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PERSONAL LIABILITY REGARDING TAXATION OF KENTUCKY CORPORATIONS: RESPONSIBLE PERSON OBLIGATIONS UNDER THE IRC AND THE KRS

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I. INTRODUCTION

The public’s attention and, as often, indignation, are turned toward the corporate world. In an era of soaring corporate bankruptcy rates and federal bailouts, the focus is on corporate fiscal responsibility and accountability of corporate officers. Because of the limited liability principles of American corporate law, however, corporate officers sometimes escape liability for their irresponsible and imprudent decisions. Instead, the corporation, as an independent legal entity, assumes responsibility for the officer’s actions, and corporate funds and assets are utilized to pay litigation expenses and damages. Imprudent or irresponsible decisions that lead to a corporation’s legal woes often also lead to the responsible officer’s resignation or retirement—and payment of a generous severance package.¹

Despite the presence of the “corporate veil,”² the Business Judgment Rule³, and exculpation clauses⁴ protecting corporate officers from personal liability

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¹ See, e.g., Bob Herbert, Working Harder for the Man, N.Y. TIMES, Jan. 8, 2007, at A19. This article details the trend of inflated executive and managerial compensation, including astronomical severance packages. These severance packages are referred to as “golden parachutes,” and can rival what an average American would earn in ten lifetimes. Id. Among these “golden parachute” severance packages, Robert L. Nardelli, the chairman and chief executive officer of Home Depot, received $210 million to “take a hike.” Id. The article also poses the question: “What would Nardelli have been worth if he’d done a good job?” Id.

² The corporate veil is “[t]he legal assumption that the acts of a corporation are not the actions of its shareholders, so that the shareholders are exempt from liability for the corporation's actions.” BLACK’S LAW DICTIONARY 390 (9th ed. 2009). Thus, piercing the corporate veil is “[t]he judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts.” BLACK’S LAW DICTIONARY 1264 (9th ed. 2009).

³ The Business-Judgment Rule is the legal “presumption that in making business decisions not involving direct self-interest or self-dealing, corporate directors act on an informed basis, in good faith, and in the honest belief that their actions are in the corporation's best interest.” * The rule shields directors and officers from liability for unprofitable or harmful corporate transactions if
arising from the claims of most civil plaintiffs, corporate officers are hard-
pressed to escape liability when the civil plaintiff is the Internal Revenue Service
(“IRS”) or the Kentucky Department of Revenue (“DOR”).

The individual corporate entity, like any individual in the U.S., faces certain
state and federal tax liabilities. When particular federal and state corporate tax
obligations go unpaid, both the Internal Revenue Code (“IRC”) and the
Kentucky Revised Statutes (“KRS”) place personal responsibility on certain
individuals affiliated with the corporation. The person held liable for unpaid
taxes is known as the “responsible person.”

Though the IRC and KRS both describe “responsible persons” as they relate
to unpaid corporate taxes, the statutory language of each expresses different
standards and factors for identifying who the responsible person is. Likewise,
federal courts and Kentucky state courts have interpreted the enforcement of
these statutes differently. This means that if a Kentucky corporation has both
unpaid state and federal taxes, different individuals in the corporation could be
held personally liable for the respective unpaid taxes. Not only do the statutes
hold different people responsible, they also have differing standards and burdens
of proof.

This article seeks to identify the different means by which the IRC and KRS
identify responsible individuals for unpaid tax purposes and analyzes the reasons
for such differences. Its focus is on “trust fund” liability cases. Thus, it contains
information for any Kentucky corporate officer or practitioner who wishes to
better understand the intricacies of the IRC’s and KRS’s policies regarding
unpaid trust fund taxes, and particularly, how federal and Kentucky state courts
have ruled on past “trust fund” liability cases. Part II of the article reviews the
IRC’s standards for identifying a responsible person and related issues. Part III

4. An exculpatory clause is a contractual provision, often found in corporate officer
employment agreements, “relieving a party from liability resulting from a negligent or wrongful
act . . . the clause may reduce the degree of care and prudence required of the fiduciary.” BLACK’S
LAW DICTIONARY 648 (9th ed. 2009).

5. Responsible Person and Lender Liability for Trust Fund Taxes – Sections 6672 and 3505,
Trust Fund Taxes] (citing Vinick v. Comr., 110 F.3d 168 (1st Cir. 1997)) (“Thus, §6672 is
intended to allow the IRS to pierce the corporate veil to reach persons responsible for the payment
of withheld taxes.”).

6. See I.R.C. § 6672 (2006); KY. REV. STAT. ANN. § 139.185; 141.340; 142.357; and 143.085
(West 2010).
7. See Ronald Michael Meneo, Responsible Person Obligations Under IRC §6672 Versus the
Employee’s Duty to Obey. 2 DEPAUL BUS. L.J. 325, 325 (1989-1990). See also In re Mando, 154
B.R. 953 (Bankr. E.D. Ky. 1993) (detailing the facts considered in determining whether an
individual is the “responsible person” who can be held liable for willfully failing to pay over
corporate withholding taxes).
8. See supra note 7.
II. FEDERAL TAXATION

A. The Trust Fund and Statutory Language

In order to explore the tax liability of corporate officials under federal law, we must conduct a brief survey of corporate officials’ duties and responsibilities under the IRC. The IRC requires corporations to withhold certain taxes from employee wages. 10  These withholdings include income taxes, 11 properly calculated Federal Insurance Contribution Act (“FICA”) (i.e., Social Security) benefits, 12 and Medicare (i.e., Hospital Insurance). 13 IRC § 7501(a) defines the corporation’s duty to withhold as follows:

Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose. 14

Consequently, both practitioners and courts often refer to these taxes as “trust funds” 15 because the corporation is said to be holding the funds in trust for the United States. 16 The employer’s only real duty though is to make sure that the taxes that are being withheld are paid to the federal government when remittance is due. 17 There is no requirement to establish an actual separate account; corporate employers are under no duty to keep these funds separate from normal operating funds. 18 As a result, the withheld funds, or trust funds become a tempting source of cash. A struggling corporation may be lured to

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11. Id.
15. Section 6672 liability has many aliases and is commonly referred to as the “100% penalty,” the “responsible person penalty,” the “trust fund penalty,” the trust fund recovery penalty,” or the “6672 penalty.” Responsible Person – Trust Fund Taxes, supra note 5, at A-3.
16. See Meneo, supra note 7, at 325 n. 1 (citing Gephart v. United States, 818 F.2d 469, 472 (6th Cir. 1987) referring to the taxes as “trust fund taxes”); Mazo v. United States, 591 F.2d 1151, 1153 (5th Cir. 1979) (referring to the taxes as “trust funds”).
17. See Gephart v. United States, 818 F.2d 469, 472-73 (6th Cir. 1987) (referring to the taxes as “trust fund taxes” which must be paid over to the government)
withdraw from funds reserved for federal tax payments when other operating funds are exhausted.19

B. Personal Liability

Because the law views a corporation as a legal individual, the IRS often first seeks to collect unpaid taxes from the corporation itself.20 By the time of the attempted collection, a struggling corporation may have already declared bankruptcy, become defunct, or lack funds available to satisfy the unpaid tax liabilities.21 To deal with this problem, Congress equipped the IRS with a mechanism to impose a penalty22 on individuals associated with the corporation in lieu of collecting the unpaid trust fund amount directly from the corporation.23 IRC § 6672 states:

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall . . . be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over . . . .24

This statutory language implies that two conditions must be met for an individual to be held liable under § 6672: (1) the individual must be a “responsible person” required to collect, account for, and pay over taxes; and (2) the individual must “willfully” fail to perform this duty.25 The United States Supreme Court held that a responsible person may be held “100% liable” for the unpaid tax if such person willfully fails to perform any one of the duties listed in the statute.26 It should be noted that Section 6672 applies only to third party taxes, which are taxes imposed on a person other than the person required to collect, account for and pay over such taxes.27 Section 6672 penalties do not apply, and personal liability does not arise for a failure to pay taxes levied directly against the corporation, such as the federal unemployment tax.28 The

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19. Id. at 906 (citing Purdy Co. of Ill. v. United States, 814 F.2d 1183, 1185 (7th Cir. 1987)).
20. However, there is no requirement for the IRS to collect from the corporate entity first. Responsible Person – Trust Fund Taxes, supra note 5, at A-5.
21. Id.
22. For practical purposes, penalties under §6672 are taxes based on delinquent amount and no further penalty is levied. See e.g., Kelly v. Lethert, 362 F.2d 629, 633 (8th Cir. 1966) (“Although §6672 denominates this liability as a ‘penalty’ it is well settled that it is, in substance, a tax.”).
23. Responsible Person – Trust Fund Taxes, supra note 5, at A-66 (§1308(c) of the Federal Revenue Act was revised in 1954 resulting in what is known today as §6672).
25. Id.
28. I.R.C § 3301 (2006). A seeming exception to this third-party rule is I.R.C. § 4103, which imposed personal liability in regard to the payment of certain fuel related taxes. See Corporate
statutory language thus gives rise to two open questions concerning personal liability, which are: (1) who is a corporation’s “responsible person” as defined by IRC §6672; and (2) what constitutes a “willful” failure to perform IRC § 6672 duties?

The IRC attempts to identify the responsible person in § 6671(b):

> The term ‘person’ as used in this subchapter, includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.29

Though this definition offers some guidance, it is often too general to define any one specific person. In fact, §6671(b) often raises more questions than it answers. For example, the task of maintaining the corporate trust fund and paying relevant FICA taxes required by the IRC is often entrusted to more than one individual.30 Additionally, Kentucky corporations come in many shapes and sizes, and no two operate exactly the same. Thus, it is hard to identify one bright-line rule based on statutory language that defines “responsible person.” An additional question raised is what constitutes “willfully” failing to collect taxes or truthfully account for such taxes.

Several federal circuits have held that the IRS bears the initial burden of proving that the taxpayer is a responsible person, and once established the taxpayer then bears the burden to prove that the failure was not willful.31 The Sixth Circuit has adopted this view holding that “[o]nce the IRS introduces a presumptively correct tax assessment, the burden of proof shifts to the taxpayer to prove by a preponderance of the evidence that he or she was not a responsible person who willfully failed to pay the withheld taxes to the IRS.”32

1. Responsible Person Case Law

Since § 6672’s promulgation, federal courts have broadly interpreted “responsible persons.” General, an individual is a “responsible person” under § 6672 if vested with the authority to direct (or avoid) the payment of the

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31. See e.g., Responsible Person – Trust Fund Tax, supra note 5, at A-18 (citing Stettler v. United States, 98-1 USTC ¶50,136 (10th Cir. 1998) (unpub. op.); Malloy v. United States, 17 F.3d 329 (11th Cir. 1994); United States v. Running, 7 F.3d 1293 (7th Cir. 1993); Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979)).
32. In re Noranha, 382 B.R. 363, 375 (Bankr. W.D. Ky. 2007) (citing McDermitt v. United States, 954 F.2d 1245, 1251 (6th Cir. 1992); Collins v. United States, 848 F.2d 740, 742 (6th Cir. 1988); Gephart v. United States, 818 F2d 469, 473 (6th Cir. 1987); United States v. Molitor, 337 F.2d 917, 922 (9th Cir. 1964)).
employer’s creditors.\textsuperscript{33} “The statutory definition of the word person is broad and is not limited to acting officers or directors of a corporation.”\textsuperscript{34} In Kentucky and across the nation, the IRS successfully uses § 6672 to penalize business owners, corporate officers, board members, bookkeepers, and accounts payable persons.\textsuperscript{35} The IRS even uses § 6672 to penalize individuals outside the corporation, including lenders, creditors, sureties, accounting firms, and prospective purchasers of ongoing businesses.\textsuperscript{36}

\textit{Johnson v. United States}\textsuperscript{37} highlights the Sixth Circuit’s current test for identifying a responsible person. In this case, Johnson was the president and chief executive officer of N & T Security, Inc.\textsuperscript{38} Johnson sought to recover certain penalties and interest assessed against him by the IRS for his connection with the corporation’s unpaid Social Security taxes and federal withholding taxes.\textsuperscript{39}

In defining the responsible person, the Johnson Court reaffirmed the Sixth Circuit’s Braden test,\textsuperscript{40} which provides that “the question of whether a \textit{trust fund penalty} . . . has been properly asserted depends upon (1) whether the taxpayer has the \textit{authority} over the corporation’s decision to pay or not to pay taxes which are at issue, and (2) whether he had the \textit{knowledge} of the tax delinquency.”\textsuperscript{41}

The court also identified the following factors as helpful in identifying a responsible person:

(1) The duties of the officer as outlined by the corporate by-laws.
(2) The ability of the individual to sign checks of the corporation.
(3) The identity of the officers, directors and shareholders of the corporation.
(4) The identity of the individuals who hired and fired employees.
(5) The identity of the individuals who were in control of the financial affairs of the corporation.\textsuperscript{42}

\begin{footnotes}
\item[33] Meneo, supra note 7 at 325. See also Franklin v. Revenue Cabinet, No. K91-R-35 (Ky. B.T.A. November 14, 1994) (holding the secretary of the company liable for the withholding tax owed).
\item[34] In \textit{re Noranha}, 382 B.R. at 374 (citing Mueller v. Nixon, 479 F2d 1348, 1350-51. (6th Cir. 1972)).
\item[36] See id. at A-16. For further reading on when persons other that owners, directors, and officer liable for penalties under §6672, see 84 A.L.R. FED. 170 (1987).
\item[38] Id. at 127.
\item[39] Id. at 127-128.
\item[41] Johnson, 583 F. Supp. at 129 (emphasis added). See also Kinnie v. United States, 994 F.2d 279, 282-83 (6th Cir. 1993); McDermitt v. United States, 954 F.2d 1245, 1250 (6th Cir. 1992); Gephart v. United States, 818 F.2d 469, 473 (6th Cir. 1987).
\item[42] Johnson, 583 F. Supp. at 129.
\end{footnotes}
Additionally, the Johnson court held that more than one person may qualify as a responsible person and that signing the employer quarterly report is a significant factor in finding one to be a responsible person. Finally, the court held that the responsible person need not be responsible for the final word on the payment of bills and taxes.

Using the above test, the court weighed the relevant factors and concluded that the corporation’s majority stockholder controlled N & T’s financial affairs and only delegated some of his control to Johnson. However, to Johnson’s detriment, the court found it relevant that he, as “the President of any corporation, had the ability to sign checks, was an officer and director of the corporation, and was a putative but not an actual stockholder.” Additionally, the court found that Johnson had decision-making powers regarding the hiring and firing of certain employees.

Although Johnson argued he never had the responsibility to pay corporate taxes and that he was a figurehead with no real authority, the court held that he was a responsible person. The court emphasized that § 6672(a) looks only to responsible persons and not the most responsible person. Thus, the fact that the majority shareholder may have been a more responsible person than Johnson did not relieve Johnson from liability under § 6672.

The Johnson court also stated that a valid “responsible person” claim could have been brought against the corporation’s majority shareholder. Allowing for multiple responsible persons risks unfairly penalizing someone who lacked the power to make the call about the taxes at issue. The Fifth Circuit has addressed this risk when it held that “[t]he rationale for the broad net of §6672 responsibility serves a valuable prophylactic purpose: it encourages officers, directors and other high level employees to stay abreast of the company’s withholding and payment of employee’s taxes.” Given the Johnson ruling, the Sixth Circuit likely would agree with the Fifth Circuit’s rationale.

43. Id.
44. Id. at 130.
45. Id.
46. Id.
47. Id.
49. Id. at 129.
50. Id. at 131 (citing Howard v. United States, 711 F.2d 729, 737 (5th Cir. 1983)). See also Gephart v. United States, 818 F.2d 469, 473(6th Cir. 1987) (holding §6672(a) provides that “any person” required to collect taxes and willfully fails to account for and pay over them is personally liable for the total amount not paid to the government).
51. Id.
2. Willfulness Requirement

The finding that an individual is a “responsible person” is only one of the two requirements for an individual to be held liable under §6672. The court must also find that the individual willfully failed to collect or truthfully account for and pay over the withheld tax in question. Federal courts have found that a responsible person acts willfully in two instances: first, when he deliberately chooses to voluntarily and intentionally pay creditors other than the government; or second, when he acts with reckless disregard of known or obvious risk that the taxes may not be remitted to the government.

The Johnson court addressed the question of willfulness after it established that Johnson was a responsible person. In Johnson, the court reaffirmed the test for willfulness established in Braden:

[I]f the plaintiff has the power and responsibility to pay accruing employment taxes of the corporation and fails to do so, at a time when he preferred other creditors over the United States, he is then ‘willful’ in his failure to pay the taxes, despite any lack of malicious or wrongful purpose.

The court also expressly adopted the Fifth Circuit’s test for willfulness established in Howard v. United States:

[W]here a responsible person has knowledge of payments to other creditors, after he was aware of the failure to pay withholding taxes, that fact alone constitutes grounds sufficient for summary judgment on the question of willfulness.

Using these two tests, the U.S. District Court of Western Kentucky found that Johnson was aware of the corporation’s failure to pay taxes for the first quarter of 1978 as early as April 20 of that year. Although he was assured by the majority stockholder that the taxes would be paid, Johnson, in his role as President of the corporation, took no steps to insure that the taxes were paid. Thus, after applying the abovementioned tests, the court found Johnson met the §6672 willful requirement because he should have been aware of the failure to pay in his capacity as the President of the corporation, despite the lack of evidence that Johnson definitely knew the trust fund taxes went unpaid.

53. Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979).
54. Id.
57. Id. (citing Braden v. United States 442 F.2d 342, 344 (6th Cir. 1971)).
58. Howard v. United States, 711 F.2d 729 (5th Cir. 1983).
60. Id.
61. Id. at 131.
62. Id.
A federal court sitting in Kentucky also addressed the willfulness issue and provided further clarification regarding mental state and culpability in In re Noronha.63 In this case, the United States Bankruptcy court held that:

The “willfulness” element under 26 U.S.C. §6672 is present “if the responsible person had knowledge of the tax delinquency and knowingly failed to rectify [the delinquency] when there were available funds to pay the government.” The debtor need not have acted with an intent to defraud under §6672; a decision to use company funds to pay debts owed to other creditors instead of paying the withholding taxes due to the IRS constitutes a “willful failure to pay” under the statute.64

On appeal, the Sixth Circuit stated that Noronha’s “deliberate choice to voluntarily, consciously, and intentionally pay other creditors rather than make tax payments” supported a finding of willful failure.65

Despite Noronha’s protests, the Bankruptcy and Appellate Courts found that she had willfully failed to pay taxes due for the corporation partly because of the proof submitted by the IRS that Noronha accepted checks from the corporation.66 This “establish[ed] that there were some funds available to pay the delinquency,” and Noronha chose to use the funds for purposes other than paying debts owed to the government.67 The Sixth Circuit affirmed this holding and the aforementioned tests for willfulness.68 Furthermore, the Sixth Circuit emphasized that Noronha had acted willfully because she deliberately chose to sign checks “after she knew that the company had failed to pay its taxes.”69

Even had Noronha established that she had no actual knowledge that the trust fund taxes were unpaid, the court still may have considered her to have acted willfully if the court determined she acted with reckless disregard. In In re Noronha, the Bankruptcy Court stated that a responsible person who “acts with a reckless disregard for obvious or known risks will be considered to have acted ‘willfully’ for purposes of Section 6672.”70 Thus, in response to Noronha’s argument that she did not learn of the tax liability early enough to rectify it, the court held that her “repeated failure to ask questions, demand information, and review documents relative to [the corporation’s] financial state while she was

64. Id. at 375-376 (citing Gephart v. United States, 818 F.2d 469, 473 (6th Cir. 1987); McDermitt v. United States, 954 F.2d 1245, 1251 (6th Cir. 1992); Bloom v. United States, 272 F.2d 215, 223 (9th Cir. 1960)). See also Braden v. United States, 442 F.2d 342, 344 (6th Cir. 1971) (“If the Appellant was aware of the fact that the taxes were unpaid, and, possessing the power and responsibility to pay them, failed to do so, then he is liable for the penalty of section 6672 notwithstanding his lack of malice or wrongful purpose.”).
66. Id.
68. Id.
70. In re Noronha, 382 B.R. at 376.
secretary-treasurer constituted . . . a reckless disregard for her duties under . . . §6672." Thus, Kentucky precedent interprets willfully expansively.

C. §6672 Penalty Defense: Lack of Willfulness

Other cases establish the outer range of willful conduct. The United States Supreme Court stated that the penalty under §6672 “cannot be construed to impose liability without fault.” A responsible person under §6672 may escape liability in two situations.

First, “‘[m]ere negligence’ is insufficient to constitute willfulness under section 6672.” In Calderone v. United States, the Sixth Circuit Court of Appeals warned that personal fault, and in turn willfulness and liability under §6672, arises when the negligence in question is gross negligence. The court attempted to clarify the gross negligence standard: “[A] person is not ‘willful’ if as a result of negligence he is unaware of the default in the payment of payroll taxes. . . . but willful conduct may also include ‘a reckless disregard for obvious or known risks.’”

Second, a responsible person may deflect personal fault when the tax has gone unpaid for some “reasonable cause.” An example would be a situation where the person had reasonable cause to believe that taxes were in fact being paid. The Sixth Circuit has yet to adopt such a defense.

D. Right of Contribution

The IRS “may choose the responsible person or persons from whom it will collect, and may proceed against any or all such responsible persons in any order

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71. In re Noranha, 382 B.R. at 376. The Sixth Circuit has rejected delegation as a defense to the willfulness requirement of §6672. In Noranha, the taxpayer attempted to argue that since the task of appropriating funds for payment to creditors was delegated to others, and she herself did not make the decisions, her behavior should not be found willful under §6672. The Court rejected the argument and held that “the fact that the plaintiff spent no time with the corporation is not a defense, since delegation will not relieve one of responsibility; liability attaches to all those under the duty set forth in the statute.” Id. (citing Cooper v. United States, 827 F. Supp. 1309, 1314 (E.D. Mich. 1993), aff’d 66 F.3d 326 (6th Cir. 1995)).


75. Id. at 259-260. See Part II(B)(2) for a discussion of gross negligence.

76. Calderone, 799 F.2d at 259-260.

77. See, e.g., Winter v. United States, 196 F.3d 339 (2d Cir. 1999) (in which the Second Circuit adopted the reasonable cause exception to willfulness under §6672).

78. Id.

79. Responsible Person – Trust Fund Taxes, supra note 5, at A-23 n.257 (citing Bell v. United States, 355 F.3d 387 (6th Cir. 2004) (the court opined that there are many extremely persuasive arguments against judicially incorporating a reasonable cause exception into §6672)).
of its choosing until the entire amount due is collected.” For decades, this practice led to inequitable results for individuals who were penalized for the entirety of the unpaid trust fund tax and were unable to pursue other responsible persons for contribution to the imposed penalty. In 1996 Congress amended §6672 to include an express right of contribution for a penalized responsible person. This amendment was incorporated as section 6672(d):

If more than 1 person is liable for the penalty under subsection (a) with respect to any tax, each person who paid such penalty shall be entitled to recover from other persons who are liable for such penalty an amount equal to the excess of the amount paid by such person over such person’s proportionate share of the penalty. Any claim for such a recovery may be made only in a proceeding which is separate from, and is not joined or consolidated with--

(1) an action for collection of such penalty brought by the United States, or

(2) a proceeding in which the United States files a counterclaim or third-party complaint for the collection of such penalty.

This statutory language implies that a right of contribution in federal court exists among responsible persons who have paid more than their proportionate share of a §6672 penalty.

To date, many questions remain unanswered because “sufficient case law guidance on the construction of I.R.C. §6672(d) has not yet developed.” For instance, the statute requires that the responsible person, from whom contribution is sought, is “liable for the penalty.” At this point, it is unclear whether this requires that the IRS actually make a determination of liability against the individual from whom contribution is sought, or alternatively, whether the statute permits an individual seeking contribution to attempt to prove the liability of another individual. Furthermore, it is unclear whether the

83. Ryesky, supra note 80, at 195.
84. Id. at 231.
86. Id. (citing IRC §6103(e)(9), which requires that the IRS “disclose to responsible persons, upon written request by such persons(s): (1) the names of any other person determined by the IRS to be liable under §6672; and (2) whether the IRS has attempted to collect the §6672 penalty from the other person, the federal nature of such collection activities, and the amount collected.”).
87. Id. (citing Spade v. Star Bank, 90 AFTR2d 2002-7147 (E.D. Pa. 2002) where the district court allowed a chief financial officer against whom the §6673 penalty was assessed to attempt to prove that he had a right of contribution from the employment agency that placed him).
person seeking contribution must have paid the entire §6672 penalty or just a portion of the penalty.88 Finally, §6672(d) authorizes a right of contribution for the “excess of the amount paid by such person over such person’s proportionate share of the penalty.”89 But, the term “proportionate share” could mean an aliquot share90 that equally distributes the burden or division based on the culpability of the individuals.91

Thus, due to the lack of §6672(d) case law, responsible persons doing business in Kentucky seeking contribution in federal court cannot predict with certainty whether they will be successful. Hopefully, “[a]s with other new statutes, the courts will eventually deal with clarifying its specific applications.”92

III. STATE TAXATION DECISIONS IN KENTUCKY

A. Kentucky Statutory Language

Every state has a separate and distinct corporate tax code. Likewise, who qualifies as a “responsible person” for various taxes levied against a corporation varies from state to state.93 The Kentucky employer withholding statutes are similar to the withholding and trust fund requirements under the IRC,94 but also differ significantly. Like IRC §6672, employers may be held personally liable for nonpayment of trust fund taxes owed under Kentucky law.95 KRS 141.340 outlines employers’ statutory withholding duty:

1) An employer shall be liable for the payment of the tax required to be deducted and withheld under KRS 141.310 and 141.315, and shall not be liable to any person for the amount of any such payment.

2) The president, vice president, secretary, treasurer or any other person holding an equivalent corporate office of any corporation subject to KRS 141.310 or 141.315 shall be personally and individually liable, both jointly and severally, for any tax required to be withheld under this chapter from wages paid to one (1) or more employees of any such corporation, and neither the corporate dissolution or withdrawal of the corporation from the state nor the cessation of holding any such

88. Id.
89. IRC § 6672(d) (2006).
90. E.g., giving one-half of the total if there were two responsible persons.
91. Ryesky, supra note 80, at 214-216.
92. Id. at 231.
94. See KY. REV. STAT. ANN. § 141.310 (West 2010). “Withholding of tax from wages paid by employer (1) Every employer making payment of wages on or after January 1, 1971, shall deduct and withhold upon the wages a tax determined under KRS 141.315 or by the tables authorized by KRS 141.370.” Id.
95. KY. REV. STAT. ANN. § 141.340 (West 2010).
corporate office shall discharge the foregoing liability of any such person; provided that the personal and individual liability shall apply to each or every person holding such corporate office at the time such tax becomes or became obligated. No person shall be personally and individually liable under this subsection who had no authority to collect, truthfully account for, or pay over any tax imposed by this chapter at the time that taxes imposed by this chapter become or became due . . . .96

While KRS 141.310 is intended to serve the same general purpose as IRC §6672, the two statutes contain very different language. Specifically, the term “willful” does not appear in the Kentucky statute.97 Furthermore, while the IRC identifies the responsible person as a “person required to collect, truthfully account for, and pay over any tax imposed,”98 KRS 141.310 expressly identifies the responsible persons as being “[t]he president, vice president, secretary, treasurer or any other person holding an equivalent corporate office of any corporation.”99 Consequently, Kentucky state courts have interpreted KRS 141.310 to have a much broader definition of responsible person and gives the Kentucky Department of Revenue quite a bit of prosecutorial discretion. This concept will be explored further in section IIIc.

B. Sales and Use Taxes

A notable difference between federal and state corporate taxation is the extent to which a person may be held personally liable. Individuals will only be held liable for unpaid federal taxes that result from trust fund withholding and certain fuel taxes.100 In contrast, state tax codes, including Kentucky’s, often hold individuals liable for other taxes levied on a corporation.101 Oftentimes these penalties are called “non trust fund liabilities.”102 According to the Kentucky State Tax Reporter,103 the president, vice president, secretary, treasurer or any other person holding an equivalent corporate office may be personally and individually assessed in regard to unpaid sales taxes, healthcare provider

96. KY. REV. STAT. ANN. § 141.340 (West 2010) goes on to state that “‘Taxes’ as used in this section shall include interest accrued at the rate provided by KRS 131.138, all applicable penalties and fees imposed under KRS 131.180, 131.410 to 131.445, and 131.990.” Apart from withholding taxes, shareholders, executives, and directors of a corporation may also be found personally liable for non-trust-fund taxes. See infra Part III(C).
97. KY. REV. STAT. ANN. § 141.310.
100. See supra Part II(A).
101. See e.g., KY. REV. STAT. ANN. § 139.185, 142.357 (West 2010) (discussing unpaid sales taxes and health care provider taxes).
103. Kentucky State Tax Reporter, ¶89-166, Kentucky, Other Liable Parties (2010).
104. KY. REV. STAT. ANN. § 139.185 (West 2010).
taxes,\textsuperscript{105} coal severance taxes,\textsuperscript{106} marijuana and controlled substance tax,\textsuperscript{107} bank franchise tax,\textsuperscript{108} and gasoline and special fuel taxes.\textsuperscript{109} Each of these non-trust-fund taxes are written in a manner very similar to the personal income and withholding tax in KRS 141.240, and their tests for responsibility and liability are virtually interchangeable.

\section*{C. Responsible Person Case Law}

Unlike §6672, KRS 141.310 expressly states that specific officers (the president, vice president, secretary, treasurer or any other person holding an equivalent corporate office) \textit{shall} be personally, jointly, and severally liable for the relevant unpaid and withheld taxes.\textsuperscript{110} Accordingly, while liability under §6672 arises only when a person is responsible for the duty set forth under the statute, officers mentioned in the statute are seemingly held strictly liable under KRS 141.310 when specified taxes levied on the corporation and trust fund taxes go unpaid.\textsuperscript{111} Also, because of the straightforward and forceful language of KRS 141.310, Kentucky courts have rarely attempted to formulate the elaborate “responsible person tests” that have developed in federal courts.

Kentucky’s test for determination of a responsible person, or lack thereof, is displayed in \textit{Nienaber v. Revenue Cabinet}.\textsuperscript{112} In \textit{Nienaber}, the Kentucky Board of Tax Appeals held that, “[b]ecause Nienaber was President of Bob’s Salads Inc., during the monthly withholding tax reporting periods . . . when the withholding taxes at issue became due, he [was] personally and individually liable for the unpaid withholding taxes owed by Bob’s Salads, Inc. . . .”\textsuperscript{113} Though the Board discussed facts such as Nienaber’s role in financial and business decisions in the fact section of the opinion, the “conclusion of law” section of the opinion makes no mention of authority, influence, or control of decision making as one would expect to see in a federal decision regarding §6672.\textsuperscript{114} This suggests that Nienaber’s position as President of the corporation was the only relevant factor.\textsuperscript{115}

\textit{Griffin v. Revenue Cabinet} displays the possibility for liability of “any other person holding an equivalent corporate office” as defined in KRS 141.340(2).\textsuperscript{116}

\begin{thebibliography}{10}
\bibitem{105} KY. REV. STAT. ANN. § 142.357 (West 2010).
\bibitem{106} KY. REV. STAT. ANN. § 143.085 (West 2010).
\bibitem{107} KY. REV. STAT. ANN. § 138.885 (West 2010).
\bibitem{108} KY. REV. STAT. ANN. § 136.565 (West 2010).
\bibitem{109} KY. REV. STAT. ANN. § 138.448 (West 2010).
\bibitem{110} KY. REV. STAT. ANN. § 141.340 (West 2010).
\bibitem{111} KY. REV. STAT. ANN. § 141.310 (West 2010).
\bibitem{113} Id.
\bibitem{114} Id.
\bibitem{115} Id.
\bibitem{116} Griffin v. Revenue Cabinet, No. K96-R-18 (Ky. B.T.A. April 7, 1998).
\end{thebibliography}
In this case, the Kentucky Board of Tax Appeals found that Griffin was personally liable for unpaid withholding taxes. Though Griffin was not an officer of the corporation, the Kentucky Board of Tax Appeals found that he was the equivalent of a corporate officer because he was a shareholder of the corporation, was a member of the board of directors, and had the sole decision making authority to decide which bills the corporation should pay. The franchise agreement, and his position as Vice-President of a fifty percent shareholder, a legal entity set up to receive all daily receipts and pay the bills of the corporation, established his responsibility as such. Other factors that were identified in the fact section of the opinion, but given no weight in the conclusion of law section, were the following: Griffin signed and completed the corporation’s Withholding Tax Return for the period in question; he was authorized to sign corporate checks; and he had access to cash receipts. The Board also stated that “[a] third party is liable as a responsible person or equivalent corporate officer if he makes the decision as to which bills to pay next.” Thus, in contrast to a case involving an actual officer, a Kentucky court or Board will undertake more analysis and consider more factors in a case where a non-officer is cited under KRS 141.340.

While Kentucky courts have not specifically addressed the issue of burden shifting in the context of KRS 141.340, it appears that the test operates in a similar manner to §6672 with the government bearing the burden of proving that the taxpayer is a responsible person. However, the Kentucky Department of Revenue has a much easier burden to overcome in order to prove an individual is a responsible person. In fact, there seems to be a presumption of responsibility when the individual is an officer.

D. Willfulness and Responsibility for Decisions

Unlike other state and federal personal liability statutes, Kentucky’s corporate statute does not contain a willfulness requirement. Instead, with the exception of shareholder cases, Kentucky imposes a broad personal liability
on responsible persons for failure to pay over trust fund and non-trust fund taxes with no mental-state requirement. 125

The test for responsible person liability under KRS 141.340 is whether the assessed party was an officer or had actual control of the financial affairs at the time liability became due. 126 An interesting application of this test is seen in Franklin v. Revenue Cabinet,127 in which PMC Holding and Investment Company agreed to assume the indebtedness and liabilities of GD&M on April 1, 1986.128 Subsequently, GD&M owed Kentucky withheld income tax from May 1, 1986, to September 30, 1986.129 The Kentucky Board of Tax Appeals found Franklin, the Secretary of PMC, liable for the full amount of the taxes owed by GD&M, despite the fact that Franklin himself held no taxpaying duties at GD&M and was simply an officeholder at a corporation which agreed to assume responsibility for said corporate tax liability.130

E. KRS Defenses

Unlike §6672’s judicially created defense regarding lack of willfulness, the statutory language of KRS 141.340 has an express defense for those associated with the corporation who lack authority. 131 The statute states, “No person shall be personally and individually liable under this subsection who had no authority to collect, truthfully account for, or pay over any tax imposed under this chapter at the time that taxes imposed by this chapter become or became due.” 132 Thus, in the rare instance where an individual is a corporate officer and has no authority whatsoever over the company’s finances, he or she will be able to escape liability under KRS 141.340.

F. Right of Contribution

KRS 141.340 states that responsible persons “shall be personally and individually liable, both jointly and severally, for any tax required to be withheld under this chapter from wages paid . . . ” 133 At first glance, the “joint and several” language seems to imply that a right of contribution would exist among the officers outlined in the statute, which would benefit corporate officers who sought contributions from one another. 134

125. Id.
128. Id.
129. Id.
130. Id.
131. KY. REV. STAT. ANN. § 141.340 (West 2010).
134. Id.
However, as no Kentucky court has read an express contribution remedy among corporate officers in §141.240, it seems far more likely that the Kentucky legislature included the “joint and several” language for the benefit of the DOR, thus making it easier to collect the entire amount due from the officers jointly. Further, no other Kentucky state law or regulation expressly creates a contribution right in the context of trust fund or non trust fund penalties.

IV. ANALYSIS

A. IRS and Kentucky Department of Revenue vs. Other Civil Plaintiffs’ Rights

At first glance, one might view personal liability of corporate officers under the federal and Kentucky statutes to be unfair and inconsistent with the traditions surrounding U.S. corporate law. While the corporate veil protects officers and other responsible persons from private creditors, individuals may view the government’s use of IRC §6672 and similar state statutes to create a superior collection right as unfair. After all, isn’t separating liability from the corporation and the decisions of officers and shareholders the point of having corporate entities in the first place?

However, there is an important difference between the corporate funds which go toward private litigants and the withheld monies constituting a “trust fund” and, in statutes such as Kentucky’s, “non-trust fund liabilities.” The difference being that the withheld taxes discussed in this article never actually “belonged” to the corporation. Unlike the money used by a corporation to pay a breach of contract judgment, which may be taken from a corporation’s retained earnings or similar funds, withholding penalties are the consequence of non-payment of funds that were held in trust for the government. Thus, the federal and state governments are much more willing to punish individuals personally responsible for the loss of their governmental funds.

In light of this rationalization, the exception to the corporate veil that is embodied in §6672 seems much more justifiable. The purpose of the corporate veil is supposedly a mechanism to protect corporate officers’ decision-making processes, which may lead to private liability from a shareholder or other third-party. However, no such shielding justification exists for a corporate officer, or other responsible person, who fails at his duty of holding and paying over third party tax funds held in trust for the government.

135. See supra Part I (discussing the legal theory of the corporate veil).
136. See supra Part III(B).
137. See, e.g., 26 C.F.R. § 301.6672-1 (2011) (requiring withholding certain fuel taxes taken directly from customers and employees and meant to be held in trust for the Government).
138. See McCall, supra note 18, at 906-907.
B. IRS v. KRS Responsible Person Statutes

1. Identifying the Responsible Person

The statutory language of §6672, similar Kentucky withholding statutes, and related case law identify responsible persons in very different manners. The federal system uses painstaking research, analysis, and legal tests to determine who is actually a responsible person under §6672. The Sixth Circuit’s analysis includes use of the Braden test to assure that the individual labeled as a responsible person had authority over the corporation’s decisions to pay or not to pay the taxes which are at issue, and knowledge of the tax delinquency. Conversely, the Kentucky withholding statutes are not carried out with the same vigor and scrutiny to uncover who was the actual responsible person. Individuals are most often labeled as responsible persons simply by virtue of being a corporate officer or, in isolated incidents, a non-officer performing duties sufficiently similar to those of a corporate officer.

2. Willfulness Requirement

Federal courts exercise similar vigor when determining if a responsible person willfully failed to pay over the trust fund tax, only finding willfulness when the individual deliberately chooses not to pay the government; and when the individual acts with reckless disregard of known or obvious risks that the taxes may not be remitted to the government. In contrast, Kentucky places a strict liability on corporate officers for unpaid trust fund and non-trust fund taxes with no mental-state requirement. Kentucky has also seemingly carved out an exception to this strict liability requirement for non-officer corporate shareholders being held liable.

3. Burden of Proof

Though the Sixth Circuit has not explicitly ruled on the issue, other circuits have ruled that the burden is initially on the government to prove that the individual is a responsible person who willfully failed to pay over taxes under

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140. See supra Part II(B)(2).
142. See supra Part III(C).
143. See supra Part III(C).
144. See supra Part II(B)(2) for a discussion of Cook v. United States, 52 Fed. Cl. 62 (Fed. Cl. 2002).
145. See supra Part III(D).
146. See supra Part III(D) for a discussion of Griffin v. Revenue Cabinet, No. K96-R-18 (Ky. B.T.A. April 7, 1998).
§6672. However, due to the statutory language of KRS withholding statutes expressly naming officers responsible persons, at the state level there seems to be a presumption that an officer is a responsible person. This places the initial burden on the individual taxpayer to prove that they should not be held responsible for the trust fund liabilities.

4. Individual Defenses and Contribution Remedy

Additionally, when an individual is held liable under §6672 he may argue an affirmative defense of “lack of willfulness” if he is able to prove that his actions, which lead to the non-payment of taxes, constituted “mere negligence,” or if the taxpayer had “reasonable cause” for the non-payment. Taxpayers liable under §6672 may also claim a right of contribution from other responsible persons who meet the statutory requirements. The Kentucky statutes do not provide a similar defense or contribution remedies for individuals assessed with trust fund and non-trust fund liabilities under the KRS.

5. Justification for differences in IRS & KRS Statutes

Few would disagree that taxpayers receive more just and fair treatment under the federal system than those charged with similar withholding penalties under Kentucky statutes. Part of the justification for this gap in equity is the fact that the IRS has more funding and resources that enables its agents to conduct investigations and seek out the most responsible party or the most responsible and “collectible” party. On the other hand, Kentucky’s Department of Revenue has a smaller budget and fewer resources to scrutinize a corporation’s inner workings. Thus, the Kentucky Department of Revenue is far more likely to simply send a deficiency notice to the company’s president in lieu of further investigation.

147. Responsible Person – Trust Fund Taxes, supra note 5, at A-18 (citing Stettler v. United States, 98-1 USTC ¶50,136 (10th Cir. 1998) (unpub. op.); Malloy v. United States, 17 F.3d 329 (11th Cir. 1994); United States v. Running, 7 F.3d 1293 (7th Cir. 1993); Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979)).
148. See supra Part III(C).
149. See supra Part III(C).
150. See supra Part II(C).
151. See supra Part II(D).
152. See supra Parts III(E) & (F).
154. See e.g., Kentucky Office of State Budget Website – Executive Operating Budget – Treasury, http://www.osbd.ky.gov (follow “Volume I – Operating Budget (Full Version)”; then look to page 39 which identifies the Kentucky Treasury Department 2010 total budget expenditures at $2,869,100).
6. Fairness

As was briefly mentioned earlier, statutes and rules determining the identity and culpability of “responsible persons” under corporate tax law vary significantly from state to state. 155 This creates a “fairness spectrum.” Similar to Kentucky, Minnesota and some other states do not require that the person act willfully in order to be subject to responsible person liability for unpaid trust fund and non-trust fund penalties. 156 Thus, these state statutes would fall on the “unfair” end of the fairness spectrum. On the “fair” end of the spectrum are states such as Florida and Illinois, which, like the §6672 federal standard, require a finding that a responsible person acted willfully in not remitting a corporation’s tax in order to be held personally liable. 157 Other states, such as Maryland and Texas, fall in the middle of the fairness spectrum. These states require a showing of willfulness from a responsible person to be held liable for unpaid taxes, but deem a showing of simple negligence sufficient to prove willfulness. 158 This is unlike the §6672 federal standard, which requires a showing of gross negligence or recklessness to hold a responsible person liable. 159

Despite the appearance of inequity between the Kentucky standard and other “fairer” state and federal standards regarding responsible person liability, it is highly unlikely that a Kentucky court or the Board of Tax Appeals will change the current application of these statutes because the application of said Kentucky statutes is well entrenched in the state case law. It is also unlikely that the Kentucky legislature will seek to amend any of the corporate withholding statutes because such an amendment may be seen as attempt to take money away from the state and would be viewed negatively by the public.

V. RECOMMENDATIONS

When incorporating a business, certain measures may be taken by officers, shareholders, and others to avoid penalization under federal and Kentucky withholding statutes. First, if such an individual is expressly charged (in job description or otherwise) with the corporate duty of accounting for and paying over state and federal taxes, that person should perform the duty with proper care and in accordance with corporate regulations and bylaws, as well as relevant federal and state taxation statutes and regulations. 160

However, if the individual is arguably not expressly or impliedly charged with the task of tax payment, the person may stand a better chance of avoiding

156. Id. at A-23 (citing MINN. STAT. § 270.101 (2010)).
157. Id. (citing FLA. STAT. ANN. § 213.29 (2010); 35 ILL. COMP. STAT. § 735/3-7(a) (2010)).
158. Id. (citing MD. CODE ANN., TAX-GEN. §10-906(d) (2010)).
159. See supra Part II(B)(2) (federal willfulness).
liability under one of the applicable withholding statutes if he or she obtains his or her job duties in writing. For example, if an individual is present during the incorporation phase of a company, he or she may want to insist that the job duties, and the duties of the individual who handles the corporation’s finances, are clearly outlined in the articles of incorporation or similar official corporate document. The wrongly charged individual may point to these documents as evidence when mounting a defense.

Further, as discussed above, statutory contribution from other responsible individuals in regard to trust fund penalties is non-existent in Kentucky and limited under federal law. Therefore, it is sensible for individuals in a corporation who are charged with the duty to collect and pay over taxes to individually contract amongst themselves to share any trust fund penalty imposed by the IRS or Kentucky Department of Revenue. Such a contract may take the form of an indemnity agreement among “responsible persons,” and a breach of this contract could potentially give rise to a valid contribution action where the person penalized under state or federal tax law can prove that another responsible person was liable for the unpaid taxes.

Also, many of the tests outlined in this article deal with identifying responsible persons by their capacity to sign checks. Thus, if an individual’s job description does not necessarily require the ability to sign company checks the individual’s name should be removed from the corporate checking and banking accounts. It has been suggested that “[individuals with check writing authority] will be the easiest targets for the IRS, because the argument will be that if other creditors were being paid, the non-payment of taxes by the check signer must have been willful, a requirement under the statute.”

Professional advisers working closely with the corporation should also be wary of their involvement with the entity, as they are not immune from corporate “tax problems.” Specifically, attorney/CPA Harry Charles has warned

161. Articles of Incorporation are “[a] governing document that set forth the basic terms of a corporation’s existence . . .” BLACK’S LAW DICTIONARY 128 (9th ed. 2009).
162. See supra Parts II(D) and III(E).
163. Responsible Person – Trust Fund Taxes, supra note 5, at A-39. It may also be possible for a corporate officer or shareholder to insist on an exculpation clause in their employment contract which would require the corporation to refund the individual who has paid a trust fund penalty. However, this clause seems futile due to the fact that the corporation who has defaulted on withholding taxes most likely would have no funds to reimburse the individual.
164. Id. However, it appears as if Kentucky state and federal courts have yet to address such a contract among responsible persons.
167. Id. (citing United States v. Vaccarella, 735 F.Supp. 1421 (S.D.Ind. 1990), in which a court held that an asset-based lender was liable for its client's unpaid taxes because the lender directly funded the company's payroll accounts and chose to pay other creditors over the IRS)
accountants, attorneys, and other individuals working closely with the corporation:

[S]hould avoid accepting a title or director position with a client’s corporation unless they are prepared to stay advised of the company’s finances. [From an advisor’s standpoint] [t]here is a fine line between wanting to make certain that the client makes proper business decisions and stepping into the client’s operations. Once the adviser crosses the line, he or she becomes a possible IRS target, because the willfulness requirement of the 100% penalty covers recklessness, or knowing that taxes are owing, but not doing anything about it.168

Charles does a very nice job of summing up the available means of avoiding personal liability for unpaid trust fund taxes in the conclusion section of his article:

The 100% penalty under Section 6672 is a potent tool for the IRS because it permits the government to recoup unpaid taxes from a failed business. The key to avoiding liability is to know the IRS’ criteria for assessing the penalty and being able to present a plausible, well-documented case for shifting the blame to another person or entity if the IRS raises the issue.169

VI. CONCLUSION

Despite liability shielding mechanisms, if either the Kentucky or federal government determines an individual associated with a corporation is a responsible person, that individual is personally liable for any and all unpaid taxes. The individual does have an opportunity to contest this liability, however, the individual contesting trust fund liability under the KRS faces a much more difficult task than an individual who stands accused of similar federal sanctions due to the extensive body of litigation and case law that has developed around I.R.C. §6672 and a concerted effort to place liability on those who were actually responsible for the non-payment of the federal trust fund taxes. Conversely, the Kentucky judicial system seems to have chosen a path of rigid form-over-substance-application of its trust fund liability statutes in lieu of a more equitable and expensive approach taken by the federal government and other states.

168. Id.
169. Id.
I. INTRODUCTION

Prior to the Supreme Court of Kentucky’s holding in Martin v. Ohio County Hospital Corp., a widow or widower was precluded from recovering spousal loss of consortium if their spouse died instantaneously as a result of negligence. Even if the spouse did not die instantly, the law before Martin limited the widow/widower’s recovery to the period of time between the injury and the death of the spouse.

