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Commonwealth of Kentucky

Court of Appeals

NO. 2015-CA-001254-MR

D.W. WILBURN, INC. APPELLANT

v.

APPEAL FROM OLDHAM CIRCUIT COURT
HONORABLE KAREN A. CONRAD, JUDGE
ACTION NO. 12-CI-00341

K. NORMAN BERRY ASSOCIATES,
ARCHITECTS, PLLC APPELLEE

OPINION
REVERSING AND REMANDING

** ** ** ** **

BEFORE: CLAYTON, STUMBO AND THOMPSON, JUDGES.

THOMPSON, JUDGE: D.W. Wilburn, Inc., appeals from a summary judgment of the Oldham Circuit Court granting summary judgment to K. Norman Berry Associates, Architects, PLLC (KNBA). The issues presented are: (1) whether Wilburn can maintain a claim for negligent misrepresentation based on allegations that KNBA failed to properly prepare plans and specifications, and otherwise

obtain permit approvals; (2) whether Wilburn's claim for purely economic loss against KNBA is barred by the economic loss rule; and (3) whether change orders and an application for final payment approval preclude Wilburn's claim against KNBA based on waiver or release. We conclude Wilburn has alleged facts sufficient to sustain a claim for negligent misrepresentation and that the economic loss rule does not apply. We further hold that Wilburn's claim is not barred based on waiver or release.

In 2005, KNBA entered into an owner/architect agreement with the Oldham County Board of Education (the Board) to design and act as architect on the construction and renovation of the North Oldham High School (the project). After the plans were prepared, the Board contracted with Wilburn to act as the general contractor on the project, which was to be completed in four phases, with a completion date of May 31, 2009. That contract incorporated the American Institute of Architects (AIA) Document A201-1997 into the contract, including its provision that any change orders be signed by the architect. Wilburn subcontracted with Link Electric, Inc. to perform the electrical work. KNBA did not have any contractual relationship with Wilburn or Link.

Under the provisions of the contract between the Board and Wilburn, claims for additional time, money or delay damages were required to be submitted within twenty-one days after the occurrence of the event giving rise to the claim or twenty-one days after the claimant first recognized the condition giving rise to the claim, whichever was later. Further, the general conditions of the contract

provided that negotiated and executed change orders resolved all claims for time and money relating to the scope of the change order. Finally, as relevant here, the general conditions provided:

> Acceptance of final payment by the Contractor, a Subcontractor or material supplier shall constitute a waiver of claims by that payee except those previously made in writing and identified by that payee as unsettled at the time of final Application for Payment.

During the course of the project, twenty change orders were signed by the Board, KNBA, and Wilburn. These change orders altered the final completion date for all phases. A comprehensive change order dated February 2, 2010, addressing various issues, including any claims regarding the final schedule and completion date, was signed by the Board, KNBA and Wilburn. Additional punch lists and closeout activity continued after that date and a final change order was not executed until February 2012. At that time, Wilburn submitted the final application for payment and signed a closeout form.

On May 4, 2012, Wilburn forwarded a letter with costs requested by Link for "general condition expenses." An email dated March 24, 2009, from Ricky George, Jr. of Link to Shannon Fraley of Wilburn claimed additional costs, including those incurred as a result of the project's delay.

After completion of the project, Link sued Wilburn asserting various claims, including that it sustained damages as a result of delays in the project's completion, which it alleged were caused by Wilburn and the Board. Wilburn filed a third-party complaint against the Board, seeking indemnity and contribution, on

any sums Link might recover from delays caused by the Board. Additionally, Wilburn filed a third-party complaint against KNBA, alleging KNBA caused the delays by failing to properly prepare plans and specifications so that the project could not be approved for a building permit without substantial delay.

Discovery commenced. Sherry Dehart, project manager for Wilburn, testified that once a project is closed, no additional amounts can be sought against the owner. Fraley, the Vice President of Field Operations and field supervisor for the project, testified that the executed change orders incorporated all costs and time relating to the issues in the change order and each was a "sort of speak now or forever hold your peace document on the issues."

