

Commonwealth of Kentucky

Court of Appeals

NO. 2013-CA-002057-MR

DIANE RECTOR, EXECUTOR
OF THE ESTATE OF
JAMES A. CALVERT

APPELLANT

v. APPEAL FROM HENDERSON CIRCUIT COURT
HONORABLE KAREN LYNN WILSON, JUDGE
ACTION NO. 12-CI-00616

LINDA SUE CALVERT, EXECUTRIX
OF THE ESTATE OF
DANNY J. CALVERT; AND
LINDAN, LLC

APPELLEES

OPINION
AFFIRMING

** ** * ** * ** *

BEFORE: JOHNSON, MAZE, AND TAYLOR, JUDGES.

MAZE, JUDGE: Diane Rector, Executor of the Estate of James A. Calvert
(James's Estate) appeals from a summary judgment by the Henderson Circuit
Court dismissing its claims against Danny J. Calvert (Danny) and Lindan, LLC

(Lindan). This Court heard oral arguments in this case on Tuesday, February 21, 2018, at the Hopkins County Courthouse in Madisonville, Kentucky.¹ James's Estate argues that the trial court erred in rejecting its claim for a reverse piercing of Lindan's corporate veil to collect on a judgment against Danny. Although Kentucky has not yet recognized a claim for reverse piercing, we agree with the trial court that James's Estate failed to present sufficiently strong equities in support of such an extraordinary remedy. Hence, we affirm.

The facts of this case are not in dispute. In 2007, James A. Calvert executed a power-of-attorney naming his son, Danny, as his attorney in fact. Thereafter, Danny executed a number of transfers of real and personal property which were not authorized under the power-of-attorney. Following James's death, his Estate filed an action in the Daviess Circuit Court challenging those transfers.² That action resulted in a judgment against Danny in the amount of \$343,636.96. This Court subsequently affirmed the judgment on appeal.³ After entry of the judgment, James's Estate filed a judgment lien in Henderson County against all real property owned by Danny.

¹ On behalf of the Kentucky Court of Appeals, we would like to express our appreciation to the Hopkins Circuit, Family, and District Court Judges, Circuit Court Clerk Karen McKnight, Hopkins County Sheriff Matt Sanderson, and to all the personnel at the Hopkins County Courthouse.

² *Diane Rector, as Executrix of the Estate of James A. Calvert and as an individual and Donna Lewis v. Danny Calvert and David Calvert*, No. 10-CI-01244 (Daviess Circuit Court).

³ *Calvert v. Rector*, No. 2012-CA-000476-MR, 2013 WL 3895828 (Ky. App. July 26, 2013).

On August 28, 2012, James's Estate filed the current action seeking to enforce the judgment against Danny and Lindan, a limited liability company in which Danny has an ownership interest. Following its establishment in 2003, Danny transferred interests in Lindan to his ex-wife, Linda Calvert, and his children, Daniel Calvert, Shawn Calvert, and Betty Moss. Around that same time, Danny also transferred the titles to his personal residence and a 10.271-acre tract to Lindan. Danny was listed as the Manager of Lindan in internal documents. However, Lindan's annual reports from 2003-2007 do not list any members other than Danny. Lindan was administratively dissolved by the Kentucky Secretary of State in 2008, but was reinstated in 2015.

James's Estate sought to collect the judgment against Lindan, arguing that the limited liability company was a sham for which its sole purpose was to shelter Danny's assets. Following extensive discovery, all parties moved for summary judgment. The trial court granted summary judgment to Lindan in an order entered on November 27, 2013, concluding that Lindan is not subject to liability for the judgment against Danny. This appeal followed.⁴

The standard on an appeal from a summary judgment is "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." *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky. App. 1996). In the proceedings before the trial

⁴ Danny Calvert died on May 14, 2014, after the filing of the notice of appeal. This appeal was delayed until the appointment of Linda Sue Calvert as Executor of Danny's Estate, and the substitution of Danny's Estate as Appellee. In the interest of consistency, we will continue to refer to him as "Danny" unless the context requires otherwise.

court, all parties agreed that there were no genuine issues of material fact.

Therefore, we conduct a *de novo* review of the trial court's determinations of law. *Lewis v. B & R Corp.*, 56 S.W.3d 432, 436 (Ky. App. 2001).

James's Estate advocates for a "reverse piercing" of Lindan's corporate veil. It is widely accepted that a corporation should be viewed as a separate legal entity, and the courts will not disturb the legal fiction of corporate separateness except in limited circumstances. *Morgan v. O'Neil*, 652 S.W.2d 83, 85 (Ky. 1983). However, courts do have the equitable authority to "pierce the corporate veil," imposing personal liability on otherwise immune corporate officers, directors, and shareholders for the corporation's wrongful acts or obligations. *Schultz v. Gen. Elec. Healthcare Fin. Servs. Inc.*, 360 S.W.3d 171, 174-75 (Ky. 2012). In this case, James's Estate seeks to accomplish the opposite—to hold Lindan liable for the obligations of its' principal, Danny.

