RENDERED: JULY 19, 2019; 10:00 A.M.
NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2017-CA-001428-MR

BRENCO, INC.; PHILIP STOCKWELL;
AND CLARK LAW OFFICE, INC. APPELLANTS

APPEAL FROM FAYETTE CIRCUIT COURT
v. HONORABLE ERNESTO M. SCORSONE, JUDGE
ACTION NO. 14-CI-02718

LEXINGTON JOINT VENTURE;
FAYETTE MALL SPE, LLC;
AND CBL AND ASSOCIATES
PROPERTIES, INC APPELLEES

AND

NO. 2017-CA-001537-MR

LEXINGTON JOINT VENTURE;
AND FAYETTE MALL SPE, LLC CROSS-APPELLANTS

CROSS-APPEAL FROM FAYETTE CIRCUIT COURT
v. HONORABLE ERNESTO M. SCORSONE, JUDGE
ACTION NO. 14-CI-02718

BRENCO, INC. AND PHILIP STOCKWELL CROSS-APPELLEES

OPINION
AFFIRMING

** ** ** ** **

BEFORE: JONES, MAZE, AND TAYLOR, JUDGES.

MAZE, JUDGE: The Fayette Circuit Court entered judgment in favor of Fayette Mall SPE, LLC ("Fayette Mall") in a dispute with its former tenant, Brenco, Inc. ("Brenco"), following a bench trial. Brenco[1] appeals that judgment, as well the trial court's pretrial orders denying it a jury trial and granting Fayette Mall summary judgment on the majority of Brenco's claims. Fayette Mall cross-appeals the trial court's orders granting Brenco summary judgment on Fayette Mall's counterclaim for fraud in the inducement and its request to pierce the corporate veil. After careful review, we affirm the trial court's judgment in its entirety.

From 2005 to 2014, Brenco operated a food and beverage store within a large shopping center on Nicholasville Road in Lexington, Kentucky ("the Shopping Center"). Appellant Phillip Stockwell is Brenco's sole shareholder. Fayette Mall owns the majority of the Shopping Center's real property, including Brenco's store. However, the Shopping Center's anchor tenants have historically owned the underlying real property for their stores and were responsible for the

[1] In this opinion, appellants/cross-appellees, Brenco, Inc., Phillip Stockwell, and Clark Law Office, Inc., are collectively referred to as "Brenco." Similarly, appellees/cross-appellants are collectively referred to as "Fayette Mall."

accompanying real estate taxes. Fayette Mall was responsible for rest of the Shopping Center real estate tax liability. The tenants who did not own their store's real property, such as Brenco, had provisions in their leases requiring they pay a share of the real estate taxes levied on the Shopping Center. This fee was based on the overall tax liability levied on the real estate occupied by the Shopping Center, minus the real estate taxes paid directly by anchor tenants, divided by the amount of space a tenant's store occupied. Disputes over these taxes would ultimately lead to this litigation.

At the time Brenco negotiated its lease, Sears was one of the Shopping Center's anchor tenants. In 2013, Sears announced it was closing its store in the Shopping Center. On June 28, 2013, Fayette Middle Anchor ("Anchor"), purchased the Sears parcel of property so the space could be converted into multiple store fronts after Sears closed permanently. Anchor and Sears then negotiated a contract in which Sears became a tenant of Anchor while Sears conducted going out of business sales. Anchor's lease provided that "Sears shall pay to Landlord [Anchor] a gross monthly fixed rent in the aggregate amount of $50,000 . . . . Landlord shall pay and be solely responsible for all real estate taxes, insurance and common area maintenance charges and expenses" in connection with the property. Anchor is an associate of Fayette Mall and both companies are owned by the same entity.

On November 19, 2013, Fayette Mall sent Brenco a tax adjustment letter notifying it that the purchase of the Sears parcel had caused a tax increase. Essentially, Fayette Mall alleged that the real estate taxes once paid by Sears would have to be shared amongst the Shopping Center's remaining tenants. Brenco objected because it did not believe this increased tax assessment complied with the terms of its lease but eventually paid the increased fee under protest. Fayette Mall sent an additional tax assessment letter the following year, and once again Brenco paid the increased fees under protest.

