Kentucky Law Journal

Volume 95 | Issue 1 Article 5

2006

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Walking the Line between Contract and Tort in Construction Disputes: Assessing the Use of Negligent Misrepresentation to Recover Economic Loss after *Presnell*

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I. INTRODUCTION

THE construction of the modern day marvel requires the exercise of the technical and creative skill of design professionals[2] as well as the expertise of modern day craftsmen who transform an idea embodied in a set of documents to a tangible product which can be enjoyed by all. This process, however, does not occur without disagreement among the various parties and often results in disputes that must be resolved through some type of dispute resolution system. Accordingly, the construction industry is one segment of our industrial culture that breeds a tremendous amount of litigation.

In a traditional construction project,[3] an owner contracts with a design professional to prepare plans and specifications for construction. Additionally, the owner may require the design professional to provide administrative services[4] throughout the course of the project, or alternatively, may hire

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1 J.D. expected 2007, University of Kentucky College of Law; M.S., Civil Engineering, University of Kentucky, 1999; B.S., Civil Engineering, University of Kentucky, 1997. The author wishes to thank his wife Emily for her patience, love, and support throughout the process of preparing this Note.

2 The term "design professional" is used throughout this Note to refer to both architects and engineers; these professionals are generally treated equally by the legal system. *See* Patricia N. Jackson, *The Role of Contract in Architectural and Engineering Malpractice*, 51 INS. COUNSEL J. 517, 517 n.4 (1984) ("Tort and contract law essentially make no distinction in treatment of the architectural and engineering professions.") (citation omitted)).

3 The sequence of events described herein is representative of the traditional design-bid-build form of contract procurement. Numerous other organizational structures are used in the construction industry. *See generally* JUSTIN SWEET, SWEET ON CONSTRUCTION LAW 84–97 (1997) (providing an overview of various organizational structures used in the construction industry including Design-Bid-Build, Fast Tracking (phased construction), Multiple Primes (separate contracts), Construction Management, and Design-Build). *See also* Carl J. Circo, *Responsibility for Shared Architectural and Engineering Services: When Specialty Designs Cause Building Disasters: Responsibility for Shared Architectural and Engineering Services*, 84 NEB. L. REV. 162, 168–72 (2005).

4 A design professional may serve as the representative of the owner during the construction project to ensure that construction occurs in compliance with the plans and specifica-

a construction manager to fulfill this role during construction.[5] Depending on the complexity of the project, the design professional may enlist the services of other specialty consultants[6] to assist with the design. Traditionally, after the design is complete, the owner solicits competitive bids, selects a general contractor, and enters into a formal contract for the construction of the project.[7] The general contractor then separately enters into a network of contracts with various subcontractors and suppliers who perform work on discrete portions of the project. The end result is a system of complicated, interwoven contractual relationships in which the various parties depend on one another to achieve a common goal—the production of a quality project that meets the owner's expectations, and the generation of a reasonable profit to all those contributing their labor and expertise.

Construction is a risky business; there are a tremendous number of variables that can affect the performance of the parties during the course of a typical project. Problems are inevitable, and disputes are sometimes unavoidable. A contractor is generally required to use the plans and specifications to provide the owner with a reliable bid for the construction of the project. In doing so, the contractor relies on the design information to develop an estimate of the amount of labor and materials required to complete specific tasks on the project. Inevitably, someone makes a mistake, whether it is in the design of the project, scheduling of construction, supply of faulty materials, or any other myriad of typical problems encountered on a project. The bottom line is that one of the parties involved in the project suffers pecuniary loss due to the improper performance of another's obligations under its contract with a third party. Generally, the design professional becomes a target when parties seek compensation for economic damages.[8]

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tions. The design professional generally reviews submittals by the contractor, such as shop drawings, and the design professional's approval is often required pursuant to the contract. The design professional might also serve as an arbiter of disputes between the owner and contractor regarding the interpretation of the plans and specifications. *See, e.g.*, JUSTIN SWEET, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 12.02 (5th ed. 1994).

5 A construction manager is typically used by an owner to provide guidance, in accordance with his or her construction experience, during the design and construction of the project. During the project, the construction manager is typically responsible for monitoring compliance with the contract documents and coordinating the schedule of the various stages of the work. *See id.* §§ 12.08, 17.03.

6 For example, an architect (or the owner under separate contract) will typically enlist the services of a geotechnical engineer to undertake an investigation of the on-site subsurface conditions to facilitate the design of a proper foundation for a structure. Furthermore, an architect will typically enlist the services of a structural engineer (either in-house or under separate contract) to design a structural system to support the building and withstand the appropriate external physical forces acting upon it.

7 *Id.* § 12.02.

8 Jackson, *supra* note 2, at 517 ("Suitors have declared 'open season' on architects and en-

One of the most troublesome issues in construction litigation is whether a contractor should have a direct cause of action for negligence against a design professional. This issue has fueled an intense legal debate regarding the liability of a design professional to third parties solely for economic loss in the absence of a contractual relationship.[9] The Kentucky Supreme Court recently addressed this issue in *Presnell Construction Managers, Inc. v. EH Construction, L.L.C.*, [10] in which it expressly adopted the Restatement (Second) of Torts § 552 as the standard for negligent misrepresentation in Kentucky.[11] Unfortunately, because the facts did not require the court to address many of the critical elements of negligent misrepresentation, the court left many stones unturned in adopting this cause of action. Thus, *Presnell* leaves the practitioner with more questions than answers as to whether the door is now wide open in Kentucky for negligence claims to be asserted against design professionals solely for economic loss. Furthermore, Justice Keller, in a concurring opinion,[12] chose to address the status of the economic loss rule[13] under Kentucky law, which also left unanswered the questions as to if—and how—the rule will be applied in future disputes involving the construction industry.

The purpose of this Note is to dissect the court's opinion and provide the practitioner with useful guidance as to the necessary elements of a negligent misrepresentation claim asserted against a design professional.

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gineers and professional malpractice claims against the 'once-sacrosanct architectural and engineering professions' have escalated to proportions not thought possible in the early 1960s.") (citations omitted).

9 *See generally* Anthony F. Earley, Note, *Liability of Architects and Engineers: A New Approach*, 53 NOTRE DAME L. REV. 306 (1978); Murray H. Wright & Edward E. Nicholas, III, *The Collision of Tort and Contract in the Construction Industry*, 21 U. RICH. L. REV. 457 (1987). This problem is not unique to the construction industry; courts and commentators continue to debate the appropriate legal theory under which hybrid tort/contract actions should be analyzed in various industries. *See* GREGORY M. COKINOS & ROBERT A. PLESSALA, THE TEXAS "ECONOMIC LOSS" RULE AND "CONTORTS," SEPARATING TORT FROM CONTRACT (1998) (presentation at the Defense Research Institute, Construction Law) *available at* http://www.cbylaw.com/Publications/gmc-economic loss.pdf; Thomas C. Galligan, Jr., *Contortions Along the Boundary between Contracts and Torts*, 69 TUL. L. REV. 457 (1994).

10 Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575 (Ky. 2004).

11 RESTATEMENT (SECOND) OF TORTS § 552 (1977); *see infra* notes 95–107 and accompanying text.

12 *See Presnell*, 134 S.W.3d at 583–91 (Keller, J., concurring).

13 Simply stated, the economic loss rule prohibits "tort recovery in negligence or products liability absent personal injury or property damage." Anthony L. Meagher & Michael P. O'Day, *Who is Going to Pay for My Impact? A Contractor's Ability to Sue Third Parties for Purely Economic Loss*, CONSTR. LAW. Fall 2005, at 27, 27. "The economic loss 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." Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 894–95 (1989).

Furthermore, it attempts to predict how the Kentucky courts will analyze this cause of action in the future by looking to other jurisdictions that have adopted similar lines of reasoning in the context of construction litigation. Part II addresses the historical debate over the appropriate remedy in cases possessing a character that can be fairly categorized as either contractual or tortious.[14] Part III provides an in-depth analysis of the opinion issued by the Kentucky Supreme Court in *Presnell*.[15] Part IV presents an analysis of the standard for liability established in section 552 for negligent misrepresentation and provides useful guidance to the practioner as to how to proceed under this cause of action in a typical construction dispute.[16] Part V concludes by presenting policy justifications for the ruling issued in *Presnell* and explains why this is an appropriate compromise between those who favor strict adherence to contractual remedies (or a rigid application of the economic loss rule) and those who favor a broad application of standard negligence principles. While noting that this cause of action reaches far beyond design professionals and applies to other individuals engaged in providing professional services,[17] the scope of this Note is limited to commercial entities involved in a typical construction dispute.

II. History of the Debate—Tort or Contract Remedies?

As mentioned previously, the typical construction project involves a complicated series of mutually-independent contracts through which each party establishes its duties and obligations to its contracting partner. Due to the presence of sophisticated networks of contractual relationships, courts and commentators have devoted much attention to whether a third party[18] not in privity with a design professional should be able to assert a claim in tort for economic loss or should be limited to contractual remedies against the individual with whom he or she is in privity.[19] The amount of commentary devoted to this topic is staggering. An extended discussion of all positions is beyond the scope of this Note, but understanding the logic of

14 *See infra* notes 18-66 and accompanying text.

15 *See infra* notes 67-125 and accompanying text.

16 *See infra* notes 126-97 and accompanying text.

17 Courts have imposed a duty to avoid the negligent infliction of economic loss upon attorneys, accountants, design professionals, termite inspectors, and other individuals in the business of supplying information for the guidance of others. *See, e.g.*, Lieder, *infra* note 22, at 1014–15.

18 In the context of construction litigation, third parties asserting claims against a design professional often include contractors, subcontractors, material suppliers, surety companies, purchasers of real estate, and subsequent purchasers of a home (in the context of latent defects).

19 *See, e.g.*, Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n, 560 N.E.2d 206, 208 (Ohio 1990); Blake Constr. Co. v. Alley, 353 S.E.2d 724, 726 (Va. 1987); Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986, 990–91 (Wash. 1994);.

the *Presnell* opinion requires a brief discussion of various positions taken by courts and commentators on the issue.

A. Demise of the Privity Doctrine Opens the Door for Tort Actions against Design Professionals

Historically, design professionals could rely upon the safety of their contractual relationships and enter into transactions with predictable certainty that their liability would not extend beyond those with whom they were in privity.[20] However, the privity defense[21] has gradually eroded in American jurisprudence[22] and no longer provides a defense to design professionals in most jurisdictions.[23] Kentucky is now among those jurisdictions that have abolished the privity requirement in actions against a design professional.[24]

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20 *See* Earley, *supra* note 9, at 307 ("Despite variance in theories of recovery, the doctrine of privity provided an effective defense to third party actions against the architect or engineer for negligence.") (citations omitted)).

21 The privity defense first originated with the ancient English case of *Winterbottom v. Wright*, (1842) 152 Eng. Rep. 402. However, it has been argued that, in fact, the court "held only that the obligation of a contract could give no right of action to one who was not a contracting party" and that "American courts erroneously applied" the holding to create the doctrine of privity in tort cases. Tabler v. Wallace, 704 S.W.2d 179, 186 (Ky. 1985) (citation omitted).

22 The privity doctrine was gradually abolished beginning with Justice Cardozo's landmark opinion in *MacPherson v. Buick Motor Co.*, 111 N.E. 1050 (N.Y. 1916), in which a Plaintiff with personal injuries was permitted to bring a negligence claim against the manufacturer of a defective car wheel with whom he was not in privity. "By 1966, the rule established in *MacPherson* had been adopted throughout the United States." Wright & Nicholas, *supra* note 9, at 466. One commentator notes that "lack of privity remains . . . a viable defense to construction defect suits in at least five states." Michael D. Lieder, *Constructing a New Action for Negligent Infliction of Economic Loss: Building on Cardozo and Coase*, 66 WASH. L. REV. 937, 944 (1991) (referencing cases from New York, New Jersey, Alabama, Maryland, and Ohio, which essentially hold that a professional is not liable for pure economic loss absent privity of contract or sufficient nexus between the parties resembling privity).

23 *See, e.g.*, Frank D. Wagner, Annotation, *Tort Liability of Project Architect for Economic Damages Suffered by Contractor*, 65 A.L.R.3d 249 (1974).

> Although, under the traditional general rule, privity of contract was required before a cause of action could arise from the negligent breach of a duty existing by virtue of contract, this requirement has been gradually eliminated in many jurisdictions, at first with respect to actions for personal injuries or death, and later in regard to suits predicated upon harm to intangible economic interests.

Id. at 252. *See also* Note, *Architectural Malpractice: A Contract-Based Approach*, 92 HARV. L. REV. 1075, 1075 n.5 (1979) (stating that *Inman v. Binghamton Housing Authority*, 143 N.E.2d 895 (N.Y. 1957), is the leading case eliminating the protection of the privity doctrine in cases regarding architect liability for negligence).

24 *See* Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 579 (Ky. 2004) (noting that privity is no longer required to maintain a tort action).

The frequency of tort claims asserted against design professionals increased with the abolishment of the privity requirement; these claims are now routine in the context of construction litigation.[25] Much of the original criticism of the privity doctrine originated in the context of products liability cases.[26] In this scenario the injustice seems clear, and traditional tort policies support the disregard of the privity requirement.[27] However, when a plaintiff suffers purely economic loss the distinction between tort and contractual remedies is blurred, and our legal system has struggled to determine the proper doctrines that apply in such situations.

B. The Argument for Reliance on Contractual Remedies

Many commentators[28] and some courts[29] advocate the position that commercial parties involved in construction disputes should be limited to their

25 *See supra* note 8 and accompanying text.

26 William David Flatt, Note, *The Expanding Liability of Design Professionals*, 20 U. MEM. L. REV. 611, 612–15 (discussing the abandonment of the privity doctrine in products liability suits and its eventual affect on design professionals in the state of Tennessee).

