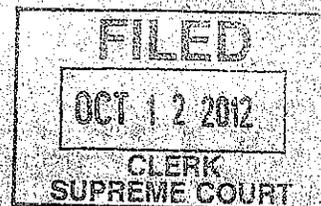


COMMONWEALTH OF KENTUCKY
KENTUCKY SUPREME COURT
CASE NO. 2011-SC-000587



RICK PANNELL

APPELLANT

Appeal from the Kentucky Court of Appeals
Case No. 2010-CA-001172

v.

and
Fayette Circuit Court
Case No. 06-CI-03131

ANN SHANNON AND
ELEGANT INTERIORS, LLC

APPELLEES

BRIEF OF APPELLANT, RICK PANNELL

Submitted by
Carroll M. Redford, III, Esq.
E-Mail: cmr@kentuckylaw.com
Susan Y.W. Chun, Esq.
Michelle L. Hurley, Esq.
MILLER, GRIFFIN & MARKS, P.S.C.
271 West Short Street, Suite 600
Lexington, Kentucky 40507
Telephone: (859) 255-6676

CERTIFICATE OF SERVICE

The undersigned does hereby certify that the Brief of Appellant, Rick Pannell, were served upon the following named individuals by U.S. mail on this the 4th day of October, 2012: Hon. Kimberly N. Bunnell, Judge, Fayette Circuit Court, 521 Robert F. Stephens Courthouse, 120 N. Limestone Street, Lexington, Kentucky 40507; Wilma Fields Lynch, Fayette Circuit Court Clerk; 103 Robert F. Stephens Courthouse, 120 North Limestone Street, Lexington, Kentucky 40507; Sam P. Givens Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; and Dan M. Rose, Hanly A. Ingram, Christopher L. Thacker, Stoll Keenon & Ogden, PLLC, 300 West Vine Street, Suite 2100, Lexington, Kentucky 40507. The undersigned does also certify that the record on appeal was not withdrawn by the undersigned from the Fayette Circuit Clerk's office on or before this date.


Carroll M. Redford, III, Esq.

INTRODUCTION

This is a case concerning whether the Appellee, Ann Shannon, is personally liable under a Lease she proposed and executed during a period in which her LLC, Elegant Interiors, LLC, was administratively dissolved. The Lease was the result of her intent to individually and personally conduct business going forward (without an LLC) and as the contracting party she should be held responsible for the bargain she made. She reinstated a limited liability company to block her personal liability for the debt. In holding to protect Appellee from personal liability, the Court of Appeals chose to ignore critical facts from the transaction that indisputably established her personal liability and to ignore a case (though unpublished¹) that is dispositive of the issue presented and instead chose to rely upon two (published²) cases that are factually distinguishable and inapplicable to the situation presented. See Exhibit 1, *Rick Pannell v. Ann Shannon and Elegant Interiors, LLC*, 2010-CA-001172-MR. Literally simultaneously, a separate panel of the Court of Appeals reached the exact opposite holding (finding the party personally liable) by relying upon the same unpublished opinion Pannell argued was applicable and dispositive.³

As a result, this case further presents the opportunity for the court to clarify the propriety of citation to and reliance upon “unpublished” Kentucky cases and the inconsistent position of various panels of the Court of Appeals and trial courts throughout the Commonwealth.

¹ *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. App. 2006)

² *Fairbanks Arctic Blind Co. v. Prather & Associates, Inc.*, 198 S.W.3d 143 (Ky. App. 2005); *Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc.*, 320 S.W.3d 654 (Ky. 2010).

³ *Ed Martin v. Pack's Inc.*, 2010-CA-001048-MR (Rendered July 29, 2011). See Exhibit 2.

STATEMENT CONCERNING ORAL ARGUMENT

Appellant respectfully requests the Court schedule oral argument in this matter. Oral argument will be helpful to the Court as there does not appear to be a *published* case that addresses the specific issues of the personal liability of the debt while there is an *unpublished* case, specifically ignored by the Court of Appeals for the instant case, but was relied upon by a different panel in a different case almost simultaneously.

STATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION i
Forleo v. American Products of Kentucky, Inc., 2006 WL 2788429
(Ky. App. 2006)..... *passim*
Fairbanks Arctic Blind Co. v. Prather & Associates, Inc., 198 S.W.3d
143 (Ky. App. 2005)..... *passim*
Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc., 320 S.W.3d
654 (Ky. 2010) i, 11-14
Ed Martin v. Pack’s Inc., 2011 WL 3207947, 358 S.W.3d 481
(Ky. App. 2011)..... *passim*

STATEMENT CONCERNING ORAL ARGUMENT ii

STATEMENT OF POINTS AND AUTHORITIES..... iii-v

STATEMENT OF THE CASE..... 1

ARGUMENT 6

I. Ann Shannon was the tenant under the March 2006 Lease, and she intended
to obligate herself personally for the sums due under that contract.....6

Pinkston v. Audubon Area Community Services, Inc., 210 S.W.3d
188 (Ky. App. 2006)6, 14
Cantrell Supply, Inc. v. Liberty Mut. Ins. Co., 94 S.W.3d 381, 385
(Ky. App. 2002)7
L. K. Comstock & Co., Inc. v. Becon Const. Co., 932 F.Supp. 948,
965 (E.D. Ky. 1994).....7
Pannell v. Shannon, 2011WL 3793415, *3 (Ky. App. 2011)..... *passim*
Lonnie Hayes & Sons Staves, Inc. v. Bourbon Cooperage Co., 777 S.W.2d
940 (Ky. App. 1989) 11
Twin City Fire Ins. Co. v. Terry, 472 S.W.2d 248 (Ky. App. 1971)..... 11

II. The Court’s reliance on *Racing Investment Fund 2000, LLC v. Clay Ward
Agency, Inc.* is misplaced and unpersuasive..... 11

KRS 275.295 *passim*

III. KRS 275.295(3)(c) does not absolve Shannon of liability for the contract
she executed when no limited liability company existed, notwithstanding
her after-the-fact reinstatement of the LLC and her self-serving testimony 14

A. Law establishing personal liability.....14
Steele v. Stanley, 35 S.W.2d 867 (Ky. 1931) 14
Oliver v. Wyatt, 418 S.W.2d 403, 406 (Ky. 1967) 14

CR 76.28(4) (c).....	16, 20
B. <i>Forleo</i> and <i>Fairbanks</i> address different factual scenarios, and <i>Forleo</i> is on point here, while <i>Fairbanks</i> is distinguishable.	16
KRS 271B.14-220(3).....	<i>passim</i>
KRS 271B.14-210(3).....	17
KRS 275.285	17-18
KRS 14A.7-030.....	18
KRS 446.080(3).....	18
<i>Snyder v. City of Owensboro</i> , 555 S.W.2d 246, 249 (Ky. 1977)	18
1. The Court of Appeals’ ruling conflicts with other case law simultaneously rendered by that Court.....	20
<i>Wolfe v. Salkind</i> , 70 A.2d 72 (N.J. 1949).....	21-23
<i>Joseph A. Holpuch Co. v. United States</i> , 58 F.Supp. 560 (Ct. Cl. 1945).....	21-23
<i>Moore v. Occupational Safety and Health Review Commission</i> , 591 F.2d 991 (4 th Cir. 1979).....	24
<i>Adam v. Mt. Pleasant Bank & Trust Co.</i> , 355 N.W.2d 868 (Iowa 1984).....	24
<i>Kessler Distr. Co. v. Neill</i> , 317 N.W.2d 519 (Iowa App. 1982)	24
C. <i>Fairbanks</i> and <i>Forleo</i> are consistent with each other, and <i>Forleo</i> correctly interprets the result under KRS 275 for the facts presented here.....	25
<i>Dolphin Offshore Partners, L.P. v. Industrial Resources Corporation</i> , 499 F.Supp.2d 1025 (E.D. Tenn. 2007)	25-27
D. Other jurisdictions have confirmed the propriety of the result urged by Pannell.....	27
1. Shannon did not cease doing business when the LLC was dissolved, and she knew or should have known of its dissolution	27
<i>Daniels v. Elks Club of Hartford</i> , 2012 WL 3139684, ___ A.3d ___ (Vt. 2012)	27, 29-31
12 V.S.A. §5060	28
11B V.S.A. § 14.22(a).....	29
41 N.Y.U. L. Rev. 607	30
2. The Court’s interpretation of KRS 275.295(3)(c) would promote fraud and abuse.	32
<i>Poritzky v. Wachtel</i> , 27 N.Y.S.2d 316 (N.Y. 1941)	32-35
<i>Cardem, Inc. v. Marketron International Limited</i> , 749 N.E.2d	

477 (Ill. App. 2001).....	33
<i>In re Estate of Plepel v. Industrial Metals, Inc.</i> , 450 N.E.2d 1244 (Ill App. 1983).....	33-34
<i>Annicet Associates, Inc. v. Rapid Access Consulting, Inc.</i> , 656 N.Y.S.2d 152 (N.Y. 1997).....	33-34
<i>Worldcom, Inc. v. Sandoval</i> , 701 N.Y.S.2d 834 (N.Y. 1999).....	34
3. A couple of Kentucky cases got it right	35
KRS 271B.14-050	36
IV. CONCLUSION	37

APPENDIX

STATEMENT OF THE CASE

Appellant Rick Pannell (“Pannell”) is the owner of commercial property on Tiverton Way in Lexington, Kentucky (“the Property”). Appellee Ann Shannon (“Shannon”) was the sole member of Elegant Interiors, LLC (“LLC”), a Kentucky limited liability company engaged in home furnishings retail sales and interior design work. Critical to this case is the date when Shannon’s entity was dissolved, as she affirmatively continued doing business in her individual capacity after that date. All of the events relevant to this case occurred during the period in which the LLC was dissolved.