Brenco subsequently filed suit against Fayette Mall but was evicted a few months later for failing to pay rent. Brenco then filed an amended complaint alleging breach of contract, fraudulent assessment of taxes, and tortious interference with prospective economic advantage. It also sought class certification for other tenants it alleged suffered fraudulent assessment of real estate taxes. Fayette Mall counterclaimed for breach of contract and unjust enrichment, alleging Brenco owed it back rent from April 2014 to August 2014. The litigation grew increasingly contentious and subject to an extraordinary amount of motion practice. Following an unsuccessful attempt at court-ordered mediation, Fayette Mall filed counterclaims for fraud in the inducement and piercing the corporate veil. These claims were premised on Stockwell allegedly providing inaccurate financial disclosures while negotiating Brenco's lease in 2004 and subsequently using the company as his alter ego. Fayette Mall also added Stockwell as a defendant. Brenco and Stockwell responded by filing an amended complaint for wrongful use of civil proceedings.

The trial court would endure a flurry of dispositive motions, some of which it granted in part and denied in part. Brenco's request for class certification was denied. However, the trial court also notified the parties at a pretrial conference that it had reconsidered the prior dispositive motions and concluded summary judgment was appropriate on all but two claims: Fayette Mall's breach of contract claim for Brenco's failure to pay rent and Brenco's breach of contract claim for Fayette Mall's calculation of the fees its tenants owed for real estate taxes. The trial court then granted Fayette Mall's request for a bench trial, citing a provision in the lease in which the parties waived their rights to a jury trial for claims arising out of the lease. Brenco objected to a bench trial, arguing Fayette Mall's request for a jury trial in its counterclaim precluded a bench trial without both parties' consent. The trial court overruled Brenco's objection.

Following a one-day bench trial, the trial court found in Fayette Mall's favor on Brenco's breach of contract claims and its claim for unpaid rent. On appeal, Brenco alleges ten grounds of error. The Fayette Mall cross-appeals the trial court's dismissal of its claims for fraudulent inducement and piercing the corporate veil. Additional facts will be developed as necessary.

I. Fayette Mall's Fraud Claim

We shall first address the issues raised in Fayette Mall's cross-appeal. Fayette Mall filed an amended counterclaim alleging fraudulent inducement. The claim was based on alleged discrepancies between financial disclosures Stockwell provided in September 2004 while negotiating Brenco's lease and Brenco's subsequent federal income tax returns. Fayette Mall conceded this claim was time-barred unless it related back to its first counterclaim. Under CR[2] 15.03(1), an amended pleading relates back to the original pleading when "the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading[.]" Fayette Mall argued its fraud claim related back to its original counterclaim because both sets of claims arose out of circumstances surrounding Brenco's lease.

We disagree. The fraudulent inducement claims related to alleged misrepresentations in Brenco's financial disclosure before the parties executed their contract. The original counterclaim related to Fayette Mall's efforts to enforce the tax provisions in the lease nearly ten years after its execution and Brenco's failure to pay rent thereafter. Although tangentially related to the parties' lease, Fayette Mall's fraud claim was a "new, factually distinct claim" that did not

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[2] Kentucky Rules of Civil Procedure.

relate back for CR 15 purposes. *Roach v. Commonwealth*, 384 S.W.3d 131, 140 (Ky. 2012).

II. Piercing the Corporate Veil

Fayette Mall argues the trial court erred by denying its attempt to pierce the corporate veil. Piercing the corporate veil is an equitable doctrine invoked by courts to allow a creditor recourse against the shareholders of a corporation. *Inter-Tel Technologies, Inc. v. Linn Station Properties, LLC*, 360 S.W.3d 152, 155 (Ky. 2012). The party seeking to pierce the corporate veil bears the burden of proof. *Tavadia v. Mitchell*, 564 S.W.3d 322, 328 (Ky. App. 2018). This is a heavy burden, and courts should disturb the legal fiction of corporate separateness only in the rarest of circumstances. *Schultz v. General Elec. Healthcare Financial Services Inc.*, 360 S.W.3d 171, 174 (Ky. 2012).