27 "Courts and legislatures prescribe rules of tort liability to serve certain fundamental policies—most importantly, compensating victims of harm; deterring wrongful conduct; placing losses on those who can and should bear or distribute them; and ensuring fairness . . . ." JAY M. FEINMAN, ECONOMIC NEGLIGENCE: LIABILITY OF PROFESSIONALS AND BUSINESSES TO THIRD PARTIES FOR ECONOMIC LOSS 13 (1995).

28 *See* Barrett, *supra* note 13 (advocating a bright-line rule for the application of the economic loss doctrine to prohibit the recovery of economic loss in the context of owner/contractor/design professional disputes); Susan Lorde Martin, *If Privity is Dead, Let's Resurrect It: Liability of Professionals to Third Parties for Economic Injury Caused by Negligent Misrepresentation*, 28 AM. BUS. L.J. 649 (1991) (arguing for the adoption of a uniform limited privity standard to analyze the liability of a design professional with exceptions based on the inability of third parties to protect themselves and a lack of existing incentives for the design professional to avoid errors); Thomas R. Yocum & Charles F. Hollis, *The Economic Loss Rule in Kentucky: Will Contract Law Drown in a Sea of Tort?*, 28 N. KY. L. REV. 456 (2001) (stating that the economic loss rule should bar a contractor from asserting a claim solely for economic loss against a design professional); Michael T. Terwilliger, Note, *Economic Loss in the Construction Context: Should Architects Be Liable for the Commercial Expectations of Contractors?*, 31 VAL. U. L. REV. 257 (1996) (advocating the adoption of a per se rule against architect liability for economic loss in the traditional design-bid-build delivery system where an adversarial relationship exists between the architect and the third party).

29 *See, e.g.*, Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443 (Ill. 1982) (economic loss rule applied to bar negligence claim against manufacturer for tank defect); Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n, 560 N.E.2d 206 (Ohio 1990) (contractor not allowed to recover damages in tort or contract from architect absent privity or sufficient nexus which could serve as substitute for privity); Blake Constr. Co. v. Alley, 353 S.E.2d 724 (Va. 1987) (stating that there is no common law duty on behalf of an architect to protect a contractor from economic loss and no recovery in tort for only economic loss in absence of privity); Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986, 993 (Wash. 1994) (holding that when parties have contracted to protect against potential economic liability, purely economic damages are not recoverable in an action for negligent misrepresentation).

contractual remedies when asserting claims for purely economic loss. The common thread in so-called "economic negligence"[30] cases is that damages are almost always the result of a failure to properly perform contractual duties owed to a third party participant in the project.[31] Proponents of sole reliance on contractual remedies usually frame their arguments in the context of the economic loss rule[32] or by advocating adherence to a strict privity or near privity requirement.[33]

1. The Role of the Economic Loss Rule in Barring Tort Claims for Pecuniary Loss.—The economic loss rule originated with the U.S. Supreme Court's opinion in *Robins Dry Dock & Repair Co. v. Flint*[34] in 1927.[35] Although the doctrine originally developed in the context of products liability, its application has gradually expanded and it is also applied in the context of service industries by some courts.[36] "An 'economic loss' is [defined as] the loss of an expectancy interest created by contract, often described as the 'benefit of the bargain.'"[37] More specifically, economic losses include "damages for inadequate value, costs of repair and replacement of [a] defective product, or consequent loss of profits—without any claim of personal injury or

30 FEINMAN, *supra* note 27, at 3 ("The law of economic negligence concerns the liability that a party to a contract [design professional] owes to a third person [contractor] when the party's breach or negligent performance of the contract causes economic loss to the third person.").

31 For example, an owner usually contracts separately with the design professional. Thus, the design professional has no contractual relationship with the contractor. However, the contractor may suffer economic loss as a result of the architect's failure to properly perform his contractual duties owed to the owner. Typically, these claims will take the form of a failure to provide adequate plans and specifications or a failure to perform an administrative duty under the contract.

32 *See supra* notes 13 & 29.

33 *See, e.g.*, Clevecon, Inc. v. N.E. Ohio Reg'l Sewer Dist., 628 N.E.2d 143, 146 (Ohio Ct. App. 1993) (holding that "lack of privity is not an absolute bar to a design professional's malpractice action when there is a nexus that can serve as a substitute for privity").

34 Robins Dry Dock & Repair Co. v. Flint, 275 U.S. 303 (1927). In *Robins*, the plaintiff brought a negligence action to recover damages for lost use of a chartered boat. The defendant was under a contract to repair the boat with its owner but had no contractual relation to the plaintiff. In denying the cause of action, the Court stated that "as a general rule, at least, a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other .... The Law does not spread its protection so far." *Id.* at 309. For a detailed discussion of the evolution of the economic loss rule, see R. Joseph Barton, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789, 1789–1803 (2000).

35 Meagher & O'Day, *supra* note 13, at 27. *But see* Barton, *supra* note 34, at 1794 (stating that the economic loss doctrine was first articulated by a California court in *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965)).

36 *See supra* note 17.

37 Barrett, *supra* note 13, at 895.

damage to other property."[38] "In its broadest formulation, the economic loss rule prohibits tort recovery in negligence or products liability 'absent physical injury to a proprietary interest.'"[39] Accordingly, courts generally have barred negligence or product liability suits unless the plaintiff has suffered personal injury or property damage.[40]

"In the construction context, the claims most commonly barred by the economic loss rule [are] for negligence, negligent misrepresentation, and fraud."[41] An illustrative case is *BRW, Inc. v. Dufficy & Sons, Inc.*[42] in which the Colorado Supreme Court barred a subcontractor (Dufficy) from asserting negligence claims[43] against an engineer (BRW) and a construction inspector (PSI). BRW was under contract with the owner to prepare plans and specifications for the construction of two bridges;[44] PSI was under contract with the owner to provide inspection services during construction to ensure compliance with the plans and specifications. Dufficy entered into a contract with another subcontractor for the fabrication, painting, and shipment of structural steel for the bridge.[45] Dufficy incurred economic damages due to unexpected delays in the application of paint to the structural steel members, allegedly due to the selection of an improper paint system by the design professional. In formulating the economic loss rule, the *BRW* Court stated, "a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law."[46] The court provided three main policy reasons for applying the economic loss rule to

38 Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443, 449 (Ill. 1982).

39 Presnell Constr. Mangers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 584 (Ky. 2004) (Keller, J., concurring).

40 Meagher & O'Day, *supra* note 13, at 27.

41 Patricia H. Thompson & Christine Dean, *Who is Going to Pay for My Impact? A Contractor's Ability to Sue Third Parties for Purely Economic Loss*, CONSTR. LAW., Fall 2005, at 37. For a state-by-state assessment of the application of the economic loss rule in the construction context, see COMM. ON CONSTR. LITIG., AM. BAR ASS'N, STATE-BY-STATE SURVEY OF THE ECONOMIC LOSS DOCTRINE IN CONSTRUCTION LITIGATION (1996).

42 BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66 (Colo. 2004).

43 Dufficy asserted claims for both negligence and negligent misrepresentation against BRW and PSI. *Id.* at 70.

44 *Id.* at 68. BRW's contract with the owner provided that its work would be performed "in accordance with the standards of care, skill and diligence provided by competent professionals who perform work or services of a similar nature." *Id.* BRW also agreed that its drawings and specifications would "represent a thorough study and competent solution for the Project as per usual and customary professional standards and shall reflect all architectural and engineering skills applicable to that phase of the project." *Id.*

45 *Id.*

46 *Id.* at 72 (quoting Town of Alma v. AZCO Constr., Inc., 10 P.3d 1256, 1264 (Colo. 2000)). As will be discussed later in this Note, Justice Keller proposed the adoption of this formulation of the economic loss rule under Kentucky law. *See infra* notes 108–25 and accompanying text.

bar a negligence claim (solely for economic loss) in the context of a construction dispute between commercial parties:

> (1) to maintain a distinction between contract and tort law; (2) to enforce expectancy interests of the parties so that they can reliably allocate risks and costs during their bargaining; and (3) to encourage the parties to build the cost considerations into the contract because they will not be able to recover economic damages in tort.[47]

In its holding, the court emphasized the importance of the parties' contractual relationship in determining whether a design professional should owe a duty to the contractor. The court stated:

> Our economic loss rule requires the court to focus on the contractual relationship between the parties, rather than their professional status, in determining the existence of an independent duty of care. The interrelated contracts in this case contained BRW's and PSI's duty of care. Dufficy's tort claims are based on duties that are imposed by contract and therefore, contract law provides the remedies. Accordingly, the economic loss rule bars Dufficy's tort claims.[48]

This court's reasoning is typical of those who apply the economic loss rule to bar negligence claims asserted by a contractor against a design professional absent privity of contract.[49]

2. Out of Bounds!—Maintaining the Distinction between Contract and Tort— Proponents of contractual remedies typically place great importance on the role of contracts in the allocation of economic risks among owners, contractors, and design professionals. A representative view of this position is pro-

47 *Id.* at 72 (citing *Town of Alma*, 10 P.3d at 1262).

48 *Id.* at 67–68.

49 *See* R.H. Macy & Co. v. Williams Tile & Terrazzo Co., 585 F. Supp. 175 (N.D. Ga. 1984); State v. Tyonek Timber, Inc. 680 P.2d 1148 (Alaska 1984); Danforth v. Acorn Structures, Inc., 608 A.2d 1194, 1198 (Del. 1992); City Express, Inc. v. Express Partners, 959 P.2d 836 (Haw. 1998); Blahd v. Richard B. Smith, Inc., 108 P.3d 996 (Idaho 2005); Prendiville v. Contemporary Homes, Inc., 83 P.3d 1257, 1264 (Kan. Ct. App. 2004); Real Estate Mktg. v. Franz, 885 S.W.2d 921, 926–27 (Ky. 1994); Fleischer v. Hellmuth, Obata & Kassabaum, Inc., 870 S.W.2d 832 (Mo. Ct. App. 1993); Floor Craft Floor Covering, Inc. v. Parma Cmty. Gen. Hosp. Ass'n, 560 N.E.2d 206 (Ohio 1990); E.J. Robinson Glass Co. v. Pilot Contracting Corp., No. C-010296, 2001 WL 1887714 (Ohio Ct. App. Dec. 19, 2001) (privity of contract or substantial nexus approaching privity required to recover economic loss); Thomson v. Espey Huston & Assocs., 899 S.W.2d 415 (Tex. App. 1995); SME Indus., Inc. v. Thompson, Ventulett, Stainback & Assocs., 28 P.3d 669, 682–84 (Utah 2001); Gerald M. Moore & Son, Inc. v. Drewry, 467 S.E.2d 811 (Va. 1996); Blake Constr. Co. v. Alley, 353 S.E.2d 724 (Va. 1987); Rissler & McMurry Co. v. Sheridan Area Water Supply, 929 P.2d 1228 (Wyo. 1996).

vided by the Washington Supreme Court in *Berschauer/Phillips Construction Co. v. Seattle School District No. 1.*[50] The issue before the court was whether a general contractor could recover economic damages caused by construction delays from an architect, a structural engineer, and a project inspector, none of whom where in privity with the contractor. Berschauer/Phillips (BP) had entered into a contract to build an elementary school.[51] BP asserted breach of contract claims against the owner but also asserted negligence claims against (1) the architect and structural engineer for inaccurate and incomplete structural engineering plans, and (2) the project inspector for negligently failing to inspect the erection of structural steel during construction of the school.[52]

In holding that the economic loss rule barred the contractor from recovering purely economic damages in tort, the court provided a typical view of those advocating reliance on contractual remedies for recovery of economic loss:

> We follow the *Stuart*[53] and *Atherton*[54] line of cases and maintain the fundamental boundaries of tort and contract law by limiting the recovery of economic loss due to construction delays to the remedies provided by contract. We so hold to ensure that the allocation of risk and the determination of potential future liability is based on what the parties bargained for in the contract. We hold parties to their contracts. If tort and contract remedies were allowed to overlap, certainty and predictability in allocating risk would decrease and impede future business activity. The construction industry in particular would suffer, for it is in this industry that we see most clearly the importance of the precise allocation of risk as secured by contract. The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract.[55]

The *Berschauer/Phillips* court also touched upon another argument advanced by proponents of the contractual approach—namely that "the expansion of duty in tort liability to include economic interests would expose

50 Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986 (Wash. 1994).

51 *Id.* at 988.

52 *Id.* at 989.

53 Stuart v. Coldwell Banker Commercial Group, 745 P.2d 1284, 1290–92 (Wash. 1987) (A condominium association asserted negligence claims against a contractor for construction defects resulting solely in economic loss. The negligence claim was dismissed, and the association was limited to its contractual remedy under the implied warranty of habitability.).

54 Atherton Condo. Apartment-Owners Ass'n v. Blume Dev. Co., 799 P.2d 250, 266 n.17 (Wash. 1990) (stating that owner's claim for economic loss against an architect is not a recognizable claim for negligence).

55 *Berschauer/Phillips*, 881 P.2d at 992.

defendants 'to liability in an indeterminate amount for an indeterminate time to an indeterminate class.'"[56] However, in the commercial context of construction litigation, the propensity for indeterminate liability seems unfounded because of the limited number of parties relying on the information provided and the foreseeable class of plaintiffs—namely contractors—who must clearly rely on the plans and specifications prepared by the design professional in constructing a project.[57]

Doctrinally, the application of the economic loss rule and the position that contractors should be limited to their contractual remedies both reach the same result. In reality, the latter is simply an argument supporting the expansion of the economic loss rule to serve as an absolute bar to third-party actions against design professionals in a commercial setting. As with most tort-related doctrines, both these positions reflect a court's policy decision that a design professional should not owe a duty to a third party to avoid causing economic loss.