Kentucky has never recognized the concept of reverse piercing by outsiders to the corporate entity, but it has been recognized in other jurisdictions. See 2 A.L.R. 6th 195, *Acceptance and Application of Reverse Veil-Piercing – Third-Party Claimant*, (2005 & cumulative supplement). A majority of jurisdictions addressing the issue recognize that the same considerations which justify traditional piercing of the corporate veil may justify reverse piercing. Consequently, reverse piercing has been allowed in cases where the corporation is dominated by the principal and has been used as a means to defraud creditors.⁵

⁵ See *In re Phillips*, 139 P.3d 639 (Colo. 2006); *C.F. Trust, Inc. v. First Flight L.P.*, 266 Va. 3, 580 S.E.2d 806 (2003); *LFC Mktg. Grp., Inc. v. Loomis*, 116 Nev. 896, 901, 8 P.3d 841 (2000);

However, a minority of jurisdictions reject the concept, concluding that outside reverse piercing bypasses normal debt-collection procedures and unfairly prejudices the rights of innocent shareholders.⁶

The trial court in this case assumed, without deciding, that Kentucky would recognize a claim under a reverse-piercing theory. In *Inter-Tel Techs., Inc. v. Linn Station Properties, LLC*, 360 S.W.3d 152 (Ky. 2012), the Kentucky Supreme Court advised, “[c]ourts should not pierce corporate veils lightly but neither should they hesitate in those cases where the circumstances are extreme enough to justify disregard of an allegedly separate corporate entity.” *Id.* at 168. While traditional and outside reverse piercing affect different corporate interest, the purposes sought to be achieved are similar. *In re Phillips*, 139 P.3d at 645. On the other hand, outsider reverse piercing is a significant extension of the concept of piercing the corporate veil, and it is likely to affect the interests of innocent third parties and other corporate creditors. *Acree v. McMahan*, 585 S.E.2d at 874-75.

Winey v. Cutler, 165 Vt. 566, 567, 678 A.2d 1261, 1263 (1996); *Roepke v. W. Nat’l Mut. Ins. Co.*, 302 N.W.2d 350 (Minn. 1981); *Minich v. Gem State Developers, Inc.*, 99 Idaho 911, 591 P.2d 1078 (1979) (*overruled on other grounds by Rueth v. State*, 103 Idaho 74, 81, 644 P.2d 1333, 1340 (1982)); *Central Nat’l Bank & Trust Co. of Des Moines v. Wagener*, 183 N.W.2d 678, 681–82 (Iowa 1971); *Fischer Inv. Capital, Inc. v. Catawba Dev. Corp.*, 200 N.C. App. 644, 657, 689 S.E.2d 143, 151 (2009); *Litchfield Asset Mgmt. Corp. v. Howell*, 70 Conn. App. 133, 799 A.2d 298, 309, 312 (2002) (*overruled on other grounds in Robertson v. Coughlin*, 266 Conn. 1, 830 A.2d 1114 (2003)); *Olen v. Phelps*, 200 Wis. 2d 155, 546 N.W.2d 176 (Wis. Ct. App. 1996); *Lambert v. Farmers Bank, Frankfort, Ind.*, 519 N.E.2d 745 (Ind. App. 1988); *Estudios, Proyectos e Inversiones de Centro America, S.A. v. Swiss Bank Corp.*, 507 So.2d 1119 (Fla. App. 1987); and *Zisblatt v. Zisblatt*, 693 S.W.2d 944 (Tex. App. 1985).

⁶ See *Floyd v. I.R.S. U.S.*, 151 F.3d 1295 (10th Cir. 1998) (applying Kansas law); *Cascade Energy and Metals Corp. v. Banks*, 896 F.2d 1557 (10th Cir. 1990) (applying Utah law); *Acree v. McMahan*, 276 Ga. 880, 585 S.E.2d 873 (2003); *Sturtevant v. Town of Winthrop*, 1999 Me. 84, 732 A.2d 264 (1999); and *Postal Instant Press, Inc. v. Kaswa Corp.*, 162 Cal. App. 4th 1510, 77 Cal. Rptr. 3d 96 (2008).