Shannon had formed Elegant Interiors in January 2000. Its initial location was on Clays Mill Road, with a retail space of approximately 1,000 square feet. Shannon subsequently leased a 1,400 square foot commercial space located on Moore Drive, followed by her move to Pannell’s Tiverton Way premises in April 2004. The April 2004 Lease agreement was between Elegant Interiors (the LLC) and Pannell, and Shannon did not personally guarantee performance or payment under that Lease. The retail space at Pannell’s Tiverton Way premises was approximately 3,645 square feet, with a monthly rental payment of approximately \$6,300. Shannon had leased the Clays Mill and Moore Drive premises at a monthly cost of approximately \$1,000 and \$1,200, respectively. Plaintiff’s Renewed Motion for Summary Judgment and Memorandum in Support; pp. 2-3; R.A. 253-254. Deposition of Ann Shannon, p. 10, lines 19-24; p. 11, lines 1-3; p. 12, lines 12-16, p. 13, lines 4-14; p. 14, lines 1-22; p. 34, lines 13-19; p. 35, lines 1-8. Thus, she increased her rental expense by nearly five times with the move of her business from Moore Drive to Tiverton Way.

Meanwhile, the business sustained an operating loss of \$4,438 for the 2003 tax year before moving to the Tiverton location. *See* Ann Shannon Tax Returns, Exhibit 1 to Plaintiff's Motion for Summary Judgment, R.A. 114-147. Shannon testified that when at the Tiverton location, the business operated at a loss during both 2005 and 2006. *See* Deposition of Ann Shannon, p. 44, lines 9-15; p. 45, lines 16-21. Tax returns show a net operating loss of \$47,883 for the 2005 tax year in particular while at the Tiverton location. Plaintiff's Renewed Motion for Summary Judgment and Memorandum in Support, p. 3, R.A. 254.

Elegant Interiors, LLC was administratively dissolved by the Kentucky Secretary of State on November 1, 2005. Plaintiff's Combined Response and Reply, p. 11, R.A. 475. The timing of the dissolution is critical as Shannon continued to do the same business in her individual capacity after that date and specifically proposed and negotiated the new terms and lease and her personal obligations in issue after that date.

In early 2006, while the LLC was dissolved, Shannon approached Pannell to propose subleasing only a portion of the Property in order to reduce her monthly rental payment. She located a tenant to sub-lease a portion of the space, and she asked Pannell to agree to partition the premises into two retail spaces, which would reduce rent under the Lease by fifty percent (50%) and therefore, according to Shannon, enable her to stay at the location. Plaintiff's Combined Response and Reply, p. 2, R.A. 466. Deposition of Ann Shannon, p. 46, lines 24-25; p. 47, lines 1-8; p. 51, lines 6-15; p. 52, lines 7-14. At that time, Pannell had available a third party willing to take over the Lease and rent the entire space from Pannell. Second Affidavit of Rick Pannell, Exhibit A to Plaintiff's Combined Response and Reply, R.A. 484. *See* Exhibit 3. However, at Shannon's

request and in consideration of her representations and agreement that she would be personally liable for all sums due going forward, Pannell agreed to partition the space as Shannon requested and allow her to downsize, rather than having a turn-key substitute tenant for the entire space.

Shannon then prepared a Release that she insisted Pannell sign contemporaneous with her signing a substitute Lease on March 2, 2006, which substitutes herself individually for her former (and dissolved) LLC. The Release provided as follows:

I agree to release 1991 sf of **my** current space and all responsibility of payment for the 1991 sf, located at 148 W. Tiverton Way, Ste 140, beginning today, March 2, 2006.... It is agreed upon that the signing of this document by both parties assures that **Ann Shannon** will not be held responsible for the building of any walls, construction, CAM costs, or any expenses pertaining to Ste 140 beginning today, March 2, 2006, **and will be only responsible for payment of the remaining 1654 SF @ 18.00 SF** and known as Ste 150, located at the same address. Upon acceptance of this document, **a new lease will be signed by Ann Shannon, for the changes in sf (1654 sf @ 18.856)** and CAM costs only for ste 150.

/s/ Ann Shannon

/s/ Rick Pannell

3-2-06

(Emphasis added). Plaintiff's Combined Response and Reply, p. 2, R.A. 466; Release, Exhibit E to Plaintiff's [Renewed] Motion for Summary Judgment, R.A. 292, attached hereto as Exhibit 4. Thus, the Release, proposed and prepared by Shannon and executed by the parties March 2, 2006, contemporaneous with **and in conjunction with the Lease**, clearly and unequivocally acknowledged in writing that Shannon considered herself to be personally liable on the April 2004 Lease; that she intended the Release to release her personally from all obligations under the April 2004 Lease to date (which was for a much

greater rental fee each month); and that she intended by executing the Release and the new Lease agreement to personally obligate herself for the terms and conditions and for the sums due under the new (March 2, 2006) Lease for rental of the partitioned (smaller) space and associated costs going forward. Pannell's agreement to those terms is evidenced by his signature on the Release as well.

Under the March 2, 2006 Lease, Shannon agreed to lease 1,654 square feet, at a monthly cost of \$2,598.98, for the remaining thirteen-month term ("the Lease"). Shannon signed the Lease in her personal capacity. *See* Lease, Exhibit B to Plaintiff's [Renewed] Motion for Summary Judgment, R.A. 266, attached hereto as Exhibit 5. Within months thereafter, Shannon stopped paying rent and abandoned the premises in or about June 2006, thereby breaching the Lease without cause. Pannell then obtained a forcible detainer against Shannon individually as tenant under the Lease. *See* Forcible Detainer Petition, Exhibit C to Plaintiff's Motion to Alter, Amend or Vacate, R.A. 526; Exhibit 6. Pursuant to the Lease's acceleration clause, Pannell also declared all rent for the remaining term of the Lease to be due and payable, in the amount of \$32,373.75. Lease, para. 23, R.A. 277, attached hereto as Exhibit 5.

After Pannell filed a Complaint to collect the sums due under the Lease, and only after she was served with the Complaint, Shannon caused Elegant Interiors, LLC to be reinstated by the Kentucky Secretary of State on August 11, 2006. Plaintiff's Combined Response and Reply, p. 11, R.A. 475; Secretary of State Website Information, Exhibit A to Complaint, R.A. 7-8, attached hereto as Exhibit 7; Civil Summons, R.A. 40.

The trial court agreed with Pannell that the Lease was breached and granted Summary Judgment against the LLC for the unpaid rent and damages. *See* Order entered

May 25, 2010, Exhibit 8. The Court rejected Shannon's argument and defense that she was constructively evicted from the premises. However, the Court further held that Shannon was not individually liable under the Lease because she was not a party to the Lease. See Order entered April 29, 2009 and Order entered October 27, 2008, Exhibits 9 and 10 respectively.

The Court of Appeals affirmed. In the instant case, *Rick Pannell v. Ann Shannon and Elegant Interiors, LLC*, 2010-CA-001172⁴ (not to be published), rendered August 26, 2011, the Court affirmed the trial court which absolved an individual of personal liability for new debt incurred solely by her and for her benefit arising from a new lease when she acted individually after dissolution of her limited liability company, Elegant Interiors, LLC. The Court specifically, intentionally and erroneously ignored and refused to consider the application of the unpublished case of *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. App. 2006)⁵ to the issues presented. Applying *Forleo* would result in the opposite holding, a reversal of the trial court's ruling absolving Shannon of individual liability thereby making her personally responsible for the debt. A copy of *Forleo* is attached as Exhibit 13.

Significantly, less than 30 days earlier in *Ed Martin v Pack's, Inc. et al.*, 2011 WL 3207947, 358 S.W.3d 481 (Ky. App. 2011) (to be published)⁶, rendered July 29, 2011 (discretionary review filed September 2, 2011), the Court of Appeals affirmed the trial court which determined *by application of the unpublished case of Forleo* that individuals were personally liable for new debt incurred after dissolution of the LLC. A copy of

⁴ Chief Judge Taylor, Caperton and Wine, Judges.

⁵ Abramson and Vanmeter, Judges; Knopf, Senior Judge.

⁶ Thompson and Vanmeter, Judges; Isaac, Senior Judge.

Martin is attached as Exhibit 2. The two cases (*Panell* and *Martin*) rendered within 30 days of each other simply cannot be reconciled except when one panel of the Court specifically ignores *Forleo* and one panel specifically relies upon *Forleo*. In *Pannell*, the Court refused to even mention by name the unpublished case (of *Forleo*) while the second panel relies completely upon it. The end result is conflicting holdings.

This Court granted discretionary review.

ARGUMENT

I. ANN SHANNON WAS THE TENANT UNDER THE MARCH 2006 LEASE, AND SHE INTENDED TO OBLIGATE HERSELF PERSONALLY FOR THE SUMS DUE UNDER THAT CONTRACT.

