



STATE OF KENTUCKY CONSTRUCTION COMPENDIUM OF LAW

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In General

The following compendium of construction law in the Commonwealth of Kentucky is designed as an overview of basic legal principles and for use as a research tool. It is not meant to be a comprehensive summary of relevant law, nor is to be interpreted as providing legal advice to the reader.

I. KENTUCKY FAIRNESS IN CONSTRUCTION ACT

The Kentucky Fairness in Construction Act adopted in 2007 by the Kentucky General Assembly has modified previous construction law in many significant areas. The practitioner should closely scrutinize the requirements of that act to determine whether it applies to their particular project. The provisions of the Kentucky Fairness in Construction Act apply to both private and public construction projects, but not to residential construction projects. The Act applies to contracts entered into after the effective date of July 1, 2007.

One effect of the Act is allowing costs and attorney's fees to be awarded to the prevailing party if the non-prevailing party is found to have acted in bad faith. Also, the Act caps retainage which can be held to ten percent until half of the work is completed and five percent thereafter, and requires the release of retainage within thirty days of substantial completion (as defined in the Act) of the project.

The Act establishes time limits for payments; undisputed amounts due from an owner or Public Authority must be made to a contractor within thirty business days of receipt of a proper request for payment. The time limit is forty-five business days for post-secondary institutions. The Act modifies mechanics' lien rights by allowing a Lien Statement to be filed on the latter of (a) 60 days of the last day of the month in which services are provided or (b) by the date of substantial completion; further, upon entry of Judgment under the Act, a contractor on a private contract can obtain a lien against the owner if the lien is filed within sixty days.

Significantly, the Act provides that certain types of provisions are null, void, and unenforceable under Kentucky construction contract law: (a) any provision that attempts to waive the right of any party to resolve any dispute through litigation, but it does allow binding arbitration as a substitution for litigation; (b) any provision which provides for the advanced waiver of mechanics' lien rights; and (c) any "No Damages for Delay" clause which attempts to waive the right of a contractor or subcontractor to recover costs, time, or damages for delays which are in the control of the owner of the real property or the Public Authority.

II. MECHANICS' AND MATERIALMAN'S LIENS

Kentucky applies different lien rules depending on whether the project is private or public. It is important to review the applicable lien statutes prior to preparing a lien in that such statutes are periodically revised.

Generally, the applicable construction law lien statute in Kentucky is KRS 376.010 *et seq.* The statute provides very detailed notice and content requirements for lien statements. Kentucky courts strictly construe those requirements and will disallow a lien if it is not strictly in compliance with the precise statutory requirements. It is imperative that you consult with an attorney who is experienced with lien requirements to avoid the many pitfalls that exist in that area of practice.

The statutory filing requirements for mechanic's liens in Kentucky are dictated by whether the project is a private or a public project. Private project mechanic's liens create a security interest in the approved property and help to establish priority of payment. In contrast, mechanic's liens on public projects attach to project funds, and not to the real property itself or the improvements thereon.

The private lien statute is KRS 376.010, allowing a lien to any person who performs labor or furnishes material to the project. The public lien statute is KRS 376.210.

Kentucky has separate lien statutes with respect to liens rights of engineers, architects, landscape artists, real estate brokers, and land surveyors who provide professional services. Those lien rights are codified at KRS 376.075(3) and require that these professionals contract directly with the owner to acquire their lien rights, whereas others who have lien rights arising out of the private and public liens need only provide labor, materials, or supplies to the project itself, regardless of whether they have contracted directly with the owner. To determine the precise deadlines for your project you should consult the specific applicable lien statute. The following are the general rules, which may have statutory and common law exceptions depending on the circumstances. Liens must be properly perfect under the statute in order to be enforceable.

The filing deadlines on private projects apply to general contractors as well as subcontractors and materialmen. It should be noted that the deadlines for each are not the same. Most significantly, because general contractors have contracted directly with the owner and work directly with the owner, general contractors do not have to provide notice to the owner of its intent to file a lien. Such general contractors must file a lien statement within six months of the last date that it provides labor or delivers materials on the project. The lien statement must be filed in the county clerk's office where the building or improvement is located. The lien claimant must file notice of the lien statement and mail it by regular mail to the owner at his last known address within seven days of filing with the county clerk. Kentucky generally strictly adheres to the perfection requirements of the statute, therefore failure to provide a copy to the owner will likely result in the lien being dissolved. Pursuant to KRS 376.090 the lien claimant must file a

lawsuit to enforce the lien within twelve months after the date the lien statement was filed with the county clerk's office, or otherwise the lien will be statutorily dissolved.