Piercing the corporate veil is permissible only when the following elements exist: "(1) domination of the corporation resulting in a loss of corporate separateness *and* (2) circumstances under which continued recognition of the corporation would sanction fraud or promote injustice." *Inter-Tel*, 360 S.W.3d at 165 (emphasis original). Regarding the first element, courts give the most emphasis to "grossly inadequate capitalization, egregious failure to observe legal formalities and disregard of distinctions between parent and subsidiary, and a high degree of control by the parent over the subsidiary's operations and decisions, particularly those of a day-to-day nature." *Id.* at 164 (quoting 1 Phillip I. Blumberg, et al., *Blumberg on Corporate Groups* § 11.03[A] (2d ed. 2012).

Fayette Mall argues it produced sufficient evidence Brenco was undercapitalized because Brenco's own tax returns showed that the company returned a net flow profit of only $10,718 from 2005 to 2013. However, "adequacy of capital is to be measured as of the time of formation of a corporation. A corporation that was adequately capitalized when formed but subsequently suffers financial reverses is not undercapitalized." 1 Fletcher, *Cyclopedia of Law of Private Corporations* § 41.33 (footnotes omitted). Brenco's allegedly low profit returns after its formation were not relevant to a piercing analysis. Moreover, inadequate capitalization means "capitalization very small in relation to the nature of the business of the corporation and the risks attendant to such businesses." *Id.* Fayette Mall produced no evidence that the assets disclosed in Brenco's tax returns were inadequate to meet the risks attendant to its business.

Fayette Mall also complains that Brenco did not observe corporate formalities. However, it was undisputed Brenco held annual meetings and submitted annual reports with the Kentucky Secretary of State. Fayette Mall's contention Brenco did not observe corporate formalities depends entirely on the fact that Stockwell injected nearly $150,000 into Brenco through a promissory note due to himself. Generally, corporate formalities are violated when the corporate assets are diverted to shareholder, not vice versa. *Tavadia*, 564 S.W.3d at 328. Fayette Mall also conceded to the trial court that Brenco repaid its debt to Stockwell only when cash was available and never at full interest. Although Stockwell's injection of his own funds into Brenco may have been unusual, doing so only improved the financial health of the company and its ability to pay its creditors. Under these circumstances, the trial court correctly found that Fayette Mall failed to show piercing the corporate veil was appropriate.

III. Jury Trial

We now turn to the issues presented in Brenco's appeal. Brenco argues it had a right to a jury on the parties' respective breach of contract claims. It contends it was entitled to rely on a demand in Fayette Mall's amended counterclaim requesting a "trial by jury on all claims so triable." We disagree under the facts of this case.

Brenco is correct that a demand for a jury trial will ordinarily prohibit a bench trial unless the other party consents. CR 38.04; *Hazard Coal Corp. v. Knight*, 325 S.W.3d 290, 295 (Ky. 2010). However, Brenco's lease stated that "With respect to any litigation arising out of this Lease, Tenant hereby expressly waives the right to trial by jury and the right to file any countersuit or crossclaim against Landlord." The effect of this waiver was that Brenco's fraud and breach of contract claims did not constitute claims "so triable" when Fayette Mall filed its amended counterclaim. Federal courts interpreting a nearly identical rule in the Federal Rules of Civil Procedure have repeatedly found that a jury demand cannot override a contractual jury waiver. *Walton v. Eaton Corp.*, 563 F.2d 66, 71-72 (3d Cir. 1977) (holding that previously waived right to jury trial cannot be revived through amended pleadings); *Westminster Securities Corp. v. Uranium Energy Corp.*, 255 F. Supp. 3d 490, 496 (S.D.N.Y. 2017) (collecting cases). This Court accepts guidance from federal authorities when Kentucky law is silent on a particular question pertaining to the Rules of Civil Procedure. *Sexton v. Bates*, 41 S.W.3d 452, 456 (Ky. App. 2001). Because the only claims to survive summary judgment in this case arose out of the lease, the trial court correctly found that Brenco did not have a right to a jury trial.

