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NOT TO BE PUBLISHED

Commonwealth Of Kentucky
Court of Appeals

NO. 2004-CA-002487-MR
AND
No. 2005-CA-000162-MR

TRUSERV CORPORATION

APPELLANT/CROSS-APPELLEE

v. APPEAL AND CROSS-APPEAL FROM CARLISLE CIRCUIT COURT
HONORABLE WILLIAM LEWIS SHADOAN, JUDGE
CIVIL ACTION NO. 03-CI-00005

FLEGLES, INC.

APPELLEE/CROSS-APPELLANT

OPINION
REVERSING ON DIRECT APPEAL
AND AFFIRMING ON CROSS-APPEAL

** ** * * *

BEFORE: KNOPF AND TACKETT,¹ JUDGES; HUDDLESTON, SENIOR JUDGE.²

HUDDLESTON, SENIOR JUDGE: In 1924, the Flegle family opened a lumberyard and hardware store in the small rural town of Bardwell, Kentucky. The lumberyard and hardware store is still

¹ Judge Julia K. Tackett concurred in this opinion prior to her retirement effective June 1, 2006.

² Senior Judge Joseph R. Huddleston sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

owned by the Flegle family through a family-owned and operated corporation known as Flegles, Inc. (The corporation, the family and the hardware store will be referred to hereinafter as "Flegles".) In 1976, Flegles joined a hardware cooperative, Cotter & Company. In 1997, Cotter & Company merged with another hardware cooperative to form the cooperative now known as TruServ Corporation (Cotter & Company as well as TruServ will be referred to hereinafter as "TruServ".) TruServ is a Delaware corporation with its principal place of business in Chicago, Illinois. In 1997, Flegles became a member of TruServ.

In the early 1990s, Flegles began to consider expanding its business, and, in 1994, it purchased property on which it built a new store in 1999. In 1996, TruServ offered to prepare, free of charge, a customized market and operational analysis of Flegles' hardware business. Then, using this analysis, TruServ would recommend how Flegles could enhance its future profitability. Flegles accepted TruServ's offer and provided the corporation the information necessary for TruServ to prepare the analysis.

TruServ produced a 500 page written projection containing recommendations for Flegles, referred to hereinafter as the "1996 projections." In the 1996 projections, TruServ recommended that Flegles would benefit if it expanded to a new location with a new store containing 28,800 square feet of

space. TruServ also recommended that Flegles add a rental program at the new location. TruServ allegedly told Flegles that the rental program could generate annual revenues between \$127,000.00 and \$202,000.00. According to Flegles, TruServ told Flegles that the expansion would not be successful without the addition of the rental program. Later, Flegles would allege that TruServ knew that the rental program would only generate average annual revenues of \$68,000.00 and would allege that TruServ's projections were not customized to Flegles' particular needs but were mere "boilerplate".

In early 1999, Flegles asked TruServ to perform yet another analysis to make sure that the proposed expansion was still feasible. According to TruServ, it prepared three different projections, one was favorable, one was less favorable and the other was unfavorable. According to Flegles, TruServ only revealed the most favorable projections to Flegles. Flegles maintains that it did not learn about the other projections until years later.

Despite the fact that all of TruServ's projections contained disclaimers that they were for general guidance only and that they did not represent a guarantee of future performance, Flegles claimed that it specifically relied on the favorable 1999 projections when it decided to build a new store

at a new location and to add the rental program. In doing so, Flegles incurred nearly \$3 million in debt.

In the 1999 projections, TruServ made estimates regarding Flegles' future sales for the years 2000, 2001 and 2002. In 2000, Flegles' sales fell short of TruServ's estimation. In 2001, Flegles' sales were close to TruServ's estimation. However, in 2002, Flegles' sales fell far short of TruServ's estimation. In 2000, Carlisle County experienced a recession in its construction industry; in addition, Flegles spent more money on advertising and salaries than assumed by TruServ when it prepared the 1999 projections. In 2001, western Kentucky experienced an economic downturn, along with the rest of the nation, after the terrorist attacks on September 11, 2001. In early 2002, the beginning of construction season in Carlisle County was delayed due to poor weather, and a large box hardware franchise store opened in nearby Paducah that competed with Flegles.

By the summer of 2002, Flegles decided to seek a loan from the United States Department of Agriculture. In its loan application, Flegles referenced the 1999 projections. During that same year, Flegles claimed that it learned for the first time that TruServ did not have the lowest prices, as it had advertised for many years. In fact, according to Flegles, the ACE hardware cooperative had lower prices.