In contrast, subcontractors and materialmen who have not directly contracted with the owner must provide notice to the owner of the project. Pursuant to KRS 376.010(2), such entities may have filed an optional preliminary filing in order to receive certain protections in priority versus other creditors, however, this optional preliminary filing of lien is not necessary to protect lien rights. A mandatory notice of intent to file mechanic's lien must be sent to the owner of the property or the owner's authorized agent. If it is a non-owner occupied project, then notice must be received by the owner within 75 days of the last date labor or services were provided. If the lien is for less than \$1,000 or 120 days if the lien is for more than \$1,000. If the project is owner occupied, the notices must be received by the owner within 75 days of the last day of labor or services provided by the claimant.

The lien claimant then has six months from the last day of labor or services provided to file its lien statement. Upon filing the lien statement, the requirements for the perfection of the lien are satisfied. The lien claimant then has 12 months from the date of the filed lien to initiate a lawsuit in order to avoid dissolution of the lien. The deadlines on operation of liens on public projects are starkly different than those on private projects. Because a lien cannot attach to the real property itself in a public project and rather only attaches to the funds owed by the public authority to the general contractor, there is no advantage for a general contractor to try to attach the funds, since those funds are already owed to the general contractor.

If there is an unusual circumstance that the project funds may be dissipated, the general contractor may evaluate whether a lien would be of use, however, that is a very unusual circumstance.

If a subcontractor or materialman has perfected a mechanic's lien on a public project, the general contractor must take certain actions. Once the lien is perfected, the public authority must withhold the amount claimed in the lien statement from any amount then due to the general contractor. If the amount due to the general contractor is not sufficient to cover the lien, public authority will withhold the difference from future payments once the general contractor has earned those payments. Significantly, the general contractor must file a protest with the public authority within 30 days from the date it receives the lien statement from the public authority.

Failure of the general contractor to file such a protest will result in the public authority paying the held funds to the lien claimant. If the general contractor timely files its protest, then the public authority will notify the lien claimant and retain the withheld funds. It is then incumbent upon the lien claimant to file a suit to enforce the lien to seek disbursement of said sums upon adjudication or court order.

The subcontractor on a public project must file a lien statement within 60 days after the last day of the month in which the services were performed or materials delivered. In addition, the Kentucky Fairness in Construction Act allows a subcontractor or materialman to also file a lien statement up to the date of substantial completion as defined in that act, in the event the substantial completion date falls outside the statutory 60 day period. Kentucky law is somewhat ambiguous in making a distinction between nongovernment owned and government owned public projects. The distinction between the two dictates where to file the lien statement. Hence the common practice is to file the lien statement in both the county where the project is located and in the county where the seat of government where the public authority is located. In addition, the lien claimant must send a copy of the lien statement with the public authority as well as proof of delivery of the lien statement of the general contractor. Upon these requirements, the mechanic's lien is perfected.

III. BREACH OF CONTRACT

A. Typical breach of contract claims

Breach of contract is the most common claim in construction cases, and can be based on any failure by a party to perform material obligations to another, such as failure to pay, bad workmanship, breach of warranty, etc. There must be a valid and enforceable contract between the parties, and basic contract principles apply in this context. For instance, a valid contract requires: the parties must have the legal ability to enter into a contract, the contract must have a legal purpose, the parties must objectively manifest their assent to the contract, and the parties must exchange consideration in the form of promises or actions. In every contract there is an implied covenant of good faith and good dealing. Ranier v. Mt. Sterling Nat'l Bank, 812 S.W.2d 154 (Ky. 1992).

B. Breach of express warranty

When a sale of goods is involved, the Uniform Commercial Code provides that the parties can create express warranties in a variety of ways: by making an affirmation regarding the goods at issue where that becomes a part of the basis of the sale, by giving any description of the goods that becomes a part of the basis of the sale, or by using any sample or model of the goods becomes part of the basis of the sale. KRS 355.2-131(1)(a)-(c). These create an express warranty that the goods will conform to the affirmation, description, sample, or model upon which the sale was made.

When no sale of goods is involved, a cause of action for breach of an express warranty may be brought as an ordinary breach of contract claim.