Under the circumstances, we conclude that the current case is not the appropriate means to recognize such a claim. We agree with the trial court that James's Estate failed to present sufficient proof to warrant piercing Lindan's corporate veil. Kentucky permits traditional piercing under an instrumentality or an alter-ego theory when two dispositive elements are met: (1) domination of the corporation resulting in a loss of corporate separateness and (2) circumstances under which continued recognition of the corporation would sanction fraud or promote injustice. *Inter-Tel Techs.* at 165. Proof of actual fraud is not required, but the injustice must be something beyond the mere inability to collect a debt from the corporation. *Id.*

In addressing the first element, the court must look to a number of factors, including but not limited to: (1) undercapitalization, (2) failure to observe corporate formalities, (3) the corporation not paying or overpaying dividends, (4) siphoning of corporate funds by a shareholder; and (5) personal guarantees of corporate debt by majority shareholders. *Id.* at 162 (Citing *White v. Winchester Land Development Corp.*, 584 S.W.2d 56, 63 (Ky. App. 1979)). Other factors which may be considered include: (1) failure to issue stock; (2) insolvency of the debtor corporation; (3) nonfunctioning of the other officers or directors; (4) absence of corporate records; (5) comingling of funds; (6) diversion of assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors; (7) failure to maintain arm's-length relationships among related entities; and (8) whether, in fact, the corporation is a mere façade for the operation of the

dominant stockholders. *Id.* at 163 (Citing *Judson Atkinson Candies, Inc. v. Latini-Hohberger Dhimantec*, 529 F.3d 371, 379 (7th Cir. 2008)). The trial court agreed with the Estate that a number of these elements were met.

Most notably, Lindan was capitalized solely through Danny's assets. Danny was the LLC's sole manager. Danny lived in the LLC's house as his own property. Lindan did little or no business beyond passively owning the property that had been conveyed to it. We also note that the other members of Lindan had little to no involvement in the operation of the LLC. Finally, Danny clearly failed to observe corporate formalities with Lindan, allowing it to be administratively dissolved in 2008. Indeed, Danny took no steps after that time either to reinstate Lindan or to wind up its affairs. In fact, the LLC was not reinstated until after Danny's death.

However, the trial court found that it would not be equitable to pierce Lindan's corporate veil to satisfy Danny's individual debts. In addition to the typical equitable considerations for a traditional corporate piercing, a court considering reverse veil piercing must weigh the impact of such action upon innocent investors and partners. *In re Phillips*, 139 P.3d at 646; *C.F. Trust*, 580 S.E.2d at 811. Likewise, trial court must also consider the availability of alternative, adequate remedies. *Id.*

As the trial court noted, Lindan was established long before his misconduct as power-of-attorney for James. Furthermore, none of Lindan's assets were proven to be related to that misconduct. Rather, Danny testified that the

creation of Lindan was part of an estate plan to preserve the children's inheritances and keep them from squandering it. Linda Calvert confirmed that this was the purpose for founding Lindan. Linda further testified that she and Danny were each involved in forming Lindan. In addition, the children each testified that they had signed documents to become owners of Lindan. The court concluded that Danny's personal insolvency was not sufficient to warrant piercing Lindan's corporate veil to the detriment of innocent members.

Against these considerations, James's Estate points out that the deeds transferring the properties refer to Danny as the owner of Lindan. Danny did not produce a signed copy of Lindan's Operating Declaration or any documentation showing valid transfers of ownership interests to Linda Calvert, Daniel Calvert, and Betty Moss. The Operating Agreement does not assign a percentage or cash value of ownership to each member, and no certificates of membership were ever issued. Moreover, Linda Calvert, Daniel Calvert, Shawn Calvert, and Betty Moss admitted that they did not pay any consideration to become members of Lindan. James's Estate points to these irregularities as creating a genuine issue of material fact concerning who actually has an ownership interest in Lindan.

James's Estate also notes that Danny paid off the mortgages on the properties in 2009, shortly after he made the unauthorized withdrawals from James's accounts. James's Estate argues that this action directly implicates Lindan and the properties in Danny's fraud. Based upon Danny's sole domination of the LLC, James's Estate argues he merely used Lindan to shield his assets from

outside creditors, and that continued recognition of the LLC would sanction fraud or promote injustice.

However, James's Estate bore the burden of proving its right to the extraordinary remedy of reverse piercing. In the proceedings before the trial court, James's Estate conceded that the facts were undisputed, and argued that it was entitled to judgment as a matter of law. Furthermore, any disputed issues of fact in this case are not material to the question of whether continued recognition of Lindan's corporate separateness would perpetuate an injustice in this case.

