RENDERED: NOVEMBER 9, 2001; 10:00 a.m.
NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court Of Appeals

NO. 2000-CA-001217-MR

DAVE VINSON — APPELLANT

v.

APPEAL FROM CAMPBELL CIRCUIT COURT
HONORABLE LEONARD L. KOPOWSKI, JUDGE
ACTION NO. 97-CI-00665

BERNIE KOERNER; JASON KOERNER;
STEVEN HARPER; GAIL BROSSART;
AND VINSON & KOERNER, INC. — APPELLEES

OPINION
AFFIRMING
** ** ** ** **

BEFORE: KNOPF, SCHRODER, AND TACKETT, JUDGES.

TACKETT, JUDGE: Dave Vinson appeals from an order of the Campbell Circuit Court dismissing his lawsuit against the appellees on the basis that his lawsuit, which is purported to be a shareholders derivative action on behalf of Vinson & Koerner Hauling, Inc. (Vinson & Koerner Hauling), was improperly brought in his individual capacity.

In early 1997 Vinson and appellee, Bernie Koerner, formed a business which invested in trucks for hauling water and gravel. While each individual initially invested $40,000.00 in the company, by agreement the investment was promptly reduced to

$30,000.00 by returning $10,000.00 to each of them. At that point Koerner contacted an attorney and Vinson & Koerner Hauling, Inc. was formed. Vinson was to be president of the company and have full responsibility for maintaining the company trucks and hiring the truck drivers. Koerner was to be the treasurer of the company. Early in the operation, Bernie Koerner transferred his shares in the business to his son, appellee Jason Koerner. Apparently Vinson and Jason were to each receive $300.00 per month, and profits were to be divided equally.

Almost immediately the business relationship between Vinson and the Koerners began to deteriorate. It appears that Vinson's chief complaints were that Bernie attempted to tell him where to park his truck, when he could load water, refused to pay his cell phone bill, overcharged him for gas, and refused to pay him additional amounts for hauling water. From Bernie's perspective, however, the business relationship began to break down because, among other things, Vinson refused to turn over receipts, refused to report on his hauls, and refused to purchase water from Bernie's water fill station.

By May 1997 the corporation was effectively no longer in operation. Vinson, in fact, had by then formed his own company, Vinson Hauling, and was using the corporation's trucks, phone numbers, and customer list in his new business. During this time several things happened: Jason transferred his shares back to Bernie; the parties reached an agreement to park the trucks; Vinson disabled and damaged the trucks; Vinson also attempted to file liens against the trucks; Vinson was removed

from the board of directors; Vinson resigned as president of the corporation; and, Vinson called a shareholders' meeting which Jason and Bernie refused to attend.

On May 30, 1997, Vinson filed a "Petition for Dissolution of Corporation" to dissolve Vinson & Koerner Hauling on the basis that the shareholders were deadlocked. In the caption, Vinson was identified as the plaintiff, and Vinson & Koerner Hauling was identified as the defendant. The petition sought the dissolution of the company, an injunction ceasing all activities of Vinson & Koerner Hauling, an equal division of the assets and liabilities of the company, and a judgment of $2,794.00 for wages and water hauling fees.

It is evident that sometime during the period from May through August 1997, through Bernie Koerner's efforts, the corporation transferred title of the company vehicles to Bernie. According to Vinson, the prices paid by Bernie for the vehicles was less than their fair market value and, moreover, Vinson claims that during this time he made advantageous offers to buyout Bernie which were improperly rejected.

On August 27, 1997, Vinson filed an "Amended Complaint." In the caption of the amended complaint, Vinson identified himself as the plaintiff and Bernie Koerner, Steven Harper, and Gail Brossart as defendants. Among other things, the amended complaint alleged Bernie Koerner misused the corporate assets and breached his fiduciary duty to the corporation and to Vinson. In response, the defendants' motion to dismiss pointed out that Vinson's amended complaint purported to be a

shareholder's derivative action, however, that Vinson had failed to name the company as the plaintiff, and had brought the action in his own name and individual capacity. The trial court denied the motion to dismiss.