C. Breach of implied warranty

A variety of implied warranties may exist under Kentucky construction law. A common law implied warranty of habitability exists in the sale of a new dwelling by a

builder, and the major structural features are impliedly warranted to be constructed in a workmanlike manner using suitable materials. Crawley v. Terhune, 437 S.W.2d 743, 745 (Ky. 1969). Also, where a project owner provides plans and specifications for instruction, she impliedly warrants to the contractor that they are fit for that purpose. See United States v. Spearin, 248 U.S. 132 (1918); Culbertson v. Ashland Cement and Constr. Co., 139 S.W. 792 (Ky. 1911); but see Codell Constr. Co. v. Commonwealth of Kentucky, 566 S.W.2d 161, 164 (Ky. App. 1977) (discussing disclaimers as to the accuracy of information provided to contractors).

In transactions involving the sale of goods, the UCC provides for a variety of implied warranties, including the implied warranty of merchantability in KRS 355.2-314. Also, when a seller has reason to know of any particular purpose for which the buyer intends to use the goods, and when the buyer is relying upon the seller's skill or judgment in selecting or furnishing suitable goods, there is an implied warranty that the goods be fit for such purpose. KRS 355.2-315.

D. Implied contracts

Where no actual contract exists, courts may still allow recovery in order to serve the interests of justice by finding implied contracts, contracts implied in fact, and quasi-contracts.

Promissory estoppel is where "[a] promise which the promissor should reasonably expect to induce action or forbearance on the part of the promisee of a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise." Meade Construction Co., Inc. v. Mansfield Commercial Electric, Inc., 579 S.W.2d 105, 106 (Ky. 1979).

Quantum meruit also may allow recovery where a party furnishes labor, materials, or other services for the benefit of another where it would be unjust for the receiving party to retain those benefits without paying for them. See Guarantee Electric Co. v. Big Rivers Electric Corp., 669 F. Supp. 1371 (W.D. Ky. 1987).

IV. NEGLIGENCE

Negligence is the failure to exercise the reasonable standard of care that a reasonably prudent person would have exercised in a similar situation. Black's Law Dictionary (7th ed. 2000). Kentucky courts recognize a cause of action for negligent construction only where the damages suffered arise from a "destructive occurrence" or a "damaging event." Real Estate Marketing v. Franz, 885 S.W.2d 921, 926 (Ky. 1994). Mere diminution in value due to a defect is not enough to support a claim of negligent construction, such as where water leaks, warping of flooring, and mold and mildew result from a structural defect. Id. In contrast, the collapse of a stone fireplace onto a child can be a "destructive occurrence" or "damaging event" for purposes of a negligent construction claim. Id. (referring to the facts of Saylor v. Hall, 497 S.W. 2d 218 (Ky. 1973)).

V. FRAUD AND MISREPRESENTATION

There are six elements of an intentional fraud claim in Kentucky; these must be proven by clear and convincing evidence. The elements are: (1) defendant makes a material misrepresentation; (2) the misrepresentation is false; (3) the defendant knows at the time of making the misrepresentation that it is false, or the defendant makes the misrepresentation recklessly, without any knowledge of its truth and as a positive assertion; (4) the defendant makes the misrepresentation with the intention of inducing the plaintiff to act, or that it should be acted upon by the plaintiff; (5) the plaintiff acts in reliance upon the misrepresentation; and (6) the plaintiff suffers injury. Sanford Construction Co., Inc. v. S & H Contractors, Inc., 443 S.W.2d 227, 231 (Ky. 1969).

A negligent misrepresentation is also actionable in Kentucky under relatively recent case law. In Presnell Constr. Managers, Inc. v. EH Constr., LLC, 134 S.W.3d 575 (Ky. 2004), the Kentucky Supreme Court adopted the standard for negligent misrepresentation set forth in Restatement Second of Torts, § 552. This cause of action arises when one supplies false information for the guidance of others and fails to exercise reasonable care or competence in obtaining or communicating the information. Liability is limited to loss suffered by the person or group for whose benefit the information was provided, where the information is known to be relied upon in a specific or substantially similar transaction. This cause of action may allow for recovery between parties who otherwise are not in privity of contract, although it is unclear whether the “economic loss doctrine,” which bars tort actions for purely economic loss absent privity of contract, would apply.

