

**Commonwealth of Kentucky**  
**Court of Appeals**

NO. 2006-CA-001508-MR

BONNIE J. GIBSON TAYLOR and  
RICKY GIBSON

APPELLANTS

v. APPEAL FROM BOONE CIRCUIT COURT  
HONORABLE KEVIN HORNE, JUDGE  
ACTION NO. 02-CI-01762

FIRST SECURITY TRUST BANK, INC. F/K/A  
FIRST SECURITY TRUST BANK, F.S.B.;  
BUILDER'S CABINET & SUPPLY COMPANY;  
BUDDY'S CARPET & FLOORING, INC.;  
H & M CONSTRUCTION CO.;  
ARLINGHAUS ELECTRIC, INC.; and  
BOONE COUNTY, KENTUCKY

APPELLEES

OPINION  
AFFIRMING

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BEFORE: ACREE AND NICKELL, JUDGES; BUCKINGHAM, SENIOR  
JUDGE.<sup>1</sup>

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<sup>1</sup> Senior Judge David C. Buckingham sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statutes (KRS) 21.580.

NICKELL, JUDGE: Bonnie Gibson Taylor and Ricky Gibson (collectively “Gibson”) have appealed from the March 22, 2006, judgment entered against them by the Boone Circuit Court. For the following reasons, we affirm.

Ricky and Bonnie, then husband and wife, contacted Kathy Zembrodt (“Zembrodt”), a mortgage broker, as they began looking for a lot on which to build a new home. Zembrodt, along with John Roth (“Roth”), owned Roth Builders, LLC (“Roth Builders”), a construction company. In August 2001, the Gibsons entered into a construction contract with Roth Builders for the purchase of a lot and the construction of a new custom home.

In September 2001, Zembrodt submitted a loan application to First Security Trust Bank, Inc. (“First Security”), seeking an interim construction loan for \$243,900.00 to finance the building of the Gibsons’ new home. Before the loan was finalized, First Security discovered a federal tax lien had been filed against Roth Builders. After refusing to finance the construction loan for Roth Builders, First Security reconfigured the loan in the Gibsons’ names.<sup>2</sup> Under the reconfigured loan, the Gibsons took title to the lot and became the borrowers, while Zembrodt and Roth became the guarantors. After this construction loan matured, the Gibsons were to obtain permanent financing from another lender.

The interim construction loan closed on November 1, 2001. The construction loan agreement specifically required all requests for advances, or

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<sup>2</sup> The Gibsons were never told First Security had denied a construction loan to Roth Builders.

“draw requests,” be signed by the borrowers.<sup>3</sup> On the date of the closing, Zembrodt and Roth presented First Security with an initial draw request for \$42,028.51 to begin the construction project. First Security dispersed this money without the Gibsons’ signatures on the draw request, although the Gibsons were present at this meeting when it was presented. First Security also issued two other disbursements without the Gibsons’ written authorization, making the total of unauthorized disbursements \$47,468.07. In paying out the remainder of the loan proceeds, they also issued four disbursements which were authorized by the Gibsons and made direct payments to the subcontractors as well.

As the loan funds were disbursed, lien releases were provided to First Security from some, but not all, subcontractors involved in the construction. Bonnie Gibson testified at trial she understood First Security would provide the lien releases. However, the Construction Loan Agreement stipulated the borrower (Gibson) was to provide all lien releases.

In April 2002, the \$243,000.00 interim construction loan was fully disbursed, but the home remained incomplete. Bonnie Gibson was unaware of the complete disbursement of the loan, and contended that according to her records, \$47,000.00 remained to be disbursed. Although the loan was intended to be fully due and payable on June 1, 2002, the date the promissory note matured, the

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<sup>3</sup> The Construction Loan Agreement reads as follows, “The Borrower shall submit a request for advance in the form approved by the Lender, executed by the Borrower and Borrower’s General Contractor. Unless otherwise specified by Lender, all requests for advances shall be made on or accompanied by AIA Form G-702/703.”

Gibsons, citing construction deficiencies, refused to make final payment. In September 2002, Zembrodt and Roth ceased operating Roth Builders and individually filed for bankruptcy. Five subcontractors filed mechanic's liens against the property for unpaid work. Other subcontractors remained unpaid but did not file mechanic's liens.

The Gibsons occupied the house for over four years without making any payments on the promissory note to First Security. They were able to move into the home despite the fact they had not closed the loan or paid the builder and subcontractors as the loan and deed for the property were in their names, rather than in Roth Builders' name.