To further complicate matters, by the fall of 2002, Flegles owed an outstanding debt to TruServ. When TruServ tried to collect the debt, Flegles became less than cordial and threatened to sue TruServ over TruServ's loss of \$131 million due to an inventory accounting error made by the co-op a few years earlier. According to Flegles, in early 2000, it learned that TruServ had lost the \$131 million during 1997, 1998 and 1999, and Flegles claimed that TruServ concealed the loss from its members. Later, Flegles would claim that had it known about the \$131 million loss, it would not have expanded to the new location. Nevertheless, Flegles remained a member of TruServ until late 2002.

On February 12, 2003, Flegles filed suit against TruServ in Carlisle Circuit Court.³ In its complaint, Flegles claimed that TruServ breached the membership agreement between Flegles and TruServ; committed fraud when it concealed the loss of \$131 million in profits; made negligent misrepresentations regarding the 1996, 1997 and 1999 projections; breached fiduciary duties owed to Flegles and fraudulently induced

³ Another hardware store, Elias Family Center, Inc., was named as an additional plaintiff in the complaint filed in February 2003. Elias is an Illinois corporation with its principal place of business in Cairo, Illinois. On July 30, 2004, Carlisle Circuit Court ordered Elias's claims tried separately.

Flegles to enter into a membership agreement with TruServ in 2000.⁴

The jury trial in the present case began on July 26, 2004, and ended on July 30, 2004. After the close of the evidence, the trial court instructed the jury regarding fraud and fraud in the inducement. The jury found TruServ liable on both claims and awarded Flegles \$1.3 million in damages. TruServ immediately moved for judgment notwithstanding the verdict (JNOV) or, in the alternative, for a new trial. But the trial court denied TruServ's motion and entered judgment against the co-op. This appeal, and a subsequent cross-appeal from Flegles, followed.

TRUSERV'S ARGUMENTS FOR REVERSAL AS A MATTER OF LAW

On appeal, TruServ argues that the trial court erred when it failed to grant judgment in TruServ's favor as a matter of law. According to TruServ, Flegles' fraud claim was based on three allegations: (1) TruServ made fraudulent misrepresentations in the 1996 and 1999 projections; (2) TruServ fraudulently concealed from Flegles that the co-op had lost \$131 million in profit between 1997 and 1999; and (3) TruServ fraudulently advertised that it had the best prices when, in fact, it did not. TruServ insists that none of these

⁴ Flegles raised this claim in an amended complaint.

allegations justify the jury's verdict in light of the current state of the law in this Commonwealth.

TruServ relies on *McHargue v. Fayette Coal & Feed Co.*⁵ for the proposition that for a misrepresentation to be used as the basis for fraud, it must relate to a past or present material fact, as opposed to a prediction of the future. TruServ also cites *Papa John's Int'l, Inc. v. Dynamic Pizza, Inc.*⁶ and *Moseley v. Owensboro Municipal Housing Com'n*⁷ and argues that, in a fraud case, it is unreasonable for a person to rely upon estimates of future profits. Finally, TruServ points out that the projections contained disclaimers that they were not guarantees of future profitability. According to TruServ, Mark Flegle, the president of Flegles, testified that Flegles was aware of the disclaimers found in the projections. Thus, TruServ concludes that Flegles could not have relied upon the projections as guarantees of future performance.

When this Court reviews a trial court's decision to deny a motion for judgment notwithstanding the verdict, we apply the same standard of review that we use when reviewing a lower court's decision to deny a motion for a directed verdict.⁸ When

⁵ 283 S.W.2d 170, 172 (Ky. 1955).

⁶ 317 F. Supp. 2d 740, 749 (W.D. Ky. 2004).

⁷ 252 S.W.2d 880, 881 (Ky. 1952).

⁸ *Prichard v. Bank Josephine*, 723 S.W.2d 883, 885 (Ky. App. 1987).

a trial court considers a JNOV motion, it must view the evidence in a light that is most favorable to the opposing party and give the opposing party every fair and reasonable inference that can be drawn from the evidence.⁹ Furthermore, the trial court may only grant judgment notwithstanding the verdict where "there is a complete absence of proof on a material issue in the action, or if no disputed issue or fact exists upon which reasonable men could differ."¹⁰

It has long been the law in the Commonwealth that to prevail on a claim of fraud, a plaintiff must establish, by clear and convincing evidence, six elements: (1) that the declarant made a material misrepresentation to the plaintiff, (2) that this misrepresentation was false, (3) that the declarant knew it was false or made it recklessly, (4) that the declarant induced the plaintiff to act upon the misrepresentation, (5) that the plaintiff relied upon the misrepresentation, and (6) that the misrepresentation caused injury to the plaintiff.¹¹ However, as TruServ points out, for a declarant's misrepresentation to be used as the basis for fraud, it must relate to an existing or past fact.¹² If the alleged

⁹ *Taylor v. Kennedy*, 700 S.W.2d 415, 416 (Ky. App. 1985).

