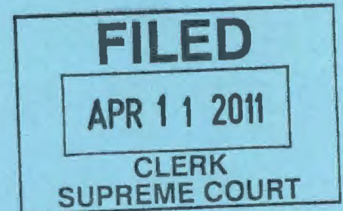
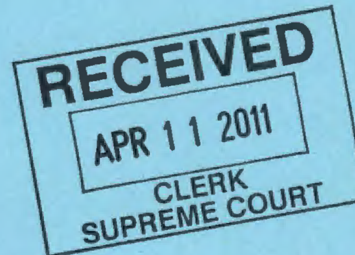
COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
NO. 2009-SC-000819-D



INTER-TEL TECHNOLOGIES, INC.
and INTER-TEL, INCORPORATED — APPELLANTS



v.

LINN STATION PROPERTIES, LLC and
INTEGRATED TELECOM SERVICES
CORPORATION — APPELLEES

ON REVIEW FROM THE KENTUCKY COURT OF APPEALS
CASE NO. 2008-CA-002266-MR and the
JEFFERSON CIRCUIT COURT, HON. IRV. MAZE, JUDGE
CASE NO. 03-CI-05485

BRIEF FOR APPELLEE LINN STATION PROPERTIES, LLC

Certificate required by CR 76.12(6)

I hereby certify that copies of this brief were served by United States mail, sufficient first-class postage prepaid, to Honorable Irv Maze, Division Ten, Jefferson Circuit Court, Judicial Center, 700 West Jefferson Street, Louisville, Kentucky 40202; Sam Givens, Clerk of the Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601;and William H. Mooney, Scott D. Spiegel, Jessica Tipton Sorrels, Lynch, Cox, Gilman & Mahan, P.S.C., 500 West Jefferson Street, Suite 2100, Louisville, Kentucky 40202 and John L. Gardner, Esq., 1615 South 52nd Street, Tempe, Arizona 85281, this 8th day of April, 2011.

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STATEMENT CONCERNING ORAL ARGUMENT

Appellee does not believe oral argument would be helpful here. The judgment of the trial court piercing the corporate veil of Integrated Telecom Services Corporation as affirmed by the Court of Appeals is supported overwhelmingly by the facts and applicable law.

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COUNTERSTATEMENT OF THE CASE

Appellee, Linn Station Properties, LLC ("Linn Station") does not accept the Statement of the Case offered by Inter-Tel, Incorporated and Inter-Tel Technologies ("Appellants").

Linn Station submits the following counterstatement more fairly, adequately and comprehensively reflects the facts upon which the trial court granted Linn Station's Motion for Summary Judgment and upon which the Court of Appeals relied in affirming.

BACKGROUND

The Lease Relationship

On December 4, 1997, Caldwell R. Willig leased an office building located at 10160 Linn Station Road in Louisville to Integrated Telecom Services Corporation ("ITS"). At that time, Mr. Willig was a principal shareholder of ITS. The lease term was six (6) years beginning January 1, 1998 and ending December 31, 2003. The monthly rent was $10,058.33. ITS was obligated as tenant to make non-structural repairs to the interior of the premises. This obligation included maintenance and repair of the utility systems within the office building. (Plaintiff's Memo, Exh. 1, ¶ 4)[1]

On July 2, 1998, Inter-Tel Technologies, Inc. ("Technologies") purchased all of the stock in ITS. Technologies was a wholly-owned subsidiary of Inter-Tel, Incorporated ("Inter-Tel"). The purchase price of $2.1 million was paid by Inter-Tel transferring shares of its stock to the sellers. (John Gardner Depo., pp. 121-122)

On July 29, 1999, Linn Station purchased the office building and the interest of the Mr. Willig as landlord in the lease. (Plaintiff's Memo, Exh. 1, ¶ 3)

[1]The Memorandum in Support of Plaintiff's Motion for Summary Judgment was filed under seal pursuant to a Protective Order. As a result, that memorandum is not paginated in the Clerk's Certification of Record on Appeal. The memorandum is part of the record albeit sealed. References in this brief to "Plaintiff's Memo" are references to this sealed memorandum.

The Lease Dispute

In February, 2002, Linn Station discovered that ITS had failed to comply with its maintenance and repair obligations under the lease. Linn Station notified ITS of the specific maintenance and repairs needed. ITS failed to honor its maintenance and repair obligations. In May, 2002, ITS ceased paying monthly rental and abandoned the leased premises. (Plaintiff's Memo, Exh. 1, ¶ 5)

On May 8, 2002, Linn Station wrote to ITS demanding compliance with the terms of the lease. Linn Station also requested notification from ITS regarding the status of its occupancy of the premises, noting that abandonment of the premises by ITS was an event of default under the lease. (Plaintiff's Memo, Exh. 1, ¶ 6)

Linn Station also filed a Demand for Arbitration with the American Arbitration Association in May, 2002. The lease provided that all disputes, other than defaults by tenant in the payment of rent, should be referred to the American Arbitration Association. (R. 19, ¶ 27) The dispute identified in the demand was the tenant's failure to maintain and repair the premises as required by the lease. ITS was notified of the filing of this demand. (Plaintiff's Memo, Exh. 1, ¶ 8)

On May 21, 2002, ITS responded to Linn Station's compliance demand of May 8, 2002 and the Demand for Arbitration. In a letter to Linn Station dated May 21, John Gardner, general counsel for Inter-Tel, wrote:

> Pursuant to your letter of May 8, 2002, please be advised of the following. Inter-Tel Technologies, Inc. is the parent company of Integrated Telecom Services Corporation (ITS). ITS, which is the only lessee on the Lease dated December 4, 1997 is now a defunct corporation with no assets. ITS abandoned the space on or about May 31, 2002. For the entire period of time that ITS occupied the space, rental was timely paid. Being defunct and having no assets there is no need for ITS to participate in an arbitration or legal proceeding. Accordingly, you may take a default against ITS in either proceeding. The parent company neither guaranteed the lease nor agreed to assume liability for same and will not pay the damages claimed.
>
> Sincerely,
> INTER-TEL INCORPORATED
> John Gardner
> General Counsel
>
> JK/ys
> cc: American Arbitration Association

(Plaintiff's Memo, Exh. 2)

Mr. Gardner acknowledged writing this letter. (Gardner Depo., p. 108)

Despite repeated attempts by the American Arbitration Association during the summer of 2002 to persuade ITS to participate in the arbitration proceeding, ITS continued to decline to participate. (Plaintiff's Memo, Exh. 1, ¶ 8)

The First Suit

On June 19, 2002, Linn Station filed a civil action against ITS in Division 5 of Jefferson Circuit Court. (R. 4, ¶ 25) This became Civil Action No. 02-CI-04610. In that action, Linn Station sought damages for rent due under the lease, the cost of restoring the premises and the value of fixtures removed improperly by the tenant.

ITS failed to plead or otherwise defend in this action despite valid service. A default judgment was entered against ITS on August 12, 2002 in the amount of $332,900 plus interest and costs. (Plaintiff's Memo, Exh. C) ITS did not appeal from the judgment.

ITS resisted Linn Station's subsequent efforts to take depositions in Kentucky to discover assets of ITS through which the default judgment might be satisfied. ITS took the position that since Inter-Tel, the parent of ITS, was not a party defendant in the first suit, discovery against it should be limited and should only occur at Inter-Tel's corporate offices in Tempe, Arizona.

Linn Station also served requests for production of documents asking ITS to identify assets owned by ITS through which the default judgment could be enforced. When asked to produce documents listing or describing its current assets, ITS responded:

> ITS does not own any current assets. For tax purposes, ITS holds in its name certain assets which are identified in the documents attached hereto. However, all these assets were supplied by Inter-Tel and are subject to Inter-Tel's perfected security interest.