In late 2002, First Security instituted foreclosure proceedings. Four of the unpaid subcontractors joined in their suit. The Gibsons counterclaimed against First Security for breach of contract, negligence, breach of fiduciary duty, fraud, and for violations of the Consumer Protection Act. The matter was ultimately docketed for a jury trial in early 2006.

Following the close of all of the evidence at trial, the judge instructed the jury on the Gibsons' breach of contract claim and granted a directed verdict on the remaining counterclaims. The jury returned a unanimous verdict in favor of First Security and judgment was entered accordingly. The Gibsons subsequently filed for bankruptcy resulting in the discharge of their liability to First Security and the subcontractors. The home was later sold at a judicial sale. This appeal followed.

The Gibsons contend the trial court made numerous errors relating to their counterclaims against First Security. These alleged errors include: ruling on issues as a matter of law instead of submitting them to the jury; incorrectly instructing the jury as to the breach of contract counterclaim; erroneously admitting into evidence real estate appraisals without the testimony of the appraiser; and precluding the introduction of evidence to rebut the admitted appraisals.

#### I. FAILURE TO INSTRUCT THE JURY ON GIBSONS' COUNTERCLAIMS

The Gibsons first contend the trial court erroneously failed to instruct the jury on their counterclaims against First Security. Specifically, the Gibsons point to the failure of the trial court to instruct on their counterclaims of breach of fiduciary duty, fraud by misrepresentation, fraud by omission, and violation of the Kentucky Consumer Protection Act. We will address these counterclaims individually to determine whether any warranted an instruction.

##### A. Breach of Fiduciary Duty

The Gibsons suggest their relationship with First Security created a fiduciary duty. While they concede banks are not traditionally considered to be in a fiduciary relationship with their customers, they argue the construction loan, promissory note and mortgage with First Security created such a relationship. Furthermore, the Gibsons suggest the fiduciary relationship imposed a duty upon

the bank to act in good faith and to fairly represent their interests as borrowers.

The Gibsons claim First Security breached this affirmative duty.

The facts in this case relating to First Security's relationship with the Gibsons are generally undisputed. Therefore, it was proper for the trial court to decide as a matter of law whether a fiduciary relationship existed between the parties and whether the Gibsons' counterclaim warranted a jury instruction. *CSX Transportation, Inc. v. First Nat. Bank of Grayson*, 14 S.W.3d 563 (Ky.App. 1999) (citing *Wolford v. Scott Nickels Bus Co.*, 257 S.W.2d 594 (Ky. 1953)).

Kentucky case law has established that generally, banks do not owe a fiduciary duty to their customers, especially to their borrowers. *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 485 (Ky. 1991). However, in some loan transactions, banks owe a fiduciary duty to borrowers to "disclose material facts affecting the loan transaction." *Id.* at 485. We have also found banks owe a fiduciary duty when they are in a relationship with their customers that is based on a high level of trust and confidence. *Henkin, Inc. v. Berea Bank & Trust Co.*, 566 S.W.2d 420 (Ky.App. 1978).

Although Kentucky courts have indicated a fiduciary relationship may exist between some banks and borrowers, we cannot conclude the facts in this case warrant a finding of such a relationship. The Gibsons had no dealings with First Security prior to this loan. The construction loan was written as interim financing only, and the relationship between the Gibsons and First Security was intended to be temporary. First Security was not providing any ongoing services to the

Gibsons. Therefore, First Security did not have a long standing history with the Gibsons on which a relationship of trust and confidence could be built. The facts of this case make it apparent no fiduciary relationship was created between the Gibsons and First Security.

Additionally, the relationship between First Security and the Gibsons does not qualify as an agency relationship. In Kentucky, courts have recognized agency as a type of fiduciary relationship created when one party has consented for the other to “act on his behalf subject to his control.” *CSX Transportation, Inc. v. First National Bank of Grayson*, 14 S.W.3d 563, 566 (Ky.App. 1999). Such is not the case here. Nowhere in the construction loan agreement do the Gibsons authorize First Security to act on their behalf. The nature of the relationship created between these two parties does not give First Security control or discretion over the Gibsons’ activities. Because the relationship between the Gibsons and First Security does not constitute either a fiduciary or agency relationship, the trial court correctly refused to instruct the jury on the breach of fiduciary duty counterclaim.

#### B. Fraud by Misrepresentation

The Gibsons also counterclaimed against First Security for fraudulent misrepresentation. To establish a claim for fraud, a claimant must establish six elements by clear and convincing evidence: 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) (citing *Wahba v. Don Corlett Motors, Inc.*, 573 S.W.2d 357, 359 (Ky.App. 1978)).

