

## The Professional Service Corporation and “Qualified Persons”



Thomas W. Volk

When extending credit to a Professional Service Corporation (herein, “PSC”) in Kentucky, lenders should take note of important statutory distinctions between a PSC and other entity borrowers. KRS Chapter 274 sets forth specific

requirements related to a “Qualified Person” that must be taken into account when making a loan to a PSC and when taking collateral as security for repayment of the loan.

Capabilities and the respective authorities of owners and managers of any entity are important factors in lending decisions, even to the extent that loan documents often include a material change in ownership or management as an “event of default.” Generally, an entity’s governing body may name anyone it chooses to hold various officer positions or to serve on the board of the entity. However, if the entity happens to be a PSC, all shareholders, all officers other than secretary and treasurer, and not less than one-half (1/2) of the directors must meet the definition of “Qualified Person” as set forth in statutes applicable to the PSC.

In Kentucky, in addition to statutes (e.g., KRS Chapters 14A and 271B) that relate to the creation and operation of corporations generally, a PSC is also subject to its own chapter, namely KRS 274.

**KRS 274.005(2)** broadly defines “Professional Service” as

“...any type of personal service to the public which requires as a condition precedent to the rendering of such service the obtaining of a license or other legal authorization and which, prior to the passage of this chapter and by reason of law or a professional code of ethics, could not be performed by a corporation. The personal services which come within the provisions of this chapter are the personal services rendered by but

not limited to certified public accountants, public accountants, chiropractors, osteopaths, physicians and surgeons, doctors of medicine, doctors of dentistry, podiatrists, chiropodists, architects, veterinarians, optometrists and attorneys-at-law.”

**KRS 274.005 (4)** defines “Qualified Person” as

“a natural person, partnership, limited liability company, or professional service corporation which is eligible under this chapter to own shares issued by a professional service corporation.”

**KRS 274.017** describes the persons and entities to whom a PSC may issue shares, and to whom the shareholders thereof may transfer or pledge shares, fractional shares, and rights and options to purchase shares. The statute also provides that any issuance, pledge or transfer in violation of this section (other than by operation of law or court decree) is void. This is important to the lender who may be considering taking a pledge of PSC shares as collateral because, under this section, the pledge may not be enforceable.

**KRS 274.015**, with reference to KRS Chapter 271B, establishes the criteria for the formation of a PSC and what must be included in the articles of incorporation:

“(1) One (1) or more individuals, each of whom is licensed to render the same professional service or who are licensed to render related professional services such that applicable licensing laws and regulations would not prohibit the practice of such multiple professional services through a single business partnership, may incorporate and form a professional service corporation by filing articles of incorporation in the office of the Secretary of State. Such articles of incorporation shall meet the requirements of KRS Chapter 271B, and in addition to the

*(Continued)*

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## The Professional Service Corporation and “Qualified Persons” (Continued)

information required by KRS 271B.2-020, such articles shall contain the following:

...(c) **A statement by the incorporator or incorporators that each of the incorporators, shareholders, not less than one-half (1/2) of the directors, and each of the officers other than secretary and treasurer is a qualified person [emphasis added] within the meaning of this chapter.**”

Similarly, **KRS 274.105** requires each PSC to file an annual report as provided in KRS 14A.6-010, which states that “...[e]ach entity and foreign entity authorized to transact business in this Commonwealth shall deliver to the Secretary of State for filing an annual report that sets forth...with respect to each... Professional service corporation, domestic or foreign, a statement that each of the shareholders, not less than one-half (1/2) of the directors, and each of the officers other than secretary and treasurer is a qualified person.”

Finally, **KRS 274.027** provides that “not less than one-half (1/2) of the directors of a professional service corporation and all the officers other than the secretary and treasurer shall be qualified persons with respect to the corporation.”

These statutes demonstrate that the concept of “Qualified Person” is determinative of who can hold specific positions within the PSC and as to transferability of shares in the PSC. This all becomes very real when the lender learns that the person listed in the official corporate records, or the person who signed loan documents as an officer other than secretary or treasurer, either never was or has lost her/his status as a “qualified person,” or when the sole shareholder of a PSC has died.

Some of the issues that may arise include whether the loan documents are valid; whether the PSC can continue to operate; and what steps can be taken at the beginning of the lending relationship or in the middle of it when such questions arise. Is an opinion of counsel sufficient protection? Maybe, but that opinion may contain reference to counsel making an *assumption* but having no actual knowledge to the contrary, that natural persons involved on behalf of the client have sufficient legal capacity to enter into the transaction or carry out their role in it. Should the lender request that the borrower provide more specific verification that a PSC’s officers are “Qualified Persons” under the statute? Can a lender rely on the certification as to the qualified status of officers required to be filed with the Secretary of State as part of the annual report?

As answers to these and other questions may vary depending upon specific factual circumstances, it is recommended that lenders have discussions about the same with counsel.

*Thomas W. Volk*

## Same-Sex Married Couples and Real Property in Kentucky



P. Branden Gross



Laura C. Tipton

In *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015), the U.S. Supreme Court held that same-sex couples have the constitutional right to marry and to have their marriages recognized in every state, including the

Commonwealth of Kentucky. The *Obergefell* decision dictates, among other things, that same-sex married couples now have the same real property rights as opposite sex married couples. These rights include the right to own real property as tenants by the entirety, as well as the rights to dower/curtesy and the attendant requirements of joinder (signature) of spouses in any conveyance, mortgage, or other transfer.

Only spouses may own real property as tenants by the entirety. The salient features of a tenancy by the entirety include a right of survivorship that one spouse cannot sever through his or her unilateral act, i.e., a spouse’s unilateral sale or mortgage of such real property would not give the grantee or mortgagee any present right of possession. Additionally, with the exception of federal tax liens, judgment creditors may not seize one spouse’s interest and sell it separately.