The effects of this harsh law can be demonstrated by the following hypothetical. A married couple, returning from their honeymoon and expecting to spend the rest of their lives together, were involved in a head-on collision. The husband, Jim, was driving, while his wife, Pam, napped in the passenger seat of their car. The driver of the truck that crashed into the couple’s car was intoxicated and speeding. Miraculously, Pam’s injuries were minor; she sustained a broken arm and bruised ribs. Jim, however, did not survive the crash. He suffered a broken neck and died instantly.
For her own personal injuries, Pam would be entitled to seek specific damages under Kentucky law. Kentucky law also recognized a widow/widower’s right to seek compensation for loss of spousal consortium. Section 411.145 of the Kentucky Revised Statutes defines spousal consortium as “services, assistance, aid, society, companionship and conjugal relationship” of the deceased spouse. If Pam were allowed to seek full recovery for loss of consortium with her husband, the purpose of tort law would have been met: the negligent party would be held accountable for the injuries he caused, and future wrongdoing would be deterred. Prior to the decision in Martin, however, Pam could only recover for the loss of consortium she suffered from the time of her husband’s injury until the time of his death. Because her husband died instantly, she would not be entitled to seek recovery of any damages for the lifelong loss of the services, assistance, aid, society, companionship and conjugal relationship her husband would have provided had he not been wrongfully killed. The value of the relationship with her husband and the future relationship she would have had was, in the eyes of Kentucky law, worthless.

The value of Pam’s claim and her ability to seek recovery for loss of spousal consortium would be significantly different if only one fact had been changed. If Jim had survived the crash, even if only for a short time, and his injuries affected his ability to provide consortium to Pam, she would have been entitled to a claim for loss of consortium from the time of his injury until his death. To illustrate the point, imagine that Jim survived the collision, but suffered catastrophic brain injury, leaving him unconscious, but alive. He survives ten years in a comatose state, but ultimately dies without ever regaining consciousness. Although this is essentially the same outcome as the previous scenario (death without regaining consciousness), Pam would have been entitled to seek damages for loss of consortium. In both hypothetical fact patterns Pam

3. Jim’s Estate would be entitled to seek compensation for the destruction of the decedent’s power to labor and earn money as a result of his wrongful death, but the Estate would be precluded from seeking damages for the affliction which has overcome the family by reason of the wrongful death. See Louisville and Nashville R.R. Co. v. Eakin’s Adm’r, 45 S.W. 529, 531-32 (Ky. 1898).
5. Id. at § 411.145(1).
6. Giuliani v. Guiler, 951 S.W.2d 318, 320 (Ky. 1997) (citing City of Louisville v. Louisville Seed Co., 433 S.W.2d 638 (Ky. 1968), overruled on other grounds by Gas Serv. Co., Inc. v. London, 687 S.W.2d 144 (Ky. 1985)).
7. See Brooks v. Burken, 549 S.W.2d 91, 92 (Ky. 1977) (noting that, at the time, “it [was] well settled law that her recovery would be limited to damages which she sustained before her husband’s death”), overruled by Martin v. Ohio Cnty. Hosp. Corp., 295 S.W.3d 104 (Ky. 2009), and abrogated by Giuliani v. Guiler, 951 S.W.2d 318 (Ky. 1997).
8. See Brooks, 549 S.W.2d at 92.
9. See id.
11. See Brooks, 549 S.W.2d at 91.
12. See id.
suffered the same loss; however, Pam’s ability to seek recovery is allowed only in this second scenario.\textsuperscript{13} Even if the second scenario had occurred, Pam would still not be able to seek full recovery for her loss. Prior to the decision in Martin, Pam would have been limited to recovering for loss of consortium from the time of injury to time of death, despite the fact that Jim would have provided her a lifetime of services, aid, and companionship throughout his lifetime had he not been wrongfully killed.\textsuperscript{14}

Fortunately, as a result of Martin, widows and widowers that have suffered the loss of their spouses as a result of a third party’s negligence are now able to seek full recovery for the loss of consortium they will suffer throughout their lifetime.\textsuperscript{15} In Martin, the Supreme Court of Kentucky rectified the inconsistent and unfair limitation on a spouse’s right to seek redress and damages for loss of consortium by holding that loss of spousal consortium damages do not cease at the time of death of the injured spouse.\textsuperscript{16}

Writing for a unanimous court, Justice Noble rejected the argument that the statutory definition of marriage in KRS § 402.005 (“a man and woman being united for ‘life’”), precluded recovery for spousal consortium after death.\textsuperscript{17} Although the legal effect of death on marriage may be determined by that statutory definition, the loss of consortium claim was grounded on compensation for the third-party’s wrongdoing, which interferes in the marital relationship.\textsuperscript{18} The court noted that the purpose of the loss of consortium claim is not about whether the marriage has ended, but rather is about whether the marital relationship would have continued but for the wrongdoing of a third-party.\textsuperscript{19} The court determined that if the legislature had wished to limit recovery for spousal consortium to the time between injury and death, it could have simply stated so within the statute.\textsuperscript{20} In the court’s view, the fact that the legislature chose not to place a limit on the duration of the loss evidenced its intent not to limit the loss.\textsuperscript{21}

The court opined:

At the crux of this claim is compensation for loss of the most compelling of human relationships, other than possibly that of parent and child. Our legislature did not intend, nor does this Court, to devalue the relationship by putting an arbitrary limit on the duration of what can be profound loss. Our statute permits that loss to be evaluated

\begin{footnotesize}
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\item \textsuperscript{13} See id.
\item \textsuperscript{14} Id.
\item \textsuperscript{16} Id.
\item \textsuperscript{17} Id.
\item \textsuperscript{18} Id.
\item \textsuperscript{19} Id.
\item \textsuperscript{20} Id.
\item \textsuperscript{21} Martin, 295 S.W.3d at 111.
\end{itemize}
\end{footnotesize}
by a jury, and therefore it is the right of bereaved spouses to have such an evaluation.  

The holding in Martin recognized the fact that the marital relationship has significant value and that value and loss does not end at the death of an injured spouse. First, this note examines and analyzes the limitations on wrongful death actions before Martin. It then explains the rationale of Martin, and the effect the holding has on recovery for spouses. Finally, it discusses the desirability of extending that rationale to the current, arbitrary limitations on an adult child’s right to seek compensation for loss of parental consortium and likewise the limitations on a parent’s right to seek compensation for loss of consortium of their adult child.

II. BACKGROUND AND HISTORY PRE-MARTIN

Loss of consortium is a common law cause of action. The common law recognized that a master had a claim when his “servant was tortiously injured because the master would suffer a loss of services in addition to whatever loss the servant suffered.” By 1619, the common law was expanded to include the marital relationship, which allowed a husband to recover when his wife was tortiously injured. At early common law, a loss of consortium claim “protected only the economic interest of the husband in his wife” and was based initially on loss of sexual congress. This meant that any claim the husband had ended at the death of his wife. The theory behind this rule was that any possibility of a spousal relationship was terminated at death, and thus, a wrongful death action

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22. Id.
23. Id.
26. Adams, 908 S.W.2d at 118.
27. Giuliani, 951 S.W.2d at 320 (citing Dietzman v. Mullin, 57 S.W. 247 (Ky. 1900)).
29. Id. at 108. See also Rogers v. Fancy Farm Tel. Co., 170 S.W. 178, 179 (Ky. 1914) (holding that a husband cannot recover for loss of services after his wife’s death). See also generally Loew v. Allen, 419 S.W.2d 734 (Ky. Ct. App. 1967) (“An action for loss of consortium is limited to compensation for the loss which accrued to the husband from the date of the injuries to the date of death or recovery of the wife.”); McGuire v. E. Ky. Beverage Co., 238 S.W.2d 1020 (Ky. 1951) (upholding the rule limiting a husband’s loss of consortium damages to the time period between his wife’s injuries and her death); City of Paducah v. McManus, 76 S.W.2d 254 (Ky. 1934) (holding a husband may sue for loss of his wife’s society when his wife’s injuries did not result in death); Louisville & Nashville R.R. Co. v. McElwain, 34 S.W. 236 (Ky. 1886) (finding that a husband has no claim for loss of his wife’s society after her death); Eden v. Lexington & Frankfort R.R. Co., 53 Ky. (14 B. Mon.) 204 (Ky. 1853) (holding that a husband cannot recover for loss of his wife’s society when she died instantaneously).
would cover all losses. Originally, a wife could not claim loss of consortium for injuries suffered by her husband.

In 1970, the Kentucky Court of Appeals expanded the claim for loss of consortium in *Kotsiris v. Ling* to allow a wife to bring a claim for the loss of her husband’s consortium. The court held that “a wife has a cause of action for loss of consortium of her husband resulting from an injury to the husband due to the negligent act of another.” With this decision, Kentucky joined twenty other jurisdictions that had abolished the archaic rule and allowed a wife to maintain a loss of consortium action.

The *Kotsiris* court carefully defined and limited the scope of its holding. First, a wife’s loss of consortium claim did not include any recovery for loss of her husband’s monetary support. Second, the claim did not include recovery for nursing services provided by the wife to the husband. The opinion specifically limited the claim for loss of consortium to recovery of “loss of society, companionship, conjugal affections, and physical assistance.”

The court emphasized two additional points of importance. The Court explained that because the wife’s recovery for loss of consortium is separate from that of the husband’s for his injuries, there is no risk of a double recovery. Additionally, the Court noted that a claim for loss of consortium may be applied retrospectively. This may occur where a wife asserts a claim for loss of consortium after the husband had already settled his claims.

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30. See supra note 29 and accompanying text; see also generally, THOMAS COOLEY, A TREATISE ON THE LAW OF TORTS OR THE WRONGS WHICH ARISE INDEPENDENTLY OF CONTRACT 470 (3d ed. 1906).


32. Prior to 1976, the Kentucky Court of Appeals was the final appellate court in the state. See *Ky. Rev. Stat. Ann.* § 21A.100 (“The records of the Court of Appeals involving proceedings before that court, prior to January 1, 1976, shall become part of the permanent records of the Supreme Court.”).

33. *Kotsiris*, 451 S.W.2d at 411-12.

34. *Id.* at 412.

35. *Id.* at 411. In joining the minority of jurisdictions, the court in *Kotsiris* overruled the 1963 case of *Baird v. Cincinnati, New Orleans & Tex. Pac. R.R. Co.*, 368 S.W.2d 172 (Ky. 1963). *Id.* at 412. The court reasoned that “the considerations militating in favor of recognition of the wife’s cause of action outweigh the considerations on which the doctrine of stare decisis rests.” *Id.*

36. *Kotsiris*, 451 S.W.2d at 412.

37. *Id.*

38. *Id.* The court reasoned that the husband or the husband’s estate could recover for his lost earnings or for the value of his wife’s nursing services. *Id.*

39. *Id.*

40. *Id.* at 412-13.

41. *Id.* at 412.

42. *Kotsiris*, 451 S.W.2d at 413.
The General Assembly codified the \textit{Kotsiris} decision on March 30, 1970, through the enactment of House Bill 222, entitled "An Act providing for the recovery for damages of loss of consortium."\footnote{1970 Ky. Acts ch. 200, sec. 1.} This bill was codified as section 411.145 of the Kentucky Revised Statutes\footnote{KY REV. STAT. ANN. § 411.145 (LexisNexis 2010).} and gave both husband and wife the right to recover damages for loss of spousal consortium.\footnote{RONALD W. EADES, KENTUCKY HANDBOOK SERIES, WRONGFUL DEATH ACTIONS § 4:7 (2009-2010 ed.).} KRS 411.145 states:

(1) As used in this section "consortium" means the right to the services, assistance, aid, society, companionship and conjugal relationship between husband and wife, or wife and husband.

(2) Either a wife or husband may recover damages against a third person for loss of consortium, resulting from a negligent or wrongful act of such third person.\footnote{KY REV. STAT. ANN. § 411.145 (LexisNexis 2010).}

This statute confirmed that the loss of spousal consortium claim belongs solely to a spouse, rather than to the estate of the deceased.\footnote{Martin v. Ohio Cnty. Hosp. Corp., 295 S.W.3d 104, 107-08 (Ky. 2009).} The statute did not address whether a loss of consortium claim was extinguished upon death of the injured spouse.\footnote{Id. at 108.} This caused much confusion and resulted in the dismissal of many claims for loss of consortium.\footnote{See id.} The statutory absence of any limitation on the right to recovery played a major role in the \textit{Martin} decision\footnote{See id.} and will be discussed at greater length later within this note.

In 1977, the Supreme Court of Kentucky revisited the issue of loss of spousal consortium in \textit{Brooks v. Burkeen}.\footnote{Brooks v. Burkeen, 549 S.W.2d 91 (Ky. 1977), overruled by Martin v. Ohio Cnty. Hosp. Corp., 295 S.W.3d 104 (Ky. 2009), and abrogated by Giuliani v. Guiler, 951 S.W.2d 318 (Ky. 1997).} In \textit{Brooks}, the plaintiff’s husband died instantly from asphyxiation while cleaning a furnace at work.\footnote{Brooks, 549 S.W.2d at 92.} The employer’s negligence allegedly caused the decedent’s death.\footnote{Id.} The decedent’s wife and children sued the employer.\footnote{Id.} The wife sought damages for her individual claim for loss of spousal consortium.\footnote{Id.} The court in \textit{Brooks} held that damages for loss of spousal consortium could only be recovered for the period of time between the injury and the death or recovery of the spouse.\footnote{Id.} Thus the court held that the wife could not recover damages for loss of consortium.
because her husband had died instantaneously. The court opined that “it is well settled law that her recovery [for loss of consortium] would be limited to damages she sustained before her husband’s death.” Furthermore, the court noted, because her husband died instantaneously while at work, the wife “lost no services, society, fellowship or affectionate relations prior to [his] death,” thereby precluding recovery. 

It should be noted that, throughout the court’s opinion, it did not rely on, interpret, review, or even make reference to Section 411.145 of the Kentucky Revised Statutes.

In addition to precluding the wife from recovering for loss of spousal consortium, the Brooks court also precluded the decedent’s minor children from recovering for loss of parental consortium. The court held that the decedent’s children could not pursue such a claim against the employer. It reasoned that “no court or legislature in the United States” had yet recognized such a claim, and it would not be the first to do so. This holding would be cited by Kentucky courts for the next several years, not only to deny spouses a right to full recovery for their loss of consortium, but also to deny minor children a right to recover damages for loss of parental consortium.

In 1983, the Kentucky Supreme Court in the case of Floyd v. Gray, emphasized two important points regarding loss of consortium. First, the court confirmed that a loss of consortium claim is separate from that of a wrongful death claim or any other cause of action. The Court explicitly stated “[l]oss of consortium is an independent cause of action authorized by KRS 411.145(2).” Second, the court addressed when a loss of consortium claim must be filed. The court held the statute of limitations for all consortium claims is one year from the date of the injury.

In 1995, eighteen years after the Brooks court limited recovery for spousal consortium from the time of injury to the time of death of the injured spouse, the Supreme Court of Kentucky affirmed that decision in Clark v. Hauck Manufacturing Co. Despite the passing of many years, the court continued to

58. Id.
60. Id. (citing Rogers v. Fancy Farm Tele. Co., 170 S.W. 178 (Ky. 1914)).
62. Brooks, 549 S.W.2d at 92.
63. Id.
64. Id.
66. Id. at 938.
67. Id.
68. Id. at 938-39.
69. Id. at 939.
refuse to recognize any recovery for loss of consortium after the death of the injured spouse. 71 In Clark, a husband was injured at work while using a defective blowtorch. 72 He sustained third degree burns over 70 percent of his body. 73 After spending forty-nine days in the hospital, the man died. 74 His wife sued the company that manufactured the torch seeking, among other damages, a claim for post-death loss of consortium. 75

The Supreme Court of Kentucky reiterated that a loss of consortium claim “is viable only for the period of time between the date of the injury and the date of death. It does not reach beyond.” 76 The court explained that the purpose of a loss of consortium claim was to “compensate for that period of time while the injured spouse was still alive but incapable of fully participating with the other spouse in conjugal relations attendant to the marital status.” 77 The court noted that if the damages for loss of consortium were extended beyond death, it would result in the surviving spouse obtaining a double recovery beyond what the wrongful death statute affords. 78 According to the Clark court, this type of recovery was never available under common law. 79 Finally, as in the Brooks case, the court in Clark did not rely on, interpret, review, or make any reference to Section 411.145 of the Kentucky Revised Statutes in its opinion. 80

In the same year that the Supreme Court of Kentucky issued the Clark opinion, Justice Wintersheimer wrote a dissent in Adams v. Miller revealing an apparent split of opinion within the Supreme Court on the topic of loss of consortium. 81 In Adams, the court refused to recognize loss of parental consortium as a recoverable category of damages. 82 Although the majority in Adams affirmed the Brooks decision and also held that children could not recover damages for loss of parental consortium, 83 the dissent of Justices

71. Clark, 910 S.W.2d at 252.
72. Id. at 250.
73. Id.
74. Id.
75. Id.
76. Id. at 252.
77. Clark, 910 S.W.2d at 250.
78. Id.
79. Id., (citing KY. REV. STAT. ANN. § 411.130). The Court also held that the loss of consortium claim was filed untimely in this case. Id. Although it was filed within a year of the decedent’s death, it was filed over a year after the injury. Id. This was in consensus with the Floyd case discussed earlier in this article. See supra notes 65-69 and accompanying text.
80. Clark, 910 S.W.2d at 252.
82. Adams, 908 S.W.2d at 116 (majority opinion).
83. Id.
Wintersheimer and Stumbo hinted that a change in the law could be forthcoming.84 Justice Wintersheimer’s dissent explained that the court had the authority to change common law to allow such claims and provided reasons for why a child’s loss of consortium claim should exist in Kentucky.85

Justice Wintersheimer’s dissent pointed to the fact that the reasoning the Brooks court relied upon to deny a child’s claim for loss of parental consortium – that no other jurisdictions recognized this type of claim – was no longer valid.86 Additionally, Justice Wintersheimer noted, “[r]ecognizing a claim for loss of parental consortium is the only appropriate progression of Kentucky law and is in harmony with the public policy objectives behind allowing claims for loss of consortium.”87 The public policy he was referring to was the need to protect children and protect their interest in the family relationship.88 His dissent foreshadowed what would be a just and appropriate expansion of loss of consortium claims just two years later.89

Shortly after the Adams case was decided, a young mother of three died as a result of medical negligence while giving birth to her fourth child.90 After the death of his wife, her husband sued for loss of parental consortium on behalf of his three minor children.91 The trial court and the intermediate appellate court both dismissed the claims because they felt constrained by the decisions in Brooks and Adams.92 In the appellate court’s opinion, however, it encouraged the Supreme Court of Kentucky to review the question of whether Kentucky law recognized a loss of parental consortium claim.93 The Supreme Court accepted discretionary review.94 That case was Giuliani v. Guiler.95

84. Id. at 117-19 (Wintersheimer, J., dissenting).
85. Id. at 117 (Wintersheimer, J., dissenting) (“I believe that the court should recognize the potential claim of a loss of parental consortium.”). See also supra notes 87-90 and accompanying text (explaining Justice Wintersheimer’s reasons for why Kentucky should recognize a loss of parental consortium claim).
86. Id. (“The court previously declined to recognize such a claim...because no court or legislature had yet done so. This is no longer the case.”); Schueler supra note 81, at 922.87. Adams, 908 S.W.2d at 117 (Wintersheimer, J., dissenting); Schueler, supra note 81, at 922. Additionally, the court held there is no separate category for hedonic damages. See Adams, 908 S.W.2d at 116 (majority opinion); Jamie M. Ramsey, Note, Giuliani v. Guiler: Stealing the General Assembly’s Thunder, 25 N. Ky. L. Rev. 445, 449 n.37 (1998). Hedonic damages are defined as “‘the value of the pleasure, the satisfaction, or the ‘utility’ that human beings derive from life, separate and apart from the labor or earnings value of life.’” Id. at 449 n.37. The court acknowledged there is another way to measure the value of one’s life, other than by his or her earning capacity. Id. However, they reasoned that one could already recover this value through the recognized category of mental suffering. Id.
88. Adams, 908 S.W.2d at 118 (Wintersheimer, J., dissenting).
89. See Schueler, supra note 81, at 922. See also Giuliani v. Guiler, 951 S.W.2d 318, 318-19 (Ky. 1997).
91. Giuliani, 951 S.W.2d at 318.
92. Id. at 319.
93. Id.
94. Id. At the time this opinion was published, the husband’s wrongful death case was in the discovery stage. Giuliani, 951 S.W.2d at 318-19.
In 1997, Justice Wintersheimer wrote the 4-3 majority opinion in *Giuliani*, in which the Supreme Court of Kentucky “adopted a new cause of action – loss of parental consortium on behalf of [minor] children whose parent is deceased . . . .”96 In reaching its decision, the court held that a child should be able to recover for loss of consortium from a wrongdoer whose negligent acts have caused the child harm.97 The *Giuliani* court explained that the archaic laws of *Brooks* and *Adams* were not ultimately binding: “[t]he loss of consortium [claim] is a judge-made common law doctrine which this Court has the power and duty to modify and conform to the changing conditions of our society.”98 The court also emphasized that “[w]hen the common law is out of step with the times, this Court has the responsibility to change that law.”99 It also noted that the reasoning in *Brooks* was no longer valid.100 Since the decision in *Brooks* twenty years prior, two state legislatures and fifteen courts had recognized a minor child’s claim for loss of parental consortium.101

The court further opined that children should have their own claim for loss of consortium, separate and distinct from that of their siblings and parents.102 Furthermore, the court noted that “[t]he claim of loss of parental consortium is a reciprocal of the claim of the parents for loss of a child’s consortium which was recognized in KRS 411.35.”103 The court was persuaded that there was no legal distinction between a parent’s claim for loss of a child’s consortium and a child’s claim for loss of parental consortium.104

Three years after *Giuliani*, the Kentucky Court of Appeals addressed whether the claim for loss of parental consortium was extinguished at the time of the parent’s death in *Charash v. Johnson*.105 In *Charash*, a decedent’s minor children filed a claim for loss of parental consortium against the physicians that caused their father’s untimely death.106 The court rejected the defendants’ argument that damages for loss of parental consortium ended at the parent’s death and instead concluded that children could recover damages for the period

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95. *Giuliani*, 951 S.W.2d at 318.
96. Ronald L. Green, *Torts*, 86 Ky. L.J. 907, 915 (1998); see also *Giuliani*, 951 S.W.2d at 320-22. This article also provides an in-depth discussion of questions that *Giuliani* leaves unanswered. See id. at 916-18 (noting that the unanswered questions include: “To Whom Does the Cause of Action Belong?”; “Who May Bring the Cause of Action?”; “What is the Measure of Damages?”; “How are Evidentiary Issues to Be Handled?”; and “What is the Effect of the Statute of Limitations?”).
97. *Giuliani*, 951 S.W.2d at 319.
98. Id.
99. Id.
100. Id.
101. Id.
102. Id. at 320.
103. *Giuliani*, 951 S.W.2d at 321.
104. Id. (citing Weitl v. Moes, 311 N.W.2d 259 (Iowa 1981)).
106. Id at 276.
of their minority. In coming to its decision, the court relied on the Kentucky Supreme Court’s holding in Giuliani that there is no legal distinction between a parent’s claim for loss of a child’s consortium and a minor child’s claim for loss of parental consortium. The court further held that “[b]ecause the claims are legally indistinguishable and reciprocal and KRS 411.135 allows for the recovery of damages through a child’s minority, the claim for loss of parental consortium does not end at a parent’s death.”

Following Charash, the next significant event leading to the Martin decision was a legislative initiative by the Kentucky Justice Association (“KJA”). When the KJA reestablished its legislative committee in 2003, it made the first attempt since Clark to extend loss of spousal consortium beyond death. With the assistance of many lawyers and victim advocates throughout the state, the KJA filed a bill that, if passed, would have changed the law of spousal consortium. The most promising legislative event took place at the legislative hearing of 2007 when the House Judiciary Committee scheduled a hearing on one of these bills. After some extremely moving testimony from several women who had lost their husbands, some as a result of a mine tragedy and others as a result of an airplane crash, Representative Rob Wilkey presented the bill on the House floor. The Bill passed in a 93 to 7 vote; however, the Senate did not act on the bill.

The events and judicial decisions discussed above provide a brief history of loss of consortium claims in the Commonwealth of Kentucky. Although not all of the holdings directly impacted the Martin decision, they all played a role in the development of the law that led to Martin’s monumental holding.

III. THE MARTIN CASE

A. Background and Facts

On June 20, 2002, Billie Carol Shreve was severely injured in an automobile crash. The collision occurred a short distance from a hospital operated by the
defendant in Martin, Ohio County Hospital Corporation.\textsuperscript{117} The EMS transported Ms. Shreve to the hospital’s emergency room where a registered nurse performed a triage assessment to determine the urgency of Ms. Shreve’s injuries.\textsuperscript{118} Ms. Shreve had indications of blunt abdominal trauma and informed the hospital staff that she was uncomfortable, but otherwise, she appeared stable.\textsuperscript{119} Her condition deteriorated rapidly; one hour and twenty-five minutes after arriving at the hospital, her blood pressure began to plummet and her pulse increased dramatically.\textsuperscript{120} She fell unconscious shortly thereafter.\textsuperscript{121}

The physicians and nursing staff determined that Ms. Shreve was in shock, was probably hemorrhaging, and was in desperate need of a surgeon.\textsuperscript{122} No surgeon was available at the hospital, or the hospital staff did not call for one.\textsuperscript{123} Moreover, the hospital did not transfer Ms. Shreve to a facility where a surgeon was available to care for her.\textsuperscript{124} Instead, the physician significantly delayed her transfer by ordering a CT scan.\textsuperscript{125} He knew he would have to send the films to another hospital to be interpreted.\textsuperscript{126} The hospital did not transfer Ms. Shreve to a facility that had the staff to care for her condition until four hours later.\textsuperscript{127} By the time she arrived at the new facility, Ms. Shreve had bled to death.\textsuperscript{128} Her husband then instituted a cause of action against the hospital and asserted a claim for loss of spousal consortium.\textsuperscript{129}

Ms. Shreve was 54-years-old when she died and had not worked for many years due to her poor health.\textsuperscript{130} Despite her declining state, Ms. Shreve served as her disabled husband’s “sole and exclusive” caregiver throughout their marriage and was also responsible for raising their three children.\textsuperscript{131} It was clear to everyone, including the jury, that Mr. Shreve’s loss of spousal consortium was the most significant of all the damages resulting from the death of his wife.\textsuperscript{132}

\textsuperscript{117} Martin, 295 S.W.3d at 106.
\textsuperscript{118} Id.
\textsuperscript{119} Id.
\textsuperscript{120} Id.
\textsuperscript{121} Id.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} Id. at 106.
\textsuperscript{125} Id.
\textsuperscript{126} Id.
\textsuperscript{127} Id.
\textsuperscript{128} Id.
\textsuperscript{129} Martin, 295 S.W.3d at 106.
\textsuperscript{130} See Conway, supra note 61, at 14.
\textsuperscript{131} Id.
\textsuperscript{132} Id. The other damages sought were part of a claim made under the Emergency Medical Treatment and Active Labor Act (EMTALA). See Martin, 295 S.W.3d at 107.
Following established Kentucky law through the decisions of *Brooks* and *Clark*, the trial court instructed the jury that it could only assess damages for loss of consortium for the period of time from injury to the time of death.133 Ms. Shreve lived only a few hours from the time of her injury until her death.134 The jury assessed Mr. Shreve’s loss of consortium in the amount of $250,000, the maximum amount allowed under the trial court’s jury instructions.135 Mr. Shreve offered a post-death loss of consortium instruction, but the court rejected the offer, and Mr. Shreve did not appeal this denial.136

The hospital, on the other hand, appealed the verdict, arguing Mr. Shreve was not entitled to any recovery, citing *Brooks* and *Clark*.137 Mr. Shreve countered that the holdings in *Brooks* and *Clark* were against Kentucky law and should be overturned.138 He contended that Kentucky should join the majority of forty-six states that already recognized a claim for loss of consortium post-death, even if the spouse’s death occurs immediately after an injury.139 The Court of Appeals, relying on the holdings in *Brooks* and *Clark*, granted a directed verdict in favor of the defendants.140 However, Justice Thompson issued a concurring opinion, which Justice Taylor joined, and this concurring opinion assisted in allowing the case to proceed to the Supreme Court.141 Justice Thompson stated, “It is my belief that the Supreme Court of Kentucky should revisit its interpretation of the common law and adopt a claim for loss of post-death spousal consortium.”142 Seemingly convinced by Justice Thompson’s concurring opinion, the Supreme Court granted discretionary review.143

133. *Martin*, 295 S.W.3d at 106-07 n.1. “The instruction stated that the jury could award money damages for the ‘[l]oss of Plaintiff, Donald Ray Shreve, of the services, assistance, aid, society, companionship, and conjugal relationship of his wife, not to exceed $250,000. Any recovery for loss of consortium ended with the death of [Mr.]s. Shreve.’”. *Id.* (alterations in original).

134. See *Conway*, *supra* note 61, at 14. An interesting side note to the case comes from the comparison timeline of the *Martin* case and other events previously discussed. *Id.* The trial court in *Martin* handed down its decision on August 28, 2006, just one day after the Comair crash that resulted in *In re Air Crash at Lexington, Ky., Aug. 27, 2006*. *Id.* When *Martin* was appealed, the briefs of the parties arrived at the appellate court while HB 403 was being considered by the legislature. *Id.* Finally, oral arguments came shortly after the ending of the legislative session. *Id.*


136. *Id.* Mr. Shreve’s choice not to appeal this denial would ultimately limit his recovery to the original $250,000 awarded by the jury, despite the fact that the Supreme Court chose to recognize a post-death loss of spousal consortium claim for the first time in Kentucky. *Id.* at 111-112.

137. See *Conway*, *supra* note 61, at 14.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. See *Martin*, 295 S.W.3d at 107. For a recognition of Ms. Martin’s (the daughter of Mr. Shreve, and Mr. Shreve’s) contributing efforts to change Kentucky’s post-death loss of spousal consortium law during the course of the *Martin* proceedings, see *Conway*, *supra* note 61 at 15. Credit should once again be given to the KJA, Paul Casi, Kevin Burke, and Bill Garmer, who
B. The Holding and Reasoning in Martin

The Supreme Court accepted review of the Martin case and noted that “[t]he issue of whether a spouse may claim loss of consortium after the death of her spouse turns on what the silence of the legislature on that issue in KRS 411.145 means.”144 The court proceeded to issue a unanimous decision that overturned Brooks and Clark, and interpreted Section 411.145 of the Kentucky Revised Statutes to allow post-death loss of consortium claims.145

The court first looked at the language of section 411.145 of the Kentucky Revised Statutes for guidance.146 The court determined that when a husband or wife suffers a loss of spousal consortium due to the negligence or wrongful act of a third party, “the legislative intent is clear that this person must compensate the spouse for the loss.”147 This meant the statute was “compensatory in nature,” supporting a finding to allow post-death loss of consortium claims.148 The court held:

It is apparent that the kinds of damage elements enumerated in the statute are those that describe the personal relationship, mental and physical, between spouses. It is equally apparent that the pain and deprivation coming from loss of such interactions does not magically disappear the day a spouse dies. It defies common sense to put a value on such losses while a spouse is lying incapacitated, but to say the loss is worthless after death . . . .

... [F]ull compensation cannot be had if the damages claimed are required to terminate at death.149

The court also noted that a jury could properly evaluate post-death damages for loss of consortium by looking at the facts and circumstances of each case.150 The court discussed the irrational and unfair results of applying the law as decided in Brooks and Clark, and pointed out that to do so essentially leaves the determination of whether a spouse could recover on fate, rather than law.151 The court further noted that “in many cases death is so sudden or follows so quickly after the injury that to cut loss of consortium damages off at death is to essentially deny the cause of action to the spouse altogether.”152 The court then pondered whether it can “reasonably be said that one whose spouse survives respectively helped the plaintiffs refine their arguments, drafted the Amicus brief, and allowed their past works to be used in the plaintiff’s brief. See id.

144. Martin, 295 S.W.3d at 107.
145. Id. at 111.
146. Id. at 109.
147. Id.
148. Id.
149. Id.
150. Martin, 295 S.W.3d at 109.
151. Id.
152. Id.
suffers more loss of consortium than one whose spouse dies.” The court found that an “obviously absurd” consequence would occur if it denied the right to claim loss of spousal consortium after death. It would encourage a “perverse incentive to potential tortfeasors . . . to kill victims instead of leaving them disabled, as only by instantly killing the victim can the tortfeasor be guaranteed to owe no loss of consortium damages.”

Also of importance to the Martin court was the fact that twenty-six jurisdictions throughout the United States recognize post-death loss of spousal consortium claims by statute. All of the statutes specifically allow the damages for loss of consortium, like those set forth in Section 411.145 of the Kentucky Revised Statutes, to extend beyond death. Although some of these states may use different mechanisms to provide post-death claims, they all do so. After explaining these trends, the court noted that Kentucky’s statute is similar to the statutes in states that recognize post-death consortium claims in that, like the other statutes, Kentucky statutes distinguish between loss of consortium claims and the claims for the injuries to the deceased spouse. Because of this similarity, the court found it was reasonable to interpret section 411.145 of the Kentucky Revised Statutes to allow post-death loss of consortium. Additionally, the court noted the expansion was reasonable because the legislature did not expressly limit those damages.

To further justify its reasoning, the court emphasized that of the states that do not include post-death loss of consortium in their wrongful death statutes, fifteen recognize that loss of consortium claims extend beyond death through the state’s case law. However, seven states extinguished loss of consortium claims at death. The court stated that because the Kentucky legislature thought it was necessary to create a statute for loss of consortium, this was evidence that they wished to depart from the common law. Section 411.145 of the Kentucky Revised Statute expanded the claim to include women and defined the elements of the damages. The court explained that the legislature could
have easily limited the damages to a specific time period, but it did not.\(^{166}\) However, the legislature included broad compensatory language in the statute: "may recover damages."\(^{167}\) Based on their review of the statutory language, the legislative history, and common sense, the court concluded that if the statute was intended to terminate damages for loss of consortium at death, it would have expressly done so; otherwise, there would have been no need for legislative action at all.\(^{168}\)

Thus, in \textit{Martin} the Supreme Court of Kentucky held that section 411.145 of the Kentucky Revised Statutes allows post-death loss of consortium claims.\(^{169}\) Furthermore, to the extent that \textit{Clark} and \textit{Brooks} (neither of which cited section 411.145 of the Kentucky Revised Statutes) held otherwise, or can be read to do so, they were overruled.\(^{170}\) Therefore, under Kentucky law, the loss of spousal consortium does not extinguish at death.\(^{171}\)

IV. ANALYSIS OF \textit{MARTIN} AND ITS EFFECTS

A. Post-Death Spousal Loss of Consortium Cases Post-Martin

\textit{Martin}'s legacy was quickly put to the test when, on March 16, 2010, \textit{McChesney v. Steiner, et al.} became the first case after \textit{Martin} in which a jury entered a verdict for loss of spousal consortium.\(^{172}\) In \textit{McChesney}, a 59-year-old husband died as a result of medical negligence.\(^{173}\) The decedent’s estate, his wife, and five minor children instituted loss of consortium claims against the hospital and physician.\(^{174}\) Relying on \textit{Martin}, the trial court submitted a jury instruction that did not limit the period of time for which the jury could assess damages for loss of spousal consortium.\(^{175}\) The jury assessed the loss of spousal consortium damages in the amount of $750,000.\(^{176}\) As for the five minor children, they all received separate recoveries for their claims of loss of parental

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166. \textit{Martin}, 295 S.W.3d at 111.
167. Id.
168. Id.
169. Id.
170. Id.
171. Id.
173. \textit{Loss of Consortium, supra} note 172, at 4; McChesney, No. 08-CI-00872, slip op. at 10.
174. \textit{Loss of Consortium, supra} note 172, at 3-4; McChesney, No. 08-CI-00872, slip op. at 1, 10-15.
175. McChesney, No. 08-CI-00872, slip op. at 10. The jury instruction stated: "‘Loss of Consortium’ as applied to Elizabeth ‘Betty’ McChesney means the loss of services, assistance, aid, society, companionship, and conjugal relationship with her husband, Arthur C. McChesney, Jr.” Id.
176. Id.
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The tortfeasors were held accountable for the full damages they caused. Thus, it appears that Martin is likely to have a meaningful impact in providing surviving spouses, like minor children, the ability to recover for loss of consortium after their spouse’s wrongful death.

B. The Logical Justification of Martin

The holding in Martin overturned a long history of case law that resulted, in many cases, in an unfair preclusion of recovery for surviving spouses, despite the recognized significant and devastating loss that they continued to suffer after their spouse’s death. The law pre-Martin effectively placed no value on the loss of consortium between a husband and wife when an injured spouse died instantly or shortly after his or her injuries, but bestowed a significant value on that loss if the spouse lived. The illogical result of applying the pre-Martin loss of consortium framework resulted in an unspoken finding that widowed spouses only grieved or suffered a loss from the time of injury to the time of their spouse’s death, regardless of how long or short that period was, and that upon death, they no longer suffered because their grief and loss were complete. Anyone who has lost a close friend or family member, regardless of the cause, undoubtedly knows this simply is not true.

The consequence of executing the pre-Martin holdings was often a complete bar to recovery for loss of spousal consortium, regardless of how extensive the surviving spouse relied upon the “services, assistance, [or] aid” of his or her injured or dead spouse. The holdings in Brooks and Clark benefited the surviving spouse only if his or her loved one suffered just long enough to allow the claim for loss of spousal consortium to be submitted to a jury. Even if the injured spouse survived a period of time, the court instructed the jurors that they could not award any damages for consortium beyond the spouse’s death.

Some examples of the injustice of implementing the pre-Martin rulings include a complete bar of recovery to a disabled surviving husband or wife that depended solely on his or her spouse for care and assistance. It could also

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177. Id. at 11-15.
178. See generally id.
180. See e.g., Brooks v. Burkeen, 549 S.W.2d 91, 92 (Ky. 1977) (noting that, at the time, “it [was] well settled law that her recovery would be limited to damages which she sustained before her husband’s death”), overruled by Martin v. Ohio Cnty. Hosp. Corp., 295 S.W.3d 104 (Ky. 2009), and abrogated by Giuliani v. Guiler, 951 S.W.2d 318 (Ky. 1997).
181. See Brooks, 549 S.W.2d at 92.
182. KY REV. STAT. ANN. § 411.145 (LexisNexis 2010).
183. See Brooks, 549 S.W.2d at 92.
185. See Brooks, 549 S.W.2d at 92.
186. See id.
include a young mother who is unexpectedly rendered a single parent with limited means to raise her children. Finding a way to replace those services would be difficult, if not impossible, without recovery from the negligent person or corporation that caused the other spouse’s untimely death. Regardless of the hardship that was created by the wrongful death of his or her spouse, and regardless of the facts evidencing the contributions of the deceased spouse prior to his or her death, the surviving spouse could only recover damages for the limited period of time that his or her spouse survived the injury. This unjust result extended to any spouse, regardless of the contributions of the spouse to the marital relationship or any aspect of their marriage.

Applying the pre-Martin holdings to various different factual scenarios created inconsistent and unjustifiable verdicts for surviving spouses, all of whom suffered the same or similar losses. An even more illogical result of the pre-Martin holdings was the fact that, by limiting and often completely precluding damages for loss of consortium upon death of the injured spouse, the wrongdoers were not held completely accountable for their actions. They were, in fact, encouraged to act more recklessly or more negligently to ensure the death of their victims. As emphasized by the Martin court, when a third party negligently or wrongfully causes a spouse to lose the consortium of a husband or wife, section 411.145 of the Kentucky Revised Statutes requires that person to compensate the spouse for their loss. The pre-Martin holdings, based on the underlying facts of the claim, could completely absolve defendants of liability for their actions if the decedent died immediately.

V. THE RATIONALE OF MARTIN SUPPORTS EXPANSION OF KENTUCKY’S LOSS OF CONSORTIUM LAW ALLOWING ADULT CHILDREN A RIGHT TO RECOVER LOSS OF PARENTAL CONSORTIUM AND ALLOWING PARENTS A RIGHT TO RECOVER LOSS OF CONSORTIUM FOR THEIR ADULT CHILDREN.

While the Martin decision was a step in the right direction, Kentucky should take yet another step and allow recovery for loss of consortium to adult children who survive their parent’s wrongful death, and likewise to parents who survive an adult child who has wrongfully died. As Judge Combs noted in her dissent in Smith v. Vilvarajah, the relationship between a parent and child is actually enhanced over time, and this could potentially render losing a parent as an adult
even more painful than as a child. Much of the rationale used by the courts to justify recognition of loss of parental consortium for minor children, a parent’s loss of consortium of minor children, and loss of spousal consortium beyond death, would also logically justify recognizing a claim for loss of parental consortium by adult children. It is simply a recognition by the courts that a minor child’s loss of parental consortium does not end at age eighteen, and, likewise, a parent’s loss of consortium does not end when a child reaches the age of eighteen.

As previously noted, “the purpose of all tort law is to compensate one for the harm caused by another and to deter future wrongdoing.” Although a cause of action allowing an adult child to recover for the loss of consortium of his or her parent does not currently exist, the Supreme Court of Kentucky certainly has the authority and duty to expand the right of recovery for loss of consortium to adult children. Similarly, the court has the authority and duty to expand the right of a parent to recover loss of consortium for children beyond age eighteen.

Because loss of consortium is a common law doctrine, the Supreme Court of Kentucky has the responsibility to change it when it does not conform to our society’s changing conditions and when it is out of sync with the times. As the Giuliani court stated, “[d]evelopment of the common law is a judicial function and should not be confused with the expression of public policy by the legislature.” It was a “natural development of the common law to recognize the need for the remedy for those children who lose the love and affection of their parents due to the negligence of another.” Similarly, recognizing a parent’s right to recover for the loss of consortium of their adult children would also be a natural development of the law.

When discussing whether it had the authority to change common law rules, the court further illustrated the need to change the law when it explained that the “[c]ommon law grows and develops and must be adapted to meet the recognized importance of the family, and the necessity for protection by the law of the right of a child to a parent’s love . . . .” The court also noted, “[t]his Court has the authority and responsibility to modify loss of consortium as a common law doctrine when necessary. The general claim for loss of consortium has long

195. See Martin, 295 S.W.3d at 110-11.
196. See Smith, 57 S.W.3d at 844 (Combs, J., dissenting).
197. Giuliani v. Guiler, 951 S.W.2d 318, 320 (Ky. 1997) (citing City of Louisville v. Louisville Seed Co., 433 S.W.2d 638 (Ky. 1968)).
198. Id. at 319-21.
199. Id.
200. Id. at 321.
201. Id at 319.
202. Id.
203. Giuliani, 951 S.W.2d at 320.
been recognized in a number of Kentucky precedents. This reasoning could just as easily be applied to the argument to give parents a right to recover damages for the loss of consortium of their adult children. Furthermore, the Giuliani court specifically emphasized:

“The law is both a progressive and resourceful science, and is ever alert to accommodate itself to the constant changing circumstances and conditions of society . . . [W]hen it is necessary . . . to employ a remedy to fit alternative situations and conditions, it is not only proper, but it is the duty of courts to do so to the end that justice may be administered.”

... 

“We do not think that the framers of our Constitution intended to shackle the hands of the judicial branch of government in its interpretation, modification or abolition of the great body of mutable common law to meet the demands of changing times.”

Thus, when the legislature does not act, courts have the authority to “adopt and apply public policy principles.”

Further, even if looking at the doctrine of stare decisis as a militating reason against extending loss of consortium claims to adult children, it does not prevent the court from expanding the loss of parental consortium to adult children, essentially expanding a minor child’s loss of parental consortium beyond the age of majority. As the court noted: “[t]he doctrine of stare decisis does not commit [the court] to the sanctification of ancient fallacy. Stare decisis does not preclude all change. The principle does not require blind imitation of the past or adherence to a rule that is not suited to present conditions.” Recovery for loss of parental consortium is allowed to other, equally significant family members in the form of minor children. Currently, under Kentucky law, there is no reason to deprive adult children of compensation for the loss of their parents’ love and affection, while allowing minor children to recover. Although the Kentucky appellate courts have chosen not to recognize an adult child’s right to bring an action for loss of parental consortium in two decisions, it does not preclude the

204. Id. (citing Dietzman v. Mullin, 57 S.W. 247 (Ky. 1900); Kotsiris v. Ling, 451 S.W.2d 411 (Ky. 1970)).
205. Id. at 321 (quoting Graham v. John R. Watts and Son, 36 S.W.2d 859 (Ky. 1931) and citing Ruby Lumber Co. v. K.V. Johnson Co., 187 S.W.2d 449 (Ky. 1945)).
206. Id. (quoting City of Louisville v. Chapman, 413 S.W.2d 74 (Ky. 1967) and citing Pryor v. Thomas, 361 S.W.2d 279 (Ky. 1962)).
207. See Giuliani, 951 S.W.2d at 320 (noting that the doctrine of stare decisis does not prevent changes in the law).
208. Id. (citing Hilen v. Hays, 673 S.W.2d 713 (Ky. 1984)) (citation omitted).
209. Id. at 320-22.
Supreme Court of Kentucky from modifying and changing the common law to conform to today’s societal needs and changes.211

In the case of Clements v. Moore, a father of five adult children was killed in a traffic collision.212 The five adult children brought a claim for loss of their father’s consortium.213 On appeal, the Court of Appeals of Kentucky rejected the plaintiffs’ argument that allowing adult children to recover for loss of parental consortium would be a “natural and logical extension” of the Giuliani decision.214 The Clements court indicated that there have been some instances of the court’s efforts in recognizing new causes of action, including the tort for breach of the covenant to act in good faith against insurance companies and the tort of negligent hiring.215 However, in the end the court felt that it did not have the authority to develop the common law at that point and ultimately denied recovery to the plaintiffs.216

Although the court ultimately ruled against the plaintiffs, it expressed its belief that the common law should be expanded.217 The court recognized that the loss of parental consortium suffered by adult children was “substantially the same as [that] experienced by their minor sibling.”218 It further stated that the adult children were no less deserving of compensation for the loss of their father’s consortium than other family members merely because they had reached the legal status of “adult.”219 Although the court ultimately viewed it as being within “the purview of the Legislature” to expand the right to adult children,220 it used the same common sense reasoning used by the Supreme Court of Kentucky in Martin to overrule the outdated and unjust preclusion of recovery to spouses.221 Thus, the reasoning used by the Clements and Martin courts supports allowing adult children to recover for their loss of parental consortium.222

211. See Smith v. Vilvarajah, 57 S.W.3d 839, 844 (Ky. Ct. App. 2000) (“[W]e decline to extend the claim for loss of parental consortium to emancipated adult children such as the appellants. We conclude that any such step must be taken either by the legislature or by our Supreme Court.”).

212. Clements v. Moore, 55 S.W.3d 838, 839 (Ky. Ct. App. 2000). The decedent was also survived by his wife and a minor child. The wife brought a wrongful death claim, as well as, a claim on behalf of the minor child for loss of consortium. See id. at 839 n.1. Both claims were settled prior to a trial. Id. It is interesting to note the opinion of the appellate court does not mention any claim by the wife for loss of spousal consortium. See id. This is most likely because the decedent died instantly and the case was pre-Martin, leaving the wife with no claim for loss of consortium. See id. See also Brooks v. Burkeen, 549 S.W.2d 91 (Ky. 1977), overruled by Martin v. Ohio Cnty. Hosp. Corp., 295 S.W.3d 104 (Ky. 2009), and abrogated by Giuliani v. Guiler, 951 S.W.2d 318 (Ky. 1997).

213. Clements, 55 S.W.3d at 839.
214. Id. at 840.
215. Id. at 840 n.8.
216. Id. at 840-41.
217. Id.
218. Id.
220. Id.
221. See Martin v. Ohio County Hosp. Corp., 295 S.W.3d 104, 109 (Ky. 2009). Judge Barber apparently felt the same way and made this known in his dissent when he stated that the plaintiff’s
In *Smith v. Vilvarajah*, a woman with three adult children allegedly died as a result of ingestion of Fen-Phen. Her three adult children instituted an action seeking recovery of damages for the loss of their mother’s consortium. Similar to *Clements*, the Kentucky Court of Appeals noted in *Smith* that the holding in *Giuliani* did not bar it from recognizing such a claim by adult children and viewed the issue as a matter of first impression. However, also similar to *Clements*, the court declined the invitation to extend the claim for loss of parental consortium to emancipated adult children, stating that it would depend upon the legislature or the Supreme Court of Kentucky to do this.