IV. Brenco's Fraud Claim

The trial court signed Fayette Mall's tendered order awarding it summary judgment on Brenco's fraud claims. Brenco's brief references three separate fraud claims.[3] The first fraud claim is based on Fayette Mall's assessment of fees for real estate taxes following Anchor's purchase of the Sears parcel. The second claim is based on Fayette Mall installing vending machines in the Shopping

[3] Brenco's fraud claims evolved throughout the litigation; hence, we only address its claims for fraud as they were articulated in Brenco's appellant brief.

Center. The third claim is based on Fayette Mall failing to collect taxes on kiosks located within the Shopping Center.[4]

A party claiming fraud must establish by clear and convincing evidence the following elements: "a) material representation b) which is false c) known to be false or made recklessly d) made with inducement to be acted upon e) acted in reliance thereon and f) causing injury." *United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 468 (Ky. 1999). Regarding the tax assessments, Fayette Mall argued Brenco could not prove the reliance element because it paid the increased fee on real estate taxes under protest. We agree. Even if Fayette Mall's tax assessments were inaccurate, Brenco cannot claim it detrimentally relied on Fayette Mall's tax assessments when it paid the increased fees for real estate taxes under protest and sued to recover the disputed amount. The trial court correctly determined that this fraud allegation was actually a breach of contract claim. Brenco has not pointed this Court to any affirmative misrepresentations by Fayette Mall regarding the vending machines and kiosks. Thus, we affirm the award of summary judgment on all of Brenco's fraud claims. The dispute over tax assessments and vending machines will be discussed in further detail while addressing Brenco's other claims.

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[4] Brenco believes the kiosks should have been required to pay a share of the real estate taxes levied on the Shopping Center, which would have reduced the fees Brenco owed to Fayette Mall.

V. Brenco's Breach of Contract Claim

When Sears owned its parcel of property, it paid the accompanying real estate taxes. As a result, the taxes levied on the store were not included in the assessment Fayette Mall used when determining Brenco's share of real estate taxes. Fayette Mall stopped providing Brenco and other tenants an offset for the real estate taxes paid on the former Sears building after it was purchased by Anchor. It did so under a provision under the lease stating "Tenant's share of real estate taxes shall be computed by multiplying the total amount of taxes assessed against the Shopping Center less only amounts contributed towards such taxes by the tenants, occupants or owners of Anchor Stores (other than Landlord [Fayette Mall] *and/or its affiliates*)[.]" Nonetheless, Brenco contends Fayette Mall breached its lease by requiring its tenants to pay a share of the real estate taxes owed by Anchor. Brenco's argument contradicts the language of the lease, which clearly states a tenant's share of real estate taxes would not be offset by contributions made by Fayette Mall's affiliates. Brenco did not dispute Anchor was Fayette Mall's affiliate. Brenco also asserts that it did not have to contribute to the real estate taxes owed on the Sears building while Sears remained a tenant of Anchor. This argument contradicts the provision in Sears' lease in which Anchor assumed liability for the real estate taxes. Accordingly, the trial court correctly found that Brenco's breach of contract claims failed.