VI. STRICT LIABILITY

Kentucky has a unique and powerful statutory provision that provides a cause of action to any party, in an individual capacity or on behalf of a class of persons or parties, damaged as a result of a violation of the building code. See KRS 198B.130. An award may include damages and the cost of litigation, including reasonable attorney’s fees. Such action must be brought within one year of when the damage is discovered or should have been discovered, but no more than ten years after the date of first occupation or settlement. The Kentucky Supreme Court in Franz held:

A private cause of action for violation of KRS Chapter 198B and the applicable building code is not dependant on KRS 446.070. KRS 198B.130 provides an independent statutory remedy, complete in itself, for violating any provision of KRS Chapter 198B or the uniform state building code enacted pursuant to this chapter. Nor does KRS 198B.130 limit the nature of the claim for damages to damages available in a tort action. It does not distinguish between damages related solely to diminution in value and damages caused by a specific actionable event or a destructive occurrence as with the traditional tort remedy. Reasonably interpreted, if a statutory violation has occurred, KRS 198B.130 requires payment of either the cost

of repair to bring the property up to code compliance or payment of the diminution in fair market value of the property because of code infractions, whichever is less.

Franz, 885 S.W.2d at 927.

VII. INDEMNITY

Indemnification clauses are not against public policy and should be enforced. Nat'l Surety Corp. v. Peoples Milling Co., Inc., 57 F. Supp. 281, 282 (W.D. Ky. 1944). The nature of one's liability is determined by the provisions of the indemnity agreement itself. USF&G v. Napier Electric & Constr. Co., Inc., 571 S.W.2d 644, 646 (Ky. App. 1978).

KRS 371.180 provides that for any contract entered into on or after June 20, 2005, "[a]ny provision contained in any construction services contract purporting to indemnify or hold harmless a contractor from that contractor's own negligence or from the negligence of his or her agents, or employees is void and wholly unenforceable."

VIII. STATUTE OF LIMITATIONS/STATUTE OF REPOSE

Time limitations vary depending on the underlying cause of action and the point in time that the cause of action accrued.

A. Statute of Limitations

Parties have ten years to sue for a breach of a written contract under KRS 413.160. The action accrues when either (1) the contract is breached or (2) the time for performance arrives. Hoskins' Adm'r v. Kentucky Ridge Coal Co., 305 S.W.2d 308, 311 (Ky. 1957). Parties can dictate when the time begins to run, and can also agree to a shorter period of limitation for claims of breach of written contracts, provided that the parties are involved in an arms-length transaction and that the period provided is reasonable. See Burlew v. Fidelity & Casualty Co., 122 S.W.2d 990 (Ky. 1938); Green v. John Hancock Mut. Life Ins. Co., 601 S.W.2d 612 (Ky. App. 1980); Webb v. Kentucky Farm Bureau Ins. Co., 577 S.W.2d 17, 19 (Ky. App. 1978). However, the parties may not lengthen the limitations period beyond that provided by statute. Citizens Bank v. Hutchinson, 113 S.W.2d 1148 (Ky. 1938).

An action for breach of an oral agreement, either express or implied, must be brought within five years under KRS 413.120. Claims based on a bond must be brought within seven years under KRS 413.220. Claims based on fraud or mistake must be brought within five years of discovery of the fraud or mistake if the plaintiff exercises reasonable diligence, under KRS 413.120(12). Even if the plaintiff fails to discover the fraud or mistake, the action must be brought within ten years of the formation of the contract or the fraud itself.

Personal injury claims for negligence must be brought within one year from the date on which the cause of action accrues. KRS 413.140(1). The cause of action accrues on the date the plaintiff discovers or should have discovered the injury and that the injury may have been caused by the defendant's conduct. Drake v. B.F. Goodrich Co., 782 F.2d 638, 641 (6th Cir. 1986).

Other limitations include the following: trespass to real or personal property must be brought within five years under KRS 423.120(4); taking, detaining, or injuring personal property must be brought within two years of accrual under KRS 413.125; and professional negligence must be brought within one year from occurrence or discovery under KRS 413.245. Various other limitations exist for other causes of action, and the limitation periods also differ where a plaintiff sues the Commonwealth of Kentucky itself.

B. Statute of Repose

The Kentucky Supreme Court has repeatedly found statutes of repose in the personal injury context to be unconstitutional. See Perkins v. Northeastern Log Homes, 808 S.W.2d 809, 811 (Ky. 1991); Tabler v. Wallace, 704 S.W.2d 179, 186-87 (Ky. 1985); Saylor v. Hall, 497 S.W.2d 218 (Ky. 1973). Statutes of repose may be enforceable in other contexts.

IX. ECONOMIC LOSS DOCTRINE

Giddings & Lewis, Inc. v. Industrial Risk Insurers, 148 S.W.3d 729 (Ky. 2011).