(Plaintiff's Memo, p. 4)

In March, 2003, counsel for ITS and Inter-Tel informed counsel for Linn Station that there were no local representatives in Louisville with knowledge or seniority sufficient to respond to any questions concerning the assets of ITS. (Plaintiff's Memo, Exh. 3)

The Second/Current Suit

On June 20, 2003, Linn Station filed this civil action against ITS, Technologies and Inter-Tel. The purpose of this action was to pierce the corporate veil of ITS and establish the liability of its parents, Technologies and Inter-Tel, for payment of Linn Station's judgment against ITS.

Linn Station served and Appellants responded to interrogatories and requests for production of documents. In addition, counsel traveled to Arizona where the discovery depositions of three (3) corporate representatives designated by Appellants were taken. (R. 79-82) Those representatives were John L. Gardner, Susan K. Sherman and Lyle Erwin. (*Id.*) Mr. Gardner is General Counsel of Inter-Tel. Ms. Sherman is a tax accountant first employed by Inter-Tel in May, 2001. Mr. Erwin is Inter-Tel's Corporate Controller.

The Relationship Among Inter-Tel, Technologies and ITS

Inter-Tel is an Arizona corporation. It began doing business in 1969. [Deposition of John L. Gardner ("Gardner Depo."), p. 18] Inter-Tel is a public holding company of all other Inter-Tel subsidiaries and affiliates. Until a merger in 2007, Inter-Tel stock was publicly traded and listed on the NASDAQ. (*Id.*, p. 8) Inter-Tel only did business through its subsidiaries. (*Id.*) Its business was the manufacture, design, sale and service of telecommunication systems and related services. (*Id.*, p. 17) Inter-Tel dealt primarily with business as opposed to residential or individual customers. (*Id.*, p. 18)

Technologies was a subsidiary of Inter-Tel. (Gardner Depo., p. 4) Technologies was incorporated in Arizona in 1979. Technologies was the retail branch of Inter-Tel. It sold the hardware and software applications that comprise a telephone system. Prior to the acquisition of ITS, Inter-Tel did not have a direct sales office in Kentucky. Technologies had no office in Kentucky either. The ITS offices became direct sales offices for Inter-Tel by and through Technologies after July 2, 1998. (Gardner Depo., p. 22)

ITS was incorporated in Kentucky in 1982. (Plaintiff's Memo, Exh. 1, ¶ 9)

As noted above, Technologies purchased all the stock in ITS on July 2, 1998, but the purchase price was paid by Inter-Tel. (Gardner Depo., pp. 121-122)

Common Officers and Directors

According to ITS, the following individuals served as its officers in 1999, 2000, 2001 and 2002:

Craig W. Rauchle, President

Kurt R. Kneip, Vice President/Secretary-Treasurer

John L. Gardner, Vice President

During the same four (4) year period, these three individuals also served as officers of Technologies and officers of Inter-Tel. (Gardner Depo., pp. 44-49)

Technologies and ITS shared substantially similar boards of directors during the years 1999 through 2002. The following chart demonstrates these similarities:

Members of Boards of Directors

Year	Technologies	ITS
1999	Steven G. Mihaylo Craig W. Rauchle Kurt R. Kneip	Steven G. Mihaylo Craig W. Rauchle Norman Stout
2000	Steven G. Mihaylo Craig W. Rauchle Kurt R. Kneip	Steven G. Mihaylo Craig W. Rauchle Norman Stout
2001	Steven G. Mihaylo Kurt R. Kneip Tim Scarafiotti	Steven G. Mihaylo Craig W. Rauchle Norman Stout
2002	Steven G. Mihaylo Craig W. Rauchle Norman Stout	Steven G. Mihaylo Craig W. Rauchle Norman Stout

(See Appellants' Answers to Plaintiff's Interrogatories and Request for Production of Documents served on August 15, 2003, Int. Nos. 4, 5 and 6)[2]

[2]These answers to discovery by Appellants together with those answers to Linn Station's first supplemental written discovery, are part of the record in a sealed envelope marked "Confidential."

Steven G. Mihaylo, Chairman and Chief Executive Officer of Inter-Tel, served on the boards of Inter-Tel, Technologies and ITS during this four (4) year period. (*Id.*) The board of directors of ITS during this period consisted entirely of officers of Inter-Tel. (*Id.*)

Undercapitalization of ITS

Prior to its acquisition by Technologies on July 2, 1998, ITS was an independent Kentucky corporation. Mr. Gardner, general counsel at Inter-Tel, described ITS as "an independent third party dealer of communications equipment." (Gardner Depo., p. 20) ITS had offices in Louisville, Lexington, Indianapolis and Charleston, West Virginia. (Gardner Depo., p. 27; [Deposition of Lyle Erwin ("Erwin Depo."), p. 9]

Once ITS was acquired by Technologies, these four offices became "four different operations" which became a part of Inter-Tel's retail division. (Erwin Depo., p. 9) The four ITS offices became direct sales offices for Inter-Tel after July 2, 1998. (*Id.*) Susan Sherman described these four offices as "branches" of Inter-Tel. [Deposition of Susan K. Sherman ("Sherman Depo."), pp. 21, 25, 26, 59, 61] Mr. Gardner referred to the Louisville location as a "branch" of Technologies (Gardner Depo., p. 24) and as a "branch" office of Inter-Tel. (*Id.*, p. 26) After July 2, 1998, the Louisville office was described in Inter-Tel documents as "Inter-Tel Louisville". (*Id.*, p. 103) The Lexington office was described as "Inter-Tel Lexington". (*Id.*) These offices were advertised by Inter-Tel's website as "direct Inter-Tel sales and service locations." (*Id.*)

All employees at ITS became direct employees of Inter-Tel on July 2, 1998. (Erwin Depo., p. 11; Gardner Depo., p. 24) All payroll expenses for these employees were paid by Inter-Tel from the Arizona headquarters. (Erwin Depo., p. 30)

After the July 2, 1998 acquisition, ITS no longer had any independent ability to conduct financial transactions. Lyle Erwin, corporate controller for Inter-Tel, testified that ITS[3] obtained its

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[3]Although Mr. Erwin testified in terms of what ITS did and did not do, Appellants also claimed that between July 2, 1998 and December 31, 2002, Technologies was the only corporation doing business at 10160 Linn Station Road in Louisville. (See Defendants' Answers to Plaintiff's First Supplemental Interrogatories and Request for Production of Documents served on December 19, 2003, Int. Nos. 26 and 27.)

inventory after July 2, 1998 from Inter-Tel Integrated Systems, another subsidiary of Inter-Tel. (Erwin Depo., pp. 19-20) Inter-Tel Integrated Systems was compensated for the inventory transferred to ITS "through inter-company transactions, credits and what-not." (*Id.*, p. 20) Mr. Erwin more specifically described a typical transaction as ". . . there would be a sale, and then a credit memo was created showing an inter-company payable on Integrated or ITS's books and the credit to receivables on Integrated's systems books." (*Id.*, p. 21) When a customer of ITS purchased a phone system after July 2, 1998, ITS would not receive or control the receipt of the payment. Rather, the payment went directly into a "lock box account." This "lock box account" was strictly a depository account controlled by Inter-Tel, ". . . so that the local offices did not have access to those funds." (*Id.*, p. 22) Once placed in the "lock box account," the money belonged to Inter-Tel. (*Id.*)

All vendors after July 1998 providing goods and services to the Louisville, Lexington, Indianapolis and Charleston locations were paid directly by Inter-Tel. (*Id.*, p. 29)

ITS had no independent financial existence after July 2, 1998. It did not pay any of its bills and was not allowed to hold any money. (Sherman Depo., p. 49) It had no bank accounts. (See Defendant's Answer to Plaintiff's Interrogatory No. 9 served August 15, 2003.)