VI. Business Torts

Fayette Mall owned and operated vending machines near Brenco's food and beverage store. Brenco argues Fayette Mall's failure to disclose its ownership of the vending machines supports its claims for tortious interference with prospective economic advantage and tortious interference with advantageous business relationship. However, the parties' lease stated "Landlord preserves the right to . . . install vending devices in such areas, including public areas, common areas, and malls[.]" A defendant's assertion of a bargained for contractual right will not support a claim for tortious interference. *National Collegiate Athletic Ass'n By and Through Bellarmine College v. Hornung*, 754 S.W.2d 855, 860 (Ky. 1988). Brenco argues the lease permitted Fayette Mall to install vending machines owned by a third parties, but ownership by Fayette Mall constituted tortious interference with its tenant's business interests. Brenco's interpretation of the lease reads language into an unambiguous contract that is not there. Nor is it a reasonable interpretation of the lease, as third-party ownership of the vending machines would not have been any more disadvantageous to Brenco's business interest than ownership by its landlord. The trial court correctly granted summary judgment on Brenco's claims for tortious interference with prospective economic advantage and tortious interference with advantageous business relationship.

VII. Wrongful Use of Civil Proceedings

Brenco argues the trial court should have permitted its claim for wrongful use of civil proceedings to go to trial because it obtained summary judgment on Fayette Mall's counterclaims. The elements for wrongful use of civil proceedings are: (1) the institution or continuation of judicial proceedings; (2) by or at the insistence of the plaintiff; (3) termination of such proceedings in the defendant's favor; (4) malice in the institution of such proceedings; (5) lack of probable cause; and (6) damages as a result of the proceedings. *D'Angelo v. Mussler*, 290 S.W.3d 75, 79 (Ky. App. 2009). "In determining probable cause for initiation of civil proceedings, all that is necessary is that the claimant reasonably believe that there is a sound chance that his claim may be held legally valid upon adjudication." RESTATEMENT (SECOND) OF TORTS § 675, cmt. e (1977). On issues of law, the question is whether it was reasonable to believe there was a sound chance the court might sustain the claim. *Id.* cmt. f. After reviewing the evidence in this case, we are confident that Brenco could not prove lack of probable cause.

Fayette Mall's fraud and piercing claims were based on its accusation that Brenco lied about its financial health during lease negotiations. According to Brenco's 2004 financial disclosure, the company had assets worth $108,542 as of August 2004. However, Fayette Mall's expert reviewed Brenco's subsequent tax returns and concluded this information differed significantly from what Brenco reported in its 2005 federal income tax return. This evidence provided a basis to believe Brenco's 2004 financial disclosures intentionally inflated the company's available assets. Fayette Mall's argument that its fraud claim was not time-barred was not so devoid of merit that it amounted to a lack of probable cause. Although this evidence did not show Brenco was inadequately capitalized for piercing purposes, a Kentucky appellate court has yet to publish an opinion explicating stating that capitalization must be measured at the time of formation. Thus, we believe Fayette Mall had at least probable cause for its fraudulent inducement claim and its request to pierce the corporate veil.

VIII. *Sua Sponte* Award of Summary Judgment

Brenco argues the trial court's judgment must be reversed because it reconsidered, *sua sponte*, previous orders denying Fayette Mall summary judgment. We disagree. An order denying summary judgment is interlocutory and is subject to revision at any time before the entry of judgment. CR 54.02. A trial court's decision to reconsider an earlier order denying summary judgment is reviewed for an abuse of discretion. *Davidson v. Castner-Knott Dry Goods Co., Inc.*, 202 S.W.3d 597, 602 (Ky. App. 2006). "The test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair, or unsupported by sound legal principles." *Id.* (quoting *Sexton v. Sexton*, 125 S.W.3d 258, 272 (Ky. 2004)). Brenco was given an opportunity to respond to all of

Fayette Mall's dispositive motions. Brenco has not alleged any new argument it would have raised or discovery it would have conducted had the trial court proceeded differently. Under these circumstances, the trial court's decision to reconsider its previous orders was not an abuse of discretion.

IX. Class Certification

The party seeking class certification bears the burden of proving four prerequisites: (a) the class is so numerous that joinder is impractical; (b) there are questions of law and fact common to the class; (c) the claims or defenses of the class representatives are typical of the claims or defense of the class; and (d) the class representative will fairly and adequately protect the interest of the class. CR 23.01. A trial court decision to deny class certification is reviewed for an abuse of discretion. *Nebraska Alliance Realty Co. v. Brewer*, 529 S.W.3d 307, 311 (Ky. App. 2017).