This issue was preserved for appeal by inclusion in Pannell's Combined Response and Reply filed October 7, 2008, R.A. 475-482, and in his Motion to Alter, Amend, or Vacate filed November 6, 2008; R.A. 508-519. On appeal, this Court should review the trial court's decision *de novo*. *Pinkston v. Audubon Area Community Services, Inc.*, 210 S.W.3d 188 (Ky. App. 2006).

The trial court and Court of Appeals summarily concluded that the "tenant" under the March 2006 Lease was "Elegant Interiors, LLC." Opinion, *supra* at *2. See also Summary Judgment (Order) at page 1, Exhibit 8. The factual basis for this conclusion was the introductory paragraph of the Lease, which by scrivener's error was not updated by the parties when they created the March 2006 Lease using the existing 2004 Lease document.⁷ It, therefore, recited "Elegant Interiors, LLC" as the "tenant," but the Lease elsewhere states that it was "for Ann Shannon." See Exhibit 5.

⁷ Neither party was represented by counsel for the 2006 negotiations and document preparation and execution.

Although the Lease contains the words “Elegant Interiors, LLC,” the Lease also very clearly provides that it is “for Ann Shannon,” and *not* “Elegant Interiors, LLC.” Shannon also signed the Lease without indicating a representative capacity. Therefore, at best, there is an ambiguity as to who was the tenant under the Lease. In making its conclusion, the Court clearly erred in concluding “the circumstances” under which the Lease was executed, which is admissible if an ambiguity exists as to the identity of the tenant under the Lease, is not the basis to show the personal liability of Shannon for the bargain she requested and entered.

Where a contract is ambiguous, parol evidence is admissible to construe the ambiguity. Moreover, the Court must construe an ambiguous contract provision to be consistent with the parties’ intention at the time the contract was executed. *See, e.g., Cantrell Supply, Inc. v. Liberty Mut. Ins. Co.*, 94 S.W.3d 381, 385 (Ky. App. 2002) (“Where a contract is ambiguous or silent on a vital matter, a court may consider parol and extrinsic evidence involving the circumstances surrounding execution of the contract, the subject matter of the contract, the objects to be accomplished, and the conduct of the parties”); *L.K. Comstock & Co., Inc. v. Becon Const. Co.*, 932 F. Supp. 948, 965 (E.D. Ky. 1994) (“In order to ascertain the intentions of the parties and to resolve the ambiguity resulting from the interplay of these [contractual] provisions, it is appropriate to consider all of the circumstances surrounding the transaction, including the acts and declarations of the parties and their underlying purposes”).

Here, it is simply undisputed that at the time Shannon signed the March 2006 Lease (without designating a representative capacity – *i.e.*, as an individual) there was no such entity as “Elegant Interiors, LLC.” It simply did not exist, and it had not existed

since November 2005, some five months prior to the signing of the Lease.⁸ She did not undertake any efforts to reinstate the LLC through the Kentucky Secretary of State until after she had abandoned the premises, failed to pay rent, had a forcible detainer judgment entered against her personally and had been served with the Summons and Complaint in the instant case. Moreover, the Court of Appeals erred by not properly considering the written Release prepared by Shannon in March 2006. Contemporaneous with the March 2006 Lease, *Shannon* prepared the written Release, in which the parties agreed as follows:

IT IS AGREED UPON THAT [sic] THE SIGNING OF THIS DOCUMENT BY BOTH PARTIES ASSURES THAT ANN SHANNON WILL NOT BE HELD RESPONSIBLE FOR THE BUILDING OF ANY WALLS, CONSTRUCTION, CAM COSTS, OR ANY EXPENSES PERTAINING TO STE 140, BEGINNING TODAY, MARCH 2, 06, AND WILL ONLY BE RESPONSIBLE FOR PAYMENT OF THE REMAINING SF @ 18.00 SF . . . AND KNOWN AS STE 150 . . .

. . . UPON ACCEPTANCE OF THIS DOCUMENT, A NEW LEASE WILL BE SIGNED BY ANN SHANNON, FOR THE CHANGES IN SF [square footage] (1654 SF @ 18.00) AND CAM COSTS ONLY FOR STE 150.

Exhibit 4 (emphasis added).

Shannon's intention, as of March 2006, is indisputable from the unambiguous Release prepared by her own hand. It is clear that as of March 2, 2006, Shannon intended to be individually responsible for payment of all sums due for the rental of Suite 150 (a reduced space, which dramatically decreased the monthly rent due under the February 2004 Lease). It is also patently clear that, in consideration of her agreement to be personally liable for the rental and CAM charges for Suite 150, Pannell agreed to bear the

⁸ Although Shannon years later signed a self-serving Affidavit stating that she believed that Elegant Interiors, LLC was the tenant under the 2006 Lease, this was prepared only after litigation commenced and she had consulted with her attorneys.

costs of the “building of . . . walls, construction, CAM costs, [and] any expenses pertaining to [Suite] 140.” This Release, again, prepared by Shannon, permitted her to “downsize” the retail shop, reducing the monthly rent obligation from \$6,300.00 to \$2,598.98, with the construction expenses of dividing the two spaces to be borne by Pannell, the Landlord. Even so, the Court of Appeals summarily (and erroneously) concluded:

Essentially, the Release merely operates to set forth the material terms of the parties new agreement and to provide that a new lease would be executed setting forth such terms. Shannon did sign the Release and the March 2006 lease without indicating that her signature was within her representative capacity as a member of Elegant Interiors. However, Shannon also signed the February 2004 lease without signifying that same was in her representative capacity. It is certainly beyond cavil that Elegant Interiors was the tenant under the February 2004 lease and that Shannon signed in her representative capacity. So, it is likewise with the March 2006 lease and the Release.

Pannell v. Shannon, 2011 WL 3793415, * 3 (Ky. App. 2011) (unpublished).

The Court of Appeals’ conclusory opinion on this point cannot withstand scrutiny or review. *See* Opinion, p. 6 (“So, it is likewise with the March 2006 Lease and the Release”), Exhibit 1 hereto. For its “evidence” that Elegant Interiors, LLC was intended by both Shannon and Pannell to be the tenant under the March 2006 Lease, the Court simply relied on the lone “fact” that Shannon “failed to designate a representative capacity” in signing the February 2004 Lease. The import of Shannon herself having prepared the March 2006 Release providing that Shannon herself would be responsible for the charges for the partitioned Suite 150 going forward was simply lost on the Court. The Release does not contain or mention the words “Elegant Interiors, LLC.” The only logical and reasonable inference that can be drawn from the Release document is that Shannon wanted, intended, and considered herself individually to be the tenant going

forward as of March 2006.⁹ If Shannon truly believed that Elegant Interiors, LLC was still a viable entity and that it was to be the tenant under the new Lease, she would not have included language in the Release stating that “**Shannon** will not be held responsible for the building of any walls . . . or expenses pertaining to Ste 140, beginning today,” nor would she have written and agreed that “Ann Shannon will only be responsible for payment of the remaining SF@18.00 . . . and . . . a new Lease will be signed by Ann Shannon for the changes in SF and CAM costs only for STE 150.” This is necessarily the case because if Elegant Interiors, LLC were truly the tenant under both Leases, Shannon would not be liable for *any* sums under *either* Lease merely as a member of a limited liability company.

The Court of Appeals also erred because it completely ignored the significant evidence in the record concerning Pannell’s intent. It did not consider or address the fact that Pannell was induced to believe *that Shannon intended* to act individually in executing the March 2006 Lease and to be individually liable under the March 2006 Lease, by Shannon’s actions and preparation of the Release. The Release repeatedly used the words “I” and “Ann Shannon,” without any mention of Elegant Interiors, LLC, much less any indication that the LLC would be a party to the new Lease or liable for any sums due thereunder. **Indeed, the Release Shannon prepared expressly states the exact opposite** – that she would be personally liable for sums due under the new Lease going forward. The evidence in the record, obviously overlooked or ignored by the Court of Appeals, shows that Pannell relied on this expression of Shannon’s intention in executing the March 2006 Lease and in agreeing to partition the space at his own cost. The

⁹ The Court’s reliance on the February 2004 Lease alone is also unpersuasive because it is undisputed that when the February 2004 Lease was signed, Elegant Interiors, LLC was a viable entity organized through the Kentucky Secretary of State’s Office, whereas at the time the March 2006 Lease was signed, the exact opposite was true.

consideration for Pannell agreeing to permit Shannon to downsize the space and reduce the rent owed each month was that she was promising to be personally liable for the rent going forward. Without the personal liability of Shannon, there would have been absolutely no consideration for Pannell releasing the LLC from the liabilities under the February 2004 Lease, allowing the tenant to downsize or taking on the costs of the downsize construction. *See* Affidavit of Rick Pannell, Exhibit 3.

Undoubtedly, a written contract may consist of more than one document. *See, e.g., Lonnie Hayes & Sons Staves, Inc. v. Bourbon Cooperage Co.*, 777 S.W.2d 940 (Ky. App. 1989) (note and purchase order signed by both parties constituted written “contract” for purposes of Statute of Frauds); *Twin City Fire Ins. Co. v. Terry*, 472 S.W.2d 248 (Ky. App. 1971) (contract of insurance may consist of several separate documents). Here, the Release was part of the parties’ agreement. Based on the terms of the Release, as prepared by Shannon herself, the parties prepared a new written Lease document “for Ann Shannon.” The Court of Appeals’ conclusory opinion on this point is not supported by the record and undisputed facts, and is simply erroneous.