The majority opinion was not unanimous, however, and Judge Combs filed a dissenting opinion. Judge Combs stated that allowing adult children to sue for loss of parental consortium would be a “logical and proper extension of the reasoning of *Giuliani*.” She emphasized that “[t]he deprivation of love, companionship, and affection” was in no way lessened by the fact that a child had reached the age of eighteen. In fact, as previously noted, Judge Combs argued that the relationship between a parent and child is actually enhanced over time, and that this could potentially render losing a parent as an adult even more painful.

Although the Kentucky Court of Appeals in *Clements* and *Smith* held that adult children could not recover for loss of parental consortium, the outcomes appear to be more a result of judicial restraint by an intermediate appellate court rather than a rejection of the merits of the case. The *Smith* court felt the need to note that the state supreme court could change this archaic law if they chose to do so. Because of the characteristically slow nature of the state legislature, it is the hope of these authors that the Supreme Court of Kentucky will expand the common law to include loss of parental consortium for adult children and to allow parents to claim loss of consortium for their children beyond the age of majority. This will ensure justice, comport with the purpose of tort law, and reflect the value that society places on those individual’s lives.

claim is a logical extension of *Giuliani*. *Clements*, 55 S.W.3d at 841 (Barber, J., dissenting). He criticized the majority opinion and stated its holding was “no more than a distinction without a difference.” *Id.*

222. See *Clements*, 55 S.W.3d at 840-41.
224. *Id.* at 841.
225. *Id.*
226. *Id.* at 844.
227. *Id.* (Combs, J., dissenting).
228. *Id.*
229. *Smith*, 57 S.W.3d at 844 (Combs, J., dissenting).
230. *Id.*
231. See *id.* at 844 (majority opinion) (“[W]e decline to extend the claim for loss of parental consortium to emancipated adult children . . . . We conclude that any such step must be taken either by the legislature or by our Supreme Court.”).
The Martin court expressly noted that neither a statute, nor the Supreme Court of Kentucky, have addressed the issue of allowing adult children to recover damages for loss of parental consortium. The court did, however, recognize that the spousal relationship is the strongest of all bonds, except for perhaps the child-parent relationship, indicating that this relationship is also worthy of protection. This being the case, it would seem logical for the Supreme Court of Kentucky to extend a minor child’s claim and a parent’s claim beyond the age of majority of the child. As the court had previously noted, “[t]he claim of loss of parental consortium is a reciprocal of the claim of the parents for loss of a child’s consortium which was recognized in KRS 411.135.” The court also stated: “[t]here is no legal distinction between the claim of a parent for loss of a child’s consortium from the claim of a child for the loss of parent’s consortium.” If Kentucky did recognize an adult child’s right to recover for the loss of their parent’s consortium, it would be joining the majority trend of other states that would likely recognize this cause of action.

In addition, ethical, social, economic, political, and legal developments have restructured the family unit to meet the demands of life in the past quarter of the century. Parents are living longer and require the care, assistance, society and love of their adult children. Many minor children suffer injuries requiring care from their parents or siblings for the remainder of their lives, well beyond the age of majority. The loss of those adult members of the family who contribute so much to provide necessary services for the parent or for the adult child is significant and valuable. If an adult child or a parent of an adult child is injured or killed as a result of someone else’s negligence, the family members that depend so much on those caregivers should be compensated.

For the same reasons that the Supreme Court of Kentucky found that the loss of spousal consortium does not end at death of the injured spouse in Martin, the court should also find that an adult child and a parent of an adult child should have the right to recover for the injuries and damages caused by another. Logic, justice, and public policy require recognition of an adult child’s claim for loss of parental consortium. The family unit, for various reasons, has morphed into a heterogeneous group comprised of different family members, with grandparents,

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234. Id. at 111.
236. Id.
237. See Stacy E. Buening, Comment, The Value of a Parent-Child Relationship: Should Adult Children in Wisconsin Be Permitted to Recover for Loss of Companionship of a Parent Who Has Died at the Hands of a Nursing Home?, 86 Marq. L. Rev. 541, 552-53 (2002) (citing 22A Am. Jur. 2d Death 252 (1962)). “[H]owever, . . . this source does not state that the trend is to allow adult children to recover from loss of companionship. It merely states that the trend is to allow recovery for loss of companionship and that some states even allow the adult child to recover.” Id. at 553 & n.75 (citations omitted).
grandchildren, aunts, uncles, and cousins playing a larger role in performing tasks and obligations for the family as a whole.

VI. CONCLUSION

Since 1970, when Kotsiris 238 was decided, the expansion of Kentucky’s loss of consortium laws has moved at a seemingly slow pace. This expansion has been characterized by a few landmark cases and statutory enactments, staggered throughout the past four decades. In 1997, the Supreme Court recognized a minor child has a right to recovery for loss of parental consortium. 239 In 2009, a spouse’s right to recover for loss of spousal consortium was no longer limited from the time of injury to the time of death. 240 The Supreme Court of Kentucky recognized the loss of, and the value of, consortium does not end at death. 241 It is logical for the Supreme Court to move forward and recognize that a child’s, and likewise a parent’s, loss of the aid, society, services, and companionship, do not end when the child reaches the age of majority.

Furthermore, there is an equally persuasive argument for extending loss of consortium claims beyond adult children to certain extended members of a family. In a large majority of families today, the members of the family that assist in caring for parents or children are not limited to a mother, father, or siblings. There are often grandparents, grandchildren, aunts, uncles or cousins that assist with the everyday services, care and assistance of elderly and minor family members. For medical reasons or as a result of negligence, many children suffer catastrophic injuries or suffer medical conditions that require extensive, life-long care and assistance beyond the age of majority. Providing those services typically falls on the shoulders of the parents and/or other family members. Precluding the child from recovering for that loss simply because they are eighteen years of age or older is illogical. Many adult children care for and assist their parents throughout their lifetimes. These services are usually necessary after the child reaches adulthood. To preclude a parent from recovering the loss of consortium for their adult children is also equally unpersuasive. The evolution of the family core has developed such that the value of each member should be recognized. The valuable contribution of each family member is worthy of protection. It certainly does not end at a specific age.

The risk of double recovery and the rise in insurance costs are unconvincing. 242 Under a proper instruction, a jury is quite capable of making such a distinction. Jury instructions can easily remedy any alleged double recovery.

238. See Kotsiris v. Ling, 45 S.W.2d 144 (Ky. 1970).
239. See Giuliani, 951 S.W.2d at 323.
241. Id.
242. See Giuliani, 951 S.W.2d 322.
recovery by properly stating that the child’s damages are separate and distinct from the parent’s injury. Rampant rumors and undue alarms regarding imagined consequences are wholly unwarranted.243

Although the Martin decision was long overdue, Kentucky courts now have the opportunity to use Martin and give the citizens of the Commonwealth, who have lost or will lose loved ones due to a wrongful death, the justice that has been withheld from them for far too long. Legislative action extending Kentucky’s loss of consortium law would be the most ideal path, but this process is often slow and will likely not occur anytime soon. However, attorneys and plaintiffs across the Commonwealth can play an active role by continuing to file loss of consortium claims. The more courts are faced with these claims, the more chances they have to end the injustice and extend Kentucky’s loss of consortium claims to deserving individuals.

243. Id.
“MURKY?”! MAYBE! A SURVEY OF CASES INTERPRETING KENTUCKY’S PROFESSIONAL MALPRACTICE STATUTE OF LIMITATIONS

The Honorable William O. Bertelsman* and Elizabeth Favret**

I. INTRODUCTION

A couple of months ago, the editors of the Northern Kentucky Law Review invited me to join with a student editor in writing an article for the Kentucky Survey issue. I gladly accepted. The editors stressed that the article should be a review of Kentucky law on a subject of practical interest to practicing attorneys. Coincidentally, at that time I was working on an opinion for a case that fit the editors’ criteria exactly: Corporex Companies, LLC v. Proskauer Rose, LLP.1 That case involved challenging issues in the application of Kentucky Revised Statute section 413.245, which is Kentucky’s professional malpractice statute of limitations.

In Corporex, able attorneys for all parties presented strong arguments for different applications of this statute to the rather unusual facts before the court. I had not been confronted with the application of this statute for many years and was not familiar with recent precedents. I found that there were problems, especially in legal malpractice cases, in determining when a professional malpractice claim accrues. These problems concerned the application of the discovery rule provided for in the statute, the effect of the continuous representation rule, and other issues.

My research revealed that, despite the apparent simplicity of the statute, both federal and state courts had been struggling with its practical applications for many years. Because attorneys are genuinely interested in when they might be sued if they make an error, or when they may or must sue if retained to represent

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a claimant against a professional, the issues presented in Corporex made a good topic for the article I had agreed to write.

This article starts with a discussion of my opinion in Corporex Companies, LLC v. Proskauer Rose, LLP in Part II. Then, Part III reviews Kentucky case law applying Kentucky Revised Statute section 413.245. Part IV provides an explanation of why the professional malpractice statute of limitations has caused so much confusion. In Part V, I recommend some steps to be taken that could help resolve this confusion. Finally, in Part VI, the student editor provides an overview of how other jurisdictions have decided when the limitations period begins to run in legal malpractice cases to give the readers a sense of other possible approaches to resolving this issue.

II. CORPOREX V. PROSKAUER

Corporex is a legal malpractice action against a law firm that gave Corporex a legal opinion that a certain tax shelter would probably be acceptable to the IRS. This tax shelter had been marketed to Corporex by an investment company. As part of the marketing process and at the suggestion of the investment company, Corporex retained Proskauer, an international law firm, to provide an opinion letter on the validity of the tax shelter. This letter was issued on Proskauer letterhead on April 5, 2002. Corporex invested $800,000 in the tax shelter based upon this opinion letter. However, the opinion letter’s predictions concerning IRS approval of the tax shelter proved overly optimistic. On April 15, 2005, the IRS sent Corporex a statutory notice of deficiency disallowing the tax shelter and assessing Corporex with $9 million in additional taxes.

On September 9, 2005, Corporex filed a refund suit seeking to overturn the additional tax assessment. Having made a substantial, good faith deposit with the Secretary of Treasury the day before, Corporex retained separate counsel for the suit.

On February 11, 2008, Corporex and the United States entered into a settlement agreement, which will be described in more detail below. On March 12, 2008, the court dismissed the refund action pursuant to a joint stipulation of dismissal provided for in the settlement agreement.

3. The facts are somewhat simplified for the purposes of this article. Id.
5. Id.
6. Id. at 680.
7. Id. at 679.
8. Id. at 680.
9. Id.
11. Id.
12. Id.
On January 16, 2009, Corporex filed its malpractice complaint against Proskauer in the United States District Court for the Eastern District of Kentucky. Subsequently, the defendant moved to dismiss on the basis of the professional malpractice statute of limitations.

One might ask, as did Corporex: “How can this be? Doesn’t the Kentucky malpractice statute clearly provide for a limitations period of one year, that would have began to run in February or March, 2008?” Indeed, at first blush it would seem so, as the statute provides:

> Notwithstanding any other prescribed limitation of actions which might otherwise appear applicable, except those provided in KRS 413.140, a civil action, whether brought in tort or contract, arising out of any act or omission in rendering, or failing to render, professional services for others shall be brought within one (1) year from the date of the occurrence or from the date when the cause of action was, or reasonably should have been, discovered by the party injured. Time shall not commence against a party under legal disability until removal of the disability.

“But wait!” argued Proskauer. “Process was not issued on us until after the year was up.” Under Kentucky law, which is applicable in federal court, an action is not commenced merely upon filing the complaint, as provided in Rule 3 of the Federal Rules of Civil Procedure; rather it is also necessary to issue process “in good faith” pursuant to Kentucky Rule of Civil Procedure 3.01.

“No, you wait,” countered Corporex, “on the day the action was filed, we sent a request for waiver of process under Rule 4(d) of the Federal Rules of Civil Procedure which substitutes for the issuance of process.” This argument made

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13. Id.
14. Id. at 681.
15. See KY. REV. STAT. ANN. § 413.140 (West 2010) (prescribes the general one-year statute of limitations for most tort claims, including medical malpractice).
16. KY. REV. STAT. ANN. § 413.245 (West 2010).
20. FED. R. CIV. P. 4(d) provides:

   (1) Requesting a Waiver. An individual, corporation, or association that is subject to service under Rule 4(e), (f), or (h) has a duty to avoid unnecessary expenses of serving the summons. The plaintiff may notify such a defendant that an action has been commenced and request that the defendant waive service of summons.
a lot of common sense, but the Advisory Committee notes for Rule 4(d) make clear that requesting waiver of process does not toll an applicable statute of limitations, and it should not be used when state law provides for requirements in addition to filing the complaint to commence an action.21

“So,” argued Proskauer, “this action was not commenced until we returned the signed waiver of service form on April 22, 2009, more than one year after the claim accrued. At the latest, the accrual date was March 12, 2008, when Corporex’s refund action was settled and dismissed.”

“So what?” said Corporex, “our claim for legal malpractice hasn’t even accrued yet.”

This brings us back to the settlement agreement between Corporex and the IRS. It did not provide for the precise amount of tax due; instead, it contained a complicated formula for how the final tax liability should be determined.22 Importantly, the final tax liability had not yet been determined at the time these arguments were made.23

When Did the Malpractice Action Accrue?

Before I tell you how I ruled, let me ask you how you would have ruled. Some of the possible dates for accrual of the claim were:

1. December 31, 2001, the date of the last transaction of a series of investments.24
2. April 5, 2002, the date of the opinion letter.
3. April 15, 2005, when the IRS sent the statutory notice of deficiency.
4. An unknown date, when Corporex retained its own attorneys to contest the tax liability.

(4) Results of Filing a Waiver. When the plaintiff files a waiver, proof of service is not required and these rules apply as if a summons and complaint had been served at the time of filing the waiver.

21. FED. R. CIV. P. 4 Advisory Committee’s note (1993 Amendments):
Some state limitations laws may toll an otherwise applicable statute at the time when the defendant receives notice of the action. Nevertheless, the device of requested waiver of service is not suitable if a limitations period which is about to expire is not tolled by filing the action. Unless there is ample time, the plaintiff should proceed directly to the formal methods for service identified in subdivisions (e), (f), or (h).

22. The letter of agreement provided:
If any portion of the I.R.C. § 6226(e) deposit or additional deposit remains after application of paragraphs 3, 6 and 7, the Taxpayers shall receive a credit of the overpayment in accordance with I.R.C. § 6402 or a refund of such amount with interest in accordance with Treas. Reg. § 301.6226(e)-1(b). Corporex, 713 F. Supp. 2d at 687.

23. Id. at 687 n.8.

4. September 8, 2005, when Corporex made a “good faith deposit” against the possible tax liability.
5. September 9, 2005, when Corporex filed the refund action against the United States.
6. February 11, 2008, when Corporex and the IRS executed the settlement agreement.
7. March 12, 2008, when the refund action was dismissed as settled.
8. Not yet, because the final amount of tax due has not yet been determined.

Unfortunately, under the cases interpreting Kentucky’s malpractice statute of limitations, an argument can be made for any of these dates. In writing this article, it is my hope that the Kentucky Supreme Court or the General Assembly will provide a definitive answer.

III. A Review of the Cases Applying KRS 413.245

A. Non-Attorney Cases

In cases involving malpractice actions against non-attorney professionals, the courts’ analyses have been straightforward and have not presented much difficulty in interpretation. The bottom line in these cases is that the statutory period begins to run when: (1) there has been an occurrence that damaged the plaintiff, and (2) the plaintiff has discovered that damage, even though the full extent of the damage cannot be ascertained.

Because damage in the non-attorney cases is usually physical injury to the person or property of the plaintiff, the occurrence and the discovery typically coincide. Thus, in Old Mason’s Home of Kentucky, Inc. v. Mitchell, the limitations period began to run against an architect when leaks appeared in the basement of a building he had designed. Likewise, in Board of Education of Estill County v. Zurich Ins. Co., the claim accrued against an engineer when the earth swelled beneath a school building for which he had performed the site analysis.

Further, Kentucky courts have applied the discovery provision of the statute to toll the accrual of a claim. For example, the discovery provision tolled the accrual of a claim against a nurse when her negligence was not revealed until a doctor’s deposition. The same factor delayed the accrual of a claim against a

26. Id. at 307-08.
28. Id. at 894.
29. Underhill v. Stephenson, 756 S.W.2d 459, 460 (Ky. 1988)
bank auditor until a conflict of interest with the bank’s officers was disclosed to the board of directors.30

However, the non-attorney cases are not completely free of difficulty. *Queensway Financial Holdings, Ltd. v. Cotton & Allen, P.S.C.*31 involved a lawsuit against an auditing firm that allegedly undervalued the reserves of an insurance company that the plaintiff corporation desired to acquire.32 Any negligence in the estimate was unapparent to the plaintiff until after the acquisition when the Commissioner of Insurance required the amount of estimated reserves to be raised.33 This event negatively affected the acquired company’s balance sheet.34 Nevertheless, the court held that the statute began to run when the purchase was finalized, not later when the Commissioner required that the reserves be raised.35 The court reasoned that the value was what it was on the day of purchase, and that the plaintiff had been damaged as of that date.36 It rejected the argument that the damage did not occur until the Commissioner directed the reserves to be raised.37

One might ask if *Queensway* can be reconciled with *Peoples Bank of Northern Kentucky, Inc. v. Crowe Chizek and Co., LLC*, where the court rejected the argument that the statute of limitations began to run when the wrongful acts occurred and held that the cause of action accrued when the wrongful acts were disclosed to the board of directors.38 Also, one might ask if *Queensway* is in conflict with the legal malpractice cases discussed below. Certainly, Proskauer strongly argued that *Queensway* required a holding that the statute began to run when Corporex made the investment.

B. The Legal Malpractice Cases

As the cases cited in this section reveal, a great deal of confusion exists regarding when a claim for legal malpractice begins to run. Many years ago, I

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32. Id. at 142-43.
33. Id. at 145-46.
34. Id.
35. Id. at 152.
36. Id. at 149-50.
37. Queensway, 237 S.W.3d at 149-50.
38. People’s Bank, 277 S.W.3d 255 (Ky. 2009). *Peoples’ Bank* arose out of the conduct of former bank officers who had engaged in fraudulent banking activities with the bank’s largest loan customer. *People’s Bank*, 277 S.W.3d at 258-59. The bank brought suit against the accounting firm who had provided accounting and auditing services during that time for aiding and abetting the misconduct of the officers. Id. at 259. The bank alleged that the firm was liable for failing to discover and disclose the misconduct to the bank. Id. The court recognized that the bank was damaged from the officers’ breaches of fiduciary duty each time they authorized loans to cover the customer’s financial troubles, but it held that the cause of action did not accrue until the officers disclosed the conflict of interest to the bank. Id. at 266. The court reasoned that it was at that point that the bank sustained fixed and non-speculative damages. Id.
filed two decisions concerning two stages of the same attorney malpractice litigation. In the first of those cases, I held that where an attorney’s misconduct caused his client’s case to be dismissed, the professional malpractice statute did not begin to run until all appeals in the underlying case had been exhausted. In the second opinion, after the defendant attorney produced evidence that the client had previously incurred expense by hiring another attorney, I held that the statute began to run when the client incurred that expense.

A review of the subsequent Kentucky cases reveals that the Kentucky courts have adopted the view of the first case, quoting it several times, but implicitly reject that of the second. In Hibbard v. Taylor, the court held that the malpractice action accrued not when the trial court directed a verdict against his client because the attorney had failed to prove an essential element of the claim, but when the appeal from the dismissal became final.

The court reached the same result in Michels v. Sklavos, where the attorney failed to exhaust administrative remedies in an employment case. Although the client knew of the omission and hired a new attorney one and a half years prior to the appeal being dismissed, the court held the claim did not accrue until the appeal became final. The court explained:

The outcome of the present case turns neither upon the continuing representation rule, nor upon the discovery portion of KRS 413.245, but upon that portion of the [o]pinion in Hibbard v. Taylor recognizing that Taylor’s cause of action first accrued “when the result of the appeal

40. Osborne I, 573 F. Supp. at 1050.
41. Osborne II, 610 F. Supp. at 129.
42. Hibbard v. Taylor, 837 S.W.2d 500 (Ky. 1992). In Hibbard, an attorney represented a client seeking to rescind a contract for the purchase of heavy equipment due to an alleged material misrepresentation as to the equipment’s condition. Id. at 500. Following a trial, the court directed a verdict against the purchaser due to his attorney’s failure to produce any evidence showing the misrepresentation was material. Id. The attorney continued to represent the equipment purchaser on appeal, where the trial court’s opinion was affirmed. Id. The attorney notified his client of the result, but “[n]o petition for rehearing or motion for discretionary review was filed, and the appellate decision became final on August 25, 1989.” Id.
43. Id.
44. Michels v. Sklavos, 869 S.W.2d 728 (Ky. 1994).
45. Id. at 729.
46. Id. at 733.
became final and the trial court’s judgment became the unalterable law of the case. Only then was Taylor put on notice that the principal damage (the adverse judgment) was real; but more importantly, only then could he justifiably claim that the entire damage was proximately caused by counsel’s failure, for which he might seek a remedy . . . .”

Alagia, Day, Trautwein & Smith v. Broadbent is the case most analogous to Corporex. It also is a tax case where the IRS assessed a deficiency after the client followed a tax attorney’s advice. In the subsequent malpractice suit, the tax attorney argued that the limitations period began to run when the clients received the statutory notice of deficiency.

In Alagia, the Kentucky Supreme Court relied heavily on Michels in deciding in favor of the aggrieved clients, stating: “[T]his case must be decided on the occurrence rule as discussed in Michels . . . . Until the legal harm became fixed and non-speculative, the statute did not begin to run. As such, the statute was tolled until the subsequent law firm and the IRS settled the claim.”

Then, the court analyzed up to four different dates from which the limitations period could have arguably begun to run:

The first is the 1985 IRS notice and the virtually simultaneous consultation between the [clients] and attorney [ ]. This date is inapplicable for two reasons: At that time, there had been no occurrence because the negligence and damages were speculative and there could have been no discovery because of the continuous representation by appellants and the presumed reliance of the clients upon the advice given. The second date suggested is January 25, 1989, when [the] attorney [ ] wrote the [clients] and informed them that a substantial payment would be required. This, too, is an improper date and for the above stated reasons. The third date, June 30, 1989, when the attorney-client relationship was terminated, has provoked intense legal debate. While the events of this date were sufficient to trigger commencement of the statute if there had been an occurrence, the discovery of negligence was ineffective as the final result was not yet known.

The court concluded that the last date, the date of the underlying claim’s settlement, was the proper starting point for the legal malpractice statute of limitations, providing that “[n]ot until damages were fixed by the final

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47. Id. at 733 (quoting Hibbard, 837 S.W.2d 500, 502 (Ky. 1992)) (emphasis added).
49. Corporex, 713 F. Supp. 2d at 685 (“Of all the cases reviewed thus far, the court notes that Alagia is the most analogous to the facts of the current dispute between Corporex and Proskauer.”).
50. Alagia, 882 S.W.2d at 122.
51. See id. at 123.
52. Id. at 125-126 (emphasis added).
53. Id. at 126 (emphasis added).
compromise with the IRS was there an occurrence of the type required to commence the running of the statute."54

Kentucky cases subsequent to Alagia have adhered to this view in legal malpractice cases, including Meade County Bank v. Wheatley,55 Lane v. Richards,56 and Doe v. Golden & Walters, PLLC.57 Accordingly, I held in

54. Id. (emphasis added).
55. Meade County Bank v. Wheatley, 910 S.W.2d 233 (1995). In Wheatley, a bank retained an attorney to conduct a title examination of property upon which it wanted to make a first mortgage loan to its customer and the attorney failed to disclose a prior recorded mortgage. Id. at 234. The bank discovered the prior mortgage when it prepared to bring an action to enforce its mortgage against the client. Id. Additionally, the bank learned that the appraised value of the property was substantially less than the prior mortgage lien. Id. Consequently, the bank subsequently purchased the property and had to satisfy the prior mortgage in the amount of $80,000. Id.

The bank then sued the attorney for legal malpractice. Id. At issue was whether the appraisal or the sale of the property commenced the running of the statute of limitations. Id. Applying the approach in Alagia, the court concluded that the statute of limitations began to run at the foreclosure sale. Id. at 235. The court reasoned that prior to that date, the bank was only aware that there may be insufficient equity, but its fear was not realized until the sale of the property. Id. “At that time, what was merely probable became fact, and thus commenced the running of the statute.” Id.

56. Lane v. Richards, 256 S.W.3d 581 (Ky. Ct. App. 2008). In Lane, the plaintiff retained an attorney to represent her in action against a school board for various violations of federal law. Id. at 583. Following the district court’s dismissal of her claim, the plaintiff hired a second attorney to appeal to the Sixth Circuit, but that appeal was also dismissed. Id. After the Sixth Circuit dismissed the appeal, the second attorney wrote the plaintiff a letter informing her that he would not file a petition for writ of certiorari to the Supreme Court on her behalf because he believed it would be futile. Id. In this letter, the second attorney also informed the plaintiff that she likely had a malpractice claim against the first attorney. Id. The plaintiff then retained a third attorney to file the petition for writ of certiorari to the Supreme Court, but that attorney failed to file the claim before the time allowed for filing the petition had expired. Id.

The plaintiff filed a malpractice action against the first attorney, less than one year after she discovered that the petition for writ of certiorari was never filed with the Supreme Court. Id. The Kentucky Court of Appeals held that the cause of action accrued when the third attorney failed to file the petition within the allowable time, making the Sixth Circuit’s judgment final. Id. at 585. However, the court applied the continuous representation rule and tolled the statute while the plaintiff reasonably relied on the third attorney’s representations that he had filed the petition. Id. Therefore, it concluded that the plaintiff’s suit was timely. Id.

57. Doe v. Golden & Walters, PLLC., 173 S.W.3d 260 (Ky. Ct. App. 2005). In Golden & Walters, attorneys represented the named class representatives in a civil rights action against the local government. Id. at 262-63. The putative class members brought a legal malpractice claim against the attorneys, alleging the attorneys falsely represented that they would represent their interests, but instead, only protected the interests of the named class representatives. Id. at 269. Specifically, the putative class members claimed that the attorneys entered into a settlement agreement without insisting that the court certify the class and failed to give notice to the putative class members that the court denied class certification. Id. As a result, their later claims were dismissed as time-barred. Id.

The court determined that the plaintiffs were injured when their claims against the local government were dismissed because the statute of limitations began running from the denial of class certification and thus had expired. Id. The plaintiffs appealed the dismissals to the Sixth Circuit. Id. at 273. The court held that the cause of action did not accrue until the Sixth Circuit issued its final opinion. Id. at 274. Because the complaint was filed before the Sixth Circuit had
Corporex that Alagia (which was directly on point) and the other cases cited above required a ruling that the claim against Proskauer was not barred by limitations.58 Indeed, that claim had not yet even accrued under the rule of Alagia because the final tax liability had not yet been fixed and determined.59

IV. WHY THE CONFUSION?

As stated above, these legal malpractice cases cause a great deal of confusion. Yet the later cases are very consistent if one looks at their facts. I suggest that much of the confusion arises from applying the language of the non-legal cases (which hold that the claim accrues when it is obvious that some damage is inevitable, even though the full extent of the damage is not known) to the legal cases. However, there is a difference between a situation where the soil heaves up under a building and where a lawsuit has been dismissed because the damage may not occur if the dismissal is reversed on appeal.

As explained in Michels, any incidental expense in the legal malpractice cases incurred prior to the conclusion of the litigation does not trigger the running of the statute as it does in the non-legal cases.60 Despite my ruling in Osborne II, I believe that the Kentucky courts’ approach is sound because it prevents premature legal malpractice actions. Once the damage is fixed, the client can recover for any expenses incurred while trying to correct the attorney’s error.61 To avoid future confusion, the rule developed in the cases cited above should be established by a rule-making body.

V. RECOMMENDATIONS

As the discussion above shows, Judge Hood’s description of the case law under KRS § 413.245 as truly “murky” is all too accurate.62 Some of this murk could be dispelled by the Kentucky Supreme Court or General Assembly establishing the principle that attorney-malpractice cases should be considered separately from the non-attorney cases. In addition, it would be even better if one of these bodies revised the entire law on the subject by clearly adopting one

issued its opinion, the court held that the cause of action was premature and dismissed the claims without prejudice. Id. at 275-76.
59. Id. at 687. Cf. Golden & Walters, 173 S.W.3d at 274-76 (finding that the cause of action had not yet accrued at the time of filing because an appeal was still pending).
60. See Michels, 869 S.W.2d 728, 733 (holding that the statute of limitations cannot begin to run until the appeal becomes final because “only then could [a plaintiff] justifiably claim that the entire damage was proximately caused by [his] counsel’s failure”) (quoting Hibbard, 837 S.W.2d 500, 502 (Ky. 1992)).
61. Queensway, supra notes 31-37, also seems to me to be inconsistent with the legal malpractice cases.
or more of the approaches of other jurisdictions, as described in this article’s next section.

VI. HOW DO OTHER JURISDICTIONS DEAL WITH THIS ISSUE?

This section compares Kentucky’s law regarding the statute of limitations for legal malpractice claims to that in other jurisdictions. Kentucky Revised Statute section 413.245 is similar to its equivalents in other states. It provides for two possible points in time where the statute of limitations begins to run: (1) the date of occurrence, or (2) the date when the plaintiff discovered or reasonably should have discovered the negligent act or omission. Kentucky utilizes many of the same common law doctrines as the other states. However, depending on the facts before the court, there are many ways a court can apply these doctrines. As a result, differences exist between how Kentucky and other states determine when the limitations period for a legal malpractice claim begins to run.

A. Statutes in Other Jurisdictions

There are a variety of statutes of limitations for legal malpractice claims among states. Like Kentucky, many states apply general statutes of limitations for professional malpractice to attorneys. However, some states have specific statutes of limitations for attorney malpractice claims. A few states even prescribe different commencement dates in their statutes of limitations for specific types of attorney malpractice claims, such as rendering title opinions or drafting last wills and testaments. Further, some states statutorily define when

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64. Ronald Mallen & Jeffrey Smith, Which Statute – Malpractice Statutes, 3 LEGAL MALPRACTICE § 23:8 (2009), at “Introduction.” E.g., FLA. STAT. ANN. § 95.11(4)(a) (West 2010); IDAHO CODE ANN. § 5-219 (2010); IND. CODE ANN. § 34-11-2-3 (West 2010); MICH. COMP. LAWS ANN. § 600.5805 (West 2010); NEB. REV. STAT. § 25-222 (2010); N.C. GEN. STAT. ANN. § 1-15 (West 2010); WYO. STAT. ANN. § 1-3-107 (2010).
65. E.g., ALA. CODE § 6-5-574 (2010); CAL. CIV. PROC. CODE § 340.6 (West 2010); CON. GEN. STAT. ANN. § 52-584b (West 2010); LA. REV. STAT. ANN. § 9:5605 (2010); MONT. CODE ANN. § 27-2-206 (2010); NEV. REV. STAT. ANN. § 11.207 (West 2010); S.D. CODIFIED LAWS § 15-2-14.2 (2010).
66. E.g., CON. GEN. STAT. ANN. § 52-584b (West 2010) (providing that the action must be brought within two years of the date that injury is sustained or discovered, but setting an outer limit of ten years from the date of the title certificate opinion). ME. REV. STAT. ANN. tit. 14, § 753-B (2010) provides:

1. Time when statute starts to run, generally. In actions alleging professional negligence, malpractice or breach of contract for legal service by a licensed attorney, the statute of limitations starts to run from the date of the act or omission giving rise to the injury, not from the discovery of the malpractice, negligence or breach of contract, except as provided in this section or as the statute of limitations may be suspended by other laws.
the cause of action accrues for statute of limitations purposes. For example, Idaho’s statute provides that “. . . the cause of action shall be deemed to have accrued as of the time of the occurrence, act or omission complained of.” In addition, Missouri provides that “the cause of action [accrues] . . . when the damage resulting [from the wrong] is sustained and is capable of ascertainment.”

B. Common Law Doctrines for Legal Malpractice Claims

1. Occurrence Rule

One common law doctrine for determining when the limitations period for legal malpractice begins to run is the “occurrence rule.” Under this rule, the presumption is that the attorney’s negligence causes at least nominal damages. Thus, the cause of action accrues and the limitations period begin to run

2. Rendering of title opinion. In an action alleging professional negligence in the rendering of a real estate title opinion, the statute of limitations starts to run on the date the negligence is discovered, but in no event may an action be commenced more than 20 years after the act or omission giving rise to the injury.

3. Drafting of last will and testament. In an action alleging professional negligence in the drafting of a last will and testament that has been offered for probate, the statute of limitations starts to run on the date the negligence is discovered.

67. E.g., KAN. STAT. ANN. § 60-513(b) (2010) (“[T]he cause[] of action . . . shall not be deemed to have accrued until the act giving rise to the cause of action first causes substantial injury, or, if the fact of injury is not reasonably ascertainable until some time after the initial act, then the period of limitation shall not commence until the fact of injury becomes reasonably ascertainable to the injured party . . . .”); MONT. CODE ANN. § 27-2-102(1)(a) (2010) (“[A] claim or cause of action accrues when all elements of the claim or cause exist or have occurred, the right to maintain an action the claim or cause is complete, and a court or other agency is authorized to accept jurisdiction of the action . . . .”); N.C. GEN. STAT. ANN. § 1-15(c) (West 2010) (“[A] cause of action for malpractice arising out of the performance of or failure to perform professional services shall be deemed to accrue at the time of the occurrence of the last act of the defendant giving rise to the cause of action . . . .”).

68. IDAHO CODE § 5-219(4) (2010).

69. MO. ANN. STAT. § 516.100 (West 2010).

70. Ronald Mallen & Jeffrey Smith, Commencement or Accrual – The Occurrence Rule, 3 LEGAL MALPRACTICE §23:10 (2009) [hereinafter Mallen & Smith, The Occurrence Rule]. See, e.g., CONN. GEN. STAT. ANN. § 52-577 (2010); IDAHO CODE ANN. § 5-219(4) (2010); ME. REV. STAT. ANN. tit. 14, § 753-B (2010); R.I. GEN. LAWS § 9-1-14.3 (2010); S.D. CODIFIED LAWS § 15-2-14.2 (2010); VA. CODE ANN. § 8.01-230 (West 2010). See, e.g., Goldsby v. Fairley, 831 S.W.2d 142, 143 (Ark. 1992) (stating that the cause of action accrues on the date of the negligent act or omission, not on the date of discovery); Farnsworth v. O’Doherty, 856 A.2d 518, 521 (Conn. App. Ct. 2004) (statute of limitations was triggered by filing of deficient complaint, not when damage occurred); Byron Chemical Co. v. Groman, 877 N.Y.S.2d 457, 458 (App. Div. 2009) (finding that the cause of action accrued “on the date the malpractice was committed,” which was the date of the negligently drafted employment agreement).

simultaneously on the date that the negligent act or omission occurs, whether or not the client is aware of any negligence at that time.  

While it may be misleading that Kentucky Revised Statute section 413.245 provides “a civil action . . . shall be brought within one (1) year from the date of occurrence . . . ,” Kentucky does not actually adhere to the common law occurrence rule. Kentucky courts have interpreted “occurrence” to be synonymous with “cause of action.” The rationale is that it only makes sense that “occurrence” means “cause of action” because the second possible date to trigger the statute of limitations is discovery of the claim. “Otherwise, the statute would be unintelligible, because a cause of action cannot be discovered until it exists.” Furthermore, this interpretation is consistent with general law requiring damage for a cause of action to accrue.

The occurrence rule was once the prevailing rule in the United States, but only a minority of states adhere to it today as the sole doctrine for determining the statute of limitations in legal malpractice suits. The majority of jurisdictions have abandoned the occurrence rule, citing differences between legal malpractice cases and ordinary negligence cases. In ordinary negligence suits, there is usually an identifiable event that marks the time the injury occurred. Thus, it makes sense to apply the occurrence rule to ordinary negligence suits. However, in legal malpractice cases, the client’s injury may not be discoverable for years, and it may take even longer to determine the full extent of damages. As a result, the occurrence rule invites speculative litigation and frustrates judicial economy because the client is forced to file suit, even though there may not be any actual damages yet.

73. KY. REV. STAT. ANN. § 413.245 (West 2010) (emphasis added).
75. Osborne I, 573 F. Supp. at 1048.
76. Id.
77. Id.
79. Mallen & Smith, The Occurrence Rule, supra note 70.
80. Id.
81. Id.
82. Id.
83. Mallen & Smith, The Occurrence Rule, supra note 70.
Nonetheless, the occurrence rule has one advantage over the other rules: it provides more certainty in deciding the commencement of the statute of limitations.\textsuperscript{84} Therefore, some jurisdictions have included the occurrence rule in their statute of limitations as “an outer-limit alternative to a shorter discovery rule.”\textsuperscript{85} Similarly, other jurisdictions hold that the claim accrues on the date of the negligent act or omission, but the limitations period may be tolled by the continuous representation rule\textsuperscript{86} or the discovery rule.\textsuperscript{87}

2. Continuous Representation Rule

Many jurisdictions, including Kentucky,\textsuperscript{88} have adopted the continuous representation rule as an equitable tolling doctrine.\textsuperscript{89} Under this rule, when an attorney continuously represents the client on the same subject matter, the statute of limitations for legal malpractice does not begin to run until the attorney-client relationship is terminated.\textsuperscript{90} “In substance, [the continuous representation rule] says that by virtue of the attorney-client relationship, there can be no effective discovery of the negligence so long as the relationship prevails.”\textsuperscript{91} The rule “recognizes the attorney’s superior knowledge of the law and the dependence of the client, and protects the client from an unscrupulous attorney.”\textsuperscript{92} The continuous representation rule allows the attorney to resolve or avoid damages.
caused by any error, or to establish that there was no error, because the client does not have to terminate the relationship early in fear of the limitations period expiring. 93 Thus, the continuous representation rule can preserve the attorney-client relationship and also avoid speculative malpractice claims. 94

3. Discovery Rule

The discovery rule is another leading doctrine for determining when the statute of limitations begins to run in attorney negligence cases. 95 In general, the discovery rule is the same across jurisdictions: “[d]iscovery exists when the plaintiff has actual or imputed knowledge of the attorney’s act or omission, the wrongful nature, and the fact of injury, that is, of the facts constituting a cause of action for malpractice.” 96

Kentucky only applies the discovery rule as a tolling doctrine. 97 It applies in cases where the cause of action accrued when the plaintiff sustained damages, but the plaintiff did not discover the cause of action until later. 98 Accordingly, courts must first determine whether the cause of action has accrued before it can determine the date of discovery. 99 Much like the Corporex opinion above, the confusion in legal malpractice cases often focuses on if and when the cause of action accrued.

The discovery rule has gained rapid acceptance because it is more equitable than the occurrence rule, allowing clients to bring suit within a reasonable time after they discovered or should have discovered the attorney’s negligence. 100 However, the disadvantage of the discovery rule is that it leaves attorneys exposed to liability for an indefinite amount of time. 101 That is why some

94. Id.
98. See id.
100. Mallen & Smith, The Discovery Rule-Defined, supra note 95, at “Status of the Rule.” In contrast, the occurrence rule forecloses the client’s remedy before he could have been expected to discover the attorney’s negligence. Id.
101. Id.
jurisdictions have adopted the discovery rule in conjunction with the occurrence rule as an outer-limit alternative.102

4. Damage Rule

The damage rule provides a fourth alternative for statute of limitations in legal malpractice claims.103 Under the damage rule, the statute of limitations does not commence until the plaintiff has suffered actual damage.104 The policy behind the rule is that it delays accrual of a legal malpractice claim until there is at least some damage.105 Consequently, it prevents some of the illogical results of applying the occurrence rule, where the plaintiff could (or must) sue before he sustained any damage.106

Kentucky applies the damage rule to determine when the cause of action accrues in legal malpractice cases. The portion of Kentucky Revised Statute section 413.245 providing that “the date of the occurrence” triggers the commencement of the statute of limitations essentially codifies the damage rule because Kentucky courts have established that the “occurrence” is the “cause of action,” which requires damages.107

Although the damage rule ameliorates the inequity of the occurrence rule, it has also created some difficulties in its application.108 States are inconsistent regarding the amount of damages required for accrual of a legal malpractice claim.109 Most jurisdictions only require some injury for the cause of action to

102. See supra note 85.
104. Mallen & Smith, The Damage Rule-General Principles, supra note 103, at “Origin of the Damage Rule.” This doctrine rejects the presumption of the occurrence rule that the negligence causes nominal damages. Id. The damage rule originated in a 1967 District of Columbia Court of Appeals decision, Fort Myers Seafood Packers, Inc. v. Steptoe & Johnson. 381 F.2d 261, 262 (D.C. Cir. 1967). In that case, an attorney incorrectly advised his client, a shipping company, that it was not required to register its boats in Venezuelan waters in order to ship there. Id. The company’s boats were later impounded because their entry under American registry was illegal. Id. The court rejected the occurrence rule and held that the cause of action accrued at the time the boats were impounded because that was when the clients sustained injury from the attorney’s negligence. Id.
106. Id.
107. See supra notes 74-77.
108. Mallen & Smith, The Damage Rule-General Principles, supra note 103, at “Determining Injury and Damage.” One cause of the inconsistent application is the courts’ interchangeable use of the terms “damages” and “injury.” Id. In the context of legal malpractice claims, “injury” means “the loss or impairment of a right, remedy or interest, or the imposition of liability.” Id. “Damages” is defined as “a sum of money awarded to a person injured by the tort of another.” Id. (quoting RESTATEMENT (SECOND) OF TORTS § 12A). The difference in the meaning of these terms is significant because the date of injury is often earlier than the date that damages are measurable. Id.
accrue, but some jurisdictions require that the full extent of damages be ascertained before accrual.\textsuperscript{110} Additionally, state courts have disagreed over whether the damages must be fixed and irreversible.\textsuperscript{111} Given these different interpretations, there is judicial inconsistency among decisions within the same state.\textsuperscript{112}

\textbf{C. The Accrual of a Legal Malpractice Claim in Different Contexts}

It is undisputed that the cause of action must accrue before the limitations period begins to run on a legal malpractice claim.\textsuperscript{113} Thus, it is important that courts determine the point in time where there was sufficient damage for a cause of action to accrue.\textsuperscript{114} Courts set different standards and rules for making that determination, simply because attorneys offer a variety of legal services and legal malpractice claims arise in different contexts.\textsuperscript{115} The events that cause damage in a legal malpractice claim during litigation may be different than the events which cause damage in legal malpractice claims involving transactional services or legal advice.\textsuperscript{116} Thus, it is useful to look at how courts have determined when there is sufficient damage for accrual of a legal malpractice claim in different contexts.

\begin{enumerate}
  \item Accrual in Non-litigation Malpractice Claims

Many legal malpractice claims involve attorney negligence outside the litigation context. These claims include negligence in drafting, amending, executing, and recording documents and instruments; rendering advice; and failing to give advice.\textsuperscript{117} One approach for these claims is that the cause of action accrues at the time of the transaction or rendering of advice, reasoning that the intended security or property interest was technically lost at that time.\textsuperscript{118}

\begin{thebibliography}{116}
\bibitem{110} Id. at “The Quantity of Damage-General Principals.”
\bibitem{111} Id. at “Determining Injury and Damage.”
\bibitem{112} Id. As a result of this uncertainty, attorneys are exposed to incurring the costs of defending unwarranted litigation.
\bibitem{113} George L. Blum, Annotation, \textit{When Statute of Limitations Begins to Run on Action Against Attorney for Malpractice Based upon Negligence—View that Statute Begins to Run from Time of Occurrence of Sustaining Damage or Injury and Other Theories}, 12 A.L.R.6th 1, § 2 (2010).
\bibitem{114} See id.
\bibitem{116} See id.
\bibitem{118} See, e.g., Anderson v. Glenn, 87 P.3d 286, 290 (Idaho 2003) (holding that the statute of limitations began to run at the time the faulty trust was created because, at that time, the clients lost control of the property and incurred some damage); Herrmann v. McMenomy & Severson, 590 N.W.2d 641, 643-44 (Minn. 1999) (holding that the cause of action accrued on the date of the last
In contrast, other states reject this theory and require some actionable damages for a cause of action to accrue, but permit some uncertainty in the amount of damages. Under this approach, the cause of action accrues as soon as an individual’s interests are harmed or rights are violated, even if there has been no judicial resolution of the matter. Likewise, if the client’s rights or interests are challenged in court, the client’s malpractice claim accrues as soon as he has to defend the validity of an instrument prepared by the negligent attorney.

illegal real estate transaction based on the negligent advice of the attorney, rather than the date the IRS assessed penalties against the company); Commonwealth Land Title Ins. Co. v. Kurnos, 773 A.2d 726, 728-29 (N.J. Super. Ct. App. Div. 2001) (finding that the cause of action accrued when the bank lost its security position due to its attorney’s negligent refinancing of the client’s home, and not when the homeowners defaulted on the loan and the security became necessary); Arnold v. KPMG LLP, 543 F. Supp. 2d 230, 236 (S.D.N.Y. 2008) (applying New York law) (holding that the cause of action accrued on the date the law firm issued its tax opinion letter, in a case where the law firm negligently endorsed entering into an illegal tax shelter); Wachovia Bank, N.A. v. Ferretti, 935 A.2d 565, 574 (Pa. Super. Ct. 2007) (holding, in a case where the attorney failed to mark a judgment against his client as “satisfied,” that the cause of action accrued when the attorney committed the error and not when the client had to pay damages against judgment debtor); Wilson v. Wohlford, No. E2004-02020-COA-R3-CV, 2005 WL 1183152, at *6 (Tenn. Ct. App. 2005) (finding that the plaintiff suffered a “legally cognizable injury” sufficient for accrual when she signed the marital dissolution agreement because she faced the potential of a breach of contract claim by her husband).


120. See, e.g., Sabes & Richman, Inc. v. Muenzer, 431 N.W.2d 916, 919 (Minn. Ct. App. 1988) (finding, where an attorney negligently advised his client that it was unnecessary to obtain a copyright for advertisement for its product, that the cause of action accrued when a similar advertisement was published, despite the unknown result of the pending copyright infringement lawsuit); Grunwald v. Bronkesh, 621 A.2d 459, 467 (N.J. 1993) (finding that damage occurred when a buyer refused to close on real estate sale after the client-seller had foregone another offer, even though the client’s lawsuit for specific performance was still pending on appeal); Hennekens v. Hoerl, 465 N.W.2d 812, 815-19 (Wis. 1991) (holding that there was sufficient damage for accrual of cause of action on the date the promissory note was due because it “harmed [the clients’] legal rights and interests,” in legal malpractice claim against attorney for drafting faulty promissory note).

121. See, e.g., Knight v. Furlow, 553 A.2d 1232, 1235 (D.C. Cir. 1989) (holding that the client’s payment of attorney’s fees and court costs to defend the validity of a will that was negligently drafted by the attorney was sufficient damage for accrual of cause of action); Rayne State Bank & Trust Co. v. Nat’l Union Fire Ins. Co., 483 So.2d 987, 996-97 (La. 1986) (finding that the cause of action did not accrue until the mortgages were challenged in an adversary proceeding and the clients had sustained damage defending their validity in court); Dixon v. Shafon, 649 S.W.2d 435, 437-38 (Mo. 1983) (finding that the cause of action accrued when the client had to retain counsel in order to defend a breach of contract claim, where the contract was allegedly negligently drafted by the attorney); Lehig v. Bornhop, 859 S.W.2d 271, 273-74 (Mo. Ct. App. 1993) (determining, in a case where attorney gave negligent tax advice, that the cause of action accrued when the IRS sent a letter disallowing the client’s tax deductions, but applying the discovery rule); Magnuson v. Lake, 717 P.2d 1216, 1219-20 (Or. Ct. App. 1986) (finding that the clients sustained damage when they had to defend the contract that was negligently prepared by their attorney in a declaratory judgment action); Robbins & Seventko Orthopedic Surgeons, Inc. v. Geisenberger, 674 A.2d 244, 246 (Pa. Super. Ct. 1996) (finding that cause of action accrued on the
Other jurisdictions require that damages be “certain and irremediable” before a legal malpractice claim accrues.122 Thus, when a lawsuit is initiated as a result of the attorney’s negligence, the cause of action accrues when the damages are finalized by a court’s judgment or settlement.123 On the other hand, if the attorney’s negligence does not result in a lawsuit, then the cause of action accrues when the client has sustained damages that cannot be remedied.124

2. The Damage Rule in Litigation Malpractice Claims

There are several different theories for determining when the cause of action accrues under the damage rule for legal malpractice actions involving an attorney’s negligence during litigation.125 Some courts have found that the claim date the IRS notified the clients that their tax deductions were disallowed, in a claim that the attorney rendered negligent tax advice).