In a landmark decision, the Kentucky Supreme Court has clarified the application of the Economic Loss Rule ("ELR") in Kentucky. Although *Giddings* was a products liability case, it has had far reaching in the construction industry for cases related to claims for defective materials.

In 2011, the Kentucky Supreme Court expressly stated that the economic loss rule applies to product liability cases in Kentucky. *Giddings*, 348 S.W.3d at 738. The Kentucky Supreme Court's first mention of the economic loss doctrine by name occurred in Justice Keller's concurrence in *Presnell Constr. Managers, Inc. v. E.H. Constr., LLC*, 134 S.W.3d 575 (Ky. 2004). There, Justice Keller explained the rule as follows:

The economic loss rule is a judicially created doctrine that marks the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others. The crux of the doctrine is not privity but the premise that economic interests are protected, if at all, by contract principles, rather than tort principles. Although originally rooted primarily in product liability cases to protect manufacturers from tort liability for damage that is limited to the product itself, the economic loss rule has evolved into a modern, general prohibition against tort recovery

for economic loss. In its broadest formulation, the economic loss rule prohibits tort recovery in negligence or products liability absent physical injury to a proprietary interest.

Id. at 583-84 (internal citations and quotation marks omitted).

To determine whether the economic loss rule applies, a court should look at the duty upon which the tort claim is premised. *Id.* at 589-90. If the plaintiff alleges the duty is created by a contract, then the economic loss doctrine bars recovery in tort. *Id.* Under the economic loss doctrine, a plaintiff cannot recover tort damages when a product injures itself, causing economic damages, but does not cause personal injury. *See id.* at 583-84. The doctrine “marks the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others.” *Id.* at 583.

When alleged damage constitutes purely economic damages that precludes tort liability, including negligence and strict liability claims. This is particularly true where the Plaintiff had the opportunity to protect itself from economic loss caused by any defect in the concrete or School, by contracting with and obtaining warranties from the concrete seller, architect, and/or builder. *See Ohio Cas. Ins. Co. v. Vermeer Mfg. Co.*, 298 F. Supp. 2d 575, 578 (W.D. Ky. 2004) (economic loss rule “applies whenever the purchasing party has the opportunity to allocate the risk of loss via contract or warranty”).

The case *Casa Clara Condo. Ass’n, Inc. v. Charley Toppino and Sons, Inc.*, 620 So.2d 1244 (Fla. 1993), is also particularly instructive when considering the “economic loss doctrine.” The Florida Supreme Court determined that a homeowner could not recover purely economic damages against a concrete supplier on a negligence theory. *See id.* at 1248. The plaintiffs in *Casa Clara* sued the concrete supplier of the concrete used on their condominium. *See id.* at 1244. Specifically, the plaintiffs alleged that the concrete used on their building had a high salt content which rusted the steel inserts in the concrete causing the concrete to rust, crack and break off. *See id.* Florida’s high court noted that the plaintiffs were not alleging any physical injury from the defective concrete nor were they alleging that a separate structure was damaged by the allegedly defective concrete. *See id.* at 1246. The plaintiffs were “seeking purely economic damages” for damage to their own building into which the concrete had been incorporated. *Id.*

The plaintiffs argued that the “concrete” was the product and it damaged other parts of their building, therefore the damages were not purely economic. *See id.* at 1247. The Florida Supreme Court rejected this argument and stated that the proper focus was on the finished product, the building, not the various components incorporated therein. *See id.* The Court stated that the “concrete became an integral part of the finished product, and, thus, did not injure ‘other’ property.” *Id.* Therefore, the “economic loss doctrine” precluded the plaintiffs’ requested tort recovery. *See id.* at 1248.

X. CLAIMS OF PUBLIC PROJECTS

Wehr Constructors, Inc. v. Steel Fabricators, Inc., 769 S.W.2d 51 (Ky. App. 1989).

This is an important Kentucky case that explains pursuant to KRS 376.070, even if lien rights have expired on public funds, a contractor has a statutory obligation to pay in full all claims for material and labor out of a sum received on the primary contract for a public project, and if the amount received by the contractor is insufficient to pay all claims, they must be paid on a pro rata basis.

This rule bars tort actions for the recovery of purely economic losses. Pure economic interests should be protected by contract principles rather than tort principles. See Presnell, 134 S.W.3d at 583 (J. Keller concurring). Kentucky courts have not explicitly adopted the economic loss doctrine, but the courts may have discussed and applied the principles of the rule simply without identifying it. See Id. at 586; Franz, 885 S.W.2d at 921. It is unclear how Kentucky courts would apply the economic loss rule in construction cases, even though a majority of courts outside of Kentucky seem to have adopted this rule, and the issue is presently under consideration by Kentucky appellate courts.