II. THE COURT’S RELIANCE ON *RACING INVESTMENT FUND 2000, LLC V. CLAY WARD AGENCY, INC.* IS MISPLACED AND UNPERSUASIVE.

The Court of Appeals relied on *Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc.*, 320 S.W.3d 654 (Ky. 2010)¹⁰, for the proposition that the March 2006 Lease and Release “cannot be reasonably interpreted as imposing individual liability on Shannon” because “a member of a limited liability company may assume individual liability only by “unequivocal terms” that unmistakably imposes [sic] such individual

¹⁰ It is coincidental that *Racing Investment Fund 2000* and the *Pannell* case both originated from the Fayette Circuit Court, Ninth Division.

liability.” *Pannell, supra* at *3. Although the Court correctly stated the holding of *Racing Investment Fund*, that case is completely inapplicable to the instant case.

In *Racing Investment Fund*, creditors of an LLC sought an order requiring its members to make additional capital contributions under the LLC’s Operating Agreement to satisfy a judgment that had been entered in favor of the creditor. *Racing Investment Fund, supra* at 665-55. It was undisputed that the judgment pertained to a debt incurred **by the LLC** when the LLC was **an active entity through the Secretary of State’s Office**. *Id.* After the judgment was entered, the LLC dissolved and began winding up. The trial court ordered the members to make additional capital contributions under a capital provision in the operating agreement. The Court held that this was erroneous because the members had not agreed “unequivocally” to assume personal liability for the debts of the LLC. *Id.* at 659.

Here, contrarily, the debt at issue was indisputably incurred when the LLC was not an active entity. It was therefore incurred by Shannon individually. The debt is not one of an LLC, but rather, a new personal obligation of Shannon, which she made clear in the release she prepared herself. Moreover, *Racing Investment Fund* recognizes that even if a valid limited liability company exists at the time the debt is incurred, a member may assume personal liability by unequivocal language evidencing an intent to be personally bound. Here, even if an LLC “existed” by virtue of the relation-back provision of KRS 275.295(3)(c), Shannon’s actions in signing the Lease without corporate designation and in preparing and executing the Release clearly evidence an intent in unequivocal language and terms to be personally liable, specifically on the new

debt being incurred. The debt being incurred by Shannon is also indisputably not debts of the 'wind up' of the entity; it is debt for going forward with business.¹¹

The Court further relied on KRS 275.295(3)(c)¹², holding that Shannon's reinstatement of the LLC "relates back" to the effective date of dissolution. The Court held that "it naturally follows that members of such company are not individually liable for actions undertaken **on behalf of the company** during its dissolution." Opinion, p. 9 (emphasis added). The Court ignored the obvious language of the Release, prepared by Shannon, to effect that "Ann Shannon . . . will be only responsible for payment of the remaining 1654 SF @ 18.00 SF." Thus, the obligation at issue was not undertaken "on behalf of the company;" rather, Shannon's own words made clear that she intended to make herself personally bound under the new Lease. Moreover, the Court cited *Fairbanks Arctic Co. v. Prather & Assoc., Inc.*, 198 S.W.3d 143 (Ky. App. 2005)¹³, in connection with the statute, but it did not discuss the facts of *Fairbanks*, which are not only distinguishable from the instant case but do not address the issues presented by *Pannell*.¹⁴ All of the extrinsic evidence shows that the March 2006 Lease was new debt, incurred by Shannon in her individual capacity and not intended to be a company debt. Pannell is not seeking to hold Shannon responsible for the debts of an LLC merely because she was a member of that LLC. Therefore, *Racing Investment Fund* is readily

¹¹ In *Martin* (at page 5), the court noted that the material alteration in the terms of an existing agreement cannot be enforced unless a consideration for the change inures to the party whom the new agreement is being enforced against. In *Pannell*, the Court completely ignored the arguments related to new consideration for the new agreement, i.e., the downsizing of the space and the rental obligation in exchange for Shannon becoming personally obligated to pay.

¹² This statute was repealed in 2010.

¹³ *Fairbanks* was rendered before *Forleo* and really only stands for the proposition that the statute on reinstatement and its retroactive application means what it says. It is not dispositive of the issues presented in *Pannell* of incurring new personal debt post dissolution.

¹⁴ The relevant statutes applicable to corporations mirror those applicable to limited liability companies. See *infra* at p. 14-24.

distinguishable and inapplicable. Alternatively, the written Release prepared by Shannon constitutes an unequivocal assumption of personal liability sufficient to satisfy *Racing Investment Fund*. See *infra*, Argument, Section I.

III. KRS 275.295(3)(C) DOES NOT ABSOLVE SHANNON OF LIABILITY FOR THE CONTRACT SHE EXECUTED WHEN NO LIMITED LIABILITY COMPANY EXISTED, NOTWITHSTANDING HER AFTER-THE-FACT REINSTATEMENT OF THE LLC AND HER SELF-SERVING TESTIMONY.

This issue was preserved for appeal by inclusion in Pannell's Combined Response and Reply filed October 7, 2008, R.A. 475-482, and in his Motion to Alter, Amend, or Vacate filed November 6, 2008; R.A. 508-519. On appeal, this Court should review the trial court's decision *de novo*. *Pinkston v. Audubon Area Community Services, Inc.*, 210 S.W.3d 188 (Ky. App. 2006).

A. Law Establishing Personal Liability.

In Kentucky, the rule that shareholders and officers are personally liable for debts made in the name of a non-existent corporation if they continue to conduct the business of the corporation (except to the extent necessary for dissolution and winding-up) is both a well-established and ancient one. *Steele v. Stanley*, 35 S.W.2d 867 (Ky. 1931) (finding that agent was personally liable for mine operation debts after mine corporation was administratively dissolved); *Oliver v. Wyatt*, 418 S.W.2d 403, 406 (Ky. 1967) (declaring that "[i]f the agent is merely purporting to be acting for a principal but is in fact acting for himself, he will be personally liable on the contract").

The Court of Appeals held that Shannon is entitled to protection from personal liability for the sums due under the Lease pursuant to KRS 275.295(3)(c), which provides that when a limited liability company is dissolved, and then reinstated:

[T]he reinstatement shall relate back to and take effect as of the effective date of the administrative dissolution, and the limited liability company shall resume carrying on business as if the administrative dissolution had never occurred.

See Exhibit 11, KRS 275.295, attached hereto.

It is undisputed that at the time Shannon prepared the Release and signed the March 2006 Lease, Elegant Interiors, LLC had been dissolved for five months. The Court noted that the administrative dissolution was the result of the LLC's "failure to file an annual report and pay a \$15 filing fee." *Pannell, supra* at *3. It also noted that Shannon testified that she "was unaware that Elegant Interiors, LLC, had been administratively dissolved at the time she executed the March 2006 lease." *Id.* at *3, fn 1. The Court explained that the LLC was reinstated on August 11, 2006, without acknowledging that this was only after Shannon was served with a Summons and Complaint in this matter and after a Forcible Detainer Judgment was entered against her.

The Court of Appeals then summarily concluded that KRS 275.295(3)(c) absolves Shannon of personal liability, relying on *Fairbanks Arctic Blind Co. v. Prather & Associates, Inc.*, 198 S.W.3d 143 (Ky. App. 2005). See Exhibit 12, *Fairbanks*, attached hereto. The Court of Appeals made this finding without any discussion of the facts of *Fairbanks* and how they compare to (and are readily distinguishable from) the facts of the instant case. The Court cautioned the undersigned for citing *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. App. 2006) (unpublished) (See Exhibit 13), stating:

Pursuant to Kentucky Rules of Civil Procedure (CR) 76.28(4)(c), a party may only cite to unpublished opinions **when there is a complete lack of published authority upon an issue.**

Pannell, supra at *4, fn 3 (emphasis added).

However, CR 76.28(4)(c) actually provides:

. . . unpublished Kentucky appellate decisions, rendered after January 1, 2003, may be cited for consideration by the court if there is no published opinion **that would adequately address the issue before the court.**

See Exhibit 14, CR 76.28 (emphasis added), attached hereto.

The foregoing (correct) standard and quotation of the Civil Rule is a far cry from a requirement that there be a “complete lack of published authority upon an issue” for a party to be permitted to refer the Court to unpublished opinions. Here, the published authority does not adequately address the issue before the Court. The Court of Appeals declined to address the relationship between *Fairbanks* and the unpublished *Forleo*. Indeed, it even refused to mention *Forleo* by name. *Forleo*, although unpublished, is directly on point with the instant case. *Fairbanks*, although published, does not address the situation at hand, as it did not even purport to address the issue of an individual officer’s liability. The conclusory citation to *Fairbanks* by the Court of Appeals is insufficient and simply does not support its holding. The court erred in relying upon it.

B. *Forleo* and *Fairbanks* address different factual scenarios, and *Forleo* is on point here, while *Fairbanks* is distinguishable.