Construction projects involve sophisticated parties who have the opportunity to bargain for certain remedies when negotiating their contracts. Accordingly, some argue that the contractor should be restricted to reliance on contractual remedies against the owner, who may then seek indemnification from a design professional if the professional has not performed his or her contractual duties owed to the owner. However, those advocating this view actually may be reading a bit too much into the contract negotiation process. In reality, standard form contracts are widely used in the industry and their provisions typically favor design professionals. Thus, a conclusion that a contractor has the ability to freely bargain for available remedies may be a bit misleading. Many jurisdictions have either refused to apply the economic loss rule in the context of construction disputes or recognized limited exceptions to the doctrine.[58]

C. The Argument for the Imposition of Tort Liability

In modern construction litigation, contractors will almost always assert a negligence claim against a design professional in addition to contractual

56 *Id.* (quoting Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931)). Justice Cardozo's opinion in *Ultramares* is recognized as the landmark case regarding accountant liability for economic loss to third parties. Cardozo's concerns are still reflected today in the context of construction litigation in New York. In negligent misrepresentation cases where a plaintiff seeks compensation solely for economic loss, New York requires that the "underlying relationship between the parties be one of contract or the bond between them so close as to be the functional equivalent of contractual privity." Ossining Union Free Sch. Dist. v. Anderson, 539 N.E.2d 91, 91 (N.Y. 1989) (holding that owner in privity with architectural firm can assert a professional negligence claim against third-party engineering consultants retained by architect, where relationship is the functional equivalent of privity).

57 *See* Terwilliger, *supra* note 28, at 282.

58 *See infra* notes 62–63.

claims they may have against their contracting partner.[59] There are numerous practical reasons why a contractor might elect to pursue a claim in tort, rather than resort to contractual remedies: (1) the contractor might be attempting to avoid contract provisions which restrict potential recovery from his or her contract partner;[60] (2) the entity with whom he or she is in privity may have become insolvent; (3) the potential pool of litigants who might contribute to a settlement may be increased by pursuing negligence claims; (4) the contractor may be seeking to take advantage of professional malpractice liability insurance as a potential source of recovery; and (5) consequential damages are generally easier to recover in a negligence action.[61] Courts addressing the imposition of tort liability on design professionals have typically done so under one of three theories: general negligence,[62] negligent misrepresentation,[63] or third-party beneficiary theory.[64]

59 Those in privity with a design professional (i.e., the owner) have been allowed to recover in both contract and tort. *See* Martha Crandall Coleman, *Liability of Design Professionals for Negligent Design and Project Management*, 33 TORT & INS. L.J. 923, 924 (1998); *see also* Penco, Inc. v. Detrex Chem. Indus., 672 S.W.2d 948, 951 (Ky. Ct. App. 1984) (citing B & C Constr. Co. v. Grain Handling Corp., 521 S.W.2d 98 (Tex. App. 1975)) (party with breach of contract claim may sometimes sue in tort for its breach).

60 One such provision is a "no damage for delay clause" which places the risk of monetary damages for delay on the contractor and limits the remedy for delay to time extensions, regardless of which party, if any, is responsible for the delay (for example, it could be weather-related). *See* SWEET, *supra* note 3, §26.10.

61 *See* Wright & Nicholas, *supra* note 22, at 457–58.

62 *See, e.g.*, United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1958); A.R. Moyer, Inc. v. Graham, 285 So.2d 397 (Fla. 1973), *questioned in* Casa Clara Condo. Ass'n, v. Charley Toppino & Sons, 620 So. 2d 1244, 1248 n. 9 (Fla. 1993) (limititing *Moyer* strictly to its facts).

63 *See, e.g.*, Hewett-Kier Constr., Inc. v. Lemuel Ramos & Assocs., 775 So. 2d 373 (Fla. Dist. Ct. App. 2000) (economic loss rule does not bar action for purely economic losses where a special relationship is established under section 552); Robert & Co. v. Rhodes-Haverty P'ship, 300 S.E.2d 503, 504 (Ga. 1983) (recognizing an exception to economic loss rule for negligent misrepresentation); Moorman Mfg. Co. v. Nat'l Tank Co., 435 N.E.2d 443 (Ill. 1982) (noting an exception to the economic loss rule in Illinois for negligent misrepresentation); Nota Constr. Corp. v. Keyes Assocs., 694 N.E.2d 401, 405 (Mass. App. Ct. 1998); Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270 (Pa. 2005); E. Steel Constructors, Inc. v. City of Salem, 549 S.E.2d 266 (W. Va. 2001) (discussed in Robert M. Stonestreet, Note, *Replacing a Solid Wall with a Chain-Link Fence: Special Relationship Analysis for Tort Recovery of Purely Economic Loss*, 105 W. VA. L. REV. 213 (2002)).

64 Third party beneficiary theory has not been very successful for plaintiffs in construction litigation. *See* Jean Fleming Powers, *Expanded Liability and the Intent Requirement in Third Party Beneficiary Contracts*, 1993 UTAH L. REV. 67, 86 (1993) ("Generally it has been held that the ordinary construction contract—i.e. one which does not expressly state the intention of the contracting parties is to benefit a third party—does not give third parties who contract with the promisee the right to enforce the latter's contract with another."); Circo, *supra* note 3, at 185–86 ("One not a party to the design contract might seek a route around the privity roadblock by claiming to be a third-party beneficiary, but that route often proves to be a narrow one. The courts have not often been receptive to this argument in construction cases."); *see also infra* note 86–87 and accompanying text.

While the majority of courts seem to apply the economic loss rule to bar general negligence claims, many recognize an exception to the doctrine for the tort of negligent misrepresentation.[65] Some commentators believe this is the proper approach because it represents a just compromise between a broad negligence standard and a per se rule barring recovery of economic loss.[66] Furthermore, the elements of negligent misrepresentation properly address many of the traditional criticisms of tort recovery for economic loss in the absence of privity. The Kentucky Supreme Court recently had the opportunity to address this situation in *Presnell*.

III. *PRESNELL*—KENTUCKY EXPLICITLY ADOPTS THE RESTATEMENT (SECOND) OF TORTS § 552 AS THE STANDARD FOR NEGLIGENT MISREPRESENTATION

Prior to *Presnell*,[67] the Kentucky Court of Appeals had either principally applied or explicitly stated that negligent misrepresentation is a recognized cause of action;[68] however, the Kentucky Supreme Court had yet to weigh in on the issue. In accordance with the principles applied by the lower courts, the Kentucky Supreme Court concluded that negligent misrepresentation is a recognized cause of action in Kentucky and adopted the Restatement (Second) of Torts § 552.[69] This discussion is limited to the application of section 552 in construction litigation. However, the adoption

65 *See, e.g.*, *Robert & Co.*, 300 S.E.2d at 504 (recognizing an exception to economic loss rule for negligent misrepresentation); *Moorman Mfg. Co.*, 435 N.E.2d 443 (noting an exception to the economic loss rule in Illinois for negligent misrepresentation). The Moorman exception for negligent misrepresentation has been limited in subsequent cases involving design professionals in Illinois. *See* 2314 Lincoln Park West Condo. Ass'n v. Mann, Gin Ebel & Frazier, Ltd., 555 N.E.2d 346, 351 (Ill. 1990) (opining that information supplied by an architect which is transformed into a building does not fit within the negligent misrepresentation exception to the economic loss rule).

66 *See* FEINMAN, *supra* note 27, at 186–89. Feinman states that the "[n]egligent misrepresentation doctrine comes the closest to incorporating all the relevant issues in economic negligence cases." *Id.* at 186. This approach has "often been adopted as a middle ground between the narrow third party beneficiary law and the broad law of negligence." *Id.* at 187.

67 Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575 (Ky. 2004).

68 *See* Ingram Indus., Inc. v. Nowicki, 527 F. Supp. 683, 684 (E.D. Ky. 1981) (predicting that the Kentucky Supreme Court would recognize the tort of negligent misrepresentation in the context of an accountant negligently causing economic loss to a third party); Morton v. Bank of the Bluegrass, 18 S.W.3d 353, 358 (Ky. Ct. App. 1999) (recognizing that negligent misrepresentation was a proper cause of action in the context of representations made by an insurer to its insured); Seigle v. Jasper, 867 S.W.2d 476, 482 (Ky. Ct. App. 1993) (negligent misrepresentation applied to an attorney performing a title examination); Chernick v. Fasig-Tipton Kentucky, Inc., 703 S.W.2d 885, 889–90 (Ky. Ct. App. 1986) (Fasig-Tipton had duty to provide a prospective purchaser with accurate information in the catalog of sale).

69 The Restatement (Second) of Torts § 552 will be hereinafter referred to as "section 552."

of this standard also affects other professionals participating in a service industry.[70]

A. An Analysis of the Opinion Issued in Presnell *and its Related Authorities*

1. The Facts of the Case.—Presnell presents a set of facts that typically arises in the context of a claim in which a plaintiff seeks to recover economic damages from a design professional with whom he or she was not in privity. In May 1996, Delor Design Group, Inc. ("Delor"), the owner, entered into a contract[71] with Presnell Construction Managers, Inc. ("Presnell"), the design professional, to act as the construction manager for the renovation of a commercial building.[72] In March 1997, Delor entered into a contract[73] with EH Construction, LLC ("EH"), the contractor, to furnish "general trades" work for the project. Work proceeded, but in November 1997, EH filed a lien against Delor's real property for materials and labor supplied to Delor for which it did not receive payment.[74] In February 1998, EH filed suit[75] "to recover damages for its economic losses, which EH alleged were the result of Presnell's alleged negligent misrepresentation and negligent supervision of the Project."[76] EH alleged that 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 other contractors and subcontractors coming in and subsequently destroying work that had already been completed by [EH].'"[77] EH also 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."[78]

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70 This cause of action is routinely applied in the context of accountant and attorney negligence.

71 Delor and Presnell entered into a Standard American Institute of Architects (AIA) contract titled "Standard Form of Agreement Between Owner and Construction Manager where the Construction Manager is NOT a Constructor." *Presnell*, 134 S.W.3d at 577.

72 *See also supra* note 5 and accompanying text providing description of typical role of construction manager.

73 Delor and EH entered into a Standard AIA contract titled "Standard Form of Agreement Between Owner and Contractor." *Id.* at 577.

74 *Id.*

75 EH also sought to enforce its lien against Delor, but Delor was dismissed from the suit due to a mediation/arbitration provision in its contract which precluded the use of a judicial proceeding to resolve disputes originating from the contract between EH and Delor. *Id.* at 578 n.2.

76 *Id.* at 578.

77 *Id.* (quoting EH complaint).

78 *Id.* (quoting EH complaint).

2. Ruling Issued by the Court of Appeals.—The trial court dismissed EH's negligence claim against Presnell "on the ground that all of Presnell's duties were under its contract to Delor and that Presnell had no duty to EH."[79] EH appealed, urging that privity between EH and Presnell was not required for a duty to arise and advocating the adoption of section 552.[80] The court of appeals sided with EH and adopted section 552 as the standard for negligent misrepresentation.

In analyzing section 552 in the context of construction disputes, the court of appeals cited with approval[81] an opinion issued by the Tennessee Supreme Court in *John Martin Co. v. Morse/Diesel, Inc.*,[82] a case with facts strikingly similar to those of *Presnell.* Morse/Diesel was under contract with the owner to serve as the construction manager[83] throughout the course of a project to construct a commercial building.[84] John Martin Co., under contract with the owner, allegedly suffered additional costs and delays during the pouring of concrete due to inaccurate elevations supplied by Morse/Diesel.

The *Morse/Diesel* court held that "a subcontractor, despite a lack of privity, may make a [negligent misrepresentation] claim against the construction manager . . . whether the negligence was in the form of negligent direction or supervision."[85] During the course of its opinion, the court addressed many of the traditional criticisms advanced for imposing tort liability for economic loss incurred by third parties, but concluded that section 552 provides a reasonable approach for the imposition of negligence liability

79 EH Constr., L.L.C. v. Delor Design Group, Inc., No. 1998-CA-001476-MR, 2000 Ky. App. LEXIS 29, at *4 (Ky. Ct. App. Mar. 31, 2000), *aff'd sub nom.* Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575 (Ky. 2004).

80 *Id.* at *4.

81 *Id.* at *10–13.

82 John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428 (Tenn. 1991) (holding that despite lack of privity, a subcontractor may assert a negligent misrepresentation claim against a construction manager, whether the negligence is in the form of negligent direction or supervision).

83 More specifically, Morse/Diesel's contract specified that he was "to act [on] behalf of the owner in the employment of the necessary subcontractors, the coordination of their schedule, and the supervision of their work." *Id.* at 429. Morse/Diesel was also responsible for reviewing and approving the plans and specifications prepared for the use of the subcontractors. *Id.*

84 This project was to be constructed by the "fast-track" method. In this method of contract organization, plans and specifications are typically not complete when construction begins and separate phases of the project are initiated upon their completion. *Id.* In this context, planning and organization are critical and the construction manager is typically responsible for performing these functions. Contractually, the owner entered into separate agreements with each entity to construct different portions of the structure. Acting as agent for the owner, Morse/Diesel executed a subcontract with John Martin to provide concrete and rough carpentry for the superstructure of the building. *Id.* at 429–30.

