

Commonwealth of Kentucky

Court of Appeals

NO. 2005-CA-001983-MR

CHARLES THOMAS AND
L & C MANAGEMENT, INC.
D/B/A L & C CONSTRUCTION

APPELLANTS

v. APPEAL FROM FAYETTE CIRCUIT COURT
HONORABLE GARY D. PAYNE, JUDGE
ACTION NO. 04-CI-03499

ARYLON BROOKS AND GLORIA BROOKS

APPELLEES

OPINION
AFFIRMING IN PART
REVERSING IN PART, AND REMANDING

** ** * ** * ** *

BEFORE: ABRAMSON AND STUMBO, JUDGES; KNOPF,¹ SENIOR JUDGE.

ABRAMSON, JUDGE: Charles Thomas, a building contractor and the sole shareholder of L & C Management, Inc. (d/b/a L & C Construction), the corporation through which Thomas carries on his business, appeals *pro se* from an August 24, 2005 judgment of the Fayette Circuit Court finding L & C and Thomas both liable to Arylon and Gloria Brooks

¹ Senior Judge William L. Knopf sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

for having breached L & C's contract with the Brookses (the Construction Contract) to build a single family residence in Lexington.² In addition to almost \$26,000.00 in compensatory damages for breach of the Construction Contract, the trial court awarded the Brookses \$25,000.00 in punitive damages and \$7,500.00 in attorney fees to remedy what the court found were Thomas's fraudulent and deceptive practices in violation of the Kentucky Consumer Protection Act (KCPA), KRS Chapter 367. Thomas contends that he is entitled to enforce an arbitration clause in the Construction Contract and further contends that the trial court erred both by awarding punitive damages for the breach of a contract and by piercing L & C's corporate veil and holding Thomas individually liable for the corporation's breach. We agree with Thomas that the award of punitive damages was not authorized. Accordingly, we must reverse that portion of the trial court's judgment that holds Thomas individually liable for punitive damages, but otherwise we affirm.

According to testimony and documents introduced at the July 7, 2005 bench trial, the parties' relationship commenced sometime in 2002, when the Brookses, Maryland residents, became interested in remodeling a house they owned at 1176 Centerville Lane in Lexington to use during their visits to that city. Mutual friends directed the Brookses to Thomas, who it happens is related by marriage to Mr. Brooks.

² The notice of appeal, prepared by Thomas, lists L & C as a party to this proceeding, but as a corporation L & C is not authorized to represent itself, and because Thomas is not an attorney he is not authorized to represent it. SCR 3.020; *Kentucky State Bar Association v. Tussey*, 476 S.W.2d 177 (Ky. 1972). L & C's claims for relief, therefore, are not properly before us. Because Thomas's claims are entwined with the corporation's, however, we shall discuss both, but shall limit any remedy to Thomas individually.

An inspection of the Brookses' house revealed extensive termite damage, so Thomas advised the Brookses, and they agreed, to demolish the old house and build a new one. On October 6, 2002, the parties executed the Construction Contract, according to which L & C undertook to prepare the site and to build a 1,000 square-foot house according to a design the Brookses chose from a design book. The Brookses agreed to pay L & C a total price of \$77,725.00, with partial payments due periodically as construction advanced. L & C undertook to begin construction by December 5, 2002 and to have the house substantially completed by July 5, 2003. Although the Construction Contract's payment schedule provided for an initial \$6,000.00 deposit with the next \$10,150.00 installment not due until the foundation had been laid, the Brookses paid L & C both the deposit and the first installment in October 2002 when the Contract was executed.

Thereafter, the project did not proceed as anticipated. Thomas testified that the demolition was delayed when it became entangled in red tape, and that once the old house had been removed there were additional bureaucratic delays before he obtained the building permit for the new house. The Brookses allege that Thomas merely neglected their house. In any event, it is undisputed that when the Brookses visited the site in June 2003 only the foundation had been completed, and when they visited again in mid-December 2003 the project had not advanced beyond the framing, siding, and rough dry walling. By then, the Brookses had paid Thomas the full contract price plus an additional \$3,840.00 for tree removal and for the disposal of asbestos removed from the old house, disposal that in fact had not occurred and that the Brookses were obliged to

arrange for themselves. The Brookses allege that they made the final installment payments under the Construction Contract in November and December 2003 relying on Thomas's assurances that the house was nearing completion. They were dismayed in December to find none of the interior work done. Thomas assured them at that time, they allege, that he would complete the plumbing, electrical, drywall, and other interior work within thirty days. Instead, however, when the Brookses returned to Lexington unannounced in May 2004, they found the house exactly as they had left it in December. Thomas then informed them that he would not complete the house unless they paid him an additional \$15,000.00.