All rental payments required under the 1997 lease agreement were paid by Inter-Tel after July 2, 1998 until Inter-Tel abandoned the premises in May, 2002. (Gardner Depo., p. 57)

The lease agreement required tenant to maintain in force liability and property damage insurance on the premises at 10160 Linn Station Road. Tenant was to provide evidence of this insurance coverage if requested by landlord. Subsequent to July 2, 1998, this insurance was obtained through Wick Pilcher Insurance, Inc., an agency in Phoenix, Arizona. This agency writes most of the insurance for Inter-Tel. (Gardner Depo., p. 72) Certificates of liability insurance prepared by this agency and applicable to the leased premises at 10160 Linn Station Road in Louisville, Kentucky showed the named insureds to be "Inter-Tel, Incorporated" and "Inter-Tel Technologies, Inc." Both insureds were shown as having the same address in Tempe, Arizona. (See Exhibit 11 to Gardner Depo.) ITS was not mentioned as an insured.

Disregard of the Formalities of Corporate Existence of ITS and Technologies

In response to a request to produce copies of all minutes of meetings of the board of directors and shareholders (and any committees of either) of ITS taking place in 1998, 1999, 2000, 2001 and 2002, Appellants produced copies of unanimous written consents of shareholders and directors of ITS in lieu of annual meetings for the years 1999, 2000, 2001 and 2002. However, none of these copies contained the signatures of any shareholders or directors or a date of execution. (See Exhibits 4 and 5 to Gardner Depo.)

Appellants were likewise unable to locate signed and dated unanimous written consents of the shareholders and directors of Technologies for the period 1998 - 2002. (*Id.*, Exhibits 6, 7)

Mr. Gardner testified the originals of these consents were lost or misplaced. (Gardner Depo., pp. 31-32; 49, 50-51) He testified further on this point by stating "I think there were only executed and signed originals." (*Id.*, p. 33) However, when asked if he had actually seen those documents himself, he denied that he had done so. (*Id.*, p. 34)

Mr. Gardner was unable to verify that the originals of these consents were actually signed or dated. Moreover, he could not identify any individual who could verify that the originals actually had been executed. (*Id.*, pp. 34-35; 43-44)

Tax Reporting in Kentucky

Appellants designated Susan K. Sherman, Tax Manager at Inter-Tel, as a witness regarding tax matters. (Gardner Depo., pp. 100, 104) Ms. Sherman took the position that all Inter-Tel sales and service business done in Kentucky was done by ITS at least since 2001 in its name. (Sherman Depo., pp. 21, 23, 26, 27, 30, 37) However, at least since 2000, Inter-Tel, Technologies, ITS and at least one other Inter-Tel subsidiary have each reported tax information to the Kentucky Revenue Cabinet. Appellants had no explanation for multiple corporations reporting tax information for one business in Kentucky during that period. (Sherman Depo., p. 31) The only tax reporting consistently practiced in the name of ITS after the year 2000 related to Kentucky Corporation Income and License

Tax Returns. As shown below, the consistent use of ITS's name in this particular area was attributable to Inter-Tel's hiring of Susan Sherman in late May, 2001.

Sales and Use Tax Reporting

ITS did not file any Kentucky sales and use tax returns during 2001, 2002 or 2003. Technologies filed eleven (of twelve) such returns in 2001 in its name reporting significant Kentucky sales. (The actual amounts of Kentucky sales in 2001 are shown in Plaintiff's Memo, p. 9) In 2002, Inter-Tel reported five (5) months of sales in Kentucky. Technologies reported sales in Kentucky during the remaining seven (7) months of 2002. In 2003, Technologies reported eleven (11) months of Kentucky sales. For the twelfth month (September), Kentucky sales were reported in the name of "Inter-Tel Datacom, Inc." (Sherman Depo., pp. 20-21)

All sales in Kentucky reported by Technologies, Inter-Tel and Inter-Tel Datacom, Inc. were generated out of the former Louisville and Lexington operations of ITS. (Sherman Depo., pp. 26-27)

On January 7, 2002, the Kentucky Revenue Cabinet began a sales and use tax audit of Technologies. The period covered by the audit was September 1, 1997 to November 30, 2001. During the audit, the Kentucky Revenue Cabinet announced a tax amnesty program. A tax amnesty application was completed on September 24, 2002 in the name of "Integrated Telecom Services, Inc. d/b/a Inter-Tel Technologies, Inc."[4] The amnesty application was accepted. Inter-Tel paid the amnesty payment to the Kentucky Revenue Cabinet. (Sherman Depo., p. 41) (The actual amount of the amnesty payment is shown in Plaintiff's Memo, p. 9.)

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[4]KRS 365.015(2)(a) prohibits corporations from conducting or transacting business in Kentucky under an assumed name unless the corporation has filed a certificate of assumed name. Mr. Gardner did not know if such a certificate was filed for ITS to do business in the name of Technologies. (Gardner Depo., pp. 107-108) Ms. Sherman was unaware of this statutory requirement. (Sherman Depo., p. 40)

Tangible and Intangible Property Tax Reporting

Tangible personal and intangible property tax returns were filed with the Kentucky Revenue Cabinet for the following years in the following names with respect to tangible personal property and intangible property held by the Louisville, Kentucky business of Inter-Tel:

Year	**Name of Business**	**Date Returns Signed**
2000	Inter-Tel Technologies	May 15, 2000
2001	Inter-Tel Technologies	April 10, 2001
2002	Integrated Telecom Services Corp.	May 13, 2002
2003	Integrated Telecom Services Corp.	May 15, 2003

(Sherman Depo., pp. 54-60)

Corporate Income and License Tax Reporting

Susan Sherman is a certified public accountant. She was hired by Inter-Tel in late May, 2001 to make sure that sales and use tax, property tax, income tax, franchise tax and public utility taxes were filed. (Sherman Depo., p. 7) Ms. Sherman headed a staff that filed tax returns for Inter-Tel and its subsidiaries in well over 100 jurisdictions in the U.S. (*Id.*, p. 8)

Ms. Sherman had no knowledge why the sales and use tax returns filed in Kentucky in 2001, 2002 and 2003 were filed under the names of various corporate entities other than ITS. (*Id.*, p. 21-22, 23-24) According to Ms. Sherman, the tangible and intangible property tax returns for 2001 filed by Technologies were actually reporting property owned by ITS. (*Id.*, p. 55) She did not know why the returns were filed by Technologies. (*Id.*, p. 57) Ms. Sherman stated that Technologies had no tangible personal property at 10160 Linn Station Road in Louisville in 2001. (*Id.*, p. 55)

Kentucky corporation income and license tax returns were filed in the name of ITS for the years 1998-2002. (*Id.*, p. 44)

Ms. Sherman was asked to explain the Appellants' statement in answers to written interrogatories that "any assets currently held by ITS are carried in the name of ITS for tax purposes only." (*Id.*, p. 67) Ms. Sherman explained that ITS was never liquidated as a corporation and its assets were never "dividended" or in any way sent up to Technologies. (*Id.*, p. 68) She explained that ITS was continued "as a separate operating unit doing business as Technologies . . . Because

we had net operating losses coming forward that we would lose if we did not keep the legal entity separate." (*Id.*, p. 69) The net operating loss shown in the Kentucky corporate tax return for ITS was used in calculating Inter-Tel's federal income tax liability. Inter-Tel filed a consolidated federal tax return. The net operating loss from ITS would offset income from other subsidiaries of Inter-Tel.[5] (Sherman Depo., pp. 53-54) Ms. Sherman also provided another reason for reporting ITS to the Kentucky Revenue Cabinet as a separate legal entity. She identified the purchase price (basis) for the ITS stock. (*Id.*, pp. 71-72) If the company was subsequently sold for an amount less than that purchase price, the resulting tax loss on the stock sale would inure to the benefit of Inter-Tel. (*Id.*) However, as Mr. Sherman further explained, if the company was liquidated, the potential tax loss deduction would have been lost. (*Id.*)

