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NORTHERN KENTUCKY LAW REVIEW

Volume 36 Kentucky Survey Issue Number 3

Kentucky Survey Issue

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Kerry Holleran* and John J. Mueller**

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I. INTRODUCTION

Legal malpractice. These words evoke dread and even fear in lawyers, and even cause lawyers to suffer nightmares. Consequently, though lawyers are inherently inquisitive, most lawyers hope simply never to have to research or to learn about the law governing legal malpractice. Despite this hope and sometimes despite a lawyer’s concerted effort to practice a case properly, the possibility of legal malpractice is a specter that lawyers are unable to escape.

The type of law an attorney practices and the number of attorneys in a firm directly affects the likelihood that a lawyer will face a lawsuit alleging he or she committed malpractice. Plaintiffs’ personal injury attorneys face more malpractice claims than any other kind of attorney, consisting of almost 20% of all claims against attorneys. Malpractice claims for real estate transactions follow closely behind those against plaintiffs’ attorneys compromising just over 16% of all malpractice claims. Attorneys who practice alone or with five or fewer fellow attorneys are sued the most, totaling over 65% of all claims, while firms with 40-99 attorneys are sued the least, or 4.11% of all claims. Attorneys are sued for many different activities ranging from filing documents (23% of claims) to referring clients to other attorneys (0.36% of claims). Just over 15% of all claims brought against attorneys deal with lawyers advising their clients.

As a profession, attorneys seem to understandably feel more comfortable as counsel and less comfortable as defendants in the profession’s common proceedings. Yet attorneys do make mistakes and lawyers specializing in legal malpractice have thriving businesses. This essay will focus specifically on one advisory element of legal malpractice, a lawyer’s peripheral duty, and will serve as an attempt to remind lawyers how to advise their clients in accord with the duty. In 1978, the Kentucky Court of Appeals held, in Daugherty v. Runner, that an attorney cannot disregard matters coming to his attention which should put him on notice that his client may have legal problems that are not totally within the scope of duties he owes his client via retainer agreement. In other words, attorneys are not only liable to their clients for express duties existing in retainer agreements, but there are also duties on the periphery of any retainer agreement or undertaking which may arise and for which attorneys may be held liable.

Although Daugherty is most frequently considered the seminal case on the peripheral duty, other courts have ruled on similar situations. This article will detail the cases of many courts outside of Kentucky to inform attorneys of the many facets of the peripheral duty. Even though Daugherty represents...
Kentucky’s common law on the peripheral duty, the decisions of other states assist in filling in Daugherty’s gaps and provide attorneys with specific examples detailing how to fully represent their clients.

Finally, although Daugherty is the seminal case on the peripheral duty, in the thirty years since its announcement, no Kentucky case has cited the peripheral duty portions of the decision\(^7\), and it has been the subject of no law review scholarship. The circumstances beg these questions: what is happening to peripheral duty cases in Kentucky? Do they not exist? Are attorneys well versed in this duty and do they advise their clients accordingly? Or are attorneys more likely to settle cases than non-lawyer defendants? This essay will attempt to answer these questions and to determine the modern relevance of Daugherty and the peripheral duty.

II. LEGAL MALPRACTICE GENERALLY

Legal malpractice is generally defined as “the failure of an attorney to use and exercise such skill, prudence, and diligence as other members of the legal profession commonly possess and exercise in representing clients.”\(^8\) The elements which constitute a legal malpractice action in Kentucky are: "(1) that there was an employment relationship with the defendant/attorney; (2) that the attorney neglected his duty to exercise the ordinary care of a reasonably competent attorney acting in the same or similar circumstances; and (3) that the attorney's negligence was the proximate cause of damage to the client."\(^9\) Actually, a lawyer-malpractice case involves two cases: the case out of which the claim of negligence or breach of duty arises and the case involving the claim of


negligence or breach of duty by the defendant lawyer. To prove a claim of lawyer malpractice, a plaintiff must show that the lawyer’s negligence caused or produced, or contributed to causing or producing, a less favorable result in the underlying case than the client or plaintiff would have achieved if the lawyer had performed non-negligently or without a breach of duty. The plaintiff proves this circumstance by a “trial within a trial,” a trial determining the outcome of the plaintiff’s legal matter if handled without negligence or breach of duty inside the trial of the lawyer-malpractice claim. In practice, the most common defense lawyers use when faced with malpractice cases is that no attorney-client relationship existed. As is true with any action other than one in which the defendant lawyer admits the existence of a relationship or in which the existence of a relationship appears from the circumstances out of which the action arises, peripheral duty cases often require a thorough investigation by the court as to whether an attorney-client relationship existed at all. If the plaintiff establishes the relationship element of the lawyer-malpractice action, the focus of proof in the action then shifts to the elements of duty and breach of the duty. The analysis of these elements may involve an examination of the existence of a peripheral duty and a consideration of whether the lawyer breached that peripheral duty. When the plaintiff establishes the relationship, duty, and breach of duty elements of the lawyer-malpractice action, the court then turns to causation or proximate causation of the damages the plaintiff seeks to recover in the action. In those cases in which the plaintiff fails to establish either a relationship giving rise to a duty (including a peripheral duty) or a breach of a duty, the court never reaches the issue of proximate causation. In a fair percentage of lawyer-malpractice actions, the court never reaches the issue of proximate causation because the plaintiff fails either to establish a relationship giving rise to a duty or a breach of a duty.

10. Marrs, 95 S.W.3d at 860.
11. Id. (citing RONALD E. MALLEN & JEFFREY M. SMITH, LEGAL MALPRACTICE § 33.8 (5th ed. 2000)).
12. Some courts and writers refer to the “trial within a trial” as a “suit within a suit” or a “case within a case.”
13. Stein, supra note 8, at 124.
15. Id.
16. Id.
18. Steinbach, 412 N.W.2d at 919.
III. THE LAWYER’S DUTY TO ADVISE

A. Contractual Underpinnings of the Lawyer-Client Relationship

Generally, the attorney-client relationship is contractual.\(^{20}\) It may be express or implied, but is created only by retainer, offer of retainer, or when a fee is paid.\(^{21}\) Appropriately worded retainer agreements can “reduce the likelihood of liability by defining the scope of the attorney’s inquiry, and by providing both an occasion for formulating and a method of stating conclusions as to why particular matters are not within the scope of his responsibilities.”\(^{22}\)

The Court of Appeals of Illinois rendered an opinion in 1980 that implicitly illustrates why lawyers need to define the scope of the lawyer’s undertaking. The court held in Zych v. Jones that even without a retainer agreement, a lawyer who enters an appearance in an action for a party without authority from or a retainer by that party, owes no duty to continue to appear in that action as that party’s counsel.\(^{23}\) Attorney J. Edward Jones appeared for Stanley Zych in an on-the-job automobile accident case which resulted in default judgment.\(^{24}\) Zych brought an action for malpractice against Jones, and was awarded partial summary judgment as a matter of law on the question of liability and $17,000 in damages from a jury.\(^{25}\)

Zych claimed that Jones filed his appearance in the automobile accident case, then failed to appear at trial, resulting in a default judgment.\(^{26}\) Zych’s driver’s license was suspended, unbeknownst to him, and he testified to having asked Jones to file for reinstatement of the license.\(^{27}\) Jones claimed he filed Zych’s appearance and assisted with Zych’s license reinstatement as favors to Zych and his employer, whom Jones also represented in the matter; he further claimed that Zych made no formal request for representation and that the two entered into no express or implied agreement.\(^{28}\) The Appellate Court of Illinois acknowledged that a presumption of authorization arises where an attorney appears of record for a party, but that presumption can be rebutted by evidence to the contrary.\(^{29}\) The court subsequently reversed and remanded, questioning whether an attorney-client relationship ever existed.\(^{30}\)

\(^{20}\) Steinbach, 412 N.W.2d at 918.

\(^{21}\) Zych, 406 N.E.2d at 74 (citing DeWolf v. Strader, 26 Ill. 225 (Ill. 1861); 7 AM. JUR. 2d Attorneys at Law § 91 (1964)).

\(^{22}\) Jeffrey M. Smith, Preventing Legal Malpractice 113 (1981).

\(^{23}\) Zych, 406 N.E.2d at 74.

\(^{24}\) Id. at 72.

\(^{25}\) Id.

\(^{26}\) Id.

\(^{27}\) Id.

\(^{28}\) Id. at 73.

\(^{29}\) Zych, 406 N.E.2d at 73-74 (Attorney Jones presented an affidavit from Zych’s employer, swearing the action was filed on the instruction of the employer so that no judgment would be rendered before plaintiff could decide which attorney he wanted to represent him. In a second
Seven years later, the Court of Appeals of Iowa, in *Steinbach v. Meyer*, held that for an attorney-client relationship to exist, a potential client must seek advice or assistance from an attorney which pertains to matters within the attorney’s professional competence, and the attorney must agree to give or actually give such advice or assistance. 31 Plaintiff, an Iowa farmer, attempted to restructure his debt through his local bank, and hired Jim Meyer, of The Meyer Firm, to prepare a cattle feeding contract he was required to provide the bank in order for the restructuring process to move forward. 32 Virgil Meyer, another attorney with The Meyer Firm, happened to be a member of the board of directors of the bank where the farmer was attempting to restructure his debt, and voted to foreclose on the farmer’s property rather than allow the debt to be restructured. 33 The farmer then sued the firm, alleging the attorney-client relationship was breached. 34 The trial court granted defendants’ motion for summary judgment, and farmer appealed. 35

Deciding an attorney-client relationship did not exist, the Court of Appeals found for the attorney. 36 They determined the legal relationship terminated when the documentation was provided by the Meyer firm, and that when Virgil Meyer voted against the farmer, he was in no way the farmer’s attorney. 37

Both cases suggest an attorney-client relationship exists when an understanding similar to a “meeting of the minds” (to borrow from contract theory) occurs. An unauthorized appearance does not create an attorney-client relationship, nor does a decision made by an attorney in the same firm who was not specifically assigned to the plaintiff. Additionally, no attorney-client relationship exists where corporate counsel makes an appearance for employees of the corporation who did not ask for such assistance. 38

affidavit. Attorney Jones swore Zych stated he would let him know if he wanted Jones to represent him, but that Zych never relayed any such information or paid any fees. Thus, attorneys who present evidence that an appearance was made on the instruction of someone other than plaintiff and that plaintiff did not expressly retain attorney or pay fees may successfully rebut the presumption. Other courts have ruled on whether the presumption was rebutted as well.). See Meldoc Properties v. Prezell, 511 N.E.2d 861, 863-65 (Ill. App. Ct. 1987) (An attorney filed special and limited appearance for defendant, who subsequently appeared *pro se*, asserting she was not properly served, and the attorney did not have the authority to appear for her. The attorney was actually retained by defendant’s ex-husband, another defendant in the underlying action. Defendant produced a letter from the attorney, suggesting she hire him or someone else. The court found the plaintiff rebutted the presumption. An attorney may similarly rebut the presumption by providing a termination letter.). 30. *Zych*, 406 N.E.2d at 74-75. 31. *Steinbach*, 412 N.W.2d at 918. 32. *Id.* at 917. 33. *Id.* 34. *Id.* at 917-18. 35. *Id.* 36. *Id.* at 919. 37. *Steinbach*, 412 N.W.2d at 919. 38. United States v. Keplinger, 776 F.2d 678, 700-01 (7th Cir. 1985) (citation omitted).
B. The Legal Concept of the Lawyer’s Undertaking

The concept of a lawyer’s undertaking is a rather simple one. In fact, it is so simple a concept that few cases even discuss its existence. The undertaking is a concept rooted in contract theory. In the law of contracts, “[a]n undertaking is a promise. It may be made with or without consideration.”\(^\text{39}\) A lawyer’s undertaking is the lawyer’s promise to perform legal services or to provide legal advice, or both.

Yet the concept of a lawyer’s undertaking is elusive. Defining the boundaries of the undertaking (i.e. what the lawyer agrees to do and what the client and lawyer expressly agree the lawyer has no obligation to do) can present rather difficult or complex issues, both for lawyer and client. For example, if a client asks an attorney to prepare a deed conveying title for forty acres of land from the client to his brother, the attorney cannot simply begin to draft the deed immediately. The attorney needs to know if he must draft a quit-claim deed or a deed with general warranties, or limited warranties. Of course these questions are easily answered; however, as a part of the undertaking, does the client also expect the attorney to determine whether the client has title to convey? Does the attorney have to search the title to determine ownership as part of the undertaking? The attorney owes it to himself and his client to define the undertaking as precisely as possible. Generally, the duties the lawyer owes the client in the particular circumstances depend on the undertaking, since the undertaking defines the nature and extent of the duties the lawyer owes the client.\(^\text{40}\)

C. The Scope of the Lawyer’s Undertaking and its Effects on Defining the Duties and Obligations Owed to the Client

When attorneys enter into agreements with clients, each task involved in the agreements may give rise to new duties owed to the client. In Watson v. Calvert Building & Loan Ass’n of Baltimore City, Maryland’s highest court held that attorneys hired by clients for merely one narrow purpose, whose representative scopes are limited and who are not generally retained by these clients, are liable only for duties expressly agreed.\(^\text{41}\) Mary A. Loar applied to the Calvert Building & Loan Association (“Calvert”) for a $700 mortgage for real property near Baltimore.\(^\text{42}\) Calvert then asked one of its agents, Ross Metzger, who was located near the property, to examine the title to the lot.\(^\text{43}\) Metzger in turn asked

\(^{39}\) Thompson v. Blanchard, 3 N.Y. 335, 337 (N.Y. 1850).

\(^{40}\) RESTATEMENT (THIRD) OF AGENCY, § 8.07 (2006); RESTATEMENT OF THE LAW GOVERNING LAWYERS (THIRD), §16 cmt. c (2000) (“The lawyer’s duties are ordinarily limited to matters covered by the representation.”).

\(^{41}\) Watson v. Calvert Building & Loan Ass’n of Baltimore City, 45 A. 879, 880 (Md. 1900).

\(^{42}\) Id.