Kentucky courts have not addressed the issue of investigative costs in construction cases, and such recovery is not provided for by statute in Kentucky.

XI. EMOTIONAL DISTRESS CLAIMS

The tort of “outrage” is a relatively new tort, allowing recovery for the intentional infliction of emotional distress irrespective of any physical touching. Kentucky courts define outrage as follows: “One who by extreme and outrageous conduct intentionally or recklessly causes severe emotional distress to another is subject to liability for such emotional distress, and if bodily harm to the other results from it, for such bodily harm.” Craft v. Rice, 671 S.W.2d 247, 251 (Ky. 1984).

Negligent infliction of emotional distress is a stand-alone cause of action, although emotional damages are generally also available in other causes of action such as negligence, where a plaintiff has suffered a physical injury or offensive “touching.” In the absence of a physical injury or offensive “touching,” Kentucky courts will not allow recovery since causation can be difficult to establish. See Deutsch v. Shein, 597 S.W.2d 141, 145-46 (Ky. 1980) (requiring an accompanying physical injury); Wilhoite v. Cobbe, 761 S.W.2d 625 (Ky. App. 1989) (no recovery for a bystander mother’s emotional distress from seeing daughter hit by a car). This is known as the “impact” rule; Kentucky is one of the few states that has such a requirement.

XII. STIGMA DAMAGES

Kentucky courts will allow stigma damages only where there has been a “physical injury to property.” Mercer v. Rockwell Int’l Corp., 24 F. Supp. 2d 735 (W.D. Ky. 1998) (holding that Kentucky law requires that there be a physical injury to property before

stigma damages can be recovered). For example, Kentucky courts have held that there could be no recovery in trespass for decreased fair market value when a person commits suicide on an owner's property, Morgan v. Hightower's Adm'r, 163 S.W.2d 21 (Ky. 1942), and according to the Mercer court, "home owners could not receive decreased fair market value if a group home for the disabled moves into the neighborhood or when someone with AIDS moves next door." Mercer, 24 F. Supp. 2d at 744, citing In Re Paoli, 35 F.3d 717, 798 n.64 (3d Cir. 1994).

Generally, in Kentucky stigma damages are limited to instances where plaintiffs show "(1) That there is a basis in reason and experience for a fear ...; (2) that such a fear enters into the calculations of a substantial number of persons who deal in the buying or selling of similar property; and (3) depreciation of market value because of the existence of such fear." Gulledge v. Texas Gas Transmission Corp., 256 S.W.2d 349, 353 (Ky. 1952). The court further explained that "the fear ... is not a separate element of damages, but is to be considered only as it is expressed as a reason by a witness or witnesses in support of an estimate of depreciated value." Id.

Mercer, 24 F. Supp. 2d at 745 n.5.

XIII. ECONOMIC WASTE

Under basic principles of contract law, the measure of damages for a breach of contract by a general contractor is the cost to remedy the defect. However, where an award based on this measure of damages would result in unreasonable economic waste, the proper measure of damages would be the difference in the fair market value between the building as it should have been constructed and the fair market value of the property as it was actually constructed. See Kohn v. Johnson, 565 So. 2d 165 (Ala. 1990).

XIV. DELAY DAMAGES

Delays to a project are considered either "excusable" or "inexcusable." Excusable delays can be either compensable or noncompensable.

Excusable delays are those that are unforeseen and are not caused by a breach of duty by a contractor. Such delays may require additional compensation to be paid to the contractor for additional overhead costs, labor and equipment costs, and for increases in material and other costs.

Non-compensable excusable delays are those where both the owner and the contractor are at fault, or those caused by external conditions such as severe weather. While the contractor may get more time to complete the project, usually neither party is entitled to additional compensation.

Where the contractor delays the project in the absence of weather delays or interference from the owner, the delay is considered inexcusable. The owner may be entitled to actual damages incurred as a result of the delay, such as lost profits, lost use of property, cost of additional financing, etc. The owner may be entitled to liquidated damages if there is an enforceable liquidated damages clause. Enforceability depends on the reasonableness of the amount in light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. Mattingly Bridge Co. v. Holloway & Son Constr. Co., 694 S.W.2d 702, 705 (Ky. 1985).