John Gardner admitted that the corporate existence of ITS after July, 1998 was maintained only for the purpose of taking advantage of an operating loss carryforward on its tax return. (Gardner Depo., p. 95) Aside from that, ITS had no operational capacity at all after July 2, 1998. (*Id.*) When asked what business ITS conducted between July 2, 1998 and December 31, 2003, Appellants answered "None." (See Appellants' Answers to Plaintiff's First Supplemental Interrogatories and Request for Production of Documents served on December 19, 2003, Int. No. 27)

October 8, 2002 Financing Statement

At the direction of John Gardner in the fall of 2002, several weeks after the default judgment was entered against ITS, a staff attorney at Inter-Tel prepared a Form UCC-1 financing statement in which ITS was described as the "debtor" and Technologies was described as the "secured party." (Gardner Depo., pp. 81-84) The financing statement was said to cover the following collateral: "All contract rights, accounts, accounts receivable, inventory, leasehold improvements, personal

---

[5]Ms. Sherman was responsible for Inter-Tel taking advantage of the net operating loss shown on the tax return of ITS. The Kentucky corporate tax returns for ITS for 1998, 1999 and 2000 were all signed on the same day – December 20, 2001. Each return shows the books and records of the corporation are in the care of Sue Sherman. Ms. Sherman did not arrive at Inter-Tel until May, 2001. Apparently, Ms. Sherman's predecessor at Inter-Tel, Brad Wallace, had earlier informed Mr. Gardner that ITS had no assets. (Gardner Depo., p. 111; Sherman Depo., pp. 14-15) Appellants do not dispute the accuracy of the tax information cited by Linn Station.

property, cash, proceeds of collateral or equivalents." This statement was recorded in the Office of the Kentucky Secretary of State on October 8, 2002. (Gardner Depo., Exh. 11)

When asked to identify the consideration paid to or received by ITS in exchange for its granting a security interest in the collateral to Technologies, the Appellants responded:

> Ten dollars and other good and valuable consideration which included but is not limited to assumption of debt by Inter-Tel Technologies, Inc. on behalf of ITS.

(Gardner Depo., p. 85)

Mr. Gardner ordered this financing statement filed ". . . so that we could protect our security interest in assets at that location which were on the books as being owned by [ITS] as opposed to Technologies, Inc., which was the business doing business there and operating there." (Gardner Depo., pp. 83-84)

When asked if it was a true and correct statement that part of the consideration was the assumption of debt of ITS by Technologies, Mr. Gardner responded:

> It would depend on what debt. Some debt may well have been assumed. Most debt was not."

(Gardner Depo., p. 85)

Mr. Gardner described the "assumed debt" to be existing maintenance responsibility for equipment sold by ITS to customers and obligations surrounding taking care of customer accounts and their telephone systems. (Gardner Depo., p. 87) Mr. Gardner explained that Technologies had assumed certain obligations of ITS because "If you go in and you buy a business and if you don't take care of customers out there with which that business deals with, you lose that customer." (*Id.*, p. 91) Mr. Gardner noted the obligation of ITS to pay rent to Linn Station was not an ITS debt which was assumed by Technologies. (*Id.*, p. 90)

There was no written security agreement between ITS and Technologies associated with the UCC-1 financing statement. (Gardner Depo., p. 94) Mr. Gardner explained that the UCC-1 was filed to protect from creditors the interest of Technologies in the assets described in the financing

statement. (*Id.*, p. 97) Mr. Gardner further explained that Technologies[6] had a "purchase money security interest" in all inventory, equipment and accounts receivable "that are generated as a result of Technologies' efforts and interest." (*Id.*, p. 92) When asked to clarify how the purchase money security interest was created by the transfer of assets to ITS, Mr. Gardner further explained "Inter-Tel. For purposes of clarification, Inter-Tel Technologies is the operating entity at that location. . . . On the books, the books show ITS has ownership of some accounts receivable and some inventory and some fixed assets at that location. And that ownership is maintained for tax purposes and not for operating purposes." (Gardner Depo., pp. 92-93) Mr. Gardner described the "tax-purposes" as "to take advantage of the tax write-offs going forward." (*Id.*, p. 93)

Technologies had been providing assets to ITS since 1998 to take advantage of the tax benefits. (*Id.*, p. 94) However, according to Mr. Gardner, the financing statement was not prepared and filed until October, 2002 due to "oversight". (*Id.*) Mr. Gardner also admitted that even though the financing statement purported to encumber its accounts receivable, ITS had no accounts receivable after July, 1998. (*Id.*, p. 97)

Linn Station moved for summary judgment on May 24, 2005. (R. 108-110) On December 29, 2005, the trial court initially sustained Appellants' request that the issues here be arbitrated. (R. 135-145) On May 14, 2007, the trial court concluded that the order for arbitration should be vacated. (R. 158-161) Appellants appealed. On May 16, 2008, the Court of Appeals affirmed the trial court's determination that the order compelling arbitration should be vacated. (See No. 2007-CA-00185-MR) The trial court granted Linn Station's Motion for Summary Judgment on November 12, 2008. (R. 293-298) On November 20, 2009, the Court of Appeals affirmed the judgment of the trial court. This Court granted discretionary review on December 9, 2010.

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[6]In answers to written discovery given to Linn Station while it was trying to enforce the default judgment, Appellants represented that Inter-Tel had a perfected security interest in these assets. See page 3, *supra*.

ARGUMENT

I. THE TRIAL COURT PROPERLY GRANTED LINN STATION'S MOTION FOR SUMMARY JUDGMENT.

A. Standard of Review.

On appeal of a summary judgment, the standard of review is whether the circuit judge correctly found that there were no issues as to any material fact and that the moving party was entitled to judgment as a matter of law. *Barnett v. Mercy Health Partners-Lourdes, Inc.*, 233 S.W.3d 723, 726 (Ky. App. 2007). Summary judgment is proper only when "it would be impossible for the respondent to produce evidence at trial warranting a judgment in his favor." *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 480 (Ky. 1991). In ruling on a motion for summary judgment, the court is required to construe the record in a light most favorable to the party opposing the motion. *Id.* at 480. A party opposing a summary judgment motion "cannot rely on the hope that the trier of fact will disbelieve the movant's denial of a disputed fact, but 'must present affirmative evidence in order to defeat a properly supported motion for summary judgment.'" *Id.* at 481.

B. The Law of the Case Rule Bars Appellants' Argument That the 2002 Default Judgment Was Void as to Them Because They Were Not Parties to the 2002 Suit. Moreover, There Is No Requirement That a Veil-piercing Claim Against an Alter Ego Must Be Asserted in the Same Case Against the Subsidiary Corporation.

Appellants argue the default judgment entered on August 12, 2002 against ITS was void as to Inter-Tel and Technologies because they were not parties to the civil action in which the default was entered. This argument fails both procedurally and substantively.

Appellants argued in their June 8, 2007 appeal in this case that the 2002 default judgment was not binding on them because they were not parties to that action. (Appellants' Brief in their 2007 appeal is attached at Appendix A) In its opinion issued on May 16, 2008, the Court of Appeals rejected this argument. (This "2008 Opinion" is attached at Appendix B) The 2008 Opinion noted that Linn Station was not trying to enforce the default judgment on the ground that Appellants were debtors in that judgment. Rather, the Court of Appeals found that Linn Station was seeking to impose liability on Appellants in the form of equitable relief by piercing the corporate veil of ITS.

Contrary to Appellants' assertion, their argument on this point was directly addressed and rejected by the Court of Appeals in the 2008 Opinion. Appellants did not seek further review of that opinion.