\(^{43}\) Id.
Watson to examine the title and submit a written report, which correctly stated the title was good, with one existing mortgage.\textsuperscript{44} Metzger paid Watson $5 for the report, and subsequently asked for an abstract of title, which Watson said he had not been paid to prepare.\textsuperscript{45} Metzger advised him to use his notes from his preliminary investigation of the property and title on October 6 from which to write the abstract, and Watson obliged, dating the abstract October 8.\textsuperscript{46} Unbeknownst to either Metzger or Watson, on October 6, Mrs. Loar confessed a lien existed whereby she owed a third party $1300, which took precedence over the mortgage.\textsuperscript{47} Calvert then sued Watson for negligently failing to report the judgment.\textsuperscript{48}

Watson claimed he was not generally Calvert’s attorney, but that his representative scope was limited by Metzger for only one limited task.\textsuperscript{49} Upon review, the Court of Appeals of Maryland determined that Watson could only be held liable for negligence if he was generally Calvert’s attorney, yet not if he was hired for the title search alone.\textsuperscript{50}

In \textit{Maillard v. Dowdell}, the District Court of Appeal of Florida held that an attorney hired to assist in the purchase of a condominium was not liable for failing to research all claims and pending cases against the condominium association since the purchasers were informed a pending claim existed.\textsuperscript{51} Plaintiffs Maillard and Lynch were in the market to buy a condominium and hired Thomas Dowdell as their attorney to help purchase the unit.\textsuperscript{52} The realty company selling the condo told the plaintiffs and their attorney that the condo association had sued the developers for minor cosmetic defects in the building, when in fact the defects were significant and pertained to the building’s structure.\textsuperscript{53} Plaintiffs learned that information only after the sale, and filed suit against their attorney for malpractice, believing Dowdell should have researched the nature of the defects and the pending action.\textsuperscript{54}

The District Court of Appeal of Florida determined that Dowdell’s scope as the plaintiffs’ attorney was limited to assisting the purchase of property, which typically includes giving an opinion as to marketability of title and handling the real estate closing.\textsuperscript{55} The court further held that plaintiffs had not alleged that Dowdell was negligent in those duties or was employed to investigate or inquire

\textsuperscript{44.} Id.  
\textsuperscript{45.} Id.  
\textsuperscript{46.} Id.  
\textsuperscript{47.} Watson, 45 A. at 880.  
\textsuperscript{48.} Id.  
\textsuperscript{49.} Id. at 880-81.  
\textsuperscript{50.} Id. at 881-82.  
\textsuperscript{52.} Id. at 513.  
\textsuperscript{53.} Id. at 514.  
\textsuperscript{54.} Id.  
\textsuperscript{55.} Id. at 515.
into the pending action. Finally, the court referred to Daugherty, stating that the plaintiffs did not allege “Dowdell completely disregarded matters coming to his attention which should reasonably have put him on notice that plaintiffs would have legal problems that were not precisely or totally within the scope of the task Dowdell was employed to perform.” Properly limiting his scope to one issue saved Dowdell from malpractice.

In front of the Supreme Court of Alaska, an attorney avoided a malpractice judgment by appropriately limiting the scope of his representation to a single issue in Sengupta v. Wickwire. Professor Mritunjoy Sengupta was a tenured professor of Mining Engineering at the University of Alaska Fairbanks, who brought grievance proceedings against the university. Sengupta was upset that he had not been considered for promotions or raises. The grievance process went terribly awry, as the hearing officer’s findings focused on Sengupta’s dishonesty during the proceedings and during his tenure at the university. He did not appeal the proceedings because his attorney, Wickwire, advised his client the university may initiate disciplinary action against him should he do so.

About three months later, UAF initiated termination proceedings against Sengupta, which the professor alleged (in a new grievance) were in retaliation for his former grievances. Sengupta was granted a pre-termination hearing, where he appeared pro se, and where the new hearing officer afforded collateral estoppel to the previous hearing’s findings. Since Sengupta did not timely appeal those findings, the university felt it was not obligated to relitigate such issues. After the university terminated Sengupta, his appeal to the president was also denied; thus, he appealed to the Superior Court, which affirmed the termination.

Wickwire agreed to handle the appeal, but made known to Sengupta that his brief would focus only on one issue: that the judge erred in concluding Sengupta had to accept the administrative hearing before a hearing officer rather than tenured faculty of his unit. Wickwire filed the appeal to the Superior Court decision forty-three days late. When the appeal was dismissed for untimeliness, Sengupta filed suit against Wickwire, alleging malpractice in that

56. Id.
57. Maillard, 528 So. 2d at 515.
59. Id.
60. Id.
61. Id.
62. Id.
63. Id. at 749-50.
64. Sengupta, 124 P.3d at 750.
65. Id.
66. Id.
67. Id. at 750-51.
68. Id. at 751.
he would have won the case had the appeal been filed within the limitations period.\textsuperscript{69} The court found for Wickwire, determining that when Sengupta appeared \textit{pro se} at his second hearing at UAF, he incidentally waived all issues regarding the former proceedings that he did not bring up in those proceedings or on their appeal.\textsuperscript{70} Because Wickwire could not have raised a retaliation claim (which Sengupta says he would have won), Wickwire was not guilty of malpractice.\textsuperscript{71}

\textit{Watson, Maillard, and Sengupta} recognize that lawyers have no liability for failing to address issues, problems, or matters outside the boundaries of a specific undertaking when the client is at least generally aware of the issue, problem, or matter and fails to ask the lawyer to pursue it or when the new issue, problem, or matter arises after the lawyer has performed the services. In \textit{Watson}, the lender’s agent, Watson’s employer, knew of the possibility that an issue, problem, or matter could have arisen after the time of the title search and before the writing of the abstract.\textsuperscript{72} Yet, the employer told Watson specifically how to address the issue: to write the abstract from his notes created when Watson concluded the title search.\textsuperscript{73} The clients in \textit{Maillard} had knowledge that someone had asserted some kind of claim against the association.\textsuperscript{74} Despite this knowledge, the clients never asked the lawyer to act on the claim.\textsuperscript{75} The issue, problem, or matter at the heart of Sengupta’s claim came into existence after the initial lawyer-client relationship and, because of the waiver, failed to exist as a viable issue at the time of the lawyer’s second representation.\textsuperscript{76} So, the lawyer’s negligence in filing the brief late had no effect, and could have had no effect, on the outcome.\textsuperscript{77} In each situation, the attorney was retained to complete one task, and was sued for malpractice for failure to complete a quite unrelated task. Watson was retained to give report on a title, but was sued for an abstract of title;\textsuperscript{78} Maillard was retained to assist in a real estate transaction, but was sued for failure to research a claim against the property;\textsuperscript{79} and Wickwire’s final representation of Mr. Sengupta was limited to one issue, while he was sued for malpractice pertaining to several issues.\textsuperscript{80} In these three cases, the attorneys’ limited scopes assured that the malpractice claims were unrelated to the duties enumerated in the retainer agreements.

\textsuperscript{69} \textit{Id.} at 751-52.

\textsuperscript{70} \textit{Sengupta}, 124 P.3d at 754-55.

\textsuperscript{71} \textit{Id.} at 755.

\textsuperscript{72} \textit{Watson} v. Calvert Building & Loan Ass’n of Baltimore City, 45 A. 879, 880 (Md. 1900).

\textsuperscript{73} \textit{Id.}

\textsuperscript{74} \textit{Maillard} v. Dowdell, 528 So. 2d 512, 514 (Fla. Dist. Ct. App. 1988).

\textsuperscript{75} \textit{Id.} at 515.

\textsuperscript{76} \textit{Sengupta}, 124 P.3d at 755.

\textsuperscript{77} \textit{Id.}

\textsuperscript{78} \textit{Watson}, 45 A. at 880.

\textsuperscript{79} \textit{Maillard}, 528 So. 2d at 513-14.

\textsuperscript{80} \textit{Sengupta}, 124 P.3d at 749-51.
D. The Lawyer’s Duty to Advise, in the Context of the Undertaking

Lawyers are typically only required to advise clients regarding issues to which they are contractually bound, via retainer agreements. In *Grand Isle Campsites, Inc. v. Cheek*, the Supreme Court of Louisiana held that an attorney’s consent to handle a specific transaction for a party does not create an attorney-client relationship as to the party’s other business matters. Mr. Cheek discovered that Humble Oil Company owned undeveloped land on Louisiana’s Grand Isle that they were willing to sell for $275,000. An associate of Mr. Cheek’s relayed the information to three businessmen, who Mr. Cheek subsequently told he held an option to purchase the property for $400,000. Mr. Cheek was made a director and one-fourth owner in the corporation formed to purchase the property, Grand Isle Campsites, Inc. Mr. Cheek later suggested his personal attorney, Mr. Fetzer, was familiar with the transaction and could handle the legal aspects of the transfer to the corporation. Fetzer handled the assignment of the option to the corporation, prepared the act of sale to the corporation, prepared the mortgage from the corporation to the bank, gave a title opinion, assured the purchasers they received good title, and issued and deposited the relevant checks.

Fetzer denied liability by producing evidence stating all three of the corporation’s partners knew he was acting as Cheek’s personal attorney and that he merely took instruction from one of the partners, Mr. Tomlinson, relative to the preparation of the documents. He stated his only other task was to assure the purchasers of the validity of the title and sale. The court found this evidence meritorious and further posited that even if Fetzer and the corporation did develop an attorney-client relationship, Fetzer’s scope was properly limited such that he held no further duties to the corporation. Three justices dissented, suggesting Fetzer violated a fiduciary relationship to the corporation in failing to disclose that Cheek stood to profit $125,000 in the sale.

In *Majumdar v. Lurie*, the Appellate Court of Illinois held that an attorney had no duty to advise a shareholder of his duties as a corporate officer when the attorney represented the corporate entity, not the individual shareholder. In 1974, defendant attorney Michael Lurie represented Bel-Austin Medical Corporation (“Bel-Austin”), which hired Dr. Majumdar, who acquired a 49%
interest in the corporation and was named its officer and director. Dr. Majumdar, six years later, asked Lurie to represent him in forming his own medical corporation. After the new corporation was developed, Dr. Majumdar sued Lurie, claiming the attorney improperly incorporated his business and failed to advise him of his fiduciary duties to Bel-Austin, failed to advise him to resign as an officer and director of Bel-Austin, and engaged in a conflict of interest by representing him and Bel-Austin concurrently.

The court looked at the scope of the contract of engagement, and decided that the complaint was void of any allegations of an attorney-client relationship. Lurie actually represented Bel-Austin, not Dr. Majumdar; since “the attorney for a corporate client owes his duty to the corporate entity not its individual shareholders, officers, or directors,” Lurie had no duty to advise Dr. Majumdar.

A New Jersey appeals court held, in 1982, that an attorney has no duty to advise clients to refrain from purchasing a small business because they may lack the experience needed to successfully run the operations themselves. When he was 23 years old, Larry Lamb and his wife acquired a bakery with a $4000 cash investment, an $8000 investment from their attorney, Barbour, and a mortgage assumption. Two short months later, the business failed and the Lambs sued Barbour, alleging their losses were a result of his negligence.

Since Lamb knew Barbour dealt primarily with tax law and business accounting, he asked Barbour to review the financial statements of the business before the acquisition was finalized. Barbour advised Lamb that the business operated at a loss and had “unduly high amounts of accounts receivable.” Lamb admitted to Barbour that the previous owners boasted enjoyment of a substantial amount of income which they did not report, and Barbour made no reply. The trial judge found for the Lambs, concluding that Barbour should have told the Lambs they may not be skilled, experienced, or possess good enough judgment to operate a business with such a vast revenue and so many employees. He also determined that Barbour should have warned the Lambs that the bakery’s previous owners may have exaggerated when they told Lamb the business enjoyed unreported income, and that Lamb’s own failure to report

92. Id. at 917.
93. Id.
94. Id. at 918.
95. Id.
96. Id.
98. Id. at 1123.
99. Id. at 1123-24.
100. Id. at 1124.
101. Id.
102. Id.
103. Lamb, 455 A.2d at 1124.
such income could result in a liability to the Internal Revenue Service. The judge further found, inter alia, that Barbour failed to obtain judgment searches, failed to check tax liabilities, and neglected to secure warranties. The judge posited that had Barbour represented his clients properly, they “would have been able to make an informed decision as to whether they should buy the businesses.”

The appeals court disagreed, noting it would have been presumptuous for Barbour to recommend the Lambs not purchase the business. Although the court pointed out the Lambs did rely on Barbour’s advice, they found that any reliance “did not justify the expectation of counseling as to the prudence of the course they had chosen” and that “[t]his decision was properly left to the exercise of plaintiffs’ business judgment.” Further, the court found that since Barbour’s out-of-pocket contribution was actually more than that of the Lambs, his doubts concerning the Lambs’ ability to handle the business were open to question.

Both *Grand Isle* and *Majumdar* explore the concept of liability when a corporation and individual are involved. Both courts uphold the same determination: simply because an attorney represents a corporation, it does not follow that the attorney must advise all members of the corporation’s board or its shareholders in their individual capacities. Attorneys who represent corporations, members of corporate boards, or corporate shareholders should specify in their retainer agreements to whom their duties are owed. *Lamb* suggests the advice an attorney owes to his client does have bounds. Attorneys do not always owe a duty to advise a client as to the prudence of his actions. Before advising any client, the careful attorney should confirm his representation of the person seeking advice, and should realize he is not required to advise his client in regard to personal judgment calls.