¹⁰ *Id.*

¹¹ *United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 468 (Ky. 1999).

¹² *Edward Brockhaus & Co. v. Gilson*, 92 S.W.2d 830, 834 (Ky. 1936).

misrepresentation relates to a future promise or an opinion of a future event, then it is not actionable.¹³

Flegles observes that Kentucky's highest court has adopted Section 542 of the Restatement (Second) of Torts which provides that

[t]he recipient in a business transaction of a fraudulent misrepresentation of the maker's opinion upon facts known to the recipient is not justified in relying thereon in a transaction with the maker unless the opinion is material and the maker (a) holds himself out as having special knowledge of the matter which the recipient does not have, or (b) stands in a fiduciary or other similar relation of trust and confidence to the recipient, or (c) has successfully endeavored to secure the confidence of the recipient, or (d) knows that the recipient will rely on his opinion.¹⁴

While Flegles claims that all four exceptions apply, it insists, in particular, that TruServ had special knowledge regarding the projections that Flegles did not have and that TruServ had a fiduciary relationship with it. Thus, it concludes, it could use the projections, which were opinions regarding future events, as the basis for a fraud claim.

¹³ *Id.* See also, *McHargue v. Fayette Coal & Feed Co.*, *supra*, note 4; *Church v. Eastham*, 331 S.W.2d 718 (Ky. 1960); and *Rivermont Inn, Inc. v. Bass Hotels Resorts, Inc.*, 113 S.W.3d 636 (Ky. App. 2003).

¹⁴ *Johnson v. Lowery*, 270 S.W.2d 943, 945, quoting Restatement (Second) of Torts § 542 (Ky. 1954).

Flegles reliance on *Johnson v. Lowery* is misplaced. Johnson, a real estate broker who had worked for many years for Ms. Lowery, agreed to sell Lowery a home he owned.¹⁵ Johnson told Lowery that the value of the property was \$26,000.00. Lowery bought the property, but when she subsequently sold it she learned it was worth only \$17,000.00.¹⁶ Lowery sued Johnson for fraudulent misrepresentation and recovered \$9,000.00.¹⁷ Johnson claimed that his opinion about the price of the property was "sales talk" or "puffing."¹⁸ In adopting Section 542 of the Restatement (Second) of Torts, the *Johnson* court held that Lowery was justified in relying on Johnson's statement regarding the purchase price the property.¹⁹ In *Johnson*, the real estate broker's statement regarding the purchase price related to an existing material fact. In this case, TruServ's alleged misrepresentations were opinions regarding future events. Thus, *Johnson* and its exceptions do not apply.

We conclude, therefore, as a matter of law that Flegles could not base a claim of fraud on the projections prepared by TruServ since they did not relate to either a past or an existing fact.

¹⁵ *Id.* at 944.

¹⁶ *Id.* at 945.

¹⁷ *Id.* at 944.

¹⁸ *Id.* at 945.

¹⁹ *Id.*

At trial, Mark Flegle testified that had Flegles known about the \$131 million loss due to TruServ's inventory accounting error, Flegles would not have expanded to the new location. According to Mark Flegle, his company needed a strong hardware co-op with which to expand. TruServ, on the other hand, contends that TruServ's losses during 1997, 1998 and 1999 had no connection with Flegles' subsequent losses. Thus, TruServ argues, to establish fraud Flegles had to prove that TruServ's \$131 million loss prior to the expansion was the proximate cause of the losses experienced by Flegles after the expansion. And, to establish proximate cause, TruServ contends, Flegles had to prove more than "but for" causation.²⁰ TruServ points out that Mark Flegle testified that TruServ's losses did not cause Flegles to lose profits after the expansion. According to TruServ, Flegles failed to prove that TruServ's 1997, 1998 and 1999 losses proximately caused Flegles' subsequent losses.

"Proximate cause" is defined as: "1. A cause that is legally sufficient to result in liability. 2. A cause that directly produces an event and without which the event would not have occurred."²¹ Flegles claims that TruServ's loss of \$131 million prior to the expansion caused Flegles to lose profits

²⁰ *Bruck v. Thompson*, 131 S.W.3d 764, 767-768 (Ky. App. 2004).