Forleo v. American Products of Kentucky, Inc., 2006 WL 2788429 (Ky. App. 2006) (unpublished) is factually on point with the instant case. In *Forleo*, Forleo and Tandy were the sole shareholders, officers, and directors of QMS, a hardwood floor installation and refinishing business. On November 1, 2000, the Kentucky Secretary of State administratively dissolved QMS for its failure to file its annual report. *Id.* at *1. Despite the dissolution, Forleo and Tandy continued doing business as QMS, including the purchasing of flooring supplies from the defendants, Lanham and AMPRO. Forleo

and Tandy failed to pay Lanham for the supplies; therefore, Lanham and AMPRO brought suit against Forleo and Tandy for breach of contract. *Id.* The trial court found that Forleo and Tandy were personally liable for the debts. On July 1, 2004, after the alleged breaches had occurred, the Kentucky Secretary of State reinstated the corporate existence of QMS. As a result of the reinstatement, Forleo and Tandy brought a motion to alter or amend the judgment arguing that “upon reinstatement, the corporate veil is retroactively applied back to the date of dissolution pursuant to KRS 271B.14-220(3).” *Id.* The trial court denied Forleo and Tandy’s motion. *Id.*

The Kentucky Court of Appeals affirmed the trial court’s finding that Forleo and Tandy remained personally liable for the debt, basing its decision on two reasons: First, “KRS 271B.14-220(3) is silent as to the issue of personal liability.” Second, “KRS 271B.14-210(3) states that a corporation may not continue any business after dissolution except that which is necessary to wind up and liquidate its business and affairs.” *Id.* Third, “the ‘shall resume’ language in “KRS 271B.14-220(3) necessarily implies that that [sic] the corporation ceased doing business after dissolution as required by KRS 271B.14-210(3).” *Id.* at *2.

The *Forleo* Court’s reasoning is clearly applicable to the instant case. First, KRS 275.295(3)(c) “is silent” as to issue of personal liability. Second, KRS 275.285, the statute governing dissolution of limited liability companies, mandates that upon the administrative dissolution of the limited liability company, it “shall be dissolved and its affairs wound up.” KRS 275.285(4). Third, KRS 275.295(3)(c) contains the same “shall resume” language as its corporate counterpart. Therefore, the “shall resume” language”

necessarily implies that [the limited liability company] ceased doing business after dissolution as required by [KRS 275.285(4)].”¹⁵

Elegant Interiors, LLC was administratively dissolved on November 1, 2005, and it was not reinstated as a valid legal entity until August 11, 2006. During that period of administrative dissolution, Shannon actively conducted new business and created new debts and contractual obligations for herself, individually. No winding up of affairs occurred; she simply abandoned the affairs of the LLC and commenced her own. Indeed, upon hearing how Shannon was having difficulty maintaining her business and her payment obligations, Pannell even offered to allow Shannon to terminate her leasehold completely because he had a substitute tenant available, which would have been a step toward terminating her business and winding up its affairs. Second Affidavit of Rick

¹⁵ KRS 275.295 was repealed effective January 1, 2011, and KRS 14A.7-030 was enacted. However, the new statute is not retroactive, and KRS 275.295 therefore applies to the instant case. See KRS § 446.080 (3) (“No statute shall be construed to be retroactive, unless expressly so declared”); *Snyder v. City of Owensboro*, 555 S.W.2d 246, 249 (Ky. 1977) (“As a general rule statutes operate prospectively rather than retrospectively, and they will not be given a retroactive effect even where the Legislature has power to enact them, unless such an intention clearly and unmistakably appears from the statute itself”).

The reinstatement of corporations and limited liability companies is now governed by KRS 14A.7-030, which provides:

- (3) When the reinstatement is effective:
 - (a) It shall relate back to and take effect as of the effective date of the administrative dissolution;
 - (b) The entity shall continue carrying on its business as if the administrative dissolution or revocation had never occurred; and
 - (c) The liability of any agent shall be determined as if the administrative dissolution or revocation had never occurred.

In contrast, KRS 275.295(3)(c) merely provided that “when the reinstatement is effective, the reinstatement shall relate back to and take effect as of the effective date of the administrative dissolution, and the limited liability company shall resume carrying on business as if the administrative dissolution had never occurred.” The former KRS 271B.14-220(3) contained like language and was likewise silent on the issue of personal liability of an agent. It appears that the General Assembly has elected to alter the statutory scheme to specifically address the liability of an agent; however, the new statute does not apply retroactively to govern this case. Moreover, the fact that the General Assembly later added a provision to the new KRS 275.295 (KRS 14A.7-030) to address personal liability only underscores the fact that, under the statute indisputably applicable to the instant case, there was no mention of liability of agents where a reinstatement occurred for acts taken during the period of dissolution. This demonstrates that the interpretation advanced by *Forleo* is the correct one to apply in the instant case. Copies of all relevant statutes are attached hereto as Exhibit 11.

Pannell, Exhibit A to Plaintiff's Combined Response and Reply, R.A. 484, attached hereto as Exhibit 3. Shannon refused that offer, choosing instead to continue the retail operations of her business, including negotiating and entering into the March 2006 Lease for herself. In short, because Shannon continued to conduct the everyday business of "Elegant Interiors" during the period it was administratively dissolved, she is personally liable for the breach of the Lease.

The case erroneously relied upon by the Court of Appeals, *Fairbanks*, contrarily, addresses an entirely different factual scenario that is not present here. In *Fairbanks*, *supra*, an administratively dissolved corporation brought suit against an individual for his impermissible co-opting of their photo-identical process, which the defendant had been hired to help develop and market. *Id.* at 143. The plaintiff then sued Prather. The defendants alleged that *the corporation* had no right to enter into the contract with him since it was administratively dissolved at the time.

In contrast to *Fairbanks*, in this case, Shannon seeks to use reinstatement of the Elegant Interiors limited liability company as a defense to personal liability under a contract she personally executed during the period of administrative dissolution. Pannell is the party who has been harmed by Shannon's wrongful behavior. At Shannon's behest, Pannell turned away another potential tenant of the entire Property, changed the terms of the Lease for her, reducing her monthly obligation, and partitioned the Property for her benefit and use at his own expense. In return for his good faith accommodation of her supposed needs and desires and his out of pocket expenses, Shannon summarily abandoned the premises.

This significant distinction was acknowledged by the *Fairbanks* Court, which, in interpreting KRS 271B.14-220(3), explained:

We conclude . . . that [the General Assembly] intended for reinstatement to restore a corporation to the same position it would have occupied had it not been dissolved and that reinstatement **validates any action taken by a corporation** between the time it was administratively dissolved and the date of the reinstatement.

Id. at 146 (emphasis added).

1. *The Court of Appeals' ruling conflicts with other case law simultaneously rendered by that Court.*

The Court of Appeals refused to address or consider the unpublished case of *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. App. 2006) (unpublished) in its Opinion. See Exhibit 13. While *Forleo* “seemingly conflict[s]” with *Fairbanks*, the refusal to address *Forleo*, citing CR 76.28(4)(c) (Opinion, p. 9, fn 3) is the reason the Court reached the wrong result. Moreover, the Court of Appeals incorrectly stated and applied the standard for whether an unpublished case may be cited by the parties or considered by the Court. It stated:

While normally this might be the end of the story, chalking up the loss of the case in bewilderment, another panel of the Court of Appeals simultaneously appreciated *Forleo*, applied *Forleo* to similar issues and got the results correct; personal liability was affirmed. As a result, the story with *Pannell* cannot stop now.

For the issues presented in *Pannell*, there is no published opinion that “adequately address[es]” the relevant issue. The cases relied upon by the Court are distinguishable from the instant case, as explained herein. This Court should grant discretionary review to address the *Forleo* case, which addresses a more particular and specific issue than what *Fairbanks* addresses. *Forleo* directly addresses the issues presented in *Pannell* and it is factually on point with *Pannell* and it should control its disposition. If a case, published or unpublished, addresses the relevant issue, shouldn’t it at least be considered? Shouldn’t that consideration or application be consistent panel-to-panel at the Court of Appeals?

The cases cited by the *Fairbanks* Court confirm that its holding was intended to be a statement of only the corporation’s liability for corporate acts taken during the period of corporate dissolution, and not that of the individual officers who acted on behalf of the corporation. The Court relied on *Wolfe v. Salkind*, 70 A.2d 72 (N.J. 1949) and *Joseph A. Holpuch Co. v. United States*, 58 F.Supp. 560 (Ct. Cl. 1945).

In *Wolfe*, the plaintiff, a corporation, sued on an oral contract, alleging that defendants agreed to pay plaintiff a commission of five percent upon the sale of three machines and accessories for \$100,000. The contract was purportedly made on December 20, 1947. The plaintiff’s corporate charter was dissolved on January 8, 1941 due to failure to pay state franchise taxes. The corporation was reinstated on March 22, 1949. The trial court entered judgment on a jury verdict in the plaintiff’s favor, and the defendants appealed.

The Court held that the reinstatement of a dissolved corporation “relates back to the date of the proclamation of the repeal and validates corporate action taken in the interim.” *Id.* at 76. It therefore affirmed the judgment, explaining:

The object of these statutes being solely the raising of revenue for the State . . . it would be inequitable to permit third persons, such as the defendants here, who had dealt with the corporation in the period when its charter had been forfeited to defend suits against them on this ground after the corporation had complied with R.S. 54:11-5, N.J.S.A., and it had been reinstated as a corporation and entitled to all its franchises and privileges. In good conscience the defendants, who are strangers to the dealings between plaintiff and the State, should not be allowed to take advantage of the plaintiff's default in paying its taxes to escape their own obligations to the plaintiff, when its default has been cured by its subsequent compliance with the statutory requirements.