85 *Id.* at 429.

for economic loss. Specifically, the court noted that "the burden is always upon the Plaintiff to establish that the supplier [of information] violated his duty to exercise due care and competence in obtaining or communicating the information."[86] Additionally, the plaintiff must be able to establish that its reliance on the information provided by the supplier was both foreseeable and justified, and comparative negligence on behalf of the user may be asserted as a defense.[87] "Each of these principles provides reasonable protection against the proliferation of litigation in this area of tort . . . [section 552] suggest[s] a properly balanced approach."[88] While *Morse/Diesel* expresses a view typical of courts adopting section 552, it is unlikely that this cause of action will be applied as broadly in Kentucky courts.[89]

3. The Ruling issued by the Kentucky Supreme Court.—a. Privity of Contract.— The Supreme Court first focused its attention on whether EH was a third-party beneficiary of the contract entered into between Presnell and Delor, which could provide one avenue through which EH might recover damages for Presnell's breach of a duty arising by contract. The court recognized the long-standing principle that "the obligations arising out of a contract are due only to those with whom it is made . . . [and] cannot be enforced by a person who is not a party to it or in privity with it . . . or, under certain circumstances, by a third-party beneficiary."[90] However, the court found that EH was "at . . . most, an incidental beneficiary of the contract" and reiterated the long-standing proposition that "[o]nly a third party who was *intended* by the parties to benefit from the contract, namely, a donee or a creditor beneficiary, has standing to sue on a contract; an *incidental beneficiary does not acquire such right.*"[91] The contracts entered into by the various

86 *Id.* at 435.

87 *Id.*

88 *Id.* This discussion was primarily in response to Justice Cardozo's warnings expressed in *Glanzer v. Shepard*, 135 N.E. 275 (N.Y. 1922) (expressing the "end and aim" of the transaction approach) and *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931) (sufficient nexus required—privity or near privity) against the imposition of limitless liability for misrepresentations resulting in economic loss to parties with whom an individual has no privity.

89 The Kentucky Supreme Court does not appear to have adopted quite as broad a view of this tort as that expressed in *Morse/Diesel*. In *Presnell*, the Court explicitly ruled that a claim for negligent supervision was not actionable because it did not arise from a duty independent of a contractual duty. Accordingly, "one who is not a party to the contract or in privity thereto may not maintain an action for negligence which consists merely in the breach of the contract." Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 579 (Ky. 2004). This highlights the Court's adherence to the doctrine that a contractor's cause of action for economic loss must arise from a design professional's independent duty arising outside the context of its contract with the owner.

90 *Id.* at 579 (citations omitted).

91 *Id.* at 579–80 (emphasis added). This is representative of the view of the majority of courts focusing on the "intent requirement" under third party beneficiary theories. These arguments are rarely successful in the context of construction disputes, primarily as a result

parties clearly indicated that EH was not an intended beneficiary of the contract entered into between Presnell and Delor,[92] and thus, EH had no standing to sue on the contract.

In addressing the status of the privity requirement as a prerequisite for an action in tort, the court stated:

> [P]rivity is no longer required to maintain a tort action, [but] one who is not a party to the contract or in privity thereto may not maintain an action for negligence which consists merely in the breach of the contract. Accordingly, unless Presnell breached some duty to EH apart from its duties to DeLor under the contract—i.e. *an independent duty*—EH, who was at the most, an incidental beneficiary of the contract between DeLor and Presnell, cannot maintain an action in negligence against Presnell.[93]

Therefore, the court ruled that EH's common law negligence claim for negligent supervision was barred because it arose solely from contractual duties owed by Presnell to Delor.[94] However, in order to determine whether Presnell owed EH an additional independent duty outside of its contract, the court turned to the tort of negligent misrepresentation.

b. Negligent Misrepresentation.—The court explicitly adopted section 552 as the standard for negligent misrepresentation in Kentucky. Section 552 states:

> § 552 Information Negligently Supplied for the Guidance of Others:
>
> (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

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of standard contract clauses which typically disclaim the extension of any third party rights to a contractor by virtue of the owner/design professional contract. *See supra* note 64 and accompanying text.

92 The clause included in the contract stated:

> The Contractor agrees that nothing contained in the Contract Documents or any agreement between the Owner and the Construction Manager or the Owner and the Design Professional creates any contractual relationship between the Construction Manager . . . and the Contractor. The Contractor waives any right the Contractor may have as an alleged third-party beneficiary of any such agreements and covenants not to sue the Construction Manager . . . as a third-party beneficiary of such agreements.

Id. at 577.

93 *Id.* at 579–80 (emphasis added) (citations omitted).

94 *Id.* at 582–83 ("EH's claim for negligent supervision does not articulate a claim that is independent of Presnell's contractual duties."). The majority opinion offered very little analysis on this issue.

> 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.[95]

The court first traced the history of this cause of action as it has developed in the lower appellate courts[96] and various federal courts[97] of Kentucky. The court concluded that section 552 is "consistent with Kentucky case law" and joined "the majority of jurisdictions" in adopting its "standards for negligent misrepresentation claims" in Kentucky.[98] Primarily because the subject of the appeal was a motion to dismiss, the court did not analyze the facts of the case to determine if EH could prevail on its claim. Furthermore, aside from noting that that section 552 is consistent with Kentucky law, the Kentucky Supreme Court expressed few policy justifications for the imposition of liability in this context. *Presnell*, therefore, offers little

95 RESTATEMENT (SECOND) OF TORTS § 552.

96 *Presnell*, 134 S.W.3d at 580–82.

97 *See* Scheck Mech. Corp. v. Borden, Inc., 186 F. Supp. 2d 724, 734 (W.D. Ky. 2001) (predicting that Kentucky would recognize section 552 based on its general adoption of the Restatement in tort situations); Goldman Servs. Mech. Contracting, Inc. v. Citizens Bank, 812 F. Supp. 738, 742 (W.D. Ky. 1992) (expressing the same view as the *Scheck* court), *aff'd*, Nos. 92-5654/5655, 1993 U.S. App. LEXIS 27733 (6th Cir. Oct. 21, 1993); Ingram Indus. v. Nowicki, 527 F. Supp. 683, 684 (E.D. Ky. 1981) (predicting that the Kentucky Supreme Court would recognize the tort of negligent misrepresentation in the context of an accountant negligently causing economic loss to a third party). *But see* Miller's Bottled Gas, Inc. v. Borg-Warner Corp., 955 F.2d 1043, 1053 (6th Cir. 1992) (predicting that Kentucky would not allow recovery on a negligent misrepresentation claim solely for economic loss).

98 *Presnell*, 134 S.W.3d at 582.

guidance to potential litigants regarding the circumstances under which relief is available.

What can be taken from the *Presnell* opinion is that "privity is not necessary to maintain a tort action" and through its adoption of section 552, Kentucky now recognizes that "the tort of negligent misrepresentation defines an independent duty for which recovery in tort for economic loss is available."[99] In *Presnell*, the court found that section 552 created a duty on behalf of Presnell "not to supply false information," and since EH's complaint alleged that "Presnell supplied faulty information and guidance to the project's contractors," the cause of action was allowed to survive Presnell's motion to dismiss for failure to state a claim on which relief could be granted.[100]

The lower appellate court's opinion offers a bit more insight into the supporting rationale for section 552[101] and situations where a defendant's conduct might lead to liability for negligent misrepresentation. The court of appeals stated that in order for EH to prevail on its claim against Presnell for negligent misrepresentation it must be able to prove that:

> (1) Presnell was acting in the course of its business, profession, or employment, or in a transaction in which it had a pecuniary (as opposed to gratuitous) interest; (2) Presnell supplied faulty information intended to guide others in their business transactions; (3) Presnell failed to exercise reasonable care in obtaining or communicating the information; and (4) EH justifiably relied upon the information and thereby incurred pecuniary loss.[102]

The court of appeals also offered further insight into the source of the independent duty created under section 552. Initially, the court examined the contract between Presnell and Delor to discern exactly what responsibilities[103] Presnell had in the administration of the contract, and found that

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99 *Id.*

100 *Id.*

101 *See supra* notes 86–89 and accompanying text (discussing the policy rationale supporting the imposition of liability under section 552 for a design professional's negligent misrepresentation).

102 EH Constr., L.L.C. v. Delor Design Group, Inc., No. 1998-CA-001476-MR, 2000 Ky. App. LEXIS 29, at *14 (Ky. Ct. App. Mar. 31, 2000), *aff'd sub nom.* Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575 (Ky. 2004).

103 The terms of Presnell's contract stated as follows:

> The contract between Presnell and Delor provided . . . that Presnell shall provide administrative, management and related services to coordinate scheduled activities and responsibilities of the Contractors with each other and with those of the Construction Manager, the Owner and the Architect to endeavor to manage the Project in accordance with the latest approved estimate of Construction Cost, the Project Schedule and the Contract Documents. [Presnell was also required to] coordinate the

the "contract provisions established that Presnell was to be in charge of coordinating the sequence of construction."[104] However, as the Kentucky Supreme Court agreed, while the contractual duties owed to Delor were representative of Presnell's obligations under the contract, "Presnell's duty to EH [did] not rest on these contractual duties."[105] Furthermore, "it [did] not rest on any *professional duty*, but [was] 'based on an independent duty [created by section 552] to avoid misstatements intended to induce reliance.'"[106] In other words, "Presnell [owed] a duty to EH to exercise reasonable care or competence in its supervision, collection and distribution of information and directions it provided to EH for guidance."[107]

c. Economic Loss Rule.—While not addressed by the majority, another important component of *Presnell* is Justice Keller's concurring opinion, in which he addressed the status of the economic loss rule in Kentucky.[108] Although neither party raised the economic loss rule in its arguments, Justice Keller stated, "the rule is clearly implicated, if not inexorably intertwined, with the legal arguments presented and authorities relied upon by the parties."[109] Justice Keller agreed with the majority's opinion but opined that the economic loss rule should also bar EH's common law negligence claim for negligent supervision. While noting that no Kentucky court had explicitly referred to the economic loss rule by name, he stated that "Kentucky appellate courts have implicitly applied [it] in the past"[110] and urged that

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> sequence of construction and assignment of space in areas where the Contractors are performing Work . . . [and] schedule and coordinate the sequence of construction in accordance with the Contract Documents and the latest approved Project construction schedule.

Id. at *12–13.

104 *Id.*

105 *Id.* at *13.

106 *Id.* (quoting Safeway Managing General Agency, Inc. v. Clark & Gamble, 985 S.W.2d 166, 169 (Tex. Ct. App. 1998)) (emphasis added).

107 *Id.* The Kentucky Supreme Court disagreed with this statement in one very important way: the duty owed by a design professional to a third party under section 552 does not encompass supervision of the project. *Supra* note 89 and accompanying text. However, this may be a meaningless distinction. By alleging that the design professional supplied false information for the contractor's guidance in exercising his duties to supervise construction of the project, a claim that is in substance one for negligent supervision may fit within the contours of negligent misrepresentation.

108 Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 583 (Ky. 2004) (Keller, J., concurring). Justice Graves joined in this concurring opinion.

109 *Id.* at 585. This was attributed to the fact that "no Kentucky appellate decision has ever used the specific phrase, 'economic loss rule' much less indicated its approval or adoption of the rule." *Id.* at 585–86 (citing Yocum & Holliss, *supra* note 28, at 467). However, Justice Keller noted that both the Kentucky Supreme Court and the Court of Appeals "have applied the rule's principles without identifying their source." *Id.* at 586.

110 *Id.* at 583. For a more detailed discussion of the evolution of the economic loss rule

the "Court should expressly adopt the economic loss rule in order to encourage contracting parties to allocate . . . risks [for economic loss] themselves."[111] Justice Keller summarized his position by stating:

> I agree with the economic loss rule's underlying rationale—i.e., the need to establish a boundary between contract law and tort law so that 'parties to a contract may allocate their risks by agreement and [will] not need the special provisions of tort law to recover for damages caused by breach of contract.' Accordingly, I would hold the economic loss rule is applicable to Kentucky tort claims.[112]

In articulating the proper formulation of the economic loss rule, Justice Keller urged the adoption of the rule as stated by the Colorado Supreme Court in *Town of Alma v. AZCO Construction, Inc.*[113]

In *Town of Alma*, the city ("Alma") contracted with the construction company ("AZCO") to construct improvements to its water distribution system. After construction was complete, Alma discovered leaks in the system and sued AZCO for breach of contract, negligence per se, negligence, and breach of the implied warranty of sound workmanship.[114] The trial court granted AZCO's motion to dismiss the negligence and breach of the implied warranty of sound workmanship claims. Relying on the economic loss rule, the court of appeals affirmed the lower court's findings and stated, "to hold otherwise would permit the non-breaching party to avoid the contractual limitations of remedy."[115] On appeal, the Colorado Supreme Court held that "a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law."[116]

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in Kentucky, see Yocum & Hollis, *supra* note 28, at 459–71. The authors of this article, written in response to the appellate court's ruling in *Presnell*, but prior to the ruling issued by the Kentucky Supreme Court, argue that the adoption of section 552 "threatens the integrity of contract law and the freedom to bargain far beyond the ambit of construction law." *Id.* at 473. Thus, the authors favor a strict application of the economic loss rule in the context of commercial transactions to bar claims solely for economic loss. In this context, the authors argue that parties could have bargained for contractual provisions allowing them to seek compensation for economic damages from a non-privity participant in the project but failed to do so. Thus, "what otherwise might have been used as a bargaining tool for either side becomes a mandatory provision in all contracts between owners and construction managers" through the creation of an independent duty under section 552. *Id.* at 472–73.

111 *Presnell*, 134 S.W.3d at 583 (Keller, J., concurring).

112 *Id.* at 589 (quoting 86 C.J.S. *Torts* § 26(a) (1997)).

113 Town of Alma v. AZCO Constr., 10 P.3d 1256 (Colo. 2000) (suit by owner against contractor; claim for negligence barred by economic loss rule because contractor did not breach a duty owed independent of its contract).

114 *Id.* at 1258.

115 *Id.* at 1258–59 (citation omitted).

116 *Id.* at 1264.