The Board and KNBA filed motions for summary judgment. Wilburn conceded that the Board should be granted summary judgment based on the undisputed record and summary judgment was granted to the Board. However, Wilburn disagreed that KNBA was entitled to summary judgment.

The trial court granted summary judgment in favor of KNBA. The court's final judgment is less than clear as to the reason for dismissing KNBA. However, it appears from reviewing the hearing and the trial court's order, the trial court was persuaded by KNBA that absent privity of contract between KNBA and Wilburn, Wilburn's claim failed. Regardless of the ambiguity in the trial court's reasoning, it is this Court's duty "to consider all the grounds raised, and to affirm the judgment if it should properly have been entered on any of the grounds raised."

Richmond v. Louisville and Jefferson Cty. Metro. Sewer Dist., 572 S.W.2d 601, 602 (Ky.App. 1977).

STANDARD OF REVIEW

Summary judgment is deemed to be a "delicate matter" because it "takes the case away from the trier of fact before the evidence is actually heard." *Collins v. Kentucky Lottery Corp.*, 399 S.W.3d 449, 451 (Ky.App. 2012) (quoting *Steelvest, Inc. v. Scansteel Service Center, Inc.,* 807 S.W.2d 476, 482 (Ky. 1991)). It is improper unless the moving party shows that there is no genuine issue of material fact with "such clarity that there is no room left for controversy." *Id.* at 452. (Quoting *Steelvest*, *Inc.*, 807 S.W.2d at 482). On appeal, our standard of review is "whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." *Scifres v. Kraft,* 916 S.W.2d 779, 781 (Ky.App. 1996).

NEGLIGENT MISREPRESENTATION

The parties agree that *Presnell Const. Managers, Inc. v. EH Const., LLC*, 134 S.W.3d 575 (Ky. 2004), is applicable, but differ on how that opinion should be interpreted.

As here*, Presnell* involved construction contracts. DeLor Design Group, Inc., the owner of commercial property to be renovated, and Presnell Construction Managers, Inc. executed an AIA document, which disclaimed any contractual relationship to third parties created by the contract. DeLor later contracted with EH Construction to perform "general trades" work.

EH filed an action against DeLor, Presnell, and others. In addition to seeking to enforce a mechanics and materialman's lien, EH alleged it suffered economic losses as a result of Presnell's negligent misrepresentation and negligent supervision. Specifically, EH's complaint alleged:

> Presnell failed to 'properly stage and time the work involved' for the Project and that as a result, EH was required to redo much of the work that it had already completed, due to the other contractors and subcontractors coming in and subsequently destroying work that had already been completed by EH. Additionally, EH alleged that Presnell was careless and negligent in coordinating the Project, and supplied faulty information and guidance and supervision to the contractors working on the Project.

Id. at 578 (internal quotations and bracket omitted). Presnell moved to dismiss on the ground there was no privity of contract between it and EH and, therefore, it owed no duty of care to EH.

The trial court dismissed EH's claim against Presnell. This Court reversed based on Restatement (Second) of Torts § 552 and held that Presnell owed duties independent of its contract with DeLor and, consequently, the claims for negligent misrepresentation and negligent supervision could be maintained.

Our Supreme Court affirmed as to the negligent misrepresentation claim but reversed as to the separate claim for negligent supervision. The Court began by noting that EH was not a party to the contract between DeLor and Presnell or a third-party beneficiary to that contract. *Id*. at 576. This fact was significant. The general rule of contracts is "whenever a wrong is founded upon a

breach of contract, the plaintiff suing in respect thereof must be a party or privy to the contract, and none but a party to a contract has the right to recover damages for its breach against any of the parties thereto." *Id*. at 579 (quoting 17 Am.Jur.2d *Contracts* § 425 (1991)). Although a third-party who is an intended beneficiary of a contract may sue on the contract, incidental beneficiaries do not have such right. *Id*.