Subsequently in March of 1999, the defendants renewed their motion to dismiss again arguing that Vinson had failed to comply with technical requirements of a shareholder's derivative suit. Vinson's response to the motion to dismiss stated, "The Amended Complaint in the first paragraph adopted and reiterated each and every allegation of the original and first Amended Complaint. Thus, Vinson & Koerner Hauling, Inc. was never dropped as a party Defendant." Several paragraphs later, Vinson states, incongruously, "The Plaintiff did bring the action for the Corporation. The Corporation is a party." In the caption, Vinson was listed as the plaintiff, and Bernie Koerner, Harper, and, Gail Brossart were listed as defendants, although it is clear that by this time Jason Koerner had been substituted in the place of Gail Brossart who was no longer a defendant. On April 19, 1999, the trial court entered an order denying the motion to dismiss.

Though Kentucky Rule of Civil Procedure (CR) 12.01 requires a defendant to serve his answer within twenty days after service of the summons, on June 5, 1999, defendants Bernie and Jason Koerner and Steven Harper filed an "Answer and Counterclaim." The answer again raised as an affirmative defense that Vinson's lawsuit had not been brought on behalf of the proper party in interest, i.e., Vinson & Koerner Hauling. The

defendants' counterclaim, in behalf of Vinson & Koerner Hauling, sought damages from Vinson for appropriating and damaging corporate property, receivables, and business of the corporation. Vinson timely answered the counterclaim.

On September 9, 1999, Vinson again filed a motion to amend his complaint, this time seeking a declaration from the court that their business relationship was a de facto partnership, that Vinson & Koerner Hauling was a sham corporation, was acting ultra vires, and finally was not properly instituted, organized or operated as a corporation. Vinson further claimed each of the defendants breached their duty to him by borrowing funds, selling assets, and exercising authority over the business assets contrary to the best interest of the business; and that Vinson had been injured by the defendants' negligent, reckless, careless, and wanton acts. Following the defendants' reply, the trial court entered an order denying the motion to amend.

On January 2, 2000, the defendants filed for summary judgment, asserting again that Vinson had failed to properly bring a shareholders derivative lawsuit. In response, Vinson filed a motion for summary judgment citing Pepper v. Litton, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939). Vinson argued that his action was proper because his "action is a direct action against the dominant and controlling stockholder and directors who breached the fiduciary duty owed to him." Vinson also noted that he had brought an action against the company, that the

company was properly served and never filed an answer, and sought a default judgment against the company.

Following replies by the parties, the trial court entered an order stating that it was treating the defendants' motion for summary judgment as a motion to dismiss, and dismissed Vinson's claims against the defendants, as well as the defendants' counterclaims. In its order, the trial court determined that Vinson had filed what purported to be a shareholders derivative action on behalf of Vinson & Koerner Hauling, but had brought the action in his individual capacity and, contrary to Kentucky Revised Statutes (KRS) 271B.7-400, had failed to name Vinson & Koerner Hauling as a party to the case.[1] The trial court further stated that "Kentucky law . . . is clear to the effect that one shareholder cannot directly sue another for damage allegedly done to the corporation," and that "[t]he fiduciary obligation is to the corporation, and the only way that a shareholder can have those activities enforced or challenged is to have a shareholders derivative action brought on behalf of the corporation." This appeal followed.

Vinson does not contend that he brought a proper shareholder derivative lawsuit; rather, he contends that, as a stockholder, he was entitled to bring an action against the appellees in his own right. We disagree.

The selection of the form of business (i.e., sole proprietorship, partnership, or corporation) is a decision of

[1]In the caption of the order, Vinson and Koerner Hauling was identified as a defendant in the case.

utmost importance in establishing a business. That decision requires weighing numerous factors including tax laws and the consequences thereof, limitation of personal liability, and spreading the amount of potential risk and profit among one or more principals to determine which form is best for a given individual, group, or company.

Vinson has not cited controlling Kentucky statutory or case law which impose a fiduciary duty between shareholders in a closely-held corporation. These duties which are recognized by law create liability upon corporate directors or officers to the corporation, not individual directors, officers, or shareholders. Vinson relies primarily upon Pepper, supra, which has no application to this case. Pepper, a federal bankruptcy case, was an attempt by the trustee of a bankrupt corporation to set aside a judgment in favor of the sole shareholder of the corporation against the corporation which had been improperly obtained by the shareholder as an artifice to avoid paying an adverse judgment in a pending lawsuit against the corporation seeking to obtain payment for unpaid royalties. It is stated in Pepper that:

> A director is a fiduciary. Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588. So is a dominant or controlling stockholder or group of stockholders. Their powers are powers in trust. Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity

> will set it aside. While normally that fiduciary obligation is enforceable directly by the corporation, or through a stockholder's derivative action, it is, in the event of bankruptcy of the corporation, enforceable by the trustee. For that standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation--creditors as well as stockholders. (Footnotes omitted.) (Citations omitted.)