In Kentucky, under KRS 381.050(1), tenancy by the entirety is disfavored. Married couples must express their intent to hold real property as tenants by the entirety (e.g., “to husband and wife, with right of survivorship”) or they will take the real property as mere tenants in common. Thus, it is important to ask same-sex married couples purchasing real property together how they want to take title, and then to reflect their wishes expressly in deeds of conveyance.

In addition to the right to hold real property as tenants by the entirety, married couples in Kentucky enjoy the rights to dower/curtesy. Under KRS 382.020, when an individual dies intestate, his or her surviving spouse is entitled to an estate in fee of one-half of the real property the other spouse owned in fee simple at death, as well as a life estate in one-third of the real property the other spouse owned in fee simple *during the marriage but not at the time of death*. For this reason, any time a married individual in Kentucky conveys, mortgages, or transfers real property, the signature of his or her spouse is required to release the dower/curtesy rights. The real property industry has not settled on how to designate the marital status of same-sex couples in real-property instruments to memorialize such release. At this time, like opposite-sex couples, local practices are dictating such designation, and those practices are diverse, e.g., “husband and husband;” “married to each other;” “a married couple.” But, practitioners working with same-sex couples should be mindful of dower/curtesy rights, the associated signature requirements, and properly memorializing the release of such rights.

*P. Branden Gross and Laura C. Tipton*

## M&P Obtains \$1.412 Million Jury Verdict on Behalf of Citizens National Bank



Thurman Senn

In early March, M&P went to trial in federal court to ask a jury to decide the extent to which an Eastern Kentucky community bank had been damaged when a defendant bank had breached four “participation agreements.” The case was *Citizens National Bank of Paintsville v. MCNB Bank And Trust Company*, No. 7:12-102-KKC (U.S. District Court, Eastern District of Kentucky, Pikeville Division). After deliberating less than two hours, jurors awarded Citizens National’s entire damage claim in the amount of \$1,412,650.64. M&P represented Citizens National Bank from the very beginning of the lawsuit and was assisted at trial by Russell Davis of the Pikeville law firm, Baird & Baird PSC. **Thurman Senn** was M&P’s lead counsel on the case. **Visit [MorganandPottinger.com](http://MorganandPottinger.com) for a full case summary.**

## Kentucky Supreme Court Amends Part IV of the Rules of Administrative Procedures



Molly Rose

On January 1, 2016, the Kentucky Supreme Court amended Part IV of the Rules of Administrative Procedures, relating to the practice of Master Commissioners. A noticeable addition to the Rules was Section 5, dealing with General Provisions of Judicial Sales. As many mortgage lenders were likely aware when dealing with foreclosures throughout the state, the time frame for

which a matter could move through foreclosure by and large depended on the county in which it was filed and the individual practices of the Master Commissioner within that county. These rules now standardize the practice, so mortgage lenders should expect greater uniformity.

Though more than one advertisement of the sale may be requested, notices of sale now only require a single publication no less than seven days or more than 21 days before the sale. Section 5 requires that all sales occur within a reasonable time not to exceed 90 days from the date of the order of referral to the Master Commissioner. If a property is “vacant and abandoned,” then the sale shall be held “expeditiously.” All successful purchasers are now required to pay full cash or make a deposit of 10% of the purchase with the balance paid within 30 days. A bond with surety (as approved by the Master Commissioner) shall be executed for any unpaid balance, and it shall bear 12% interest. A judgment creditor is only allowed to credit bid up to its judgment amount. If a judgment creditor bids over its judgment amount, then it appears it too will be required to execute the bond and surety. The report of sale shall be filed no later than three business days after the date of sale. Finally, the Master Commissioner shall execute and deliver the deed to the purchaser of the property no later than five business days after the court has confirmed the sale and approved the deed, and all costs, fees, and/or purchase price have been paid.

In sum, these rules should create greater consistency and efficiencies of foreclosures throughout the state.

*Molly Rose*

## Awards & Recognitions

Morgan & Pottinger is pleased to announce that **Thomas Coffey**, **Taylor Hamilton** and **Bradley Salyer** have been named shareholders of the firm.



Thomas Coffey



Taylor Hamilton



Bradley Salyer

Morgan & Pottinger’s **Thomas Coffey**, **John T. McGarvey** and **Molly E. Rose** have been recognized as “Top Lawyers” in *Louisville Magazine*.



Thomas Coffey



John T. McGarvey



Molly Rose

Morgan & Pottinger sponsored the University of Kentucky College of Law Alumni Reception at Vincenzo’s Italian Restaurant in Louisville on March 3.



Pictured L to R: Mindy Sunderland (M&P), Jared Cox (BGD) and Taylor Hamilton (M&P)



Pictured L to R: Chris Gorman (Attorney General of Kentucky, 1992-1996), David Brennan (Dean of the University of Kentucky College of Law) and John McGarvey (M&P)



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## FirmNews

### **M&P IS PLEASED TO ANNOUNCE:**

M&P obtained a \$1.412 million jury verdict on behalf of Citizens National Bank of Paintsville, in the U.S. District Court for the Eastern District of Kentucky, in loan participation action.

**Bradley Salyer** was accepted into the 2016 class of Leadership Bowling Green.

**Branden Gross** testified in front of the Kentucky House Banking & Insurance Committee on February 10, 2016, in support of House Bill 335.

M&P has joined the Kentucky League of Cities Cornerstone Partner Program.

M&P was a silver sponsor of the 2016 Mortgage Bankers Association of Kentucky Education Conference.

#### **Please note our new address in Louisville:**

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Actual resolution of legal issues depends on many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter. If you have any questions about this newsletter, or suggestions for future articles, contact Eric Jensen, Editor.

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