**E. The Lawyer’s Duty to Advise as to Matters Falling Outside the Scope of the Undertaking – the Lawyer’s “Peripheral Duty” to Advise**

A California Court of Appeal held that a workers’ compensation attorney may have a duty to advise clients of third party claims for which he is not retained if those claims arise out of the same occurrence as other claims for which he is retained in *Nichols v. Keller*. Plaintiff Nichols was a union

104. *Id.*
105. *Id.*
106. *Id.* at 1125.
107. *Id.* at 1126.
108. *Id.*
111. *Lamb*, 455 A.2d at 1126.
boilermaker hired to work on a multi-floor construction project.\textsuperscript{113} Nichols was injured when a large metal object fell on his head from a scaffolding above him.\textsuperscript{114} He hired Keller to represent him in his workers’ compensation proceeding, which was still pending at time of appeal.\textsuperscript{115} The following year, during a trip to a medical appointment, Nichols discussed his accident with union employees.\textsuperscript{116} They explained to Nichols that he may have had a third party claim against either his employer or the general contractor, and that if his attorney had never advised him of those possibilities, he may have a legal malpractice claim as well.\textsuperscript{117}

Upon review, the court of appeal found that workers’ compensation attorneys have a duty to advise and counsel their clients on all matters arising out of their injury, and if the attorney wishes not to represent the client in all matters, he must advise him to consult other counsel.\textsuperscript{118} Whether Keller owed Nichols a duty was a triable issue because Keller offered evidence suggesting his duty was strictly limited to filing the workers’ compensation claim, while Nichols offered expert testimony suggesting Keller’s actions fell well below the standard of care of a workers’ compensation attorney.\textsuperscript{119}

In addition to an attorney’s duty to represent his client under any express or implied agreements, he must also advise his client of any issues on the periphery of those agreements. In 1978, the Kentucky Court of Appeals held in Daugherty v. Runner that attorneys may be liable for failure to advise clients of legal problems or remedies that are not entirely within the scope of the acts laid out in their retainer agreements.\textsuperscript{120} The court actually upheld a jury verdict exonerating Runner, an attorney accused of malpractice; even though the attorney was acquitted by the jury, the court expressed twice in the opinion that had they been the triers of fact, they would have ruled differently.\textsuperscript{121}

In February of 1972, Lula Daugherty Roach and her husband were in an automobile accident near Richmond, Kentucky.\textsuperscript{122} Mrs. Roach received emergency assistance at the scene, and was then transferred to St. Joseph Hospital in Lexington.\textsuperscript{123} She was admitted on February 22, 1972, and died in the hospital on March 17, 1972 of bronchial pneumonia caused by peritonitis and bacterial endocarditis.\textsuperscript{124} The day she died, her husband sought out Runner and entered into a contract to “institute a claim for damages against any and all

\textsuperscript{113} Id. at 604.
\textsuperscript{114} Id.
\textsuperscript{115} Id.
\textsuperscript{116} Id.
\textsuperscript{117} Id. at 604-05.
\textsuperscript{118} Nichols, 19 Cal. Rptr. 2d at 610.
\textsuperscript{119} Id. at 608-09.
\textsuperscript{120} Daugherty v. Runner, 581 S.W.2d 12, 17 (Ky. Ct. App. 1978).
\textsuperscript{121} Id. at 18, 20.
\textsuperscript{122} Id. at 14.
\textsuperscript{123} Id.
\textsuperscript{124} Id.
responsible parties as a result of injuries received upon the 22nd day of February, 1972.\textsuperscript{125} More than a year later, Mr. Roach entered into another contract with an unnamed second attorney who was to represent Roach in the medical malpractice claim.\textsuperscript{126} Byrd Daugherty was appointed ancillary administrator of the estate since Mr. Roach was a nonresident.\textsuperscript{127} The second attorney filed suit in August of 1973, and Fayette Circuit Court granted summary judgment against Daugherty for failing to file within Kentucky's one-year limitations period for medical malpractice.\textsuperscript{128}

Daugherty subsequently sued Runner for malpractice.\textsuperscript{129} At trial, the parties presented conflicting testimony, creating a question of fact for the jury. Runner claimed he was never hired to follow through with a medical malpractice case, that he had never done one before, and was unqualified to take one to trial.\textsuperscript{130} Daugherty and the estate argued that Runner did not even examine the hospital records until after the statute of limitations expired for medical malpractice.\textsuperscript{131} The estate also argued that Daugherty should have advised his client that he did not handle medical malpractice cases.\textsuperscript{132} The Court of Appeals expressed a lack of clarity as to why the unnamed second attorney did not file the med-mal claim within the limitations period, but nonetheless speculated it may have been Daugherty’s duty to either file the claim himself or at least advise the family to find another attorney to file the claim.\textsuperscript{133}

The court determined the standard of care for legal malpractice, stating that by virtue of a lawyer's admission to the practice of law and the his or her offering of legal services, a lawyer implicitly promises he or she “possesses to an ordinary extent the technical knowledge commonly possessed by those in the profession, and that he will give to the matters submitted to him such care and attention as is ordinarily given similar affairs by men of his profession.”\textsuperscript{134}

The court explained the limitations on an attorney’s implicit promise of competence:

He does not agree, in the absence of special contract to that effect, that he will make no mistake of judgment. On the contrary, the law recognizes, in fixing this liability of the attorney, that human judgment is fallible. Courts, as well as lawyers, do disagree concerning the many

\begin{itemize}
\item 125. Id.
\item 126. Daugherty, 581 S.W.2d at 14.
\item 127. Id.
\item 128. Id.
\item 129. Id.
\item 130. Id.
\item 131. Id. at 14-15, 17.
\item 132. Daugherty, 581 S.W.2d at 14.
\item 133. Id. at 14-15.
\item 134. Id. at 15.
\item 135. Id.
\end{itemize}
matters about which each one may have a fairly fixed opinion. The law is a science, it is true, but an imperfect one, for the reason that it depends for exemplification and enforcement on the imperfect judgments and consciences of men. Therefore when the attorney has used ordinary care in acquainting himself with the facts, his misjudgment as to the law thereon will not generally render him liable.136

Next the court discussed the estate’s second contention: that even if Runner was not hired to pursue the medical malpractice claim, he nonetheless had a duty to “obtain and examine the medical records of the patient, to investigate the treatment procedures administered to her, and to inform his client that there may have been some question about the medical care and treatment she received, but that he did not handle medical malpractice.”137 Runner argued that he owed his client no duties as to a medical malpractice claim because he was not retained for such purpose.138 The court viewed the question from the perspective of a layman client, who knows little of legal remedies, and determined that to absolve Runner of all duties not mentioned in a retainer agreement would have put an overwhelming burden on Daugherty in that she would have had to recognize for herself the potential legal remedies available to her on the date she retained her attorney.139 The court refused to impose such a burden on layman unskilled in the law.140 Instead, the court stated that an attorney “cannot completely disregard matters coming to his attention which should reasonably put him on notice that his client may have legal problems or remedies that are not precisely or totally within the scope of the task being performed by the attorney.”141

After thoroughly considering the appealed issues of both parties, the court found no abuse of discretion and no reason to overturn the jury’s verdict, although Justice Hayes mentioned one last time that had the justices sat as jury members rather than Court of Appeals judges, they would have likely found the evidence sufficient for a legal malpractice claim.142

IV. THE PERIPHERAL DUTY AND ITS APPARENT CONFLICT WITH THE CONCEPT THAT A LAWYER’S UNDERTAKING DEFINES THE DUTIES THE LAWYER OWES TO THE CLIENT

Liability may arise for a lawyer when the lawyer breaches a duty within the scope of the employment or undertaking; however, this is not where the lawyer’s

136.  Id. at 15-16.
137.  Id. at 17.
138.  Daugherty, 581 S.W.2d at 17.
139.  Id.
140.  Id.
141.  Id. (citing Owen v. Neely, 471 S.W.2d 705, 708 (Ky. 1971)).
142.  Id. at 20.
A lawyer may also face liability when he or she fails to advise a client about a reasonably apparent matter that could affect the client, the client’s rights, or the client’s obligations, even if the client never employed the lawyer to advise about or to perform services in relation to the matter. Lawyers must advise clients concerning collateral matters, or alert the client to the need to seek other legal counsel regarding a matter the lawyer declines or lacks the expertise to handle.

In certain circumstances, attorney-client relationship may be implied where attorney led would-be client reasonably to expect he was being represented. In 1994, a Colorado federal district court held that while attorneys may certainly limit the scope of their employment, whether attorneys breached duties to clients depends on whether the duties fell within that scope. In *International Tele-Marine Corp. v. Malone & Associates, ITC*, a Florida corporation, wanted to go public with 600,000 shares of its stock. ITC chose a Colorado brokerage corporation, Malone & Associates (“Malone”), to underwrite the deal; Malone’s attorneys were the firm Brenman Raskin Friedlob & Tenenbaum, P.C. (“BRF”). ITC retained Florida law firm Holland & Knight to help file with the Securities and Exchange Commission (“SEC”). ITC entered into a written agreement with Holland & Knight and a payment agreement with BRF, only to find out a few days later that Malone was being investigated by the National Association of Securities Dealers (“NASD”). Malone settled the investigation, but with penalties ranging from suspension of limited duties to suspension of all duties from 15 to 75 days and a $161,000 fine. A BRF attorney suggested that the settlement should be disclosed in the SEC documentation. Nearly two months later, Holland & Knight filed the SEC documentation with the disclosure of the NASD investigation, stating the penalties imposed by the NASD settlement had not affected Malone’s ability to create the documents. The following month, Malone again found itself with regulatory issues: the Office of the Comptroller of the State of Florida brought legal action against Malone and other brokerage firms. Only weeks later, Malone ceased operations.

143. *Id.* at 17.
145. *Daugherty*, 581 S.W.2d at 17.
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.*
152. *Id.*
154. *Id.*
completely, which prevented ITC from going public since the SEC documentation could not be approved.\footnote{Id. at 1430.}

ITC alleged breach of duty of loyalty, fiduciary duty, and contract, among other claims.\footnote{Id.} The court focused on whether an attorney-client relationship existed.\footnote{Id. at 1431.} After evaluating the relevant documentation and testimony, the court determined that a reasonable jury could conclude, based on the evidence, that ITC reasonably believed BRF was its attorney.\footnote{Id. at 1433.}

Next, the court was faced with the issue of whether BRF’s scope of representation was limited to one issue, and if so, whether the scope extended to disclosing Malone’s regulatory matters.\footnote{International Tele-Marine Corp., 854 F.Supp. at 1433-34.} The court found that a jury question existed as to the issue of scope because the written agreements delegated NASD filings to BRF.\footnote{Id. at 1434.}

Fifteen years before the Court of Appeals of Kentucky was faced with the peripheral duty in \textit{Daugherty}, the Court of Appeal of Louisiana found the duty existed in \textit{Aladdin Oil Co. v. Marque}.\footnote{Aladdin Oil Co. v. Marque, 157 So. 2d 368, 374 (La. Ct. App. 1963).} Aladdin Oil Company (“Aladdin”) sued the estate of Robert Hickerson, an attorney, for malpractice stemming from a title search for fifty lots of real property.\footnote{Id. at 369.} Hickerson had an interest in the property, and believed he was familiar with its title.\footnote{Id. at 370.} He subsequently relied on the assurance of a prior purchaser, Breazeale, that his outstanding mortgage had been paid; however, Breazeale had not paid the mortgage and Hickerson’s title search was faulty.\footnote{Id. at 371.} Hickerson’s estate argued that he was employed as a notary, and not an attorney, but the district court found the estate liable for Aladdin’s financial loss.\footnote{Id. at 374.}

The Court of Appeals also found the estate’s distinction between notary and attorney immaterial since Hickerson would have been liable for the same amount regardless of his capacity to Aladdin.\footnote{Id. at 369.} The court held that it was Hickerson’s duty, both as attorney and as notary, to advise his clients of the prior sale and mortgage, and that it was not sufficient for him to take the prior owner’s word that the outstanding mortgage had been paid.\footnote{Id. at 371.} Moreover, since Hickerson held an interest in the property as well, and was paid $12,000 from the proceeds of
the sale, the court found Hickerson relied on the word of Breazeale at his own risk.168

V. PARAMETERS OF THE PERIPHERAL DUTY

The Supreme Court of Tennessee, in Jamison v. Norman, held that a Tennessee attorney had no peripheral duty to advise his client of the workers’ compensation laws of nearby states when retained to represent such client in a personal injury action only.169 Forrest Jamison worked for a trucking company in Nashville and was severely injured on the job while in Atlanta, and subsequently hired Norman to represent him in a personal injury action arising out of the accident.170 Jamison did not seek Norman’s advice on the workers’ compensation claim, as another attorney was handling that claim, but Norman did advise Jamison that in Tennessee, the workers’ compensation carrier would be entitled to reimbursement of any damages Jamison should win in a personal injury action.171 Jamison later settled the workers’ compensation claim for $79,000, without ever consulting Norman in the matter.172

Norman attempted to no avail to settle the personal injury action in Tennessee, and later referred Jamison to a personal injury attorney in Georgia to file suit.173 The Georgia attorney advised Jamison that under Georgia law, he would not have had to reimburse the workers’ compensation carrier had he also filed the workers’ compensation action in that state.174 Jamison won the personal injury suit in Georgia and later filed a malpractice action against Norman for the $79,000 he had to reimburse to the workers’ compensation carrier’s insurer.175 The trial court dismissed the action upon Norman’s motion for summary judgment, only to have the court of appeals reverse upon review, finding a genuine issue of material fact “concerning the professional standards under the circumstances” of the case.176

The court found for the attorney, citing the facts that the Jamisons had elected to file the workers’ compensation claim on their own and did not seek legal advice from Norman on that issue.177 Moreover, the court found the workers’ compensation claim to be fully outside the area of Norman’s employment, and said it would be “an anomaly for him to handle the worker’s compensation claim, and yet impose a duty on Mr. Norman to advise him how to

168. Id.
170. Id. at 408-09.
171. Id. at 409.
172. Id.
173. Id.
174. Id.
175. Jamison, 771 S.W.2d at 409.
176. Id. at 408.
177. Id. at 410.
proceed in the worker’s compensation action, or where to file the complaint, or
the fairness of the settlement.”

In *Landis v. Hunt*, the Court of Appeals of Ohio held that a peripheral duty
existed where no fee was paid or fee arrangement discussed when clients relied
upon the attorney’s advice in refraining from filing medical malpractice
claims. Conversely, the court also held that a probate attorney owes no
peripheral duty to investigate whether a wrongful death claim should be pursued
each time he probates a will. In January of 1982, Tom Landis had a mole
removed and tested for cancer. His family physician misread test results and
pronounced the mole nonmalignant. Months later, a specialist reread the
results and pronounced the mole malignant. Landis soon underwent surgery
to remove part of his hip bone. Fourteen months later, the Landises contacted
attorney Richard Hunt to explore the possibility of a medical malpractice suit.
Hunt told the Landises he did not handle medical malpractice cases, but that he
would consult with an attorney who did. He called William Ahern, who
related that the one-year statute of limitations was a complete defense to any of
the Landises’ claims. Hunt relayed this information to the Landises in a letter,
which they testified they did not receive. Tom Landis died in 1984, and Mrs.
Landis retained Robert Herkins to probate her husband’s estate. Five years
later, after watching a television program about malpractice claims, Mrs. Landis
consulted a fourth attorney who assisted her in filing malpractice claims against
Hunt, Ahern, and Herkins.