123. See, e.g., Pope v. Zanetis, No. IP 00-1125-C H/G., 2002 WL 425050, at *8 (S.D. Ind. Feb. 22, 2002) (applying Indiana law) (holding that the cause of action accrued on the date the divorce became final, in a case where the attorney negligently advised and prepared an antenuptial agreement); Perez-Abreu, Zamora & De La FE, PA v. Taracido, 790 So.2d 1051, 1054 (Fla. 2001) (holding, in a case where the attorneys negligently represented their client in a stock transaction, that the cause of action did not accrue until the underlying proceeding settled); Peat, Marwick, Mitchell & Co. v. Lane, 565 So.2d 1323, 1326-27 (Fla. 1990) (finding that the statute of limitations commenced when the tax court entered its judgment under the rationale that damages were speculative until the tax court’s judgment because the taxpayers could petition the court for a redetermination of the deficiency); Price v. Holmes, 422 P.2d 976, 980-81 (Kan. 1967) (determining that the cause of action accrued, in a lawsuit against an attorney for negligently drafting a will, at the time the will was declared void by the court); U.S. Nat’l Bank of Oregon v. Davies, 548 P.2d 966, 969 (Or. 1976) (rejecting the attorney’s argument that the cause of action accrued when the clients had to defend a claim brought against them as a result of the attorney negligently advising them to accept trust funds of a corporation for payment of a stock, and suggesting that the clients would have had to lose their lawsuit to prove the damages were certain).
124. See, e.g., Bone v. Sudweeks, 808 P.2d 876, 879-880 (Idaho 1991) (determining, in a case where the attorney failed to properly file a release of lis pendens for the client’s development property, that a cause of action accrued when an investor withdrew his offer to buy the property due to the cloud on the title); Shideler v. Dwyer, 417 N.E.2d 281, 284-85 (Ind. 1981) (holding, in a case where an attorney negligently drafted a will, the cause of action accrued at the time of testator’s death because that was when the damage became “irremediable”); Keystone Distrib. Park v. Kennerk, Dumas, Burke, Backs, Long, & Salin, 461 N.E.2d 749, 750-51 (Ind. Ct. App. 1984) (holding that the cause of action accrued, in a case where the attorney failed to notify the client that there was a problem with the economic development bond it was seeking to procure, when construction on the commercial property began); Antone v. Mirviss, 720 N.W.2d 331, 337-38 (Minn. 2006) (finding the cause of action accrued, in a malpractice action against attorney for faulty antenuptial agreement, when the client entered into marriage and his separate property was converted into marital property); Snipes v. Jackson, 316 S.E.2d 657, 660-61 (N.C. App. 1984) (finding that the cause of action accrued when the IRS assessed the tax deficiency caused by the attorney’s negligent advice); Carvel v. Bottoms, 900 S.W.2d 23, 29-30 (Tenn. 1995) (holding, where attorney failed to include pipeline easement in the deed he prepared, that the cause of action accrued when the utility company moved a pipeline closer to the clients’ house).
125. See generally George L. Blum, supra note 113, §§ 5-7; George L. Blum, Annotation, Attorney Malpractice – Tolling or Other Exceptions to Running of Statute of Limitations, 87 A.L.R.5th 473, §§ 8-9 (2010).
accrues when the client incurs incidental costs related to litigation, even if the outcome of the underlying suit could potentially change. Accordingly, the limitations period begins to run as soon as the client has to pay court costs or attorney fees as a result of the attorney’s negligence.

Where there are no incidental costs or the jurisdiction does not adhere to that rule, most courts agree that the cause of action does not accrue until there is at least a final judgment. However, there is a split among jurisdictions whether the limitations period begins to run when the final judgment could be reversed on appeal. Some states adhere to the rule that the client must exhaust all appeals in the underlying case before he can bring a legal malpractice claim. Thus, when the client appeals the judgment in the underlying lawsuit, the statute of limitations does not begin to run until the highest appellate court has affirmed the judgment. In the alternative, if the client does not appeal the judgment, the cause of action accrues when the time period for re-filing or filing an appeal has expired. Additionally, in jurisdictions following the “exhaustion-of-appeals rule,” courts dismiss as premature legal malpractice cases filed while an appeal in the underlying lawsuit is pending.

127. E.g., Jankowski v. Taylor, Bishop & Lee, 273 S.E.2d 16, 18 (Ga. 1980) (finding that the cause of action accrued when the client’s complaint was dismissed for lack of prosecution after his attorney did not appear at court, even though the time to re-file had not expired, because the client sustained “appreciable” damage when he incurred costs and his lawsuit was delayed); Braud v. New England Ins. Co., 576 So.2d 466, 468-69 (La. 1991) (holding, in a case where the attorney improperly obtained default judgment and the opposing party filed a nullity action, that the cause of action accrued the date the nullity action was filed because the client incurred expenses to defend it); Frankston v. Denniston, 907 N.E.2d 244, 250-51 (Mass. App. Ct. 2009) (finding that the client sustained damage when she had to pay additional attorney fees to her attorney to fix problems caused by his negligence, when the attorney failed to advise the client that the statute of limitations for her claim would expire soon).
128. Id. at “Future and Contingent Events – Judicial Resolution or Approval.”
129. Id. at “Appeals and Post-Judgment Relief.”
130. See, e.g., Amfac Distrib. Corp. v. Miller, 673 P.2d 795, 796-99 (Ariz. Ct. App. 1983), aff’d 673 P.2d 792 (Ariz. 1983) (discussing the rationale behind the exhaustion-of-appeals rule); Bonanno v. Pothoff, 527 F. Supp. 561, 563 (N.D. Ill. 1981) (applying Illinois law) (holding that the cause of action accrued when the appellate court in the underlying case upheld the dismissal under the doctrine of res judicata); Neylan v. Moser, 400 N.W.2d 538, 542 (Iowa 1987) (holding that the cause of action accrued when the state supreme court affirmed the trial court because that was when the client’s damage became “irreversible”).
131. See Brite Lights Inc. v. Gooch, 713 N.E.2d 155, 158 (Ill. 1999) (finding that the cause of action accrued at the end of the one-year period for refiling when the client’s complaint was dismissed for lack of prosecution); Basinger v. Sullivan, 540 N.E.2d 91, 93-94 (Ind. Ct. App. 1989) (holding that damage occurred sufficient for accrual of the action when the limitation period in the underlying suit expired without suit being filed).
A similar approach is that the cause of action for legal malpractice arising out of litigation accrues upon final judgment of the trial court, but the lawsuit is tolled until all underlying appeals are exhausted. The rationale is that it prevents the client from having to take on two “inherently inconsistent litigation postures.”

In contrast, courts in other states reject the “exhaustion-of-appeals” rule, and hold that the cause of action accrues at the time of the judgment, even if it is appealable. The theory is that the client has sustained damages at the time of the final judgment. Tennessee is an example of a state that finds this rule to be preferable because it creates an easy, identifiable point to commence the statute of limitations.
D. Conclusion

Even though most states utilize the same common law doctrines, there are no clear majority rules to decide what triggers the running of the statute of limitations for legal malpractice claims. In general, most jurisdictions apply the damage rule and/or the discovery rule, and many also apply the continuous representation rule. There are numerous inconsistencies regarding when the legal malpractice claim accrues because states have different standards for the amount of damage required for a cause of action to accrue. Because there is currently no majority rule, the best solution for Kentucky would be to establish its own clear rule.
I. INTRODUCTION

Despite the number of neighborhood squabbles – and sometimes significant property damage and personal injury caused by overhanging trees – there is a paucity of Kentucky case law on encroaching vegetation. In Kentucky, a cluster of cases, many of which have some age to them, define the duties of public and private landowners. However, a 2008 Kentucky Court of Appeals decision revisited the issue of the Commonwealth’s liability for damage caused by fallen trees and found a new duty in this area, only to be reversed by the Kentucky Supreme Court based upon the defense of sovereign immunity for the public defendant. Despite a rebuking reversal by the highest court in the Commonwealth, substantial questions remain in Kentucky law concerning the duties of public and private landowners to others for damages caused by overhanging trees.

Part II of this article will examine Kentucky case law and provide both historical and modern perspectives on landowner liability regarding encroaching trees. Specifically, part II will explore the development of a cause of action for encroaching trees in Kentucky courts, Kentucky’s adoption of the “Massachusetts rule,” changes and modifications in the area of notice to landowners, and the distinction between rural and urban land. Part III will

2. See infra Part II.
4. Sexton, 256 S.W.3d at 31, 36.
5. See infra Part V.
6. See Schwalbach v. Forest Lawn Mem’l Park, 687 S.W.2d 551, 552 (Ky. Ct. App. 1985) (citing Michalson v. Nutting, 275 Mass. 232, 175 N.E. 490 (1931)). The Massachusetts rule states that “[a]s against adjoining proprietors, the owner of a lot may plant shade trees upon it, or cover it with a thick forest, and the injury done to them by the mere shade of the trees is damnum absque injuria. It is no violation of their rights.” Id.
discuss the governmental immunity issue. Part IV will examine the
development of the recent Kentucky Supreme Court decision, Commonwealth of Kentucky v. Sexton, 7 closely scrutinizing its analysis of this subject matter. 8 Part V will address practical ways that the Kentucky legal professional might approach such a situation in light of likely future developments in this area.

Cheryl M. Bailey’s Annotation, Tree or Limb Falls onto Adjoining Private Property: Personal Injury and Property Damage Liability, 9 provides an excellent national survey on the topic of encroaching vegetation. It notes that various theories have been employed in attempting to assign liability in this area, such as negligence, nuisance, strict liability, and trespass, 10 and that [t]he trend for urban areas, where both the danger and its consequences are generally apparent, is to reject the distinction between natural and artificial conditions and the immunity from liability predicated thereon and to impose upon the landowner a duty of reasonable care to eliminate the dangers to adjoining property presented by unsound trees, even if the trees grew on and became part of the land by natural condition. 11

The annotation enumerates several possible items of damage; in addition to traditional personal injury and wrongful death damages, 12 the following types of damages may be recoverable:

costs incurred in removing the fallen tree, market value of buildings and other structures destroyed, cost of repairs to buildings and other structures, cost of repairs to vehicles plus towing and storage costs, value of other property damaged or destroyed, inconvenience, loss of complete enjoyment of property, value of animals killed or veterinary expenses connected with treating injured animals, value of trees and/or other vegetation damaged or destroyed on the adjoining land, lost wages, and depreciation in the value of the adjoining landowner’s property. 13

Practitioners should also consider Eric M. Larsson’s, Cause of Action Against Adbutting Landowner for Damages Caused by Encroaching Trees or Other Vegetation. 14 Larsson outlines proof considerations for both plaintiffs’

7. Sexton, 256 S.W.3d at 32-36.
8. See infra Part IV(B).
10. Id. § 2[a].
11. Id.
12. Id. § 2[b].
13. Id. (footnotes omitted).
14. Eric M. Larsson, Cause of Action Against Adbutting Landowner for Damages Caused by Encroaching Trees or Other Vegetation, 38 CAUSES OF ACTION 2D 1 (2009). Section 1 begins:
and defense counsel. Plaintiffs’ counsel should consider obtaining lay testimony, including photographic and documentary evidence regarding whether the tree’s defect was noticeable and expert testimony regarding the same; testimony regarding communication of concerns about a tree’s condition to the landowner; and photographs, maps, and zoning plans or codes that show whether the area is rural or urban.

For defense counsel, Larsson suggests obtaining counter-lay testimony regarding the condition of the tree and the lack of any visible decay, defect, or previously fallen debris; information regarding the measures taken by the defendant to care for the tree; and expert testimony regarding the same. Also, meteorological evidence of wind and storm conditions can be helpful for a force majeure/act of God defense.

II. DEVELOPMENT OF LIABILITY FOR ADJACENT LANDOWNERS

In 2008, a Kentucky Court of Appeals opinion stated that “[s]urprisingly, there is no case authority in Kentucky directly addressing [liability caused by trees on adjoining properties].” The following historical review will analyze relevant cases dating back to the 1949 case, Shrader v. Commonwealth.

A. Development of a Cause of Action

In jurisdictions that recognize liability for encroachment of trees onto adjoining property, claims for damages usually have been brought under private nuisance or negligence causes of action. Shrader v. Commonwealth provides insight into the Commonwealth’s standards for bringing an action in negligence for damage caused by trees on real property.

This article discusses the particular elements, defenses, procedures, and proof essential to a cause of action in nuisance or negligence against an adjoining landowner for damages caused by encroaching trees and other vegetation. Such actions may arise over a period of time due to the natural growth of roots or branches. They may also arise suddenly, as when a branch or entire tree falls onto a neighboring property.

Id. § 1. Defenses listed in this article include failure to state a claim, lack of knowledge of condition, due care with regard to any duty owed to plaintiff, force majeure/act of God, contributory/comparative negligence, acquiescence, laches, and estoppel. Id. §§ 18-23.

15. Id. pt. III, subdiv. B.
16. Id. § 27.
17. Id. § 28.
18. Id.
22. Shrader, 218 S.W.2d at 408.
1. Negligence

*Shrader* consolidated related cases in which petitioners had brought actions before the Board of Claims against the Commonwealth of Kentucky for personal injury and property damage incurred after a boulder, approximately three-and-a-half feet in diameter, rolled from a cliff onto U.S. 42 in Jefferson County.\(^{23}\) The court singled out one particular negligence action, based upon the negligence theory of res ipsa loquitur, as being representative of the others.\(^{24}\) The boulder struck a truck in the outer lane of the highway, damaging the truck and injuring the passenger.\(^{25}\) At the location where the accident occurred, the road ran through a cut in the cliff that had been created by blasting the cliff wall.\(^{26}\) There were steep, rocky banks that were approximately twenty feet high and overlooked the right-of-way of the road, which was under the supervision and maintenance of the defendant, the Kentucky Department of Highways (“DOH”).\(^{27}\)

The plaintiffs charged that the Commonwealth was negligent in carelessly allowing loose rock to remain above the road in a dangerous position.\(^{28}\) However, the Board of Claims found that the plaintiff had not sufficiently proven that there was a dangerous condition, that DOH had notice of such dangerous condition, or that DOH should have noticed the dangerous condition by exercising ordinary care.\(^{29}\) Further, the evidence showed that the roadway “was constructed by qualified road contractors according to plans and specifications” of DOH.\(^{30}\) The rock cuts were made in conformance with accepted engineering practices, the road was carefully inspected, and all loose rocks were removed from the cuts.\(^{31}\) There was no proof of any previous accidents due to falling rocks in the area.\(^{32}\) There was also no evidence of what caused the rock to fall from the cliff.\(^{33}\)

The Board of Claims cited the Kentucky Court of Appeals case, *Commonwealth v. Dever*, wherein the court held:

> [T]he Highway Commission, even when the State has waived its immunity from suit, is not an insurer against accidents arising from defects or dangerous conditions on a public road. Its duty is merely that of a private corporation or municipality subject to suit, namely,
to exercise ordinary care to prevent injury from defects in the highway.\textsuperscript{34}

The Board of Claims rejected the plaintiff’s res ipsa loquitur theory of negligence because DOH did not have sufficient management, control, or knowledge to justify the application of the doctrine; moreover it determined that DOH did not even owe a duty of care to the plaintiff.\textsuperscript{35} Although the Kentucky Court of Appeals upheld the Board of Claims’ finding,\textsuperscript{36} it indicated that it may have reached a different conclusion if it were the Board of Claims.\textsuperscript{37}

2. The Massachusetts Rule

Liability to adjoining landowners for damage resulting from debris falling off overhanging trees was an issue faced by a Kentucky court in 1985.\textsuperscript{38} The question arose in Schwalbach v. Forest Lawn Memorial Park, which introduced the “Massachusetts rule.”\textsuperscript{39} The case centered on alleged damage from trees in a highly commercialized area in Northern Kentucky and pitted a commercial plaintiff against a commercial defendant.\textsuperscript{40}

In Schwalbach, the plaintiffs, who owned an apartment building, sued Forest Lawn Memorial Park for damages caused by an apparently healthy tree located near the boundary line separating their properties.\textsuperscript{41} The damages complained of were the result of normal droppings of debris and leaves from the tree.\textsuperscript{42} The plaintiffs complained that the damages caused by the overhanging limbs from the property owned by Forest Lawn had caused them trouble for ten years.\textsuperscript{43} Forest Lawn had previously responded to complaints by removing six branches from the offending tree.\textsuperscript{44}

The trial court applied the Massachusetts rule and suggested that it would have been more reasonable for the Schwalbachs to remove the offending limbs back to the boundary line.\textsuperscript{45} The Massachusetts rule states that “[a]s against

\textsuperscript{34} Commonwealth v. Dever, 143 S.W.2d 1065, 1066-67 (Ky. 1940).
\textsuperscript{35} Shrader, 218 S.W.2d at 408 (citing City of Corbin v. Benton, 152 S.W. 241 (Ky. 1913) (noting that the city did not have sufficient management or control over the streets to support the application of res ipsa loquitur when the plaintiff fell upon stepping on a broken stone in the pavement)).
\textsuperscript{36} Id. at 410.
\textsuperscript{37} Id.
\textsuperscript{38} Schwalbach v. Forest Lawn Mem’l Park, 687 S.W.2d 551, 552 (Ky. Ct. App. 1985).
\textsuperscript{39} Id. at 552.
\textsuperscript{40} Id. at 551-52.
\textsuperscript{41} Id.
\textsuperscript{42} Id. at 551.
\textsuperscript{43} Id.
\textsuperscript{44} Schwalbach, 687 S.W.2d at 552.
\textsuperscript{45} Id.
adjoining proprietors, the owner of a lot may plant shade trees upon it, or cover it with a thick forest, and the injury done to them by the mere shade of the trees is *damnum absque injuria*.\(^{46}\) It is no violation of their rights.\(^ {47}\)

The Schwalbachs, citing the *Sprecher v. Adamson Co.* case from California as persuasive authority, urged the court to adopt a “modern rule” that would require individuals to be held responsible for private nuisances on real estate.\(^ {48}\) The Kentucky Court of Appeals seemed to leave the possibility of adopting this approach open for the future, but it nevertheless applied the Massachusetts rule.\(^ {49}\)

The Kentucky Court of Appeals agreed with *Michalson v. Nutting* in finding no distinction between damage caused by shade trees and damage caused by overhanging branches or invading roots in concrete or septic systems.\(^ {50}\) The court also noted that the neighbor had the right to cut off intruding boughs and roots on this property.\(^ {51}\) “Self-help” is the only remedy in many jurisdictions for an aggrieved neighbor whose property is exposed to overhanging trees or invading tree roots.\(^ {52}\) From a policy perspective, imposing liability upon landowners for damage resulting from natural droppings and other regular debris from healthy trees would give rise to numerous lawsuits.\(^ {53}\) The court contrasted such a situation with a claim for damages from a dead tree that was likely to fall, which might be based upon a theory of negligence seeking damages or requiring removal.\(^ {54}\)

This case presents an issue of first impression in Kentucky. Although we might reach a different result if the tree was known, or should be known, to be so rotten so as to cause a serious threat or nuisance to adjoining property, the apparent good condition of this tree and the other facts in this case are such that we agree with the result reached by the trial court.\(^ {55}\)

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46. *Damnum absque injuria* is defined as, “[l]atin, [damage without wrongful act.] Loss or harm that is incurred from something other than a wrongful act and occasions no legal remedy.” BLACK’S LAW DICTIONARY 450 (9th ed. 2009).
48. *Schwalbach*, 687 S.W.2d at 552 (citing *Sprecher v. Adamson Cos.*, 636 P.2d 1121, 1128 (Cal. 1981) (using ordinary negligence rules in determining a landowner’s liability for harm caused by the condition of the land)).
49. Id.
50. *Schwalbach*, 687 S.W.2d at 552. See also *Michalson*, 175 N.E. at 491.
51. *Schwalbach*, 687 S.W.2d at 552.
52. Larsson, *supra* note 14, § 3.
53. *Schwalbach*, 687 S.W.2d at 552.
54. Id.
55. Id.
3. Notice of Diseased or Defective Tree

In *Lemon v. Edwards*, a motorist was injured when a large tree, located fifteen feet off an adjacent gravel road on heavily wooded property, fell on her vehicle.56 The owner of the property did not reside on the land, and the evidence showed that he traveled the road perhaps only four or five times a year.57 The motorist alleged liability on the landowner’s part, claiming that the tree had been dead for several years and that the owner was negligent in not having it removed.58

The court noted that there was no Kentucky precedent on point and thus looked to persuasive authority from other jurisdictions.59 It then observed that most of the relevant cases held the landowner liable if he or she knew the tree was defective, but that differing views existed as to liability if the owner did not know of the defect but could have discovered it by inspection.60

The court went on to note that several cases distinguished between rural lands, including forests, and those in urban and suburban areas.61 The cases from other jurisdictions held that the owners of forest and rural lands had no duty to inspect trees to ascertain whether or not they were defective.62 The *Lemon* Court took a narrower position tailored to the facts at hand:

We think that at least with respect to forest lands adjacent to little-used roads in sparsely settled areas there is a sound basis for not imposing upon the landowner a duty of inspection to determine whether, through natural processes of decay, trees on the land have become dangerous to users of the road.63

Accordingly, the court held that the landowner was not liable because the basis of a duty would be “an unreasonable burden in comparison with the risk involved.”64

4. Notice Revisited

*Schwalbach* was the last word regarding encroaching trees in Kentucky’s two highest courts until the decisions in *DeRossett v. Tyson*65 and

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56. 344 S.W.2d 822, 822 (Ky. 1961).
57. *Id.* at 823.
58. *Id.* at 822.
59. *Id.* at 823.
60. *Id.*
61. *Id.* See also Chambers v. Whelen, 44 F.2d 340 (4th Cir. 1930); Zacharias v. Nesbitt, 185 N.W. 295 (Minn. 1921).
62. *Lemon*, 344 S.W.2d at 823. See also Chambers, 44 F.2d at 341; Zacharias, 185 N.W. at 296.
63. *Lemon*, 344 S.W.2d at 823.
64. *Id.*
Commonwealth v. Sexton\textsuperscript{66} were rendered approximately twenty-three years later. DeRossett, a case between two private landowners, defined what constitutes notice of a defective or diseased tree.\textsuperscript{67} DeRossett also established that liability was imputed simply by notice.\textsuperscript{68}

In DeRossett v. Tyson, a landowner sued the owner of an adjoining lot for damage caused by an overhanging dead pine tree that had fallen onto her property, damaging her house and sparking a fire.\textsuperscript{69} The defendant, who inherited the land from her sister, was over eighty years old at the time of the trial.\textsuperscript{70} She denied ownership of the land and claimed that she did not take over the property for her own use in any way, other than paying the real estate taxes.\textsuperscript{71} Her home was located about a mile and a half away.\textsuperscript{72} However, the plaintiff provided evidence that she had called the property owner several times about the specific tree, including a final call made on the day before the tree fell.\textsuperscript{73} The defendant had contacted several people in her efforts, including a city police officer, a representative from the electric company, the defendant’s pastor, and several people who gave estimates to the defendant land owner to have the tree removed.\textsuperscript{74}

The defendant landowner contended that she did not know how rotten and dangerous the tree was and that she had taken substantial steps toward having it removed.\textsuperscript{75} Her witnesses included several people who provided her estimates of the cost to have the tree removed.\textsuperscript{76} She also claimed that she had not been to the property and had only seen the tree from a distance.\textsuperscript{77} The trial court’s jury instructions stated that the defendant had the duty to use ordinary care to learn whether there was a serious threat that the tree might fall onto the adjoining property and cause damage, but the instructions added a requirement that there needed to be proof that she failed to take normal steps to remove the tree, or to allow others to remove the tree, before liability could be imposed.\textsuperscript{78} The jury found in the defendant’s favor.\textsuperscript{79} The Kentucky Court of Appeals reversed, rejecting the requirement that the plaintiff needed to prove that the
landowner failed to take reasonable steps to remove the tree.\textsuperscript{80} Specifically, the court held that the defendant had notice of the defective tree and failed to rectify the problem with the tree before the damage occurred.\textsuperscript{81}

The \textit{DeRossett} court noted the dearth of relevant, prior case law in Kentucky, and it cited a Georgia case, \textit{Klein v. Weaver}, for guidance.\textsuperscript{82} \textit{Klein} held, in relevant part, that “[i]n regard to liability for a defective tree the ordinary rules of negligence apply. The owner of a tree is liable for injuries from a falling tree only if he knew or reasonably should have known the tree was diseased, decayed or otherwise constituted a dangerous condition.”\textsuperscript{83} The \textit{DeRossett} court stated that the plaintiff was only required to prove that the adjoining landowner knew or should have known that the tree was in a dangerous condition and that she failed to cure the problem before it fell and damaged her house.\textsuperscript{84} The court found that the plaintiff had proven this, and it reversed the lower court’s holding.\textsuperscript{85}

\textbf{B. Distinctions Between Rural and Urban Land}\textsuperscript{86}

Courts have previously discussed the extent of landowners’ duty to inspect vegetation based on the location of the land.\textsuperscript{87} For example, the Kentucky Court of Appeals found in \textit{Lemon} that there was no duty to inspect due to the “sparsely settled” location of the incident.\textsuperscript{88} \textit{Commonwealth v. Callebs} solidified this rule in Kentucky in relation to governmental duty.\textsuperscript{89} While driving on U.S. Highway 25 East on the outskirts of Barbourville, Cecil Callebs was killed when a large sycamore tree that stood approximately twelve feet from the edge of the pavement fell onto his vehicle during a wind storm.\textsuperscript{90} Callebs’ administratrix filed a claim for wrongful death,\textsuperscript{91} but the Board of Claims found there was no negligence on the part of DOH.\textsuperscript{92} However, the circuit court reversed the board’s holding.\textsuperscript{93} The Kentucky Court of Appeals

\begin{itemize}
\item \textsuperscript{80} Id. at *3-4.
\item \textsuperscript{81} Id. at *4.
\item \textsuperscript{82} Id. at *3 (citing Klein v. Weaver, 593 S.E.2d 913 (Ga. Ct. App. 2004)).
\item \textsuperscript{83} Klein, 593 S.E.2d at 914 (quoting Willis v. Maloof, 361 S.E.2d 512, 513 (Ga. Ct. App. 1987)).
\item \textsuperscript{84} DeRossett, 2008 WL 2065841, at *4.
\item \textsuperscript{85} Id.
\item \textsuperscript{86} Some courts in other states have rejected the notion of a heightened duty for urban landowners and apply a general duty of care regardless of the population distribution where the land is located. See Taylor v. Olsen, 578 P.2d 779, 782 (Or. 1978).
\item \textsuperscript{87} E.g., id. (citing O’Brien v. United States, 166 F.Supp. 231 (D. Or.1958) and Hensley v. Montgomery County, 334 A.2d 542, 546-47 (Md. Ct. Spec. App. 1975)).
\item \textsuperscript{88} Lemon v. Edwards, 344 S.W.2d 822, 823 (Ky. 1961).
\item \textsuperscript{89} 381 S.W.2d 623, 624 (Ky. 1964).
\item \textsuperscript{90} Id. at 623.
\item \textsuperscript{91} Id.
\item \textsuperscript{92} Id. (finding no negligence after hearing extensive evidence).
\item \textsuperscript{93} Id. (instructing the Board to grant an award of $10,000).
\end{itemize}
then reversed the circuit court. The court of appeals noted that DOH did not have actual notice of the defective condition of the tree.

The court specifically stated that “[t]he issue in the case is whether the department was chargeable with constructive notice of the defective condition, or, stated another way, whether a reasonable inspection would have disclosed the condition. This involves the question of how close an inspection was reasonably required.”

The court recognized that there was conflicting evidence concerning the ability to observe the defective condition of the tree. The court also felt that the law did not require DOH to make a “walk-around” inspection of the tree, which may have involved entering upon private land.

We have been cited to no authority, nor has our research disclosed any, imposing by law so great an inspection duty on public highway authorities in an area such as here involved. Although the area may have been within the city limits of Barbourville, it was not truly urban in character, and in the near vicinity there were wooded hillsides along the road. In such an area we cannot say as a matter of law that the burden of a walk-around inspection of each tree near the highway (perhaps requiring the obtaining of entry permission from the abutting landowners) would not be unreasonable in comparison with the risk.

Thus, the court found that there was no duty for DOH to inspect the trees along the road.

In contrast to Callebs, the Kentucky Court of Appeals in Commonwealth v. Maiden, found that there was a duty to inspect in a busy, developed area. In Maiden, the plaintiff filed a lawsuit against DOH after she fell into a large pothole in a parking area in the city of Middlesboro. Although the case did not involve overhanging trees, the court contrasted the facts of the case with those from Callebs and held that DOH was negligent in failing to conduct a walk-around inspection of the parking areas during off hours when the parking spaces were not occupied, because the parking lot was located in a busy commercial area. Such an inspection would have required a small

94. Id. at 624.
95. Callebs, 381 S.W.2d at 623.
96. Id.
97. Id.
98. Id. at 624.
99. Id. at 624.
100. Id.
102. Id. at 313.
103. Id.
investment of time, unlike inspection of the rural, lightly traveled highway abutted by private property in *Callebs*.

III. SOVEREIGN IMMUNITY

Governmental entities, which generally have sovereign immunity, are sometimes sued for damage caused by overhanging trees. Sovereign immunity, which *Black’s Law Dictionary* defines as “[a] government’s immunity from being sued in its own courts without its consent,”\(^{105}\) applies to Kentucky governmental entities under K.R.S. § 44.072.\(^ {106}\) The case of *Caneyville Volunteer Fire Department v. Green’s Motorcycle Salvage, Inc.*\(^ {107}\) explained the rationale behind the doctrine:

> The doctrine of sovereign immunity, as embodied in Ky. Const. Section 231, purports to prohibit claims against the government treasury absent the consent of the sovereign. Sovereign immunity is a bedrock component of the American governmental ideal, and is a holdover from the earliest days of the Commonwealth, having been brought over from the English common law. The doctrine has been included in all four of the Commonwealth’s constitutions and predated each.\(^ {108}\)

Furthermore, “the crucial determination in sovereign immunity analysis boils down to whether the entity being sued is the sovereign, its agency, or one who goes about the business of conducting the sovereign’s work.”\(^ {109}\) One determines that an entity is a state agency if, “when viewed as a whole, the entity is carrying out a function integral to state government.”\(^ {110}\)

Regarding the activities of actual employees or public officers of the Commonwealth, Kentucky courts have held that “[i]n Kentucky, personal liability for a public officer or employee’s negligent performance of duties depends in part on whether the powers or duties in question were ministerial or discretionary in nature.”\(^ {111}\)

“Discretionary acts or functions are ‘those involving the exercise of discretion and judgment, or personal deliberation, decision, and judgment . . .

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104. *Id.* at 314.
106. KY. REV. STAT. ANN. § 44.072 (LexisNexis 2010). *See also* KY. REV. STAT. ANN. § 44.073 (LexisNexis 2010); KY. CONST. § 231 (LexisNexis 2010). *See infra* note 150.
107. 286 S.W.3d 790 (Ky. 2009).
108. *Id.* at 799 (citing Ky. Ctr. for the Arts Corp. v. Berns, 801 S.W.2d 327, 329 (Ky. 1990)).
110. *Id.* (citing Berns, 801 S.W.2d at 332).
111. *See* Ashby v. Louisville, 841 S.W.2d 184, 188 (Ky. App. 1992) (citing Thompson v. Huecker, 559 S.W.2d 488, 495 (Ky. App. 1977)).
“A ministerial act, on the other hand, is ‘one that requires only obedience to the orders of others, or when an officer’s duty is absolute, certain and imperative, involving merely execution of a specific act arising from fixed and designated facts.’”

Interestingly, with regard to the maintenance of state highways, the court in Commonwealth v. Maiden noted that in some cases there can be governmental liability:

We have held that the law applicable to municipal corporations in respect to defects in streets applies equally to the state (where immunity has been waived) in respect to defects in state highways.

. . . As concerns notice of defects, the rule is that if the defect has existed for such a period of time that the authorities, by exercise of ordinary care and diligence, should have discovered it, notice will be imputed.

This rule puts the notice and frequency requirement for these inspections—depending on the type of implicated property or highway—at issue.

IV. COMMONWEALTH v. SEXTON

The 2008 Kentucky Supreme Court case of Commonwealth v. Sexton reversed a ruling by the Kentucky Court of Appeals that purported to establish a new duty for the Commonwealth in urban areas. The full progression of this case warrants close examination.

A. Background

In Sexton, a homeowner sued DOH because a dead tree fell from adjoining property that DOH owned, damaging the homeowner’s garage and destroying his car. Mr. Sexton owned a home in Okolona, within the city limits of Louisville. The tree was approximately ten to twenty-five feet from Mr.

112. Rowan County v. Sloas, 201 S.W.3d 469, 477 (Ky. 2006) (citing Yanero v. Davis, 65 S.W.3d 510, 522 (Ky. 2001)).
113. Id. at 478 (citing Yanero, 65 S.W.3d at 522).
115. Maiden, 411 S.W.2d at 313-14; see also Shrader v. Commonwealth, 218 S.W.2d 406, 408 (Ky. 1949) (treating the Highway Commission DOH like a private entity and holding that it must exercise ordinary care to prevent injury from defects in the highway).
116. 256 S.W.3d 29, 36 (Ky. 2008).
Sexton’s garage.\textsuperscript{120} DOH was working on a road project two hundred feet from where the tree fell.\textsuperscript{121} However, there was no connection between the project and the timing of the tree’s fall.\textsuperscript{122}

The Board of Claims found, through Sexton’s testimony, that the tree was “clearly visible” from the site where DOH was working.\textsuperscript{123} Sexton did not notify DOH about the condition of the tree before it fell, nor did he know that the Commonwealth owned the lot.\textsuperscript{124} A DOH engineer testified before the Board of Claims that no one from DOH inspected or would have inspected the empty land adjoining Mr. Sexton’s before the tree fell and that DOH did not know of the tree’s defect.\textsuperscript{125} The hearing officer for the Board of Claims found that tree inspection and removal of potentially dangerous trees was a ministerial act for DOH.\textsuperscript{126} Furthermore, the hearing officer found that DOH had constructive notice of the defective tree and was, therefore, negligent in failing to remove it.\textsuperscript{127} The Board of Claims adopted the hearing officer’s Findings, Conclusions, and Order and awarded damages to the owner.\textsuperscript{128} The Jefferson Circuit Court affirmed the Board of Claims’ decision,\textsuperscript{129} and Mr. Sexton was awarded $7,875.00: $1,000 for his homeowner’s insurance deductible and $6,785 for his car.\textsuperscript{130}

\textbf{B. Kentucky Court of Appeals Opinion}

On appeal, DOH argued that the Jefferson Circuit Court’s ruling affirming the Board of Claims’ decision should be reversed for any of the following three reasons:

\begin{enumerate}
\item that any acts or omissions by the Department in this case in relation to the vacant lot and the condition of any trees located thereon, were discretionary rather than ministerial in nature, and that therefore, the Commonwealth and all of its agencies are immune from suit for damages resulting from its negligence.\textsuperscript{131}
\end{enumerate}

\begin{thebibliography}{9}
\bibitem{120} Sexton II, 256 S.W.3d at 31.
\bibitem{121} Sexton I, 2006 Ky. App. LEXIS 153, at *2.
\bibitem{122} \textit{Id}.
\bibitem{123} \textit{Id}.
\bibitem{124} \textit{Id}.
\bibitem{125} Sexton II, 256 S.W.3d at 31.
\bibitem{126} \textit{Id}.
\bibitem{127} \textit{Id}.
\bibitem{128} Sexton I, 2006 Ky. App. LEXIS 153, at *3.
\bibitem{129} \textit{Id}.
\bibitem{130} \textit{Id} at *2-3.
\bibitem{131} \textit{Id}.
\end{thebibliography}
(2) that the Board’s findings of fact are not supported by substantial evidence and are therefore clearly erroneous, and

(3) that the Board and the circuit court relied on the wrong legal standard pertaining to the Department’s duty to inspect the lot, and as to whether it could be charged with constructive notice of the condition of trees on the lot.

Rather than analyzing whether the act of inspecting the trees is a ministerial or discretionary function of DOH, the Kentucky Court of Appeals framed the issue as whether all urban landowners had a duty to adjoining landowners to prevent damage from defective trees. The court of appeals relied on the Second Restatement of Torts, Section 363, which states that possessors of urban land who fail to use reasonable care to prevent an unreasonable risk are subject to liability to persons using a public highway nearby. The opinion also cited Professor Prosser with regard to the

132. Id.
133. Id. at *3-4. If the Commonwealth has waived immunity for the negligent acts of state agencies and their employees acting within the scope of their employment, then these actions must be brought in front of the Board of Claims. See Yanero v. Davis, 65 S.W.3d 510, 524 (Ky. 2001); KY. REV. STAT. ANN. §§ 44.072, 44.073 (LexisNexis 2009). Section 44.072 of the Kentucky Revised Statutes deals with the sovereign immunity of state government agencies and explains that the immunity is only waived when a statute explicitly intends to waive such immunity. KY. REV. STAT. ANN. § 44.072 (LexisNexis 2009). This section provides:

It is the intention of the General Assembly to provide the means to enable a person negligently injured by the Commonwealth, any of its cabinets, departments, bureaus or agencies, or any of its officers, agents or employees while acting within the scope of their employment by the Commonwealth or any of its cabinets, departments, bureaus or agencies to be able to assert their just claims as herein provided. The Commonwealth thereby waives the sovereign immunity defense only in the limited situations as herein set forth. It is further the intention of the General Assembly to otherwise expressly preserve the sovereign immunity of the Commonwealth, any of its cabinets, departments, bureaus or agencies or any of its officers, agents or employees while acting in the scope of their employment by the Commonwealth or any of its cabinets, departments, bureaus or agencies in all other situations except where sovereign immunity is specifically and expressly waived as set forth by statute. The Board of Claims shall have exclusive jurisdiction to hear claims for damages, except as otherwise specifically set forth by statute, against the Commonwealth, its cabinets, departments, bureaus, agencies or any of its officers, agents or employees while acting within the scope of their employment by the Commonwealth, its cabinets, departments, bureaus or agencies.

Id.

134. Sexton I, 2006 Ky. App. LEXIS 153, at *13 (stating that this case squarely presents the issue of whether an urban landowner owes his neighbor a duty of reasonable care to prevent an unreasonable risk of harm arising from defective or unsound trees on the premises).

135. Id. at *10-11 (citing RESTATEMENT (SECOND) OF TORTS § 363 (1965)). This section provides:
outdated reasons behind the traditional rule insulating landowners from liability when trees grow beyond the property line.\footnote{136} The court of appeals went on to state that “in contemporary urban settings, the reason for the [Massachusetts] rule has little viability.”\footnote{137}

The court of appeals opinion also analyzed Schwalbach v. Forest Law Memorial Park,\footnote{138} wherein it had rejected\footnote{139} the holding of Sprecher v. Adamson Companies.\footnote{140} Sprecher had declined to adopt Section 363(2) of the Restatement (Second) of Torts, which sets forth a standard of reasonable care concerning trees close to highways.\footnote{141} The Sprecher court criticized the restatement rule because of the anomaly that a landowner would owe a duty of care to strangers on the highways, but not to his neighbors.\footnote{142} The Kentucky Court of Appeals stated that it previously had declined to follow Sprecher because, as evidenced by Schwalbach, it would “result in innumerable lawsuits and impose liability upon a landowner for the natural processes and cycles of trees.”\footnote{143} The court then stated that the facts of Schwalbach were considerably different than the Sexton case at hand and that the court was not departing from the reasoning or ruling of Schwalbach as it applies to healthy trees that are no threat to neighboring property.\footnote{144} The court of appeals in Sexton thought the issue before it was narrower — whether an urban landowner

\begin{footnotes}
\item[136] Except as stated in Subsection (2), neither a possessor of land, nor a vendor, lessor, or other transferor, is liable for physical harm caused to others outside of the land by a natural condition of the land.
\item[137] Id. at *11 (citing WILLIAM L. PROSSER, LAW OF TORTS, § 57, (4th ed. 1971)). This section provides:
\begin{quote}
The origin of the traditional rule that a possessor of land has no duty to remedy purely natural conditions on his land, even if they are dangerous to his neighbors, harkens back to a time in England and America when most land “was unsettled or uncultivated, and the burden of inspecting it and putting it in a safe condition would have been not only unduly onerous, but out of all proportion to any harm likely to result.” This “traditional rule” is what is now called the Massachusetts Rule.
\end{quote}
\item[138] Id. See also supra Part II(A)(2).
\item[139] Id. at *11 (citing W ILLIAM L. \textsc{prosser}, LAW OF TORTS, § 57, (4th ed. 1971)).
\item[139] Id. at *11 (citing William L. Prosser, Law of Torts, § 57, (4th ed. 1971)).
\item[140] Schwalbach v. Forest Lawn Mem’l Park, 687 S.W.2d 551, 552 (Ky. Ct. App. 1985) (holding that the applicable rule in Kentucky is the “Massachusetts” rule).
\item[141] Sexton I, 2006 Ky. App. LEXIS 153, at *11-12 (citing Sprecher, 636 P.2d at 1125).
\item[142] Id.
\item[143] Id. at *12 (quoting Schwalbach, 687 S.W.2d at 552).
\end{footnotes}
“owes his neighbor a duty of reasonable care to prevent an unreasonable risk of harm arising from defective or unsound trees on the premises.”

The court stated, “[w]e believe that the time has come for us to recognize the common-sense duty of reasonable care that an urban landowner owes to his neighbor.” Judge Henry set forth the reasoning behind the court’s decision:

[Appellant] argues that it is unreasonable to impose upon it a duty to conduct an inspection of trees on its property. While we agree that no such duty exists in rural, sparsely populated settings, in urban areas such a duty is slight in proportion to the potential danger, as evidenced by the facts of this case.

Thus, the Kentucky Court of Appeals affirmed the Jefferson Circuit Court’s decision. In doing so, it created a new rule that an urban landowner has a “duty to others outside of his land to exercise reasonable care to prevent an unreasonable risk of harm arising from defective or unsound trees on the premises.” Furthermore, the Kentucky Court of Appeals held that the new duty was ministerial as to a public landowner, and, therefore, in such cases sovereign immunity is waived.

In his dissent, Judge Schroder argued against judicial creation of a new duty when none previously existed. His brief dissent stated simply, in its entirety, the following:

Our first inquiry is whether or not the Department owed a duty of care to Sexton. We all agree that under present law, there is no duty. The majority believes it’s time to create a duty. I must dissent. The General Assembly could, and probably should consider creating such a duty, but not the courts. Also, the urban/rural

145. Id. at *13.
146. Id. at *17.
147. Id. at *13-14.
148. Id. at *20-21.
149. Sexton II, 256 S.W.3d 29, 31 (Ky. 2008). The opinion of the Kentucky Court of Appeals also discussed the issue of comparative negligence on the part of Mr. Sexton for not reporting the defective tree to the DOH. Sexton I, 2006 Ky. App. LEXIS 153, at *20. The court also considered the actual value of the car, but the court did not rule on these issues because they were not presented for the court’s review. Id.
150. Sexton II, 256 S.W.3d at 32; see KY. REV. STAT. ANN. § 44.073 (West 2009). This statute deals with both the waiver of state government agencies’ sovereign immunity in negligence claims for the negligent performance of ministerial acts and the jurisdiction of the Board of Claims. This section provides:

(2) The Board of Claims shall have primary and exclusive jurisdiction over all negligence claims for the negligent performance of ministerial acts against the Commonwealth, any of its cabinets, departments, bureaus, or agencies, or any officers, agents, or employees thereof while acting within the scope of their employment by the Commonwealth or any of its cabinets, departments, bureaus, or agencies. Id.
distinction invites a number of questions, such as do we classify by city limits, population density, lot size, etc?\textsuperscript{151}

Judge Schroder’s secondary point regarding the confusion created resonates in the Kentucky Supreme Court’s opinion that followed.\textsuperscript{152}

C. Kentucky Supreme Court Appellate Briefs

The Commonwealth appealed and the Kentucky Supreme Court granted discretionary review of the court of appeals’ decision.\textsuperscript{153}

1. Kentucky Department of Highways’ Brief

After losing its case before the Board of Claims, whose decision was affirmed by the Jefferson Circuit Court and the Kentucky Court of Appeals, DOH appealed to the Kentucky Supreme Court.\textsuperscript{154} DOH argued that the court of appeals’ decision to impose a duty on landowners to inspect trees and remove dead trees in urban areas “[g]rossly expanded and retroactively imposed” the duty on the Transportation Cabinet to apply to a situation that occurred three-and-a-half years before its opinion.\textsuperscript{155}

It is respectfully submitted that if there was no duty in the first place, either by legal precedent, statutes or regulations when the events of the underlying case occurred, by definition, it was impossible to breach this nonexistent duty. There was nothing ministerial to be performed and no person could be charged with the responsibility to perform a nonexistent duty because, without the existence of a duty there could be no breach or ultimate liability as a matter of law; no one could have notice or knowledge of it; and any activities that took place or activities which did not occur relative to the tree could only have been discretionary. The negligent performance of or the failure to perform discretionary activities is not a basis upon which an award could have been made through the Board of Claims nor affirmed by the Jefferson Circuit Court nor affirmed by the Court of Appeals.\textsuperscript{156}

DOH argued that this new duty would result in numerous lawsuits and confusion as to what amounts to a defective or unsound tree.\textsuperscript{157} Next, DOH

\textsuperscript{151} Sexton I, 2006 Ky. App. LEXIS 153, at *21 (Schroder, J., dissenting).
\textsuperscript{152} Sexton II, 256 S.W.3d at 32 (stating that the court granted discretionary review because it was concerned about the magnitude of the new duty created by the court of appeals).
\textsuperscript{153} Id. at 30.
\textsuperscript{154} Id.
\textsuperscript{155} Brief for Appellant at 6-7, Sexton II, 256 S.W.3d 29 (Ky. 2008) (No. 2006-SC-0454-D).
\textsuperscript{156} Id. at 7.
\textsuperscript{157} Id. at 15. The DOH stated:
contended that the nature of the word “urban” and its meaning would extend the duty to every city or town in Kentucky. It also argued that it would be difficult to determine when land within the city limits is not urban. The distinction between urban and rural, it contended, is particularly “blurred” in areas where, as in Jefferson County (Louisville) and Fayette County (Lexington), the entire county is technically part of the city, yet many underdeveloped areas exist within the counties’ limits.

DOH also made a Fourteenth Amendment equal protection argument regarding the fairness of distinguishing between urban and rural landowners. It offered the following hypothetical:

If two landowners each reside on five hundred acres of farmland and forest, but their houses are ten feet apart with a fence running between them and one landowner has a large dead tree extending over the roof of his neighbor’s house, would that mean that the owner of the defective or unsound tree would come under the Massachusetts or traditional rule because he lives in a rural area and he would not have a ministerial duty to remove the tree or otherwise prevent an unreasonable risk of harm because he is in a rural area, but his fellow citizen, living in an urban setting with the same distance between his neighbor’s home, would be subject of the new ministerial duty created by the Court of Appeals in the current case? This would be unequal protection under the laws even though the risk of harm arising from the defective or unsound trees would be the same.