The Kentucky Fairness in Construction Act makes any “no damages for delay” clause in contracts entered into after July 1, 2007 void and unenforceable. These are provisions which attempt to waive, release or extinguish the right of a contractor or subcontractor to recover costs, additional time, damages, or to receive an equitable adjustment in its contract for delays which are in the control of the owner or Public Authority. Provisions which permit a contractor or subcontractor to recover delay costs, which require that notice of the delay be communicated to the property owner, which provide for reasonable liquidated damages, or which specify which delay costs that are recoverable by a contractor or a subcontractor are fully enforceable.

XV. RECOVERABLE DAMAGES

A. Direct Damages

Damages directly resulting from a breach of contract are recoverable, for the purpose of restoring the non-breaching party to the same financial position in which he or she would have been had the breach not occurred. For example, where an owner fails to pay the full amount, the contractor may sue to recover the full amount, and where a building does not conform to the agreement, the owner may sue to recover the cost to remedy the defect or the difference in market value.

B. Consequential Damages

Consequential damages are those resulting from a party’s breach of contract that were a foreseeable consequence of a breach when the contract was formed. In the construction context, an award of consequential damages may be more likely since the participants may be both experienced in the industry and aware of the damages that a breach of contract may cause.

A waiver of consequential damages by one or both parties is generally enforceable in Kentucky unless it is severely one-sided, oppressive or unfairly surprising. See Conseco Fin. Servicing Corp. v. Wilder, 47 S.W.3d 335, 341 (Ky. App. 2001) (“A fundamental rule of contract law holds that, absent fraud in the inducement, a written agreement duly executed by the party to be held, who had an opportunity to read it, will be enforced according to its terms.”). However, although a party may release another from liability for ordinary or gross negligence, a party cannot agree to release another from liability for

willful or wanton negligence. Sparks v. Re-Max Allstar Realty, 55 S.W.3d 343, 349 n.16 (Ky. App. 2000).

C. Loss of Use

Damages for “loss of use” are awarded in a variety of contexts. In construction cases, loss of use damages are typically awarded in instances of “inexcusable delay” caused by the fault of the contractor, as discussed above.

A caveat is appropriate: one may not recover interest as a result of an injury to personal property and loss of use damages at once. The Kentucky Supreme Court held that “a party may sue for the injury done [to the] personal property, and the jury may in their discretion allow him interest on the sum found, and should be so instructed, or he may sue for damages occasioned by the injury and also for the loss of the use, but he cannot recover interest as well as damages for the loss of the use. Nucor Corp. v. General Electric Co., 812 S.W.2d 136, 142 (Ky. 1991) (emphasis added), quoting Schulte v. Louisville & N. R. Co., 108 S.W. 941 (Ky. 1908).

D. Punitive Damages

In Consolidated Sales Co. v. Malone, the Court of Appeals of Kentucky, as the highest state court during that time period, summarized the case law regarding punitive damages as follows:

"It is well established in numerous decisions that in order to justify an instruction on punitive damages there must be a wanton disregard of the rights of others. There must be willfulness, wantonness, and malice." Jefferson Dry Goods Co. v. Stoess, 304 Ky. 73, 199 S.W.2d 994, 997-998 (1947).

"Exemplary or punitive damages are generally defined as those given in enhancement of compensatory damages on account of the wanton, malicious or reckless character of the acts complained of. They go beyond actual damages suffered and are allowed where the tort is aggravated by evil motive, actual malice or deliberate violence." Great Atlantic & Pacific Tea Co. v. Smith, 281 Ky. 583, 136 S.W.2d 759, 768 (1940).

"There must be a showing that the acts were either willful or malicious or that they were performed in such a way as would indicate a gross neglect or disregard for the rights of the person wronged." Ashland Dry Goods Co. v. Wages, 302 Ky. 577, 195 S.W.2d 312, 315 (1946).

As we understand these statements of principle, punitive damages must be premised on one or both of these two circumstances: (1) the defendant's conduct was malicious, in that he acted in bad faith, and was

not motivated by a belief that he had probable cause to detain the plaintiff, or (2) even though he may have acted in good faith, his treatment of the plaintiff was grossly in excess of what the circumstances, as the defendant actually believed them to be, reasonably required.

Consolidated Sales Co. v. Malone, 530 S.W.2d 680, 682-83 (Ky. 1975).

E. Emotional Distress

There are no reported Kentucky cases specifically discussing the issue of emotional damages for defective construction of a home, but emotional damages are generally available to any plaintiff who has suffered a physical injury or offensive "touching." In the absence of a physical injury or offensive "touching," courts will require a very high degree of evidence showing a correlation between the alleged bad act and the damages complained of.