However, as the *Presnell* Court pointed out, duty, rather than privity, is a fundamental element under modern tort law. *Id*. EH could recover from Presnell, if Presnell "breached some duty to EH apart from its duties to DeLor under the contract—*i.e.* an independent duty[.] *Id*. at 579-80.

With little discussion of EH's negligent supervision claim, the Court held that it was not one independent of Presnell's contractual duties. *Id*. at 582-83. Presnell did not have a common law duty to supervise the project and, that duty, if it existed, arose only because of its contract with DeLor. Because EH could not enforce the terms of the contract, the negligent supervision claim was properly dismissed.

The focus of the majority opinion in *Presnell* was the negligent misrepresentation claim. Unlike the negligent supervision claim, it could proceed. The Court found that aside from Presnell's contractual duties to DeLor, Presnell owed an independent duty to EH arising from tort. That duty was found in Restatement (Second) of Torts § 552, which provides:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
>
> (2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
>
> (3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

Section 552 comment (a) states that "the law promotes the important social policy of encouraging the flow of commercial information upon which the operation of the economy rests." Restatement (Second) of Torts § 552 Comments (1977).

Prior to *Presnell*, Section 552 had been cited with approval in Kentucky appellate decisions, but not explicitly adopted. *Presnell*, 134 S.W.3d at 580. In *Presnell,* the Court took the opportunity to do so stating the "we join the majority of jurisdictions and hereby adopt § 552's standard for negligent misrepresentation claims[.]" *Id*. at 582. As stated by the Court: "[T]he tort of

negligent representation defines an independent duty for which recovery in tort for economic loss is available." *Id*.

Noting that the summary judgment in Presnell's favor was "essentially a dismissal for failure to state a claim for relief," the Court examined the pleadings and concluded the complaint was sufficient:

> Presnell's duty under § 552 was not to supply *false information,* and EH's complaint alleges that "Presnell ... supplied faulty information and guidance" to the Project's contractors. This allegation was sufficient to avoid what was essentially a dismissal for failure to state a claim for relief. It may develop during discovery or trial that EH cannot prove the elements of the independent tort of negligent misrepresentation, but at this time, EH's complaint sufficiently states a claim against Presnell for negligent misrepresentation.

Id.

Other jurisdictions have observed that there is no reason to exclude architects from the duty imposed under Section 552. For example, in *Davidson & Jones, Inc. v. New Hanover Cty.*, 41 N.C. App. 661, 666, 255 S.E.2d 580, 583-84 (1979), the Court stated the issue and its conclusion as follows:

> The question before us is whether in the absence of privity of contract an architect may be held liable to a general contractor and his subcontractors for economic loss resulting from breach of a common law duty of care. We answer, 'Yes.'

The Court explained its reasoning:

> An architect, in the performance of his contract with his employer, is required to exercise the ability, skill, and care customarily used by architects upon such projects. 5 Am.Jur.2d, Architects, s 8, pp. 669-70.

> Where breach of such contract results in foreseeable injury, economic or otherwise, to persons so situated by their economic relations, and community of interests as to impose a duty of due care, we know of no reason why an architect cannot be held liable for such injury. Liability arises from the negligent breach of a common law duty of care flowing from the parties' working relationship. Accordingly, we hold that an architect in the absence of privity of contract may be sued by a general contractor or the subcontractors working on a construction project for economic loss foreseeably resulting from breach of an architect's common law duty of due care in the performance of his contract with the owner.

Id. at 667, 255 S.E.2d at 584.