In their current appeal, Appellants argued to the Court of Appeals that the trial court had ignored ". . . material issues of fact and questions of law existing in the record including how Linn Station could, with full knowledge of its potential piercing claim, file suit against only ITS, and then attempt to prevent either Technologies or Inter-Tel from asserting a defense on the merits of the underlying claim by bringing suit to pierce the veil based upon the default judgment." (Appellants' Brief, pp. 5-6)

This is essentially the same argument rejected in the 2008 Opinion. The Court of Appeals recognized that the argument "could" have been asserted in the earlier appeal. Appellants now take the position that the argument was asserted in the earlier appeal but that it was not directly addressed ". . . due to the holding that all matters relating to the merits of the case should be resolved by the Trial Court as opposed to arbitration." (Appellants' Brief, p. 6) This position is erroneous. Appellants raised two issues that were rejected in the 2008 Opinion: (1) the trial court's denial of arbitration was contrary to public policy and (2) the default judgment was void as it related to Inter-Tel and Technologies. Contrary to Appellants' claim that the Court of Appeals in 2008 only decided the first issue, the Court of Appeals decided against Appellants on both issues. Appellants' attempt to reargue the second issue here is barred from further consideration by the "law of the case" rule.

The Court of Appeals correctly held it was barred from considering the void judgment argument as a result of the "law of the case" rule. Under that rule, parties on a second appeal may not relitigate matters affecting the subject matter of the litigation which could have been introduced in support of the contention of the parties on the first appeal. *Hutchings v. Louisville Trust Co.*, 276 S.W.2d 461, 466 (Ky. 1955). The "law of the case" doctrine in Kentucky has been aptly described as follows: "The doctrine, as defined by the decisions, is that one adjudication settles all errors relied upon for a reversal, whether mentioned in the opinion of the court or not, and all errors lurking in the record on the first appeal which might have been, but were not expressly, relied upon as error."

City of Louisville v. River Excursion Co., 68 S.W.2d 792, 795 (Ky. 1934). Clearly, since Appellants now admit the argument was made in the earlier appeal, the argument is barred from consideration here. *Inman v. Inman*, 648 S.W.2d 847, 849 (Ky. 1983).

In addition to the procedural bar, Appellants' argument that the 2002 judgment is void as to them also has no substance. Appellants have concocted a new wrinkle on their "void judgment" argument from a statement in *Boles v. National Development Company, Inc.*, 175 S.W.3d 226, 251 (Tenn. Ct. App. 2005) (copy attached as Appendix C). The Court of Appeals cited *Boles* on page 7 of its Opinion for the principle that a suit against an alter ego to pierce the corporate veil in connection with a previously-obtained judgment is not a separate and independent cause of action. Appellants assert the *Boles* Court "clarifies" this statement in a footnote which Appellants interpret to mean that a corporate debtor and its alter ego must be pursued in the same action. (Appellants' Brief, p. 7) Examination of the *Boles* case and the authorities cited therein reveal the fallacy in Appellants' argument.

The portion of *Boles* on which Appellants rely addressed whether the trial court's exercise of personal jurisdiction over the non-resident individual alter ego by piercing the corporate veil met due process requirements. In affirming the exercise of personal jurisdiction over the individual alter ego, the *Boles* case cited *Matthews Const. Co., Inc. v. Rosen*, 796 S.W.2d 692 (Tex.1990) (copy attached as Appendix D).

The *Matthews* case is important here for two reasons. First, *Matthews* involved and specifically approved a second lawsuit against an alter ego brought to impose on the alter ego a previously obtained judgment. The alter ego had not been a party to the first action. *Matthews* demonstrated that a second suit against an alter ego to pierce the corporate veil in connection with a previously obtained judgment, although not a separate and independent cause of action, was still a viable suit to enforce the prior judgment. 796 S.W.2d at 693. Second, *Matthews* shows that the purpose of Footnote 4 in *Boles* (upon which Appellants boldly rely on page 7 of their brief) is to clarify that liability cannot be imposed on the alter ego unless the alter ego was a party to the action

seeking to impose that liability. "[T]he action" referred to in Footnote 4 in *Boles* is the action to pierce the corporate veil. Moreover, Footnote 4 is intended to clarify that the Tennessee courts were not following the California practice, discussed in *Matthews*, where the name of an alter ego was simply added to the judgment after the judgment was final on appeal. That California practice is not implicated here because Technologies, Inter-Tel and ITS were all parties to this action to pierce the corporate veil of ITS.

This Court should reject Appellants' claim that the August 12, 2002 default judgment cannot be enforced against them in a veil-piercing action because they were not parties to the 2002 suit against ITS.

C. The Record Clearly Supports Piercing the Corporate Veils of Technologies and Inter-Tel Under the Facts of this Case.

This Court should affirm the decisions below that the corporate veils of Technologies and Inter-Tel should be pierced. These decisions determined that these corporate parents had so united with ITS that their corporate separateness had ceased and then the parents unjustly hid behind the defunct corporate form of ITS in order to deprive Linn Station of remedies that would otherwise have been available to it had ITS not been rendered and maintained as a shell only by Appellants. The courts below further considered the fact that Appellants were maintaining ITS for "tax purposes" but not for "operating purposes" and that the effect of such treatment was to provide a financial benefit to Appellants but not to creditors such as Linn Station. Moreover, Appellants fail to show there are any issues of material fact or that the decisions below are erroneous as a matter of law.

1. Law Applicable to Piercing the Corporate Veil.

The responsibility of corporate shareholders for corporate liabilities was addressed by the Kentucky Court of Appeals in *White v. Winchester Land Dev. Corp.*, Ky. App., 584 S.W.2d 56 (1979). *White* recognized that three (3) theories had been utilized to hold shareholders responsible for corporate liabilities. These theories have been referred to as: (1) the instrumentality theory; (2) the alter ego theory; and (3) the equity formulation. *White* at 61.

The *White* case noted the three (3) elements under the instrumentality theory which must be established in order to pierce the corporate veil:

(1) the corporation was a mere instrumentality of the shareholder;

(2) the shareholder exercised control over the corporation in such a way as to defraud or harm the plaintiff; and

(3) a refusal to disregard the corporate entity would subject the plaintiff to unjust loss. *White* at 61.

These three elements must coexist before the corporate veil will be pierced under this test.

The alter ego formulation consists of two (2) elements: (1) the corporation is not only influenced by the owners, but also there is such unity of ownership and interest that their separateness has ceased; and (2) the facts are such that continuing recognition of the separate corporate existence would sanction a fraud or promote injustice.

The *White* decision acknowledged these two (2) formulations as "helpful as an analytical framework" but concluded "whether the corporate veil should be pierced depends upon the innumerable equities of each case." *White* at 62.

The *White* court summarized its assessment of the applicable law as follows:

> Because this issue depends not only on close-connectedness (which is inevitable in all closely-held businesses) but also upon such actions as would indicate unfair dealings, an examination of those other factors is mandated. (Citations omitted) Indeed, a number of factors are considered in all the cases no matter what "test" is being applied. (Citations omitted)
>
> Generally speaking, the corporate veil should only be pierced 'reluctantly and cautiously' and then only in the presence of a combination of the following factors: (1) undercapitalization; (2) a failure to observe the formalities of corporate existence; (3) nonpayment or overpayment of dividends; (4) a syphoning off of funds by the dominant shareholder(s); and (5) the majority shareholders having guaranteed corporate liabilities in their individual capacities. 1 *Fletcher's Cyclopedia of Private Corporations* ¶ 41.

584 S.W.2d at 62.

2. **The Trial Court Properly Pierced the Corporate Veil Here.**

The facts here indicate unfair dealings on the part of Appellants. ITS ceased to exist as a going concern in July, 1998. Its business, property and employees were consumed by Inter-Tel. Thereafter, when it was advantageous to Inter-Tel to perform the obligations of ITS, those obligations were performed by Inter-Tel. For example, Inter-Tel would assume obligations to the pre-July 1998 customers of ITS if that was necessary to Inter-Tel's retention of the customer's business. If the payment of rent was required for Inter-Tel to continue to receive the benefits of ITS's lease with Linn Station, Inter-Tel would pay the rent. However, when the obligations under the lease became onerous to Inter-Tel, it refused to perform, pushing ITS forward as the truly responsible but impecunious (defunct) entity. When it was inconsistent with Inter-Tel policy for ITS to have any operating funds, Inter-Tel deprived ITS (permanently) of operating funds. When sales tax reporting in Kentucky under the name of Technologies or Inter-Tel was convenient or otherwise inconsequential, those names were used. However, where Kentucky corporate tax reporting necessitated the use of the name of ITS in order to assure the ITS operating loss carryforward could take its beneficial place in the calculation of Inter-Tel's federal consolidated tax return, the name of ITS was used (after December 20, 2001).