It is foreseeable that there will be numerous lawsuits throughout the Commonwealth by which the courts or juries will have to decide what amounts to a defective or unsound tree. For example, is a tree that has been struck by lightning and permanently weakened and damaged but still standing straight a defective or unsound tree; is a large tree that is green and alive but wrapped in parasitic vines defective or unsound; is a perfectly healthy tree but which is growing unnaturally at a leaning angle a defective or unsound tree. All of the above and many other conditions may, in the perception of an adjoining landowner, present an unreasonable risk of harm and it is foreseeable there will be numerous lawsuits brought by landowners against their fellow neighbors to obtain injunctive relief for a Court to enter an order directing the defendant landowner to remove trees at his expense or otherwise expose himself to potential liability.

Id. 158. BLACK’S LAW DICTIONARY 1680 (9th ed. 2009) (“of or relating to a city or town; not rural”). 159. Brief for Appellant at 16, Sexton II, 256 S.W.3d 29 (Ky. 2008) (No. 2006-SC-0454-D). 160. Id. 161. Id. (pointing to Olmsted Parks as an example of a rural area that is located within city limits). 162. Id. 163. Id. at 16-17.
DOH argued that “there is no justification, standard nor legal precedent, nor legislative requirement or direction to make such a distinction.”164 While the hypothetical raised very valid questions, the Kentucky Supreme Court did not address the equal protection argument.165

DOH also questioned how employees of the Commonwealth or urban landowners as a whole would recognize dead trees, especially during the winter when it is much more difficult to ascertain whether or not a tree is healthy.166 Furthermore, DOH noted that problems likely would arise as to who would judge whether a tree is “unsound.”167 It may be difficult for people without training to make such an assessment, and there may also be dead branches or limbs hidden in the canopy of the tree that could prove just as injurious even though the tree overall may appear to be healthy.168 Additional questions, such as what constitutes an inspection, how often inspections should occur, who would be qualified to do an inspection, and whether urban landowners would be obligated to hire professionals to inspect all of their trees, were presented by DOH.169

2. Sexton’s Brief

Sexton’s brief argued that the court of appeals did not create a new rule or duty of care but rather formally recognized an existing duty of care for the first time.170 He argued that the central issue was whether an urban landowner owes a duty of care to adjoining landowners for damages as the result of a fallen dead tree.171 He maintained that the court of appeals properly applied the duty “retrospectively,”172 citing Haney v. City of Lexington,173 which held that “[i]t is within the inherent power of the Supreme Court of any state to give such a decision either prospective or retrospective application without offending constitutional principles.”174 Moreover, Kotsiris v. Ling states that “[t]he court also finds that the changing of the rule is fully within the

164. Id. at 19.
167. Id.
168. Id.
169. Id.
171. Id.
172. Id. at 6, n.1 (Appellee’s brief notes that appellants stated that the court of appeals applied the duty on urban landowners “retroactively.” Appellee also claimed that Kentucky courts tend to use “retrospectively” for application of previously unenforced duties on a defendant, citing Kotsiris v. Ling, 451 S.W.2d 411, 413 (Ky. 1970), so the Appellee’s brief used “retrospective” as well.).
173. Haney v. City of Lexington, 386 S.W.2d 738 (Ky. 1964) (applying a new rule in a government immunity action both prospectively and retrospectively).
competence of the judicial function.” Sexton relied on the court of appeals decision that “[i]f it is within the ‘competence of the judicial function,’ a court of appeals has the power to change the rule.”

3. Reply Briefs

In its reply brief, DOH argued that none of the plaintiff’s cases supporting retroactive application of the new rule controlled the case at hand. First, Haney states that such retrospective application should not be used when dealing with real property law. Second, in Seale v. Riley, the Kentucky Court of Appeals did not retrospectively apply its holding to pending appeals due to the unfairness to litigators’ normal “practice,” thereby allowing only prospective application of its holding. DOH argued that Seale applied because DOH was not in the “practice” of inspecting trees on all of its land.

D. Kentucky Supreme Court Opinion

In reviewing the court of appeals’ decision, the Kentucky Supreme Court noted that the decision would create a duty for the Commonwealth to exercise ordinary care to prevent an unreasonable risk of harm arising from defective or unsound trees with regard to state-owned, urban lands. The Supreme Court expressed concern regarding the previously unrecognized duty on urban landowners. Also, the Kentucky Supreme Court reviewed the court of appeals’ finding that the administration of this new duty was ministerial in nature, which would result in waiver of sovereign immunity by DOH.

The Kentucky Supreme Court took a different approach in reviewing the case than the court of appeals. Rather than deciding whether DOH owed a duty of reasonable care to prevent damage from dead or defective trees to adjoining landowners, the Supreme Court focused initially on whether DOH’s supposed duty to inspect and remove dangerous trees on DOH-owned land was

175. Id. at 7 (quoting Kotsiris, 451 S.W.2d at 412).
176. Id.
178. Id. at 4 (citing Haney, 386 S.W.2d at 741 (“It must be remembered that we are not dealing here with the law of real property or other fields where stability and predictability are often of utmost concern.”)).
179. Id. at 5 (citing Seale v. Riley 602 S.W.2d 441 (Ky. Ct. App. 1980)).
180. Id.
182. Id.
183. Id. at 31-32.
184. Id. at 32.
185. Id. at 31-32.
a ministerial or discretionary function. Justice Minton quoted Section 231 of the Kentucky Constitution, which states that “[t]he General Assembly may, by law, direct in what manner and in what courts suits may be brought against the Commonwealth.” He emphasized that, “[t]he Board of Claims Act provides for a waiver of sovereign immunity for negligence in the performance of ministerial acts only.” The Supreme Court determined that the conclusion of the lower courts and the Board of Claims was incorrect in finding that tree inspection on state-owned land is a ministerial act.

The Court then examined the factors for determining when the action by a government agency is ministerial or discretionary. First, the Court stated that “the fact that an agency occasionally or even regularly engages in a particular act does not necessarily mean that the act is a ‘routine duty’ not involving ‘significant judgment, statutory interpretation, or policy-making decisions.’” An agency’s “routine duties” are usually standardized in statutes or regulations that specifically state the actions that the agency must take. However, there are no statutes or regulations specifically requiring DOH to inspect trees on its land. Second, the trees located on the property

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186. Id. at 32.
187. Sexton II, 256 S.W.3d at 32 (citing KY. CONST. § 231 (West 2009)); see also Yanero v. Davis, 65 S.W.3d 510, 523-24 (Ky. 2001); Commonwealth v. Kelley, 236 S.W.2d 695, 696 (Ky. 1951) (“Immunity from suit has always been an attribute of state sovereignty.”).
188. Sexton II, 256 S.W.3d at 32; see also KY. REV. STAT. ANN. § 44.073(2) (West 2009) (stating that the Board of Claims shall have primary and exclusive jurisdiction over all negligence claims for the negligent performance of ministerial acts against the Commonwealth).
189. Id.
190. Id. at 32-33 (stating that it is necessary to determine whether the acts involve policy-making decisions and significant judgment, or are merely routine duties).
191. Id.
192. Id. at 33, n.5 (citing Collins v. Commonwealth Natural Res. & Envtl. Prot. Cabinet, 10 S.W.3d 122, 126 (Ky. 1999) (finding act to be ministerial, in light of statutes and regulations clearly setting forth duties, in particular regulations requiring inspection of certain details relevant to case)).
193. Sexton II, 256 S.W.3d at 33; see KY. REV. STAT. ANN. § 176.050 (West 2009). The duties of the Department of Highways are stated as:

(1) The department shall:
   (a) Investigate all problems relating to the construction and maintenance of roads in the state;
   (b) Examine all projects and ascertain the feasibility of all routes;
   (c) Obtain information as to the proper type of road for any project;
   (d) Examine all types of road materials which may be used in the construction or maintenance of any road to be constructed by the department or under its direction or supervision;
   (e) Require the design plans for all road projects constructing a new route to identify, if at all feasible, one (1) or more publicly owned sites at least four (4) acres in size, along the proposed new route that will be used as waste sites during the construction phase of the project but that have the potential for a city, county, or other governmental entity to turn the site into an industrial park.
in question did not affect any roads. 194 Third, the Court found that DOH had no actual notice of the defective tree. 195 Finally, no case law existed at the time the tree fell that imposed a duty on DOH to inspect or remove defective trees. 196 To the contrary, earlier decisions had held that there was no duty to inspect for dead trees — even along roads. 197 The Court then compared the situation to Commonwealth v. Callebs, where the Kentucky Court of Appeals did not impose upon DOH a duty to remove a defective tree partly because it might have required an entry on private land. 198 The court in Callebs did not create a duty to inspect on Commonwealth-owned land either. 199

The Kentucky Supreme Court concluded that, “therefore, especially in light of the lack of statutes or regulations specifically imposing such a duty, there was no authority requiring such regular, recurrent inspection of all trees located on highway department property that tree soundness inspection could fairly be characterized as a ministerial act by the highway department.” 200

upon completion of the road project, regardless of whether the site currently has the infrastructure necessary to support an industrial park;
(f) Consult with all legislative bodies affected by a new road construction project during the design phase for the purpose of soliciting local government officials’ preferences for the location of waste sites that could be turned into an industrial park;
(g) From time to time, examine and have examined and audited all of its books, papers and records;
(h) Cause to be made all necessary surveys in the establishment and construction of the system of public highways; all necessary maps, prints, plans and specifications of all work to be done on the roads; estimates of costs; advertisement for bids; contracts for construction or maintenance; and all necessary forms in connection therewith; and
(i) Promulgate administrative regulations under KRS Chapter 13A for the care and maintenance of roads after they have been constructed.
(2) The department may publish bulletins containing useful information concerning the construction and maintenance of roads.
(3) An invoice or bill to be paid out of the road or bridge funds shall not be approved by the department for payment until it has been carefully examined by the department to ascertain if the bill or invoice is in every respect a proper and legitimate charge against the road or bridge funds. The commissioner may call before him any person who may have information respecting any bill or invoice.

Id.
194. Sexton II, 256 S.W.3d at 34.
195. Id.
196. Id.
197. Id. (citing Commonwealth v. Callebs, 381 S.W.2d 623 (Ky. 1964); see also, Shrader v. Commonwealth, 218 S.W.2d 406 (Ky. 1949) (holding that the DOH was not liable for failing to discover a loosen boulder along a highway).
198. Sexton II, 246 S.W.3d at 35 (citing Callebs, 381 S.W.2d at 624).
199. Id.
200. Id.
Thus, the act was discretionary, immunity had not been waived, and no claim could be brought against the commonwealth.\footnote{Id. at 35-36.}

The Court purposefully did not address the issue of whether a private urban landowner has a duty to remove dead or defective trees.\footnote{Id. at 36 (stating “[b]ecause we conclude that the performance of discretionary rather than ministerial acts is at issue here and that sovereign immunity has not been waived, it is not necessary for us to address whether a private landowner in an urban area is liable in tort for damages caused to a neighbor’s property by dead or otherwise defective trees falling.”).} However, in dicta, the Court alluded to a possible duty: “[F]or example, though we need not definitively decide the issue in this case, if a state entity has actual notice of the existence of a dead or dangerous tree on property owned by that state entity, inspecting or removing the tree may be a ministerial act.”\footnote{Id. at 33.}

\section*{V. The Future of Landowner Liability}

So where will the Kentucky courts go following \textit{Sexton}? The Kentucky Supreme Court accurately recapped the sparse Kentucky case law regarding potential liability of landowners to those on adjoining lands in the event of damage from overhanging trees.\footnote{\textit{Sexton II}, 256 S.W.3d at 32-35.} The Court noted a lack of statutes or regulations governing duties of DOH as a basis for adhering to precedent.\footnote{Id. at 35.} Due to a lack of statutory guidance, it is difficult to predict whether the state legislature will address this area. Given the current financial hardships in Kentucky, the time does not appear ripe for Kentucky to implement more duties on DOH.

However, \textit{Sexton} is an interesting and important case, not only for its analysis of the lack of a duty of public landowners, without prior notice of diseased or damaged trees, to inspect trees on their property, but also for its references to the case law touching upon this subject in the realm of private land ownership.\footnote{Id. at 31 (“An urban landowner owes a] duty to others outside of his land to exercise reasonable care to prevent an unreasonable risk of harm arising from defective or unsound trees on the premises.”) (alteration in original).} A panel of Kentucky Court of Appeals judges found the issue compelling enough to impose a duty upon urban landowners.\footnote{Id. at 35.} Much of the \textit{Sexton} case concerned issues of sovereign immunity and the distinction between ministerial and discretionary duties; the Kentucky Supreme Court’s decision is ultimately based on the finding that any inspection of the trees by public employees is a discretionary act, and, therefore, the Commonwealth does not waive its immunity by doing so.\footnote{Id. at 35.} However, \textit{Sexton} is an instructive case because of the discussions on the nature and existence of the duty, if any,
of landowners to others outside their property lines. For example, Sexton leaves unanswered the question of whether a public landowner would be liable for damage caused by overhanging trees if it had prior notice of the condition of the tree or trees in question. The Sexton opinion also references a section of the Kentucky Court of Appeals opinion that discusses Section 363 of the Restatement (Second) of Torts. This section of the Restatement addresses “the traditional rule of no landowner liability for harm to persons outside the land caused by natural conditions on the land with an exception for harm caused to persons injured by defective trees while traveling on the highway in an urban area.”

Although the Kentucky Supreme Court references Schwalbach’s dicta that “perhaps traditional rules of non-liability for failing to discover and remedy a dangerous natural condition (specifically, a dead or dying tree) should be re-examined,” Kentucky still adheres to the “Massachusetts rule” as to “cases involving the natural dropping of leaves and other naturally occurring debris onto the property of another landowner.” Owners of adjoining land can exercise self-help to cut back encroaching tree branches on their properties and may be able to sue for the costs incurred in undertaking such abatement, but they cannot recover damages.

Just prior to the Kentucky Supreme Court’s decision in Sexton, the Kentucky Court of Appeals rendered an unpublished decision in DeRossett v.

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209. Id. at 36, n.14. The court stated:
   “We note that some of the authorities that deal with a landowner’s liability for dead or otherwise defective trees falling specifically concern a tree falling on a highway or other public roadway – a fact pattern that may implicate different duties or concerns than that in the present case dealing with damage to nearby private property.”

Id.

210. Restatement (Second) of Torts § 363 (1965). This section further provides:
   § 363 Natural Conditions
   (1) Except as stated in Subsection (2), neither a possessor of land, nor a vendor, lessor, or other transferor, is liable for physical harm caused to others outside of the land by a natural condition of the land.
   (2) A possessor of land in an urban area is subject to liability to persons using a public highway for physical harm resulting from his failure to exercise reasonable care to prevent an unreasonable risk of harm arising from the condition of trees on the land near the highway.

Id. See also Lemon v. Edwards, 344 S.W.2d 822 (Ky. 1961) (holding that landowner was not liable for personal injury and property damage to motorist traveling in car hit by landowner’s falling dead tree, as there was no duty to inspect rural land for defective trees posing danger to users of seldom-used adjoining road).

211. Sexton II, 256 S.W.3d at 35, n.13 (citing Schwalbach v. Forest Lawn Mem’l Park, 687 S.W.2d 551 552 (Ky. Ct. App. 1985)).

212. Id.

213. See Larsson, supra note 14, § 3.
Tyson,\textsuperscript{214} which held that overwhelming notice to the private landowner that a tree on her property was defective would result in liability based upon traditional rules of negligence.\textsuperscript{215} The decision did not distinguish between properties in a “rural” or “urban” area.\textsuperscript{216}

Therefore, the upshot of Sexton appears to be that, for DOH, liability might exist for damage from defective or dying trees that injure people driving on a public highway in an urban area, but no liability attaches for that same scenario in a rural context.\textsuperscript{217} Because the court decided Sexton on the basis that the public landowner’s tree inspections were discretionary acts and, accordingly, did not constitute a waiver of sovereign immunity, Sexton does not provide a final, definitive word on whether Kentucky’s highest court would find a new duty for urban landowners for damage from encroaching defective or dying trees on adjoining property that is not a public highway.\textsuperscript{218} The case also does not evidence support for finding a new duty for landowners—urban or rural—for damage caused by healthy trees encroaching onto adjoining property where there is no prior notice of the condition.\textsuperscript{219}

It is likely that Kentucky courts will find a duty for urban landowners to inspect and/or remove defective or dying trees that threaten adjoining landowners’ private property, and the distinction between public property owners and private property owners will matter less.\textsuperscript{220} In the private landowner context, there seems to be growing sentiment to find such a duty in urban areas, based upon Schwalbach’s dicta and the Kentucky Court of Appeals’ decision in Sexton.\textsuperscript{221} Also, although it was not cited in Sexton and it did not involve an urban/rural analysis, DeRossett v. Tyson found liability on the part of a private landowner for damage to an adjoining landowner’s house.\textsuperscript{222} Clearly, the overwhelming notice on the part of the property owner in DeRossett was significant.\textsuperscript{223}

It seems hard to justify the allowance of dying or defective trees overhanging another’s property in an urban area where the trees should be easily viewed and inspected. However, problems with this approach remain in

\begin{itemize}
\item 215. Id. at *4.
\item 216. Id.
\item 217. See Sexton II, 256 S.W.3d at 35. See also Lemon v. Edwards, 344 S.W.2d 822 (Ky. 1961).
\item 218. See Sexton II, 256 S.W.3d at 36 (declining to address whether a change in liability for damage to a neighbor’s property caused by dead or defective trees was needed).
\item 219. See id.
\item 221. See Schwalbach, 687 S.W.2d at 552.
\item 223. Id. at *3-4.
\end{itemize}
defining what is an “urban area,” determining what is a reasonable inspection, and distinguishing a “defective or dying tree” from one that it not (i.e., a tree might take a long time to decay and might not show obvious exterior signs of inner weakening). All of these questions, however, would likely be considered questions of fact rather than questions of law and, therefore, could be decided by a jury. There could be a flood of lawsuits holding landowners responsible for knowing more about the natural processes of decay of trees. This concern of an influx of cases and more stringent inspection duties upon public landowners (state agencies), along with the issues of what constitutes “urban” areas and “decay,” were raised by DOH in its brief to the Kentucky Supreme Court. DOH also raised an interesting equal protection argument regarding the traditional rural/urban distinction found in cases in this area.

VI. CONCLUSION

A few of the possible scenarios of landowner liability for damages caused by overhanging trees have been established in Kentucky law, while others still await to be addressed by the courts. Largely, Kentucky courts use ordinary negligence principles if private or governmental entities have notice of any defects. The commonwealth does not have a duty to inspect trees on its property. The remoteness of the land and location of the trees will be considered by the courts to determine if a duty to inspect exists for non-governmental landowners. Landowners, both public and private, are not liable for damage caused by natural dropping of foliage from a healthy tree,

225. Id. at 20.
226. Id.
227. Id. at 14-16.
228. Id. at 16-17 (arguing that landowners in rural and urban areas would receive different protection from the law because a landowner in a rural area may not have a duty to remove a defective tree hanging over adjacent landowners’ property, while a landowner under the same situation but in a rural setting would owe a ministerial duty to remove the tree).
229. See DeRossett v. Tyson, No. 2007-CA-001042-MR, 2008 WL 2065841, at *3 (Ky. Ct. App. May 16, 2008) (holding that knowledge of the defective tree and failure to remedy the defect were enough to impute liability onto the defendant); Lemon v. Edwards, 344 S.W.2d 822, 823 (Ky. 1961) (holding that a landowner does not have a duty to inspect his land for decaying or defective trees); Schwalbach v. Forest Lawn Mem’l Park, 687 S.W.2d 551, 552 (Ky. Ct. App. 1985) (adopting the “Massachusetts rule,” which states that an adjoining landowner is not liable for the natural droppings of a healthy tree).
230. See Sexton II, 256 S.W.3d 29, 36 (Ky. 2008) (declining to address whether a change in liability for damage to a neighbor’s property caused by dead or defective trees was needed).
231. See DeRossett, 2008 WL 2065841, at *3 (citing Klein v. Weaver, 593 S.E.2d 913 (Ga. Ct. App. 2004)).
232. See Sexton II, 256 S.W.3d at 35.
233. See Lemon, 344 S.W.2d at 823.
and people affected by these natural droppings have the limited remedy of self-help. 234 The recovery of such abatement costs is not entirely settled or standardized in Kentucky. 235

234. See Schwalbach, 687 S.W.2d at 552.
235. Id.
THE 2010 AMENDMENTS TO KENTUCKY’S BUSINESS ENTITY LAWS

Thomas E. Rutledge*

The 2010 General Assembly adopted a number of amendments, most of which are technical, to Kentucky’s business entity laws. This series of amendments is less systematic and narrower in scope than the across-the-board amendments adopted by the 2007 General Assembly.1 Still, a series of amendments were adopted across the business entity laws in response to and for the purpose of legislatively overriding portions of the Kentucky Court of Appeals’s ruling in Barone v. Perkins.

I. LEGISLATIVE HISTORY

Senator Tom Jensen introduced Senate Bill (“S.B.”) 150, containing the 2010 amendments to the Kentucky business entity laws, on February 8, 2010. The bill was assigned to the Judiciary Committee on February 10.2 The Judiciary Committee held a hearing on the proposal on February 11,3 and the bill was passed out of Committee on a vote of ten yays and one nay. S.B. 150 was unanimously voted out of the Senate on February 24,4 and came before the House Judiciary Committee on March 10.5 After adoption of the L3C study amendment,6 the bill was voted out of House Committee by a unanimous vote. The bill came before the House on March 24,7 where it passed by a vote of

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4. Id.
5. Id.
6. See infra notes 279 through 281 and accompanying text.
7. http://www.lrc.ky.gov/record/10RS/SB150.htm. A proposed floor amendment to the Kentucky Uniform Limited Partnership Act (“KyULPA”) and the Kentucky Revised Uniform Limited Partnership Act (“KyRULPA”) would have permitted a limited partner to withdraw from the limited partnership and receive a “pro rata distribution” of its assets upon a variety of bases including the limited partner’s belief of fraud in the operation of the limited partnership. In effect, limited partnerships would have lost capital lock-in. The floor amendment was withdrawn on
ninety-six yays and two nays. On March 29, 2010, the Senate agreed to certain technical corrections made in the House, and unanimously voted in favor of the bill. The amendments (the “2010 Amendments”) set forth in S.B. 150 took effect on July 15, 2010. The amendments are discussed below.

II. THE RESPONSE TO BARONE V. PERKINS

The decision rendered by the Kentucky Court of Appeals in Barone v. Perkins, as it touches upon business entity law and specifically the rule of limited liability, may well and likely is dicta; that said, it is dangerous dicta and has for that reason been expressly overruled.

The facts of the Barone v. Perkins decision are relatively straightforward. Frank and Christine Barone retained Glen Perkins Custom Homes, LLC (“Perkins LLC”) to build a personal residence. Glen Perkins built the home, but after closing the Barone’s became dissatisfied with the home’s workmanship and construction. In response, they sued Glen Perkins and Edward Hacker, the other member of Perkins, LLC, asserting claims in tort, breach of contract, and violation of applicable building codes. The defendants moved for summary judgment shortly after filing their answer. Defendants supported their motion by affidavits asserting that, inter alia, neither of the named defendants had been involved with the various alleged deficiencies in the home and that they could not, as a matter of law, be held liable for those alleged deficiencies. The plaintiffs objected to the motion for summary judgment, noting that no discovery had yet taken place. However, they submitted no affidavits or affirmative evidence in opposition to the defendants’ motions for summary judgment. The court granted summary judgment, holding that based upon the affidavits submitted, neither defendant had been involved in the alleged tortious conduct and therefore could not be personally liable. The plaintiff appealed.

March 23, 2010 in the face of written objections from this author, Turney Berry and Professor Daniel S. Kleinberger, reporter for the Uniform Limited Partnership Act (2001).

9. Id.
10. See KY. OP. ATT’Y GEN. 10-002 (2010).
12. Id. at *1.
13. Id.
14. Id. The decision notes, but does not explain why, neither the LLC nor the various subcontractors involved in the complained-of work were not named as parties in the action. It is noted that, at the time the suit was filed, the LLC was not in good standing with the Secretary of State, but that during the pendency of the action it was reinstated to good standing.
15. Id.
16. Id.
17. Id.
18. Id. at *2.
19. Id. at *3.
The Court of Appeals upheld the grant of summary judgment, holding that it was not premature. Rather, citing the standard of summary judgment under *Lewis v. B&R Corporation* and *Steelvest, Inc. v. Scansteel Service Center, Inc.*, the Court of Appeals held that there were no combination of facts on which the plaintiffs could prevail.

Had the court stopped at this point, it would have been unnecessary to modify Kentucky’s various business organization acts, and *Barone v. Perkins* would be yet another minor skirmish in the continuing war over the appropriate standard for summary judgment. The court, however, continued with its analysis and substantively considered the scope and limits of the liability shield afforded by the LLC Act. Referencing that Act, the court held that because the defendants were at all times acting as members, not employees, of the company, and because neither had committed an individual tort, they were immune from liability for the actions they had undertaken on behalf of the LLC. In the course of this discussion, the Court of Appeals contrasted the LLC Act with the Kentucky Business Corporation Act (“KyBCA”), noting that the latter includes an express statutory recognition that a shareholder otherwise enjoying limited liability may be personally liable “by reason of his own acts or misconduct.”

Relying upon the LLC Act’s lack of an equivalent statutory provision, the Court differentiated the liability shields provided by the two statutes holding, inter
alia, that the liability shield provided by the LLC Act is more robust than that provided by the KyBCA.  

This differentiation does not stand up to scrutiny. Section 6.22(2) of the Model Business Corporation Act is a recitation of generally applicable agency law, which states that an agent, in the discharge of responsibilities on behalf of a principal, is always personally liable for his or her own tortious conduct. While it is true that the Court of Appeals, in reliance upon the trial court’s finding of fact, noted that the defendants had not personally engaged in any tortious conduct, the differentiation between the statutes as to the presence or absence of language addressing liability for one’s “own acts or conduct” must relate to liability arising in tort; assuming the corporation is properly disclosed as the principal, the agent will not be held liable on a contract entered into by the agent on behalf of the principal. This effort to distinguish between the LLC and Business Corporation Acts is especially troubling because the LLC Act expressly incorporates “the principles of law and equity,” which includes the law of agency.

Also curious is the effort by the Court of Appeals to characterize defendants Perkins and Hacker, the members of the LLC, as “members” versus “employees.” In almost every circumstance, LLC members will be characterized as members by default because it will be impossible to characterize

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   An agent is subject to liability to a third party harmed by the agent’s tortious conduct. Unless an applicable statute provides otherwise, an actor remains subject to liability although the actor acts as an agent or an employee, with actual or implied authority, or within the scope of employment.
As set forth in Comment b to the Restatement (Third) of Agency § 7.01:
   The justification for this basic rule is that a person is responsible for the legal consequences of torts committed by that person. A tort committed by an agent constitutes a wrong to the tort’s victim independently of the capacity in which the agent committed the tort. The injury suffered by the victim of a tort is regardless of whether the tortfeasor acted independently or happened to be acting as an agent or employee of another person.

See also Brewer Machine & Conveyor Mfg. Co., Inc. v. Old National Bank, 248 F.R.D. 478, 482 (W.D. Ky. 2008) (“It is commonly recognized that an agent is responsible for his own tortious acts, notwithstanding the agency relationship and regardless of whether the principal is also liable. Restatement (Third) of Agency, § 7.01 (2006).”); Smith v. Isaacs, 777 S.W.2d 912, 914 (Ky. 1989) (“the agent of a corporation, albeit a principal shareholder and office of the corporation, is personally liable for a tort committed by him although he was acting for the corporation.”), quoting Peters v. Frey, 429 S.W.2d 847, 849 (Ky. 1968); Young v. Vista Homes, Inc., 243 S.W.3d 352; 363 (Ky. App. 2007) (“an agent or corporate officer is not immune from liability for his own intentional misconduct or for negligence based upon a breach of his own duty.”)(citations omitted).
32. Id.
Moreover, the court does not explain how the liability shield of the LLC Act would be applied differently between a “member” and an “employee,” especially as the rule of limited liability encompasses any “member, manager, employee or agent of” an LLC. In addition, because Glen Perkins LLC was member-managed, both Perkins and Hacker were imbued with apparent agency authority on behalf of the LLC in its ordinary course of business.

In response to the Barone court’s attempts to differentiate between the limited liability provided by the KyBCA and the LLC Act, and its reliance upon the express statutory language incorporating the general rule set forth in agency law, the 2010 Amendments revised the limited liability provision of the LLC Act to incorporate Section 7.01 of the Restatement (Third) of the Law of Agency, as embodied in KRS § 271B.6-220(2). The 2010 Amendments also made parallel revisions to the provisions of the Kentucky Uniform Limited Partnership Act (2006), the Kentucky Cooperatives and Associations Act, the

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35. See, e.g., Treas. Reg. § 301.7701-2(c)(iv)(A) (while liability for trust fund taxes on compensation payments made to a non-member employee of a single member LLC will be a liability of the LLC, payments to members are self-employment income and liability for trust fund taxes, and considered personal to each member); Rev. Rul. 69-184, 1969-1 C.B. 256 (a bona fide partner in a partnership is not an “employee” of the partnership for purposes of FICA, FUTA and withholding obligation or “under the usual common law rules applicable in determining the employer – employee relationship”); Restatement of the Law (Third) Employment Law (Tentative Draft No. 2 (April 3, 2009)) § 1.03 (“Unless otherwise provided by law, an individual is not an employee of an enterprise if the individual through an ownership interest controls all or part of the enterprise.”); Ky. Rev. Stat. Ann. § 342.012(1) (a “qualified member” of an LLC, defined at KRS § 342.012(3), is protected by worker’s compensation only if there is an affirmative election of coverage).


38. The LLC Act has been revised by adding a new subsection (3) to KRS § 275.150 providing that the general rule of limited liability “shall not affect the liability of a member, manager, employee or agent of a [LLC] for his own negligence, wrongful acts, or misconduct.” See 2010 Acts, ch. 133, § 31. This addition, which reflects the law of an authorized agent’s responsibility for his or her conduct, should be distinguished from the liability imposed on a purported agent when acting on behalf of a non-existent principal or outside the scope of the agent’s actual authority. Both are addressed at KRS § 275.095. It bears noting that the overbroad reading by the Barone Court of the absence in KRS § 275.150 of language equivalent to KRS § 271B.6-220(2) was avoided in J. Stan Dev., LLC v. Lindo, No. 2008-CA-001796-MR, 2009 WL 3878084 (Ky. App. Nov. 20, 2009) and Dzurilla v. All American Homes, LLC, 2010 WL 55923 at *3 (E.D. Ky. Jan. 4, 2010).

39. The amendments to KyULPA (2006) are made in two sections, namely the addition of KRS § 362.2-303(2) and KRS § 362.2-404(4). These amendments address, respectively, the liability shield afforded all limited partners in a KyULPA limited partnership and as well the general partners in a KyULPA limited partnership that is elected to be a limited liability limited partnership. See 2010 Acts, ch. 133, §§ 61-62. The presence of a provision of this nature in KyRUPA at the time of its adoption was a carry-forward from the predecessor LLP act. See Ky. Rev. Stat. Ann. § 362.1-306(4); id. § 362.220(3); see also Allan W. Vestal and Thomas E. Rutledge, Modern Partnership Law Comes to Kentucky: Comparing the Kentucky Revised Uniform Partnership Act and the Uniform Act from which it was Derived, 95 Ky. L.J. 715, 731, note 102 and accompanying text (2006-07).
Rural Electric & Telephone Cooperative Act, and the Kentucky Nonprofit Corporation Act. The statutory recognition that one is subject to liability for their own torts does not modify duties *inter se* the various business organizations. Just as the “except that he may become personally liable by reason of his own acts or misconduct” language of KRS § 271B.6-220(2) neither limits nor modifies the director’s standard of culpability for breach of the duty of care, the addition of equivalent language in the other acts does not modify the responsibilities *inter se* the business organization. To that end, the addition of Restatement § 7.01 language to the statutes identified above does not: (a) modify the standard of culpability for a breach of the duty of care; (b) affect the ability to modify (or even eliminate) that duty of care or culpability for its violation; or (c) otherwise create a basis for liability.

III. BRINGING SUIT ON BEHALF OF AN LLC

KRS § 275.335 identifies who has the authority to initiate a legal action on behalf of and in the name of an LLC. KRS § 275.340 provided that the determination that a person did not have proper authority to initiate an action on behalf of an LLC could not be “asserted as a defense to an action brought by the LLC or as the basis for the LLC to bring a subsequent suit in the

40. In the Cooperatives and Associations Act, a series of amendments were necessary. First, subsection (3) of KRS § 272.201 has been deleted, 2010 Acts, ch. 133, § 13, and replaced with new section KRS § 272.203, created by 2010 Acts, ch. 133, § 3. That new KRS § 272.203, patterned upon KRS § 271B.6-220, provides the rule of limited liability and as well the rule that a member or other person acting on behalf of an association is liable for consequences of his or her own actions. In addition, a new subsection (2) has been added to § 272.490, that subsection repeating the rule of KRS § 271B.6-220. See 2010 Acts, ch. 133, § 14.

41. Sections 279.090 and 279.390 of KRS have been revised to incorporate language based upon KRS § 271B.6-220(2). See 2010 Acts, ch. 133, §§ 47, 48.

42. In the Nonprofit Corporation Act, KRS § 273.187 has been redrafted to restate the rule of limited liability while, at the same time, repeating the rule of personal liability for one’s own conduct. See 2010 Acts, ch. 133, § 15.

43. KY. REV. STAT. ANN. § 271B.8-300(5).

44. See, e.g., KY. REV. STAT. ANN. § 275.170(1).

45. See, id. § 275.180(1).

46. The authority to bring an action on behalf of an LLC may be expanded or restricted in the LLC’s operating agreement. See KY. REV. STAT. ANN. § 275.335 (“Unless otherwise provided in a written operating agreement”). In Maitland v. Int. Registries, LLC, 2008 WL 2440521 (Del. Ch. June 6, 2008), the fifty-percent member of an LLC filed suit against the LLC; the other member sought, on behalf of the LLC, to retain counsel and defend the suit. The operating agreement in question provided that “the decision of the members holding a majority of the LLC interest as to all such matters shall be controlling.” On that basis, the court determined that the second member did not have the authority to retain counsel on behalf of the LLC. Similarly, in Ward v. Hornik, 2002 WL 1199249 (E.D.Pa. June 3, 2002), a complaint authorized by members holding sixty-four percent of the voting interests was dismissed when the operating agreement required two-thirds of the voting interests to take action.
same cause of action.” KRS § 275.340 has caused mischief by its application in a manner not intended. Consequently, it has been deleted.47

The rationale for this provision was twofold. The first was to preclude an LLC that did not prevail in an action brought in its name from asserting that it was not bound by the action, thereby avoiding issues of res judicata, collateral estoppel, law of the case, claim preclusion, and the like. The second rationale for the provision was to preclude defendants sued by an LLC from being able to have the action dismissed due to lack of authority. Otherwise, the LLC had to take whatever steps necessary to authorize the action, during which time the statute of limitations on its claim may have run or the defendant may have otherwise realized additional defenses.48

This statute had not been applied in actions between the LLC and third parties, but rather in actions inter se the members. In Lourdes Medical Pavilion, LLC v. Catholic Health Care Partners, Inc.,49 the operating agreement at issue required the consent of both LLC members to initiate legal action on behalf of the LLC.50 One member, in its own name and on behalf of the LLC, brought an action against the other member.51 The court found that, in bringing the action, the plaintiff member acted outside the bounds of the operating agreement.52 However, citing KRS § 275.340, the Court determined that the action should not be dismissed - notwithstanding the lack of actual authority in the plaintiff member to bring suit on behalf of the LLC against the other member.53 The Lourdes court eviscerated KRS § 275.33554 and ignored the “maximum enforcement of operating agreements” directive in KRS § 275.003(1).55 To avoid this and similar results, the 2010 Amendments repealed KRS § 275.340.56 Actual authority to bring an action on behalf of an LLC will continue to be determined under the operating agreement and KRS § 275.335. Courts will

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47. Repealed by 2010 Kentucky Laws Ch. 133 (S.B. 150).
48. KRS § 275.340 is based upon Section 1103 of the Prototype Limited Liability Company Act, the primary source document for the original 1994 Kentucky LLC Act. See infra notes 154 and 185. The official comment to Prototype LLC Act § 1102 (KRS § 275.345) provides in part “Section 1103 provides for the consequences of unauthorized suits vis-à-vis third parties.”
50. Id. at *6.
51. Id. at *4.
52. Id. at *10-11.
53. Id. at *14. Although not an issue in this decision, it must be wondered whether the defendant member had a viable cause of action against the plaintiff member for breach of the operating agreement and, if so, what would be the damages.
54. See KY. REV. STAT. ANN. § 275.335 (reciting who may bring suit on behalf of an LLC and making that authority subject to a contrary rule in a written operating agreement).
55. At the time of the Lourdes decision, the “maximum enforcement of operating agreements” language was codified at KRS § 275.015(14). See also Rutledge, The 2007 Amendments, supra note 1 at 260, n. 210.
instead make determinations as to whether the action has been properly authorized and whether the LLC is bound by any judgment rendered under generally applicable principles of law.\(^{57}\)

IV. LIMITS ON DISTRIBUTIONS BY LIMITED LIABILITY PARTNERSHIPS

The various legislative acts that provide limited liability to the owners of business entities\(^{58}\) also provide limits on the distributions that may be made to those owners. These limits preserve the concept of creating a “trust fund” to insure that some assets remain available to satisfy the claims of more senior creditors.\(^{59}\) Under these various limitations, when certain tests are not satisfied, the entity may not make a distribution to its owners.\(^{60}\) The notable exceptions to this rule had been the limited liability partnership provisions in the Kentucky Uniform Partnership Act (“KyUPA”)\(^{61}\) and the Kentucky Revised Uniform Partnership Act (“KyRUPA”).\(^{62}\) Prior to the 2010 Amendments, neither of these statutes provided limitations upon distributions that a LLP could make.\(^{63}\) The 2010 Amendments added limitations on distributions by an LLP when the LLP is insolvent or would be made insolvent by the distribution.\(^{64}\) Each of the new provisions provides a two-year “look back” period for recovery from those that authorized an improper distribution.\(^{65}\) These new provisions are similar to

\(^{57}\) In this respect, the deletion of KRS § 275.340 from the LLC Act does not create a gap in the Act. None of the KyRUPA, KyULPA, Kentucky Business Corporation Act (“KyBCA”), Kentucky Nonprofit Corporation Act (“KyNPCA”), or other business organization acts contains a provision equivalent to KRS § 275.340.

\(^{58}\) This reference to “owners” includes corporate shareholders, members in an LLC, partners in the various forms of partnerships, and others.

\(^{59}\) See KY. REV. STAT. ANN. § 271B.6-400(3); id. § 275.225(1); id. § 362.473 and id. § 362.2-508. See also BAYLESS MANNING, A CONCISE TEXTBOOK ON LEGAL CAPITAL 46 (3rd ed.), citing Wood v. Dummer, 30 F.Cas. 435 (No. 17,944) (C.C.D. Me. 1824); In re Mortgage America Corp., 714 F.2d 1266, 1269 (5th Cir. 1983); Bear, Inc. v. Smith, 303 S.W.3d 137, 146 (Ky. App. 2010), quoting Reeves v. East Cairo Ferry Co., 158 S.W.2d 937, 938 (Ky. 1942).

\(^{60}\) See KY. REV. STAT. ANN. § 271B.6-400(3); id. § 275.225; id. § 362.473; id. § 362.2-508.

\(^{61}\) See id. § 362.555; id. § 362.220(2).

\(^{62}\) See KY. REV. STAT. ANN. §§ 362.1-1001 through 1-1003; id. 362.1-306.

\(^{63}\) Absent an election to be an LLP there is no need for a provision limiting distributions; a creditor claim is enforceable against the partners. See id. § 362.220(1); id. § 362.1-306(1).

\(^{64}\) See id. § 362.1-1003, created by 2010 Acts, ch. 133, § 5; id. § 362.601, created by 2010 Acts, ch. 133, § 4. Notably, even in the absence of a statutory limitation on distributions, fraudulent conveyance law would apply.

provisions that have been added by several other states, most recently Ohio in its 2008 adoption of Revised Uniform Partnership Act.66

V. EFFECT OF THE DISSOLUTION OF AN LLC

The provision addressing the effects of the dissolution of an LLC67 has been both clarified and corrected.68 Previously subsection (3)(d) provided that dissolution did not change several individual rules of the operating agreement69 or the Act.70 Such a selective listing, however, raised the question whether items not listed were altered by dissolution. The 2010 Amendments revised the text of § 275.300(2) to answer that question by stating that unless the operating agreement provides to the contrary, dissolution does not amend the operating agreement.71 Furthermore, the revised text expressly states that dissolution does not in and of itself terminate capital contribution obligations previously undertaken.72

Furthermore, all of pre-revision KRS § 275.300 was prefaced with “unless otherwise provided in a written operating agreement,” thereby implying that it set forth only default rules that are subject to private ordering.73 Certain substantive provisions, however, were clearly not subject to contrary private ordering, examples being the restriction of a dissolved LLC to those activities “appropriate to wind up and liquidate its business and affairs”74 and the provision that pending actions are not abated by dissolution.75 Therefore, the

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67. KY. REV. STAT. ANN. § 275.300.
69. For example, it was stated that quorum requirements are not altered. KY. REV. STAT. ANN. § 275.300(3)(d). Any quorum requirements must arise from the operating agreement as the LLC Act is silent as to quorum.
70. For example, this presumably refers to the standards applicable to members and managers, at a minimum KRS § 275.170 and KRS § 275.185(3). See KY. REV. STAT. ANN. § 275.300(3)(c).
71. KY. REV. STAT. ANN. § 275.300(3)(d) as amended by 2010 Acts, ch. 133, § 39. This clarification needs to be understood in the context of the rule that an LLC exists after its dissolution (see KY. REV. STAT. ANN. § 275.300(2)) and that the dissolution does not effect a member’s disassociation from the LLC. See KY. REV. STAT. ANN. § 275.280.
72. Id. § 275.300(3)(d) as amended by 2010 Acts, ch. 133, § 39. This provision is in partial affirmation of the ruling of the Court of Appeals in Racing Investment Fund 2000, LLC v. Clay Ward Agency, Inc., No. 2007-CA-00282-MR, 2008 WL 5102151 (Dec. 5, 2008), wherein, notwithstanding the dissolution of an LLC with capital call provisions in its operating agreement, the Court found that capital calls could be made against the various members in order to satisfy a company obligation. “Therefore, RIF, albeit dissolved, still exists as a legal entity subject to a capital call.” Slip op. at 8.
73. KY. REV. STAT. ANN. § 275.300
74. Id. § 275.300(2).
75. Id. § 275.300(3)(c), recodified by 2010 Acts, ch. 133, § 39 to KY. REV. STAT. ANN. § 275.300(4)(b).
2010 Amendments revised the section to provide greater clarity to those provisions that are subject to private ordering. Now subsections (1) and (3) are expressly subject to modification in a written operating agreement while subsections (2) and (4) are not.76

VI. FOREIGN LIMITED PARTNERSHIPS TRANSACTING BUSINESS IN KENTUCKY

Addressing a lacuna in the Kentucky Uniform Limited Partnership Act (2006) (“KyULPA”), the 2010 Amendments added a new section which makes clear the consequences to a foreign limited partnership of transacting business in Kentucky without having qualified to do so.77 KRS § 362.2-911(1) provides that the limited partnership may not maintain an action or proceeding until it procures a certificate of authority.78 Notwithstanding the inability of a foreign limited partnership to maintain an action if it has been transacting business without having qualified to do so,79 the section expressly provides that the failure of a foreign limited partnership to qualify to do business does not impair the validity of contracts or acts of the limited partnership, nor is the foreign limited partnership precluded from defending an action in Kentucky.80 Finally, the new section expressly provides that the personal liability of both general and limited partners is not impaired by the failure of the foreign limited partnership to qualify.81

VII. ADMINISTRATIVE DISSOLUTION

Under existing law a Kentucky corporation, LLC or other business entity may be administratively dissolved for failure to maintain a registered agent or a registered office.82 Before its amendment in 2007, the Kentucky Business Corporation Act (“KyBCA”) called for the Secretary of State to mail notice of

76. See id. § 275.300 as amended by 2010 Acts, ch. 133, § 39.
77. See id. § 362.2-911, created by 2010 Acts, ch. 133, § 6. This provision conforms to KRS §§ 362.507, 362.1-1103, 275.390 and 271B.15-020. The Uniform Limited Partnership Act (2001), 6A U.L.A. 325 (2008), is silent as to the consequences of a foreign limited partnership transacting business without authority. Since 2007, the foreign qualification provisions of KyRULPA have been repealed (see 2007 Acts, ch. 137, § 181) and all foreign limited partnerships qualify under KyULPA. See also Rutledge, The 2007 Amendments, supra note 1 at 235.
78. See KY. REV. STAT. ANN. § 362.2-911, created by 2010 Acts, ch. 133, § 6. In Modern Motors, LLC v. Yelder, No. 2009-CA-000648-MR (Ky. App. Jan. 29, 2010), the court held that KRS § 275.390(1), upon which new KRS § 362.2-911(1) is based, does not bar the filing of a compulsory counterclaim even though a compulsory counterclaim is not itself a defense.
79. See id. § 362.2-911(1), created by 2010 Acts, ch. 133, § 6. Accord KY. REV. STAT. ANN. § 271B.15-020(1); id. § 275.390(1); and id. § 362.1-1103(1).
82. See, e.g., KY. REV. STAT. ANN. § 271B.14-200(2); id. §§ 275.295(1)(b); id. § 362.2-809(1)(b).
administrative dissolution to the registered agent at the registered office
address. In 2007, the KyBCA was amended to provide that the Secretary of
State would send notice of administrative dissolution of a corporation to the
address of the principal place of business. Similar amendments have now been
made across the KyBCA (which now addresses revocation of authority as well),
the Kentucky Nonprofit Corporation Act (“KyNPCA”), the LLC Act, and
KyULPA. With these amendments, notice of any administrative
dissolution or revocation of a certificate of authority will be sent to the
business entities’ principal place of business address. Needless to say, these
revisions make it more incumbent (it was already mandated by statute) that
business entities keep their principal address records up to date.

The 2010 Amendments added a provision to the KyNPCA addressing
the dissolution of a nonprofit corporation that reaches the end of its life as defined in
its articles of incorporation. That provision - which stated that a nonprofit
corporation that had reached the end of its duration as defined in its articles of
incorporation would be afforded sixty days from that date within which to amend
or delete that date, after which it could not be reinstated and would be required
to liquidate it business and affairs - was subsequently superseded by the adoption
of the Kentucky Business Entity Filing Act. After sixty days, however, the
corporation may not be reinstated and must proceed to liquidate its business and
affairs. The new provision was consistent with revisions made in 2007 to the

83. See KY. REV. STAT. ANN. § 275.295
84. See also Rutledge, The 2007 Amendments, supra note 1 at 256.
86. See id. § 273.3181 as amended by 2010 Acts, ch. 133, § 19; id. § 273.3182(2) as amended
87. See id. § 275.295(4)(a) as amended by 2010 Acts, ch. 133, § 38; id. § 275.445 as amended
by 2010 Acts, ch. 133, § 46.
88. See id. § 362.2-907 as amended by 2010 Acts, ch. 133, § 68.
89. This also applies in the case of a foreign LLP qualified to transact business under KRS
§ 362.1-1102, a statement of foreign qualification.
90. In the case of a notice of administrative dissolution of a limited partnership governed by
KyULPA, the notice will be sent to the designated office. See KY. REV. STAT. ANN. § 362.2-809(2)
amended by 2010 Acts, ch. 133, § 64. See also KY. REV. STAT. ANN. § 14A.2-010(12).
91. See, e.g., KY. REV. STAT. ANN. § 275.040 (“A [LLC] that changes the mailing address of
its principal office shall deliver to the Secretary of State . . . a statement of change . . .”) (emphasis
added); id. § 362.2-115(1) (“In order to change its designated office, registered office or agent for
service of process, a limited partnership or a foreign limited partnership shall deliver to the
Secretary of State for filing a statement of change . . . .”) (emphasis added); and id. § 271B.5-025
(“A corporation that changes the mailing address of its principal office shall delivery to the
Secretary of State for filing, on a form supplied by the Secretary of State, a statement of change
. . . .”) (emphasis added). See also KY. REV. STAT. ANN. § 14A.5-010.
93. Id. Effective January 1, 2011 this provision was superseded by KRS § 14A.8-010, created
94. KY. REV. STAT. ANN. § 273.3182(4), created by 2010 Acts, ch.133, § 20, now KRS §14A-
8-010(2)
KyBCA and the LLC Act. As further amended, the KyBCA, the LLC Act, and the KyNPCA provide that the Secretary of State is not under an obligation to send notice of its dissolution when an entity reaches the end of its period of duration. Consequently, it may not be argued that notice from the Secretary of State is a precondition to the dissolution of the organization upon reaching the period of duration as set forth in its organic filing.