Id. The *Fairbanks* Court cited *Wolfe* for the proposition that “the majority rule” is that “reinstatement validates a dissolved corporation’s interim acts.” *Fairbanks, supra* at 144.

The *Fairbanks* Court also cited *Joseph A. Holpuch Co. v. United States, supra*. There, the plaintiff was an Illinois corporation that was organized in 1913 and administratively dissolved in on June 8, 1931. It was reinstated in 1936. The plaintiff had entered into a contract with the United States for construction of a Veteran’s Administration home on December 30, 1931. The plaintiff sued after the defendant terminated the contract. The defendant argued that at the time the contract was executed, the plaintiff “was not a corporation as it held itself out to be.” *Id.* at 562.

The Court held that the plaintiff had capacity to sue, and that the defendant could not use the plaintiff’s dissolution as a defense. The Court explained:

It would be inequitable for the State to collect taxes levied on the privilege of doing business as a corporation the right to exercise the privilege. So when it accepted payment of taxes in default, together with penalties, and set aside the dissolution decree, we think it intended to validate the exercise of the corporate franchise in the years for which the taxes were paid.

Contracts entered into without the payment of license taxes are void only because the laws of the State imposing the taxes make them void, either expressly or by implication. We will not assume that the State of Illinois intended to accept taxes on the exercise of the corporate franchise and at the same time make the corporation's contracts illegal because it was not authorized to exercise the franchise.

If the effect of the decree setting aside the dissolution decree is what we have supposed, the defendant here cannot complain; its rights were in nowise prejudiced thereby. **Only the State levying the taxes is interested in the nonenforcement of contracts entered into without prior payment of them. The other contracting party is not injured thereby. If defendant has breached its contract with plaintiff, certainly it should not escape liability therefore because the corporation did not pay its taxes when due, where the State, in consideration of the payment of penalties, has forgiven the corporation therefor.**

We think it was the purpose of this decree vacating the dissolution decree to give validity to all acts done in the meantime and hence, we conclude that plaintiff can maintain an action for the breach of a contract entered into between the dates of the two decrees.

Id. at 563-64 (emphasis added).

The *Fairbanks* Court applied the reasoning of *Wolfe* and *Joseph A. Holpuch* and concluded that Kentucky's reinstatement statute "validates any action taken by a corporation between the time it was administratively dissolved and the date of its reinstatement." *Fairbanks, supra* at 146. It simply did not address whether KRS 271B.14-220(3) could be used to shield the *shareholders* of the administratively dissolved corporation from personal liability for acts undertaken by the shareholders during the period of dissolution. The shareholders of the dissolved corporation obviously do not stand in the same position as a third party who attempts to use the corporation's failure to pay taxes to the State to avoid liability under a contract with the corporation.

The purpose of KRS 275.295 was to make clear that the *corporation* remains liable for acts done for the corporation by its shareholders during the period of dissolution; it is not a means for an individual to avoid personal responsibility. The majority of jurisdictions support this interpretation. See, e.g., *Moore v. Occupational Safety and Health Review Commission*, 591 F.2d 991 (4th Cir. 1979) (“The Virginia reinstatement statute does not relieve the directors, who have continued the corporate business, of individual liability for actions in the interim period between dissolution and reinstatement”); *Adam v. Mt. Pleasant Bank & Trust Co.*, 355 N.W.2d 868 (Iowa 1984) (“In the absence of statutory direction, a majority of jurisdictions suspend limited liability and find personal liability for occurrences during suspension of a corporate charter, notwithstanding a later reinstatement”); *Kessler Distr. Co. v. Neill*, 317 N.W.2d 519 (Iowa App. 1982) (Corporation’s president personally liable for debts purportedly incurred by corporation during time when corporate charter was suspended, notwithstanding that corporate charter was later reinstated).

The “as if it never happened” language in KRS 275.295(3)(c) speaks only to the retroactive liability of the corporation (or limited liability company). It prevents a situation in which a corporation could enter into contracts during its period of dissolution in its own name, become reinstated, and then escape liability on the contracts on the basis that because it did not exist at the time the contracts were executed, the contracts were void *ab initio*. The statute expressly provides as much with its reference to validating the acts of the corporation. However, the statute does not affect the well-established rule that a shareholder is liable for individual acts taken in the corporation’s name (or otherwise) following dissolution, except to the extent the acts are necessary to effect the

dissolution and winding-up of the corporation. Clearly, entering into a new lease for a different-sized space going forward for years is not “dissolving” or “winding-up” a business.

C. Fairbanks and Forleo are consistent with each other, and Forleo correctly interprets the result under KRS 275 for the facts presented here.

The Court of Appeals incorrectly declined to even address or consider the relationship between *Fairbanks* and the reasoning set forth in the unpublished *Forleo*. However, an examination of the two opinions reveals that they are legally consistent, with each addressing a different factual scenario.

In *Dolphin Offshore Partners, L.P. v. Industrial Resources Corporation*, 499 F.Supp.2d 1025 (E.D. Tenn. 2007), the United States District Court for the Eastern District of Tennessee construed *Forleo* and *Fairbanks*. See Exhibit 15. In *Dolphin*, the plaintiff entered into a contract with the defendant Industrial Resources Corporation (“IRC”) pertaining to the purchase and sale of certain shares of stock. The president of IRC, Malcolm Ratliff, signed the Agreement “as IRC’s president.” *Id.* at 1026. The plaintiff alleged that IRC breached the Agreement. IRC was a Kentucky corporation that had been administratively dissolved “as of the date of the Agreement’s execution.” *Id.* The plaintiff argued that Ratliff’s estate was liable for IRC’s breach “since Mr. Ratliff executed the Agreement on behalf of an administratively dissolved corporation.” Mr. Ratliff’s widow asserted the reinstatement of IRC as a defense to the estate’s liability under the Agreement. *Id.* The Court applied Kentucky law, and it granted summary judgment to the plaintiff, holding Ratliff’s estate responsible for Ratliff’s actions, and denied the defendant’s cross-motion for summary judgment. *Id.*

As is the case here, the plaintiff in *Dolphin* cited *Forleo*, while the defendant contended that *Fairbanks* applied. The Court noted that the *Fairbanks* Court had applied the following reasoning in declining to find personal liability:

Fairbanks was a breach of contract action. Therein, it was the *plaintiff* who was, as of the date of the contract's execution, administratively dissolved. The defendants argued that the contract was null and void due to the dissolution, even though the plaintiff's corporate status had since been reinstated. Interpreting Kentucky's reinstatement statute, Ky.Rev.Stat. § 271B.14-220, the *Fairbanks* court stated that “[i]n good conscience the defendants, who are strangers to the dealings between plaintiff and the State, should not be allowed to take advantage of the plaintiff's default in paying its taxes to escape their own obligations to the plaintiff[.]” *Fairbanks*, 198 S.W.3d at 145 (citation and quotation omitted).

Id. at 1027 (emphasis added).

The Court noted that “eleven months later – and without mention of *Fairbanks* – Kentucky’s Court of Appeals decided *Forleo*.” *Id.* The Court then summarized the relationship and consistency between the two cases as follows:

Although *Fairbanks* and *Forleo* are facially in conflict, this court concludes that *Forleo* controls the present matter. The court first notes that the dissolved corporation in *Fairbanks* was *the plaintiff*, unlike the case at bar. Far more importantly, despite *Fairbanks*'s broad and general holding that “reinstatement validates any action taken” between dissolution and reinstatement, the issue of officer liability was not before that court.

Conversely, in *Forleo*, Kentucky's Court of Appeals was presented with the exact issue and fact pattern now before this court. *Forleo*, whether unpublished or not, is the best indicant of Kentucky law on this point. Lastly, despite the arguable inconsistency between the two holdings, *Fairbanks* and *Forleo* share an important common theme of holding contracting parties responsible for the bargains they make.

Id. at 1027 (some emphasis added).

The instant case is factually on point with *Forleo*, as it involves the (former) member of a dissolved limited liability company who continued to do business after the

dissolution of the company. It is unlike *Fairbanks*, where a “stranger to the relationship” between the corporation and the state attempted to seize upon the corporation’s failure to keep its organization through the Secretary of State’s Office current. Here, the Court of Appeals’ holding permits Shannon to take advantage of her own failure to keep the limited liability current, and permits her to be absolved of liability for action she personally chose to undertake on her own behalf and for her own personal benefit during the period of dissolution. The Court of Appeals’ reliance on *Fairbanks*, which did not address individual liability of the corporate officers and involved a different factual scenario, is misplaced. As the *Dolphin* Court succinctly stated, both *Fairbanks* and *Forleo* have a common aim and result – each “hold[s] contracting parties responsible for the bargains they make.” *Id.* at 1027. This is consistent with KRS 275.295(3)(c), which addresses the liability of the *company* only, and not the individual members. The Court of Appeals’ holding in this case has the opposite result – it permits the contracting party to escape liability – and is not supportable by the inapplicable *Fairbanks* or KRS 275.295(3)(c).