The *Town of Alma* court emphasized that the first step in applying the economic loss rule is to focus on the source of the duty that the plaintiff claims the defendant owed.[117] The court addressed the fundamental distinctions between the interests protected by contract and tort law and the source of the duties created under each regime.[118] The court then reasoned that the limitation of tort remedies in situations where the parties have participated in the negotiation of a contract "serves to encourage parties to confidently allocate risks during their bargaining without fear that unanticipated liability may arise in the future, effectively negating the parties' efforts to build these costs considerations into the contract. The economic loss rule thus serves to ensure predictability in commercial transactions."[119] Therefore, the first step in determining the "availability of a contract or tort action lies in determining the source of duty that forms the basis of the action."[120] Reinforcing this conclusion, the court referenced a discussion of this issue by the South Carolina Supreme Court:

> The question, thus, is not whether the damages are physical or economic. Rather the question of whether the plaintiff may maintain an action in tort for purely economic loss turns on the determination of the *source of the duty* [the] plaintiff claims the defendant owed. A breach of a duty which arises under the provisions of a contract between the parties must be redressed under contract, and a tort action will not lie. A breach of duty *arising independently* of any contract duties between the parties, however, may support a tort action.[121]

Applying the rule to the facts of the case, the Colorado Supreme Court found that AZCO's contract with Alma explicitly defined AZCO's duty of care.[122] Thus, AZCO did not owe an independent duty to Alma outside of

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117 "The key to determining the availability of a contract or tort action lies in determining the source of the duty that forms the basis of the action." *Id.* at 1262.

118 "The essential difference between a tort obligation and a contract obligation is the source of the duties of the parties." *Id.* Tort duties are normally imposed by law "to protect all citizens from the risk of physical harm to their persons or to their property[,] . . . without regard to any agreement or contract . . . [while] contractual duties arise from promises made between parties." *Id.* "Contract law is intended to enforce the expectancy interests created by the parties' promises so that they can allocate risks and costs during their bargaining." *Id.*

119 *Id.*

120 *Id.* (In note 8, the court states that a more accurate term for the economic loss rule would be the independent duty rule.) *Id.* at 1262 n.8.

121 *Id.* at 1262 (quoting Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85, 88 (S.C. 1995) (emphasis added)); *see also* Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 589 (Ky. 2004) (quoting the same passage).

122 *Town of Alma*, 10 P.3d at 1264. The Court examined the contractual provisions relating to various guaranties provided by AZCO and found that the "contractual provisions demonstrate that AZCO expressly assumed the duty to guarantee its quality of workmanship

its contractual obligations. Furthermore, Alma sought recovery solely for the "cost of repair and replacement of the water lines that were the subject of the contract";[123] this constitutes economic loss damages and must be supported by an independent duty of care in order to support a claim for negligence. Since such an independent duty was lacking, the court dismissed the negligence claim.[124]

In summary, under the economic loss rule articulated in *Town of Alma* and endorsed by Justice Keller, the first step in determining whether a plaintiff may maintain an action for purely economic loss is to determine if there is an independent duty arising outside of the provisions of the contract, rather than classifying the damages sought as either physical or economic. Therefore, even under this view of the economic loss rule, the tort of negligent misrepresentation is an exception and is not barred[125] because it establishes a duty that is not seeded in the parties' contractual obligations. However, this version of the rule would bar common law negligence claims, such as claims for negligent supervision.

IV. What Does the Future Hold? How Will *Presnell* Apply in the Context of Construction Litigation?

A. Why Would a Contractor Elect to Sue in Tort?

Fundamentally, one might wonder why a third-party contractor would elect to sue a design professional in tort, rather than assert a breach of contract claim against the owner with whom he or she has a contract.[126] Practically speaking, there are numerous reasons why it may be in the best interest of the contractor to pursue such a course of action:

(1) The contracting partner may be insolvent.
(2) The injured party may wish to preserve good relations with its partner, relations that would be soured by litigation.

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and its materials when it undertook to install the water system." *Id.*

123 *Id.*

124 *Id.*

125 *Presnell*, 134 S.W.3d at 590 ("With this Court's adoption today of . . . § 552, we have created an independent tort action of negligent misrepresentation, which is not barred by the economic loss rule.").

126 *See, e.g.*, United States v. Spearin, 248 U.S. 132 (1918) (landmark case establishing the "Spearin Doctrine," which stands for the proposition that the owner impliedly warrants that the information, plans, and specifications supplied to the contractor are accurate and suitable for their intended use); *see also* Matthew J. Steffey, *Negligence, Contract and Architects' Liability for Economic Loss*, 82 Ky. L.J. 659, 682–83 (1994) (discussing the contractor's contractual remedies against the owner for deficient plans and specifications).

(3) The injured party and the contracting partner may settle the dispute for an amount that is less than the extent of its entire loss.
(4) The action against the contracting partner may be limited in amount or barred altogether, either by a provision in the contract or by the operation of a rule of law.[127]

Whatever the rationale, the reality of the modern environment in construction litigation is that contractors almost routinely assert negligence claims against design professionals and courts are willing to entertain a tort claim for economic loss in the form of negligent misrepresentation as opposed to general negligence.

B. Misrepresentation

Misrepresentation generally comes in one of two forms: intentional or negligent. Most jurisdictions adhere to the view that intentional misrepresentation will give rise to a claim for damages solely in the form of economic loss.[128] However, this cause of action is much more restrictive than negligent misrepresentation due to its focus on the element of intent, which requires that the defendant intended to deceive the plaintiff through a false representation.[129]

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127 FEINMAN, *supra* note 27, at 559; *see also supra* notes 59–61 and accompanying text.

128 *See* Barton, *supra* note 34, at 1802–12 (stating that the majority of jurisdictions recognize that intentional misrepresentation (fraud) is an exception to the economic loss rule).

129

> "Negligent misrepresentation" is a lesser included claim of fraudulent misrepresentation, and it differs from fraudulent misrepresentation only in that, while the latter requires knowledge that the pertinent statement was false, the former merely requires that the person who made the statement failed to exercise reasonable care or competence to obtain or communicate true information.

37 AM. JUR. 2D *Fraud and Deceit* § 128 (2005) (quoting Fleming Cos. v. GAB Bus. Servs., 103 F. Supp. 2d 1271, 1276 (D. Kan. 2000)); *see also* William L. Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231, 233 (1966) ("The intent involved is intent to mislead (referring to intentional misrepresentation), to deceive; and it requires something in the way of knowledge or belief that what is misrepresented is in fact false . . . ."). In Kentucky, intentional misrepresentation is referred to as fraudulent misrepresentation (also referred to as fraud or deceit) and requires that the defendant (1) made a material representation, (2) which is false, (3) which was known to be false or made recklessly, (4) which was made with the inducement to be acted upon, (5) which the plaintiff acted in reliance upon, (6) which has caused the plaintiff injury. Harman v. Sullivan Univ., No. 03-738-C, 2005 U.S. Dist. LEXIS 10904, at *12 (W.D. Ky. June 6, 2005) (citing Rivermont Inn v. Bass Hotels & Resorts, 113 S.W.3d 636, 640 (Ky. Ct. App. 2003)); *see also* Sanford Constr. Co. v. S & H Contractors, 443 S.W.2d 227 (Ky. 1969) (fraud claim asserted by subcontractor against contractor for misrepresentations made as to amount and character of earthwork required on grading project). A fraudulent misrepresentation occurs by either an intentional assertion of false information or a willful failure to disclose the

Negligent misrepresentation, as applied in the context of construction litigation, traces its roots back to 1962 when the California[130] and Tennessee[131] courts were among the first to allow a contractor to assert a claim against a design professional absent privity. However, many states were hesitant to expand liability for economic loss and continued to adhere to the application of the economic loss rule to bar claims for negligent misrepresentation.[132] Even in states that recognize negligent misrepresentation as an exception to the economic loss rule, some courts have refused to extend this cause of action to sophisticated participants in a construction project, reasoning that such individuals should be able to contractually prescribe their limits of liability for economic damages to third parties.[133] Nonethe-

truth. *Id.* (citing United Parcel Serv. v. Rickert, 996 S.W.2d 464, 469 (Ky. 1999)).

130 M. Miller Co. v. Dames & Moore, 18 Cal. Rptr. 13 (Cal. Ct. App. 1961). In *M. Miller Co.*, a contractor asserted a negligence claim against a non-privity engineer for conducting soil tests in a negligent manner. *Id.* at 14. Allegedly, the soil report failed to disclose unstable material underlying a construction site which resulted in the plaintiff submitting a lower bid than it would have had the conditions been represented accurately. *Id.* at 14. The court noted "that a third party not in privity with the defendant could still recover damages for the defendant's negligent performance of a contract where the circumstances were such that the transaction was intended to affect the plaintiff and the injury to the plaintiff was foreseeable." *Id.* at 15 (citing Biakanja v. Irving, 320 P.2d 16 (Cal. 1958)). While the claim sounded in misrepresentation, the court actually analyzed it as a general negligence claim and applied a balance of factors test to determine that the engineer should be liable to the contractor. The court stated:

> [T]he determination whether in a specific case the defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury, and the policy of preventing future harm.

Id. at 15 (citing Lucas v. Hamm, 364 P.2d 685, 687 (Cal. 1961)).

131 Tex. Tunneling Co. v. City of Chattanooga, 204 F. Supp. 821 (E.D. Tenn. 1962), *aff'd in part and rev'd in part*, 329 F.2d 402 (6th Cir. 1964). In *Texas Tunneling*, a contractor sought to recover damages for misrepresentations made by an engineer in the form of geologic reports included as part of the documents distributed for use by prospective bidders. The court ruled that the contractor could pursue a negligent misrepresentation claim despite the lack of privity because the engineer owed an independent duty to "the class of persons [i.e. potential bidders] whose reliance upon and injury by the misrepresentations [could] reasonably be foreseen." *Id.* at 835. On appeal, the district court's approval of the negligent misrepresentation action was rejected, but nevertheless the "opinion became regarded as an important precedent for the misrepresentation action." FEINMAN, *supra* note 27, at 47 n.44.

132 *See supra* note 29.

133 *See* Flow Indus. v. Fields Constr. Co., 683 F. Supp. 527, 530 (D. Md. 1988) (rejecting negligent misrepresentation claim by general contractor against supplier to subcontractor stating that "where . . . the controversy concerns purely economic losses allegedly caused by statements made during the course of a contractual relationship between businessmen, it is plainly contract law which should provide the rules and principles by which the case is to be

less, it appears that in the context of construction disputes, the economic loss rule is on the way out, and courts are increasingly willing to recognize an exception for negligent misrepresentation.[134]

Numerous courts around the country recognize that a third party may bring an action seeking recovery solely for economic loss against a design professional despite the lack of privity.[135] However, jurisdictions vary in

governed."); Universal Contracting Corp. v. Aug, No. C-030719, 2004 Ohio App. LEXIS 6661, at *17 (Ohio Ct. App. Dec. 30, 2004) ("Where the parties are sophisticated business entities that have contracted to protect against potential economic loss, contract principles override the tort principles embodied in Section 552, and economic damages are not recoverable except as provided in the contract or by the rules of contract interpretation.").

134 *See* Meagher & O'Day, *supra* note 13, at 27–28 (stating that a "growing number of courts" are increasingly willing to discard the economic loss rule and "permit negligence actions by contractors or subcontractors against design professionals" due to the level of control that design professionals possess during the construction process). *But see* STEVEN M. SIEGFRIED, 2-5A CONSTRUCTION LAW § 5A.07 (Matthew Bender & Company 2006) (noting that "[t]he majority of cases that have considered the issue have refused to permit tort claims for solely economic loss against architects and engineers" but recognizing that many courts allow an exception for negligent misrepresentation). Courts that have been willing to recognize an exception for negligent misrepresentation have likely been persuaded by the comments provided by the drafters of the Restatement. Illustration 9, which has been cited with approval by some courts, is illustrative of the application of section 552 in the construction context:

> The City of A is about to ask for bids for work on a sewer tunnel. It hires B Company, a firm of engineers, to make boring tests and provide a report showing the rock and soil conditions to be encountered. It notifies B Company that the report will be made available to bidders as a basis for their bids and that it is expected to be used by the successful bidder in doing the work. Without knowing the identity of any of the contractors bidding on the work, B Company negligently prepares and delivers to the City an inaccurate report, containing false and misleading information. On the basis of the report C makes a successful bid, and also on the basis of the report D, a subcontractor, contracts with C to do a part of the work. By reason of the inaccuracy of the report, C and D suffer pecuniary loss in performing their contracts. B Company is subject to liability to C and to D.

RESTATEMENT (SECOND) OF TORTS § 552, illus. 9 (1977). For cases citing illustration 9 with approval, see, for example, Jim's Excavating Service v. HKM Associates, 878 P.2d 248, 255 (Mont. 1994); Bilt-Rite Construction v. Architectural Studio, 866 A.2d 270, 276 (Pa. 2005).