Another revision made throughout business entity acts deals with the timing of transmission of a notice of administrative dissolution or revocation of a certificate of authority. Annual reports are due by June 30 of each year. Previously, the statutes provided that after sixty days had elapsed from that due date, notice of administrative dissolution or of revocation of the certificate of authority would be mailed. That notice then triggered a sixty-day cure period. Under the revised statutes, the Secretary of State may mail notices of administrative dissolution and revocation of the certificate of authority immediately after the June 30 due date. The sixty-day cure period is not impacted by these revisions.

VIII. THE PROFESSIONAL SERVICE CORPORATION ACT

The 2010 Amendments made several revisions to the Professional Service Corporation Act (“PSC Act”). Most of the revisions made in KRS § 274.017(1) are grammatical in nature, however the revisions to KRS § 274.017(1)(d) make clear that the requirement that the professional service be permitted by the articles of incorporation applies both to the corporation at issue as well as a corporation seeking to be a shareholder thereof. The revisions to KRS § 274.017(2) confirm the ruling in National Loan Investors, L.P. v. Retina Assoc., P.S.C., which held that, notwithstanding an otherwise valid pledge agreement of the stock in a Professional Service Corporation (“PSC”), a non-professional is not a “qualified person” able to exercise on an otherwise valid pledge and take ownership of the shares.

95. See id. § 271B.14-220(5); id. § 275.295(2)(b); see also Rutledge, The 2007 Amendments, supra note 1 at 247-48.
96. See KY. REV. STAT. ANN. § 273.3181 (1).
97. See, e.g., id. § 271B.16-220(3); id. § 275.190(3); id. § 362.2-210(3); id. § 362.1-121(3); id. § 273.3671(3); id. § 386.392(3). Effective January 1, 2011, the provision addressing the due date for annual reports will be KRS § 14A.6-010(4).
98. See, e.g., KY. REV. STAT. ANN. § 275.295(1)(a) (prior to repeal by 2010 Acts, ch. 151, § 151).
99. See, e.g., id. § 271B.15-310(2); id. § 271B.14-210(2); id. § 275.295(2)(b); id. § 275.445(2).
100. See id. § 271B.14-200(1) as amended by 2010 Acts. ch. 133, § 7; id. § 271B.15-310(1) as amended by 2010 Acts, ch. 133, § 11. Effective January 1, 2011 this provision was superseded as to its substance by KRS § 14A.7-050(1)(a) as created by 2010 Acts, ch. 151, § 35.
103. See KY. REV. STAT. ANN. § 274.005(4).
The revisions to what was formerly KRS § 274.245(1) state that the qualified shareholder requirement is to be applied as if the foreign corporation were itself incorporated in Kentucky. The deletion of KRS § 274.245(2) serves to make two clarifications: (a) the rules applicable to whether a foreign professional service corporation must qualify to do business will be the same terms that apply to foreign business corporations in general, and (b) the prior exception from qualification if no office is maintained in Kentucky will no longer apply.

The amendments revised the PSC Act to explicitly provide that the rules applicable to business corporations in general, including shareholder limited liability, also apply to professional service corporations. These rules are subject, of course, to the PSC’s retention of certain supervisory liability and other applicable rules of personal liability under professional regulatory rules. Kentucky law as it relates to shareholder liability will apply equally to the actors on behalf of a foreign PSC, notwithstanding the internal affairs doctrine, with respect to services rendered in Kentucky.

Finally, a new provision expressly authorizes a PSC that is no longer rendering professional services to delete the PSC provisions from its articles of incorporation and thereafter be governed solely by KRS chapter 271B.

IX. THE ASSUMED NAME ACT

The 2010 Amendments made minor revisions to the Assumed Name Act to add greater clarity as to what constitutes the real name of a foreign business trust or foreign not-for-profit corporation, and to add the obviously missing “certificate” to KRS § 365.015(6).

X. THE CONSEQUENCES OF DEFAULTING ON OBLIGATIONS UNDERTAKEN IN AN OPERATING OR PARTNERSHIP AGREEMENT

The LLC Act, KyRUPA and KyULPA contemplate that there may be obligations to make additional capital contributions in the future, or to
make or perform other obligations. Unlike the LLC Act, however, which provides that such obligations are enforceable only if set forth in writing, neither the partnership nor the limited partnership acts contain a similar statute of frauds provision. Each of these acts has now been supplemented to provide that the operating/partnership agreement may specify the penalties or consequences of a failure to satisfy an otherwise enforceable obligation. The statute also introduces a non-exclusive list of the penalties/consequences to which the parties may agree. In each instance, the language adopted is based on the Delaware LLC Act. These additions serve to rebut the argument that Man-O-War Restaurants, Inc. v. Martin may still apply to LLCs and other non-corporate entities, notwithstanding the freedom of contract principles embodied in these acts. The 2002 amendment to KRS § 271B.6-270 overruled Martin as it applied to corporations.

XI. CHARGING ORDERS

Further revisions have been made to the various charging order provisions. First, KyRUPA has been revised to make clear that a partner’s transferee

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113. Indeed, it is possible to issue corporate shares that are assessable, the constitutional prohibition therefore having been removed in 2002, but that practice is at best atypical.


117. See Del. Code Ann. tit. 6, § 18-502(g). Other jurisdictions with similar provisions include Ohio. See Ohio Code § 1776.24.

118. 932 S.W.2d 366 (Ky. 1996).


120. See Ky. Rev. Stat. Ann. § 275.003(1) (“It shall be the policy of the General Assembly through this chapter to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements....”); id. § 362.1-104(3) (“Subject to KRS 362.1-103(2), it shall be the policy of the Commonwealth through this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements....”); and id. § 362.2-107(3) (“Subject to KRS 362.2-110(2), it shall be the public policy of the Commonwealth in this chapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements....”).


122. In 2007, significant revisions were made to the charging order provisions of the LLC Act (KRS § 275.260), KyRUPA (KRS § 362.1-504) and KyULPA (KRS § 362.2-703). See Rutledge, The 2007 Amendments, supra note 1 at 252-53.
benefits from exemption laws just as a partner would, and the LLC Act has been revised for grammar and terminology. Next, the charging order provisions of KyRUPA, KyULPA, and the LLC Act have been supplemented to address procedural issues for their issuance and service, making explicit that (a) the LLC/partnership is not a necessary party to the application for a charging order, and (b) that service of the charging order on the LLC or partnership may be made by the court or as it should direct. Finally, the charging order provisions of KyUPA and KyRULPA have been deleted and replaced with the language employed in KyRUPA and KyULPA, respectively. With these revisions, the rights of the charging order’s holder are the same, irrespective of the statute governing the LLC or partnership in question.

XII. THE DOCTRINE OF INDEPENDENT LEGAL SIGNIFICANCE

The doctrine of independent legal significance has been expressly incorporated into the KyBCA, the LLC Act, KyRUPA and KyULPA. Under the doctrine of independent legal significance, “a]ction taken in accordance

123. KY. REV. STAT. ANN. § 362.1-504(6). This revision brought the charging order provision of KyRUPA fully into accord with the charging order provision of the LLC Act (KRS § 275.265(5) and KyULPA (KRS § 362.2-703(5)).


126. Id. § 362.285 as amended by 2010 Acts, ch. 133, § 49.


128. See KY. REV. STAT. ANN. § 362.285 as amended by 2010 Acts, ch. 133, § 49; id. § 362.481 as amended by 2010 Acts, ch. 133, § 50. As to the charging order generally, see Thomas E. Rutledge, Charging Orders: Some of What You Ought to Know (Part I), 9 J. PASSTHROUGH ENTITIES 15 (Mar./Apr. 2006); (Part II), 9 J. PASSTHROUGH ENTITIES 21 (Jul./Aug. 2006). In contrast with Nevada (see N.R.S. § 78.746), Kentucky has not sought to include a charging provision in its business corporation act. See also Thomas E. Rutledge, Nevada’s Corporate Charging Order: Less There Than Meets the Eye, 11 J. PASSTHROUGH ENTITIES 21 (Mar./Apr. 2008).

129. For example, while the charging order provisions of KyUPA and KyRULPA were previously silent as to whether or not the charging order was the exclusive means by which the judgment creditor could move against the partnership interest, such is now express in both of those acts. All the acts now use the (seemingly) permissive “may,” as contrasted with a mandatory “shall,” as to the court’s capacity to issue a charging order. This word accommodates the application of exemptions that may apply, but is not intended to otherwise require an evidentiary hearing to require, for example, the judgment creditor proving the judgment debtor to be a partner/member of the partnership/LLC to which the charging order is directed or that the partnership/LLC generates distributable income that will, pursuant to the charging order, be diverted in satisfaction of the judgment.

130. See KY. REV. STAT. ANN. § 271B.1-430, created by 2010 Acts, ch. 133, § 1; id. § 275.003(5), created by 2010 Acts, ch. 133, § 28; id. § 362.1-104(5), created by 2010 Acts, ch. 133, § 52; id. § 362.2-107(4), created by 2010 Acts, ch. 133, § 59. The failure to incorporate the rule of independent legal significance into the statutes governing seldom used structures such as the business trust was simply an exercise in efficiency, and should not be interpreted as an indication that the doctrine, as a component of the common law, does not there apply.
with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections.\textsuperscript{131}

This doctrine is applied in circumstances where the effect of a transaction may be accomplished in either of two manners that have different procedural or substantive requirements.\textsuperscript{132} If the requirements of one “path” are satisfied, the transaction is valid notwithstanding that the requirements of another path are not satisfied.\textsuperscript{133} For example, consider an LLC owned 60%/20%/20% whose operating agreement requires the consent of 80% of the members for its amendment. The 60% member holds a meeting of the members to consider a merger of the LLC into another LLC – the first LLC’s operating agreement is silent as to mergers and therefore the default of approval by a majority-in-interest of the members applies.\textsuperscript{134} While the two 20% members vote against the transaction, the 60% member’s vote is sufficient. The members are now bound by the new operating agreement\textsuperscript{135} and there is no right to dissent from the merger.\textsuperscript{136} In response to the minority-member’s argument that the “merger” was nothing but an amendment of the operating agreement for which 80% approval was necessary, the doctrine of independent legal significance states that the mere fact that the outcome is identical or similar does not mean it should be set aside.\textsuperscript{137} Rather, an action is appropriate when a permissible means is employed to achieve a permissible end, even though the requirements to another (and perhaps more direct or restrictive) means to the same end are not employed.\textsuperscript{138} These amendments track certain Delaware revisions made in 2009.\textsuperscript{139}

\begin{footnotesize}
\begin{enumerate}
\item[131.] Orzeck v. Englehart, 195 A.2d 375, 377 (Del. 1963). See also Hariton v. Arco Electronics, Inc., 188 A.2d 123 (Del. 1963), aff’d 182 A.2d 22 (Del. Ch. 1962); Warner Communications, Inc. v. Chris-Craft Industries, Inc., 583 A.2d 962, 970 (Del. Ch. 1989) (referencing “Our bed rock doctrine of independent legal significance”), and Benchmark Capital Partners IV, L.P. v. Vague, 2002 W.L. 1732423 (Del. Ch. July 15, 2002), aff’d sub. nom. Benchmark Capital Partners IV, L.P. v. Juniper Financial Corp., 822 A.2d 396 (Del. 2003); Ernest L. Folk, III, De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc., 49 VA. L. REV. 1261 (Nov. 1963). In Lach v. Man O’War LLC, 256 S.W.3d 563 (2008), the plaintiff argued that the transaction undertaken was invalid as the effect was indistinguishable from a conversion for which the approval of the plaintiff would have been required. The Court rejected that argument of equivalency, but on other basis determined the transaction to have been improper.
\item[132.] See Orzeck, 195 A.2d at 377.
\item[133.] Id.
\item[134.] See KY. REV. STAT. ANN. § 275.350(1). This rule is subject to modification in a written operating agreement.
\item[135.] Id. § 275.360(4).
\item[136.] Id. § 275.345(3).
\item[137.] See Orzeck, 195 A.2d at 377.
\item[138.] The doctrine of independent legal significance applies inter se the business entity and does not impact upon successor liability to third parties under cases such as American Railway Express Co. v. Commonwealth, 228 S.W. 433 (Ky. 1920), Conn. v. Fales Division of Mathewson Corp., 835 F.2d 145 (6th Cir. 1987), Pearson v. National Feeding Systems, Inc., 90 S.W.3d 46 (Ky. 2002) and Parker v. Henry A. Petter Supply Co., 165 S.W.3d 474 (Ky. 2005).
\item[139.] See DEL. CODE ANN. tit 6, § 15-1201 as amended by S.B. 83, 145th Delaware General Assembly; DEL. CODE ANN. tit. 6, § 17-1101(h), created by H.B. 142, 145th Delaware General Assembly; and DEL. CODE ANN. tit. 6, § 18-1101(h), created by S.B. 82, 145th Delaware General
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some may question whether this is the correct rule, a different rule of construction may be provided for in the controlling documents.

XIII. MEMBER RESIGNATION

The 2010 Amendments reversed the fiduciary “lock-in” rule that had set the members of Kentucky LLC’s in an unfavorable position vis-à-vis fiduciaries in other Kentucky business entities. Directors and officers of a corporation are fiduciaries to the corporation; absent truly extraordinary circumstances they have a unilateral power to resign from those positions and terminate their ongoing fiduciary obligations. Likewise, general partners in a general or a limited partnership are fiduciaries (as well as mutual agents) of the partnership and the other partners; they enjoy a unilateral power to resign as general partners and thereby terminate their ongoing fiduciary obligations. On the other hand, shareholders, qua shareholders, are not fiduciaries to either the corporation or to the other shareholders, and have no right to resign. Similarly, absent extraordinary circumstances, limited partners in a limited partnership are not


141. See, e.g., KY. Rev. Stat. Ann. § 275.003(1) (“It shall be the policy of the General Assembly through this chapter to give maximum effect to the principles of freedom of contract and the enforceability of operating agreements.” . . . ); id. § 362.1-104(3) (“Subject to KRS 362.1-103(2), it shall be the policy of the Commonwealth through this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements . . . .”); and id. § 362.2-107(3) (“Subject to KRS 362.2-110(2), it shall be the public policy of the Commonwealth in this subchapter to give maximum effect to the principles of freedom of contract and the enforceability of partnership agreements . . . .”).


143. See, e.g., 1 William Meade Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 345.


146. The inter-shareholder fiduciary obligation principles of cases following from Donahue v. Rodd Electrotype Co. of New England, 328 N.E.2d 505 (1975), and section 7.01(d) of the Principles of Corporate Governance are exceptional, aberrational and analytically flawed, but that is a discussion for another day.
fiduciaries. While certain statutes have afforded them the power to resign, this power is based upon economics and not fiduciary law. Therefore, the general rule is that fiduciaries have the power to unilaterally withdraw from the office that gave rise to the fiduciary obligations and prospectively terminate those obligations.

However, prior to the 2010 Amendments, members in Kentucky LLCs found themselves in a different position. Depending on which fiduciary duty is at issue, members in a member-managed LLC owe fiduciary obligations to at least the LLC, if not the other members as well. While in a manager-managed LLC, the members, qua members, do not ab initio have fiduciary obligations to either the LLC or the other members; such obligations can arise by private ordering. What is atypical vis-à-vis other forms of organization was that members, qua members and as fiduciaries, did not have the unilateral power to terminate the position that gave rise to the fiduciary obligations unless that right was provided in a written operating agreement. Absent a provision addressing the power to resign in a written operating agreement, a member desiring to resign from the LLC was at the mercy of the other members permitting him or her to do so.

That situation could leave an LLC member in a precarious position. Consider the case of a member in a plumbing repair company organized as an LLC. That member would like to resign and set up his own plumbing company (where, as we know, he will make far more money than he would as an attorney). As a member, he owes a fiduciary duty of loyalty to the LLC, and is precluded from competing with the LLC. If the controlling operating agreement was silent as to resignation, that member found himself at the mercy of all the other members in the current LLC. If the member were not released by the other

147. See, e.g., RULPA § 603, 6B U.L.A. 286 (2008); IND. CODE. § 23-16-7-3.
148. KY. REV. STAT. ANN. § 275.170(1) (duty of care obligations in an LLC are owed by members, absent private ordering to the contrary, to both the LLC and the other members); id. § 275.170(2) (duty of loyalty obligations of members in an LLC, absent private ordering to the contrary, are owed to the LLC); RULLCA § 409(b), 6B U.L.A. 488 (2008) (member’s duty of loyalty); RULLCA § 409(c), 6B U.L.A. 489 (2008) (member’s duty of loyalty).
149. KY. REV. STAT. ANN. § 275.170(4); accord RULLCA § 409(g)(1), 6B U.L.A. 489 (2008). See also Mitchell v. Smith, 2009 WL 891908, *2 (D. Utah March 31, 2009) (“Because Defendant’s Counterclaim relies solely upon Plaintiff’s status as members [of the LLC] for the existence of fiduciary duties, and because Utah law prohibits such a finding based solely upon membership, the Court finds that Defendant has failed to state a cause of action which relief may be granted.”); Katris v. Carroll, 842 N.E.2d 221 (Ill. App. 2005); ULQ, LLC v. Meder, 666 S.E.2d 713 (Ga. App. 2008); Ledford v. Smith, 618 S.E.2d 627 (Ga. App. 2005); Dragt v. Dragt/DeTray, LLC, 161 P.3d 473 (Wash. App. 2007). Whether a particular LLC is member-managed or manager-managed is not determined by a substantive review and characterization of the inter se management structure defined in the operating agreement. Rather, as set forth in the official commentary to the Prototype LLC Act § 401, “Irrespective of the provisions in the operating agreement, whether an LLC is ‘manager-managed,’ as that phrase is used in the Act, depends on whether the articles of organization so provide.”
150. See KY. REV. STAT. ANN. § 275.280(3) (prior to amendment by 2010 Acts, ch. 133, § 37).
151. Id.
152. Id. § 275.170(2).
members, but nevertheless opened the competing venture, then (a) there was a manifest breach of the duty of loyalty, and (b) the member was required to turn over to the LLC all profits and benefits derived from the new venture.153 Understandably, from the perspective of that member desiring to open his own business, this was not an advantageous situation.

Under the LLC Act as adopted in 1994, a member had the right to unilaterally resign from the LLC.154 A member’s resignation (a dissociation) effected the dissolution of the company,155 but if the LLC was continued by the other members, the resigning member was entitled to a liquidating distribution of the fair value of the resigning member’s interest in the LLC.156 This rule was merely a default, and could be modified in the written operating agreement.

In 1998, the provision allowing a member to unilaterally withdraw from an LLC was deleted from the Kentucky LLC Act, and replaced by the following provision:

Unless otherwise provided in a written operating agreement, a member has no right to withdraw from an LLC. If the written operating agreement does not specify a time a member may withdraw, a member shall not withdraw without the consent of all other members remaining at the time.157

As a result a member had no right to withdraw from a Kentucky LLC unless such a right (a) is set forth in a written operating agreement or, (b) at the time resignation is desired, all of the other members consent.158

153. Id.
154. See id. § 275.280(3) (as adopted 1994 Ky. Acts, ch. 389, § 56 and prior to amendment by 1998 Ky. Acts, ch. 341, § 37); see also Prototype LLC Act § 802(C). The Prototype LLC Act was drafted by a task force of the Committee on Partnerships and Unincorporated Business Organizations, since renamed the Committee on LLCs and Unincorporated Entities, Section of Business Law, American Bar Association, and was a primary source for the initial Kentucky LLC Act. See Thomas E. Rutledge and Lady E. Booth, The Limited Liability Company Act: Understanding Kentucky’s New Organizational Option, 83 KY. L.J. 1, 55-83 (1995) (hereinafter “Rutledge and Booth, LLC Act”). The Prototype is reproduced at 3 LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (hereinafter “Ribstein and Keatinge on LLCs”) APPENDIX C (2nd Ed.).
158. A written operating agreement may provide a threshold other than all of the members to approve, on a case by case basis, a resignation. As adopted in 1992, the Delaware LLC Act afforded a member the unilateral right to withdraw upon six months prior written notice, whereupon the former member is/was to receive the fair value of their interest in the company. DEL. CODE ANN. tit. 6, §§ 18-603, 18-604 (both as prior to 1996 amendments). Although not retroactive to LLCs formed prior to the 1996 amendments (DEL. CODE ANN. tit. 6, § 18-603), from July 31,
Having reconsidered the matter and the anomaly of a default rule under which a fiduciary may not unilaterally resign, the legislature revised the LLC Act to provide that unless a contrary rule is set forth in a written operating agreement, a member in a member-managed LLC may resign on thirty days notice. In a manager-managed LLC, however, the old rule remains in place; there is no right of resignation unless it is set forth in a written operating agreement or the resignation is approved by all other members. Absent contrary private ordering, a member who has resigned is treated as his or her own assignee, having only the rights of an assignee. While the addition of a member’s right to resign from a member-managed LLC will to some degree limit the utility of a member-managed LLC for estate planning purposes, any actual impact upon valuation discounts should be minimal because: (a) upon resignation the former member becomes an assignee of his or her own membership interest having, consequently, the same (and no greater) economic rights as before the resignation, (b) there is no right to liquidate the interest (i.e., capital lock-in is retained), and (c) the impact of the change can be entirely avoided by utilizing a manager-managed, rather than a member-managed, LLC.
The references to “former members” in KRS subsections 275.310(2) and (3) have been corrected to refer to the “assignees.” A reference to assignees was also added to KRS § 275.300.

XIV. MERGERS AND CONVERSIONS

The 2010 Amendments also revised the LLC Act, KyRUPA and KyULPA sections discussing mergers. Assume that a merger’s surviving entity is an LLC, a partnership, or a limited partnership governed by the KyLLC Act, KyRUPA, or KyULPA, respectively. If the plan of merger provides for a written operating or partnership agreement, the agreement becomes binding on the members or partners in that surviving business entity. This addition conforms to the effect of conversion provisions. Further, the Amendments revised the LLC Act and KyULPA to provide that in a merger, the surviving entity’s articles of organization/operating agreement/certificate of limited partnership will be effective and binding upon the members/partners. The ability to impose a contribution obligation on a member, however, is limited by the requirement that such obligations are enforceable only if “set forth in a writing signed by the member.” It may be argued that the signed writing requirement in KRS § 275.200(1) is satisfied by becoming a member of an LLC and signing an operating agreement that, by amendment or by a merger approved by less than all members, adds a contribution obligation. This argument, however, is at best a strained reading and conflicts with the clear intent of the provision. Nevertheless, limited partners in a limited partnership, all partners in a limited liability limited partnership, and partners in a limited liability partnership will

166. See id. § 275.310(2) as amended by 2010 Acts, ch. 133, § 40 (references to “former members” deleted and replaced with “assignees”); KY. REV. STAT. ANN. § 275.310(3) (same). The “former members” appeared in section 905 of the Prototype LLC Act, upon which KRS § 275.310 was based. See also KY. REV. STAT. ANN. § 275.255(1)(b). This clarification addresses the assertion made in the dissent filed in Spurlock v. Begley, No. 2007-CA-002523-MR (Ky. App. Dec. 31, 2008), n. 10. While the application of KRS § 275.255(1)(d) was there ignored, the revisions made to KRS § 275.310 preclude such a reading in future controversies.

167. See id. § 275.300(2)(d) as amended by 2010 Acts, ch. 133, § 39. Prior to this addition, a strict reading would indicate that, notwithstanding an assignee’s rights to receive the distributions that would otherwise be made to the assignor (KY. REV. STAT. ANN. § 275.255(1)(b)), a dissolving LLC may not make distributions to assignees.

168. See id. § 275.365(11), created by 2010 Acts, ch. 133, § 42; id. § 362.1-906(7), created by 2010 Acts, ch. 133, § 57; id. § 362.2-1109(8), created by 2010 Acts, ch. 133, § 70.

169. See KY. REV. STAT. ANN. § 275.375(2)(d) (effect of conversion into LLC); id. § 362.1-904(2)(d) (effect of conversion into partnership); id. § 362.2-1105(2)(d) (effect of conversion into limited partnership).

170. See id. § 275.365(10), created by 2010 Acts, ch. 133, § 42; id. § 362.2-1109(7), created by 2010 Acts, ch. 133, § 70.

171. Id. § 275.200(1). No similar statute of frauds requirement exists in KyRUPA or KyULPA.

172. See, e.g., id. § 275.175(2)(a) (majority-in-interest of members may amend operating agreement); id. § 275.350(1) (majority-in-interest of members may approve merger).
want to protect themselves from contribution obligations being imposed by including a statute of frauds provision in the controlling partnership agreement.

It has been made express that there are no vested rights under an operating, partnership, or limited partnership agreement or certificate of limited partnership. These provisions make clear that an otherwise permissible amendment to organizational documents and the terms of the merger or conversion does not implicate a vested right that is subject to protection.

Under the Amendments, the conversion of a partnership into an LLC cancels any statement of partnership authority. Previously, a conversion cancelled only a statement of registration or statement of qualification as an LLP. As the filing of a statement of partnership authority under a particular name created a “real name,” it must be separately cancelled if the converted LLC is to utilize the name of the converting partnership (absent its automatic cancellation by the conversion).

XV. CLARIFICATION OF KRS § 275.170

The 2010 Amendments, entirely as a point of clarification and without any modification to the substantive rules already in place, supplemented KRS § 275.170(1) to make clear that it constitutes the statutory standard of care, set forth in terms of a standard of culpability, applicable to members and managers in an LLC. Similarly, the amendments supplemented KRS § 275.170(2) to make clear that it constitutes the standard of loyalty imposed on members and managers in an LLC.

The clarifications were a response to several court decisions that indicated a level of confusion regarding the provisions that recite the default standards of care and loyalty. With respect to the standard of care in KRS § 275.170(1), the decision rendered in Gaunce v. Wertz (which did not reflect a proper

173. See KY. REV. STAT. ANN. § 275.003(6), created by 2010 Acts, ch. 133, § 28; id. § 362.1-103(6), created by 2010 Acts, ch. 133, § 51; and id. § 362.2-110(6), created by 2010 Acts, ch. 133, § 60. The LLC Act contained a similar provision that referred only to the articles of organization. See KY. REV. STAT. ANN. § 275.025(6); see also id. § 271B.10-010(2).

174. For example, having resigned from a partnership, a former partner (now a transferee) cannot assert a property interest in the terms of the partnership agreement as it existed at the point of resignation and thereby “freeze” the deal even as he or she is no longer a party to that agreement. At the same time, an amendment that impacts upon a unilateral contract would not be effective.

175. See KY. REV. STAT. ANN. § 362.1-303.

176. See id. § 365.015(b)(2).

177. See id. § 362.1-105(4).

178. Id. § 275.100(2).

179. See id. § 275.170(1) as amended by 2010 Acts, ch. 133, § 32.

180. See id. §§ 275.170(1), (2) as amended by 2010 Acts, ch. 133, § 32.

181. That the standards of care and loyalty may be modified in a written operating agreement is manifest from the lead-in provision of KRS § 275.170 (“Unless otherwise provided in a written operating agreement”).

interpretation of the provision) was problematic. The *Gaunce* court failed to appreciate that the LLC Act recites the standard of care as misconduct that is “wanton or reckless.” The *Gaunce* court wrote that the claim was not for breach of fiduciary duty, but rather for wanton or reckless misconduct. In fact, the claim is for breach of the duty of care, and liability will only attach against the member or manager charged if the violation was itself wanton or reckless. As originally written, the Kentucky LLC Act was based primarily upon the ABA’s Prototype LLC Act, and KRS § 275.170(1) is a verbatim adoption of section 402(A). The commentary to section 402(A) provides in part “Subsection (A) sets forth the gross negligence standard of care for those participating in management.”

Whether, in the first instance, the member’s or manager’s aspirational standard of care should be negligence, gross negligence, or some other standard is a point not addressed in the LLC Act. Should the fiduciary standard of care be modified in a written operating agreement, both the aspirational standard of care and the level of culpability need to be addressed.

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183. Id.
184. Id. at *2.
185. See supra note 154. The statement of the Kentucky Court of Appeals in *Randy Welty and Hartford Fire Insurance Company v. Hargus Sexton*, No. 2000-CA-002847-MR (Ky. App. Feb. 1, 2002) that “The Kentucky Limited Liability Company Act ... is generally similar to the model act promulgated by the Uniform Law Commissioners” is accurate only to the extent that the Uniform Limited Liability Company Act (ULLCA, 6B U.L.A. 545 (2008)) is similar to the Prototype. In fact ULLCA and the Prototype are more dissimilar than similar, and ULLCA was not completed until well after the 1994 LLC Act was drafted.
186. Language substantially equivalent to KRS § 275.170(1) also appears in section 409(c) of the Uniform Limited Liability Company Act (6B U.L.A. 598 (2008)), where it is expressly labeled a “duty of care,” a labeling that is carried forward in the comment. A bifurcation of the standard of care and the standard of culpability is set forth in the Kentucky Business Corporation Act, wherein a director’s standard of care is defined in KRS § 271B.8-300(2), informed by KRS § 271B.8-300(1), while culpability for monetary damages does not attach except as provided in KRS § 271B.8-300(5), namely upon a demonstration that the failure to satisfy the standard of care constituted “willful misconduct or wanton or reckless disregard for the best interests of the corporation and its shareholders.” See also *Sahni v. Hock*, No. 2007-CA-001785-MR, slip op. at 14-15 (Ky. App. 2010) (complaint that corporate director breached fiduciary duty but which did not allege director “committed willful misconduct or that he acted with wanton or reckless disregard for the best interests of the corporation and its shareholders” did not “sufficiently allege a cause of action under KRS § 271B.8-300.”).
187. Contrast KY. REV. STAT. ANN. § 271B.8-300(2) (defining duty of care as that of an ordinarily prudent person in a like position); id. § 362.1-404(3) (stating a partial definition of duty of care as that of a reasonable person in a like position in similar circumstances and in the best interests of the partnership). Whether in a future session of the General Assembly an express aspirational standard of care, with presumably a gross negligence standard of culpability, should be substituted for the exact formula will need to be assessed.
188. A bifurcation of the standard of care and the standard of culpability is set forth in the Kentucky Business Corporation Act, wherein a director’s standard of care is defined in KRS § 271B.8-300(2), informed by KRS § 271B.8-300(1), while culpability for monetary damages does not attach except as provided in KRS § 271B.8-300(5), namely upon a demonstration that the failure to satisfy the standard of care constituted “willful misconduct or wanton or reckless disregard for the best interests of the corporation and its shareholders.” See also *Sahni v. Hock*,
The formula employed in Prototype LLC Act section 402(A) and KRS § 275.170(1), reciting only the standard of culpability without a corresponding standard of care is curious, but it is clear that the standard of care is set forth in the statute. In effect, absent private ordering to the contrary, the standard of care in an LLC is the same standard as the limit of the protections provided by the Business Judgment Rule. Whether and when the Business Judgment Rule should apply in the contractual realm of LLCs and other unincorporated business organizations is subject to debate, but careful drafting of an operating agreement defining standards of care and culpability differing from KRS § 275.170(1) will avoid that issue.

The standard of loyalty set forth in KRS § 275.170(2) is a verbatim adoption of section 402(B) of the Prototype, for which the commentary provides in part:

Subsection (B) which is based on UPA § 21, sets forth the duty of loyalty of LLC managers and managing members – that is, the duty to act without being subject to an obvious conflict of interest.

The duty of loyalty under this section is defined to include two major components: “self-dealing,” that is, a manager’s reaping an individual profit by or through an LLC transaction in which the manager participated; and liability for appropriating for personal use property belonging to the LLC without the firm’s consent. Such appropriation, in effect, would amount to unauthorized compensation. This duty is based on the fact that LLC property is owned by the firm as a whole rather than by individual managers or members. Note that “property” is defined to include records of the LLC that are in the manager’s control. Because of the similarity of this section with the UPA, it was anticipated that the courts would interpret a section such as this to impose duties

No. 2007-CA-001785-MR, slip op. at 14-15 (Ky. App. 2010) (complaint that corporate director breached fiduciary duty but which did not allege director “committed willful misconduct or that he acted with wanton or reckless disregard for the best interests of the corporation and its shareholders” did not “sufficiently allege a cause of action under KRS § 271B.8-300.”)

189. See KRS § 275.170; Prototype LLC ACT, § 402.


similar to those in the general partnership, including the duty not to appropriate partnership opportunities.\footnote{PROTOTYPE LLC ACT § 402 Commentary. Language equivalent to KRS § 275.170(2) also appears in section 409(b)(1) of the Uniform Limited Liability Company Act (6B U.L.A. 597 (2008)), language labeled as and described in the comment thereto as a duty of loyalty. A comparison of KRS §§ 275.170(2) and 362.250(1) make manifest that the law developed under the latter must inform the interpretation of the former.}

The decision in \textit{Patmon v. Hobbs} drove the need for clarification of KRS § 275.170(2).\footnote{280 S.W.3d 589 (Ky. App. 2009). The \textit{Patmon} decision is the first published ruling of a Kentucky court addressing KRS § 275.170. This decision was not appealed to the Kentucky Supreme Court. The unpublished ruling in \textit{Welty v. Sexton}, No. 2000-CA-002847-MR (Ky. App. Feb. 1, 2002), addressed KRS § 275.170(2), but did not review it as the fiduciary standard of loyalty or address the remedy for a breach thereof.} When discussing the existence and quality of the duty of loyalty in LLCs, the \textit{Patmon} decision is an instance of “partial right answer but wrong reason.” Because it was the impetus for the amendment of KRS § 275.170(2), a review of the decision is worthwhile.

The Kentucky LLC Act is based upon the Prototype LLC Act,\footnote{2007, after this dispute was initiated, the Kentucky adoption of Prototype LLC Act § 402(B) was amended (see Rutledge, \textit{The 2007 Amendments}, supra note 1 at 248-49), but not in a manner relevant to this dispute. Curiously, KRS § 275.170(2), as quoted by the Court of Appeals (280 S.W.3d at 595), is the statute as it existed after its amendment in 2007, and not as it existed in 2004, while it is paraphrased (\textit{id.} at 598) in its 2004 form.} and contains a verbatim adoption of Prototype section 402(B)’s duty of loyalty.\footnote{In 2007, after this dispute was initiated, the Kentucky adoption of Prototype LLC Act § 402(B) was amended (see Rutledge, \textit{The 2007 Amendments}, supra note 1 at 248-49), but not in a manner relevant to this dispute. Curiously, KRS § 275.170(2), as quoted by the Court of Appeals (280 S.W.3d at 595), is the statute as it existed after its amendment in 2007, and not as it existed in 2004, while it is paraphrased (\textit{id.} at 598) in its 2004 form.} In \textit{Patmon v. Hobbs}, the Kentucky Court of Appeals addressed the existence and quality of the duty of loyalty in LLCs.

Hobbs, the 51% managing-member of American Leasing and Management, LLC (“American Leasing LLC”), a member-managed LLC,\footnote{Whether a particular LLC is member-managed or manager-managed is not determined by a substantive review and characterization of the \textit{inter se} management structure defined in the operating agreement. Rather, reference is made to the election made in the articles of organization. \textit{See}, e.g., PROTOTYPE LLC ACT § 202(D); KY. REV. STAT. ANN. § 275.025(1)(d). As set forth in the} purported to

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\textbf{KRS § 362.250(1)} & 
\textbf{KRS § 275.170(2)} \\
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Every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property. & Each member and manager shall account to the limited liability company and hold as trustee for it any profit or benefit derived by that person without the consent of more than one-half (1/2) by number of the disinterested managers, or a majority-in-interest of the members from: (a) Any transaction connected with the conduct or winding up of the limited liability company; or (b) Any use by the member or manager of its property, including, but not limited to, confidential or proprietary information of the limited liability company or other matters entrusted to the person as a result of his status as manager or member. \\
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\textit{See also} \textit{Prudential Building & Loan Ass’n v. City of Louisville}, 464 S.W.2d 625, 626-27 (Ky. 1971).

\textit{Patmon} decision is an instance of “partial right answer but wrong reason.” Because it was the impetus for the amendment of KRS § 275.170(2), a review of the decision is worthwhile.

\textit{The Kentucky LLC Act is based upon the Prototype LLC Act, and contains a verbatim adoption of Prototype section 402(B)’s duty of loyalty. In \textit{Patmon v. Hobbs}, the Kentucky Court of Appeals addressed the existence and quality of the duty of loyalty in LLCs. Hobbs, the 51% managing-member of American Leasing and Management, LLC (“American Leasing LLC”), a member-managed LLC, purported to}
transfer certain build-to-suit lease agreements between that LLC and a third party to an LLC of which Hobbs was the sole owner. Hobbs did not seek approval for the transfers from the other members of American Leasing LLC and it received nothing in consideration for the transferred agreements. Patmon, a member of American Leasing LLC, brought suit against Hobbs individually and in the name of the LLC. The trial court required that Hobbs reimburse American Leasing LLC for out-of-pocket expenditures that benefited his separate LLC, but it determined that no damages were due the LLC consequent to Hobbs’ transfer of the build-to-suit lease agreements because the LLC was not in a financial condition to perform on the contracts.

On appeal, the Kentucky Court of Appeals found that Hobbs violated his duty of loyalty to the LLC only after an unfortunate and unnecessary diversion through the business corporation act and various decisions on fiduciary duties, such as Steelvest. Only the Patmon decision’s conclusion focused on the language of KRS § 275.170(2) and (correctly) identified it as the statutory recitation of the standard of loyalty for Kentucky LLCs. Thereafter, the Court determined that Hobbs had violated his duty of loyalty and was liable for damages but only after: (a) stating that Kentucky courts have not determined

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200. Patmon, 280 S.W.3d at 591.
201. See KY. REV. STAT. ANN. § 275.170(2) (addressing requirement of disinterested approval of what is otherwise a conflict of interest transaction).
202. Patmon, 280 S.W.3d at 592.
203. Id. at 593.
204. Treating, it would seem, the corporate model of fiduciary duties in general and its duty of loyalty in particular as the normative paradigm for all business organizations, a point of reference neither supported in the decision nor supportable in general. Rather, choice of entity matters. The rights, duties and obligations of participants in different types of business structures are different depending upon the type selected. Patmon, 280 S.W.3d at 593-94. There likely exist no normative rights and duties, with the exception of the contractual obligations of good faith and fair dealing, that apply universally to business organizations irrespective of form.
205. Patmon, 280 S.W.3d at 598. See also Steelvest, Inc. v. Scansteel Service Center, Inc., 807 S.W.2d 476 (Ky. 1991).
206. Patmon, 280 S.W.3d at 598. Consequent to this decision, KRS § 275.170(2) was amended to expressly label it as the LLC Act’s duty of loyalty provision. See KY. REV. STAT. ANN. § 275.170(2) as amended by 2010 Acts, ch. 133, § 32.
207. Patmon, 280 S.W.3d at 593. As detailed in a leading treatise on partnership law, “A partner cannot, without the consent of his partners, acquire for himself a partnership asset, e.g., by substituting a contract with himself for one with the partnership….” ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP 390 at note 59 (West 1968) (citations omitted). “Nor may he divert to his own use or profit a ‘partnership opportunity.’” Id. at 391, note 62 (citation omitted). See also II ALAN R. BROMBERG AND LARRY E. RIBSTEIN, BROMBERG AND RIBSTEIN ON PARTNERSHIP (hereinafter “BROMBERG & RIBSTEIN ON PARTNERSHIP”) § 6.07(c) (listing, as an example of taking an unauthorized benefit from partnership property “taking over a partnership contract”) (citations omitted); Mason v. Underhill, No. 2006-CA-002144-MR (Ky. App. May 5, 2008) (quoting 59A Partnership AM.JUR.2d § 295 (2003) for the proposition a “partner has a duty to share with the partnership those business opportunities clearly related to the subject of its operations.”).
whether members have a duty of loyalty (notwithstanding the fact that the statute makes it clear that they do), (b) a discussion of a possible breach of the duty of loyalty by Hobbs because he acted inconsistently with the statutory conflict of interest provision of the business corporation act, and (c) discussing whether the existence of an opportunity is dependent upon the ability of the LLC to exercise it, and therefore subjects the LLC to a “futility defense.”

Hobbs, as a member of a member-managed LLC, owed the company a statutory duty of loyalty under the LLC Act that included the duty to not use the LLC’s property for his own account. It is unnecessary to analogize the position of a member to that of other positions in other forms of business organizations, except, perhaps, to emphasize the differences in the comparative statutory provisions that govern them. Moreover, in some circumstances, analogy to other entity statutes is not only unhelpful but also confusing. While it may be fair to state that corporate officers and directors owe fiduciary

208.  *Patmon*, 280 S.W.3d at 593 (“In Kentucky, there is relatively little caselaw regarding limited liability companies and no caselaw concerning fiduciary duties in the limited liability company context.”).  See also *Purcell v. Southern Hills Instruments, LLC*, 847 N.E.2d 991, 996 (Ind. App. 2006) (“In Indiana, there is relatively little case law regarding LLCs and no case law concerning fiduciary duties in the LLC context.”).

209.  This point was recognized by the trial court, which wrote in its conclusions of law “KRS 275.170(2) creates a statutory duty of loyalty ….”  *American Leasing and Management, LLC v. Hobbs*, 04-CI-4901, Jefferson Circuit Court, Div. 3 (Judge Perry), Sept. 24, 2007.

210.  *Patmon*, 280 S.W.3d at 597 (“[W]e must determine not only that Hobbs’ activities breached the statutory standards found in KRS 275.170 and KRS 271B.8-310(1) ….”) (emphasis added).

211.  *Id.* at 597, 598.

212.  See generally 3 William Meade Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* § 862.10.  Certain courts have held that the futility defense is available only in instances of full disclosure.  See *id.*, note 4 and accompanying text.  This rule has been embodied in the Principles of Corporate Governance, which provide that while futility (“fairness”) may be a defense to the misappropriation of an opportunity when there has been full disclosure, it is not available in the absence of disclosure.  See *See ALI Principles of Corporate Governance* § 5.05(a); *id.* Comment to § 5.05(a) (“Section 5.05(a) sets forth the general rule requiring a director or senior executive to first offer an opportunity to the corporation before taking it for personal advantage. If the opportunity is not offered to the corporation, the director or senior executive will not have satisfied § 5.05(a).”); see also infra note 238.

213.  *See supra* note 199 and accompanying text.


215.  *Patmon*, 280 S.W.2d at 594 (“For the foregoing reasons, the Court finds that Kentucky [LLCs], being similar to Kentucky partnerships and corporations, impose a common-law fiduciary duty on their officers and members in the absence of contrary provisions in the [LLC] operating agreement.”).  Statements of this nature are troubling in that they fail to identify the basis upon which the purported analogy relies.  For example, if LLC members are similar to corporate shareholders, how can it be concluded that the former are fiduciaries – Kentucky courts have not adopted *Donahue v. Rodd Electrotype Corp.* or § 7.01(d) of the *Principles of Corporate Governance*, either imposing fiduciary obligations upon shareholders qua shareholders.  The analogy would suggest that members are not fiduciaries, an analogy that must fail as the LLC Act provides expressly, in a member-managed LLC, that members are fiduciaries.
duties to the corporation and that partners owe duties to the partnership, it does not follow that “being similar to Kentucky partnerships and corporations,” LLCs impose fiduciary obligations upon their “officers and members.” Rather, it is the LLC Act, as modified by the operating agreement and supplemented by other private ordering, that ab initio imposes defined obligations. The Patmon Court’s determination that Hobbs was a fiduciary to American Leasing LLC was, at least initially, based on his statutory agency on behalf of the LLC. While it is accurate that a member in a member-managed LLC enjoys apparent agency authority on behalf of the LLC, and that all else being equal an agent bears a fiduciary duty to the principal, the more accurate statement is that a member in a member-managed LLC owes the duties required by the controlling agreement, the LLC Act and general agency law. For example, under agency law, an agent is held to the standard of care of simple negligence, while under the LLC Act, a member is held to a standard of wanton or reckless misconduct. Both agents and LLC members must observe standards of loyalty, but the LLC Act is the primary source of the conduct and liabilities of a member. It is, at best, incomplete to say that the fiduciary standards applicable to members in a member-managed LLC first arise from the default status of agent for the company without careful statutory and factual analysis. It needs to be recognized that member fiduciary duties can be modified or even eliminated by the operating agreement.

Hobbs owed a duty of loyalty, imposed by and defined by statute, to the LLC. In this case, the statutory duty appears not to have been modified in a

216. *Patmon*, 280 S.W.2d at 594-95.
217. *Id.* at 295.
218. *Id.*
221. See Ky. Rev. Stat. Ann. § 275.135(1) (“(1) Except as provided in subsection (2) of this section, every member shall be an agent of the limited liability company for the purpose of its business or affairs . . .”).
222. See Restatement (Third) of Agency § 1.01.
223. For example, while on a prospective basis a member’s fiduciary obligations will terminate upon ceasing to be a member (see, e.g., Ky. Rev. Stat. Ann. § 275.280(3)), a former member may not then utilize trade secrets learned in the course of being a member against and in competition with the LLC.
224. See Restatement (Third) of Agency § 8.08.
227. The LLC Act does not impose a fiduciary duty of good faith upon the participants in an LLC. See KRS § 275.170. While the common law of partnerships treated good faith as a fiduciary duty, no inclusion of that concept was made in the LLC Act. Moreover, in modern business organization acts, good faith is treated as a contractual, and not a fiduciary, obligation. See, e.g., Ky. Rev. Stat. Ann. § 362.1-404(4); *id.* § 362.2-408(4). To the extent good faith exists as a fiduciary, and not a contractual, obligation, as interpreted by the Delaware Courts, it is integrated
written operating agreement, but it is not clear that determination was ever found as a matter of fact in the case.\textsuperscript{228} It is against that background that Hobbs’ conduct must be assessed.

American Leasing LLC was in the build-to-suit leasing business.\textsuperscript{229} After determining the real estate needs of a prospective tenant it would enter into a contract to buy the location, build a structure according to the lessee’s specifications, and lease the property to the lessee.\textsuperscript{230} The LLC had performed on at least one agreement with O’Reilly Auto Parts and negotiated three additional agreements with O’Reilly.\textsuperscript{231} The \textit{Patmon} court described those agreements as “pending”\textsuperscript{232} when Hobbs directed that they be modified to wholly substitute the name of his separate LLC. But for one other point of modification, nothing else (it would appear) needed to be done before the contracts were executed.\textsuperscript{233} It is a stretch of credibility to treat a deal so near closing as being a mere opportunity rather than a current asset - a point of distinction not relevant under the applicable duty of loyalty.