Although the trial court granted the three attorneys’ motions for summary
judgment, the appellate court reversed as to Hunt. Despite the fact that no fee
arrangement was discussed or money exchanged, the court found that Hunt’s
consultation with the Landises created an attorney-client relationship when Hunt
rendered legal advice based on the facts relayed to him by the Landises.
Moreover, the court found the Landises relied on Hunt’s information in
refraining from pursuing medical malpractice claims, which further helped
constitute an attorney-client relationship. On the contrary, the court found Herkins, an attorney who presumably was hired via retainer and financially compensated for his work, owed no peripheral duty to Mrs. Landis to inquire as to whether the circumstances of Mr. Landis’s death gave rise to a wrongful death claim. The court held that no such duty exists “without something being said by the client which would cause the probate attorney to make further inquiry into the circumstances of a decedent’s death to explore the possibility of a wrongful death claim.”

VI. KENTUCKY CONJECTURE

Although nine members of Daugherty’s jury found that the attorney had not committed malpractice, the Court of Appeals of Kentucky mentioned twice in the opinion that had they sat as jurors, they may have came to a different conclusion. Although this is dicta, it leads one to believe that the court’s standard as to whether or not an attorney has breached a duty arising outside the express context of a retainer agreement is relatively low; however the court’s willingness to overturn the jury’s decision was limited as well.

In spite of the court’s standard, what does Daugherty say about the way Kentucky may rule on other peripheral duty or contractual duty issues? The court agrees with a passage from Mr. Roach’s brief, stating,

> Maybe we, as a profession, have not discharged our responsibility to inform the public as a whole, and more specifically, Mr. Roach, that we specialize and limit our practice. However, in the end result, the effect on the client is the same; the public expects, and has the right to demand, that their legal affairs will be approached with expertise and initiative and anything short of that is a violation of the trust and confidence reposed in a member of our profession.

Although one could dispute whether many other courts would hold lawyers to such a high standard, the court implied that attorneys must always advise their clients as to the limitations and specializations of their practices. However, the court may not have weight to hold a client to such standard, considering its approval of a jury instruction in the case that imposed no duty on the attorney to advise his clients of his limited or specialized practice. Instead, the jury instruction said an attorney should “[n]ot . . . undertake representation in a legal matter in which he knew or should have known he was not competent without associating with himself a lawyer that was competent to handle it” and that the

193. *Id.* at 559.
194. *Id.* at 561.
195. *Id.*
197. *Id.* at 20.
198. *Id.* at 18.
attorney should “[n]ot . . . undertake representation in a legal matter without preparation adequate in the circumstances.” 199 The jury is not charged with the task of considering whether the attorney told the client of the limitations or specializations of his practice, yet the court seems to favor that approach even if it could not hold an attorney to such a standard.

How would the Kentucky Supreme Court rule on an issue similar to that which the Tennessee Supreme Court faced in Jamison v. Norman, where the court held that a personal injury attorney may need to advise lawyers of other claims arising out of the same occurrence for which he was retained, but has no duty to advise clients of the laws which would govern the transaction in another state? 200 Daugherty provides no evidence that Kentucky would extend the rule so far. 201 Neither the court’s focus on advising clients of the limitations of attorneys’ practices nor its approval of the jury instruction which states that attorneys need to seek advice from competent attorneys lends any weight to the conclusion that the court would hold for the plaintiff in such an action. 202 Yet the court, in its oft-quoted statement, says, “An attorney cannot completely disregard matters coming to his attention which should reasonably put him on notice that his client may have legal problems or remedies that are not precisely or totally within the scope of the task being performed by the attorney.” 203 Would an out-of-state remedy apply? In Jamison, the plaintiff would have saved tens of thousands of dollars had his attorney realized the Georgia laws were more favorable to his client than those of Tennessee, yet the Tennessee Supreme Court held the attorney had no duty to advise the client accordingly. 204 At the least, Kentucky attorneys should consider Jamison’s holding when representing plaintiffs who have been in work-related automobile accidents in other states; if the client will not have to reimburse the worker’s compensation paid to him in the state where the accident occurred, a Kentucky court could hold an attorney responsible for the amount the client must reimburse.

The question also arises as to what Kentucky would do in a situation such as Landis v. Hunt, where no retainer or attorney-client relationship existed, but nonetheless liability arose when an attorney advised a client not to pursue medical malpractice claims. 205 Daugherty suggests the Kentucky courts would agree. Daugherty held that an attorney hired to pursue one claim may be liable for failing to advise his client of additional actions which could be filed based on the same transaction or occurrence. 206 Attorney Runner was not hired to pursue

199. Id.
201. See Daugherty, 581 S.W.2d at 12.
202. Id. at 17-18.
203. Id. at 17 (citing Owen v. Neely, 471 S.W.2d 705 (Ky. 1971) (emphasis added)).
204. Jamison, 771 S.W.2d at 410.
206. Daugherty, 581 S.W.2d at 17.
the additional claims, and failed to advise his clients of their existence. It then follows that an attorney who was not hired to pursue a claim, but does advise his client in regard to such claim will likely also be held liable in a Kentucky court. In neither relationship did a written retainer agreement exist as to the claims on which the plaintiffs’ alleged malpractice, yet it seems analogous to hold Hunt liable for faulty advice if Runner was found possibly liable for giving no advice at all. In both cases, the result was the same: faulty advice which caused the clients damage.

Taken as a whole, Daugherty cautions that Kentucky attorneys should never advise clients without retainer agreements that state what the lawyer has no obligation to do as well as precisely as what the lawyer has an obligation to do. If an attorney does create a contractual relationship with a client, he should properly limit his scope to the issues he has agreed to represent. Attorneys should identify any matters which are outside their expertise and should advise clients of their limitations or seek out qualified co-counsel. Non-Kentucky cases can serve as advisory opinions for Kentucky attorneys as well. Steinbach suggests that termination letters are held valid by courts, thus attorneys should habitually send them to clients, keeping record copies themselves, whenever they finish representing a client. New retainer agreements can always be drawn up if the client seeks advice on a new matter. Attorneys should realize their appearance in court for a client creates a rebuttable presumption that the attorney has been retained as the client’s counsel. Since retainer agreements with limited scopes limit an attorney’s liability, the prudent attorney will realize that he has no duty to advise a client in regard to matters outside those agreements and will refrain from doing so. Attorneys with corporate entities as clients likely have no duty to the corporations’ shareholders, and should thus state in their retainer agreements. Lastly, attorneys likely have no duty to advise a client as to whether he or she is mature enough to take on great responsibility.

VII. MODERN KENTUCKY MALPRACTICE CASES

A. Recent Malpractice Statistics

Interestingly, Daugherty has only been cited in Kentucky cases for help defining malpractice or for help answering procedural questions since its

207. Id.
208. See Steinbach v. Meyer, 412 N.W.2d 917, 919 (Iowa Ct. App. 1987); see also Smith, supra note 22, at 2-5, 11.
209. Steinbach, 412 N.W.2d at 919.
Thirty years later, why is this so? Do Kentucky attorneys already know about this duty? Are Kentucky attorneys so well-versed in the peripheral duty that they strictly adhere to it in the advice they give to clients? Or are they settling out of court? According to an American Bar Association study, 26% of claims filed against attorneys are settled. Being familiar with the judicial system and its precedential nature, attorneys may be more prone to settle cases when they find obvious precedent on their opponents’ sides. Moreover, 61% of malpractice claims filed against attorneys are abandoned by plaintiffs. Such a high rate of abandonment may be because attorney-defendants are more likely to file dismissal motions on claims against them, which in turn may cause a rise in fees from the plaintiffs’ new attorneys. Rather than pay the new attorneys to respond to or file motions, plaintiffs may give up. The settled and abandoned claims equal 87% of claims filed against attorneys, and these do not reach final judgment in the courts. Attorneys are quite successful in the claims that do make it to court, as plaintiffs win only 2.42% of cases filed against attorneys. Conversely, attorneys win almost 10% of cases filed against them by their clients. It appears as though attorneys do not allow many cases against them to go to trial unless they are fairly certain they will win; otherwise, the familiarity of attorneys with the legal process seems to persuade them to settle when the odds are not in their favor.

B. A Modern Hypothetical

Many peripheral duty cases today appear in the context of real estate transactions. For example, attorneys are often retained to assist small business owners in purchasing real property upon which to relocate their businesses. If attorney Johnson is retained to assist plaintiff Smith in purchasing a house which plaintiff Smith plans to remodel and turn into a business, attorney Johnson’s contractual duties will typically include giving an opinion as to the marketability of the house’s title and assisting in the real estate closing. These duties will generally appear in the retainer agreement and both attorney Johnson and plaintiff Smith will likely agree these are the duties for which attorney Johnson was retained. Attorney Johnson posits that the title is quite marketable and the closing goes smoothly. Plaintiff Smith subsequently spends months remodeling the house to fit the needs of her business. She wants to open a daycare center, so she builds a fence around the house and also enlarges doorways and builds ramps, since she may have special needs children who will need wheelchair access. After spending hundreds of dollars on advertising, plaintiff Smith

214. See supra note 7.
215. AM. BAR ASS’N STANDING COMM. ON LAWYERS’ PROF’L LIABILITY, supra note 1, at 8.
216. Id.
217. Id.
218. Id.
accepts applications from children and opens her daycare center. One week into operation, the local sheriff appears at plaintiff Smith’s door and demands she stop running the daycare center from the home. She is in violation of the local zoning ordinances, which have zoned the area for single-family residences only. Plaintiff Smith calls attorney Johnson and asks him why he failed to advise her to check the zoning ordinances; she also asks why he did not bother to check the ordinances himself. Unsatisfied with his response that he was not retained to check zoning ordinances, but was hired to express his opinion as to marketability of title and to assist with the closing, plaintiff Smith files a malpractice suit against attorney Johnson. Attorney Johnson retains an attorney who specializes in malpractice to represent him in plaintiff Smith’s action. The malpractice attorney advises attorney Johnson to settle the claim.

C. What Can Attorneys Do to Act in Accord with the Peripheral Duty?

Since retainer agreements detail the precise situations for which attorneys are liable, drafting them appropriately is essential to avoiding the breach of a peripheral duty. Listing in the agreement what the attorney is liable for may not be enough information; a retainer agreement should also detail what types of issues the attorney is not liable for, should note that other remedies may be available which the attorney will not investigate, and should recommend the client seek new counsel for any claims not expressly listed in the retainer. For example, if the attorney in Daugherty had written into his retainer agreement that he was not responsible for filing a medical malpractice action, that he was not responsible for any medical malpractice research, and that the client should seek alternate counsel for any claims other than negligence, he may have had a better defense. Attorneys may even need to review retainer agreements a second or third time in order to refresh themselves of the duties owed to their clients if significant time has passed since the document was drafted. Once an attorney no longer represents a client, he should send non-engagement letters, which often “eliminate the need for litigating the issue of whether an attorney-client relationship was ever established.” Open discourse with clients can also help attorneys avoid being sued; clients who understand what their attorney is and is not capable of at the outset of a case may be less likely to decide to resolve disputes with attorneys in court.

222. Id.
VIII. PRACTICE POINTERS

In addition to serving as advocates for clients, lawyers serve as advisors.\(^\text{223}\) Even a lawyer acting as an advocate serves, at various times and in various circumstances during the litigation, as an advisor. So, one important function of a lawyer is to advise.

In Kentucky and in many other states, the rules of professional conduct address the lawyer’s role as counselor or advisor. Though Kentucky Supreme Court Rule 3.130 (2.1) is a rule of professional conduct, the rule provides guidance to lawyers in discharging their civil legal duty to advise clients.\(^\text{224}\) The rule provides that “[i]n representing a client, a lawyer shall exercise independent professional judgment and render candid advice.”\(^\text{225}\) The Supreme Court’s commentary to the rule explains that generally “a lawyer is not expected to give advice until asked by the client.”\(^\text{226}\) The commentary proceeds to provide that “when a lawyer knows that a client proposes a course of action that is likely to result in substantial adverse legal consequences to the client, duty to the client under Rule 1.4 may require that the lawyer act if the client’s course of action is related to the representation.”\(^\text{227}\) This commentary “suggests that an attorney should, on his own initiative, offer legal advice in two circumstances: (1) when the client is unaware of the potentially adverse legal consequences of a proposed course of action, and (2) where the offering of advice would be in the client’s best interests.”\(^\text{228}\)

A properly drafted fee agreement or retainer agreement controls the lawyer’s exposure to malpractice liability in both of these circumstances. In drafting a fee agreement or retainer agreement, a lawyer should specify the legal matter in detail, remembering that in construing any ambiguity in the agreement, including one concerning the scope of the undertaking, a court will act to protect the client and the client’s reasonable expectations concerning the scope of the undertaking. Moreover, in drafting a fee agreement, a lawyer has “a duty to inform the client of not only what the subject of the representation is, but further, what it is not.”\(^\text{229}\)

\(^\text{223}\) Doe v. Hughes, Thorsness, Gantz, Powell & Brundin, 838 P.2d 804, 807 (Alaska 1992) (“An important part of an attorney’s duty to a client is the duty to advise the client of action the client should take in a given set of circumstances.”).

\(^\text{224}\) KY. SUP. Ct. R. 3.130 (2.1).

\(^\text{225}\) Id.

\(^\text{226}\) KY. SUP. Ct. R. 3.130 (2.1) cmt. 5.

\(^\text{227}\) Id.

\(^\text{228}\) In re Consupak, Inc., 87 B.R. 529, 551 (Bankr. N.D. Ill. 1988) (citing MODEL RULES OF PROF’L CONDUCT R 2.1 (1983)).

\(^\text{229}\) THE MISSOURI BAR ASSOCIATION, FEE AGREEMENT SAMPLE FORMS AND COMMENTS 3 (2007), available at http://members.mobar.org/pdfs/lfr/lfrsamples.pdf. These forms represent a valuable source of commentary for practitioners in Kentucky, even though published by a bar association other than the Kentucky Bar Association. These forms also provide great resources for a lawyer in Kentucky wanting to manage malpractice risks beginning with the drafting of a fee agreement or retainer agreement. As with any form, though, Kentucky lawyers should avoid
This means that in drafting a fee agreement or retainer agreement concerning a claim to recover compensation for injuries suffered in an automobile accident, for example, the lawyer needs to say more than that he or she undertakes to represent the client concerning all matters relating to or arising out of a particular incident or all matter relating to a claim for personal injuries suffered on a particular date. The lawyer should identify in the agreement the party against whom the lawyer has agreed to assert, or to prosecute, claims.