135 *See, e.g.*, Gulf Contracting v. Bibb Co., 795 F.2d 980 (11th Cir. 1986) (contractor versus architect); Malta Constr. Co. v. Henningson, Durham & Richardson, Inc., 694 F. Supp. 902 (N.D. Ga. 1988) (claim by contractor against engineer for deficient drawings and plans); *Tex. Tunneling Co.*, 204 F. Supp. 821 (claim by subcontractor against engineer for misrepresentation of geologic conditions); United States v. Rogers & Rogers, 161 F. Supp. 132 (S.D. Cal. 1958); Berkel & Co. Contractors, Inc. v. Providence Hosp., 454 So. 2d 496 (Ala. 1984); Carroll-Boone Water Dist. v. M & P Equip. Co., 661 S.W.2d 345 (Ark. 1983); Donnelly Constr. Co. v. Oberg/Hunt/Gilleland, 677 P.2d 1292 (Ariz. 1984) (claim by contractor against architect); Bay Garden Manor Condo. Ass'n v. James D. Marks Assocs., 576 So. 2d 744 (Fla. Dist. Ct. App. 1991) (claim by condominium association against engineering firm performing inspection of building); Robert & Co. Assoc. v. Rhodes-Haverty P'ship, 300 S.E.2d 503 (Ga. 1983) (claim by

how they attempt to define the relationship that must exist between the parties to support a claim. Generally, courts take one of three approaches: (1) limited privity,[136] (2) section 552,[137] or (3) general foreseeability.[138] Predictably, courts and commentators disagree on the most favorable approach.[139] Kentucky has clearly adopted the standards for negligent mis-

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prospective home purchaser against engineer conducting home inspection); S.E. Consultants v. O'Pry, 404 S.E.2d 299 (Ga. Ct. App. 1991) (claim by subsequent purchaser of home against engineer conducting percolation tests on lot); Normoyle-Berg & Assocs. v. Vill. of Deer Creek, 350 N.E.2d 559 (Ill. App. Ct. 1976); Gurtler, Hebert & Co. v. Weyland Mach. Shop, Inc., 405 So. 2d 660 (La. Ct. App. 1981); Milton Co. v. Council of Unit Owners of Bentley Place Condo., 708 A.2d 1047 (Md. Ct. Spec. App. 1998), *aff'd*, 729 A.2d 981 (Md. 1999); Prichard Bros. v. Grady Co., 428 N.W.2d 391 (Minn. 1988); *Jim's Excavating Serv.*, 878 P.2d at 252–55; Conforti & Eisele, Inc. v. John C. Morris Assocs., 418 A.2d 1290 (N.J. Super. Ct. Law Div. 1980), *aff'd*, 489 A.2d 1233 (N.J. Super. Ct. App. Div. 1985); Pompano Masonry Corp. v. HDR Architecture, Inc., 598 S.E.2d 608, 612 (N.C. Ct. App. 2004); *Bilt-Rite Contractors, Inc.*, 866 A.2d 270 (claim by contractor against architect for defective specifications); Tommy L. Griffin Plumbing & Heating Co. v. Jordan, Jones & Goulding, Inc., 463 S.E.2d 85 (S.C. 1995); Mid-Western Elec. v. DeWild Grant Reckert & Assocs., 500 N.W.2d 250, 254 (S.D. 1993); John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428 (Tenn. 1991) (claim by contractor against construction manager); E. Steel Constructors, Inc. v. City of Salem, 549 S.E.2d 266 (W. Va. 2001) (no privity of contract required to recover economic loss); Aikens v. Debow, 541 S.E.2d 576 (W. Va. 2000).

136 This approach requires that the information provider and the plaintiff be in privity or in a privity-like relationship. *See, e.g.*, Essex v. Ryan, 446 N.E.2d 368 (Ind. Ct. App. 1983) (claim by subsequent purchaser of property not allowed against surveyor where purchaser was stranger to original contract); Ossining Union Free Sch. Dist. v. Anderson, 539 N.E.2d 91 (N.Y. 1989) (cause of action for negligent misrepresentation allowed by owner against engineer where there is a limited privity relationship); Ultramares Corp. v. Touche, 147 N.E. 441 (N.Y. 1931) (recovery for negligent misrepresentation only allowed where there is privity or a privity-like relationship between plaintiff and information provider).

137 *See, e.g., Tex. Tunneling Co.*, 204 F. Supp. 821 (claim by subcontractor against engineer for misrepresentation of geologic conditions); *Bilt-Rite Contractors., Inc.*, 866 A.2d 270 (claim by contractor against architect for defective specifications); *John Martin Co.*, 819 S.W.2d 428 (claim by contractor against construction manager).

138 This approach applies a traditional tort analysis focusing on foreseeability, which "holds that a professional is liable for a merely negligent misrepresentation to any foreseeable person who relies on the misrepresentation and, thereby, suffers economic injury." Martin, *supra* note 28, at 668; *see, e.g.*, Bacco Constr. Co. v. Am. Colloid Co., 384 N.W.2d 427 (Mich. Ct. App. 1986) (engineer liable to contractor because it was foreseeable that engineer's miscalculations would cause harm to contractor); H. Rosenblum, Inc. v. Adler, 461 A.2d 138 (N.J. 1983) (accountants who prepared audit owed duty to all those they reasonably foresaw to be recipients of corporation's financial statements for proper business purposes), *superseded by statute*, N.J. STAT. ANN. § 2A:53A-25 (West 2006), *as recognized in* E. Dickerson & Son, Inc. v. Ernst & Young, LLP, 825 A.2d 585, 587 (N.J. Super Ct. 2003); Citizens State Bank v. Timm, Schmidt & Co., 335 N.W.2d 361 (Wis. 1983) (liability imposed on accountants for foreseeable injuries resulting from negligent acts unless recovery denied on grounds of public policy).

139 *See, e.g.*, Martin, *supra* note 28 (arguing for a retention of the limited privity requirement with categorical exceptions in cases involving negligent misrepresentations causing economic loss); Prosser, *supra* note 129 (providing a general overview of approaches taken by various courts addressing liability for both intentional and negligent misrepresentation); Phillip Horne, Note, Onita Pacific Corp. v. Trustees of Bronson: *The Oregon Supreme Court*

representation set forth in section 552; therefore, further discussion will be limited to this formulation of the rule and to cases in which other courts have applied it in the context of construction litigation.

C. An In-Depth Look at the Elements of Negligent Misrepresentation

As stated previously, the *Presnell* decision offers very little in the way of guidance regarding the critical elements of negligent misrepresentation. Therefore, this section presents an analysis of its elements, points out critical areas of importance in construction litigation, and provides further insight as to how section 552 may be applied in Kentucky.

1. Who is in the Business of Supplying Information?—The first element of section 552 requires that the defendant be in the business of supplying information for the guidance of others.[140] Additionally, the information provided must be false, and the information provider must have a pecuniary interest in the transaction.[141] In *Presnell*, the defendant was acting in the capacity of a construction manager and was presumably responsible for providing truthful information to the contractor for his guidance in carrying out his responsibilities under his contract with the owner. Logically, this same argument can be extended (and has been extended by other courts) to the more typical role of a design professional participating in a construction project.[142]

Generally, courts have had little trouble reaching the conclusion that a design professional is in the business of supplying information.[143] In fact, in the majority of cases, the court spends little time, if any, analyzing this element of the cause of action. This is a logical conclusion because there are

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Recognizes the Negligent Misrepresentation Tort, 72 OR. L. REV. 753, 756–62 (providing a history of the development of the negligent misrepresentation action and varying positions taken by state courts).

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> 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.

RESTATEMENT (SECOND) OF TORTS § 552(1) (1977) (Emphasis added).

141 This requirement would be satisfied in the case of a design professional receiving a fee for his services. *See* RESTATEMENT (SECOND) OF TORTS § 552 cmt. d (1977) ("The fact that the information is given in the course of the defendant's business, profession or employment is a sufficient indication that he has a pecuniary interest in it . . . .").

142 *See supra* note 135.

143 *See* FEINMAN, *supra* note 27, at 587–88 ("The initial element [business of supplying information] of the § 552 standard for liability . . . is obviously met in the case of architects and engineers.").

numerous tasks performed by the design professional on a typical project that support the conclusion that he or she is in the business of supplying information.

A design professional is typically responsible for the preparation of plans and specifications (information) that are supplied to and used by potential bidders in formulating a bid for a project.[144] Additionally, a design professional may make representations to the contractor while performing administrative responsibilities, which are assumed as part of his or her contract with the owner.[145] A specialty consultant, such as a geotechnical engineer, may provide a report of subsurface conditions that the general contractor or a subcontractor will use to determine quantities of excavation required or to determine the type of equipment and the amount of time required to remove materials.[146] Furthermore, an engineer could supply a report, such as an evaluation of the integrity of a structure or an environmental assessment of a parcel of land, to a prospective purchaser.[147] In each of these instances, it is quite clear that the design professional is supplying information in his or her professional capacity, as part of his or her business, for the guidance of others in a business transaction. Furthermore, a design professional's negligent misrepresentation could injure a third party in a variety of ways.[148] Thus, most courts conclude that the requirements of section 552(1) are met under these circumstances.

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144 *See, e.g.*, Farrell Constr. Co. v. Jefferson Parish, 693 F. Supp. 490, 492 (E.D. La. 1988) (An architect is under a duty to "exercise the degree of professional care and skill customarily employed by other architects in preparing plans and specifications.").

145 *See, e.g.*, John Martin Co. v. Morse/Diesel, Inc., 819 S.W.2d 428 (Tenn. 1991) (holding that a subcontractor, despite lack of privity, may assert a negligent misrepresentation claim against a construction manager, whether the negligence is in the form of negligent direction or supervision).

146 *See, e.g.*, Tex. Tunneling Co. v. City of Chattanooga, 204 F. Supp. 821 (E.D. Tenn. 1962) (claim by subcontractor against engineer for misrepresentation of geologic conditions), *aff'd in part and rev'd in part*, 329 F.2d 402 (6th Cir. 1964); M. Miller Co. v. Dames & Moore, 18 Cal. Rptr. 13 (Cal. Ct. App. 1961); RESTATEMENT (SECOND) OF TORTS § 552 cmt. h, illus. 9 (1977).

147 *See, e.g.*, Bay Garden Manor Condo. Ass'n v. James D. Marks Assocs., 576 So. 2d 744 (Fla. Dist. Ct. App. 1991) (exception to the economic loss doctrine where engineering firm provided technical information upon which the owners relied).

148 FEINMAN, *supra* note 27, at 586. The author states that a design professional's negligent misrepresentation may harm a contractor in one of three general ways.

> In jobs put out to bid, the architect or engineer often assists in the preparation of the bid documents. If a statement about the condition of the site in the bid documents is erroneous, the builder is likely to incur *additional and unexpected costs of performance.* Similarly, if the plans, drawings, or specifications of the contract are imprecise or incorrect, the contractor may *suffer delay and greater expense in completing its performance satisfactorily.* Finally, during performance the architect or engineer may *improperly advise the owner* as to whether a contractor has complied with

Surprisingly, a minority of jurisdictions have ruled that in some instances a design professional is not supplying "information" when providing plans and specifications for use during construction.[149] One commentator stated that it is "true the contractor follows the plans and specifications, but that of itself does not make a design professional a person in the business of providing information."[150] Supporters of this position argue that "information contained in the plans and specifications is the depictive work product mandating a result, not a product which the person is supposed to interpret for his or her own purposes."[151] Thus, the plans and specifications are viewed as a component of the end product rather than "information." While it is true that a design professional does not supply information in the same context as other service professionals, such as an accountant or an attorney, a conclusion that they are not in the business of supplying information is without merit. The design professional is paid a fee for using his or her skills and training to provide information that is relied on by others prior to and during construction. Accordingly, just as the businessperson relies on information provided by an accountant in purchasing a prospective business, a contractor relies on plans and specifications prepared by a design professional in crafting a bid for the construction of a structure. If the plans and specifications prove to be erroneous, the contractor is at grave risk of suffering economic loss.

In reality, the jurisdictions that have ruled that a design professional is not in the business of supplying information are simply expressing their disfavor for recognizing a claim in tort for economic loss in alternate form and use this theory as a way to further limit construction project participants' liability for economic damages. Arguably, a strict application of the economic loss rule[152] or adhering to a privity or near privity standard[153] achieves the same result. In any event, this represents a minority view, and in states recognizing section 552, the majority of courts find that design

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> the terms of the contract, either in completing its performance according to standard or in requesting a change, as a result of which the *contractor may not receive payment or may have to do additional work.*

Id. at 586–87 (citations omitted) (emphasis added).

149 *See, e.g.*, Tolan & Son v. KLLM Architects, Inc., 719 N.E.2d 288, 296–300 (Ill. App. Ct. 1999) (engineer or architect not in the business of supplying information for the use of others because the information was ancillary to the production of a tangible product such as a building).

150 STEVEN M. SIEGFRIED, 2-5A CONSTRUCTION LAW § 5A.06 ¶ 4 (2006).

151 *Id.*

152 *See, e.g.*, BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66 (Colo. 2004) (denying negligent misrepresentation claim by subcontractor against design professional based on the economic loss rule).

153 *See, e.g.*, Vill. of Cross Keys, Inc. v. U.S. Gypsum Co., 556 A.2d 1126, 1131–32 (Md. 1989) (whether a duty exists in negligence and negligent misrepresentation cases depends on whether there is an intimate nexus between parties).

professionals are in the business of supplying information for the guidance of others.

2. Foreseeability of the Plaintiff and Justifiable Reliance.—The second element of section 552 focuses on the foreseeability of the plaintiff and the plaintiff's reliance[154] on the information provided. Section 552(2) states that:

> [T]he 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.[155]

a. Foreseeable Plaintiff.—In a typical construction project, the design professional usually provides information to the owner. The owner passes the information on to contractors for their use in the preparation of bids and for guidance during construction of the project. Courts allowing recovery for negligent misrepresentation rarely have trouble finding that a contractor is a foreseeable plaintiff and is a member of the "limited group of persons for whose benefit and guidance"[156] the design professional provides information.[157] As the comments to section 552 indicate, the identity of the individual to whom the information is eventually supplied does not have to be known at the time the negligent misrepresentation is made; it is sufficient that the individual is a member of the limited group of persons to whom the owner intends to supply the information.[158] Therefore, the foreseeability requirements of section 552 will normally be satisfied, even though a specific contractor is usually not identified at the time a design professional provides information.

At some point, the plaintiff's connection with the design professional will become too remote and a court might rule that the plaintiff is not a

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154 The plaintiff's reliance must also be justified. RESTATEMENT (SECOND) OF TORTS § 552(1) (1977).

155 *Id.* § 552(2).

156 *Id.*

157 *See, e.g.*, Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 287 (Pa. 2005) (The imposition of a duty on an architect pursuant to section 552 is consistent with traditional notions of tort duty because "the professional is well aware that the design will be provided to and utilized by others in their own business dealings.").