In *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 581 Pa. 454, 866 A.2d 270 (2005), a general contractor filed an action against an architect for alleged negligent misrepresentation in the plans and specifications upon which the contractor relied in submitting the winning bid for a school construction project. After discussing numerous cases where Section 552 has been applied in the architect/contractor scenario, the Court concluded that negligent misrepresentation was well suited to the facts:

> [G]iven the tenor of modern business practices with fewer generalists and more experts operating in the business world, business persons have found themselves in a position of increasing reliance upon the guidance of those possessing special expertise. Oftentimes, the party ultimately relying upon the specialized expertise has no direct contractual relationship with the expert supplier of information, and therefore, no contractual recourse if the supplier negligently misrepresents the information to another in privity. And yet, the supplier of the information is well aware that this third party exists (even if the supplier is unaware of his specific identity) and

> well knows that the information it has provided was to be relied upon by that party.

Id. at 479-80, 866 A.2d at 286.

To calm fear that the tort may be too broadly applied, the Court in *Bilt-Rite* pointed out that Section 552 is "narrowly tailored" and limited by its "foreseeability requirement." *Id*. at 479, 866 A.2d at 286. It observed that "Section 552 is not radical or revolutionary; reflecting modern business realities, it merely recognizes that it is reasonable to hold such professionals to a traditional duty of care for foreseeable harm." *Id*. at 480, 866 A.2d at 286.

We conclude the circuit court erred when it held that KNBA did not owe a duty to Wilburn separate from its contractual duties to the Board. Specifically, Wilburn asserts that the plans prepared by KNBA upon which Wilburn reasonably and foreseeably relied, were negligently prepared because they were rejected by the Commonwealth's Office of Housing, Building and Construction and not approved until January 2008 causing a delay in the project and causing Wilburn to incur additional costs. Like our Supreme Court in *Presnell*, we cannot say at this point, Wilburn could not prove the elements of negligent misrepresentation.

THE ECONOMIC LOSS RULE

KNBA argues that even if Wilburn has stated a claim for negligent misrepresentation, it cannot recover damages because of the economic loss rule. For several reasons, we disagree.

The economic loss rule is one created by the judiciary that "marks the border between tort and contract law." *Giddings & Lewis, Inc., v. Industrial Risk Insurers,* 348 S.W.3d 729, 738 (Ky. 2011). The rule has its origins in products liability actions where the parties' duties are defined by the Uniform Commercial Code (U.C.C.) and their contract. As observed in *Louisville Gas and Elec. Co. v. Cont'l Field Sys., Inc.*, 420 F. Supp. 2d 764, 769 (W.D. Ky. 2005), "[v]irtually every classic description of the economic loss rule pertains to and often limits its application to the sale of products [in order to] ... preserve the distinction between the remedies available under the U.C.C. and those available in tort." The rule "prevents the commercial purchaser of a product from suing in tort to recover for economic losses arising from the malfunction of the product itself, recognizing that such damages must be recovered, if at all, pursuant to contract law." *Giddings & Lewis, Inc.,* 348 S.W.3d at 733. Stated differently, "the economic loss rule prohibits purchasers of products from recovering purely economic damages under most tort theories." *HDM Flugservice GmbH v. Parker Hannifin Corp.,* 332 F.3d 1025, 1028 (6th Cir. 2003).

In *Giddings & Lewis, Inc.*, our Supreme Court "charted a course in what commentators and courts across the country have referred to as the 'choppy waters' of the economic loss rule." *Giddings & Lewis, Inc.*, 348 S.W.3d at 733. The Court held as follows:

> Today we hold that the economic loss rule applies to claims arising from a defective product sold in a commercial transaction, and that the relevant product is

> the entire item bargained for by the parties and placed in the stream of commerce by the manufacturer. Further, the economic loss rule applies regardless of whether the product fails over a period of time or destroys itself in a calamitous event, and the rule's application is not limited to negligence and strict liability claims but also encompasses negligent misrepresentation claims.

Id. Notably, the negligent misrepresentation claim fell within the realm of the sale of a commercial product because it was alleged the seller misrepresented that a diffuser cell system could operate safely at a speed specified by the purchaser.

KNBA argues that despite that the Supreme Court limited the rule "to claims arising from a defective product sold in a commercial transaction" the economic loss rule should be applied to claims under Section 552. We disagree.