In addition, the lawyer needs to consider whether the client has the possibility to assert claims against parties other than the named defendant or the possibility of pursuing alternate or additional claims by other means or in other tribunals. So, the lawyer should state in the fee agreement or retainer agreement whether the lawyer will investigate the possibility the client has claims against other unnamed parties for any compensation relating to the same incident or injuries and whether the lawyer will undertake any other responsibilities concerning those matters. To address the subject completely, “[i]f the client has other possible causes of action arising from the facts and circumstances giving rise to [the lawyer’s] representation, [the lawyer has] a duty to inform the client of these possible actions, that [the lawyer will represent, or will decline to represent] the client [concerning those matters], that the client should seek independent representation if the client wishes to pursue a remedy, and that delay or failure to do so may result in the client being barred by a statute of limitations from being able to recover under these other causes of action.”

Additionally, the lawyer needs to advise the client in the fee agreement as to whether the lawyer undertakes a myriad of other potential matters relating to or arising out of the claim for personal injuries. Lawyers undertaking a matter for a contingent fee have a particular interest in defining the scope of the undertaking as precisely as possible. For example, the lawyer needs to specify whether he or she provides representation concerning:

1. Any counterclaim asserted by any defendant;
2. Any appeal of any adverse judgment;
3. Any re-trial of the action following an appeal;
4. A declaratory judgment concerning insurance coverage for the damages incurred in the incident;
5. Any interlocutory appeal or any interlocutory proceedings arising out of the action (such as, an original action in the Court of Appeals of Kentucky seeking a writ of mandamus to protect confidential or privileged information or documents);
6. Any post-trial proceedings other than an appeal.

merely copying the form verbatim. Rather, Kentucky lawyers should use the form as a checklist of items to cover in the fee agreement or retainer agreement and as a source of language to use when drafting such an agreement.

230. Id.
If the lawyer follows these practice pointers, the lawyer will reduce, to the extent possible, the risk of facing a claim by a client that the lawyer failed to represent the client properly on a matter the lawyer may never have intended to handle – that is, on a “peripheral” matter.

IX. CONCLUSION

An element of unpredictability runs through every facet of the legal profession. An attorney may think a case is a slam-dunk, yet he can still lose; a judge may think the evidence in a case easily proves the defendant guilty beyond a reasonable doubt, but the jury may deadlock. Similarly, it is always possible that a client will be unhappy with his attorney should he lose the case. If the client felt wronged by the circumstances that got him to trial in the first place, he may feel doubly wronged if he does not receive a remedy in court. Clients may then choose to sue their attorneys as a last ditch efforts for a remedies. The recent criminal and civil trials regarding the Kentucky Phen-fen litigation have helped to widely publicize legal malpractice claims.231 Now that legal malpractice is commonly found in Kentucky media outlets, Kentucky attorneys need to be quite cautious and careful to avoid inviting malpractice claims from clients. The rationale behind preventing legal malpractice is somewhat circular: Just as lawyers must protect their clients, they must also protect themselves, which in turn, also protects their clients. Everyone wins when attorneys practice adequate malpractice preventative measures.

Government Tort Liability: A Survey Examination of Liability for Public Employers and Employees in Kentucky

Matthew T. Lockaby∗ and JoAnna Hortillosa**

I. INTRODUCTION

The doctrine of sovereign immunity is one of the most disparaged legal principles by courts and legal scholars. Rooted in English common law, it is based on the theory that “the King can do no wrong.”¹ Under the doctrine, no one can bring suit against the government without its consent, and individuals harmed by the torts of the government, its agencies, or its employees are often left without a remedy.²

The reasons for its unpopularity, of course, are numerous. For instance, application of the doctrine is generally avoided on the basis that it is unjust to force an injured party to bear exclusively the loss even though he would have been able to recover if the tortfeasor had been a private person or entity.³ The government, it is argued, is in a better position to bear the burden and has the ability to shift it to the entire community.⁴ It has also been said that, by denying a remedy to any person harmed by the tortious conduct of the government, its agencies, or its employees, the application of the sovereign immunity doctrine “results in a deprivation of life, liberty, and property without due process of law.”⁵

Despite the many criticisms, however, sovereign immunity is still alive, though not necessarily kicking, today. Many courts observe the issue of immunity more in terms of a reasoned approach to the policies involved, and

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¹ See WILLIAM BLACKSTONE, 1 COMMENTARIES *238.
² See RESTATEMENT (SECOND) OF TORTS § 895A, cmt. a (1979) (quoting Kawananakoa v. Polyblank, 205 U.S. 349, 353 (1907) (“A sovereign is exempt from suit, not because of any formal conception or obsolete theory, but on the logical and practical ground that there can be no legal right as against the authority that makes the law on which the right depends.”)).
⁴ Haney v. City of Lexington, 386 S.W.2d 738, 739 (Ky. 1964).
⁵ Id. (quoting James M. Talley, Jr., Torts – Judicial Abrogation of the Doctrine of Municipal Immunity in Tort Liability, 41 N.C.L. REV. 290, 291 (1963)).
give less regard to its historical significance. In recent years, courts have markedly adopted the view that protection should be made available to injured parties. Recent Kentucky decisions reflect this viewpoint, which was espoused years ago by Abraham Lincoln, writing that “[i]t is as much the duty of the Government to render prompt justice against itself in favor of citizens as it is to administer the same between private individuals.” Lincoln’s words have been echoed by Kentucky’s former Chief Justice, John Palmore: “sovereign immunity should be limited strictly to what the Constitution demands, for the simple reason that in a civilized society it is morally indefensible.”

While a great deal of uncertainty still exists as to “what the Constitution demands,” the modern tendency has been recession from absolute sovereign immunity. For instance, in Kentucky, judicial decisions have been the driving force behind the ever-narrowing scope of the sovereign immunity doctrine. In *Calvert Investments, Inc. v. Louisville & Jefferson County Metropolitan Sewer District*, the Supreme Court of Kentucky upheld Chief Justice Palmore’s early refusal to apply the sovereign immunity doctrine beyond “what the Constitution demands,” instead deferring to the sovereign immunity of the central state government mandated by Sections 230 and 231 of the Constitution of Kentucky.

6. Forrester v. White, 484 U.S. 219, 224 (1988) (explaining that, except with respect to immunities expressly granted by constitutional or statutory provisions, immunity issues are resolved by examining the nature of the functions with which a particular official or class of officials has been lawfully entrusted and evaluating the effect that exposure to particular forms of liability would likely have on the appropriate exercise of those functions).

7. *See Calvert Invs., Inc. v. Louisville & Jefferson County Metro. Sewer Dist.*, 805 S.W.2d 133, 138 (Ky. 1991) (noting that extending sovereign immunity based on the concept that the government can do no wrong or that the government cannot afford to compensate those whom it wrongs in circumstances where a private entity would be required to pay is unacceptable in a just society).


9. *Cullinan*, 418 S.W.2d at 411 (Palmore, J., dissenting). *See also Haney*, 386 S.W.2d at 742 (stating that in the context of municipal corporations, “the rule is liability – the exception is immunity”).

10. *See Haney*, 386 S.W.2d at 740-41 (noting that the legislature is not especially interested with the common law and therefore the responsibility falls on the courts to address unjust rules which were judicially created).

11. *Calvert*, 805 S.W.2d at 138 (quoting *Cullinan*, 418 S.W.2d at 411 (Palmore, J., dissenting)).

12. *Ky. Const.* § 230 states:

   No money shall be drawn from the State Treasury, except in pursuance of appropriations made by law; and a regular statement and account of the receipts and expenditures of all public money shall be published annually. No money derived from excise or license taxation relating to gasoline and other motor fuels, and no moneys derived from fees, excise or license taxation relating to registration, operation, or use of vehicles on public highways shall be expended for other than the cost of administration, statutory refunds and adjustments, payment of highway obligations, costs
As a consequence of the narrowing of the sovereign immunity doctrine, however, courts have created pockets of government tort liability and governmental immunity that can be difficult to navigate. This article explores the parameters of government tort liability in Kentucky. It is intended to serve as a reference for practitioners prosecuting and defending claims asserted against public employers and public officials. Section II of this article opens with a discourse on the abrogation of absolute sovereign immunity and the emergence of municipal liability for tort claims in federal and Kentucky courts. Section III discusses the circumstances that give rise to tort liability for government employees. Section IV addresses the immunities available to government entities and their employees, and is presented in four subsections. Subsection A addresses sovereign immunity and the limitations on bringing suit against the Commonwealth. Subsection B analyzes governmental immunity. Subsection C discusses official and qualified official immunity. And Subsection D briefly addresses other immunities in Kentucky, including legislative and judicial immunity. Finally, Section V closes with a cursory review of government tort liability in Kentucky.

II. MUNICIPAL LIABILITY

Municipal liability emerged in Kentucky with the abrogation of sovereign immunity as it applied to municipal corporations.15 Today, municipal liability is not limited to municipal corporations (i.e., cities), but its scope is narrower in the case of other local governmental entities for which sovereign immunity is still available (i.e., counties).16 Whether those entities are entitled to immunity from liability is addressed in Section III.B. of this article; this section focuses on the factual considerations that make a subsequent governmental immunity analysis either necessary or irrelevant.

For purposes of municipal liability, a “‘municipal corporation’ means nothing more than a local government entity created by the state to carry out ‘designated’ functions.”17 The term originally applied to cities, towns, and
villages, as well as their agencies that constituted separate entities, such as hospitals, education institutions, transit companies, and utilities.\footnote{Id. See also RESTATEMENT (SECOND) OF TORTS § 895C, cmt. a (1979).}

In \textit{Monell v. Department of Social Services},\footnote{Monell, 436 U.S. at 690 (holding that Congress intended municipalities and other local government units to be included among those persons to whom § 1983 applies and cannot be entitled to an absolute immunity under the Civil Rights Act of 1871).} the Supreme Court of the United States opened the door to municipal liability for a violation of civil rights under the Civil Rights Act of 1871 (42 U.S.C. § 1983).\footnote{42 U.S.C. § 1983 (1996) states, in its original language: \begin{quote} [A]ny person who, under color of any law, statute, ordinance, regulation, custom, or usage of any State, shall subject, or cause to be subjected, any person . . . to the deprivation of any rights, privileges, or immunities secured by the Constitution of the United States, shall, any such law, statute, ordinance, regulation, custom, or usage of the State to the contrary notwithstanding, be liable to the party injured in any action at law, suit in equity, or other proper proceeding for redress[.] \end{quote}} Under \textit{Monell}, local governing bodies, and local officials sued in their official capacities, can be sued directly under § 1983 for monetary, declaratory, and injunctive relief where the alleged unconstitutional action implemented or executed a policy statement, ordinance, regulation, or other decision officially, and in some instances unofficially, adopted or promulgated by those whose edicts or acts may be fairly said to represent official policies.\footnote{Monell, 436 U.S. at 690.}

In Kentucky, \textit{Haney v. City of Lexington} was the landmark case that repudiated common law municipal immunity by departing from the settled rule that municipal corporations were immune from tort liability.\footnote{Haney, 386 S.W.2d at 742.} Prior to \textit{Haney}, courts divided the “designated” affairs of municipal corporations into two seemingly discrete categories: governmental functions and proprietary functions, shielding municipal corporations whose activities were considered governmental from tort liability under the sovereign immunity doctrine and imposing liability on those which carried out proprietary functions.\footnote{Id. at 740.}

\textit{Haney} documented some of the constructions from Kentucky cases that developed in the wake of the rule of municipal liability, finding that the question of whether the entity was performing a governmental or proprietary function was a distinction without a difference.\footnote{Id. (“At most, the distinctions seem to be contrived and without sensible basis. That which was proprietary in some states was deemed governmental in others.”).} For example, a city could be subject to liability for its negligent failure to maintain its streets in a reasonably safe condition for public travel\footnote{Id. (citing Lampton & Burks v. Wood, 250 S.W. 980 (Ky. 1923)).} but was immune from tort liability for any negligent acts which might occur when those same streets were sprinkled with water or
oil or for injuries resulting from defects in a bridle path located exclusively within a city park. Although a city was not liable for the construction of a sewer (which was considered a governmental function), a city was liable for damages when a negligent part of the construction later caused a connecting residence’s basement to flood. The *Haney* decision also noted that the operation of a cemetery was proprietary, but operation of a park was governmental.

The court viewed the development of these constructions as evidence of courts’ reluctance to apply an ancient rule that was unduly harsh and openly disfavored in Kentucky. For decades, courts feigned this distinction as a way to escape application of the rule of municipal immunity. Until *Haney*, courts were not certain that changing the application of the sovereign immunity doctrine was a judicial task. A thoughtful consideration of the roles of the courts and the legislature, however, coupled with an examination of recent decisions of other jurisdictions restricting the application of the sovereign immunity doctrine, persuaded the court that it was time to move away from municipal immunity.