Deeming Thomas's refusal to complete the house a breach of the Construction Contract, the Brookses hired counsel and, following a partial mediation of the dispute in June 2004, brought the present action in August 2004. Their complaint, which alleged only breach of contract, sought compensatory damages for the cost of completing the house and for travel expenses incurred while the Brookses arranged for and oversaw the additional work, amounts eventually determined to total \$25,801.08. The complaint also sought attorney fees and \$25,000.00 for the Brookses' "stress and anxiety as well as the outrageous conduct of the Defendants." As noted above, Thomas does not challenge the eventual awards of compensatory damages and attorney fees, and accordingly we affirm those aspects of the trial court's judgment. Thomas contends, however, that the trial court erred by awarding punitive damages.

Before addressing the punitive damages issue, we may briefly dispose of Thomas's contention that the trial court's entire judgment should be vacated and the case remanded for arbitration. Thomas bases this contention on paragraph 14 of the Construction Contract which does indeed provide that "all disputes with the Renovation Contractor will be arbitrated through the Mediation Center of Kentucky." Even if this provision gave Thomas a right to demand arbitration, however, arbitration rights will be deemed waived unless timely asserted. *Conseco Finance Servicing Corp. v. Wilder*, 47 S.W.3d 335 (Ky.App. 2001); *Valley Construction Company, Inc. v. Perry Host Management Company, Inc.*, 796 S.W.2d 365 (Ky.App. 1990). The parties in this case did, apparently, mediate a portion of their dispute prior to the law suit, but at no point during the litigation did Thomas move the trial court to enforce the alleged arbitration clause by ordering the parties to submit their outstanding differences to an arbitrator. Thomas thus waived any arbitration right he may have had, and, moreover, his failure to raise this issue in the trial court precludes his raising it for the first time on appeal. *Newell Enterprises, Inc. v. Bowling*, 158 S.W.3d 750 (Ky. 2005). The Construction Contract's arbitration clause, therefore, does not provide any basis for disturbing the trial court's judgment.

We agree with Thomas, however, that the trial court erred by awarding the Brookses punitive damages. The court appears to have relied on the KCPA as justifying such an award, but in *Craig v. Keene*, 32 S.W.3d 90 (Ky.App. 2000), this Court held that the KCPA does not apply to residential building contracts such as the one involved in this

case. Even if the KCPA did apply, moreover, that Act does not expand the right to claim punitive damages, but only makes clear that it does not “limit a right to punitive damages where one previously existed.” *Ford Motor Company v. Mayes*, 575 S.W.2d 480, 487 (Ky.App. 1978) (discussing KRS 367.220(1), which states that the Act does not limit the right to seek punitive damages). As Thomas correctly notes, “Kentucky has long followed the general rule that punitive damages ordinarily are not recoverable for a breach of contract.” *Ford Motor Company v. Mayes*, 575 S.W.2d at 486. *See also* KRS 411.184(4). To be sure, tort damages, including punitives, are sometimes recoverable in the context of a contract breach, *Hanson v. American National Bank & Trust Company*, 865 S.W.2d 302 (Ky. 1993); *Faulkner Drilling Company, Inc. v. Gross*, 943 S.W.2d 634 (Ky.App. 1997), but this is so only when the breach involved independently tortious conduct. *Presnell Construction Managers, Inc. v. EH Construction, LLC*, 134 S.W.3d 575 (Ky. 2004) (concurring opinion by Justice Keller); *Ford Motor Company v. Mayes*, *supra*. Kentucky law has not recognized a fraudulent misrepresentation claim where a contract is involved unless the fraud induced the contract. *Hanson v. American National Bank & Trust Company*, *supra*; *Faulkner Drilling Company, Inc. v. Gross*, *supra*. This is consistent with the law of other jurisdictions, which have disallowed misrepresentation claims where a contract is involved unless the misrepresentation occurred before the contract was formed, it satisfied all the elements of that tort, and it involved either a matter extraneous to the contract’s terms or a risk not contemplated to be a part of the contract. *See Kaloti Enterprises, Inc. v. Kellogg Sales Company*, 699 N.W.2d 205, (Wis.

2005); *Robinson Helicopter Company, Inc. v. Dana Corporation*, 102 P.3d 268 (Cal. 2004).

Here, the Brookses' complaint does not allege that the Construction Contract was fraudulently induced nor does it allege a tort independent of the breach of contract. Rather, the Brookses emphasize Thomas's allegedly fraudulent misrepresentations concerning the project's progress, and contend that they give his breach a sort of tortious gloss that justifies punitive damages. As noted, however, the law is otherwise. The Brookses' complaint demonstrates that they understood Thomas's failure to perform his duties under the Construction Contract for what it was, not as the completion of a fraud, but as the breach of the Construction Contract. We do not doubt that the Brookses were seriously inconvenienced and distressed by Thomas's breach, particularly by his utterly unprofessional failure to notify them promptly as soon as he determined that he could not or would not complete performance at the agreed upon price, but stress and inconvenience are virtually inevitable consequences when substantial contracts go awry and thus do not alone imply the sort of extraordinary and outrageous circumstances that justify punitive damages. *Ford Motor Company v. Mayes, supra*. Thomas's decision not to perform this Construction Contract was unfortunate and perhaps blameworthy, but the failure to perform was a breach of contract, not a tort, and so did not subject Thomas to punitive damages. The trial court erred by ruling otherwise.