Another factual matter that curiously was not addressed by either the trial court or the court of appeals: a “consent resolution and agreement” of the members of the LLC was referenced by the Court of Appeals.\textsuperscript{234} Interestingly, that document provides that any member may have other business activities, even those that compete with the company, “with the exception of O’Reilly Auto Parts, Inc.”\textsuperscript{235} Thus the document singled out the O’Reilly relationship as belonging to the LLC. It was only pursuant to Hobbs’s authority as the “managing member” of the LLC that he had the ability to have the agreements

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\textit{as a “subsidiary element” of the duty of loyalty. See Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006).}
\end{flushright}
\textsuperscript{228} While the opinion references an “Executive/Partnership Agreement,” (\textit{Patmon}, 280 S.W.3d at 591, 594) and indicates that it somehow addressed Hobbs’ duty of loyalty, \textit{id.} at 594 (“This duty [of loyalty] is confirmed in the Executive/Partnership Agreement drafted and signed by Hobbs.”), its contents are never expanded upon. This agreement was an exhibit to the Appellant’s (\textit{Patmon’s}) brief to the Court of Appeals. \textit{id.}
\textsuperscript{229} \textit{id.} at 591.
\textsuperscript{230} \textit{id.}
\textsuperscript{231} \textit{id.}
\textsuperscript{232} \textit{Patmon}, 280 S.W.3d at 592.
\textsuperscript{233} \textit{id.} (highlighting that an O’Reilly representative testified that he was prepared to sign the agreements with the LLC).
\textsuperscript{234} \textit{id.} at 591. This document was filed as an exhibit to the Appellants’ (\textit{Patmon’s}) Brief to the Court of Appeals.
\textsuperscript{235} This provision of the Consent Resolutions and Agreement, which otherwise appointed Hobbs the “President” and the “managing Member” of American Leasing LLC, provides in full: \textit{FURTHER RESOLVED, that this agreement shall not be construed to require the continued or full time services of any member and each member is free to pursue such other business opportunities as he may determine in his own best interest with the exception of O’Reilly Auto Parts Inc., including without limitation, any business or venture that may be competitive with the Company.}
executed in the name of his separate LLC. His only available argument was that because of American Leasing LLC’s lack of financial capacity to perform thereon, the agreements with O’Reilly were somehow not those of the LLC.

As previously detailed, the duty of loyalty in a Kentucky LLC, embodying as it does predecessor partnership law, provides that the expropriation of the opportunity gives rise to the obligation to disgorge all of the benefits derived therefrom, irrespective of the ability of the venture to directly exploit the opportunity. The violation of the duty to the LLC is the taking of the opportunity irrespective of the LLC’s capacity to perform. That is, it is the action, not the damages, that is the focus of the duty of loyalty. It is on this point that the Patmon opinion clearly fails. Having determined that Hobbs diverted LLC property for his own benefit, the court imposed upon Patmon the burden of demonstrating that the LLC had could the ability to acquire the LLC’s

236. Id. While Hobbs was the “managing-member,” American Leasing, LLC, consequent to the terms of its articles of organization, remained member-managed. See supra note 199 and accompanying text.

237. See Patmon, 280 S.W.3d at 597 (by relying on the LLC’s alleged inability to perform on the O’Reilly agreements, Hobbs implicitly acknowledged that they were otherwise LLC assets).

238. See J. William Callison and Maureen A. Sullivan, Partnership Law and Practice § 12.8 (“If an opportunity belongs to a partnership and it is not presented to it, the courts generally hold the usurping partner accountable for all profits derived from the opportunity, even when the partner argues that the partnerships did not have access to the funds or other resources with which to pursue the opportunity if it had been so offered to it.”); Bromberg & Ribstein on Partnership, supra note 207 at § 6.07(d), text at note 83 (“If an opportunity is deemed to belong to the partnership, the courts will usually hold the usurping partners accountable (unless the other partners were aware of the opportunity and turned it down), even if the defendant claims that the partnership would have been unable or unwilling to take advantage of the opportunity if it had been offered.”); 2 Carter G. Bishop and Daniel S. Kleinberger, Limited Liability Companies–Tax and Business Law ¶ 10.03[1][a][v] (“The ‘account for’ statutes therefore have dramatic implications for self-dealing transactions. If the transaction has been completed and the person with managerial authority has profited, that person must either show the required consent or disgorge all profits. It is generally no defense that the transaction was fair to the [LLC].”) (citations omitted); 1 Ribstein and Keatinge on LLCs, supra note 154 at § 9.3, p. 9-12 (“A manager may not appropriate for personal use property belonging to the LLC without the firm’s informed and disinterested consent.”) (citations omitted). As detailed in a leading treatise on partnership law, “A partner cannot, without the consent of his partners, acquire for himself a partnership asset, e.g., by substituting a contract with himself for one with the partnership. . . .” Crane and Bromberg on Partnership, supra note 207 at 390, note 59 (citations omitted). “Nor may he divert to his own use or profit a ‘partnership opportunity.’” Id. at 391, note 62 (citation omitted). See also Bromberg & Ribstein on Partnership, supra note 207 at § 6.07(c) (listing, as an example of taking an unauthorized benefit from partnership property “taking over a partnership contract”) (citations omitted); Mason v. Underhill, No. 2006-CA-002144-MR (Ky. App. May 5, 2008) (quoting 59A Partnership Am.Jur.2d § 295 (2003) for the proposition a “partner has a duty to share with the partnership those business opportunities clearly related to the subject of its operations.”).

239. Patmon, 280 S.W.3d at 597 (“[T]he trial court has already determined that Hobbs’s diversion of the O’Reilly build-to-suit lease projects was indeed a corporate opportunity of [the LLC] that he diverted for his own use.”).
capacity to perform on the agreements. The two positions are irreconcilable – the build-to-suit lease agreements cannot be both assets of the LLC diverted by Hobbs in violation of his fiduciary obligation, and assets only if Patmon is able to demonstrate the capability to perform. If Hobbs violated his duty of loyalty the analysis should turn immediately to damages and other relief. If financial capability to perform is an element of the duty of loyalty, it would go to the question of whether company property has been appropriated. Further, if capacity to perform is a factor in defining the property, and capacity is lacking, then there has been no property and no breach of loyalty for having appropriated it. It appears that the Court of Appeals made “ability to perform” an element of the proof of damages. This implication, however, conflicts with the court’s recognition that the contracts had value even if the LLC could not perform.

240. Id. at 598 ("[I]t is still necessary for Patmon to establish that [the LLC] had the financial wherewithal to undertake the O’Reilly project.") See also id. at 599 ("Finally, Patmon will be able to present evidence as to whether [the LLC] could have taken advantage of the business opportunity of the O’Reilly build-to-suit leases.").

241. Id. at 598. ("Thus, we remand this case to the trial court to determine a remedy for Hobbs's common-law breach of fiduciary duty and failure to follow the statutory guidelines of KRS 275.170. Pursuant to KRS 275.170, at a minimum, Hobbs is required to hold in trust all benefits and profits derived by him as the result of his misuse of the build-to-suit leases.").

242. Id. at 596 ("One theory of this [opportunity] doctrine holds that opportunity does not exist for a business if financially unable to undertake the opportunity.").

243. Id. at 598 ("[W]e remand this case to the trial court to determine a remedy for Hobbs’s common-law breach of fiduciary duty and failure to follow the statutory guidelines of KRS 275.170").

244. Id. at 596 ("In Kentucky, however, the focus is on the fiduciary's duty – not the lost opportunity."). The Patmon decision does not consider whether the futility defense of financial incapacity is even available absent disclosure. See supra notes 213 and 239.

245. Id. at 598 ("Further, a possibility exists that [the LLC] could have sold its business opportunity to another venture and profited in that manner."). See also 1 RIBSTEIN AND KEATINGE ON LLC'S, supra note 154 at § 9.3, p. 9-15 ("Even if the firm cannot engage in the activity [due to financial inability], it should at least have the opportunity to obtain and sell an option or information about the activity to a third party or to the manager."). This case may have been characterized as one of waste rather than as one of breach of loyalty by the appropriation of a company asset. “Waste” occurs when a venture “is caused to effect a transaction on terms that no person of ordinary, sound business judgment could conclude represent a fair exchange.” See Steiner v. Meyerson, 1995 WL 441999, * 1 (Del. Ch. July 18, 1995), 21 DEL. J. CORP. L. 320, 324 (1995). In another formulation waste is “a transfer of corporate assets that serves no corporate purpose.” or for which “no consideration at all is received.” See Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000); see also Lewis v. Vogelstein, 699 A.2d 327, 336 (Del.Ch. 1997). While typically seen in the context of corporations, waste can also occur (and is equally actionable) in the context of a partnership. See, e.g., In re Dissolution of Demoville Partnership, 26 So.3d 366 (Miss. App. 2009) ("Margaret allowed [Margie Allen] to waste partnership assets at a time when she knew her mother was suffering from dementia, which included impaired judgment and memory."); In re Matter of the Estate of William Brandt, 81 A.D.2d 268, 279 (N.Y. 1981) (“We are also of the view that the trusts, as a limited partner, have standing to complain of a waste and diversion of partnership assets which results in a diminution of the value of the partnership itself with consequent effect upon the trusts’ interest therein.”); EEC Property Company v. Kaplan, 578 N.W.2d 381 (Minn. App. 1998) (upholding arbitrator’s determination that majority of partners engaged in waste of partnership assets by means of a below market lease agreement). It is uncontroverted that Hobbs’ act of transferring to his own LLC the O’Reilly contracts was not for
Even if lack of capacity to perform was a factor in determining whether the contracts were LLC property, the burden of proof must be on the agent and not the principal.246

Hobbs owned 51% of the LLC, Patmon owned 44%, and another party (Gray) owned 5%.247 Therefore the approval of a transaction that would have otherwise violated Hobbs’s duty of loyalty was vested in Patmon.248 Nonetheless, Hobbs never presented the question to the other members so there was never even the opportunity for them to consent.249 While the duty of loyalty modification in the consent resolution gave Hobbs the right to engage in activities competitive with those of the LLC, that right did not extend to the O’Reilly relationship.250 In summary, the LLC Act provided Hobbs’s conduct could have been excluded from his duty of loyalty in the operating agreement or sanctioned by the other members.251 Hobbs chose neither of these avenues.252 Consequently, he violated his duty of loyalty in expropriating company property to his own benefit.253

The determination that Hobbs violated his KRS § 275.170(2) duty of loyalty was correct, as was the conclusion that the O’Reilly contracts were company property. The question should have turned immediately to the matter of remedy. Initially Hobbs is obligated to surrender all profits and benefits derived from the diverted contracts.254 Hobbs should not be able to reduce the amount owed by identifying proceeds that were diverted to others he brought into his new

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246. See supra note 238; see also Irving Trust Co. v. Deutsch, 73 F.2d 121 (C.C.A. 2d Cir. 1934) (“If directors are permitted to justify their conduct on such a theory, there will be a temptation to refrain from exerting their strongest efforts on behalf of the corporation since, if it does not meet the obligations, an opportunity of profit will be open to them personally.”); Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1149 (Me. 1995) (“Reliance on financial ability will also act as a disincentive to corporate executives to solve corporate financing and other problems.”).

247. Patmon, 280 S.W.3d at 592.

248. See KY. REV. STAT. ANN. § 275.170(2) (conflict of interest may be waived by majority-in-interest of the disinterested members).

249. Patmon, 280 S.W.3d at 595 (“Hobbs concedes and the court found that he never obtained consent from any member of [the LLC].”)

250. See supra notes 234-235 and accompanying text.

251. Patmon, 280 S.W.3d at 594.

252. Id.

253. Id.

254. KY. REV. STAT. ANN. § 275.170(2) (“shall account to the [LLC] and hold as trustee for it ....”).
venture;

255.  Patmon, 280 S.W.3d at 592 (“Subsequently, Hobbs and Steve Habeeb formed another [LLC] which was eventually assigned these leases. The company was started so that Hobbs would provide the leases and Habeeb would obtain the financing for the projects.”).


257.  See, e.g., Bromberg & Ribstein on Partnership, supra note 207 at § 6.07(i), text at note 166.

258.  See Bromberg & Ribstein on Partnership, supra note 207 at § 6.07(i), text at note 159 (citations omitted); see also I F. Hodge O’Neal and Robert B. Thompson, O’Neal and Thompson’s Oppression of Minority Shareholders and LLC Members § 3.17 note 34 and accompanying text; see also Steelvest, 807 S.W.2d at 487 (“Accordingly, we determine, as a matter of law, that a breach of fiduciary duty is equivalent to fraud.”).


260.  17 U.S. (4 Wheat) 518 (1819). In general, a “Dartmouth College provision” incorporates the state statute governing the business entity into the entity’s governing document. For example, the provision added to KyULPA states: “A limited partnership governed by this subchapter is subject to any amendment or repeal of this subchapter.”


262.  See id. § 275.225(2) as amended by 2010 Acts, ch. 133, § 34.
to the LLC. However, this rule may be modified in the Articles of Organization or a written operating agreement.264

The correction in KRS § 275.365(4) of “chooses” for “choices” corrects a typographical error that has existed since the adoption of the LLC Act in 1994.

Being in conflict with the Assumed Name statute, and specifically KRS § 365.015(8), the provision requiring that a corporation converting into an LLC cancel its assumed names has been deleted.265

In conformity with KyRUPA and KyULPA,266 the LLC Act has been amended to exempt LLCs from the reach of KRS § 381.135.267

The LLC Act has been amended to authorize provisions in an operating agreement that affords rights to third parties,268 and explicitly states that a

264. See id. § 275.265(1) as amended by 2010 Acts, ch. 133, § 36. Accord DEL. CODE ANN. tit 6, § 18-702(a)(1) (providing a default rule of approval of all incumbent members of the LLC to the admission of assignee as a member but without the necessity of approval from “the member assigning the limited liability company interest”). With this revision, it remains the right of the incumbent members other than the assignor to determine whether they are willing to be members with the assignee. When this provision was originally drafted in 1994, it was provided that the unanimous consent of the members was required to admit an assignee as a member. That provision was amended in 1998, and that voting threshold was dropped to majority-in-interest. See KY. REV. STAT. ANN. § 275.265(1) as amended by 1998 Acts, ch. 341, § 36. With this modification, in certain scenarios, the members lost the ability to determine with whom they would be in business. For example, in an LLC owned 70% by a single member and with the balance of 30% spread amongst three otherwise equal members, the 70% owner could unilaterally assign a 10% interest to a third-party and then, exercising the majority vote, unilaterally cause the assignee to be admitted as a member of the company. With this revision, such an outcome, absent of provision to the contrary in the Articles of Organization or a written operating agreement, could not take place. This amendment to KRS § 275.265(1) introduces parallelism with KRS § 275.280(1)(c)2, which provides that the assignor member does not vote with respect to whether they will, consequent to the assignment of all of their interests in the LLC, be removed as a member. See also Thomas E. Rutledge, Assigning Membership Interests: Consequences to the Assignor and Assignee, 12 J. PASS THROUGH ENTITIES 35 (July/Aug. 2009).

265. KY. REV. STAT. ANN. § 275.376 as amended by 2010 Acts, ch. 133, § 44.

266. See id. § 275.220(3), created by 2010 Acts, ch. 133, § 33; see also id. § 275.240(1) (members have no property right in property owned by LLC). When KRS § 275.240(1) is read in concert with Mills v. Mills, No. 2007-CA-000774-MR (Ky. App. Oct. 24, 2008), it is clear that KRS § 381.135, absent private ordering to the contrary, should not apply to LLCs. Pursuant to a written operating agreement an LLC may elect into the application of KRS § 381.135. Whether, absent this carve-out, the property of a farm LLC was ever subject to the partition provisions of KRS § 381.135 is open to question. By its terms, KRS § 381.135 is applicable to a “farm corporation or partnership.” The definition of a “corporation” may include a “company” (KY. REV. STAT. ANN. § 446.010(8)), the definition of a “company” may include a “person” (KY. REV. STAT. ANN. § 446.010(7)), and the definition of a “person” may include a “limited liability company.” Id. § 446.010(27). Whether such a tortured stroll through definitions is appropriate is open to debate. Further, KRS § 381.135(1)(a)1 was added in 1998, after the adoption of the LLC Act, and as that amendment did not include a reference to an LLC, including the LLC within the scope of the provision would violate principles of statutory construction. See also Thomas E. Rutledge and R. David Lester, Recent Developments in the Valuation of Farm Properties, 5 THE KY CPA 17, 17-18 (2010).

268. KY. REV. STAT. ANN. § 275.003(3), created by 2010 Acts, ch. 133, § 28. A provision of this nature could provide, for example, that for as long as a loan from a particular lender is
contractual obligation of good faith and fair dealing exists in each operating agreement.\textsuperscript{269}

A new section has been added to the Business Corporation Act providing that a special meeting of the board of directors may be called by judicial order upon an application filed by at least one-third of the incumbent number of directors.\textsuperscript{270}

The Nonprofit Corporation Act has been amended to make explicit that the member’s right to inspect corporate records encompasses a right to copy those records\textsuperscript{271} and that the right of inspection is not subject to limitation by the articles of incorporation or the bylaws.\textsuperscript{272}

The filing fee for a foreign business trust applying for a certificate of authority has been set at $100.\textsuperscript{273}

A company does not “file” an annual report; that is the task of the Secretary of State after the submitted document is reviewed.\textsuperscript{274} Rather, a company “delivers” an annual report for filing. “Deliver,” as contrasted with “file,” for a

\textsuperscript{269}See \textit{id.} § 275.003(7), created by 2010 Acts, ch. 133, § 28. \textit{Accord KY. REV. STAT. ANN.} § 362.1-404(4); \textit{id.} § 362.2-305(2); and \textit{id.} § 362.2-408(4). \textit{See also Farmers Bank and Trust Co. of Georgetown, Kentucky v. Willmott Hardwoods, Inc.}, 171 S.W.3d 4, 11 (Ky. 2005) (“Within every contract there is an implied covenant of good faith and fair dealing, and contracts impose on the parties thereto a duty to do everything necessary to carry them out.”).

\textsuperscript{270}See \textit{KY. REV. STAT. ANN.} § 271B.8-205, created by 2010 Acts, ch. 133, § 2. While previously the Business Corporation Act provided a mechanism by which the shareholders could apply to the court to call a special meeting of the shareholders, there existed no equivalent provision with respect to calling a meeting of the directors. A similar provision has been added to the Nonprofit Corporation Act. \textit{See id.} § 273.223(2), created by 2010 Acts, ch. 133, § 16.

\textsuperscript{271}See \textit{id.} § 273.233 as amended by 2010 Acts, ch. 133, § 17. This amendment brings the Nonprofit Corporation Act into accord with the other acts, all of which provide that the right to inspect includes a right to copy. \textit{See id.} § 271B.16-020(1) (“entitled to inspect and copy”); \textit{id.} § 274.042 (adopting the rule of KRS § 271B.16-020); \textit{id.} § 275.185 (“may . . . inspect and copy”); \textit{id.} § 362.2-403(2) (“inspect and copy”); \textit{id.} § 362.2-407(1) (“inspect and copy”). This addition to the statute is a clarification of the statutory formula; even without it the right of inspection carried with it the right to copy. \textit{See, e.g., 18A AM.JUR.2D Corporations} § 338; \textit{5A FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS} § 2241 (“The right of a shareholder to make copies, abstracts and memoranda of documents, books and papers is an incident to the right of inspection, being recognized at common law.”) (citations omitted); \textit{Kaufman v. The Bryn Mawr Trust Co.}, 1981 WL 394 at *4 (Pa. Com. P1. 1981); \textit{Bramley v. Jessup & Moore Paper Co.}, 77 A. 16 at 19-20 (Del. 1910); \textit{Mickman v. American International Processing, LLC}, 2009 WL 2244608 (Del. Ch. July 28, 2009).

\textsuperscript{272}This language is drawn from KRS § 271B.16-020(4).

\textsuperscript{273}\textit{KY. REV. STAT. ANN.} § 386.4426(3) as amended by 2010 Acts, ch. 133, § 73. That same $100 fee applies each time the foreign business trust seeks to amend its certificate of authority. \textit{Id.} § 386.4428(3) as amended by 2010 Acts, ch. 133, § 74.

\textsuperscript{274}See also Rutledge, \textit{The 2007 Amendments, supra} note 1 at 253, note 163.
business organization’s obligation to submit an annual report is now consistent across the various business entity acts.275

The provisions addressing annual reports filed by corporations have been revised to make explicit that the report must list the Secretary of the corporation; a tendered report that does not list a Secretary will be returned for correction and resubmission.276 Foreign corporations not utilizing the MBCA formula (i.e., not requiring the designation of a “secretary”) should identify the person having the custody of and capacity to authenticate the records of the corporation.277


276. Every business corporation organized in the Commonwealth of Kentucky is required to have a “secretary,” that being the title assigned to the person responsible “for preparing minutes of the directors’ and shareholders’ meetings and for authenticating records of the corporation.” Id. § 271B.8-400(3) (requirement to have the officer); id. § 271B.1-400(23) (defining the “secretary” and referencing KY. REV. STAT. ANN. § 271B.8-400(3)). There exists no statutory requirement that a corporation have a president, a treasurer or any of the other typically seen officers. Each domestic and each foreign business corporation is required, on an annual basis, to file an annual report with the Secretary of State. Id. § 271B.16-220(1). Prior to the most recent amendments, the information required in the annual report included “The names and business addresses of its directors and principal officers.” Id. § 271B.16-220(1)(d). With respect to a Kentucky corporation, those principal officers would include, and indeed may be limited to, the secretary. Effective January 1, 2011, the requirement to file an annual report was superseded as to its substance by KRS § 14A.6-010, created by 2010 Acts, ch. 151, § 11.

While the statute describes what appears to be substantially an inter se role for the secretary (i.e., the preparation and maintenance of director and shareholder minutes), it is clear from the definition of the office that the role of secretary also affects the relationship of the corporation to third parties through the capacity to authenticate corporate records (KY. REV. STAT. ANN. §§ 271B.1-400(23), 271B.8-400(3)), the provision that the secretary of the corporation services as an alternative agent for receipt of service of process (id. § 271B.5-040(2)) and that they are as well the agent of the corporation for receipt of any other notice to be given it. Id. § 271B.1-410(4). In addition to that role, the corporate secretary has an important role in receiving service of process. When a corporation either has no registered agent or that agent cannot be with reasonable diligence served, the KyBCA provides that service of process may be made on “the secretary of the corporation at its principal office” by either registered or certified mail, return receipt requested. Id. § 271B.5-040(2). Rejecting annual reports that do not identify the corporate secretary:

(1) Serves a prophylactic benefit in that it identifies corporations that are otherwise violating the Business Corporation Act by not having a secretary; and

(2) Benefits third parties who may need to make service upon the corporate secretary when the registered agent is not able to be served or need to otherwise give notice to the corporation.

277. See MBCA § 1.40(20) (defining the person discharging the MBCA § 8.40(c) obligations as the “secretary”). For example, while a Tennessee corporation is not required to designate a “secretary,” that not being a defined term (see TENN. CODE § 48-11-201), it is required to have an officer to whom is delegated “responsibility for preparing minutes of the directors’ and shareholders’ meetings and for authenticating records of the corporation.” See TENN. CODE § 48-18-401(c).
The requirement that documents filed on behalf of a “private corporation” with a county clerk bear a scrivener block has been deleted.278

XVII. L3Cs

A proposal that Kentucky authorize the formation of the so-called “low-profit limited liability company,” or “L3C,” was introduced to the 2010 Kentucky General Assembly.279 In light of the significant controversy that exists with respect to the utility and effectiveness of the L3C structure,280 S.B. 150 was amended by the House Judiciary Committee to provide that the interim

278. See KY. REV. STAT. ANN. § 382.335(1) as amended by 2010 Acts, ch. 133, § 72. The reasons for this deletion are twofold. Initially, what is a “private corporation” is less than clear, as such could, conceivably, include business organizations that are not incorporated. See id. § 446.010(8) (defining a “corporation” as including, based upon the context, a “company, partnership, joint stock company or association”). Second, KRS § 382.335 required that any documents relating to the “organization or dissolution of a private corporation” include a scrivener block. Early in 2009, the Secretary of State instituted an on-line filing system for, among other documents, corporate articles of incorporation. The Secretary of State’s on-line system does not create a document that includes a scrivener block. Absent this amendment to KRS § 382.335, articles of incorporation filed on-line with the Secretary of State could not be filed with a county clerk. This is a problem as KRS § 271B.1-200(10) requires that Articles of Incorporation be filed with a county clerk of the county in which the registered office is maintained. Hence the amendment of KRS § 382.335.


280. After its introduction, Representative Flood was kind enough to meet with the author to review concerns and criticism of the L3C. Examples of that criticism include: David Edward Spenard, Panacea or Problem: A State Regulator’s Perspective on the L3C Model, 65 EXEMPT ORGANIZATION TAX REVIEW 131 (February, 2010); J. William Callison, L3Cs: Useless Gadgets?, 19 ABA BUSINESS LAW TODAY 55 (Nov./Dec. 2009); Carter G. Bishop, The Low-Profit LLC (L3C): Program Related Investment by Proxy or Perversion?, SUFFOLK UNIVERSITY LAW SCHOOL, LEGAL STUDIES RESEARCH PAPER SERIES, RESEARCH PAPER 10-09 (Feb. 12, 2010); David S. Chernoff, L3Cs: Less Than Meets the Eye, 21 TAXATION OF EXEMPTS 3 (2010); and J. William Callison and Allan W. Vestal, The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures, 35 VT. L. REV. 273 at 274 (2010):

But a funny thing happened on the way to the L3C party. Congress has not enacted L3C tax legislation, and substance and form have not aligned. Notwithstanding this setback, the L3C promoters have continued to lobby for state adoption and additional states have considered L3C legislation in 2010. In our view, without changes to federal PRI rules, the L3C construct has little or no value. Indeed, the existence of the state law form, without matching federal income tax substance, is dangerous since the ill-advised may assume value and use the Form. Therefore, unless and until tax law embraces the L3C, the form should be shelved. Further, the L3C concept is flawed as a matter of federal tax law, and it seems unlikely that the substance will be created to match the form. In our view, this is particularly the case with respect to “tranchsed” investment L3Cs due to the “private benefit” rule. Therefore, we conclude that the L3C is business entity device before its time, a time which likely will never come.
committee, working in concert with various stakeholders, would review the issue and prepare a recommendation for the 2011 General Assembly.281

XVIII. REVISIONS TO THE KENTUCKY UNIFORM PRINCIPAL AND INCOME ACT

At the time of its adoption, the Kentucky Uniform Principal and Income Act defined “entity” to include a “partnership,” but did not reference the limited partnership. This was entirely appropriate as, at that point in time, every limited partnership was also a partnership.282 However, with the adoption of KyRUPA and KyULPA, limited partnerships are now a distinct body and do not fall within the definition of a partnership.283 For that reason, the Kentucky adoption of the Uniform Principal and Income Act has been amended to expressly include the “limited partnership” within the definition of “entity,” thereby precluding an argument that the Act does not extend to limited partnerships.284 That same section has been revised to include a statutory or business trust within the definition of an “entity.” 285


In 2007, the Kentucky General Assembly, with House Bill (“H.B.”) 334,286 enacted a broad series of amendments across Kentucky’s various business entity acts which were largely driven by an effort to rationalize and make consistent similar provisions across business entity laws.287 On the last day of the session, the bill came up before the entire Senate, where it was amended on the Senate floor to include the substance of the provisions that previously appeared in 2007 H.B. 181.288 As part of these additions, the Senate unfortunately amended the

281. 2010 Acts, ch. 133, § 78 (not codified in Kentucky Revised Statutes). On April 23, 2010, the Committee on LLCs, Partnerships and Unincorporated Entities, Section of Business Law, American Bar Association, passed a resolution against further state adoption of L3C legislation. The proposed form of that resolution was set forth in XXVII PUBOGRAM 5 (April, 2010).
283. This statement is correct as far as KyRUPA (KRS ch. 362.1) and KyULPA (KRS ch. 362.2) are related. However, the definition of “partnership” set forth at KRS § 446.010(24), which defines a “partnership” as including both a general and a limited partnership, could be applied notwithstanding KRS § 362.1-202(2) and its rejection of limited partnerships from its scope.
284. KY. REV. STAT. ANN. § 386.466(1).
285. KRS § 386.466(5) has been corrected by the Revision of the Statutes to add the “tax” that was inadvertently left out of the provision when it was otherwise adopted verbatim from the uniform act. This correction was made on September 9, 2008, and is included in KRS § 386.466 as amended by 2010 Acts, ch. 133, § 76. Additional 2010 revisions to the Kentucky Uniform Income and Principal Act were continued in H.B. 188 (2010 Acts, ch. 21). See also James E. Hargrove, 2010 Changes to the Kentucky Trust & Estate Practice, 74 BENCH & BAR 5 (September 2010).
286. 2007 Acts, ch. 137.
287. See Rutledge, The 2007 Amendments, supra note 1 at 229.
title of the bill to reflect that it was now “[a] bill dealing with post-secondary education,” notwithstanding that the bill governed business entity laws. Ultimately, the House concurred in the amended bill, including with the now flawed title.

In response to this mistake, the substantive provisions of 2007 H.B. 223 have been reenacted. In addition to the reenactment of the substantive provisions of the 2007 legislation, the 2010 legislation makes clear that these provisions are to be applied as of June 26, 2007, which was the effective date of the 2007 legislation.

XX. CONCLUSION

The 2010 Amendments to Kentucky’s business entity laws were not as wide sweeping as the 2007 amendments. Nevertheless, they provide important clarification of many issues. Most importantly, the Amendments corrected the confusion that could have resulted from the Kentucky Court of Appeal’s ruling in Barone v. Perkins. Overall, the 2010 Amendments demonstrate the continued effort by Kentucky’s legislature and business bar to ensure that the Kentucky business acts remain current.

289. Id.
290. Id.
291. 2010 Acts, ch. 51. This Act was introduced by Senator Jensen as S.B. 152. www.lrc.ky.gov/record/10RS/SB152.htm It was assigned to the Senate Judiciary Committee on February 10, 2010 and hearings took place on February 11. Id. The bill was voted out of committee on a unanimous vote. Id. The bill came before the entire Senate on February 24, 2010 when it received the unanimous approval of all thirty-eight Senators. Id. On March 10, 2010, in concert with Senate Bills 150 and 151, the bill was approved by the House Judiciary Committee by a unanimous vote. The bill was voted out of the House on March 18 on a vote of 96 in favor and one against. Id. It was signed by Governor Beshear on March 30, 2010. Id.
Under Kentucky law there may be organized numerous forms of business organization including the business corporation, the nonprofit corporation, the general partnership, the limited partnership, the limited liability company, the business trust, the cooperative corporation, the cooperative association, the rural electric cooperative, the rural telephone cooperative and the professional service corporation. If different forms of business organization are understood
to be standardized contracts, each subject to a greater or lesser degree to modification by private ordering by which different arrangements inter-se the business organization and between the business organization and third parties are arranged, then there is benefit in having a robust menu of options. Still, there exists no benefit when there are nonsensical distinctions in and between the various acts. In recent years efforts have been undertaken, on a section by section basis, to reduce the degree of inconsistency between the various acts. Specifically, efforts have targeted inconsistencies as a result of drafting accidents, rather than the inconsistencies that have arisen out of policy issues.¹²

Still, there remains an insufficient level of irrationality and inconsistency across business organization statutes. Practitioners have increased transaction costs, which are passed on to the client, in the need to specifically review the statutory provisions on an entity by entity basis to avoid confusion and error. Those transaction costs can be significantly reduced by establishing, to the degree possible, a single consistent rule applying across all forms of business organization. Second, the personnel in the Secretary of State’s office must remember and assess compliance with a myriad of nonsensical rules. A single series of rules will increase the efficiency of the Secretary of State’s office and the functionality of on-line filing and processing systems.

To that end, the Kentucky Business Entity Filing Act (hereinafter “BEFA”) seeks to centralize Secretary of State filing rules that are either the same or substantially the same across the various forms of business organization. This has been accomplished by (a) preparing a common set of provisions that apply across all business organizations, (b) removing substantive provisions from the various business organization acts dealing with those issues now addressed in the business entity filing act and (c) making the filings performed by the various forms of business organizations subject to the BEFA. Graphically, we achieve the following structure:

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As a general rule, the BEFA did not aim to substantively change business organization law. For example, each form of business organization has a different set of procedures that are employed with respect to the amendment of such entity’s initial organizational filing with the Secretary of State’s office.\(^{13}\) These various requirements regarding amendment of the organizational filing have not been altered. Conversely, certain attestation and sealing requirements that exist in some business organizations and not in others and which impose nonsensical policing obligations on the Secretary of State’s office have been deleted.\(^{14}\) Still, certain practices that were previously applied across nearly all, but not all, business organizations have not, by reason of the Kentucky Business Entity Filing Act, been universally applied.\(^{15}\) For example, neither a Rural Electric Cooperative nor a Rural Telephone Cooperative has been required to maintain a registered office or agent,\(^{16}\) and no such requirement has been added,\(^{17}\) but an annual report obligation will now apply to limited partnerships

13. For example, in a business corporation, an amendment to the articles of incorporation must, in most instances, have received the approval of both the board of directors and the shareholders, whereupon articles of amendment are delivered to the Secretary of State for filing. Ky. Rev. Stat. Ann. § 271B.10-030(2). Articles of amendment to the articles or organization of an LLC need be approved only by the members of the LLC. Ky. Rev. Stat. Ann. § 275.030(2). Conversely, in the case of a Rural Electric Corporation, while the substance of the amendments to the articles of incorporation must be approved by both the board of directors and the members, there exist attestation requirements with respect to the articles of amendment as filed with the Secretary of State’s office. See Ky. Rev. Stat. Ann. § 279.050. Similar attestation requirements, with the requirement as well that the corporate seal be affixed to the articles of amendment, apply in the case of rural telephone cooperatives. Ky. Rev. Stat. Ann. § 279.410.

14. See, e.g., supra note 49.

15. See, e.g., supra note 124.

16. See Ky. Rev. Stat. Ann. § 279.030(1) (the absence of such a requirement indicates that the articles of incorporation of Rural Electric Cooperative need not set forth either a registered office or registered agent); id. § 279.330 (the absence of such a requirement indicates that the articles of incorporation of Rural Telephone Cooperative need not set forth either registered office or registered agent).

17. None of rural electric cooperatives, rural telephone cooperatives nor limited partnerships governed by the Kentucky Revised Uniform Limited Partnership Act are obligated to file an annual report.
governed by the Kentucky Revised Uniform Partnership Act.18 To that end, in addition to a series of general provisions,19 BEFA addresses:

- filing requirements with respect to documents filed by or issued by the Secretary of State;20
- business entity names;21
- the registered office and registered agent;22
- changes in the principal place of business;23
- annual reports;24
- administrative dissolution;25
- the expiration of the term of business entities that are not perpetual;26 and
- qualification of foreign entities to transact business in Kentucky.27

Conforming amendments within the various business entity laws and elsewhere have also been made.28

The “Burden” of Cross-Referencing

Some practitioners may have an initial objection to cross-referencing a distinct statute when working within a particular business organization act, fearing that the need to flip back and forth between the two will lead to confusion. Such concerns are overblown and will be quickly remedied by reviewing both the business entity act and the revised business organization act under consideration. While many of the substantive provisions of the various business organization acts have been deleted, an example being those governing the registered office and registered agent, there have been substituted within the organic acts cross-references to the provisions of the business entity filing acts addressing registered offices and registered agents.29 Each of these provisions will serve as a (friendly) reminder of the need to reference BEFA. Further, as BEFA sets forth consistent rules across all business organizations for the subject

18. See supra notes 154 through 158 and accompanying text.
19. See supra notes 34 through 45 and accompanying text.
20. See supra notes 48 through 93 and accompanying text.
21. See supra notes 94 through 119 and accompanying text.
22. See supra notes 120 through 142 and accompanying text.
23. See supra notes 143 through 151 and accompanying text.
24. See supra notes 152 through 168 and accompanying text.
25. See supra notes 169 through 178 and accompanying text.
26. See supra notes 179 through 184 and accompanying text.
27. See supra notes 185 through 214 and accompanying text.
28. The bulk of the legislation containing the filing act was comprised of those conforming amendments. While the filing act was comprised of 48 substantive provisions, 102 other sections amended existing statutes, and 144 other statutes were entirely deleted. Set forth as Exhibits A, B and C are cross-reference tables of the pre-BEFA laws of business corporations, LLCs and KyRUPA/KyULPA partnerships deleted in S.B. 151 to the superseding provisions of BEFA.
matters it addresses, the drafting of those new acts will be able to focus exclusively on the substantive provisions entailing policy decisions. Furthermore, if one steps away from the predominant acts, namely those governing the business corporation and the LLC and reviews the range of the lesser applied acts, it is clear that cross referencing between statutes is quite common. For example, every professional service corporation, except to the extent provided in the Professional Service Corporation Act, is governed by the Business Corporation Act.\footnote{30} Provisions from the Business Corporation Act addressing service on a foreign corporation and the withdrawal from transacting business in Kentucky are expressly incorporated by reference in the Nonprofit Corporation Act.\footnote{31} Cooperative corporations and associations are governed by, except to the extent set forth in their organic acts, either the Business Corporation Act or the Nonprofit Corporation Act.\footnote{32} Irrespective of any express cross-incorporation, individual business entity acts do place limitations upon other forms of business organizations. For example, “cooperative” may not be used in the name of any business organization not governed by the Cooperative Corporation Act\footnote{33} even though that limitation does not appear in any of the Business Corporation, Nonprofit Corporation, Partnership, Limited Partnership, or Limited Liability Company Acts. A central filing provision such as the BEFA is not, therefore, entirely an innovation in Kentucky business entity law.

\textit{Legislative History and Codification}

The Kentucky Business Entity Filing Act was submitted to the 2010 Kentucky General Assembly by Senator Tom Jensen on February 8, 2010 as S.B. 151. The bill was assigned to the Judiciary Committee on February 10.\footnote{34} The Judiciary Committee held a hearing on the proposal on February 11, and the bill was passed out of committee on a unanimous vote. S.B. 151 was voted out of the Senate on February 24 on a vote of 38 to 0. The proposal came before the House Judiciary Committee on March 10, and it was voted out of Committee on another unanimous vote. On March 23 the bill was voted out of the House by a vote of 96 in favor and 1 against. On March 29 the Senate concurred in the technical corrections made in the House, and then approved the bill on a vote of 36 in favor and zero against. The bill was signed by Governor Beshear on April 13, 2010.

\footnote{31}{\textit{Id.} § 273.363.}
\footnote{32}{\textit{Id.} § 272.042.}
\footnote{33}{\textit{Id.} § 272.050.}
The Kentucky Business Entity Filing Act is codified at KRS ch. 14A.

Effective Date

The Business Entity Filing Act has a delayed effective date of January 1, 2011. The delayed effective date is intended to afford the Secretary of State time to update its procedures to accommodate the new act. This will include the preparation of new forms, the updating of old forms and their related instructions and, as necessary, on-line filing procedures. In addition, the delayed effective date will afford practitioners time to become comfortable with the new systems and procedures. The corresponding edits to the otherwise existing language of the business entity acts are likewise not effective until January 1, 2011.

The substantive provisions of the Kentucky Business Entity Filing Act will be reviewed substantially in the order codified. Thereafter, material impacts upon the various business entity forms are highlighted herein.

The Substantive Provisions of the Kentucky Business Entity Filing Act


The Kentucky Business Entity Filing Act is applicable to each “entity” and “foreign entity.” As such its provisions apply irrespective of a cross-reference from the organic act. The Secretary of State is vested with the powers “reasonably necessary” to perform the duties required by the filing act.

A new series of provisions enable the Secretary of State to issue interrogatories to a domestic or foreign entity in order to ascertain compliance with the filing act. Penalties may be imposed on those failing to respond to interrogatories, and the entity, if domestic, is then subject to administrative dissolution or, if foreign, to revocation of the certificate of authority for failure

35. See 2010 Acts, ch. 151, § 152.
36. For example, while there were previously four different forms, each type specific, for the qualification of various types of foreign entities (Forms FCO, FLC, FNP and FNT), there will now be a single application for a certificate of authority.
37. KY. REV. STAT. ANN § 14A.1-010, created by 2010 Acts, ch. 151, § 1.
38. Id. § 14A.1-020, created by 2010 Acts, ch. 151, § 2. Both “entity” and “foreign entity” are defined terms. See KY. REV. STAT. ANN. §§ 14A.1-070(7) and (10). “Entity” means a corporation, business trust, partnership, limited partnership or limited liability company, governed as to its internal affairs by the laws of the Commonwealth of Kentucky. “Foreign entity” means a corporation, not-for-profit corporation, cooperative, association, business or statutory trust, partnership, limited partnership, or limited liability company not organized pursuant to the laws of the Commonwealth of Kentucky or as to its internal affairs, governed by the laws of the Commonwealth of Kentucky.
39. “Organic act” is a defined term (see KY. REV. STAT. ANN. § 14A.1-070(19), created by 2010 Acts, ch. 151, § 7) and refers to the law pursuant to which an entity or foreign entity is organized.
40. KY. REV. STAT. ANN. § 14A.1-030, created by 2010 Acts, ch. 151, § 3.
41. See id. § 14A.1-050(2), created by 2010 Acts, ch. 151, § 5.
to respond. These express provisions as to the ability of the Secretary of State to issue interrogatories and to compel the answering thereof supplement and implement, rather than supplant, the Secretary of State’s general visitorial powers.

It is important to understand the appropriate scope and limitations of interrogatories from the Secretary of State. The Secretary of State is empowered to issue interrogatories for the purposes of insuring compliance with either BEFA or the applicable organic act as such relates to the interface of the entity with the Kentucky Secretary of State. As such, it would be appropriate for the Secretary of State to issue an interrogatory inquiring as to (i) the principal place of business address of a limited liability company when it has reason to believe that the LLC in question has in fact moved from that address, (ii) confirm the continuing validity of a mailing address provided by a foreign entity which has surrendered its certificate of authority when mail transmitted to that address is returned to the Secretary of State with the explanation that the period of time for forwarding to the new address has expired or (iii) upon receipt of a filing by a limited partnership signed by one who is identified as a general partner but who is not listed on the certificate of limited partnership. Conversely, it would not be appropriate for the Secretary of State to issue an interrogatory seeking, in the case of a corporation, a list of its shareholders, or in the case of an LLC, a copy of its operating agreement or other written record as to the agreed contributions of the members. While a corporation is required to maintain a list of its shareholders, and an LLC is required to maintain a listing of the agreed contributions of its members, neither concerns matters over which the Secretary of State has oversight responsibility. Therefore an interrogatory making these or similar inquiries would be inappropriate and validly resisted.

42. See id. § 14A.1-050(1), created by 2010 Acts, ch. 151, § 5.
43. See id. § 14A.1-030, created by 2010 Acts, ch. 151, § 3.
44. See id. §§ 14A.9-060(2)(c), (f), created by 2010 Acts, ch. 151, § 45.
45. See id. § 14A.1-020(c), created by 2010 Acts, ch. 151, § 9.
46. See KY. REV. STAT. ANN. § 271B.7-200(1).
47. See id § 275.185(1)(c)(1).
48. Whether, with the adoption of Federal legislation akin to the Incorporation Transparency and Law Enforcement Assistance Act (S.B. 569, introduced March 11, 2009), a listing of the owners, record or beneficial of a business entity will need to be made available upon interrogatories for the Secretary of State remains to be seen. See also Marcia Coyle, Feds Want More Corporate Data, NAT’L LAW JOURNAL 1 (Jan. 11, 2010) (revealing the U.S. Treasury and Justice Department’s interest in obtaining more data about the owners of corporations and LLCs in order to crack down on illegal conduct of shell companies.). See also Thomas E. Rutledge, Requiring Disclosure of Business Entity Ownership: Proposed New Laws are Burdensome, But With the Benefit of Being Ineffective, 13 J. PASSTHROUGH ENTITIES 47 (July/Aug., 2010) (describing three pending law proposals which are all targeted at curtailing the use of business entities to further money laundering, terrorism support, and other similar illegal activities.) ; J.W. Verret, Terrorism, Finance, Business Associations and the “Incorporation Transparency Act”, 70 LOUISIANA L. REV. 857 (Spring 2010) (discussing the Levin Bill, which would require states to maintain lists of beneficial owners of business entities that would be subject to subpoena, and argues that the benefits of the Bill would not outweigh the costs associated with the Bill).
2. Filing Requirements with Respect to Documents Filed by or Issued by the Secretary of State

A single provision reciting the physical requirements of a document delivered to the Secretary of State for filing replaces the various provisions in the various acts.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010, created by 2010 Acts, ch. 151, § 8.} While the individual organic acts previously addressed who could sign documents delivered for filing,\footnote{Accord KY. REV. STAT. ANN. §§ 271B.1-200(i)-(ii); id. § 275.045; id. § 362.1-108; id. § 362.2-121.} those requirements are now set forth in a free-standing provision.\footnote{Accord KY. REV. STAT. ANN. §§ 271B.1-200(i)-(ii); id. § 275.045; id. § 362.1-108; id. § 362.2-121.}

A condition precedent to an effective filing is the payment to the Secretary of State of the applicable filing fee.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(10), created by 2010 Acts, ch. 151, § 8; id. § 14A.2-100(5), created by 2010 Acts, ch. 151, § 8.} Previously it was provided by regulation that the Secretary of State may cancel a filing made for which the filing fee cannot be collected.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(10), created by 2010 Acts, ch. 151, § 8; id. § 14A.2-100(5), created by 2010 Acts, ch. 151, § 8.} That right of cancellation, conditioned upon notice from the Secretary of State and opportunity for cure, is now set forth in the statute.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(10), created by 2010 Acts, ch. 151, § 8; id. § 14A.2-100(5), created by 2010 Acts, ch. 151, § 8.} The notice from the Secretary of State that the funds in satisfaction of the filing fee are not available may be sent via e-mail.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(10), created by 2010 Acts, ch. 151, § 8; id. § 14A.2-100(5), created by 2010 Acts, ch. 151, § 8.} This provision provides statutory authority for the effect of, and presumably supersedes 30 KAR 1:050 which, in operative part provided that “an entity which pays for its filing fees by check which is later dishonored shall have its filing voided and removed from the records of the Secretary of State.” However, the statute is likely broader in application than is the regulation that it is restricted by its terms to dishonored checks and, read narrowly, would not extend to, for example, fraudulent money orders or ultimately rejected credit card payments.

A new provision defines when a document is received (as contrasted with filed) by the Secretary of State,\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(11), created by 2010 Acts, ch. 151, § 8 (stating that a document delivered electronically that is self-operative will be treated as received on the date of receipt).} a point that may be important if a document must be received or submitted, as contrasted with filed, by a particular date. What documents will be treated as “self-operative” will develop over time with advances in automation of the filing process.

All communications from the Secretary of State may be done electronically,\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(12), created by 2010 Acts, ch. 151, § 8.} and communications by mail will be regular postal mail to the principal office address.\footnote{Accord KY. REV. STAT. ANN. § 14A.2-010(12), created by 2010 Acts, ch. 151, § 8.} It is expressly provided that an acknowledgement of
filing or explanation as to why a document was not filed may be transmitted electronically.59

Other than for documents that are filed electronically with the Secretary of State, the Secretary of State may require that printed or typewritten documents be accompanied by up to two exact or conformed copies.60 The number of additional copies of a particular filing required will be determined by Secretary of State office practices and as deemed appropriate formal regulation. Notwithstanding the Business Entity Filing Act, articles of incorporation filed with respect to a rural electric cooperative are required to be executed in triplicate originals, all of which are filed with the Secretary of State,61 while articles of incorporation filed with respect to a rural telephone cooperative require four executed originals be delivered to the Secretary of State.62 With respect to statements filed to KyRUPA, the Secretary of State may require up to one exact or conformed copy.63

A document meeting the statutory requirements and delivered for filing will be filed by the Secretary of State,64 which act is evidenced by the time and date of filing mark.65 The filing of a document does not create a presumption as to its validity or the accuracy of the information set forth therein.66 A refusal to file may be appealed by an action in Franklin Circuit Court.67

Documents delivered to the Secretary of State for filing shall be effective upon either filing by the Secretary of State or a delayed effective time and date as set forth in the document.68 Note that, under this formula, a document containing a delayed effective time and date is filed even before it is effective.69 Where there is provided a delayed effective date, but no effective time, it will be effective as of 5:00 p.m. in the prevailing time in Franklin County, Kentucky.70

A delayed effective date may be no more than 90 days after the document is

60. Id. § 14A.2-010(9), created by 2010 Acts, ch. 151, § 9.
61. Id. § 279.040(1).
62. Id. § 279.350(1).
63. Id. § 362.1-108(8).
64. Id. § 14A.2-100(1). Accord KY. REV. STAT. ANN. § 271B.1-250; id. § 275.070; id. § 273.2524; id. § 362.1-111; id. § 362.2-124. See also 30 KAR 1:020 (requiring that a corporation or LLC be in “good standing” in order for documents delivered to the Secretary of State to be filed).
65. KY. REV. STAT. ANN. § 14A.2-100(2); id. § 14A.2-035. Accord KY. REV. STAT. ANN. § 271B.1-260; id. § 273.2525; id. § 275.075; id. § 362.1-112; id. § 362.2-124(5).
66. Id. § 14A.2-100(6)(c).
67. Id. § 14A.2-110(1).
68. Id. § 14A.2-070.
69. Under the formula employed in several of the prior acts, it was provided that a document with a delayed effective date but no effective time would be effective “at the close of business” on that delayed effective date. See, e.g., KY. REV. STAT. ANN. § 271B.1-230(2); id. § 275.060(2); id. § 362.1-110(2); and id. § 362.2-120(2). It was not specified, however, from where it is determined when is the close of business; is it of the Secretary of States office, which as to filings closes at 4:30 p.m., or rather as of the close of business of the entity making the filing.
70. KY. REV. STAT. ANN. § 14A.2-070(2).
Certain of the predecessor statutes were silent, however with respect to how a document setting forth a delayed effective date in excess of 90 days after the date of filing would be treated. Under the Kentucky Business Entity Act, it is made clear that where a claimed delayed effective date is in excess of that maximum 90 day period, the effective date shall be advanced to the ninetieth day after filing.