Favoring the scope of abrogation adopted by the Supreme Court of Wisconsin, the Court of Appeals repudiated tort immunity for ordinary torts committed by municipal corporations and eliminated the confusion attendant to

26. *Id.* (citing Kippes v. City of Louisville, 131 S.W. 184 (Ky. 1910) and City of Georgetown v. Red Fox Oil Co., 15 S.W.2d 489 (Ky. 1929)).  
27. *Id.* (citing City of Louisville v. Pirtle, 180 S.W.2d 303 (Ky. 1944)).  
28. *Haney*, 386 S.W.2d at 740 (citing Smith’s Adm’t v. Commissioners of Sewerage of Louisville, 143 S.W. 3 (Ky. 1912)).  
29. *Id.* (citing Bd. of Councilmen of Frankfort v. Buttimer, 143 S.W. 410 (Ky. 1912)).  
30. *Id.* (citing City of Hopkinsville v. City of Burchett, 254 S.W.2d 333 (Ky. 1953)).  
31. *Id.* (citing Baker v. City of Lexington, 310 S.W.2d 555 (Ky. 1958)).  
32. *Id.* (citing V. T. C. Lines, Inc. v. City of Harlan, 313 S.W. 2d 573 (Ky. 1957)) (emphasizing its unwillingness to enforce the rule of municipal immunity because it provided no remedy for persons harmed by negligence of a municipal corporation).  
33. *Id.* at 741 (citing V. T. C. Lines, Inc. v. City of Harlan, 313 S.W.2d 573 (Ky. 1957)) (noting that the legislature might expect the courts themselves to correct an unjust rule which was judicially created and the courts should undertake to change the doctrine of municipal immunity because a great number of the legislators are not lawyers nor are they interested in the details of law).  
34. *Haney*, 386 S.W.2d at 741 (comparing the varying degrees of abrogation adopted in recent decisions of the high courts of other jurisdictions) (citing Hargrove v. Town of Cocoa Beach, 96 So.2d 130 (Fla. 1957)); (citing Molitor v. Kaneland Cnty. Unit Dist., 163 N.E.2d 89 (Ill. 1959)) (abolishing tort immunity of school districts for incongruities in court opinions trying to fit particular conduct into categories of governmental or proprietary); (citing Muskopf v. Corning Hosp. Dist., 359 P.2d 457 (Cal. 1961)) (rejecting the doctrine of governmental immunity from tort liability); (citing Williams v. City of Detroit, 111 N.W.2d 1 (Mich. 1961)) (rejecting governmental immunity from tort liability); (citing Holtz v. City of Milwaukee, 115 N.W.2d 618 (Wis. 1962)) (rejecting the doctrine of municipal immunity); (citing Spanel v. Mounds View Sch. Dist., 118 N.W.2d 795 (Minn. 1962)) (finding the doctrine of municipal immunity from tort liability to be archaic).  
35. *Id.* at 742 (quoting Holtz, 115 N.W.2d at 619).
the governmental/proprietary analysis, holding that upon a showing that the entity in question falls within the definition of a municipal corporation, that entity will be subject to tort liability regardless of what type of function it performs. The court tempered its decision, though, expressly indicating that the holding only applied to municipal corporations. The court also carefully explained that its holding did not reach the doctrine of state immunity, governmental immunity of other local governmental entities other than municipalities, such as counties, and immunity for the exercise of legislative, quasi-legislative, judicial, and quasi-judicial functions.

The Kentucky legislature addressed this latter pocket of immunity in 1988 when it enacted the Claims Against Local Governments Act. The Act, which applies to both municipal corporations and counties, addressed the myriad issues that arose from Haney's abolition of municipal tort immunity. The Act provides, in part, that "a local government shall not be liable for injuries or losses resulting from . . . [a]ny claim arising from the exercise of judicial, quasi-judicial, legislative, or quasi-legislative authority or others, [or] exercise of judgment or discretion vested in the local government." For instance, under the Act, cities are not liable for failing to enforce laws or regulations enacted for public safety, such as building codes and fire safety codes. To be sure, the Claims Against Local Governments Act does not immunize local governments from liability for the negligent performance of ministerial duties (which is addressed at length in Section IV, below); however, with respect to judicial, quasi-judicial, legislative, and quasi-legislative functions, the Kentucky courts have consistently held, and the Haney decision at least implicitly suggested, that these classes of functions are "non-tortious," and therefore not subsumed by the Haney abrogation of municipal tort immunity.

The Kentucky courts have also analyzed the applicability of municipal liability to local governmental entities other than municipal corporations.

36. Id.
37. Id.
38. Id. (citing Foley Constr. Co. v. Ward, 375 S.W.2d 392, 393 (Ky. 1964)) (upholding the rule that sovereign rights are supreme, absolute power to govern, which are possessed and exercised by both the United States and the individual states).
39. Id. (noting that discussion on the immunity or liability of other government units was intentionally omitted from the court’s analysis).
40. Haney, 386 S.W.2d at 742.
43. KY. REV. STAT. ANN. § 65.2003 (West 2006).
44. See Griffith, 2003 Ky. App. LEXIS 161, at *12; see also Bolden v. City of Covington, 803 S.W.2d 577 (Ky. 1991); Grogan v. Commonwealth, 577 S.W.2d 4 (Ky. 1979); Siding Sales, Inc. v. Warren County Water Dist., 984 S.W.2d 490 (Ky. Ct. App. 1998).
46. See Haney v. City of Lexington, 386 S.W.2d 738, 742 (limiting discussion to governmental immunity as it applied to municipal corporations and not other local government
Local boards of health and metropolitan sewer districts, for example, are municipal corporations that are also subjected to tort liability. Under Kentucky law, counties, as political subdivisions recognized and authorized by the Constitution of Kentucky, are entitled to sovereign immunity, except as otherwise provided by the legislature. Under federal law, however, political subdivisions, including counties, are routinely denied any immunity and, like municipal corporations, fall within the class of “persons” subject to liability under § 1983.

The scope of municipal liability today includes all local government entities, both municipal corporations that perform special functions at the local level and other entities that perform a combination of governmental functions and other acts similar to a private corporation. Subjecting local government entities to tort liability recognizes the fact that their interests are not always congruous with those of the Commonwealth. Municipal corporations and other local government entities acting in a private or proprietary capacity are afforded no more immunity than a private corporation.

III. OFFICIAL LIABILITY

In Kentucky, the extent and type of damages available to a plaintiff in a lawsuit against a public official depends, as do the immunities available to the public official, on whether the claims were asserted against the official in his official and/or individual capacity. The distinction is an important one because,
depending on the type of claim, a public official may be entitled to absolute
sovereign immunity or governmental immunity or only qualified official
immunity.54

One of the most common issues to arise with respect to claims against public
officials is whether the claim was asserted against the public official in his
individual and/or official capacity.55 Consider both Calvert Investments, Inc. v.
Louisville & Jefferson Metropolitan Sewer District56 and McCollum v. Garrett.57
In Calvert, the plaintiff brought a claim against the Louisville & Jefferson
County Metropolitan Sewer District and its board members, together with the
Louisville & Jefferson County Board of Health and its director of the division of
environmental health, as well as the Commonwealth of Kentucky, Natural
Resources and Environmental Protection Cabinet.58 The plaintiff, however, did
not specify in the complaint whether the officials were sued in their individual
capacity.59 Nor did the complaint state a basis for the officials’ liability in their
individual capacity or seek damages against them personally.60 Persuaded by the
“failure to specify individual capacity in the heading, the lack of specificity in
the body, and the failure to seek judgment against the individuals in the
concluding demand,” the court concluded that no claims were asserted against
the officials in their individual capacities.61

In McCollum, Charles McCollum, a county attorney, was accused of
malicious prosecution.62 The complaint against McCollum referred to him as
“Charles R. McCollum, III, Henderson County Attorney,” and “alleged that he is
and was at all relevant times the Henderson County Attorney.”63 McCollum
argued that the complaint only asserted an official capacity claim because it
referred to him by his official title and failed to specify individual capacity.64
The court, however, was not persuaded by these facts alone. Instead, upon
examining the substance of the complaint, rather than relying alone on its face,
the court liberally construed the complaint to have sufficiently asserted a claim
against McCollum in his individual capacity.65

54. McCollum, 880 S.W.2d at 532.
55. Id. at 532.
56. Calvert Invs., Inc. v. Louisville & Jefferson County Metro. Sewer Dist., 805 S.W.2d 133
   (Ky. 1991).
57. McCollum v. Garrett, 880 S.W.2d 530 (Ky. 1994).
58. Calvert, 805 S.W.2d at 134.
59. Id.
60. Id. at 139.
61. Id.
62. McCollum, 880 S.W.2d at 531.
63. Id. at 532.
64. Id.
65. Id. at 533 (citing Smith v. Isaacs, 777 S.W.2d 912 (Ky. 1989)) (concluding that the court
   should examine the substance of the pleading rather than search for a technical error upon which to
   strike down a claim or defense, as was formerly the case at common law).
The distinction between official capacity and individual capacity claims is a judicial construction that broadens the scope of government tort liability while protecting the ability of the public officials to effectively perform necessary functions of state government. And, as McCollum illustrates, the construction is quite broad given the liberal standard the Kentucky courts employ in evaluating whether an individual capacity claim was sufficiently asserted.

Despite McCollum’s liberal construction, plaintiffs’ counsel should explicitly specify the capacity in which individual defendants are being sued, either in the caption of the complaint or in its body. A failure to do so may, in some instances, later preclude an amendment to the complaint and an award of certain damages, such as punitive damages.

Conversely, when defense counsel is confronted with a complaint that is silent with respect to the capacity in which individual defendants have been sued, two strategic options are commonly available. Defense counsel, for instance, could file a motion to dismiss the individual defendants in cases where the public entity that employs the individual defendants has also been named as a defendant. The argument, of course, is that the official capacity claims against the individual defendants are redundant and that no individual capacity claims have been asserted (or, alternatively, that the allegations in the complaint do not satisfy the McCollum standard).

As a practical matter, many courts may be reluctant to dismiss the individual defendants and instead opt to grant the plaintiff leave to amend the complaint to specify the capacity in which the individual defendants have been sued. While the individual defendants are still parties, defense counsel can now properly plan a discovery strategy.

Defense counsel may also consider ignoring a plaintiff’s failure to allege the capacity in which individual defendants have been sued. Counsel can proceed with its defense of the action, await the expiration of the statute of limitations on an individual capacity claim, and address the plaintiff’s failure in a summary judgment motion. This strategy has the advantage of potentially precluding an amendment of the complaint, notwithstanding the relation-back principle in Rule 15 of the Kentucky and Federal Rules of Civil Procedure, given the prejudice to defendants of having to defend what is essentially a new claim after discovery has closed. Again, as a practical matter, defense counsel should still address as an alternative argument any possible individual capacity claims in its summary judgment motion.

Regardless of the tactics defense counsel chooses to employ, which undoubtedly rests on the particular facts and circumstances of each case, the capacity in which individual defendants are sued is a technical yet important

66. Calvert, 805 S.W.2d at 139 (noting that individuals cannot escape personal liability for tortious misconduct by cloaking themselves in sovereign immunity).

67. McCollum, 880 S.W.2d at 534.
aspect of any lawsuit. And knowledge of the differences between individual and official capacity claims – and the consequences of asserting or failing to assert each – can make a significant difference in the ultimate outcome of a case.

IV. IMMUNITY

A. Sovereign Immunity

American courts accepted the rule of tort immunity in the early stage of our nation’s history. On the basis of early cases, the rule was firmly established on the procedural ground that the federal government could not be sued without its prior consent.68 “This principle was recognized as applicable to the Commonwealth of Kentucky as early as 1828.”69 The absolute immunity from suit afforded to the state also extends to state officials sued in their official capacities when the state is the real party against which relief in such cases is sought.70

Congress also waived the sovereign immunity of the United States, expressly consenting to be sued in the district courts with the adoption of the Federal Tort Claims Act (FTCA) in 1946.71 The FTCA waived the sovereign immunity of the federal government

for money damages . . . for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred.72

Sovereign immunity from tort actions does not imply that a tort has not been committed. Instead, immunity acts as a bar against liability, denying relief to any person harmed by the tortious conduct of the government where state sovereign immunity is mandated by the constitution. Courts defer to the state sovereign immunity doctrine when application of the doctrine is “what the Constitution demands.”73

68. See Cohens v. Virginia, 19 U.S. 264, 380 (1821) (declaring that no suit could be commenced or prosecuted against the United States without its consent).
69. Yanero v. Davis, 65 S.W.3d 510, 518 (Ky. 2001) (citing Divine v. Harvie, 23 Ky. 439, 441 (Ky. 1828)).
70. Id.
72. Id.
73. See Cullinan v. Jefferson County, 418 S.W.2d 407, 411 (Palmore, J., dissenting); see also Calvert, 805 S.W.2d at 138 (noting that §§ 230 and 231 of the Constitution of Kentucky do not distinguish between intentional and non-intentional torts and it is not an appropriate function of the court to make such a distinction).
B. Governmental Immunity

The doctrine of sovereign immunity trickles down to local governmental entities that do not fall within the definition of municipal corporations. The result is governmental immunity, the doctrine “that limits imposition of tort liability on a governmental agency.” The basic tenet of governmental immunity is that “it is not a tort for government to govern.” In other words, a state agency is cloaked with immunity from tort liability to the extent that it is performing a governmental, as opposed to a proprietary, function. The implicit premise, of course, is rooted in the separation of powers doctrine, that “courts should not be called upon to pass judgment on policy decisions made by members of coordinate branches of government in the context of tort actions.”

The governmental/proprietary distinction was criticized and abolished in the context of municipal corporations because its application led to inconsistent results. Kentucky courts continue to use the distinction in the governmental immunity analysis, however, because it affords a reasonable compromise between allowing state agencies to perform their governmental functions without having to answer for their decisions in the context of tort litigation, and allowing private enterprises to pursue their legitimate business interests without unfair competition from government agencies performing purely proprietary functions without the same costs and risks inherent in commercial enterprise.

Yanero addressed the nature of governmental immunity enjoyed by local boards of education. In Yanero, a high school baseball player sustained a head injury while not wearing a helmet at batting practice and brought a negligence action against the county board of education, the high school’s athletic director and assistant coaches, and the unincorporated high school athletic association. In finding that the board of education was entitled to governmental immunity, the court explained that a local board of education is an arm of the state engaged in a governmental function insofar as it operates common schools and provides

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74. Section III of this article discusses municipal liability and the distinction between municipal corporations and other local government entities.

75. Yanero, 65 S.W.3d at 519 (citing 57 Am.Jur.2d Municipal, County, School and State Tort Liability § 10 (2001)).

76. Dalehite v. United States, 346 U.S. 15, 57 (1953); see also Yanero, 65 S.W.3d at 519 (explaining the premise that courts should not be called upon to assess the policy decisions of another branch of government in the context of tort actions because such actions furnish an inadequate crucible for testing the merits of social, political or economic policy).

77. Yanero, 65 S.W.3d at 519 (citing 72 Am.Jur.2d, States, Territories and Dependencies § 104 (1974)).

78. Id.

79. Id. (citing Haney v. City of Lexington, 386 S.W.2d 738, 740 (Ky. 1964)) (“At most, the distinctions seem to be contrived and without sensible basis. That which was proprietary in some states was deemed governmental in others.”); see also RESTATEMENT (SECOND) OF TORTS § 895C, cmt. e. (1979).