Id. At 308 U.S. 306-307, 60 S.Ct. 245, 84 L.Ed. 289 - 290.

As stated in the excerpt, a fiduciary obligation is normally enforceable directly by the corporation or through a stockholder's derivative action, however it says nothing about the obligation being enforced by a shareholder directly against another shareholder. Contrary to Vinson's position, Pepper does not hold that a shareholder may bring a lawsuit directly against another shareholder.

Vinson's alternative argument is that we adopt Justice Leibson's dissent in the case Estep v. Werner, Ky., 780 S.W.2d 604 (1989). Justice Leibson urged Kentucky to adopt as a standard of conduct reasonably owed from one co-shareholder to another in a closely-held corporation, the rule stated in Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. 578, 328 N.E.2d 505, 515 (1975):

> "[W]e have defined the standard of duty owed by partners to one another as the [single] 'utmost good faith and loyalty.' [citations omitted]. Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard. They may not act out of avarice, expediency or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."

Justice Leibson noted as of that time twenty-one jurisdictions had judicially adopted this standard. In his brief, Vinson cites seven judicial decisions and twenty-four statutes wherein this, or a similar rule has been adopted. While the majority in Estep did not explicitly reject the notion of a direct action by one shareholder in a closely-held corporation against another and, stated to the contrary, "there may be certain nonstatutorily imposed fiduciary duties that exist among shareholders in closely-held corporations," it nevertheless did not adopt Justice Leibson's proposal.

We are bound by established precedents of the Kentucky Supreme Court. The Court of Appeals cannot overrule established precedent set by the Kentucky Supreme Court or its predecessor court. Special Fund v. Francis, Ky., 708 S.W.2d 641, 642 (1986). However, this rule has not prevented an intermediate appellate court from considering the viability of a cause of action where the issue has not been definitively resolved by the Kentucky Supreme Court. See Oakley v. Flor-Shin, Inc., Ky. App., 964 S.W.2d 438 (1998). While the issue of whether one shareholder in a closely-held corporation may bring a direct cause of action against another shareholder for a violation of a duty owed by one shareholder to another was not definitively resolved by the Kentucky Supreme Court in Estep, nevertheless, in light of the rejection of Justice Leibson's position proposed in his dissent, we must reject Vinson's invitation to adopt it now.

Vinson next contends that Jason Koerner violated his duty as an officer and shareholder when he transferred his shares

of the corporation stock back to his father two days prior to a duly and properly noticed shareholders' meeting, but without notice to Vinson pursuant to KRS 271B.12-020(4), and thereby making Jason liable to Vinson pursuant to KRS 446.070. Aside from the problems with suing a fellow shareholder as previously discussed, we note that KRS 271B.12-020(4) provides that:

> The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting in accordance with KRS 271B.7-050. The notice shall also state that the purpose, or one of the purposes, of the meeting is to consider dissolving the corporation.

We cannot agree with Vinson that this statute required Jason Koerner to provide notice to him prior to selling his shares to Bernie Koerner.

Finally, Vinson contends that Bernie Koerner defrauded him when he refused Vinson's offer to buy him out, and then set out on a course to destroy the corporation. For the reasons previously discussed, Vinson does not have a personal cause of action against Bernie Koerner to redress these allegations. "Improper manipulation of funds by the controlling stockholder creates a cause of action in favor of the corporation rather than in favor of a stockholder as an individual, as does a wrongful diversion of corporate assets." Security Trust Co. v. Dabney, Ky., 372 S.W.2d 401, 403 (1963) (quoting 13 Fletcher, Cyclopedia of Corporations, § 5924, pp. 395-396.)

To summarize, we agree with the trial court that the proper cause of action to redress the alleged wrongs of Bernie Koerner and the other appellees was a shareholders derivative

lawsuit. Upon the recovery by the corporation of any misappropriated property and/or damages from the appellees, Vinson could then recover any amounts due him upon the settling of the financial affairs of the company following its dissolution.

For the foregoing reasons the judgment of the Campbell Circuit Court is affirmed.

ALL CONCUR.

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