158 RESTATEMENT (SECOND) OF TORTS § 552 cmt. h (1977) ("[I]t is not required that the person who is to become the plaintiff be identified or known to the defendant as an individual when the information is supplied.").

member of the foreseeable group of individuals for whom the information was supplied. For instance, the typical construction project involves extensive networks of subcontracts for other items of work, contracts with material suppliers, and relationships with surety companies who undertake an obligation to assume a contractor's responsibilities in the event of default. A negligent misrepresentation made by a design professional could potentially harm all of these individuals. Thus, a critical question is at what point along this relationship continuum the liability of the design professional will terminate.

One of the central criticisms of imposing tort liability for economic loss is that defendants are exposed to liability "in an indeterminate amount for an indeterminate time to an indeterminate class."[159] The requirements of section 552(1) present a solution by limiting potential plaintiffs to a foreseeable class. At what point along this continuum the line will be drawn varies based on the facts of the case. In general, a contractor or subcontractor[160] is a member of this foreseeable group of persons. However, other entities, such as surety companies and material suppliers, present a much more attenuated connection to the design professional; it is unlikely that the majority of courts would hold a design professional liable to these groups.[161]

b. Justifiable Reliance.—Another requirement of section 552 is that the plaintiff be justified in relying on the information supplied by the design professional.[162] This element provides the design professional with the best opportunity to mount a solid defense against a claim for negligent misrepresentation. Additionally, a court must evaluate this component in light of the language of the contracts existing between the parties and any disclaimers that might be included within plans and specifications provided to the contractor.

The following example illustrates the application of this component in a typical construction project. Assume that the owner retains company *X*,

159 Ultramares Corp. v. Touche, 174 N.E. 441, 444 (N.Y. 1931); *see also supra* notes 56–57 and accompanying text.

160 *See, e.g.*, Boren v. Thompson & Assocs., 999 P.2d 438 (Okla. 2000) (architect owes duty to subcontractor not to negligently certify payments to contractor); Seattle W. Indus. v. David A. Mowat Co., 750 P.2d 245 (Wash. 1988) (claim by subcontractor against architect).

161 *Compare* Am. Fid. Fire Ins. Co. v. Pavia-Byrne Eng'g Corp., 393 So. 2d 830, 838 (La. Ct. App. 1981) (engineer or architect owes same degree of care to surety as that owed to owner), *with* Great Am. Ins. Co. v. Wade-Trim/Assocs., Inc., No. 90-1948, 1992 U.S. App. LEXIS 244, at *8 (6th Cir. Jan. 7, 1992) (refusing to impose duty on architect or engineer to surety where contract established services were not for protection of surety).

162 Terwilliger, *supra* note 28, at 293–94 ("[T]he foreseeability requirement [of negligent misrepresentation] . . . [requires that] the faulty information given on plans and specifications must be intended by its negligent supplier to be specifically relied upon by a particular party or settled class of parties . . . and this class [must] reasonably rely on the information negligently supplied.").

a geotechnical engineering firm, to design a foundation for a new building and to provide a general assessment of the geological conditions present on the site. *X* conducts a site investigation and provides a report to the architect for use in designing the foundation of the structure and to a general civil engineering firm for use in developing a site preparation plan. In this report, *X* indicates that rock will be encountered at Elev. 100.[163] Based on this report, the civil engineer prepares a site excavation plan designed to minimize the quantity of rock excavation required on the project and reduce the owner's expenditures for site preparation. The architect also uses this report to design the foundation for the building. Contractors receive a copy of *X*'s report during the bidding process. However, a standard disclaimer is included within the plans and specifications, stating that the report is provided for information only and the contractor is not entitled to rely on the report.[164] Thus, the contractor is required to perform his or her own site investigation and draw his or her own conclusions as to the subsurface conditions. Despite the presence of the disclaimer, the contractor relies on *X*'s report and incurs economic loss when rock is encountered at Elev. 110.[165] Assuming that the report was prepared negligently, does the contractor have a valid negligent misrepresentation claim against *X*?

This scenario highlights the importance of the justifiable reliance component of section 552. If the report was supplied to the contractor for his or her use in computing a bid without qualification, this scenario would clearly fit within the confines of section 552.[166] *X* supplied information for the contractor's guidance and the contractor relied upon the information

163 Elevation (Elev.) refers to the height of a fixed reference point above mean sea level (or some other assumed datum). *See generally* Wikipedia.org, http://en.wikipedia.org/wiki/Elevation (last visited Oct. 17, 2006). In this hypothetical, Elev. 100 represents a height above an assumed datum. For example, if the lowest point on this piece of property is assigned an elevation of zero (point one), a point located at Elev. 100 (point two) would be one hundred feet higher than point one. This means that if rock is encountered at Elev. 90, it is located ten feet below the level predicted in the report. Conversely, if rock is encountered at Elev. 110, it is located ten feet above the location predicted in the report. When rock is encountered at an elevation above that used for design and bidding purposes, construction costs typically increase dramatically because more rock must be removed to prepare the site and construct the building.

164 Disclaimers of the accuracy of geotechnical reports are routinely included when this information is provided to contractors as part of a bid package. The inclusion of this condition alters the typical situation contemplated by the drafters of section 552, see RESTATEMENT (SECOND) OF TORTS § 552 illus. 9 (1977), because the presence of the disclaimer indicates that the information is not being provided to contractors for use in their bid. Kentucky has found such disclaimers to be enforceable, subject to certain limitations. *See* Codell Constr. Co. v. Commonwealth, 566 S.W.2d 161, 164 (Ky. Ct. App. 1977).

165 Typically, delay and economic loss would result due to an increase in labor and equipment costs. The contractor would be required to use more costly equipment for excavation. In addition, the amount of time required to remove rock, as opposed to soil, during excavation operations would be much longer.

166 *See supra* note 134 and accompanying text.

in computing his or her bid. *X* failed to exercise reasonable care and competence in obtaining or communicating the information. Due to the false information provided in the report, the contractor suffered pecuniary loss and would be entitled to assert a negligent misrepresentation claim against *X*. However, because the plans included a disclaimer that places the contractor on notice that he or she is not entitled to rely on the accuracy of the report, the contractor's claim would fail because his or her reliance was not justified.[167]

Applying the justifiable reliance component of section 552 in this fashion produces the proper result because it takes into account the expectations of the various parties at the time the contract is formed.[168] Many

167 *See* APAC-Carolina, Inc. v. Greensboro-High Point Airport Auth., 431 S.E.2d 508, 517–18 (N.C. Ct. App. 1993). In *APAC*, the court upheld a summary judgment ruling in an action involving a negligent misrepresentation claim by a contractor against an engineering company. The contractor alleged that the engineering company "failed to properly prepare plans, misrepresented the amount of necessary undercut work, and misled [the contractor] into believing that such work would not be significant." *Id.* at 517. The court found that the contractor's reliance on the amount of undercut (removal of unstable soil) work presented in the plans was not justified. The contract included a clause which required that the bidder "carefully examine the site of the proposed work, the proposal, plans, specifications, and contract forms" in order to draw his own conclusions about the quantity of work to be performed. *Id.* Furthermore, the clause stated, "[t]he submission of a proposal shall be prima facie evidence that the bidder has made such examination and is satisfied as to the conditions to be encountered in performing the work and as to the requirements of the proposed contract, plans, and specifications." *Id.* at 518. The court concluded that the contractor's reliance was not justified because "the plans and specifications discussed the potential undercut work, the contact addressed undercut work . . . [and the contractor] did not fully inspect the available information, and the quantities stated in the contract were merely estimates." *Id.; see also* Sanford Constr. Co. v. S & H Contractors, Inc., 443 S.W.2d 227 (Ky. 1969) (discussing issues of reliance in the context of a fraudulent misrepresentation action involving a claim by a subcontractor against a contractor stemming from alleged misrepresentations regarding subsurface conditions at a construction site); Marcellus Constr. Co. v. Vill. of Broadalbin, 302 A.D.2d 640 (N.Y. App. Div. 2003) (upholding grant of summary judgment to engineer on negligent misrepresentation claim where no relationship tantamount to privity was present with contractor and reliance on report of subsurface conditions not justified in light of instructions advising bidders they were required to conduct their own investigation of site conditions); David Pflumm Paving & Excavating, Inc. v. Found. Servs. Co., 816 A.2d 1164, 1170–71 (Pa. Super. Ct. 2003) (economic loss rule bars claims solely for economic loss and distinguishing the facts of the case from section 552 illustration 9 because bidders were specifically told not to rely on report), *abrogated by* Bilt-Rite Contractors., Inc. v. Architectural Studio, 866 A.2d 270, 286 (Pa. 2005) (economic loss rule does not bar negligent misrepresentation claim against architect solely for economic loss).

168 "The contract" is used here to indicate all contracts used during the process. In this example, when *X* entered into a contract with the owner to provide geotechnical information, he did so with the expectation that the information was prepared for design purposes only. It was his "expectation" that the contractor would be forced to draw his own conclusions about the site, and thus, he would not be liable for any economic loss incurred by the contractor in reliance on the report. Additionally, the contractor received notice that he was not entitled to rely on the report. Therefore, it was his "expectation" that he should proceed with caution in formulating a bid for the project and take appropriate action to ensure that he was providing

times, a design professional's motivation for performing specific tasks during the preparation of plans and specifications conflicts with the manner in which a contractor may use the information. Therefore, the information provided is neither sufficient nor intended for the contractor's guidance in that particular aspect of his or her business. Furthermore, it is unrealistic to expect a design professional to possess the same level of skill and knowledge of the intricate details of the construction trade as a contractor. Through the enforcement of limiting language included in contracts, plans, and specifications, a court can produce a reasonable compromise between those favoring imposition of tort liability and those proposing sole reliance on contractual remedies. If the contractor is forced to draw his or her own conclusions about certain aspects of the project, he or she can adjust the bid accordingly to account for any additional risk. Alternatively, the contractor can choose to conduct his or her own investigation, or hire his or her own design professional to assess the project and provide the information needed to create a reliable bid.[169] Thus, while privity is not required for a contractor to assert a negligent misrepresentation claim against a design professional, the language included in the contract documents should not be wholly discarded from the court's analysis when determining if the plaintiff's reliance was justified.[170]

In *Mid States Steel Products Co. v. University of Kentucky*, the Kentucky Court of Appeals addressed a somewhat similar factual scenario in the context of a construction dispute.[171] A contractor had filed numerous claims against a design professional, one of which was for negligent misrepresentation based on allegedly negligent design drawings supplied during the

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a realistic bid.

169 It is important to note that while this view is generally accepted, there may be some situations in which the amount of time that the contractor may have to conduct such an investigation is unreasonable. Alternatively, the site of the project may be inaccessible during the bidding process. In such situations, a court should consider the circumstances in determining whether the contractor's reliance was justified despite the presence of a disclaimer included within the plans. Otherwise, the express language of the contract would produce an absurd and unreasonable result.

170 Some courts might also allow a similar challenge framed in the context of comparative negligence on behalf of the relying party. *See* Mark A. Olthoff, *If You Don't Know Where You're Going, You'll End Up Somewhere Else: Applicability of Comparative Fault Principles in Purely Economic Loss Cases*, 49 DRAKE L. REV. 589, 615–17 (2001). Kentucky adheres generally to the doctrine of comparative negligence, although it has not issued a ruling on similar facts. *See* Hilen v. Hays, 673 S.W.2d 713 (Ky. 1984), *superseded by statute*, KY. REV. STAT. ANN. § 411.182 (West 2006), *as recognized in* Baker v. Webb, 883 S.W.2d 898 (Ky. Ct. App. 1994).

171 Mid States Steel Products Co. v. Univ. of Ky., No. 2004-CA-001434-MR, 2006 WL 1195914, *11 (Ky. Ct. App. May 5, 2006). Although the portion of the claim based on negligent design drawings was dismissed, the contractor was able to maintain its negligent misrepresentation claim on the basis of assurances made by the architect concerning when complete drawings would be provided to the contractor. *Id.*

bidding process.[172] The contractor acknowledged that it was aware of problems with the design drawings at the time it submitted its bid. Therefore, the court determined that the contractor did not rely upon the information at the time of its bid and dismissed the negligent misrepresentation claim based on the supply of negligent design drawings.[173] Although this particular case is still wading its way through the appellate process, the decision appears to offer a bit of comfort to design professionals. It provides one concrete example of a way in which a design professional can use the reliance component of section 552 as a defense to a negligent misrepresentation claim asserted by a contractor related to information supplied during the bidding process.

3. What is the Standard of Care?—Based on the plain language of section 552, a duty is imposed upon the supplier of information to "exercise *reasonable care or competence* in obtaining or communicating the information."[174] However, the question remains as to whether this is simply an ordinary reasonable person standard or if it is based on a professional negligence standard.[175] At least one court has stated that section 552 "imposes a simple reasonable man standard upon the supplier of the information."[176] However, other courts have framed the inquiry in the context of a professional negligence standard.[177] The comments offered by the drafters of section 552 seem to indicate that the standard of care should be established in light of the particular business or the type of profession in which the informa-

172 The contractor submitted a bid for steel fabrication and erection on the project. *Id.* at *1. Steel fabricators normally rely on design drawings in order to accurately fabricate steel members in their shop that are later placed into the appropriate location within a structure. Therefore, if design drawings are incomplete at the time of the bid, it is very difficult for a fabricator to estimate accurately the cost of materials and labor required to complete the project.

173 *Id.* at *11.

174 RESTATEMENT (SECOND) OF TORTS § 552(1) (1977) (emphasis added).

175 "Generally, individuals 'performing architectural and engineering services are performing professional services, and the law imposes upon such persons the duty to exercise a reasonable degree of skill and care, as determined by the degree of skill and care ordinarily employed by their respective professions under similar conditions and like surrounding circumstances.'" Constance Frisby Fain, *Architect and Engineer Liability*, 35 WASHBURN L.J. 32, 35 (1995) (quoting Housing Auth. v. Greene, 383 S.E.2d 867 (Ga. 1989)).