When analyzed in the context of the five (5) factors cited in *White*, *supra*, the facts here compel the conclusion that the corporate veil of ITS should be pierced. ITS had been clearly uncapitalized since it was acquired in 1998. In fact, ITS has had no capital of its own. ITS conducted no financial transactions for its account since July 1998. ITS paid no bills. ITS had no income. ITS had no bank accounts. ITS had no employees. All rental payments under the lease since July 1998 were paid by Inter-Tel. Inter-Tel insured the leased premises. Inter-Tel and Technologies were the beneficiaries of the insurance coverage.

ITS and Technologies failed to observe the formalities of corporate existence. ITS and Technologies were asked in written discovery served in June 2003 to produce copies of the minutes of meetings of directors and shareholders of ITS taking place in 1998, 1999, 2000, 2001 and 2002.

The only documents produced were unsigned and undated copies of unanimous written consents by directors and shareholders for those years. Inter-Tel's general counsel, Mr. Gardner, said the originals were "lost". He was unable to confirm the originals were actually signed or identify anyone who could so confirm. Mr. Gardner's deposition was taken in August 2004 in Tempe, Arizona. Since that deposition, no copies of the original unanimous written consents for either ITS or Technologies evidencing the fact that they were actually signed have been produced by Appellants.

Appellants do not dispute that ITS has never paid any dividends to its sole shareholder, Technologies. (Appellants' Brief, pp. 20-21)

It is somewhat awkward to assess the question of whether Technologies and Inter-Tel "syphoned off funds" from ITS. ITS had no funds to syphon after July 1988. All funds belonged to Technologies and Inter-Tel. However, when this factor is assessed against Appellants' contention that ITS has remained a viable entity since July 1998, it is clear any value generated from the four (4) business locations previously operated by ITS was, in truth, generated by, through and for Technologies and Inter-Tel – not ITS. Certainly, ITS has received no benefit from such efforts. Any funds ITS might have earned had it been maintained as a going concern were diverted to and consumed by Technologies and Inter-Tel.

Technologies and Inter-Tel undeniably guaranteed the payment of any corporate liabilities of ITS. ITS had no money and no bank accounts. ITS could not pay and did not pay any of its corporate liabilities since July 1998. The payroll obligations to its former employees were paid by Inter-Tel. Its utility bills were paid by Inter-Tel. Its rent was paid by Inter-Tel.

The *White* case involved an attempt to pierce the veil of a corporation owned by individual shareholders. That decision recognized "It is noteworthy that the cases that apply these tests [instrumentality, alter ego and equity formulation] show that the courts have been more willing to 'pierce the corporate veil' when the defendant is a corporation that owns some subsidiary, rather than an individual controlling shareholder." (Citations omitted) *White* at 61, fn. 6.

The treatment of parent-subsidiary situations as currently addressed in *Fletcher Cyclopedia of the Law of Private Corporations* reflects the same analysis utilized in *White*:

> For purposes of piercing the corporate veil in order to hold a parent liable for its subsidiary's acts, the terms 'instrumentality", "alter ego" and "agent" are sometimes deemed equivalent and interchangeable. Many cases disregard the corporate entity where it is so organized and controlled, and its affairs are so conducted, that it is merely an instrumentality, agency, conduit or adjunct of another corporation.

Fletcher Cyc. Corp. ¶ 43.

In assessing whether the corporate veil should be pierced in a given case, courts consider whether the parent owns all of the stock of the subsidiary; whether the corporations have common officers and directors, or both; the disregard by one corporation of the normal corporate formalities in regard to the other; undercapitalization of the subsidiary; the holding out by one that the other is a department or division of the parent or that it stands behind it; whether the subsidiary's financial obligations are paid by checks drawn on the parent's bank account; whether funds earned by the subsidiary are directly deposited into the parent's bank accounts; and whether the subsidiary has it own separate bank accounts. *Id.* In this case, all these factors weigh in favor of piercing the veil.

As these facts undeniably demonstrate, ITS has been used by Inter-Tel and Technologies as an expedient and chamelonic entity which assumes whatever form or structure might be most advantageous to those parents' current circumstances. For example, ITS was portrayed as a defunct corporation with no assets by Mr. Gardner in May, 2002 when Linn Station demanded compliance with the terms of the lease. Mr. Gardner took the same position in declining to participate in an arbitration proceeding filed by Linn Station regarding certain claims under the lease. Mr. Gardner testified, however, that he learned prior to October 8, 2002 that ITS "had book assets for tax purposes." (Gardner Depo., p. 109) At that point, Mr. Gardner caused the UCC-1 financing statement to be prepared and filed. His purpose was to protect the assets of ITS from creditors. However, he admitted those assets were maintained in the name of ITS for "tax purposes" and not for "operating purposes." (*Id.*, p. 93) He also admitted that some of the collateral described in the

financing statement did not belong to ITS at all, *i.e.*, accounts receivable. On November 6, 2002, Mr. Gardner signed an affidavit in support of a motion to quash a subpoena issued in the first lawsuit in which he again swore that ITS was a defunct corporation. (Plaintiff's Memo, Exh. 4) On March 12, 2003, ITS served an answer to a document request in the first lawsuit seeking documents showing the transfer of any assets by ITS subsequent to July 2, 1998. ITS answered the request as follows:

> No such documents exist. Any 'assets' that existed during the time period from July 2, 1998 through the present were consumed as a result of the normal course of business and/or winding up of business transactions. Any 'assets' currently held by ITS are carried in the name of ITS for tax purposes only and have been supplied by Inter-Tel Technologies and are subject to a perfected security agreement.

(Sherman Depo., p. 66)

Fairly translated, this answer says that any assets ITS owned in July, 1998 had long ago been used and consumed in the ordinary course/winding up of business. The only assets owned currently by ITS are only "owned" by ITS for tax purposes. These assets were supplied by Technologies and are encumbered by a chattel mortgage in favor of Technologies. A UCC financing statement was filed to support "a perfected security interest" in Inter-Tel Technologies, Inc. (Plaintiff's Memo, Exh. 5)

Subsequent discovery disclosed there is no security agreement, perfected or otherwise, between ITS and Technologies.[7] Discovery also disclosed no ITS except in the form of a shell which exists on paper only for tax purposes.

Piercing the corporate veil of ITS in the circumstances is supported by the decision in *Collett v. American Nat'l Stores, Inc.*, 708 S.W.2d 273 (Mo. App. 1986). *Collett* involved the abandonment after four years of a twenty-five year lease by a grossly undercapitalized corporate subsidiary. The parent was held liable for the subsidiary's breach of the lease. The court concluded the veil of the subsidiary should be pierced because (1) the parent so completely controlled the subsidiary with

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[7]A valid security agreement requires "authentication" by the debtor. KRS 355.9-203(2)(c)(1). The UCC financing statement is unsigned.

respect to the transaction attacked that the subsidiary at the time had no separate mind, will or existence of its own; (2) the control was used by the parent to perpetuate an unjust act in contravention of plaintiff's legal rights; and (3) the control and breach of duty proximately caused the injury or unjust loss complained of. *Id.* at 283.

The court in *Collett* noted that control by the dominant corporation alone was insufficient to pierce the corporate veil. 708 S.W.2d at 286. An additional finding of improper use of that control was necessary. Examples of such improprieties that would satisfy the standard included actual torts, violations of statutory duties, undercapitalization or the stripping of assets from the servient corporation. The *Collett* court found the gross undercapitalization of the subsidiary constituted an improper use of control by the parent.