D. Other jurisdictions have confirmed the propriety of the result urged by Pannell.

1. *Shannon did not cease doing business when the LLC was dissolved, and she knew or should have known of its dissolution.*

One Court has recently construed a statute identical to KRS 275.295(3)(c). In *Daniels v. Elks Club of Hartford*, 2012 WL 3139684, ___ A.3d ___ (Vt. 2012) (to be published) (See Exhibit 16), the plaintiff sought foreclosure of a mortgage on two parcels of real estate owned by the defendant, Elks Club of Hartford, Vermont (“Club”). Certain creditors of the Club had junior mortgages on the properties. The Court reversed a

summary judgment entered in the plaintiff's favor, which held that the plaintiff had standing to foreclose and dismissed the creditors' counterclaims, and the creditors appealed. *Id.* at ¶ 1.

The creditors included the Vermont Human Rights Commission ("VHRC"), four individual women, and a lawyer. Their interest in the property arose following a judgment obtained against the Club in civil rights litigation ("litigation"). In the litigation, the Club was found liable for discrimination against women, resulting in attachments on the property in favor of the women and the VHRC, and eventually the lawyer¹⁶. Although the Club was at one time a corporation, at the time of the litigation and at the time it discriminated against the individual women, the Club was an unincorporated voluntary association. *Id.* at ¶ ¶ 2; 3. The Court affirmed that the plaintiff was entitled to foreclose, but it reversed and remanded its dismissal of the creditor's counterclaims. *Id.* at ¶3.

In the foreclosure action, the creditors alleged that the plaintiff, who was a member of the Club, was liable to creditors for the amount of their judgment. Under Vermont law, members of a voluntarily association are individually liable for the debts of the association. *Id.* at ¶43; 12 V.S.A. § 5060 (where an execution on a judgment against a partnership, association or company is returned unsatisfied "an action of contract for the amount unpaid may be brought against any or all of the partners, associates or shareholders upon their original liability").

However, following entry of the judgments at issue, the Club reinstated its corporate charter. It argued that under the terms of Vermont's reinstatement statute, its

¹⁶ The lawyer obtained a separate judgment against the Club relative to legal fees owed after the Club ceased paying for his services. *Id.* at ¶77.

members could not be liable for the debt because a reinstatement “relates back to and takes effect as of the effective date of the administrative dissolution and the corporation shall resume carrying on its activities as if the administrative dissolution had never occurred.” *Daniels, supra*, ¶58; 11B V.S.A. §14.22(a). This, of course, mirrors the language of KRS 275.295(3)(c).

The activities that gave rise to the litigation occurred in 1996 and 1997. The Club had been administratively dissolved in 1989, and it was reinstated in May 2008. *Daniels*, ¶67. The Court held that the Club could not use the retroactive reinstatement to shield the members from personal liability. It noted that whether the statute “should be interpreted to allow members of a reinstated corporation to escape personal liability for actions taken during the period when the corporation was terminated” was an issue of first impression in Vermont. The Court explained, “contrary to the argument of plaintiff and the dissent, we cannot conclude that the statute explicitly answers this question.” *Id.* ¶59. Here, similarly, contrary to the arguments advanced by Shannon and the Court of Appeals’ conclusory citation to KRS 275.295(3)(c), the statute does not expressly address the issue of personal liability of members of an administratively dissolved LLC, as it speaks to the actions of the *company* only during the period of dissolution. The *Daniels* Court noted that the “shall resume carrying on its activities” language in the Vermont statute simply “restores the powers of the corporation to conduct business as if the termination never occurred. It does not address the liability limitation of the persons who govern or are members of the Club.” *Id.* ¶59. The Court held:

We disagree with plaintiff's contention that reinstatement of the Club's corporate status categorically reinstates the corporate liability shield with regard to creditors' judgments, which resulted from liability incurred after termination of its corporate status and before reinstatement. As more fully

explained below, we believe that whether there is a liability shield should depend on the expectations of the parties. In this case, if creditors cannot collect from the Club, they can collect from individuals who were members at the time the debts arose and who were aware, or should have been aware, of the Club's status as an unincorporated association.

Id. at 56 (emphasis added).

The Court noted that the Club was not reinstated until after the creditors had obtained a judgment against the Club, and the creditors dealt with the Club believing it was a voluntary association (which would have made the members individually liable for the Club's debts). *Id.* ¶67. It also emphasized the reliance of the creditors on the Club's status and the fact that if it upheld the personal liability of the Club members, the creditors would be getting what they bargained for and expected, and nothing more:

The vast majority of the cases on reinstated corporations involve contractual liabilities with respect to business corporations. [In those cases] the creditor typically entered into a contract believing it was dealing with an active corporation. **Following reinstatement of the corporation, the creditor had the corporate liability it expected. Adding personal liability of persons who act for the corporation is a windfall,** justified necessarily as deterrence of the conduct or omission that caused the termination of the corporation. These are cases covered by the dissent's rationale: "there is nothing inherently 'inequitable [in] requir[ing] corporate creditors that have dealt with individuals as agents of the corporation to seek relief solely from the corporation.'" *Post*, ¶ 102 (quoting 41 N.Y.U. L.Rev. at 607). The circumstances here are totally different.

The Club functioned as a voluntary association for nineteen years after its corporate status was terminated, far longer than in the vast majority of reported decisions we have found. Creditors dealt with it as a voluntary association, not as a corporation. This action does not arise out of a commercial transaction, and **there is no evidence that that creditors had an expectation of responsibility being exclusively corporate.** Under Vermont law, the Club while acting as a voluntary association had the same liability as it had as a corporation, but the members had individual liability if the Club failed to pay a judgment against it. **If anything, creditors relied upon that liability.**

Id. ¶¶ 69, 70 (emphasis added).

In the instant case, similarly, Pannell relied on Shannon's personal liability (i.e., the fact that she was acting as an individual and not through the LLC) in agreeing to release the LLC from its obligations for rental of the entire leased property under the March 2004 Lease. Shannon prepared the Release, in which she repeatedly confirmed her own personal liability and the fact that she was acting on her own behalf and not as representative of the LLC. Pannell relied on this change in circumstance (i.e., going from dealing with an LLC to an individual personally) in agreeing to accommodate Shannon's request to "down-size" and be responsible for only a portion of the partitioned space going forward. Affidavit of Rick Pannell, Exhibit 3. Like the Club in *Daniels*, Shannon did not even attempt to reinstate the LLC until after the litigation occurred. Although she later testified that she did not "know" that the LLC had been administratively dissolved at the time she prepared the Release and signed the March 2006 Lease, this self-serving, after-the-fact contention is belied by her use of "I" and "Ann Shannon" repeatedly throughout the Release she prepared (without so much of a mention of "Elegant Interiors, LLC"). If Shannon's personal liability is upheld here, Pannell will not be obtaining a "windfall" because he relied on Shannon's promise of personal liability in partitioning the space and entering into a new Lease, and he will be getting that for which he bargained, and no more.

Moreover, the *Daniels* Court made clear that the standard to be considered is not one of actual knowledge – it noted that the Club members "knew or should have known" that the Club's corporate charter had been administratively dissolved. *Daniels, supra*. Therefore, Shannon's self-serving testimony regarding her purported lack of actual knowledge is irrelevant. Shannon was the sole member of the LLC at issue. A party who

wishes to do business through a limited liability company and obtain the benefits of a business entity organized through the Secretary of State's Office should be said to have constructive knowledge of the fact that he or she must take steps annually, including the payment of fees and the filing of an annual report, in order to retain that status and its benefits. Therefore, Shannon "should have known" that the LLC was administratively dissolved on November 1, 2005, and she must be charged with that knowledge.

2. The Court's interpretation of KRS 275.295(3)(c) would promote fraud and abuse.

Numerous other courts have declined to interpret reinstatement statutes as providing a shield from personal liability for corporate officers who conduct business (other than winding up) during the period of dissolution.

In *Poritzky v. Wachtel*, 27 N.Y.S.2d 316 (N.Y. 1941), the Defendant's corporation was administratively dissolved in 1935. Thereafter, he continued to purchase meat from the Plaintiff in the corporation's name. In 1940, the Plaintiff brought suit against the Defendant individually for breach of contract. Like the instant case, after the lawsuit was filed, in 1941, the Defendant caused the corporation to be reinstated. The Court held that, notwithstanding the existence of a "reinstatement" provision in the state tax code, the Defendant was personally liable for the debt. The Court explained:

To approve the application of the statute which the defendant urges would encourage fraud and abuse. Under such a construction, a former officer of a dissolved corporation could obtain credit and then upon subsequent discovery of the non-existence of the corporation, by merely paying arrears in franchise taxes, could shift the personal liability which the law would otherwise impose upon him back to the corporation.

Id. at 318.

The Court also noted that the corporation was "without assets, so that if [Plaintiff] is limited to an action against the corporation he will have a valueless remedy." *Id.*

Similarly, Elegant Interiors, LLC is now out-of-business and without assets. Combined Response and Reply, p. 18, R.A. 482.