176 Bilt-Rite Contractors, Inc. v. Architectural Studio, 866 A.2d 270, 286 (Pa. 2005).

177 *See* Davidson & Jones, Inc. v. County of New Hanover, 255 S.E.2d 580, 585 (N.C. Ct. App. 1979) (While discussing the duty of an engineer in the context of negligent misrepresentation, the court stated that "[an] engineer is required to exercise that degree of care which a . . . engineer of ordinary skill and prudence would exercise under similar circumstances. . . ."); *see also* Roger W. Slone, *Architects' and Engineers' Liability under Iowa Construction Law*, 50 DRAKE L. REV. 33, 49–50 (2001) (stating that when architects or engineers are acting in a capacity in which they are supplying information to others "the tort of negligent misrepresentation would still require *the standard of the ordinary skill, care, and learning of members of the profession in similar circumstances*") (emphasis added).

tion provider is engaged.[178] Thus, it would appear that the drafters would advocate a professional negligence standard that would require expert testimony to prove the information provider has failed to exercise reasonable care in obtaining or communicating the information.

In cases involving professionals, Kentucky courts generally apply a reasonable person standard where conduct is evaluated in light of the circumstances in the case.[179] If a design professional allegedly supplies false information and fails to exercise reasonable care, it would seem that testimony from a professional possessing the same skills and training as that of the defendant would be required to determine if he has failed to comply with the standard of care.[180] Otherwise, it would be difficult for the average juror to apply his or her own experience in evaluating the defendant's behavior.

However, in *Mid States Steel Products Co.*, the Kentucky Court of Appeals indicated that this cause of action does not require expert testimony

178 RESTATEMENT (SECOND) OF TORTS § 552, cmt. f. (1977).

> The care and competence that the supplier of information for the guidance of others is required under the rule stated in this Section to exercise in order that the information given may be correct, must be exercised in the following particulars. If the matter is one that requires investigation, the supplier of the information must *exercise reasonable care and competence* to ascertain the facts on which his statement is based. He must exercise the *competence reasonably expected of one in his business or professional position in drawing inferences from facts not stated in the information.* He must exercise *reasonable care and competence in communicating the information* so that it may be understood by the recipient, since the proper performance of the other two duties would be of no value if the information accurately obtained was so communicated as to be misleading.

Id. (Emphasis added).

179 *See* DAVID J. LEIBSON, KENTUCKY PRACTICE SERIES TORT LAW § 10.16 (stating that Kentucky cases adhere to a negligence standard of care "to act as the reasonable person 'under like or similar circumstances'"). Arguably, this standard could lead to the conclusion that expert testimony would be required in a case involving a professional accused of making a negligent misrepresentation.

180 *See* Perkins v. Hausladen, 828 S.W.2d 652, 654–55 (Ky. 1992) (citing W. PAGE KEETON ET AL., PROSSER & KEETON ON TORTS § 39 (5th ed. 1984) (expert testimony generally required in a medical malpractice case unless "any layman is competent to pass judgment and conclude from common experience that such things do not happen if there has been proper skill and care"—application of the doctrine of res ipsa loquitur)).

Some courts have found that expert testimony is not required in cases involving negligence claims against design professionals. *Compare* Jaeger v. Henningson, Durham & Richardson, Inc., 714 F.2d 773, 775–76 (8th Cir. 1983) (applying "common knowledge" exception and stating that no expert testimony required to find design professional negligent in supervisory capacity, but expert testimony required to find design professional negligent in preparing plans and specifications), *with* City of York v. Turner-Murphy Co., 452 S.E.2d 615, 616–18 (S.C. Ct. App. 1994) (refusing to adopt a bright line rule disposing of expert testimony requirement in claims against design professionals for negligent supervision).

to establish the applicable standard of care.[181] In a separate portion of the court's opinion discussing the statute of limitations that should apply to negligent misrepresentation, the court held that a negligent misrepresentation claim is one for ordinary negligence, not professional malpractice.[182] Thus, the court, apparently applying this same line of reasoning, concluded that expert testimony is not required.

Upon a close reading, the court's result appears to be quite confusing. The contractor had actually alleged two different misrepresentations to support the negligent misrepresentation claim against the design professional: (1) supplying negligent design drawings, and (2) making assurances as to when the contractor would receive complete design drawings.[183] The court dismissed part (1) of the claim because it found that the contractor did not rely on the design drawings, but found that part (2) asserted a valid claim for negligent misrepresentation.[184] A logical assumption is that had the contractor been able to establish that he justifiably relied on the design drawings, he would have made a valid claim for negligent misrepresentation based on the allegations in part (1). However, in a later portion of the opinion, the court indicated that part (1) was a professional malpractice claim and part (2) was an ordinary negligence claim.[185] Therefore, based on the court's reasoning, negligent misrepresentation is either an ordinary or professional negligence claim, depending on the nature of the misrepresentation made to the injured party.

Whether the court actually intended this result is an open question, but it certainly seems to be a confusing interpretation of the law. A more desirable approach would be to evaluate the design professional's conduct in light of the standard of care within the profession and require expert testimony in support of the claim. However, at this time *Mid States Steel*

181 Mid States Steel Prods. Co. v. Univ. of Ky., No. 2004-CA-001434-MR, 2006 WL 1195914, at *12 (Ky. Ct. App. May 5, 2006) (negligent misrepresentation claim is not professional negligence claim; it is an ordinary negligence claim that does not require expert testimony).

182 *Id.* at *12. The design professional argued that KRS § 413.245, which provides a one year statute of limitations for professional negligence, should apply to this cause of action. However, the court, citing to *Safeway Managing General Agency, Inc. v. Clark & Gamble*, 985 S.W.2d 166 (Tex. Ct. App. 1998), held that negligent misrepresentation is an ordinary negligence claim, not one for professional malpractice. Thus, it declined to apply KRS § 413.245 and held that KRS § 413.120(7) provides the applicable statute of limitations. This statute "provides a five-year limitations period for 'an action for an injury to the rights of the plaintiff, not arising on contract and not otherwise enumerated.'" *Mid States*, 2006 WL 1195914, at *12 (quoting KY. REV. STAT. ANN. § 413.120(7) (West 2006)).

183 *Id.* at *11.

184 *Id.*

185 *Id.* at *12. The court does not explain why it considered this to be a professional malpractice claim, but presumably, it considered the fact that the allegation involved design drawings, rather than assurances made to the contractor, to make this aspect of the claim one for professional malpractice rather than ordinary negligence.

Products Co. is the only guidance available under Kentucky law, and it appears that negligent misrepresentation is an ordinary negligence claim and the use of expert testimony is not required.

4. Summary—Foretelling the Future After Presnell.—In summary, if one thing is clear from *Presnell* it is that section 552 creates a duty, arising independently from any contractual obligations, upon design professionals to exercise reasonable care in supplying information for the guidance of other participants in the construction process. As referenced previously, a design professional can fit within the confines of section 552 in a variety of contexts in the performance of his or her duties on a typical project,[186] and the *Presnell* holding is not likely to be limited to the role of a construction manager. In fact, subsequent to *Presnell*, state and federal courts in Kentucky have issued opinions in cases involving a section 552 cause of action that supports this conclusion.[187]

Presnell also reinforces the position that privity is no longer a bar to a tort action in the state of Kentucky, even if the alleged damages arise in the context of a construction dispute where the parties are sophisticated and engaged in a commercial transaction.[188] Furthermore, section 552 will allow a party who is not in privity with a design professional to bring an action solely for economic loss when he or she has been damaged by the design professional's failure to exercise reasonable care in supplying information for his or her guidance in a business transaction. However, an analysis of this cause of action cannot proceed in a vacuum that ignores the contractual relations among the various parties and their position as sophisticated entities engaged in a common enterprise. Thus, it is likely that the courts will analyze a plaintiff's case in light of the contracts between the parties to determine if the plaintiff's reliance on the information supplied was justified.

186 *Supra* notes 143–48 and accompanying text.

187 *See* Forbes v. Cemex, No. 1:03CV67-R, 2005 U.S. Dist. LEXIS 15322, at *11–15 (W.D. Ky. July 28, 2005) (plaintiff failed to establish that employer made negligent misrepresentation regarding the status of life insurance following termination of an employee; health insurance notices contained no statements regarding life insurance); Harman v. Sullivan Univ. Sys., No. 03-738-C, 2005 U.S. Dist. LEXIS 10904, at *19 (W.D. Ky. June 6, 2005) (student presented sufficient evidence to create material issue of fact as to whether university negligently misrepresented that she could take a national certification examination upon graduation); *Mid States Steel Prods. Co.*, 2006 WL 1195914, at *12 (contractor may assert negligent misrepresentation claim against architect); Crown Mortgage Co. v. Decarlo, No. 1999-CA-002928-MR, 2004 WL 2315049, at * 1 (Ky. Ct. App. Oct. 15, 2004) (plaintiff attempted to hold insurance agent liable for negligent misrepresentation).

188 *Supra* notes 90–94 and accompanying text.

D. What Effect Will Presnell *Have on the Status of the Economic Loss Rule in Kentucky?*

As previously discussed, Justice Keller urged Kentucky courts to formally adopt the economic loss rule and provided a preferred formulation of the rule.[189] Even under this formulation, however, negligent misrepresentation is an exception to its sweeping bar of tort actions for economic loss.[190] In the context of construction litigation, this leads to the conclusion that general negligence claims are barred.[191] However, this adds little in the context of construction disputes because the principle applied by the majority in *Presnell* produces the same result.[192]

At least one court has opined that Kentucky is not ready to adopt the formulation of the economic loss rule suggested by Justice Keller. In *Louisville Gas & Electric Co. v. Continental Field Systems*,[193] the plaintiff ("LG&E") sought damages from two contractors resulting from a broken fan shaft placed on an electrical generating unit.[194] The allegations contained a negligence claim against each of the contractors for failure to exercise ordinary care in performing their work. The contractors sought to have the negligence counts dismissed "on the grounds that the economic loss rule bars any claim for economic damages and negligence that actually arises from breach of contract."[195] "All parties seem[ed] to acknowledge that [the contractors] were providing a service to LG&E, rather than selling a product."[196] The district court acknowledged that the economic loss rule serves to preserve the distinction between contract and tort and that Kentucky courts would apply it in the appropriate circumstances. However, the court was unwilling to expand the application of the rule beyond the context of economic loss resulting from damage to a product to encompass economic damages arising from the provision of services.

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189 *Supra* notes 108–25 and accompanying text.

190 Presnell Constr. Managers, Inc. v. EH Constr., L.L.C., 134 S.W.3d 575, 583 (Ky. 2004) (Keller, J. concurring) (agreeing with the result reached by the majority that negligent misrepresentation is an exception to the application of the economic loss rule).

191 For instance, if a party not in privity sought to assert a professional negligence claim against a design professional, the economic loss rule would bar the claim unless it stemmed from damage to person or property.

192 *Supra* note 94 and accompanying text.

193 Louisville Gas & Elec. Co. v. Continental Field Sys., No. 3:01CV-387-H, 2005 U.S. Dist. LEXIS 7634 (W.D. Ky. Mar. 17, 2005).

194 The two contractors were Continental Field Systems, who was under contract with LG&E to provide maintenance and repair services, and Advanced Welding Systems, who had no contractual relationship with LG&E but was providing services at Continental's request. *Id.* at *3.

195 *Id.* at *11

196 *Id.*

> This Court's previous discussion of the economic loss rule has assumed that its application is limited to circumstances involving the sale and provision of products .... Defendants rely heavily upon the concurring opinion of two justices in *Presnell*. ... 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.[197]

If this court's reception of Justice Keller's concurring opinion is representative, then it will have little effect on the landscape of litigation in Kentucky. Arguably, in the field of construction litigation, this is the proper result. Nevertheless, defendants facing a claim solely for economic loss will predictably continue to reach out and attempt to expand the economic loss rule beyond the context of products liability.

V. Conclusion

It is clear that in cases involving a claim by a third party against a design professional, counsel is wise to couch a claim in terms of negligent misrepresentation to avoid potential defenses. *Presnell* clearly establishes that neither the economic loss rule nor the absence of privity will bar claims for negligent misrepresentation in Kentucky. However, there is little consistency on this issue in jurisdictions across the country and it is imperative that counsel determine the law of the jurisdiction prior to drafting a complaint.

From a policy perspective, Kentucky has adopted a rule that achieves a compromise between the debate over strict adherence to contract remedies and broad imposition of tort liability. Section 552 contains important limitations on the class of plaintiffs who may bring a cause of action, ensuring that the imposition of liability for negligent misrepresentation will not lead

197 *Id.* at *14–15 (citations omitted).

to a flood of new litigation.[198] The imposition of tort liability for a design professional's negligent misrepresentation also provides an incentive for the design professional to adhere to the proper standard of care, thus serving the goal of producing a quality project for the owner. Furthermore, it certainly seems just to impose liability upon the design professional when a contractor, placed in a position of reliance by necessity, incurs economic loss due to the design professional's negligence.

Presnell will also have an impact on the conduct of participants in the construction industry outside of the courtroom. Parties are likely to develop new forms of contractual terms in an effort to avoid the consequences of tort liability for negligent misrepresentation. In addition, the use of disclaimers may become more prevalent as a means of placing the contractor on notice that he or she is not entitled to rely on certain portions of the design information. Predictably, insurance companies will soon take notice of Kentucky's willingness to impose liability for economic loss on design professionals, and an increase in malpractice liability insurance rates may ensue. Conversely, as the particulars of the elements of the cause of action develop in the courts, contractors may be able to reduce some of the contingency costs included in their bids to offset unforeseen risks involved in the project. In addition, design professionals may become more attuned to the construction process, and projects may proceed in a more cooperative environment where the parties are more interested in achieving a compromise that is in the best interests of the project rather than focusing on cynical projections of another party's motives.

198 *Supra* notes 86–88 and accompanying text.