80. Yanero, 65 S.W.3d at 520.

81. Id. at 517.
public education within a particular geographic area, which includes authorization and supervision of interscholastic athletics. 82 Public schools are the responsibility of the state, and local school boards, which were created by the General Assembly, exist simply as agencies of state government to discharge the General Assembly’s constitutional obligation. 83 As such, a local school board is an agency of the state government entitled to governmental immunity and not a “government” in itself, entitled to sovereign immunity. 84

A state agency or arm of the state government is not vicariously liable (i.e., does not lose its governmental immunity) simply because one of its agents or employees can be held liable for negligence. 85

C. Immunity for Public Officials

Official immunity is an immunity from tort liability afforded to public officials and employees who have performed discretionary acts within the course and scope of their employment. 86 The application of the immunity is determined not by the status or title of the official performing the act, “but on the function performed.” 87 When a public official is sued in his official capacity, his actions are “afforded the same immunity, if any, to which the agency itself would be entitled.” 88 Accordingly, a member of a local school board sued in his official capacity may be entitled to governmental immunity, while an official employed by the state government may be entitled to sovereign immunity.

When public officials are sued in their individual capacities, however, they are only entitled to qualified official immunity. 89 Qualified official immunity is an affirmative defense which must be specifically pled by the defendant. 90 It protects public officials from damages liability “for good faith judgment calls

82. Id. at 526-27.
83. Id. at 526 (citing Rose v. Council for Better Educ. Inc., 790 S.W.2d 186, 211 (Ky. 1989)).
84. Id.
85. Williams v. Kentucky Dep’t of Educ., 113 S.W.3d 145, 154 (Ky. 2003). See also Schwindel v. Meade County, 113 S.W.3d 159, 163 (Ky. 2003) (holding that the Claims Against Local Governments Act does not constitute a waiver of a county’s immunity from vicarious liability for damages arising from the tortious performance of ministerial acts by its employees); Monell v. Dep’t of Soc. Servs., 436 U.S. 658, 693 (concluding that a municipality cannot be held liable solely because it employs a tortfeasor, or in other words, a municipality cannot be held liable under § 1983 on a respondeat superior theory because § 1983 plainly imposes liability on a government that, under color of some official policy, “causes” an employee to violate another’s constitutional rights; Congress did not intend § 1983 liability to attach where such causation was absent). In this instance, negligence means the negligent performance of a ministerial act, which is addressed at length in Section IV.C. below.
86. Yanero, 65 S.W.3d at 521.
87. Id. (citing Salyer v. Patrick, 874 F.2d 374 (6th Cir. 1989)).
88. Id. at 522.
89. Id.
made in a legally uncertain environment." In other words, public officials are protected against "bad guesses in gray areas." The basic policy supporting this deference to public officials is that they "are not expected to engage in the kind of legal scholarship normally associated with law professors and academicians."

A public official, therefore, is entitled to qualified official immunity if he has in good faith performed a discretionary act or function within the course and scope of his employment. Each of these elements is addressed in turn.

1. Discretionary and Ministerial Acts

Qualified official immunity is available only when a public employee engages in discretionary acts or functions. Discretionary acts are "those involving the exercise of discretion and judgment, or personal deliberation, decision, and judgment." Discretionary acts are also those that necessarily require the exercise of reason in the adaptation of a means to an end, and discretion in determining how or whether the act shall be done or the course pursued. Discretion in the manner of the performance of an act arises when the act may be performed in one of two or more ways, either of which would be lawful, and where it is left to the will or judgment of the performer to determine in which way it shall be performed.

A "ministerial act, on the other hand, is 'one that requires only obedience to the orders of others, or when the officer's duty is absolute, certain, and imperative, involving merely execution of a specific act arising from fixed and designated facts.'" A government employee will not be immune for the negligent performance or omission of a ministerial act which does not require the exercise of reason or judgment to determine how the act will be performed.

In discerning whether government officers performed a ministerial or discretionary act, it is necessary to determine whether the subject act involved any "significant judgment, statutory interpretation, or policy-making decisions”
or were simply routine duties. By way of analogy, rule-making is an inherently discretionary function; enforcement of or adherence to known rules a ministerial one. For instance, in James v. Wilson, the Kentucky Court of Appeals determined that school officials were entitled to qualified official immunity, holding that the enactment of safety rules is a discretionary function. But in Williams v. Kentucky Department of Education, the Kentucky Supreme Court held that a defendant was not entitled to qualified official immunity because his failure to comply with the board of education’s code of conduct constituted the negligent performance of a ministerial duty.

In recent years, the Kentucky courts have extended the defense of qualified official immunity in a number of cases. Particular acts that have been construed as discretionary include internal investigations, strip-searches, supervision of others, and hiring and firing decisions. Each of these cases, and the acts recounted therein, required personal deliberation and judgment as to the manner in which the acts were to be performed.

There are a number of cases, though, where the Kentucky courts have not cloaked public officials with immunity. The courts have determined that driving a police cruiser safely, complying with a code of conduct, and conveying information are ministerial acts because they do not require significant judgment or the exercise of reason.

98. Id. (quoting Stratton v. Com., 182 S.W.3d 516, 520 (Ky. 2006) (quoting Collins v. Com. Natural Res. and Environmental Prot. Cabinet, 10 S.W.3d 122, 126 (Ky. 1999) (“To decide whether mine site inspection by Cabinet employees is ministerial or discretionary, it is necessary to determine whether the acts involve policy-making decisions and significant judgment, or are merely routine duties.”))).

99. Yanero, 65 S.W.3d at 529.


102. See, e.g., Greenway Enterprises, Inc. v. City of Frankfort, 148 S.W.3d 298, 302 (Ky. Ct. App. 2004) (holding that the city manager and sewer director, in advising the city to deny hookups until the current system was repaired, was a discretionary function) and Estate of Clark ex rel. Mitchell v. Daviess County, 105 S.W.3d 841, 845 (Ky. Ct. App. 2003) (holding that the decision of the Daviess County Fiscal Court, the engineers, and road foreman with respect to whether and how a portion of a certain road was guarded using guardrails and warning signs was a discretionary function).

103. Rowan County v. Sloas, 201 S.W.3d 469, 477 (Ky. 2006).

104. See also Thompson v. Huecker, 559 S.W.2d 488 (Ky. Ct. App. 1977) (holding that the re-employment of the plaintiff was a discretionary function).

105. Jones v. Latham, 150 S.W.3d 50, 53 (Ky. 2004) (“Act of safely driving a police cruiser, even in an emergency, is not an act that typically requires any deliberation.”).

106. Williams v. Kentucky Dept. of Educ., 113 S.W.3d 145, 151 (Ky. 2003) (compliance with Board of Education Code of Conduct was a ministerial duty).

107. Kea-Ham Contracting, Inc. v. Floyd County Dev. Auth., 37 S.W.3d 703, 708 (Ky. 2000) (erroneous conveyance of information by chairman of county development agency that interim financing for project had been obtained was ministerial error).

108. See also Upchurch v. Clinton County, 330 S.W.2d 428, 430 (Ky. 1959) (employing a dog warden and establishing a dog pound were ministerial duties); and id. at 431 (duty of school board
2. Good Faith Element

In addition to performing a discretionary function, a public official, in order to be entitled to qualified official immunity, must perform it in good faith. What constitutes good faith, however, has been defined in the negative: that which does not constitute bad faith.109 Bad faith, in turn, is found when an “officer or employee willfully or maliciously intended to harm the plaintiff or acted with a corrupt motive.”110 Bad faith can also be found when the official acts objectively unreasonably, meaning, when the official’s actions or omissions violate one of the plaintiff’s “clearly established” rights that the official knew or should have known was afforded to the plaintiff.111

For bad faith to exist, however, the right claimed to be violated must be clearly established.112 A clearly established right, of course, cannot exist in a “legally uncertain environment.”113 Thus, in determining whether the right violated was clearly established, the courts look to “whether the officer had fair notice that her conduct was unlawful, [the] reasonableness [of which] is judged against the backdrop of the law at the time of the conduct.”114 “If the law at that time did not clearly establish that the officer’s [or employee’s] conduct would violate the [law], the officer should not be subject to liability.”115 This inquiry, moreover, is a specific one, “undertaken in light of the specific context of the case, not as a broad general proposition.”116

3. Scope of Authority

Finally, in order for a public official to be entitled to qualified official immunity, he must not only perform discretionary acts in good faith, but must do so within the course and scope of his employment. This element has been vaguely defined and broadly construed,117 requiring only that the action taken by

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109. Rowan County v. Sloas, 201 S.W.3d 469, 481 (Ky. 2006) (citing Yanero v. Davis, 65 S.W.3d 510, 523 (Ky. 2001)) (“Characteristically, the Court has defined these elements by identifying the circumstances in which qualified immunity would not be available.”).

110. Id. (quoting Yanero, 65 S.W.3d at 523). Compare Yanero, 65 S.W.3d at 523 (noting that qualified official immunity is not available to a government officer whose acts resulting in harm to the plaintiff were intentional), with Federal Tort Claims Act, 28 U.S.C. § 1346(b) (1970) (stating that the United States shall not be liable for “any claim arising out of assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract”).

111. Sloas, 201 S.W.3d at 481 (citing Yanero, 65 S.W.3d at 523).

112. Id. (citing Jefferson County Fiscal Court v. Peerce, 132 S.W.3d 824, 834 (Ky. 2004)).

113. Id. at 482 (citing Peerce, 132 S.W.3d at 834).

114. Id. (quoting Brosseau v. Haugen, 543 U.S. 194, 198 (2004)).

115. Id. at 482.

116. Id.

the public official be within the “outer perimeter” of the official’s line of duty.\textsuperscript{118} To be within this “outer perimeter,” the official’s conduct must merely bear some reasonable relation to and connection with his duties and responsibilities.\textsuperscript{119} The alleged wrongfulness of the official’s conduct, however, is not evidence of the official’s general scope of authority and does not raise questions of whether the defendant exercised his discretionary duties appropriately or whether he violated the law.\textsuperscript{120} Government officials, otherwise, would be subjected to an unreasonably broad area of liability if courts framed the scope of authority around wrongfulness.\textsuperscript{121}

It has been argued, and validly so, that immunities can at times provide too much protection to public officials, leaving deserving plaintiffs with meritorious claims without a remedy.\textsuperscript{122} Without immunities, however, public officials would be left in a perpetual state of paralysis in the fear that their actions or inactions would leave them open to personal liability. Such a state, of course, at best, breeds ineffective and inefficient governmental services and, at worst, stifles employment and retention of quality public servants. Though controversial, the importance of immunity cannot be denied.

\textbf{D. Miscellaneous Immunities}

Absolute immunity under the sovereign immunity doctrine protects public officials sued in their official capacities when the Commonwealth is a real party against which the relief in such cases is sought.\textsuperscript{123} Under the Eleventh Amendment to the United States Constitution, a state may not be sued absent its own consent.\textsuperscript{124} Governmental immunity cloaks public officials sued in their

\begin{quote}
The Supreme Court has declared that, with respect to immunity, “jurisdiction” [of a federal employee to act] ought to be defined broadly to include acts “having more or less a connection with the general matters committed by law to the official’s supervision.” In other words, an act is within the official’s jurisdiction if it is “not manifestly or palpably beyond his authority.”
\end{quote}

\textsuperscript{118.} \textit{Id.} at 487 (quoting \textit{Vest}, 565 F. Supp. at 684).
\textsuperscript{119.} \textit{Id.} at 488.
\textsuperscript{120.} \textit{Sloas}, 201 S.W.3d at 490 (“[F]or qualified official immunity to be applicable, the discretionary act must be such that it was made, rightfully or wrongfully, ‘within the general scope of [the official’s] authority.’”) (quoting Franklin County v. Malone, 957 S.W.2d 195, 201 (Ky. 1997), \textit{reversed in part} by \textit{Yanero v. Davis}, 65 S.W.3d 510 (Ky. 2001)).
\textsuperscript{121.} \textit{Id.} (quoting \textit{In re Allen}, 106 F.3d 582, 594 (4th Cir. 1997) (“If these were the relevant inquiries, any illegal action would, by definition, fall outside the scope of an official’s authority.”)).
\textsuperscript{123.} \textit{Yanero}, 65 S.W.3d at 518.
\textsuperscript{124.} The Eleventh Amendment to the United States Constitution provides that “[t]he Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or
official capacities when a state agency or arm of the state government is the real party against which the relief is sought.\textsuperscript{125} And, all public officials sued in their individual capacities are entitled to qualified official immunity for the performance of discretionary duties in good faith within the course and scope of their employment.\textsuperscript{126}

Legislators, judges, and prosecutors are also entitled to immunity – absolute sovereign immunity – in the performance of their legislative, judicial, and prosecutorial functions, respectively.\textsuperscript{127} The underlying policy for absolute immunity for the performance of legislative, judicial, and prosecutorial functions is not to protect those individuals from liability for their own unjustifiable conduct, but to protect their public roles against the deterrent impact of a threat of suit. This is especially true in cases where the lawsuit alleges nothing more than improper motives, when in fact there has been nothing more than a mistake or a disagreement with the decision made.\textsuperscript{128}

V. CONCLUSION

In certain circumstances, Kentucky citizens injured by the actions or inactions of public entities and their officials, protected by various immunities, may not be able to recover damages. Whether immunity is available to a public entity or official is a controversial issue, one that has valid competing arguments both for and against. The doctrine of sovereign immunity, for example, is widely disfavored, but its application is still justifiable because it allows the state government, its agencies, and officials to carry out the essential functions integral to state government.

The Kentucky courts, however, have been retreating. Municipal immunity, for instance, was the first judicial departure from absolute immunity and, at present, liability is the rule rather than the exception. Other local governmental entities and arms of state government, such as local school boards of education, are also subject to liability when acting in a proprietary or private capacity. They still retain governmental immunity, however, when carrying out governmental functions.

Liability against public officials hinges in many instances on whether the claims are asserted against the officials in their official capacity or individual capacity. Public officials are cloaked with the immunity protecting the respective public entity that employs them when they are sued in their official capacity.

Subjects of any Foreign State.” U.S. CONST. amend. XI. See also Hans v. Louisiana, 134 U.S. 1, 15 (1890) (interpreting the Eleventh Amendment to also preclude suits by citizens of the same state).

\textsuperscript{125} Id.
\textsuperscript{126} Sloas, 201 S.W.3d at 475.
\textsuperscript{127} Yanero, 65 S.W.3d at 518.
\textsuperscript{128} Id. (citing \textit{RESTATEMENT (SECOND) OF TORTS} § 895D, cmt. c (1979)). Cf. Dugger v. Off 2nd, Inc., 612 S.W.2d 756, 758 (Ky. Ct. App. 1980) (finding that prosecutor was not entitled to immunity for issuing a warrant).
But when sued in their individual capacity, public officials must be performing discretionary functions in good faith within the course and scope of their employment to avoid personal liability. In other words, public officials are immune from liability even when they acted negligently, as long as their actions required significant judgment or deliberation, were made in good faith, and not manifestly or palpably beyond their authority.

