1914).

Next, we consider whether Bank had actual notice of the equitable lien. Again, we conclude it did. This inquiry is crucial to determining the priority of creditors because an equitable lien takes priority over a subsequent valid and recorded mortgage acquired with actual or inquiry notice of the equitable lien. *Heck's,* 963 S.W.2d at 630.

Bank had numerous pieces of information about Statewide, Ball and the Ball brothers in its file. Some of that information was provided in response to requests from Bank; some was collected by HireRight; and some was collected by Bank itself. Among the pieces of information Bank had in its file were corporate bylaws requiring approval of at least five directors to take action and corporate resolutions signed by only four directors. Additionally, Bank had copies of stock purchase agreements executed by all five brothers specifying actions to be taken in the event of a shareholder's death.

We believe, as did the trial court, that had Bank reviewed these documents it *should* have noticed inconsistencies and asked basic questions—most notably, what happened to Garland's interest? These documents reasonably placed Bank on sufficient notice to prompt it to inquire further. Many other matters of inquiry leap from the documents Bank had in its possession. Since Garland had signed the bylaws and the stock purchase agreement, why did he not sign the "unanimous" corporate resolutions? If he was deceased, what happened to his one-fifth interest? Was his interest purchased by the corporation or other shareholders? Were the corporations dissolved and liquidated as required by the stock purchase

agreements, and if so, where are the new bylaws? Furthermore, since the bylaws require a minimum of five directors at all times, who is the fifth director, or have those bylaws been superceded? Do we have the current bylaws?

The foregoing matters of inquiry are not novel questions, but they are critical, and Bank, being on reasonable notice, should have asked them. These three documents—corporate bylaws, corporate resolutions and stock purchase agreements—which Bank admits it possessed—sufficiently establish Bank had notice of Estate's interest in Statewide and Ball *before* the $2.5 Million loan was finalized. The onus was on Bank to read the documents it requested and received. Thus, even though Bank recorded the mortgage promptly after the promissory note was made, its interest, as the trial court found, was inferior to Estate's equitable lien.

Next, although Bank possessed sufficient documents to put it on inquiry notice of an equitable lien, it nevertheless chooses to place blame on Estate for its decision not to file a *lis pendens* notice which would have given Bank constructive notice of the lien. *Heck's,* 963 S.W.2d at 630. While filing a *lis pendens* notice may have been the best practice, Bank has not cited any case mandating Estate's filing of a *lis pendens* notice under the facts of this case. Moreover, given Bank's failure to discover Estate's dissolution action filed pursuant to the stock purchase agreements, we are not confident Bank would have found a *lis pendens* notice had one been filed. Thus, we reject Bank's attempt to deflect attention away from its own failure to exercise due diligence—whether

required by its in-house lending policy or general principles of good business, or—as in this case—both.

Bank further argues finding the dissolution lawsuit would not have disclosed Estate was asserting an interest in the corporations, let alone an equitable lien, because the complaint did not expressly state, "we're asserting a lien." We deem this argument disingenuous given the precise language of Paragraph 18 of Count I of the Amended Complaint[14] which reads:

> The Plaintiff is entitled to have the Stock Purchase Agreements enforced and be paid for the value of the Plaintiff's interest in the Corporate Defendants by the Individual Defendants.

Additionally, the demand in the Amended Complaint reads in part:

> 1. That the Corporate Defendants be appraised pursuant to the Stock Purchase Agreements and the Plaintiff have a judgment against the Individual Defendants for the Plaintiff's share of the Corporate Defendants.

Reading these two passages separately and certainly together, one would have to conclude an interest—whether labeled a "lien" or not—was being forcefully asserted and should have been investigated before loaning $2.5 Million and expecting to be first in line for repayment in the event of default.

Finally, Bank argues its commercial lending policy is for its own protection and did not create an independent basis for awarding summary judgment to Estate. Bank requested certain information and acquired even more details on

[14] At oral argument, counsel for Bank conceded the differences in the original complaint filed in December 2005, and the first amended complaint filed in July 2006, were miniscule and insignificant.

its own and through HireRight's limited searches. Collecting and then ignoring the information cannot be said to constitute due diligence. Moreover, Bank should have found the dissolution lawsuit filed by Estate had Bank followed its own manual and searched ten years of public records for defendants engaged in civil litigation in Kentucky—a revelation that would have caused a reasonably prudent person to inquire further before finalizing a significant commercial loan. Hence, if Bank is correct and its lending policy is strictly for its own protection, it failed itself by not complying with its own policy.

We need not address Bank's third question—whether Bank's failure to follow its own due diligence policy was sufficient reason to award summary judgment to Estate. That was an additional ground mentioned by the trial court, but not determinative of our result today. As an appellate court, we may uphold a trial court's ruling on any ground supported by the record. *Kentucky Farm Bureau Mut. Ins. Co. v. Gray*, 814 S.W.2d 928, 930 (Ky. App. 1991) (internal citation omitted).

We, therefore, hold the stock purchase agreements executed by the five Ball brothers created equitable liens, both contractual and non-contractual, in Estate for one-fifth of Ball and one-fifth of Statewide. The award of summary judgment in Estate's favor and the award of judgment against Bank in the amount of $256,912.00 are affirmed.

D. LAMBERT, JUDGE, CONCURS.

ACREE, CHIEF JUDGE, DISSENTS AND FILES SEPARATE OPINION.

ACREE, CHIEF JUDGE, DISSENTING: Respectfully, I dissent. Clearly, much effort has gone into the majority opinion. However, I fear certain concepts have been conflated, or so it seems to me, and this has led to an erroneous result.

