COURT OF APPEALS OF WISCONSIN
DISTRICT I

SCOTT SMITH,

Plaintiff-Respondent-
Cross-Appellant,

ALPHA CARGO TECHNOLOGY, LLC,

Plaintiff,

Appeal No.: 2015-AP-207

v.

GREG KLEYNERMAN,

Defendant-Appellant-
Cross-Respondent,

RED FLAG CARGO SECURITY SYSTEMS, LLC,

Defendant.

Appeal from the Circuit Court for Milwaukee County
Honorable Pedro Colon, Presiding
Case No. 2011CV18551

REPLY BRIEF OF CROSS-APPELLANT SCOTT H. SMITH

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INTRODUCTION

Smith proved that Kleynerman made three statements, and all of the evidence at trial showed that the statements were unquestionably false. Kleynerman cannot point to any credible evidence to support a finding that the statements were true. Kleynerman's argument against a new trial ignores the evidence of jury confusion, and attempts to categorize a logically inconsistent verdict as a legally superfluous one. Finally, Smith is entitled to a new trial on punitive damages because the trial court failed to properly instruct the jury to resolve the inconsistent answers involving the punitive damages questions.

ARGUMENT

I. THE COURT ERRED IN DENYING SMITH'S MOTION TO CHANGE THE JURY'S ANSWER TO QUESTION 5.

A. THE JURY'S ANSWER THAT KLEYNERMAN'S STATEMENTS WERE "NOT UNTRUE" WAS UNSUPPORTED BY EVIDENCE.

1. There Was No Credible Evidence That Glaser and Grinberg Intended to Invest $250,000 in ACT.

It is not reasonable to infer that Kleynerman's statement regarding the $250,000 investment meant that Glaser and Grinberg would invest money that would benefit ACT. (R.156, 10:2-15, R.App.293.) The evidence was clear that

Glaser and Grinberg did not invest in ACT. Kleynerman must therefore argue that the jury could have inferred that Glaser and Grinberg agreed to invest in production that benefitted ACT. The evidence in support of that argument is sorely lacking. Kleynerman points only to the absence of a different statement, namely that "ACT, not Red Flag, would open a manufacturing and distribution facility;" ACT's financial situation in 2009; and supposed benefit to ACT in the form of opportunities to receive sales commissions. (Resp't's Br. 7–8.) Kleynerman addresses neither Glaser's nor Kleynerman's statements at trial that there was never any plan to invest in ACT, and that the plan was always to create a separate company. (R.154, 51:18-21, R.App.261; R.152, 179:11-12, 191:2-3.)

Kleynerman must suggest an alternative interpretation of the statement because there is no evidence that the statement, as it is written, is "not untrue." The jury was not asked if Kleynerman misrepresented that Glaser and Grinberg would invest in *production* that would benefit ACT. The jury was asked if Kleynerman misrepresented that Glaser and Grinberg would invest $250,000 *into ACT*. (R.112, 2, A.App.104.)

2. No Credible Evidence Supports the Finding that It Was "Not Untrue" that "Kleynerman and Smith Would Still Own 49% of ACT After the Sale."

Kleynerman next argues that the statement that Kleynerman and Smith would own 49% of ACT after the sale is true because Smith and Kleynerman still own more than 49% of ACT. (Resp't's Br. 7–8.)

First, the statement is demonstrably false because Kleynerman's and Smith's ownership interests in ACT did not change after the sale. This argument cannot distract from the fact that the jury's answer was unsupported by any evidence. The jury was asked to decide whether or not the statement was "untrue." (R.112, 2, A.App.104.) Kleynerman admits that the statement is false by stating that Kleynerman and Smith still each own 50% of ACT. (Resp't's Br. 8.) The statement did not say that they would own at least 49%, which is Kleynerman's argument. Therefore, the statement standing alone *is* false, even without taking into account the other misrepresentations made by Kleynerman and his larger scheme of misrepresentation.