KNBA relies on *Cincinnati Ins. Cos. v. Staggs & Fisher Consulting Engineers, Inc.*, 2008-CA-002395-MR, 2013 WL 1003543 (Ky.App. 2013) (unpublished). In that unpublished case, a panel of this Court stated: "Although the rule originally applied to products liability cases, it has spread into the realm of construction litigation." *Id*. at 2. KNBA argues that based on *Staggs & Fisher*, the economic loss rule applies outside the realm of products liability and applies where a service has been rendered in the form of providing information.

The case cited has no precedential value. Nevertheless, it is relied upon here and was relied upon in *NS Transp. Brokerage Corp. v. Louisville Sealcoat Ventures, LLC*, No. 3:12-CV-00766-JHM, 2015 WL 1020598 (W.D. Ky. 2015) (unpublished).

In *NS Transp. Brokerage Corp.*, the Court questioned the wisdom of the *Skaggs & Fischer* result and its view that the economic loss rule should be extended beyond the products liability realm. *Id*. at 3. Consequently, it limited the decision strictly to its facts stating:

> At most, even if one were to conclude that it was decided correctly, *Staggs & Fisher* might stand for the proposition that the economic loss rule applies to construction contracts of the sort found under the facts of that case. It cannot however, stand for the proposition that the economic loss rule applies to the type of services contract as we have in this case.

Id. Ultimately, the Court concluded that prior federal opinions interpreting Kentucky law had consistently held that Kentucky would not expand the economic loss rule to construction service contracts. *Id*. at 5.

As the federal Court noted, before and after the explicit adoption of the rule in *Giddings & Lewis, Inc.*, federal courts applying Kentucky law "consistently have held that the Kentucky Supreme Court would not apply the economic loss rule to service contracts." *Id.* at 4. However, we find it unnecessary to determine which view, that of a prior panel of this Court or the federal court, is more persuasive. The facts in this case lead us to conclude the economic loss rule is not applicable to a negligent misrepresentation claim where there is no privity of contract.

The *Presnell* decision does not mention the economic loss rule even though the claim was for "exclusively economic losses." *Presnell*, 134 S.W.3d at 576. The rule is discussed in Justice Keller's concurring opinion where he

concluded the economic loss rule precluded recovery for EH's negligent supervision claim. That conclusion, whether proven to be right or wrong, has some basis in the law because the negligent supervision claim arose from a breach of Presnell's contractual duties. Justice Keller recognized this distinction stating that with the adoption of Restatement (Second) of Torts § 552 (1977), the Court "created the independent tort action of negligent misrepresentation, which is not barred by the economic loss rule." *Id.* at 590 (Keller, J. concurring).

After *Presnell*, the federal court in *Louisville Gas and Elec. Co*., found the absence of any such discussion by the majority indicative of our Supreme Court's unwillingness to expand the economic loss rule beyond products liability cases. In doing so it reasoned:

> Defendants rely heavily upon the concurring opinions of two justices in *Presnell Const. Managers, Inc. v. EH Const., LLC,* 134 S.W.3d 575, 583 (Ky. 2004) (Keller, J., concurring). However, that concurring opinion is not persuasive evidence that Kentucky courts will apply the economic loss rule to services. *Presnell* and EH are similarly situated to LG & E and Advanced Welding in that neither pair were in privity nor maintained a contractual relationship. Consequently, the economic loss rule, which bars tort claims among those in a contractual relationship for the sale of goods, by definition could not apply. Concurring opinion neither considered nor analyzed the difficulties of applying the rule to circumstances beyond the sale of goods. Moreover, the Court's majority decided the case without any reference to the economic loss rule.
>
> This Court believes that it is on sound ground in predicting that Kentucky courts would apply the economic loss rule in its classic definition. However, it would be pure speculation to suggest that Kentucky

> courts would adopt the broader application of the rule discussed in the *Presnell* concurrence.

Louisville Gas and Elec. Co., 420 F.Supp.2d at 769-70 (footnote omitted).