> Making a corporation a supplemental part of a [sic] economic unit and operating it without sufficient funds to meet obligations to those who must deal with it would be circumstantial evidence tending to show either an improper purpose or reckless disregard of the rights of others.

Collett at 287 quoting *May Dep't Stores v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 55 (1937).

The court also determined that proximate cause was established where the action of the parent corporation renders the subsidiary insolvent. *Id.*

Considering that all relevant factors to be evaluated in a corporate veil piercing analysis supported its actions, the trial court properly pierced the corporate veil of ITS and held Technologies and Inter-Tel liable for the default judgment of August 12, 2002. The decision of the trial court was properly affirmed by the Court of Appeals.

3. **The Corporate Veil of Inter-Tel May Be Pierced With or Without First Piercing the Veil of Inter-Tel Technologies.**

Appellants argue generally against the allowance of veil-piercing actions against grandparent corporations. Appellants also argue more specifically the corporate veil of a grandparent corporation cannot be pierced unless the corporate veil of the parent corporation sequentially is pierced first. Appellants cite no authority in support of either proposition. These arguments not only ignore the

reality here that the corporate veil of ITS was properly pierced as to both Inter-Tel and Technologies under the circumstances, but also ignore the fact that the Court of Appeals was correct in concluding ". . . the case law of other jurisdictions is replete with examples of piercing actions against grandparent holding companies." (Opinion, p. 16)

Appellants attack the three cases[8] cited by the Court of Appeals as examples of this principle. These attacks are without merit. None of the three cases contain any indication that the corporate veil of a grandparent holding company cannot be pierced or that the corporate veil of the parent must be pierced first. Moreover, there are a number of other authorities approving the piercing of the grandparent's veil. None of these authorities impose or suggest any requirement that the corporate veil of the parent be pierced first.

The corporate veil of the grandparent and parent were both pierced in *United Rubber, Cork, Linoleum and Plastic Workers of America, AFLCIO v. Great American Industries, Inc.*, 479 F. Supp. 216 (S.D.N.Y. 1979). In that case, plaintiff/union had a collective bargaining agreement with Linear, Inc. Linear, Inc. was owned by Rubatex Holding Corporation, a wholly owned subsidiary of Rubatex Corporation. Rubatex Corporation was a wholly owned subsidiary of Great American Industries, Inc. The trial court found Linear, Inc. was unable to perform its obligations to the plaintiff/union under the collective bargaining agreement because its parent and grandparent exercised total control and domination over Linear to continually increase Linear's debt to the grandparent and parent while systematically stripping Linear of what few assets it possessed. The court pierced the corporate veil of the parent and grandparent holding them liable for Linear's obligation to the plaintiff/union under the labor contract. The court concluded ". . . the whole process was orchestrated by Great American, and for its benefit, through the efforts of Rubatex and Rubatex Holdings." 479 F. Supp. at 245.

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[8] *Milford v. Commercial Carriers, Inc.*, 210 F. Supp. 2d 987 (N.D. Ill. 2002); *Brown v. Advantage Engineering, Inc.*, 732 F. Supp. 1163 (N.D. Ga. 1990); and *Hando v. PPG Industries, Inc.*, 771 P.2d 956 (Mont. 1989).

Gorrill v. Icelandair/Flugleidir, 761 F.2d 847 (2nd Cir. 1985) involved wrongful employment termination claims against an employer/subsidiary coupled with a claim to pierce the corporate veil of the subsidiary's grandparent, Iceland Air. The Second Circuit affirmed the trial court's piercing of the corporate veil of the grandparent. The Second Circuit noted in its opinion that the corporate parent, Hekla Holdings, Ltd., was not a party in the trial court and took no part in the transactions at issue. 761 F.2d at 849 n.1. Nevertheless, the corporate veil of the grandparent was pierced in this case without the parent even being a party to the action.

In re Cambridge Biotech Corporation, 186 F.3d 1356 (Fed. Cir. 1999), involved the Federal Circuit Court of Appeals affirming the trial court's piercing of the corporate veil of a grandparent to effectively enforce a sublicensing agreement where the sublicensing rights were actually owned by a subsidiary of a subsidiary of the grandparent corporation.

In *Uebelacker v. Paula Allen Holdings, Inc.*, 464 F. Supp. 2d 791 (W.D. Wisc. 2006), plaintiff asserted defamation, breach of contract and fraudulent misrepresentation claims against Allen & Associates, a wholly owned subsidiary of Workstream U.S.A., Inc., which was a wholly owned subsidiary of Workstream, Inc. The parent and grandparent filed a motion to dismiss the complaint because there was no allegation of any interaction between plaintiff and either the parent or the grandparent corporation. The motion was denied on the basis that the plaintiff's allegations illustrated a link among the defendants from which it was reasonable to infer that the parent corporations may have exerted some control over their subsidiary.

In addition to the authorities relied upon by the Court of Appeals, these authorities reflect that the corporate veil of a parent or grandparent of a wholly owned subsidiary of both may be pierced using the same standards applicable in any veil-piercing action. There is no authority supporting Appellants' claimed requirement of sequential piercing. Moreover, there was sufficient evidence to support piercing the corporate veil of Technologies as well as the corporate veil of Inter-Tel in this case.

The Court of Appeals noted Technologies functioned as the operating entity of ITS. (R. 17) (Opinion) Appellants claim Technologies never functioned as the "operating entity" of ITS but that Technologies was the operating entity itself. (Appellants' Brief, p. 15). This claim ignores (1) the tax amnesty application filed in September 2002 in the name "Integrated Telecom Services, Inc. d/b/a Inter-Tel Technologies"; (2) the testimony of Inter-Tel's tax manager, Susan K. Sherman, that ITS was continued as a separate operating unit doing business as Technologies; and (3) numerous tax reportings to the Commonwealth of Kentucky were made in the name of ITS. Moreover, the Court of Appeals properly found that Technologies owned all the stock of ITS, had officers and directors in common with ITS, Technologies failed to offer any evidence that it had followed corporate formalities and ITS and Technologies appeared to be interchangeable when filing state tax returns.

4. A Showing of Fraud or Criminal Acts is Not Required in Order to Pierce the Corporate Veil

Kentucky law does not require, as Appellants suggest, the presence of fraud or criminal conduct in order to permit a court to pierce the corporate veil. Although such conduct should certainly encourage disregard of the corporate entity, the corporate veil also may be pierced in Kentucky if a refusal to do so would subject the plaintiff to unjust loss or promote injustice. *White, supra*, pp. 61-62.

The cases cited by Appellants of *Poyner v. Lear Siegler, Inc.*, 542 F.2d 955 (6th Cir. 1976) and *American Commercial Lines, Inc. v. Ostertag*, 582 S.W.2d 51 (Ky. App. 1979), both were decided prior to the *White* case which sets forth the law on corporate veil piercing in Kentucky. Another of Appellants' cited cases, *Thompson v. Quorum Health Resources, LLC*, 2007 WL 2815972 (W.D. Ky. 2007), does not involve the application of any Kentucky law at all.

Moreover, neither *Poyner*, *Ostertag* or *Thompson* involved facts similar to those here. In *Poyner*, the court noted that although the parent bought all the stock of the subsidiary ". . . there is no suggestion that [subsidiary's] operations were altered in any material respect." 542 F.2d at 960.

In *Ostertag*, the court found "[T]here is no evidence that [parent] exercised its control as the sole stockholder of [subsidiary] to frustrate recovery for injuries to barge employees regardless of the merits of their claims. The record further revealed that [subsidiary] had its own bank accounts, issued its own financial statements, operated out of its own offices and negotiated its own labor contracts." 582 S.W.2d at 53. In *Thompson*, the trial court granted defendant's motion to dismiss based upon the insufficiency of allegations on the face of the complaint. "Plaintiff alleges none of the traditional conditions for piercing the corporate veil . . .". 2007 WL 285972. These cases are not helpful to Appellants here.