Danny testified that he transferred all of his ownership interest in Lindan to his ex-wife and children, remaining only as Lindan's manager. But regardless of his ownership interest, it is clear that Danny retained exclusive control over Lindan and its assets. However, the second element of traditional piercing requires the court to examine the equities of disregarding the LLC's separate existence. Thus, for purposes of this case, the more relevant question is whether there are innocent third parties who can claim ownership interest in Lindan.

Danny's ex-wife and children all testified, under oath, that Danny transferred interests to them. Lindan's attorney also testified about drafting the Operating Agreement, as well as Danny's intention to transfer interests to Linda and the children, although he did not see any party execute the Agreement. Any dispute concerning the validity of those interests would be well beyond the scope of a traditional piercing claim, much less a reverse piercing claim. Furthermore,

Danny's attempt to use Lindan for "estate planning" was not an improper purpose which necessitates disregarding its separate existence. Finally, and most significantly, there was no evidence directly tracing the proceeds of Danny's misconduct into the payment of the mortgages.

Finally, we note that James's Estate could have pursued these claims against Danny's personal interest in Lindan. However, James's Estate did not seek to attach any personal interest which Danny held in the LLC prior to his death. James's Estate still may be able to pursue such a claim against Danny's Estate. The validity of the alleged ownership interests of third parties could be resolved in that action. However, the viability of such an action at this point is speculative and we decline to address it further. In light of all of the circumstances, the trial court correctly found that the extraordinary remedy of reverse piercing of Lindan's corporate veil is not justified in this case.

Accordingly, we affirm the judgment of the Henderson Circuit Court.

JOHNSON, JUDGE, CONCURS.

JUDGE TAYLOR CONCURS IN PART, DISSENTS IN PART,
AND WRITES SEPARATE OPINION.

TAYLOR, JUDGE, CONCURRING IN PART AND DISSENTING IN PART:

Respectfully, I concur in part and dissent in part to the majority opinion. I fully concur with the majority's decision that affirmed the circuit court's order declining to recognize "reverse piercing" of the corporate veil to attach Lindan's assets to

pay the Daviess County judgment in favor of the Estate of James A. Calvert against Danny Calvert (and his Estate).

However, I must respectfully dissent in part as concerns the entry of summary judgment that effectually precludes the James' Estate from seeking to attach and enforce its judgment against Danny Calvert's **ownership interest** in Lindan, LLC, for which genuine issues of disputed material fact exist, in my opinion.

The complaint in this case clearly sets out claims against both Danny Calvert and Lindan, LLC. The Estate of James Calvert, Danny's father, obtained a final judgment in Daviess Circuit Court against Danny Calvert for breach of fiduciary duty and fraudulent transfers. This judgment, totaling \$343,636.96 in money damages, was affirmed by this Court. As noted, the action in Henderson Circuit Court was against both Lindan and Danny Calvert, individually, who passed away during the pendency of this appeal. The claim of the Estate of James Calvert thus succeeded against the Estate of Danny Calvert that has also been made a party to this appeal.

The circuit court, in its order granting summary judgment, seems to acknowledge that Danny Calvert had an ownership interest in Lindan, LLC, as does the majority in this opinion. However, the circuit court fails to address the direct claim against Danny Calvert to enforce the judgment against his **ownership interest** in Lindan, LLC. While perhaps inartfully pleaded in the complaint, the

claim was sufficiently pleaded under CR 8.01 to assert a viable claim against that ownership interest that was not addressed below.

In Kentucky, CR 69.02 clearly contemplates the attachment of assets owned by a judgment debtor in favor of a creditor. In this case, Calvert's ownership interest in Lindan, LLC, was an attachable asset at the time this case was commenced on August 28, 2012. In fact, when Lindan, LLC, was administratively dissolved in 2008, Danny Calvert was shown as the only member or owner of the LLC at that time, and as argued by appellant, may have owned all of Lindan and its assets at the time this case was commenced.

KRS 275.260 provides the exclusive remedy in Kentucky to satisfy a creditor's judgment against a member's ownership interest in an LLC. KRS 275.260(2) allows a court to issue a charging order against a member's ownership interest for the unsatisfied amount of the judgment. And, KRS 275.260(3) provides that the charging order constitutes a lien against the ownership interest and the rights of the owner to receive distributions from the LLC. KRS 275.260(4) also permits a foreclosure of the ownership interest subject to the charging order that would allow that interest to be sold at a court ordered sale.

Accordingly, these unresolved issues and the circuit court's failure to address them preclude entry of summary judgment, in my opinion. Given that the fifteen-year statute of limitations to enforce the Daviess County judgment has not run pursuant to KRS 413.090 and to avoid a repetitive lawsuit to address these

issues, I would reverse and remand this matter back to the circuit court for resolution.

BRIEF AND ORAL ARGUMENT
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BRIEF AND ORAL ARGUMENT
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