Second, Kleynerman misstates Smith's argument as claiming that the "statement was false because Kleynerman and Smith ended up owning *more* than 49% of ACT after the transaction." (*Id.* at 7.) Kleynerman told Smith that, after the transaction, together they would own 49% of ACT *because Glaser*

and Grinberg were investing in ACT. Smith believed he would partly own the company that was continuing ACT's work in the security seal business. For the statement to be true, Kleynerman's and Smith's joint ownership interest must have decreased from 100% to 49%. The ownership interests did not change, and it undisputed that Kleynerman and Smith did not own 49% of ACT after the sale. Accordingly, there is no credible evidence in the record to support the jury's finding.

3. No Credible Evidence Supports the Jury's Finding That Grinberg and Glaser Needed Smith to Remain on at ACT After the Transaction.

Kleynerman seeks to add words like "ongoing" or "perpetual employment" to the representation about Smith's role after the Transaction in order to bolster his argument that it was true. (Resp't's Br. 8–9.) Glaser's testimony was clear: Smith's contacts were the only thing he wanted from Smith.

Glaser testified that "[w]e needed sales and I didn't have the contacts for sales and they had the knowledge." (R.152, 181:3-4.) Smith's knowledge and connections were crucial to Glaser's decision to *invest* in the venture. (App. Br. 15; R.152, 192-93.) The Transaction was structured so that Red Flag would obtain all sales opportunities and potential customers, and Smith's

knowledge and contacts would become worthless. (R.139, PX15, § 4(f), R.App.313; R.139, DX67, § 2.1(b), R.App.300.) Glaser then manufactured a reason to cut Smith out of the business altogether, despite the fact that Smith's absence from the meeting in Mexico was approved by the primary client contact, who himself was not at the meeting. (R.151, 19:18-20:12.) Although Kleynerman attempts to use Glaser's testimony to show that Smith was needed after the transaction, the testimony shows the opposite: that Smith was needed before the Transaction and during the Transaction, but not afterward.

B. KLEYNERMAN'S MISREPRESENTATIONS ARE NOT NON-ACTIONABLE STATEMENTS ABOUT FUTURE PERFORMANCE.

The evidence at trial shows that Kleynerman knew that the three representations were untrue at the time he made them. Therefore, the exception to the statements on future performance rule applies.

Kleynerman cites *Alropa Corp. v. Flatley*, a 1938 case, for the proposition that "a future promise is actionable as a misrepresentation . . . when the plaintiff can demonstrate that 'the promisor ha[d] a present intent not to perform." (Resp't's Br. 11, citing, 226 Wis. 561, 566, 277 N.W. 108 (1938)). More recently this exception has been applied to opinions about future events when "the speaker knows of facts incompatible with his opinion." *Lundin v.*

Shimanski, 124 Wis. 2d 175, 192, 368 N.W.2d 676 (1985). The record shows that Kleynerman knew of facts incompatible with his statements. As to the first statement, Kleynerman stated at trial that "[F]rom beginning never was conversation [sic] or something that Bruce first told that he will invest company to Alpha Cargo Technology." (R.154, 51:18-21, R.App.261.) If Kleynerman knew "from [the] beginning" that Glaser had no plan to invest in ACT, then he knew of a fact incompatible with his statement when he told Smith that "Glaser and Grinberg would invest at least $250,000 in ACT." (R.112, 2, R.App.104.)

Kleynerman knew that Glaser had no plans to invest in ACT, and was not going to purchase a 51% share of ACT that would leave Smith and Kleynerman with 49%. In addition, Kleynerman was copied on email correspondence in which Glaser discussed "plead[ing] ignorance" to Smith regarding the structure of the Transaction so that Smith would remain unaware of the true details of the deal. (R.139, PX44, R.App.323.) Kleynerman knew that the true nature of the deal was to strip ACT of its assets, gain access to Smith's contacts, and then cut him out of the company. Kleynerman therefore knew of facts that were incompatible with his statement, regardless of whether or not it was a statement about future performance.