The Gibsons have failed to show First Security made such fraudulent misrepresentations to warrant a jury instruction. They argue First Security acted fraudulently when its officials reassured them everything was going fine and according to schedule, when it guaranteed payment to certain subcontractors, and when it informed them Roth Builders was entitled to pre-completion payments. We cannot find any of these representations rise to the level of fraud.

The Gibsons have not demonstrated First Security's conduct satisfied the six elements necessary to establish a claim of fraud. *Rickert, supra*. First, none of the alleged fraudulent conduct constituted a material representation because none of the statements made by the Bank went to the essence of the contract. Also, the Gibsons failed to demonstrate First Security made the statements to induce the Gibsons to act in any certain way or that they were in fact induced to act.

Further, the Gibsons have not shown the representations made by First Security were known by its officials to be false or were made recklessly. No evidence adduced at trial indicated First Security's officials had knowledge of serious problems with the loan or the construction project when they assured the Gibsons everything was going fine. Moreover, nothing in the loan agreement stipulates Roth Builders would not receive pre-completion payments; therefore, First Security did not misrepresent to the Gibsons that Roth was entitled to payment. The Gibsons failed to produce sufficient evidence warranting an



instruction on this claim. Thus, the trial court was correct in refusing to submit this issue to the jury.

### C. Fraud by Omission

To establish a claim for fraud by omission, the Gibsons had to show First Security had a duty to disclose a material fact, failed to disclose that fact, the failure induced them to act, and they suffered actual damages. *Smith v. General Motors*, 979 S.W.2d 127, 129 (Ky.App. 1998). The Gibsons failed to produce such evidence.

The Gibsons argue First Security failed its duty to disclose several material facts. First, they argue First Security failed to disclose the amount of disbursements made without their authorization. However, the record demonstrates the Gibsons were present at the closing when First Security dispersed the sum of \$42,028.51 to Zembrodt and Roth without their signatures on the draw request. Thus, the Gibsons were on notice that such disbursements were made. Second, they argue First Security failed to disclose the lack of mechanic's lien releases to accompany those disbursements. However, the Construction Loan Agreement clearly stipulated the Gibsons, as borrowers, were to provide all lien releases. Third, they argue First Security failed to disclose the prior denial of a construction loan to Roth Builders. However, the mere fact First Security chose to reconfigure the loan with the Gibsons as sole borrowers should have placed the Gibsons on reasonable notice to inquire as to the necessity for the reconfiguration.

Thus, after reviewing the evidence, we hold the Gibsons failed to carry their burden of establishing the required elements to sustain a fraud by omission claim.

Moreover, in Kentucky, a duty to disclose is created only between parties having a confidential or fiduciary relationship or when a statutory duty exists. *Rivermont Inn, Inc. v. Bass Hotels & Resort, Inc.*, 113 S.W.3d 636, 641 (Ky.App. 2003). Because First Security was not in an agency or fiduciary relationship with the Gibsons, it owed no duty to disclose material facts. Therefore, it cannot be liable for fraud by omission and the Gibsons were not entitled to a jury instruction on this claim.

#### D. Violations of Kentucky's Consumer Protection Act

The Gibsons also claim the trial court erred in refusing to instruct the jury on their counterclaim asserting First Security violated the Kentucky Consumer Protection Act ("the Act").<sup>4</sup> Specifically, the Gibsons argue First Security acted in violation of the Act in releasing loan funds outside the provisions of the loan agreement, i.e., without their express written consent. The Gibsons rely on KRS 367.170, which states:

- (1) Unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.
- (2) For the purposes of this section, unfair shall be construed to mean unconscionable.

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<sup>4</sup> KRS Chapter 367.

However, the Gibsons have failed to show First Security committed “false, misleading, or deceptive acts” in its loan transactions with the Gibsons. Again, a large portion of the contested disbursements were made by First Security to Zembrodt and Roth in the Gibsons’ presence at the closing. The Gibsons thus had reasonable notice of such disbursements and practices. Kentucky case law has clearly established a consumer may recover under the Act only if they demonstrate intentional or grossly negligent conduct that amounts to “substantial wrongs” rather than mere irritations. *Capital Cadillac Olds, Inc. v. Roberts*, 813 S.W.2d 287, 291 (Ky. 1991) (citing *Dare to Be Great, Inc. v. Commonwealth*, 511 S.W.2d 224 (Ky. 1974); *Feathers v. State Farm Fire and Casualty Co.*, 667 S.W.2d 693 (Ky.App. 1983)).