Whatever limitations on the economic loss rule that our Supreme Court ultimately accepts or rejects, we are convinced that it does not apply to a claim under Section 552 where there is no contractual relationship between the parties. It is the very purpose of the tort to compensate purely economic losses when there is no contractual remedy available but there is a breach of the duty described in that Section. To apply the rule would essentially eviscerate the tort. We agree with the Court in *Bilt-Rite,* 581 Pa. at 484, 866 A.2d at 288, that the result would simply be "nonsensical." "[I]t would allow a party to pursue an action only to hold that, once the elements of the cause of action are shown, the party is unable to recover for its losses." *Id*.

We conclude that the economic loss doctrine does not apply to a claim of negligent misrepresentation in the architect/contractor scenario. In accordance with *Presnell*, *Giddings & Lewis, Inc.*, and persuasive state and federal case law, we hold that KNBA is not entitled to summary judgment on the basis of the economic loss rule.

WILBURN'S WAIVER OR RELEASE OF ITS NEGLIGENT MISREPRESENTATION CLAIM

KNBA argues that even if Wilburn can proceed on its negligent misrepresentation claim under Section 552, the final change order executed after the substantial completion date and the final application for payment was

submitted and the project closed out, any claims for delay damages against KNBA were settled and resolved. Again, we disagree.

Summary judgment is appropriate when a party's claim for damages is barred by a contractual provision. *See Codell Const. Co. v. Commonwealth,* 566 S.W.2d 161 (Ky.App. 1977). The question is whether there was a contract between KNBA and Wilburn wherein Wilburn waived or released its negligent misrepresentation claim. KNBA's reliance upon the various change orders signed by the Board, KNBA and Wilburn and the general condition clauses in the contract between the Board and Wilburn is misplaced.

As Wilburn conceded below, the provisions of the contract between the Board and Wilburn, the change orders and final application for payment would preclude any claim for delay damages against the Board. However, as stated earlier, KNBA was not a party to those documents and cannot seek to enforce their provisions.

The change orders common in the construction industry modified the contract between the Board and Wilburn, which included the provisions of the 1997 version of the AIA document A201. Section 7.2 of that AIA document requires change orders to be made by a written instrument prepared by the architect and signed by the owner, contractor, and architect, stating their agreement upon the change in the work, as well as the amount of the adjustment, if any, in the contract sum and the extent of the adjustment, if any, in the contract time. While KNBA's signature was required by the terms of the contract between Wilburn and the

Board, the change orders did not constitute a contract between KNBA and Wilburn.

There is nothing in the change orders or application for final payment which would waive or release a negligent misrepresentation claim against KNBA. "Absent a provision to the contrary, one specifically endorsed by [KNBA], any change order executed by the parties affected only the contract between [the Board] and [Wilburn]." *Nelson v. Commonwealth*, 235 Va. 228, 245, 368 S.E.2d 239, 249 (1988). KNBA was not entitled to summary judgment on the basis of waiver or release.

CONCLUSION

As in *Presnell*, it may be that Wilburn cannot prove the elements of negligent misrepresentation. We merely hold that summary judgment was improper based on the ground that Wilburn has not stated a claim for negligent misrepresentation under *Presnell*. We further hold that the economic loss rule does not apply to a claim of negligent misrepresentation where there is no privity of contract. Finally, we hold that Wilburn's claim for negligent misrepresentation against KNBA was not waived or released.

Based on the foregoing, the summary judgment of the Oldham Circuit Court dismissing Wilburn's claim for negligent misrepresentation against KNBA is reversed and the case remanded for further proceedings.

ALL CONCUR

BRIEF FOR APPELLANT:

Morgan H. Eaves
Michael R. Eaves
Richmond, Kentucky

ORAL ARGUMENT FOR APPELLANT:

Michael R. Eaves
Richmond, Kentucky

BRIEF AND ORAL ARGUMENT FOR APPELLEE:

Robert M. Brooks
Louisville, Kentucky