In addition, an opinion about a third-party's intentions can fit into this exception. *Lundin v. Shimanski*, 124 Wis. 2d 175, 368 N.W.2d 676 (1985); *Zingale v. Mills Novelty Co.*, 244 Wis. 144, 11 N.W.2d 644 (1943). In *Lundin*, a buyer purchased an ice cream manufacturing unit because of the salesman's statement that a conditional use permit would be easily obtained for the space that was planned to be the stockroom. 124 Wis. 2d at 194. When authorities ordered the buyer to make extensive changes or discontinue operations, the buyer sued the salesman for intentional misrepresentation. *Id.* at 193. The court held that while the salesman's "representations were statements of opinion concerning how the city would handle the permit application," he knew that the space would be objectionable to the permit board and the claim was therefore not barred by the pre-existing fact rule. *Id.* at 194, 368 N.W.2d 676.

Kleynerman's statements about Glaser's post-Transaction intentions are not barred as future promises because Kleynerman knew of facts incompatible with his statements.

C. SMITH REASONABLY RELIED ON KLEYNERMAN'S MISREPRESENTATIONS.

Kleynerman argues that Smith could not reasonably rely on Kleynerman's misrepresentations because of information in the Transaction

documents. Kleynerman notes that "[w]hether the falsity of a statement could have been discovered through ordinary care is to be determined in light of the intelligence and experience of the misled individual." *Williams v. Rank and Son Buick, Inc.*, 44 Wis. 2d 239, 246, 170 N.W.2d 807 (Wis. 1969). However, Kleynerman neglects the next sentence in *Williams* which notes that "the relationship between the parties" should also be considered. *Id.*

After the death of Smith's wife, Kleynerman assumed a special role with regard to Smith. He told Smith that he should "do whatever it takes" to deal with his grief, and that he would "handle the business." (R.150, 167:18-21, R.App.174.) Kleynerman took on this fiduciary role, promising to protect Smith's interests in the Transaction. Smith trusted Kleynerman completely, and viewed him as a "brother." (R.150, 163:24, R.App.170.) Smith's reliance on Kleynerman's misrepresentations was reasonable in light of that trust and Kleynerman's promises to protect Smith's interests.

Smith was grieving and depressed while the Transaction was negotiated and consummated. He trusted that the representations of his longtime friend and co-owner were true. Kleynerman argues that Smith was an "active participant in the negotiations" (Resp't's Br. 15), but the authorship of this purported evidence of Smith negotiating terms was disputed at trial. (R.150, 195:15-222, 196:23-197:17, 198:1-23, 200:17-202:17.) Smith could barely drag

himself out of bed to sign the Transaction documents, let alone negotiate them. (R.150, 205:5-14, R.App.192; R.151, 11:2-7, R.App.202.)

Kleynerman argues that "the precise terms" of the deal were spelled out in the Memorandum of Understanding ("MOU"), Asset Sale Agreement, and Sales Representative Agreement. However, the terms of the Transaction documents are not so specific as to be inconsistent with the understanding that Kleynerman's misrepresentations created. The MOU is silent as to the amount of Glaser's and Grinberg's investments, and where those investments would be made. (R.139, PX8, R.App.298.) The MOU is also silent as to the issue of Smith's ongoing role, and it is vague, at best, regarding ownership structure. (*Id.*)

Additionally, neither the Asset Sale Agreement, nor the Sales Representative Agreement, contains language that would serve to put Smith on notice of Kleynerman's and Glaser's post-transaction plans. Both documents contain references to an investment, but are silent as to the amount and in which entity the investment would be made. Both Agreements are silent as to ownership structure, and while the Sales Representative Agreement does address ACT's role post-Transaction, it does not do so in a manner that should have alerted Smith to the fact that Kleynerman lied to him.

Kleynerman's representations gave Smith the impression that Glaser and Grinberg would invest $250,000 in ACT and they would all split the profits evenly as equal partners. (R.150, 190:6-21, 191:17-25, R.App.187-88.) Operating on that belief, Smith, a non-attorney, who was severely depressed and grieving, reasonably relied on his close friend's statements about the Transaction. The documents did not contain language specifically contradictory to Smith's understanding.