Finally, Thomas contends that the trial court erred by piercing L & C's corporate veil and finding him individually liable along with the corporation for the

corporation's breach of contract. As Thomas notes, our courts have long recognized that, generally, a corporation is a distinct legal entity, whose shareholders, officers, and directors are not personally liable for the acts and obligations of the corporation. *May v. Sullivan*, 300 Ky. 321, 188 S.W.2d 469 (1945); KRS 271B.6-220. This privilege of limited liability is generally regarded as an important component of a robust economy. Courts, therefore, are reluctant to disregard a corporation's separate existence, but will do so, and "pierce the corporate veil," when it appears that the privilege of doing business in the corporate form has been abused so as to perpetrate a wrong. *Morgan v. O'Neil*, 652 S.W.2d 83 (Ky. 1983); *White v. Winchester Land Development Corporation*, 584 S.W.2d 56 (Ky.App. 1979).

A party advocating that the corporate form be disregarded has the burden of establishing both an abuse of the form and a wrong. These elements must be assessed in light of the totality of circumstances, but generally the first element focuses on the relationship between the corporation and the owners or other corporate actors, while the second element concerns the relationship between the corporation and the plaintiff. Courts have identified several factors bearing on this first relationship such as (1) whether the corporation is inadequately capitalized, (2) whether the owners observe corporate formalities, (3) whether the corporation issues stock or pays dividends, (4) whether it operates without a profit, (4) whether there is a commingling of corporate and personal assets, (5) whether the owners use corporate assets as their own, or in general deal with the corporation at arms length, (6) whether there are non-functioning officers or

directors, (7) whether the corporation is insolvent at the time of the transaction, (8) whether corporate records have been maintained, and (9) whether others pay or guarantee debts of the corporation. *White v. Winchester Land Development Corporation, supra*; *Hildreth v. Tidewater Equipment Co., Inc.*, 838 A.2d 1204 (Md. App.2003); *Mars Electronics of N.Y., Inc. v. U.S.A. Direct, Inc.*, 28 F.Supp.2d 91 (E.D.N.Y. 1998). No single factor is dispositive, and generally several must be present to justify piercing. These factors must be weighed, of course, within the context of Kentucky law, under which it is perfectly legal for a corporation to be owned by a single shareholder. The second element concerns such factors as whether the corporate form was used to disguise the entity with whom the plaintiff dealt, to fraudulently induce him to act when otherwise he would not have, or to unjustly eliminate recourse for corporate obligations. *White v. Winchester Land Development Corporation, supra*.

In this case, Thomas is the sole shareholder and Chief Executive Officer of L & C. Although the record with respect to this issue was not extensively developed, it appears that L & C at least maintained a checking account in its name; filed corporate taxes and the annual reports required by law; and carried on business, such as the Construction Contract in this case, in the corporate name. On the other hand, however, the record also shows that during the months when the Brookses were paying L & C nearly \$80,000.00 there were substantial disbursements from the corporate checking account, totaling nearly \$40,000.00, for purposes not clearly related to the corporation. Thomas paid corporate monies to himself at will, and though some of those payments

may well have been reimbursement for services rendered to the corporation, the services were seldom documented. These unaccounted for disbursements and the disbursements to Thomas apparently left the corporation incapable of fulfilling its Construction Contract with the Brookses, and unjustly limited the corporation's ability to respond to the Brookses' claim for damages. The record further shows that while Thomas used an L & C form contract for the agreement with the Brookses, he also held himself out as a family member dealing with them personally. These circumstances provide substantial evidence in support of the trial court's implicit findings that Thomas abused the corporate form by disregarding it and by using it to mislead the Brookses, and that he thereby wronged the Brookses by unjustly undermining their security. The trial court did not err, therefore, by piercing L & C's corporate veil and holding Thomas individually liable for the Brookses' compensatory damages.

In sum, there is no dispute that L & C breached its contract with the Brookses to build their house or that the Brookses are entitled to compensatory damages to remedy that breach. The trial court did not err by holding Thomas individually responsible for L & C's compensatory obligation, as Thomas manipulated L & C for personal rather than corporate purposes and unjustly impaired the company's ability to respond in damages to the Brookses. The trial court did err, however, by awarding the Brookses punitive damages, which our law does not allow for purely economic losses stemming from the breach of a contract. Because the corporation has not properly challenged the trial court's judgment, the award of punitive damages against it must

stand, but the award of those damages against Thomas individually must be set aside. Accordingly, we reverse that portion of the Fayette Circuit Court's August 24, 2005 judgment awarding punitive damages against Thomas individually, affirm the judgment in all other respects, and remand for entry of a new judgment consistent with this opinion.

ALL CONCUR.

BRIEFS FOR APPELLANT:

Charles Thomas, *pro se*
Lexington, Kentucky

BRIEF FOR APPELLEE:

Donald R. Todd
Lexington, Kentucky