I begin with the first legal conclusion in the majority's analysis by which it establishes the following point of law: when containing "all three elements required for a valid contract, . . . a stock purchase agreement . . . create[s] a contractual equitable lien [and] need not specify it is creating an 'equitable lien' to establish a lien." I cannot agree with this sweeping statement. If *this* stock purchase agreement constitutes an equitable lien based on nothing more than what is required for any contract, then *every* stock purchase agreement, *a posteriori*, would constitute a lien on a corporation's property.[15] That, I believe, is a dangerous precedent.

The majority notes that "[n]either party disputes the stock purchase agreements [are] contracts[.]" Nothing further needed to be said. But when the opinion goes on to identify the contractual elements of the November 2001 agreements, it erroneously states that letters dated April 27, 2005, and June 29, 2005, were evidence of the stock purchase agreements' offer and acceptance. That

[15] By this pronouncement, every contract of every kind would meet this standard, making every contract a lien on some property somewhere.

is not so. Proof of offer and acceptance with regard to the stock purchase agreements is the signatures of the parties to them, *D.L. Walker & Co. v. Lewis*, 267 Ky. 107, 101 S.W.2d 685, 687 (1937), not the correspondence four years later.

However, that 2005 correspondence does bear on the issue of performance of the stock purchase agreements. The four surviving brothers pursued that performance by accepting the Estate's offer to sell Garland's shares to them. The brothers then reneged on their acceptance; why the Estate chose not to enforce the brothers' separate agreement to purchase Garland's shares is not explained in the record. But even that transaction said nothing of a lien.

I also disagree with the majority that, when it comes to creating a contractual equitable lien, "the language chosen by the brothers could not be clearer[.]" On the contrary, the brothers could have used the word "lien" or "security" or "collateral" or some such term of encumbrance somewhere in the agreement's body, but they did not. The majority does not find the absence of such language anywhere in the documentary record troublesome. I do. Absent some modicum of a reference to the concept of a lien, how can we possibly divine the parties' intent to create one by contract?

Furthermore, neither Garland, nor the Estate, nor the brothers, nor the corporate entities ever acted as though they believed the stock purchase agreement created a lien. Neither the Estate's complaint nor its amended complaint asserts a lien or uses that word or any other words suggestive of an encumbrance. No *lis pendens* was filed. If the Estate believed it had a lien, why did it sit on its hands

and thereby sit on its rights? The majority holds that none of this behavior – behavior consistent only with an *absence* of a contemporary belief that a lien existed – casts doubt on its conclusion that a lien nevertheless did exist.

The majority opinion also states that any conclusion other than that there is an equitable lien "would allow Garland's death to extinguish his interest[.]" This is not correct. It is wrong to suggest that only the stock purchase agreements were evidence that the "Estate still had a contractual one-fifth interest" in the corporations when Garland's brothers borrowed $2.5 Million. Before and after the loan, and before and after Garland's death, his interest in the corporations, and therefore the subsequent interest of the Estate in the corporations, has always been represented by stock certificates, not the stock purchase agreements. Neither the Bank nor the majority should need to ask, as the majority insists the Bank should have, "what happened to Garland's interest?" The answer has always been that Garland's interest in the corporations, represented by stock certificates, became the property of the Estate upon Garland's death and would have become so even if there was no stock purchase agreement.

After the four surviving brothers reneged on their agreement to purchase Garland's shares from the Estate, they obtained a loan, in part by providing the Bank with a corporate resolution explicitly representing that all directors had signed it. The majority says the Bank should have known that this resolution was a misrepresentation; the Bank, says the majority should have examined more closely the corporate bylaws from thirty-five years earlier that

required a minimum of five directors and wondered why only four signatures were on the resolution. The majority sees that as a failing of the Bank – a duty it owed to the third-party Estate and a duty breached. But why should we not deem – why did the Estate not view – the brothers' acts of signing the resolution as a misrepresentation and conspiracy to defraud a financial institution *and* the Estate? I consider it neither. The Bank was transacting with a corporate entity and needed the corporation to express its own authority to borrow; that is accomplished by corporate resolution. The brothers, no doubt, believed they were telling the truth when they said all directors had signed the resolution. If that was their sincere belief, how can we fault the Bank for believing their representation?

I would also note that the Estate experiences a windfall if we affirm the trial court. The five brothers were equal shareholders; after Garland died, the Estate held Garland's stock. The corporate loan, corporate assets, the default, the foreclosure, and the dissolution impacted each of the one-fifth owners equally. If the four surviving brothers are innocent parties here (and, frankly, I am not entirely convinced), then allowing the Estate to be treated differently than each of the other one-fifth owners, and awarding it one-fifth of the proceeds of the sale of corporate assets, is simply inequitable.

Because I cannot conclude that any kind of lien can be identified in any of these documents, I must also conclude that the Bank could not possibly have had notice of any lien. I reach the same conclusion as our highest court many years ago when deciding how much diligence a bank was expected by our law to

undertake to discover an unrecorded third-party lien: "it is sufficient to say that due diligence required the bank to go no further than to examine the record" for the claimed lien of a third party "whose loss is attributable solely to his own negligence in failing to have his lien [filed] of record." *Metcalf v. Tewmey*, 220 Ky. 787, 295 S.W. 1052, 1054 (1927).

In summary, I cannot agree with the majority's conclusion that the stock purchase agreements created an equitable lien of any kind in favor of Garland or his Estate. For that reason, I respectfully dissent.

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