F. Attorney's Fees

Attorney's fees are recoverable in Kentucky if provided for by statute or in the contract itself, or in rare circumstances under the doctrine of equity. It is well established that "in the absence of a statute or contract expressly providing therefore, attorneys' fees are not allowable as costs...nor recoverable as an item of damages." Dulworth & Burress Tobacco Warehouse Co. v. Burress, 369 S.W.2d 129, 133 (Ky. 1963) (emphasis added). Thus, contract terms awarding attorney's fees to one party or another in the event of a dispute are enforceable in Kentucky.

Very few statutes provide for the recovery of attorney's fees. However, as discussed above under "Strict Liability," KRS 198B.130 provides for the recovery of attorney's fees in a cause of action for the violation of a building code. Also, the Kentucky Fairness in Construction Act mandates the award of costs and reasonable attorney fees to the prevailing party in an action to enforce the Act, whether in a court proceeding or arbitration. Again, this applies to contracts entered into after July 1, 2007.

G. Expert Fees and Costs

Expert fees and costs are probably not recoverable in a construction case, because such recovery is only allowed in Kentucky where specifically provided for by statute. In Brookshire v. Lavigne, the Court of Appeals of Kentucky stated:

As a general rule, "[f]ees paid by a party to expert witnesses are not recoverable as part of the cost of the action, unless specifically authorized by statute." 20 Am. Jur. 2d Costs §65 (1965). KRS 453.040 states that "[t]he successful party in an ordinary action shall recover his costs," but the statute makes no provision for the recovery of expert witness fees.

Brookshire v. Lavigne, 713 S.W.2d 481 (Ky. App. 1986). Likewise, in the construction context, KRS 198B.130 does allow the recovery of attorney’s fees, but it does not provide for the recovery of fees and costs relating to witnesses.

An example of a statute that provides for an award of expert fees and costs is KRS 453.260, but it allows such an award only in: (1) a civil action brought by the Commonwealth against a private party, and (2) in a civil action brought by a private party against the Commonwealth to challenge the assessment or collection of taxes. This statute clearly does not allow for an award of expert fees and costs in the construction context

The Kentucky Fairness in Construction Act requires that costs and attorney’s fees be awarded to the prevailing party if there is a finding of bad faith. However, it is unclear whether courts will interpret “costs” in this new statute to include an award of expert fees and costs; there is a colorable argument that since standard costs are already available to a prevailing party where there is a finding of bad faith, the legislature must have intended “costs” here to include expert fees and costs. Otherwise, the legislature had no reason to explicitly award “costs” here in addition to attorney’s fees if there is a finding of bad faith.

It is unclear whether a contractual provision providing for recovery of expert witness fees and costs would be enforceable under Kentucky law. Such provisions have not been prohibited by the courts or by statute, and could possibly be enforceable like provisions awarding attorney’s fees, if they are not found to be unconscionable.

XVI. INSURANCE COVERAGE FOR CONSTRUCTION CONTRACTS

Contractors may provide various types of insurance required by the project owner, including commercial general liability insurance, workers’ compensation, loss of use, automobile insurance, environmental hazards insurance, and builders’ risk insurance. Courts interpret policies by their “plain and ordinary meaning” if the words used are “clear and unambiguous.” St. Paul Fire & Marine Ins. Co. v. Powell-Walton-Milward, Inc., 870 S.W.2d 223 (Ky. 1994). Also, courts tend to favor the insured—when an ambiguity appears on the face of the policy or in the application of a provision to a particular claim, courts must adopt the reasonable construction that is most favorable to the insured. Wine v. Globe Am. Cas. Co., 917 S.W.2d 558 (Ky. 1996). Exclusions are narrowly interpreted, and all questions are generally resolved in favor of the insured. Eyler v. Nationwide Mut. Fire Ins. Co., 824 S.W.2d 855, 859 (Ky. 1992).

Builders’ risk coverage, or “all-risk” policies, cover the physical work itself on a construction project, regardless of fault. Generally, whoever may get better rates for builders’ risk coverage will obtain the policy. Where a project involves an addition to an existing facility or a renovation, the policy will cover only the additional work being performed, not the existing facility.

Commercial general liability insurance policies cover the negligent acts of the contractor and those for whom the contractor is responsible, such as subcontractors or suppliers. However, one must bear in mind the aforementioned rule in KRS 371.180, which prohibits indemnification of another party against one's own negligence.

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