The Kentucky Court of Appeals recently decided that manipulation of the corporate form which limited the corporation's ability to respond to plaintiff's damage claim was sufficiently "unjust" conduct to justify piercing the corporate veil. *Thomas v. Brooks*, 2007 WL 1378510 (Ky. App. 2007); accord *Collett, supra*. The repeated assertions by Appellants that Linn Station must prove fraud in order for the court to pierce the corporate veil of ITS are simply not true.

Sonora Diamond Corp. v. Superior Court, 99 Cal. Rptr. 2d 824 (Cal. App. 2000) is cited by Appellants for the principles that neither (1) the contribution of funds by a parent to a subsidiary nor (2) difficulty in enforcing a judgment against the subsidiary merit veil piercing. However, unlike the present case, the facts in *Sonora* actually supported the California court's application of these principles. There, the subsidiary had its own bank account and employees. The funds loaned were in fact provided to the subsidiary. Moreover, in *Sonora*, there was no evidence of injustice flowing from recognition of the separate corporate identity of the subsidiary and a creditor's inability to collect a debt, without more, was insufficient evidence of injustice. There is ample evidence of injustice in the instant case.

Appellants extract statements from *Folger v. Cottle*, 2002 WL 414339 (Cal. App. 2002) and *Haywood v. Louisiana Sugar Cane Products*, 692 So. 2d 524 (La. App. 1997) to the effect that difficulty in enforcing or collecting a debt does not support piercing the corporate veil and some

conduct amounting to bad faith must be shown. These cases are distinguishable on their facts as neither involved the manipulative control over a subsidiary as was exercised here.

Appellants cite *In Re Rave Communications, Inc.*, 138 B.R. 390 (S.D.N.Y. 1992) which held that under New York law merely pleading that an entity had insufficient assets to pay a claim does not state a cause of action to pierce the corporate veil. This result is neither surprising nor helpful to Appellants given the extensive record of manipulation and injustice here.

Finally, Appellants argue Linn Station has not been subjected to an unjust loss because Linn Station knew ITS was defunct when it obtained the default judgment. Appellants also argue Linn Station's loss was not unjust because Linn Station knew ITS was not an operating entity and did nothing to protect itself. These are red herrings, indeed. There is no evidence that Linn Station knew ITS was not an operating entity. The 2002 letter from Linn Station's counsel to Technologies and ITS requested a Tenant Estoppel Certificate that showed ITS as the tenant, not Technologies. That certificate was ultimately signed by John Gardner, General Counsel of Inter-Tel, as Vice President of ITS. Linn Station was not informed about ITS being a "defunct" corporation until Mr. Gardner's letter of May 21, 2002, which was sent after ITS had defaulted in the performance of its lease obligations. Of course, Linn Station was <u>later</u> advised by Gardner that ITS was <u>not</u> a defunct corporation with no assets.

Prior to May 2002, the rent under the lease was being timely paid. Appellants' assertion that Linn Station should have pursued a lease assignment or a guaranty from ITS's parents is undercut by the fact that, while the lease was being performed, there was no basis to seek either an assignment or a guaranty.[9]

The unjust loss here resulted from the improper use of the control exercised by Technologies/Inter-Tel over ITS to cause it to breach its lease while knowing ITS would not be able

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[9]Appellants suggest that Linn Station sought a guaranty from ITS's parents, which request was denied. (Appellants' Brief, pp. 21-22) Appellants apparently interpret the format of the "Tenant Estoppel Certificate" as a "request" for a guaranty. This is incorrect. The Tenant Estoppel Certificate at ¶ 11 asks that all guarantors of the lease be identified. There were none. Asking the tenant to sign that form cannot fairly be construed as a request for a guaranty.

to respond in damages (a condition specifically caused by the parents). Their control was used improperly because Technologies/Inter-Tel presented and used ITS as an operating and responsible entity when it suited their purposes to do so. Technologies/Inter-Tel continued this presentation and use of ITS even after they had deprived ITS of all economic substance. However, when the presentation and use of ITS as an operating and responsible entity did not suit their purposes, Technologies/Inter-Tel presented ITS as "a defunct corporation with no assets." This manipulation of ITS continued into the fall of 2002 when John Gardner caused a UCC-1 financing statement to be prepared describing ITS as the "debtor" and Technologies as the "secured party," implying ITS had rights in property it could convey to Technologies. Perhaps the most outrageous evidence of the injustice in these circumstances is Mr. Gardner's description of ITS's property interests in the fall of 2002 as being maintained for "tax purposes" and not for "operating purposes." (Gardner Depo., pp. 92-93) In other words, Technologies/Inter-Tel could derive financial benefits from ITS but creditors could not. Such hocus-pocus clearly justifies piercing the corporate veil.

Appellants claim piercing the veil of ITS to reach Inter-Tel is improper. (Appellant's Brief, p. 5) This argument ignores the pervasive control exercised directly by Inter-Tel over the activities of ITS. The argument further ignores the significant body of case law from other jurisdictions, discussed above, that approve the piercing of the grandparent's veil.

Kentucky law also recognizes that subsidiaries may lose their independent identity by reason of exceptional integrated business relationships. *Square D Co. v. Kentucky Bd. of Tax Appeals*, 415 S.W.2d 594 (Ky. 1967). The intermingled character of the relationship between Inter-Tel, Technologies and ITS also justifies ignoring their separate corporate identities and treating the independent corporations as a unitary business. Contrary to the claim that Technologies owned all stock in ITS, Inter-Tel also held itself out as the owner of 100% of the voting stock of ITS. (Gardner Depo., Exh. 15) Mr. Gardner had testified that ITS was a subsidiary of Technologies. (*Id.*, p. 4) However, when confronted with Exhibit 15 to his deposition (an exhibit to Inter-Tel's 2002 SEC Form 10-K) (a copy of Exh. 15 is attached at Appendix E) stating Inter-Tel owned 100% of the stock

of ITS, Mr. Gardner, counsel for Inter-Tel and ITS, explained that "on the books," ITS was a subsidiary of Technologies "[B]ut by legal terms, a sub of a sub is also a sub of a parent." (*Id.*, p. 127) All these corporations were completely intermingled by their own conduct which merits piercing the corporate veil of ITS with respect to both Technologies and Inter-Tel.

CONCLUSION

The actions of Technologies and Inter-Tel left ITS an empty shell, devoid of substance to satisfy the demands of its creditors. This was the culmination of a course of conduct which made it impossible for ITS to operate and satisfy its obligations. This unfair conduct is exactly the kind of abuse of the corporate form that corporate veil piercing principles are intended to prohibit. ITS was completely undercapitalized, its owners did not observe corporate formalities, it paid no dividends, made no profit, had no employees and no bank accounts, its assets were nonexistent (for "tax purposes" only), its lease with Linn Station was used by the parents as their own, it was insolvent at the time of the breach of the lease, and its parents (selectively) paid all of its bills. Coupled with the fact that the parents continued to reap financial benefit from the theoretical existence of ITS while unjustly restricting its ability to respond in damages to Linn Station, all of these factors weigh heavily in favor of piercing the corporate veil of ITS and holding both parents liable for the default judgment of August 12, 2002. *White, supra*; *Thomas v. Brooks, supra.* The totality of such conduct justifies piercing the corporate veil.

The trial judge correctly found that there were no issues as to any material fact and that Linn Station was entitled to judgment as a matter of law. The Court of Appeals properly affirmed the trial court's order that the corporate veil (shell) of ITS be pierced, holding Technologies and Inter-Tel

liable for the August 12, 2002 judgment in favor of Linn Station against ITS. This honorable Court should affirm as well for the multitude of reasons shown.

This 8th day of April, 2011.

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