Even if First Security’s conduct violated the loan agreement as claimed, we are unable to conclude its behavior amounted to the intentional or gross negligence required. While we agree First Security should not have disbursed the loan funds without the Gibsons’ written authorization, there is no question the funds disbursed by First Security were to pay the subcontractors working on Gibsons’ home, nor that these subcontractors were entitled to receive payment for their labors.

The Gibsons have offered no proof to suggest the funds released by First Security were in any way mishandled, or the subcontractors who submitted invoices prior to complete disbursement of the loan proceeds were not paid. They have also failed to establish they were in anyway harmed by First Security’s

allegedly negligent conduct. The Gibsons claimed they would have been more careful and would have asked more questions had they known the status of their loan. However, this unsupported statement falls short of establishing the loan or the construction project would have been better handled had the Gibsons known about the problems. First Security was not grossly or intentionally negligent in releasing loan funds, nor were they negligent in their assurances to the Gibsons that everything was going fine with the project. Therefore, the trial court correctly refused to instruct the jury on this claim.

## II. JURY INSTRUCTION ON GIBSONS' BREACH OF CONTRACT CLAIM

The Gibsons' counterclaim for breach of contract was the only counterclaim on which the trial court instructed the jury. In support of their argument, the Gibsons asserted First Security materially breached the Construction Loan Agreement when it issued disbursements without their authorization and without receiving mechanic's lien releases from the subcontractors. In regard to this counterclaim, the trial judge issued the following interrogatory:

Do you find that the Plaintiff, First Security Trust Bank, Inc. breached the Construction/Term Loan Agreement by disbursing loan proceeds without the authorization of the Defendants, Gibson, that the disbursement was a material breach of the of the (sic) Agreement, and that as a result of said breach, the Defendants Gibsons suffered a pecuniary loss?

The Gibsons argue this interrogatory was insufficient because it failed to include information about the lack of mechanic's lien releases to accompany

First Security's disbursements. They contend the instruction should have included information about disbursements made to Roth Builders that were unaccompanied by mechanic's lien releases. The Gibsons argue the lien release issue was important to their counterclaim alleging First Security materially breached the loan agreement in disbursing the loan proceeds, and the trial court should have included the requested information about lien releases in its interrogatory.

We believe this interrogatory adequately encompassed all the Gibsons' contentions that First Security breached the loan agreement. Whether the Bank breached the agreement by disbursing the funds without releases was adequately covered by the court's interrogatory, because it questions whether the disbursements, in general, were a breach of the loan agreement. Furthermore, because the loan agreement stipulated Gibson, not First Security or Roth Builders, was to provide the lien releases, we are unable to conclude as a matter of law that First Security was in breach of the agreement by releasing the funds without such releases. Therefore, we hold the instruction was proper and adequately presented the issue to the jury.

### III. EVIDENTIARY ISSUES

Finally, the Gibsons contend certain evidentiary rulings of the circuit court were made in error. They claim the trial court erroneously overruled their motion *in limine* to exclude two written appraisals regarding the market value of their home. They further contend the trial court erred in allowing the appraisals to be presented as evidence, without the accompanying testimony of the appraisers

who prepared the written reports. The Gibsons contend the appraisals constituted inadmissible hearsay without accompanying testimony from the appraisers to authenticate the reports and submit to cross-examination. They further argue the trial court erred in not allowing them to introduce additional valuations of their home rebutting First Security's appraisals.

First Security contends the appraisals were relevant evidence and were properly admitted by the trial court. The appraisals were not introduced in an effort to show the actual value of the property, but rather, they were introduced to demonstrate First Security acted with due diligence in their business dealings with the Gibsons by ordering two separate appraisals of the home.

While the appraisals constituted written assertions entered into evidence without the testimony of the appraisers who prepared them, they did not constitute hearsay evidence under KRE<sup>5</sup> 801 since they were not introduced to prove the truth of the matter asserted—the value of the Gibsons' home—but rather they were offered to prove the due diligence of the Bank. The purported valuations of the Gibsons' home were irrelevant. Because the appraisals had the tendency to prove or disprove First Security acted with due diligence, they were properly admitted under KRE 401 as relevant evidence.<sup>6</sup> Furthermore, the trial judge was correct in preventing the Gibsons from introducing additional evidence to

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<sup>5</sup> Kentucky Rules of Evidence.

<sup>6</sup> KRE 401 defines relevant evidence as “evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence.”

challenge First Security's appraisals because the actual value of the home was not disputed.

#### IV. CONCLUSION

For the reasons stated herein, the judgment of the Boone Circuit Court is affirmed.

ALL CONCUR.

BRIEF FOR APPELLANT:

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BRIEF FOR APPELLEE:

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