D. THE ECONOMIC LOSS DOCTRINE DOES NOT BAR SMITH'S MISREPRESENTATION CLAIM.

Kleynerman asserts that Smith's intentional misrepresentation claim is barred by the economic loss doctrine. The economic loss doctrine, however, does not apply to these facts. "It is well settled that the economic loss doctrine was created to . . . protect commercial parties' freedom to allocate economic risk by contract; and encourage the party best situated to assess the risk of economic loss, *the commercial purchaser*, to assume, allocate, or insure against that risk." *Digicorp, Inc. v. Ameritech Corp.*, 2003 WI 54, ¶ 35, 262 Wis. 2d 32, 662 N.W.2d 652 (emphasis added). This doctrine presupposes a transaction in which adverse commercial parties contracted at arm's length and that the *commercial purchaser* is best situated to assess the risk of economic loss. Thus, it has no application where, as here, a *non-adverse*, equal member of an LLC

fraudulently induced the other equal member into a series of contracts *unrelated to the purchase of goods with a third-party*.

The law of misrepresentation is particularly appropriate in business transactions to ensure that a party can formulate "business judgments without being misled by others," and that its purpose is to protect the "interest of not being cheated." *Ollerman v. O'Rourke Co.*, 94 Wis. 2d 17, 29–30, 288 N.W.2d 95 (1980). This is precisely what occurred: Kleynerman intentionally misled Smith to cheat him out of any interest in ACT's intellectual property and business goodwill by cajoling Smith into entering a series of contracts that left Kleynerman and Glaser with everything, and Smith and ACT with nothing. Kleynerman cannot hide behind the protections of the economic loss doctrine because "Wisconsin law does not allow the party perpetrating the fraud to hide behind contractual remedies." *Digicorp,* 262 Wis. 2d ¶ 39.

II. SMITH IS ENTITLED TO A NEW TRIAL ON HIS INTENTIONAL MISREPRESENTATION CLAIM.

A. INCONSISTENT VERDICT ANSWERS MUST RESULT IN A NEW TRIAL.

Kleynerman incorrectly argues that the jury's verdict was not inconsistent but rather superfluous. The case Kleynerman cites in support of this argument, *Mackenzie v. Miller Brewing Co.*, is inapposite because there, the jury awarded compensatory damages against two defendants, but awarded

punitive damages against a third defendant without any underlying award of compensatory damages. 2000 WI App 48, ¶ 86, 234 Wis. 2d 1, 608 N.W.2d 331. In *Mackenzie* the jury's conclusion was legally impossible because it did not assess any compensatory damages, but assessed punitive damages. *Id.* ¶ 85.

This case differs from *Mackenzie* because the jury not only awarded punitive damages, but also found that "Kleynerman act[ed] maliciously toward Mr. Smith, or in an intentional disregard for the rights of Smith by *intentionally misrepresenting material facts* to Smith[.]" (R.112, R.App.106.) The inconsistency is not merely the award of punitive damages alone, but also the logically inconsistent findings regarding whether Kleynerman made intentional misrepresentations. Kleynerman ignores Question 13 in order to argue that the verdict lacks inconsistency. (Resp't's Br. 24.)

The circuit court found that the verdict was inconsistent, and sent the jury back to continue deliberations, twice, before losing patience and accepting the inconsistent verdict. (R.155, 93:12-14, R.App.287.) The jury's answers to Questions 4, 5, and 13 on the Special Verdict form are "logically repugnant to one another." *Kain v. Bluemound E. Indus. Park, Inc.*, 2001 WI App 230, ¶ 40, 248 Wis. 2d 172, 635 N.W.2d 640, The verdict inconsistency here is similar to the inconsistency in *Seif v. Turowski*, an auto collision case in which the jury found that the respondent-defendant, "was negligent in the operation of his

auto but that such negligence was not a cause of the accident . . . [yet] still attributed 10 percent of the causal negligence to him." 49 Wis. 2d 15, 20, 181 N.W.2d 388 (1970). The Supreme Court held that the *Seif* verdict was inconsistent and ordered a new trial on liability due to the inconsistent verdict. *Id.* at 25. In addition, Smith did not waive the error in the verdict because, as in *Seif*, the defect was not apparent without knowing the jury's answer. *Id.* at 22.