The trial court found Brenco did not show joinder was impractical because Brenco readily identified the proposed class members. Brenco argues this finding was an abuse of discretion because it identified ninety-eight tenants assessed the same Sears tax bill. However, there is no magic number or formula that satisfies the numerosity requirement. *Hensley v. Haynes Trucking, LLC,* 549 S.W.3d 430, 443 (Ky. 2018). "Practicability of joinder also depends on the size of the class, the ease of identifying its members and determining their addresses, facility of making service on them, and their geographic dispersion." *Id.* Brenco has not provided this court with any reason to believe it would be impractical to identify and provide service to ninety-eight business entities operating out of same shopping center. We can also find no error in the trial court's finding that Brenco failed to show commonality of typicality given Brenco's failure to present evidence that other members in its class had identical or substantial similar leases with Fayette Mall. Even if Brenco's claims had merit, we find no abuse of discretion in the denial of its motion for class certification.

X. Motion to Add a Party

CBL and Associates Properties, Inc. ("CBL") negotiated Brenco's lease for Fayette Mall's predecessor in interest, Lexington Joint Venture ("LJV"). Brenco eventually moved to add CBL as a party because of representations CBL made to Brenco while negotiating the lease. The parties then entered into a joint stipulation that CBL was LJV's agent during the lease negotiations, and the trial court marked the motion as resolved by agreed order. On appeal, Brenco argues the trial court committed reversible error by excluding CBL as a party. We agree with Fayette Mall that the parties' stipulation means that there is not an adverse trial court order for Brenco to appeal. An appellate court is without authority to review issues not decided by the trial court. *Ten Broeck Dupont, Inc. v. Brooks*, 283 S.W.3d 705, 734 (Ky. 2009). No further discussion on this issue is warranted.

XI. Punitive Damages

Brenco argues that the trial court erred by awarding punitive damages on a breach of contract claim. The trial court did no such thing. What it did do was enforce a liquidated damages provision in the lease permitting, in the event of a breach by Brenco "twice the Minimum Annual Rent per month[.]" This clause explicitly stated it was not a penalty but mere recognition that "the actual damages Landlord will incur by reason of Tenant's failure to comply with terms of this Section are likely to be uncertain and not easily proven." It was undisputed Brenco failed to provide rent for certain months and was evicted from the Shopping Center before completing its lease. "Where, at the time of the execution of the contract, damages may be uncertain in character or amount, or difficult to reasonably ascertain, a provision for liquidated damages will be enforced, provided the amount agreed upon is not greatly disproportionate to the injury which might result." *United Services Auto. Ass'n v. ADT Sec. Services, Inc.*, 241 S.W.3d 335, 340-41 (Ky. App. 2006). Besides mislabeling the trial court's award of damages as "punitive," Brenco has not articulated any reason why the liquidates damages provision in its lease was unenforceable under Kentucky law. We therefore decline to disturb the trial court's award of damages.

XII. Denial of Litigation Costs

Brenco argues the trial court erred by denying its motion for litigation costs because summary judgment was entered on Fayette Mall's counterclaims. Stockwell does not cite any statute or contract provision entitling it to costs. "[W]ithout a sound basis in contract or statute, a trial court may not award attorneys' fees. The trial court is still empowered to order a party to pay attorneys' fees as a sanction, but only when the integrity of the court is at stake." *Seeger v. Lanham*, 542 S.W.3d 286, 295 (Ky. 2018). Despite Brenco's efforts to cast Fayette Mall in the most villainous light, the integrity of the judicial process was never at stake in this case.

XIII. Conclusion

The judgment of the Fayette Circuit Court is affirmed.

JONES, JUDGE, CONCURS.

TAYLOR, JUDGE, CONCURS IN RESULT ONLY.

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