The Secretary of State may certify that a document is of record, but that certification does not extend to the accuracy of the information in the document.

With respect to all filings made with the Secretary of State, a single provision addresses the consequences of a false filing. Across the board, this offense shall be a misdemeanor punishable by a fine of up to but not to exceed $100. The penalty is applicable as to the person who signs a document (a) knowing it is false in a material respect and (b) intending that the document be delivered to the Secretary of State for filing. It bears noting that this penalty is applicable not only with respect to filings made on behalf of a business entity. For example, certain of the statements filed under the Kentucky Revised Uniform Partnership Act (2006) are made not on behalf of the partnership but rather on behalf of the individual or person making the filing.

A filed document may be corrected with the correction relating back to the date of the initial filing except as to persons who relied upon the error, in which instance the correction is effective only prospectively from the date of filing.

An entirely new provision, one which has no antecedent in Kentucky business entity law, will permit the withdrawal of filings made with the Kentucky Secretary of State having a delayed effective time or date. Before the time that the filing in question takes effect, the parties thereto may deliver to the Secretary of State a statement of withdrawal. If withdrawn, the filing will never become effective and shall be null and void. The filing fee for a statement of withdrawal is equal to that for the filing being withdrawn. A statement of withdrawal may not be filed once a document becomes effective.

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71. See, e.g., id. § 271B.1-230(2); id. § 275.060(2); id. § 362.1-110(2); id. § 362.2-120(2).
72. Id. § 14A.2.070(2).
73. KY. REV. STAT. ANN. § 14A.2-120(3). Accord KY. REV. STAT. ANN. § 271B.1-270; id. § 273.2526; id. § 275.080; id. § 362.1-113; and id. § 362.2-125.
74. Id. § 14A.2.030(2), created by 2010 Acts, ch. 151, § 10.
75. See id. § 362.1-1202.
76. See id. § 362.1-304 (statement of denial filed by one who seeks to deny that they are a partner in a partnership).
77. KY. REV. STAT. ANN. § 14A2-090(3). Accord KY. REV. STAT. ANN. § 271B.1-240; id. § 273.2523; id. § 275.065; id. § 362.2-207.
78. See id. § 14A.2-080, created by 2010 Acts, ch. 151, § 15.
79. See id. § 14A.2-080(2), created by 2010 Acts, ch. 151, § 15.
80. See id. § 14A.2-080(1) (“may withdraw the filing before it takes effect”) (emphasis added).
The Secretary of State is authorized to create certain forms and has the authority to make the use of those forms mandatory. Other forms may be prepared and made available, but their use may not be made mandatory.

With respect to most domestic entities, the Secretary of State may issue a certificate of existence. Exceptions are made for general partnerships, limited partnerships not governed by the Kentucky Uniform Limited Partnership Act and business trusts, any of which may cease to exist without a filing to that effect with the Secretary of State. A certificate of existence may be relied upon as “conclusive evidence” that the entity in question, as of the date and time of the certificate, exists. A certificate of authorization may be issued for a foreign entity that is qualified to transact business in Kentucky, which certificate is conclusive evidence of that authority. A certificate of authorization is not available for foreign general partnerships or certain foreign telephone or electric cooperatives. The Secretary of State may issue other certificates restricted to documents of record and not attesting to the accuracy of the information contained therein.

83. Id. § 14A.2-130, created by 2010 Acts, ch. 151, § 20.
84. Id. § 14A.2-130(4), created by 2010 Acts, ch. 151, § 20.
85. Id. § 14A.2-130(3), created by 2010 Acts, ch. 151, § 20. Accord Ky. Rev. Stat. Ann. § 271B.1-280; id. § 273.2527; id. § 275.085; and id. § 362.2-207. See also Donald W. Glazer, Scott FitzGibbon and Steven O. Weise, FitzGibbon and Glazer on Legal Opinions § 6.2.2 (3rd Ed. 2008); M. John Sterba, Jr., Legal Opinion Letters: A Comprehensive Guide to Opinion Letter Practice (3rd Ed. Aspen Publishers); § 6.1.4 (“Because opinion preparers customarily do nothing more than rely on certificates of government officials (which normally are presented at closing), good standing opinions usually add little of value analytically. However, good standing opinions do provide comfort that the opinion preparers do not know the certificates to be unreliable and do place on them the responsibility for confirming that appropriate certificates have been obtained from the proper officials. In situations in which the benefits of good standing opinions are marginal, the Committee believes that the opinion process could be streamlined if opinion recipients were to refrain from requesting them and relied on the certificates alone.”)
86. Ky. Rev. Stat. Ann. § 14A.2-140, created by 2010 Acts, ch. 151, § 21. See also FitzGibbon and Glazer on Legal Opinions, supra note 85 § 7.1.3; ABA Opinion Guidelines § I(c)(2); M. John Sterba, Jr., Legal Opinion Letters: A Comprehensive Guide to Opinion Letter Practice (3rd Ed. Aspen Publishers); § 4.1.6 at p.6-74 (“Because opinion preparers customarily base foreign qualification and foreign good standing opinions solely on certificates of government officials, which normally are presented at closing, those opinions add little (if anything) of value other than confirming that the opinion preparers do not know the certificates on which the opinions are based to be unreliable. The Committee believes that the opinion process could be streamlined without any meaningful detriment to opinion recipients if absent special circumstances the practice of rendering foreign qualification and foreign good standing opinions were discontinued and opinion recipients were to rely directly on the certificates themselves.”)
87. KRS § 14A.2-140(4). For a foreign limited liability partnership that has filed a statement of foreign qualification (see Ky. Rev. Stat. Ann. § 362.1-1102), a certified copy of that statement may be issued. If a foreign rural electric or telephone cooperative does apply for a certificate of authority (see Ky. Rev. Stat. Ann. § 14A.9-030), a certificate of authorization may be issued.
There has been centralized in a single provision the requirement that certain documents filed by business entities be recorded as well with the county clerk. Unlike the prior statutes, which were ambiguous as to what documents needed to be filed with the county clerk, the new law provides an exclusive listing of documents subject to filing, namely:

- articles of incorporation and all amendments thereto;  
- articles of organization and all amendments thereto;  
- certificates of limited partnership and all amendments thereto;  
- applications for certificate of authority;  
- amendments to a certificate of authority;  
- withdrawals of a certificate of authority;  
- articles of merger;  
- any statement of change of principal office address; and  
- statements of change of registered agent or registered office or both.

As a point of clarity, it is made clear that annual reports do not have to be filed with the county. While it is the general rule that county-level filings are done in the county in which the entity maintains its registered office address, in that neither rural telephone nor rural electric cooperatives are obligated to maintain a registered agent, it is provided that they need to file articles of incorporation, amendments thereto, and any articles of merger to which they are a party with the county clerk for that in which the principal office address is maintained. A corresponding revision to KRS section 64.012(2) has been made in order to provide consistency between the two provisions. In accordance with prior law, a document filed by the Secretary of State is effective irrespective of any failure to file same with the county clerk.

89. Id. § 14A.2-040  
90. This provision will address the articles of a business or nonprofit corporation, of a professional service corporation, of an agricultural cooperative association, and of a rural telephone or rural elective cooperative.  
93. Id. § 14A.2-040(3).  
94. Id. § 14A.2-040(2).  
95. See id. § 64.012(2), as amended by 2010 Acts, ch. 151, § 49.  
96. See, e.g., id. § 271B.1-230(3); id. § 275.060(3); id. § 362.1-110(3); and id. § 362.2-120(3).
3. Names of Business Entities

The various requirements as to the names of both domestic and foreign entities have all been compiled into a single section.97 Nonsubstantive changes have been made with respect to what names are and are not permissible and the required designators. An entity’s real name must be distinguishable from any name of record with the Secretary of State; “name of record with the Secretary of State” is a defined term.98 The capacity of a professional regulatory board to set forth additional requirements as to names is expressly preserved.99 It remains the law that there are no required identifiers for limited partnerships organized under the 1970 adoption of the Uniform Limited Partnership Act or any predecessor law.100 Consistent with prior law,101 while the filing of a particular name will preclude the filing of any name that is not distinguishable upon the records of the Secretary of State, the filing does not of itself automatically preclude others from using that name or protect it from use by other persons.102 Rather, with respect to efforts to achieve intellectual property protection with respect to a particular name, it will be necessary that appropriate trademark, copyright, service mark or other filings be made.103 It should be noted that certain terminology, when used in business entity names, may implicate other statutes. For example, any of the use of “Bank,” “Banker,” “Banking” or “Trust” implicate review by the Department of Financial Institutions,104 while “Engineer,” “Engineering,” “Surveyor,” “Surveying” or “Land Surveying” implicate review by the State Board of Licensure for Professional Engineers and Land Surveyors.105

Names may be reserved on behalf of a domestic or a foreign entity provided the name to be reserved is distinguishable upon the records of the Secretary of State.106 A reserved name must contain the appropriate identifier for the entity or foreign entity on whose behalf it is reserved.107 A reserved name may be transferred by its holder upon appropriate notice to the Secretary of State.108 Unless sooner cancelled,109 a name reservation is effective for 120 days and may, in the 30 days prior to the expiration, be extended for an additional 120 days from its otherwise applicable date of expiration.110 The ability to renew a

97. See id. § 14A.3-010, created by 2010 Acts, ch. 151, § 23.
99. Id. § 14A.3-010(21), created by 2010 Acts, ch. 151, § 23.
100. Id. § 14A.3-010(10).
101. See id. § 271B.4-010(6); id. § 275.100(6); id. § 362.2-108(7).
102. KY. REV. STAT. ANN. § 14A.1-010(17).
103. See also Allen and Rutledge, 2006 Amendments to the Assumed Name Statute, supra note 12 at 63.
104. See KY. REV. STAT. ANN § 286.2-685.
105. See id. § 322.060.
106. Id. § 14A.3-020(1), created by 2010 Acts, ch. 151, § 24.
107. Id. § 14A.3-020(2).
108. Id. § 14A.3-020(3).
109. Id. § 14A.3-020(4).
110. KY. REV. STAT. ANN. § 14A.3-020(1).
reserved name is consistent with changes made in 2007; prior to then, reserved names were not renewable. A foreign entity desiring to reserve a name is not obligated to be qualified to transact business.

A foreign entity may register its real name, if necessary modified in order to satisfy the requirement as to an appropriate identifier, and provided the name is otherwise distinguishable upon the records of the Secretary of State. The statute sets forth the requirements as to the application to register a name; there is no provision in the statute directing the Secretary of State to issue a form for this filing. All name reservations expire on the January 1 following the filing date, and are renewable at any time between October 1 and December 31.

A foreign entity desiring to qualify to transact business is held to the same standards as to name distinguishability and required identifiers as apply to domestic entities. Where the real name of a foreign entity does not meet those requirements, the foreign entity may either supplement its name with a required identifier or adopt a fictitious name pursuant to which it will transact business in Kentucky. If a foreign entity qualified to transact business in Kentucky changes its real name in its jurisdiction of organization, and that new name is not distinguishable upon the records of the Kentucky Secretary of State, the foreign entity will need to register a fictitious name pursuant to which it will transact business in Kentucky.

There has been added an explicit cross-reference to the assumed name statute for all domestic business entities transacting business other than under their real names, and all foreign entities transacting business either under their real or fictitious name. The assumed name statute has not, in response to the Business Entity Filing Act, been amended. The definition of what constitutes the real name of a business organization for purposes of the assumed name statute are unaltered, and the filing fees to be paid to the Kentucky Secretary of State for assumed name filings continue to be governed as before as does the county-level filing. While, in the course of drafting the Business Entity Filing Act, consideration was given to incorporating therein the assumed name statute.

113. Id. § 14A.3-030, created by 2010 Acts, ch. 151, § 25.
114. Id. § 14A.3-030(2).
115. Id. § 14A.2-050(1).
116. Id. § 14A.3-030(4).
118. On such a change of name in the jurisdiction of organization, the foreign entity will be required to amend its certificate of authority. See Ky. Rev. Stat. Ann. § 14A.9-040, created by 2010 Acts, ch. 151, § 43.
120. Id. § 14A.3-050, created by 2010 Acts, ch. 151, § 27.
121. Id. § 365.015(11).
122. See id. § 365.015(11); id. § 64.012(1)(a)(16).
Such a change was rejected for a pair of reasons. Initially, the assumed name act has application to sole proprietorships, as well as other entities, and as sole proprietorships fall out of the otherwise applicable scope of the Business Entity Filing Act, it seemed that the incorporation would be confusing. Further, as the assumed name statute is a consumer protection provision, it was thought best to leave it as a freestanding provision with the balance of chapter 365 so as to avoid any implication that the assumed name statute is, on a going-forward basis, meant to be construed for purposes other than for consumer protection.

4. The Registered Office and Agent

With certain exceptions, every domestic and every foreign entity qualified to transact business in Kentucky is obligated to maintain a registered office and agent. As noted previously, inconsistent rules have been applied across the various business entity acts with respect to what forms of business organization could or could not serve as the registered agent of a particular form of organization. Under the BEFA, irrespective of the form of organization, the registered agent thereof may be any of the following:

- an individual resident in Kentucky;
- a domestic entity; or
- a foreign entity authorized to transact business in Kentucky,

provided that the business address of the registered agent is the same as that of the registered office. The effective appointment of the registered agent requires that they, in writing, accept the appointment.

Across all entities and foreign entities required to maintain registered office and agent, a single provision provides for the change of either or both. Similar to the appointment of the initial registered agent, the appointment of a successor registered agent must include, or be accompanied by, the registered agent’s consent to serve in that capacity.

123. See Allen and Rutledge, 2006 Amendments to the Assumed Name Statute, supra note 12.
124. KY. REV. STAT. ANN. § 14A.4-010(1). The exceptions are domestic and foreign general partnerships that are not limited liability partnerships (KY. REV. STAT. ANN. § 14A.4-010(4)), domestic limited partnerships governed by the 1970 limited partnership act (KY. REV. STAT. ANN. § 14A.4-010(5)), and domestic rural telephone and electric cooperatives and foreign rural telephone and electric cooperatives not required to qualify to transact by a filing with the Secretary of State. KY. REV. STAT. ANN. §§ 14A.4-010(6), (7).
125. For example, while a limited partnership could serve as the registered agent of a business corporation (see KY. REV. STAT. ANN. § 271B.5-010(1)(b)(5)), it could not do for a nonprofit corporation (see KY. REV. STAT. ANN. § 273.182(a)-(b)) or for a limited partnership. See KY. REV. STAT. ANN. § 362.407(1)(B); id. § 362.2-114(3). Under prior law, there existed no mechanism by which a domestic or foreign business trust could serve as registered agent, even for a business trust.
127. Id. § 14A.4-010(2), created by 2010 Acts, ch. 151, § 28. Accord KY. REV. STAT. ANN. § 271B.5-010(2); id. § 273.182(2); id. § 275.115(2); id. § 362.1-117(2); id. § 362.2-114(2).
129. Id. § 14A.4-020(1)(e), created by 2010 Acts, ch. 151, § 28.
promulgate a form for the change of registered office, or registered agent, or both,\textsuperscript{130} and the Secretary of State has the authority to make use of that form mandatory.\textsuperscript{131} A registered agent who moves its business address (i.e., the registered office) needs to notify each entity for which it is the registered agent and file a change of registered office address with the Secretary of State.\textsuperscript{132} A change of registered office or change of registered agent is effective on the filing of the statement of change.\textsuperscript{133}

A registered agent may resign that role by delivering a statement of resignation to the Secretary of State.\textsuperscript{134} That resignation may be of only the registered agent capacity, or as well serving as the registered office for the entity or foreign entity. After filing of the statement of resignation, the Secretary of State is directed to mail one copy of the resignation to the entity or foreign entity at its principal place of business address as of record with the Secretary of State.\textsuperscript{135} Under prior law, the agency of the registered agent, as well as the designation of the registered office, was terminated effective 31 days after the filing of the statement of resignation.\textsuperscript{136} Under the new law, the resignation is effective upon the 31st day of the filing of the statement of resignation or the designation by the entity or foreign entity of a successor registered office and registered agent, whichever date is earlier.\textsuperscript{137} Should the entity, within the 60 day period after the filing of the statement of resignation of the registered agent, fail to designate a replacement agent and as necessary, a replacement office, if domestic it will be subject administrative dissolution,\textsuperscript{138} and if foreign, will be subject to having its qualification to transact business revoked.\textsuperscript{139}

A new provision, patterned upon Delaware law, requires that each entity and each foreign entity provide to its registered agent the business address and phone  

\begin{enumerate}
\item[130.] Id. § 14A.2-020(1)(c)-(d).
\item[131.] Id. § 14A.4-020(2).
\item[132.] Id. § 14A.4-020(2). There is a $10 fee for each statement of change with a cap at $2,000. See Ky. Rev. Stat. Ann. § 14A.2-060(1)(l).
\item[133.] Id. § 14A.4-020(3). Certain of the predecessor statutes, including KRS § 275.120(3) and § 362.1-118(3), provided that a change of registered office or registered agent was effective upon the “delivery” of the statement of change to the Secretary of State, thereby improperly conflating the delivery of a document with the Secretary of State’s filing thereof. The BEFA makes clear that either change is effective upon the Secretary of State’s filing of the statement of change.
\item[134.] Ky. Rev. Stat. Ann. § 14A.4-030, created by 2010 Acts, ch. 151, § 30. As to limited partnerships governed by KyRULPA, the ability to resign is new. Previously, changing the registered agent required an amendment of the certificate of limited partnership, and that the registered agent could not accomplish unilaterally.
\item[135.] Id. § 14A.4-030(2).
\item[136.] See, e.g., id. § 275.125(3); id. § 362.2-116(3); and id. § 386.388(3)
\item[137.] Id. § 14A.4-030(3), created by 2010 Acts, ch. 151, § 30.
\item[138.] See Ky. Rev. Stat. Ann. § 14A.7-010(1)(b), created by 2010 Acts, ch. 151, § 35. In the case of the failure by a domestic limited liability partnership to designate a replacement agent, and as necessary, replacement office, the dissolution will be of only the statement of qualification. See also Vestal and Rutledge, Modern Partnership Law Comes to Kentucky, supra note 3 at 717-18 (2007)
\end{enumerate}
number of a natural person authorized to receive communications from the registered agent. This provision serves several purposes. First, the registered agent benefits by having instructions from the business entity for whom they are serving as the registered agent as to whom they should contact upon the receipt of legal process or any notice or demand that has been served upon the registered agent. Presumably when the registered agent forwards process, notice or demand received to the communications contact, it will be difficult if not impossible for the entity to later assert that the registered agent failed to provide them adequate notice of the same. The business entity, or foreign business entity, benefits by knowing that the registered agent will transmit process, notice, or demand to a specific individual, rather than addressing it to the entity. Failure by an entity or foreign entity to provide the registered agent information as to a current communications contact is expressly set forth as a legitimate basis on which the registered agent may resign, although there is no obligation to do so. Pursuant to otherwise legitimate interrogatories from the Secretary of State, the registered agent may be required to divulge the name and contact information with respect to the communications contact.

The registered agent appointed on behalf of a domestic or foreign entity is its “agent for service of process, notice, or demand required or permitted by law to be served on the entity or foreign entity.” It is through the registered agent that interrogatories from the Secretary of State may be served upon an entity or foreign entity. The balance of this provision specifies alternative means for effecting service of process or delivering a notice or demand where either there is not a registered agent or that agent cannot with “reasonable diligence” be served. In those instances, the service of process, notice or demand may be transmitted to the entity or foreign entity by registered or certified mail, return receipt requested, addressed to the entity or foreign entity at its principal office. Service, whether of legal process, or of the delivery of a demand or a

140. KY. REV. STAT. ANN. § 14A.4-010(3). This provision is based on Delaware Law. See DEL. CODE ANN. tit. 6, § 18-104(g); DEL. CODE ANN. tit. 8, § 132(d).
141. KY. REV. STAT. ANN. § 14A.4-010(3).
142. Id. § 14A.4-040(1), created by 2010 Acts, ch. 151, § 31. Being patterned on existing law (see, e.g., KRS § 271B.5-040(1); id. § 275.130(1); id. § 362.2-117(2)), prior law as to service through the registered agent and default judgments continues to apply. See, e.g., J.P. Morgan v. Engle, 2006-CA-001182-MR (Ky. App. Sept. 21, 2007) (assertion by the defendant that they “somehow misplaced the complaint” not accepted as a valid basis to set aside default judgment); Dakota Enterprises, Inc. v. Carter, No. 2001-CA-002417-MR (Ky. App. May 30, 2003) (registered agent’s regular and long term absence from business address not a basis for setting aside default judgment); and Crop Production Services, Inc. v. Williamson, No. 1998-CA-000124-MR (Ky. App. June 25, 1999) (default judgment would not be set aside based upon registered agent’s failure to properly forward the complaint to the defendant).
143. See infra notes 38-47 and accompanying text.
144. While the antecedent acts were clear that the registered agent was the agent of the entity for not only service of process, but also any notice or demand that could be made, the statutes were less than clear as to whether the alternative means of communication by registered or certified mail extended only to service of legal process or as well other notices or demands. To that end, the
notice, is perfected upon actual receipt of the certified or registered mail, on the date upon which the return receipt is signed on behalf of the entity or foreign entity or 5 days after the transmission of the communication as evidenced by the postmark.\textsuperscript{145} There is retained the rule that either service through the registered agent or the alternative means of service by certified or registered mail are not exclusive of other means by which service of process, of a notice or of a demand may be made.\textsuperscript{146}

The role of the registered agent has been defined as the forwarding of process and notices received and of maintaining the information on the communications contact.\textsuperscript{147}

5. Changes in the Principal Place of Business Address

Most domestic business organizations are required, in their initial filing with the Secretary of State’s office, to recite, inter alia, a principal place of business address,\textsuperscript{148} and all foreign entities who qualify to transact business are likewise

Business Entity Filing Act has been clarified to make clear that the alternative means of delivery by registered or certified mail extends to legal process and any other notice or demand that may be served on the entity.

145. Ky. Rev. Stat. Ann. §§ 14A.4-040(2)(a) – (c). This provision repeats the prior rules. See, e.g., id. § 271B.5-040(2); id. § 275.130(2); and id. § 362.1-120(2).

146. Id. § 14A.4-040(3). This provision repeats the prior rules. See, e.g., Ky. Rev. Stat. Ann. § 271B.5-040(3); id. § 275.130(3); id. § 362.1-120(4). As to this last provision, see also Ky. Rev. Stat. Ann. § 271B.5-040(2) service on a business corporation may be accomplished by notice to the secretary at the principal place of business address of the corporation; id. § 275.145 (providing, in the case of a member-managed LLC, notice to any member shall constitute notice to the LLC and that, in the context of a manager-managed LLC, notice to any manager shall constitute notice to the LLC); id. § 362.1-301 (providing that each partner is an agent of the partnership); id. § 362.190 (providing that each partner is an agent of the partnership); id. § 362.523 (applying the general partner’s agency authority as set forth in KRS 362.190 to limited partnerships subject to the Kentucky Revised Uniform Limited Partnership Act); and id. § 362.2-402 (each general partner of a limited partnership governed by the Kentucky Uniform Limited Partnership Act (2006) is an agent of the limited partnership).

147. Ky. Rev. Stat. Ann. § 14A.4-050, created by 2010 Acts, ch. 151, § 32. This provision is based upon section 14 of the Model Registered Agents Act ("MRAA"). See MRAA § 14, 6B U.L.A. 685 (2008). While in the drafting of the Business Entity Filing Act consideration was given to the wholesale adoption of the Model Registered Agents Act (6B U.L.A. 659 (2008)), doing so was ultimately rejected for reasons including its departure from established Kentucky practice requiring the registered agent to sign the form pursuant to which they are so designated, the desire to avoid the differentiation of various registered agents into classes of commercial and non-commercial and, as to commercial registered agents, the desire to avoid an additional burden upon the Secretary of State of maintaining the list of entities that have named a commercial registered agent as their registered agent. See Model Registered Agents Act § 5, 6B U.L.A. 672 (2008).

148. See, e.g., Ky. Rev. Stat. Ann. § 271B.2-020(1)(d) ("The mailing address of the corporation’s principal office."); id. § 272.131(1)(c) ("The place where its principal business will be transacted."); id. § 272.390(1)(b) ("The place where its principal business will be transacted."); id. § 273.247(1)(e) ("The mailing address of the corporation’s principal office."); id. § 275.025(1)(c) ("The mailing address of the initial principal office of the [LLC]."); id. § 279.030(1)(a) ("The place, including the county, where its principal office will be located."); id. § 279.330(1)(b) ("The address of its principal office."); id. § 362.555(1) ("the address of its
required to set forth an equivalent address.\textsuperscript{149} Previously, while some entities updated this information by a distinct filing, which had the effect of amending the organic filing, others did so by directly amending that organic filing. Under BEFA, all changes in the principal office address\textsuperscript{150} shall be made by a distinct filing.\textsuperscript{151} As numerous notices from the Secretary of State are sent to the entity at the principal place of business address, and as third-parties may use the principal place of business address for service of a demand, notice or process,\textsuperscript{152} it is incumbent that this information be kept up to date. Under the new system, all changes in the principal office address shall be done on a form provided by the Secretary of State's office.\textsuperscript{153} In addition, this procedure will apply to the update of the principal office address set forth on statements of registration as a limited liability partnership filed under the Kentucky Uniform Partnership Act and statements of qualification filed under the Kentucky Revised Uniform Partnership Act (2006).\textsuperscript{154} These filings are specifically listed as neither constitutes an “organizational filing”\textsuperscript{155} and as such, this subsection was necessary in order to bring those filings within the common provisions for changes of principal office address. Also, a limited partnership will update its “designated office” in the same manner.\textsuperscript{156}

\textsuperscript{149} See, e.g., KY. REV. STAT. ANN. § 271B.15-030(1)(d) (requiring that a foreign corporation seeking authority to transact business in Kentucky set forth on its application “[t]he street address of its principal office”); id. § 362.415(1)(d) (“A mailing address for the limited partnership.”); id. § 362.1-1001(3)(b) (“The address of the partnership’s chief executive office and, if different, the street address of an office in this Commonwealth, if any.”); id. § 362.2-201(1)(b) (“The street address of the initial designated office.”); and id. § 362.420(1)(a)(3) (“The location of the principal place of business”). This provision does not extend to a business trust as they are not obligated, at the time of formation, to file a principal place of business address with the Secretary of State. Rather, a business trust records and updates its principal office address on its annual report.

\textsuperscript{150} The defined term is “principal office.” See KY. REV. STAT. ANN. § 14A.1-070(25).

\textsuperscript{151} Id. § 14A.5-010, created by 2010 Acts ch. 151, § 42.

\textsuperscript{152} See id. § 14A.4-040(2).

\textsuperscript{153} Id. § 14A.5-010.

\textsuperscript{154} Id. § 14A.5-010(2).

\textsuperscript{155} “Organizational filing” is a defined term. See Id. § 14A.1-070(21).

\textsuperscript{156} KY. REV. STAT. ANN. § 14A.5-010(3).
6. Annual Reports

Generally speaking, each domestic entity is required to file an annual report with the Secretary of State. Those entities not subject to this requirement are:

- General partnerships organized under KyRUPA that are not limited liability partnerships;
- General partnerships, including those that are limited liability partnerships, organized under KyUPA;
- Limited partnerships not governed by KyULPA or KyRULPA;\footnote{157}
- Rural telephone cooperatives; and
- Rural electric cooperatives.

All foreign entities qualified to transact business are obligated to file an annual report.\footnote{158}

A substantive change was made as to certain limited partnerships. The Kentucky Uniform Limited Partnership Act (2006) imposed an annual report obligation upon all limited partnerships formed thereunder\footnote{159} and the repeal of the foreign qualification provisions of the Kentucky Revised Uniform Limited Partnership Act\footnote{160} imposed that same requirement upon all foreign limited partnerships qualified to transact business.\footnote{161} Under the Business Entity Filing Act, beginning in 2011, limited partnerships organized under the Kentucky Revised Uniform Limited Partnership Act (“KyRULPA”)\footnote{162} will be required to file an annual report. A KyRULPA limited partnership that fails to do so may be administratively dissolved.\footnote{163}

In parallel with changes otherwise made for annual reports filed by business and nonprofit corporations,\footnote{164} the annual report must expressly list the corporation’s secretary. Every business corporation organized in the Commonwealth of Kentucky is required to have a “secretary,” that being the title ascribed to the person responsible “for preparing minutes of the directors’ and shareholders’ meetings and for authenticating records of the corporation.”\footnote{165} There exists no statutory requirement that a corporation have a president, a treasurer or any of the other typically seen officers. Each domestic and each foreign business corporation is required, on an annual basis, to file an annual

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\footnote{157}{Limited partnerships governed by Kentucky’s 1970 adoption of the 1916 Uniform Limited Partnership Act (1970 Acts, ch. 97, repealed by 1988 Acts, ch. 284, § 65) or a predecessor law remain exempt from any annual report requirement.}
\footnote{158}{KY. REV. STAT. ANN. § 14A.6-010(1).}
\footnote{159}{See id. § 362.2-210.}
\footnote{160}{See 2007 Acts, ch. 137, § 181.}
\footnote{161}{See also Rutledge, The 2007 Amendments, infra note 12 at 235.}
\footnote{162}{KY. REV. STAT. ANN. §§ 362.401 through 362.525. See also id. § 362.527.}
\footnote{163}{See id. § 14A.7-010(1)(a), created by 2010 Acts, ch. 151, § 35.}
\footnote{164}{See id. § 271B.16-220 as amended by 2010 Acts ch. 133, § 12; id. § 273.3671 as amended by 2010 Acts ch. 133, § 23.}
\footnote{165}{Id. § 271B.8-400(3) (requirement to have the officer); id. § 271B.1-400(23) (defining the “secretary” and referencing KRS § 271B.8-400(3)); id. § 273.227(3) (requirement to have the officer); id. § 273.161(10) (defining the “secretary”).}
report with the Secretary of State. Prior to the most recent amendments, the information required in the annual report included “T[le names and business addresses of its directors and principal officers.” With respect to a Kentucky corporation, those principal officers would include, and indeed may be limited to, the secretary. Foreign corporations not utilizing the MBCA formula (i.e., not requiring the designation of a “secretary”) should identify the person with custody of and capacity to authenticate the records of the corporation.

While the statute describes what appears to be substantially an inter-se role for the secretary (i.e., the preparation and maintenance of director and shareholder minutes), it is clear from the definition of the office that the role of secretary also affects the relationship of the corporation to third parties through the capacity to authenticate corporate records, the provision that the secretary serves as an alternative agent for receipt of service of process, and that they are also the agent of the corporation for receipt of any other notice to be given it. Rejecting annual reports that do not identify the corporate secretary:

(i) serves a prophylactic benefit in that it identifies corporations that are otherwise violating the applicable corporation by not having a secretary; and

(ii) benefits third parties who may need to make service upon the corporate secretary when the registered agent is not able to be served or who may need to otherwise give notice to the corporation.

Under the predecessor law, the annual report of an LLC that elected to be member-managed was required to list the name and business address of one member. Under the Business Entity Filing Act this request is eliminated, and a member-managed LLC there is no need to single-out a member and make of public record their affiliation with the LLC. Where, on the other hand, the LLC is manager-managed, the requirement to identify all managers remains in place.

166. KY. REV. STAT. ANN. § 271B.16-220(1)(d); id. § 273.3671(1)(d).
167. See MBCA § 1.40(20) (defining the person discharging the MBCA § 8.40(c) obligations as the “secretary”). For example, while a Tennessee corporation is not required to designate a “secretary,” that not being a defined term (see TENN CODE § 48-11-201), it is required to have an officer to whom is delegated “responsibility for preparing minutes of the directors’ and shareholders’ meetings and for authenticating records of the corporation.” See TENN. CODE § 48-18-401(c).
168. KY. REV. STAT. ANN. § 271B.1-400(23); id. § 271B.8-400(3); id. § 273.227(3); id. § 273.161(10).
169. Id. § 271B.5-040(2). When a corporation either has no registered agent or that agent cannot be with reasonable diligence served, the KyBCA provides that service of process may be made on “the secretary of the corporation at its principal office” by either registered or certified mail, return receipt requested. Id. § 271B.5-040(2).
170. KY. REV. STAT. ANN. § 271B.1-410(4).
171. Id. § 275.190(1)(d).
172. Id. § 14A.6-010(1)(d)(ii).
An annual report may be amended. 173

7. Administrative Dissolution

With certain exceptions, the Secretary of State may initiate the administrative dissolution of a domestic entity:

- that does not respond to interrogatories from the Secretary of State;
- that does not file its annual report by the due date;
- that does not have a registered office or registered agent for sixty days or more;
- that does not notify the Secretary of State within 60 days after a change in the registered office or agent, a resignation of the registered agent or the discontinuance of a registered office; 174 or
- for such other reasons as may be provided in the Business Entity Filing Act or otherwise in the organic law governing an entity. 175

There exist a number of exceptions and qualifications to the otherwise generally applicable basis for initiating an administrative dissolution. First, neither a general partnership that is not a limited liability partnership, a rural electric cooperative, nor a rural telephone cooperative is obligated to file an annual report or to maintain a registered office or registered agent. Thus, no such failure to do so will trigger administrative dissolution. Further, as a limited partnership that is governed by an organic limited partnership act other than the Kentucky Uniform Limited Partnership Act (2006) or the Kentucky Revised Uniform Limited Partnership Act is not obligated to file an annual report, such failure to do so cannot be the basis for administrative dissolution. Each of these entities is, however, responsible for answering interrogatories from the Secretary of State, and, to that extent, each of these forms of organization are still subject to administrative dissolution for failure to respond. 176

An entity will be given notice of the grounds for administrative dissolution sent to the principal office address. 177 If those grounds are not addressed or remedied during a 60 day cure period commenced from the date the notice was

173. Id. § 14A.6-010(6). See also Rutledge, The 2007 Amendments, infra note 12 at 254-55.
174. Given that a registered office or agent cannot be changed, and a registered agent may not resign and a registered office may not be discontinued without a filing with the Secretary of State, it is difficult to contemplate a fact situation that would give rise to initiation of proceedings for administrative dissolution. Still, as a provision of this nature does appear in the Model Business Corporation Act and has appeared as well in the antecedent Kentucky acts, this provision has been retained in the Business Entity Filing Act.
176. What “administrative dissolution” would mean with respect to a general partnership that was not formed pursuant to a filing with the Secretary of State’s office would entail is not addressed in the statute, nor is it addressed within the body of either the Kentucky Uniform Partnership Act or the Kentucky Revised Uniform Partnership Act.
178. Id. § 14A.2-010(12).
sent, the entity will be administratively dissolved. An entity administratively dissolved continues to exist but is restricted to activities necessary to wind up and liquidate its affairs. Administrative dissolution may be cured and relates back to the date of dissolution, but reinstatement is not possible if the entity has taken certain steps to wind up its affairs. The denial of an application to reinstate may be appealed to the Franklin Circuit Court.

8. The Expiration of the Term of Business Entities Which Are Not Perpetual

Although such did not fall within the ministerial ambit of administrative dissolution, there has previously been provided in several of the business entity acts that a business entity with a defined term would, upon reaching that defined term, be treated as having been administratively dissolved. Certain of those acts have in recent years been amended to provide that, within the 60 days after the entity has reached the end of its term, it may amend its organic filing to either delete or extend that term. There existed, however, difficulties with integrating the limitations upon reinstatement of an entity that had dissolved for having reached its term as contrasted with an entity that has, for example, simply failed to file its annual report. In response to those problems, reaching the end of duration is no longer treated as an administrative dissolution, but rather as a unique category of end of existence.

Having reached the end of its term as defined in its organic filing within the 60 days thereafter the entity may either delete the term provision or extend it to a future date. In either instance, that amendment will relate back and be effective as of the previously provided-for date of termination, and the existence of the entity will not be interrupted. Conversely, after the 60 day cure period has run, amendment of the organic filing is no longer permitted, and the organization must proceed to wind up and terminate.

The Secretary of State may, with respect to a business entity with a limited period of duration, issue a certificate of dissolution during the 60 day period during which the business entity may still cure its dissolution for having reached the end of its term. During that 60 day cure period, the Secretary of State’s office will not be able to issue, with respect to that business entity, a certificate

179. Id. § 14A.7-020(2).
180. Id. § 14A.7-020(3).
181. Id. § 14A.7-030.
182. Id. § 14A.7-030(4).
184. See, e.g., id. § 271B.14-200(4); id. § 275.395(1)(d).
187. Id. § 14A.8-010(2). At this point, the entity should be considered to have been consigned to the black pools of death.
188. Id. § 14A.8-010(3).
of existence unless and until the organic filing has been amended to extend or delete the termination date.

Whether and to what degree the owners and agents of an entity dissolved for having reached the end of its duration continue to have limited liability will be addressed by other law.189

9. Qualification of Foreign Entities to Transact Business in Kentucky

Under BEFA all foreign entities will qualify to transact business by applying for a certificate of authority.190 Exceptions exist for foreign LLPs, which will continue to file a statement of foreign qualification191 and for foreign general partnerships that are not LLPs – they are not obligated to qualify.192 A single provision sets forth that certain activities may be conducted by a foreign entity without a need for such foreign entity to qualify to transact business in Kentucky.193 While such activities will not necessitate a foreign entity qualifying to transact business in Kentucky, such activities may trigger long-arm jurisdiction, tax nexus, and/or professional regulation.194 A foreign professional service corporation’s obligation to qualify to transact business will be determined as it would be for any business corporation; the prior provision that qualification was not required if the PSC does not maintain an office in Kentucky195 has been eliminated.196

A foreign entity transacting business without a certificate of authority is subject to a fine of $2 per day and is barred from maintaining an action in

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189. See id. § 14A.8-010(4). For example, while reaching the end of its defined period of duration is a cause for dissolution of an LLC (see KY. REV. STAT. ANN. § 275.285(1)), it is clear that the limited liability enjoyed by members and managers survives dissolution. See id. § 275.300(3)(i); see also Rutledge, The 2007 Amendments, supra note 12 at 239-42.

190. KY. REV. STAT. ANN. § 14A.9-010(1).

191. Id. § 14A.9-010(4)(a). See also id. § 362.1-1102.

192. Id. § 14A.9-010(4)(b).

193. Id. § 14A.9-010(2), created by 2010 Acts, ch. 151, § 40.

194. Id. § 14A.9-010(5). See, e.g., Intercargo Ins. Co. v. B.W. Farrell, Inc., 89 S.W.3d 422 (Ky. App. 2002) (stating that a Louisiana performance bond issuer is subject to long-arm jurisdiction where a bond was signed in Kentucky following a board meeting in Kentucky authorizing bond and the issuer used letterhead of an affiliate with a Kentucky address); Commonwealth Dep’t of Educ. V. Gravitt, 673 S.W.2d 428 (Ky. App. 1984) (stating that a foreign corporation that agreed to modify a van in Kentucky is subject to long-arm jurisdiction); Commonwealth v. Nat’l Steeplechase and Hunt Ass’n, Inc., 612 S.W.2d 347, 348-49 (Ky. App. 1981) (showing that an association whose activities did not require qualification to transact business is subject to service of process under the long-arm statute); Mich. Wis. Pipeline Co. v. Commonwealth, 474 S.W.2d 873 (Ky. 1971) (stating that a foreign corporation with property in Kentucky, subject to taxation and jurisdiction in Kentucky, is not required to qualify to transact business where all activities were in interstate commerce). The long-arm statute is KRS § 454.210.

195. KY. REV. STAT. ANN. § 274.245(2).

Kentucky courts until it does so, but its acts are not otherwise impaired and it may defend an action initiated against it.

All foreign entities will apply for a certificate of authority on the same form. The obligations under certain predecessor acts to submit a certificate of existence from the jurisdiction of organization has not been carried forward into BEFA. Rather, there is substituted a representation that the entity validly exists under those laws. The registered agent must sign or otherwise give written consent to the appointment. All foreign qualifications in effect as of the effective date of BEFA are grandfathered and remain effective.

A foreign entity, having been issued a certificate of authority, has the same but not greater rights and privileges, and is subject to the same restrictions and liabilities, imposed upon a domestic entity of like character. With the exception of the authority of professional regulatory boards to regulate activities undertaken through a foreign business entity, the Commonwealth of Kentucky is not authorized to regulate the internal affairs, including the inspection of books, of a foreign entity authorized to transact business in Kentucky.

A certificate of authority will need to be amended if the foreign entity changes its real name, its period of duration, its jurisdiction or its form of organization. With respect to a change in form of organization, under prior law, when a foreign entity underwent a conversion, it was necessary that the certificate of authority issued to the predecessor be withdrawn and the successor qualify to transact business in accordance with the requirements applicable to the new form. Under the new law, it will only be required that the existing certificate of authority of the predecessor entity be amended to indicate new

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197. KY. REV. STAT. ANN. §§ 14A.9-020(4). While a certificate of authority is required to “maintain” an action, it is not required in order to initiate an action. Kattula v. Stout, 2007 WL 2155690 (W.D. Ky. 2007).


199. KY. REV. STAT. ANN. § 14A.9-030. See also id. § 14A.2-050(1)(b).

200. Id. § 14A.9-030(2).

201. Id. § 14A.9-030(3).

202. Id. § 14A.9-030(4).

203. Id. § 14A.9-050(2).

204. Id. § 14A.9-050(4).


206. KY. REV. STAT. ANN. § 14A.9-040(1).

form of organization.\textsuperscript{208} A change in the principal address of a foreign entity will be reflected not by amending the certificate of authority but rather by a distinct filing with the Secretary of State’s office,\textsuperscript{209} and likewise a change in the registered agent, registered office or both will be accomplished by means of a distinct filing.\textsuperscript{210}

Under prior law, a foreign business entity, having been qualified to transact business in Kentucky, applied for a “Certificate of Withdrawal,”\textsuperscript{211} and until granted the foreign entity could not “withdraw from this Commonwealth.”\textsuperscript{212} The process implied by this language is that the application for a certificate of withdrawal is subject to substantive review and that the foreign entity is affirmatively precluded from ceasing activities in Kentucky until the certificate is granted. Needless to say that is not the case, and the procedure and the terminology employed in the BEFA conform to the real circumstances and practice.

Under the new law, a foreign entity that desires to forfeit its right to transact business in Kentucky may do so by filing a Certificate of Withdrawal.\textsuperscript{213} Assuming that the document is complete and other requirements such as the filing fee are satisfied, upon filing, the right to transact business is terminated. The suggestion of substantive review of the application to withdraw is deleted, as is the suggestion that a foreign entity may not stop actually transacting business before receiving a Certificate of Withdrawal. Proper execution of the Certificate will be determined under KRS § 14A.2-020.

The Secretary of State is directed to create a form Certificate of Withdrawal,\textsuperscript{214} and is further empowered to make the use of that form mandatory.\textsuperscript{215}

As was the case under prior law, a foreign entity that has withdrawn is well advised to keep current the information provided the Secretary of State as to the mailing address. Service of process is complete upon delivery to the Secretary of State,\textsuperscript{216} and likely a failure to receive notice of the suit because a forwarding address is out of date will not be a basis for setting aside a default judgment.\textsuperscript{217}

\textsuperscript{208} KY. REV. STAT. ANN. § 14A.9-040(1)(d)
\textsuperscript{209} Id. § 14A.9-040(3); id. § 14A.5-010.
\textsuperscript{210} Id. § 14A.9-040(4); id. § 14A.4-020.
\textsuperscript{211} See, e.g., id. § 275.435(2).
\textsuperscript{212} See, e.g., id. § 275.435(1).
\textsuperscript{213} Id. § 14A.9-060(1).
\textsuperscript{214} KY. REV. STAT. ANN. § 14A.2-050(1)(d).
\textsuperscript{215} Id. § 14A.2-050(2).
\textsuperscript{216} Id. §§ 14A.9-060(2)(d), (4)
\textsuperscript{217} See, e.g., J.P. Morgan v. Engle, 2006-CA-001182-MR (Ky. App. Sept. 21, 2007) (assertion by the defendant that they “somehow misplaced the complaint” not accepted as a valid basis to set aside default judgment); Dakota Enterprises, Inc. v. Carter, No. 2001-CA-002417-MR (Ky. App. May 30, 2003) (registered agent’s regular and long term absence from business address not a basis for setting aside default judgment); and Crop Production Services, Inc. v. Williamson,
A foreign entity may have its certificate of authority revoked for a variety of reasons, including the failure to file an annual report, its dissolution in its jurisdiction of organization or failure to answer interrogatories. The Secretary of State, believing grounds exist for revocation of the certificate of authority, will give notice to the foreign entity at its principal place of business address, and during the 60 days after the mailing of that notice the foreign entity may remedy or otherwise address the grounds for revocation. Absent cure, the Secretary of State may revoke the certificate of authority by signing a certificate of revocation, a copy of which will be sent to the foreign entity at its principal place of business address, whereupon the foreign entity’s authority to transact business is terminated and, while the authority of the previously appointed registered agent is not terminated, the Secretary of State becomes an alternative registered agent. The revocation of the certificate of authority may be appealed to the Franklin Circuit Court.

Conclusion

The Kentucky Business Entity Filing Act is a significant step in rationalizing and organizing Kentucky’s various business entity laws. Non-policy driven distinctions between the various forms of business organizations, at least to the degree to which they relate to filings and interface with the Secretary of State’s office, have been significantly eliminated. The task of rationalization is not, however, yet completed. While piecemeal efforts to rationalize structures and provisions that appear throughout the various laws continue, at the same time there exist the numerous distinctions and open questions regarding the application of non-business entity statutes among the various forms of business entities. Those individualized efforts must continue. Still, even as those issue by issue reviews are undertaken and resolved, as new business entity statutes are adopted in Kentucky, candidates including the Uniform Statutory Trust Entity Act, the Uniform Limited Cooperative Association Act and the Model Nonprofit Corporation Act (2008), all can be integrated into the Kentucky Business Entity Filing Act and in so doing take advantage of a single consistent filing system.

218. KY. REV. STAT. ANN. § 14A.9-070; id. § 14A.1-050(1).
219. Id. § 14A.9-080(1).
220. Id. § 14A.9-080(2).
221. Id.
222. Id. §§ 14A.9-080(4), (5).
223. Id. § 14A.9-090.
### Exhibit A

**Provisions of the Business Corporation Act (KRS Ch. 271B) Superseded by BEFA**

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Exhibit C

PROVISIONS OF KYRUPA AND KYULPA (KRS CH. 362.1 AND 362.2) SUPERSEDED BY BEFA

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