Lack of credible evidence to support the jury's answer to Question 5 and the logically inconsistent finding in Question 13 entitle Smith to a new trial on his intentional misrepresentation claim.

B. THE JURY WAS MISLED BY THE VERDICT FORM.

Kleynerman cites *Runjo v. St. Paul Fire & Marine Ins. Co.*, as an example of when a verdict form conflicts with jury instructions. In *Runjo*, the combination of a verdict form that was inconsistent with jury instructions "in effect, allowed the jury to answer "no" and "yes" to the same question. It allowed the jury to find that [a doctor] did obtain informed consent in answering the liability question, but also to find that [he] did not obtain informed consent by awarding damages." 197 Wis. 2d 594, 604–05, 541 N.W.2d 173 (Ct. App. 1995).

Much like in *Runjo*, the verdict form allowed the jury to answer both "yes" and "no" to the question of whether Kleynerman intentionally misrepresented material facts to Smith. (R.112, A.App.103-108.) Combined with the lack of evidence to support a finding that Kleynerman's statements were true, this Court may infer that the "jury was probably misled." *Runjo v. St. Paul Fire & Marine Ins. Co.*, 197 Wis. 2d 594, 604, 541 N.W.2d 173 (Ct. App. 1995).

III. SMITH IS ENTITLED TO A NEW TRIAL ON PUNITIVE DAMAGES.

Jury confusion led to an inconsistent verdict. (R.112, A.App.103-108.) The jury intended to award punitive damages, but became confused by the verdict questions. The trial court should have instructed the jury to continue deliberating to resolve the inconsistency, and directed the jury to the appropriate questions, regarding the intentional misrepresentation questions. Because the trial court did not properly instruct the jury, a new trial on punitive damages is appropriate. *Schwigel v. Kohlmann*, 2002 WI App 121, ¶ 26, 254 Wis. 2d 830, 647 N.W.2d 362.

Reinstating the punitive damages award, alternatively, does not amount to a "transfer," as Kleynerman claims, but rather merely upholds the award to punish and deter Kleynerman's egregious conduct. A "reliance on any

particular theory of tort damages does not foreclose an award of punitive damages to deter intentional wrongdoing, if such damages are deemed appropriate." *Pro-Pac, Inc. v. WOW Logistics Co.*, 721 F.3d 781, 788 (7th Cir. 2013).

CONCLUSION

The circuit court erred in dismissing Smith's intentional misrepresentation claim, and this Court should grant a new trial on it. Additionally, a new trial should be ordered on the issue of punitive damages, or alternatively, this Court should remand for reinstatement of the $200,000 punitive damages award.

November 24, 2015,

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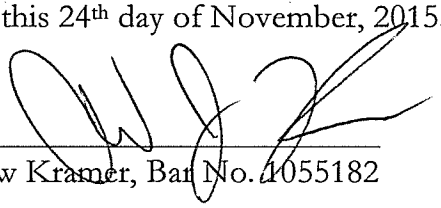
CERTIFICATION AS TO FORM/LENGTH AND ELECTRONIC BRIEF

I certify that the foregoing Reply Brief meets with the form and length requirements of Rule 809.19(8)(b) and (c) for a brief produced with a proportional serif font. The length of the brief is 2,992 words.

In accordance with Wis. Stat. § 809.19(12)(f), I hereby certify that the text of the electronic copy of the Appellant's Brief is identical to the text of the paper copy of the Appellant's Brief.

Dated this 24th day of November, 2015.



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CERTIFICATION OF SERVICE

I hereby certify that on November 24th, 2015, I filed with the Court by messenger an original and nine copies and served three copies of the Reply Brief of Cross-Appellant Scott H. Smith upon counsel for the parties by electronic and first class mail:

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