²¹ Bryan A. Garner, *Black's Law Dictionary* 213 (7th ed. 1999).

after the expansion. To support this proposition, Flegles relies on Mark Flegle's testimony, noted above, that had Flegles known about the \$131 million loss it would not have expanded because it required a strong co-op with which to expand. Flegles does not explain how this testimony establishes proximate cause, that is, how TruServ's \$131 million loss directly produced Flegles' subsequent loss of profits. So, at trial, Flegles failed to establish one of the essential elements of fraud: causation. Since it failed to establish causation, the trial court should have directed a verdict in TruServ's favor.

Also at trial, Flegles claimed that TruServ fraudulently claimed to have the best prices. Citing *McHargue v. Fayette Coal & Feed Co.*,²² TruServ argues that such a claim is merely "sales talk," which is also known as "puffing"; and TruServ insists that "sales talk" can not serve as the basis for fraud.²³ According to TruServ, Flegles has been in the hardware business since the 1970's and it has performed comparisons between TruServ's prices and the prices of TruServ's competitors. Since Flegles had access to TruServ's prices and the prices of TruServ's competitors, Flegles could not use TruServ's sales talk regarding its prices as a basis for fraud.

²² *Supra*, note 4, at 171.

²³ *Id.* at 172.

As the *McHargue* court pointed out, sales talk is a universal and expected practice. Accordingly, the court held that such representations were not actionable as fraud where the parties have dealt with one another at arm's length and each have equal access to the information.²⁴ There are four exceptions to this rule where: (1) the declarant holds himself out as having special knowledge which the recipient does not have, or (2) the declarant has a fiduciary duty to the recipient, or (3) the declarant has successfully gained the confidence of the recipient, or (4) the declarant knows that the recipient will rely of his opinion.²⁵ However, the exceptions set forth in *Johnson* do not apply to this case. According to Mark Flegle's testimony, representatives from various other hardware co-ops had visited Flegles for many years attempting to lure the hardware store away from TruServ. Thus, Flegles would have had access to pricing information from TruServ's competitors. And, as TruServ points out, Flegles eventually did its own price comparison between TruServ and its competitors, although at trial Mark Flegle claimed this document had been lost during discovery and so was never disclosed to TruServ. The first exception in *Johnson* does not apply.

²⁴ *Id.*

²⁵ *Johnson v. Lowery, supra*, note 13, at 945.

The existence of a fiduciary relationship is a question of fact left for the jury.²⁶ The jury in this case was not given an opportunity to and did not make a finding of fact that a fiduciary relationship existed between TruServ and Flegles. Thus, the second exception does not apply. As for the last two exceptions, there is no evidence that TruServ sought to gain Flegles' confidence nor is there evidence that TruServ expected Flegles to rely on TruServ's sales talk. Thus, Flegles could not use TruServ's sales talk as the basis for a claim of fraud.

TRUSERV'S ARGUMENT FOR REVERSAL BASED ON ERRORS DURING VOIR DIRE

TruServ argues that, during the *voir dire* examination of potential jurors, several of them openly admitted to being biased in favor of Flegles. While there is merit to TruServ's argument, we find it unnecessary to address it given our disposition of this appeal.

FLEGLES' ARGUMENTS ON CROSS-APPEAL

In Flegles' complaint, it claimed that TruServ breached its fiduciary duty and that TruServ made negligent misrepresentations to Flegles. Flegles insists that it proved both of these claims at trial. Thus, Flegles argues, the trial court erred when it failed to instruct the jury regarding both of these claims.

²⁶ See *Trieseler v. Helmbacher*, 168 S.W.2d 1030, 1036 (Mo. 1943), cited in. 36A Corpus Juris Secundum, *Fiduciary* (1961).

Alleged errors regarding jury instructions are questions of law that this Court reviews *de novo*.²⁷ "Instructions must be based upon the evidence and they must properly and intelligibly state the law."²⁸ While Flegles' claims it has proved that TruServ breached its fiduciary duty and proved TruServ made negligent misrepresentations, it cites to nothing in the record to support its argument. Thus, we assume that the evidence did not support an instruction for either breach of fiduciary duty or negligent misrepresentation.

CONCLUSION

The judgment is reversed on direct appeal and is affirmed on cross-appeal.

ALL CONCUR.

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²⁷ *Howard v. Commonwealth*, 618 S.W.2d 177, 178 (Ky. 1981).

²⁸ *Id.*