In *Cardem, Inc. v. Marketron International Limited*, 749 N.E.2d 477 (Ill. App. 2001), the Defendant, president of a corporation, signed a promissory note on its behalf. At the time the note was signed, the corporation had been dissolved for failure to file annual reports. The Plaintiff argued that the Defendant was personally liable on the note because he “signed the note knowing that [the corporation] had been dissolved.” *Id.* at 478. At the time, the Defendant was the sole shareholder and officer of the corporation. *Id.* The corporation was reinstated two months after the note was signed. *Id.* The Court held that the Defendant was personally liable for the sums due under the note. Specifically, the Court cited *In re Estate of Plepel v. Industrial Metals, Inc.*, 450 N.E.2d 1244 (Ill. App. 1983), in which the Court had held that permitting a corporate officer to escape personal liability under such circumstances “is against public policy because it would create a mechanism by which just debts could be easily evaded.” *Plepel*, 450 N.E.2d at 807; *Cardem*, 749 N.E.2d at 480.

In *Annicet Associates, Inc. v. Rapid Access Consulting, Inc.*, 656 N.Y.S.2d 152 (N.Y. 1997), a New York Court held that a corporate officer was personally liable for debts incurred by continuation of a dissolved corporation, regardless of the corporation’s subsequent reinstatement. In *Annicet*, the Plaintiff contracted with the Defendant corporation in August 1994 for provision of services to the corporation. The services were rendered in June 1995. The corporation was administratively dissolved effective November 1, 1994. It was reinstated in January 1997.

Construing the New Hampshire reinstatement statute, the Court found that the officer was personally liable on the contract. That statute provided that upon filing a certificate of “revival” relative to a dissolved corporation, the reinstatement “shall validate all contracts, acts matters and things made, done and performed within the scope of its charter by the corporation, its officers and agents during the time when it charter was forfeited . . . with the same force and effect and to all intents and purposes as if the charter had at all times remained in full force and effect . . .” *Id.* at 863. The foregoing language mirrors that of KRS 275.295(3)(c), which provides that a reinstated limited liability company shall resume business “as if the administrative dissolution had never occurred.” However, relying on *Poritzky*, the Court found that the officer was individually liable for the debt. Notably, the *Annicet* Court found the shareholder individually liable even though the contract had been executed prior to the dissolution. Compare *Worldcom, Inc. v. Sandoval*, 701 N.Y.S.2d 834 (N.Y. 1999) (Shareholders of corporation which was administratively dissolved were personally liable in an action for breach of contract entered into by the corporation after its dissolution, even though the corporation was reinstated after the action was filed). The *Annicet* Court based its holding on “[t]he salient premise of the *Poritzky* case [] that fraud and abuse would be encouraged if an officer of a dissolved corporation were allowed to conduct business in the corporate name” and then avoid personal liability through reinstatement of the corporation. *Id.* at 864.

Here, similarly, the Court of Appeals’ construction of the reinstatement would promote fraud and abuse, and, in particular, permit Shannon to benefit from her wrongdoing. This entire dispute was caused by Shannon. Shannon is the party who

desired the reduction in space and rent. Pannell did not approach Shannon about downsizing her leased space; Shannon approached Pannell. Pannell worked in good faith with Shannon to avoid her further defaulting on her lease of the Property, as her LLC was obligated under the 2004 Lease for rent for the entire Property. Pannell even offered to release Shannon from the remaining term of the 2004 Lease of the entire Property because Pannell had a third party available to lease the entire space, but Shannon refused that offer. Pannell clearly relied upon Shannon being personally responsible for all sums owed or else he would have never agreed to a reduction in the lease in size and rent for no consideration to him.

Elegant Interiors is now out-of-business and has been since March 2, 2006 or effectively sooner. As was the case in *Poritzky*, the trial court's construction of the applicable statute leaves Pannell with a "valueless remedy." Pannell is unable to recover any sums from Elegant Interiors, LLC. There is no question that an injustice will be worked upon Pannell if Shannon is not held liable for breach of the parties' agreement. She must be held responsible for the bargain she made.

3. *A couple of Kentucky cases got it right.*

The recently published case of *Martin v. Pack's Inc., et al.*, 2011 WL 3207947, 358 S.W.3d 481 (Ky. App. 2011), also conflicts with the Court's Opinion in *Pannell*. In *Martin*, a construction subcontractor brought an action against a dissolved corporation and its owners for breach of contract. The subcontractor, Pack's Inc., asserted that Martin and Collinsworth, the dissolved corporation's former owners, were personally liable for the contract based on their actions undertaken after the corporation, Southeastern Construction, Inc. ("Southeastern"), was dissolved. Specifically, Pack's

and Southeastern had entered into a contract for the construction of a gas station at a Kroger supermarket. Following completion of the gas station in November 2004, Pack's was owed \$77,879.50 as a final payment. On November 9, 2004, Southeastern was administratively dissolved by the Secretary of State. Martin then requested that Keith Pack, the owner of Pack's, execute a waiver of his right to file a lien relative to the project. In exchange, Martin promised that Southeastern would send Pack's final payment when Southeastern received the remaining money it was owed by Kroger. Mr. Pack executed the waiver, but Southeastern did not make the payment. Martin, Collinsworth, and Pack then negotiated a payment schedule. Martin and Collinsworth paid the first payment of \$10,000 but did not make any subsequent payments. *Id.* at * 1. The trial court entered summary judgment in Pack's favor, holding Martin and Collinsworth personally liable for the debt because the agreement was made after Southeastern was dissolved. Martin appealed.

The Court upheld the trial court's decision, which was specifically based on the *Forleo* decision. Martin argued that the facts of his case were distinguishable from *Forleo* because his actions following dissolution "reflected a debt that preexisted the dissolution of his company." *Id.* at * 2. However, the Court explained that Martin incurred a new debt by executing the payment schedule because there was new consideration for the promise to pay -- in the form of Pack's waiver of its right to file a mechanic's lien. *Id.* at *3. The Court held that Martin was not shielded from liability under KRS 271B.14-050, which provides that a dissolved corporation may undertake certain business to "wind up and liquidate its business affairs," because the contract

involved a new obligation and consideration, and his actions therefore “exceeded the scope of activity envisioned by [the statute].”¹⁷

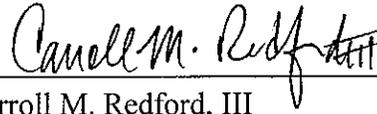
Similarly, in the instant case, the contract undertaken while the LLC was dissolved was a new liability. Shannon inquired whether Pannell would agree to partition the space and reduce the monthly rent because she could not afford the rental payments for the entire space. Pannell required Shannon to assume personal liability under the new Lease in consideration for partitioning the space and agreeing to relieve Elegant Interiors (and Shannon) of any liability under the previous Lease. Thus, the March 2006 Lease constituted a new liability undertaken by Shannon individually, for which consideration existed.

CONCLUSION

In sum, *Forleo* is right and it should be followed. *Martin* applies *Forleo* so it got it right. *Forleo* should not be ignored simply to reach a specific result. Certainly, even if (a panel of) the court chooses to ignore existing case authority, it should not be able to create and rely upon a non-existent prohibition against citing unpublished cases to justify its result. Applying *Forleo* to *Pannell* like *Forleo* was applied in *Martin* results in *Pannell* being reversed and remanded for entry of a Judgment against Shannon, individually, for all sums owed. The Court should further take the opportunity to make clear the appropriate consideration to be given to unpublished opinions from the Court of Appeals.

¹⁷ In *Martin*, the parties never reinstated the entity so they did not present a defense based on reinstatement or KRS 275.295. We do not think that is a difference that is controlling in *Pannell*. *Pannell* is a more realistic situation whereby a member of a defunct or broke LLC simply abandons any semblance of a real ‘wind up’ or proper dissolution but will jump on reinstatement if it will provide individual protection from liability.

Respectfully submitted,



Carroll M. Redford, III
Miller, Griffin & Marks, P.S.C.
271 West Short Street, Suite 600
Lexington, Kentucky 40507
(859) 255-6676

ATTORNEYS FOR APPELLANT,
RICK PANNELL

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APPENDIX

1. *Pannell v Shannon, et al.*, 2010-CA-001172-MR, August 26, 2011 Opinion Affirming from Kentucky Court of Appeals.
2. *Ed Martin v. Pack's Inc., et al.*, 2010-CA-001048-MR, July 29, 2011 Opinion Affirming from Kentucky Court of Appeals, 358 S.W.3d 481 (Ky. App. 2011).
3. Various affidavits.
4. Release document between Ann Shannon and Rick Pannell dated March 2, 2006.
5. Lease Agreement (March 2006) for Ann Shannon.
6. Forcible Detainer Judgment, June 22, 2006.
7. Secretary of State website information for Elegant Interiors, LLC. dated July 21, 2006.
8. Order dated May 25, 2010.
9. Order dated April 29, 2009.
10. Order dated October 27, 2008.
11. KRS 275.295; KRS 275.285; 14A.7-030; 271B.14-220(3).
12. *Fairbanks Arctic Blind Co. v. Prather & Associates, Inc.*, 198 S.W.3d 143 (Ky. App. 2005).
13. *Forleo v. American Products of Kentucky, Inc.*, 2006 WL 2788429 (Ky. App. 2006)
14. CR 76.28.
15. *Dolphin Offshore Partners, L.P. v. Industrial Resources Corporation*, 499 F.Supp.2d 1025 (E.D. Tenn. 2007)
16. *Daniels v. Elks Club of Hartford*, 2012 WL 3139684, ___ A.3d ___
17. Other cases from outside Kentucky.

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