In the case of legislators, judges, and prosecutors, the immunity available in their representative capacities is absolute, provided, of course, that they are performing legislative, judicial, or prosecutorial functions.
FROM MAIN STREET TO WALL STREET: MORTGAGE LOAN SECURITIZATION AND NEW CHALLENGES FACING FORECLOSURE PLAINTIFFS IN KENTUCKY

Chris Markus, * Ron Taylor, ∞ and Blake Vogt†

I. INTRODUCTION

The identity of a real party in interest in a mortgage foreclosure lawsuit has received much attention lately as the concept of mortgage loan ownership has grown increasingly complex. This complexity is a byproduct of the secondary mortgage market described by Ben S. Bernanke, Chairman of the Board of Governors of the United States Federal Reserve, as follows:

Whereas once most lenders held mortgages on their books until the loans were repaid, regulatory changes and other developments have permitted lenders to more easily sell mortgages to financial intermediaries, who in turn pool mortgages and sell the cash flows as structured securities. These securities typically offer various risk profiles and durations to meet the investment strategies of a wide range of investors. The growth of the secondary market has thus given mortgage lenders greater access to the capital markets, lowered transaction costs, and spread risk more broadly, thereby increasing the supply of mortgage credit to all types of households.¹

At any temporal point in the process described by Mr. Bernanke — also termed securitization — one or more of the financial institutions involved may possess some attribute or characteristic consistent with traditional notions of mortgage loan ownership. As a corollary, litigants have sometimes struggled to identify which entity (or entities) involved in this transaction is a “real party in interest” and thereby cloaked with the requisite standing to prosecute a foreclosure.²

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² For a good example of this struggle, see Glynn v. First Union Nat’l Bank, 912 So. 2d 357 (Fla. Dist. Ct. App. 2005). In Glynn, the foreclosing Plaintiff, Union National Bank,
Recently, this struggle manifested itself in the United States District Court for the Northern District of Ohio, where fourteen cases (collectively captioned In re Foreclosure Cases) were dismissed after Judge Christopher Boyko concluded that the plaintiff financial institutions did not satisfy constitutional standing requirements after they failed to provide documentation sufficient to demonstrate that they were entitled to enforce the promissory notes and mortgages upon which they sued at the time the complaint was filed. Judge Boyko further observed that the plaintiffs’ failure to produce such documentation meant that diversity jurisdiction could not be invoked and a local general order had been violated.

Judge Boyko’s decision grabbed headlines not only because of the poignant language it employed, but also because it required foreclosing plaintiffs and their attorneys to reevaluate what documentation is necessary to establish that they are entitled to enforce the debt instrument. Less than a month after the decision was issued Judge Thomas M. Rose of the Southern District of Ohio, cited Judge Boyko’s decision and made a similar ruling demanding foreclosure plaintiffs in twenty-seven cases “submit evidence showing that they had standing..." acknowledged confusion in the record transfers of the note and mortgage,” that apparently resulted from the fact that Union National did not receive a formal, executed assignment of the mortgage until after the foreclosure action had been commenced despite the fact that “that equitable transfer of the mortgage loan] to First Union occurred prior to filing the complaint.” Id. at 358. The scenario presented by Glynn – i.e., a formal assignment of mortgage executed after the foreclosure has been filed, but evincing a transaction that predates the filing of the complaint – is a common one and is reflective of the fact that a mortgage loan may be transferred repeatedly on the secondary mortgage market before a formal assignment of mortgage is executed sufficient for state-law recording purposes. Notably, the Glynn Court implicitly acknowledged the fact that while the formal assignment of mortgage was not executed until after the foreclosure was commenced, First Union acquired its ownership interest in the mortgage loan prior to commencement of the foreclosure – and thus possessed standing to prosecute the foreclosure. Id...


4. Id. at *2.


6. In re Foreclosure Cases, 2007 WL 3232420, at *3 n.3 (“[The] ‘you just don’t understand how things work,’ argument reveals a condescending mindset and quasimonopolistic system where financial institutions have traditionally controlled, and still control, the foreclosure process.”).

This article examines *In re Foreclosure Cases* through the lens of Kentucky law and provides a guide for Kentucky state court practitioners as they untangle issues of mortgage loan ownership in the context of foreclosure actions. Relevant background information concerning *In re Foreclosure Cases* is provided, and the authors explain how securitization of mortgage loans has prompted courts to more closely scrutinize the evidence determinative of whether a foreclosure plaintiff is a proper real party in interest. A discussion of relevant Kentucky case law and statutes and their import in foreclosure proceedings is also included.

II. BACKGROUND AND FACTS

A. The Boyko Decision: Dismissal of Foreclosure Actions for Improper Invocation of Diversity Jurisdiction and Standing Due to Insufficient Documentation of Mortgage Loan Ownership.

In each foreclosure complaint filed in *In re Foreclosure Cases*, the plaintiff alleged that it was the “holder and owner” of the subject note and mortgage. In each case the plaintiff was not the lending institution responsible for originating the loan. Accordingly, the copies of the note and mortgage the plaintiffs submitted to the court as exhibits to their complaints identified the mortgagee and payee as entities other than the plaintiffs. No other documents were filed with the complaint indicating that the loan in question had been transferred to the plaintiff prior to the date the foreclosure was commenced. On October 10, 2007, Judge Boyko issued an order requiring these plaintiffs “to file a copy of the executed [assignment demonstrating [p]laintiff was the holder and owner of the [n]ote and [m]ortgage as of the date the [c]omplaint was filed.” The court ultimately concluded the plaintiffs did not provide proper documentation to demonstrate ownership of the mortgage loan as of the date the complaint was filed. As a result, the court decided diversity jurisdiction was not properly invoked, the plaintiffs lacked standing, and the cases were dismissed without prejudice.

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9. See cases cited supra note 7.
11. Id.
12. Id.
13. See id.
14. Id.
15. Id.
While the plaintiffs submitted mortgage assignments evincing a transfer of an interest in the mortgage loan, these assignments were executed after the date on which the relevant action was commenced. Thus, the court said the assignments were insufficient to demonstrate that the plaintiffs had standing on the date the complaint was filed. In dismissing the cases, Judge Boyko admonished one of the plaintiffs’ attorneys for his “condescending mindset” after the attorney remarked, “[j]udge you just don’t understand how things work.” Judge Boyko went on to criticize the financial institutions that initiated the foreclosures for “worry[ing] less about jurisdiction requirements and more about maximizing returns.”

B. The Effect of Securitization and the Secondary Mortgage Market on Foreclosure Cases

Many, if not all, of the mortgage loans that were the subject of In re Foreclosure Cases were held by securitization trusts. Briefly, securitization can be defined as:

the sale of equity or debt instruments, representing ownership interests in, or secured by, a segregated, income producing asset or pool of assets, in a transaction structured to reduce or reallocate certain risks inherent in owning or lending against the underlying assets and to ensure that such interests are more readily marketable and, thus, more liquid than ownership interests in and loans against the underlying assets.

In the context of mortgage lending, securitization has taken loans from the local bank on Main Street to Wall Street where hundreds or even thousands of mortgages from various locales are pooled together and interests in the pool are sold as mortgage-backed securities. Mortgage loan securitization involves many players. For example, a typical securitization trust might be characterized by the certificate holders, the trustee who is vested with bare naked title to the trust assets, and the servicer who is responsible for collecting and applying the mortgage payments of borrowers. Securitization and the secondary mortgage market are characterized by multiple changes in the ownership of loans included

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17. Id. at *2.
18. Id.
19. Id. at *3 n.3.
20. Id. at *3.
23. The servicer is usually the entity that handles delinquent loans and foreclosures. However, “[t]he servicer can only do what the securitization documents allow it to do.” Id.
in the mortgage pool or changes in the servicing rights for those loans. For this reason, a simple recordation of an assignment of a mortgage at the local county recorder or county clerk’s office is no longer a practical method of tracking the myriad of transfers of ownership or servicing rights that a single mortgage that is part of a securitization trust may experience.24

Despite the inherent complexity of securitization, the process does have its advantages, most notably liquidity. Securitization takes a mortgage, an automobile, or a student loan and transforms it into capital to allow financial entities to lend more money.25

On the other hand, securitization has made it more difficult to discern who has a right to sue when there is a payment default on the underlying debt instrument.26 This scenario is especially pertinent today as foreclosure rates have increased both nationally and in Kentucky. In October 2008, Kentucky had 1,060 new foreclosure filings, bringing the yearly total to 10,282 total filings.27 The Kentucky counties with the highest foreclosure actions are those in the heavily populated areas of Northern Kentucky, Fayette County and particularly Jefferson County where in December 2008 there were 405 foreclosure filings.28

III. DISCUSSION

A. The Import of In re Foreclosure Cases for the Kentucky Practitioner

Judge Boyko’s sharp criticism leveled at the plaintiffs and their attorneys in In re Foreclosure Cases is a reminder to foreclosing plaintiffs in Kentucky – and the attorneys representing them – that these plaintiffs will ultimately be required to prove that they are entitled to enforce the debt or instrument upon which they sue.29

The actual application of In re Foreclosure Cases to a Kentucky state court foreclosure is somewhat limited because the dismissal in the federal case was

24. See generally Kurt Eggert, Held Up In Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine, 35 CREIGHTON L. REV. 503, 538-39 (2002); Bair, supra note 22. The typical securitization of a mortgage looks something like this. (1) First, the borrower negotiates with a mortgage broker for the terms of the loan. Often the original lending institution and the mortgage broker have no further contact with the borrower after this step. (2) The loan is then transferred from the broker to the lender. (3) This lender sells the loan to a different financial entity referred to as an issuer. (4) Next, the new financial entity pools together the loan with other loans into a mortgage pool. (5) The loan will then be transferred to another financial entity that then transfers the loan to a special purpose vehicle and are then packaged and sold to investors as mortgage backed securities. (6) Borrowers then make payments to a servicer who remits these payments to the issuer for distribution to the investors.


28. Id.

29. See supra notes 19-20 and accompanying text.
predicated largely on diversity jurisdiction, an issue not implicated in state court. Nevertheless, the facts that led to the dismissals in *In re Foreclosure Cases* have become, with increasing frequency, a focus of Kentucky courts.

**B. Demonstrating the Foreclosing Plaintiff is Entitled to Judgment**

In order to prove that a foreclosing plaintiff is entitled to judgment, it must establish that it is entitled to enforce the underlying promissory note and thus, is the real party in interest. Article III of the Uniform Commercial Code (hereinafter Article III), codified at Kentucky Revised Statutes sections 355.3-101 through 355.3-605 governs the creation, transfer, and enforcement of negotiable instruments, including most promissory notes secured by mortgages. Once a plaintiff has established it is entitled to enforce the note, no additional showing of a concomitant interest in the corresponding mortgage is necessary because the mortgage follows the note. Stated differently, a transfer of the note carries with it an automatic equitable assignment of the mortgage. A recorded assignment of mortgage is necessary to charge third parties with constructive notice of the transfer of the mortgage loan. However, such recordation – or lack thereof – does not affect a foreclosing plaintiff’s ability to enforce the note and foreclose the mortgage so long as that plaintiff has satisfactorily demonstrated that it is entitled to enforce the note by one of the means set forth in Article III.

1. Establishing the Identity of a Real Party in Interest.

Kentucky Rule of Civil Procedure 17.01 reads, “[e]very action shall be prosecuted in the name of the real party in interest.” The purpose of the rule is to avoid a scenario where a single defendant is exposed to multiple suits brought by different parties based on the same underlying claim. The Kentucky Court of Appeals discussed the concept of the “real party in interest” in *Taylor v.*

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34. *See id.* § 355.3-301; *discussion infra* Part III.B.2.

35. *See discussion infra* Part III.B.3.

36. *KY. R. CIV. P.* 17.01 (LexisNexis 2008) (note that this language is similar to *FED. R. CIV. P.* 17(a)(1) which states, “[a]n action must be prosecuted in the name of the real party in interest.” *FED. R. CIV. P.* 17(a)(1)).


38. Prior to 1976, the Kentucky Court of Appeals was the state’s court of last resort.
There, the court asked: “does [the plaintiff] satisfy the call for the person who has the right to control and receive the fruits of the litigation?” In the context of a mortgage foreclosure case this question is answered by reference to Article III.

Article III governs negotiable instruments, including most promissory notes that are the subject of a foreclosure action. A typical real estate mortgage loan transaction involves two operative documents, a promissory note and a mortgage. The promissory note is usually a “negotiable instrument” as defined in Article III because it is a (1) promise or order (2) that is unconditional (3) “to pay a fixed amount of money, (4) with or without interest or other charges described in the promise or order if it [i]s (5) payable to the bearer or to order at the time it is issued or first comes into possession of a holder, (6) [i]s payable on demand or at a definite time and (7) [d]oes not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money.”

The fact that the note is secured by a mortgage does not remove it from the purview of Article III.

Section 3-301 of Article III identifies those persons entitled to enforce a negotiable instrument. Naturally, such a person would be a real party in interest in a mortgage foreclosure case. A “person entitled to enforce” means the “holder

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39. Taylor v. Hurst, 216 S.W. 95 (Ky. 1919) This court interpreted the term “real party in interest” as it was used in the Kentucky Civil Code of Practice, which was the precursor to current KY. R. Civ. P. 17. However, this distinction does not change the relevant analysis of the term. Id. at 96.

40. Id. at 96.

41. See U.C.C. § 3-301 (2002).

42. See generally U.C.C. § 3-106, cmt. 1 (2005) (“In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration of the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement.”).

43. The promissory note executed with a mortgage discloses the terms of the loan, the monthly payments, number of payments, amount due, and interest. Conversely, the mortgage, sometimes known as a deed of trust, is a document that states that “the home itself is security for the loan.” Difference Between Mortgage Note & Mortgage?, http://activerain.com/blogsview/136298/Difference-between-Mortgage-Note (July 1, 2007, 12:21 EST).

44. A promise is a “written undertaking to pay money signed by the person undertaking to pay. An acknowledgement of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.” KY. REV. STAT. ANN § 355.3-103(1)(i) (LexisNexis 2008).

45. A promise is unconditional unless it states an expressed condition to payment, is governed by another record, or if rights or obligations connected with the promise is stated in another record. However, a promise is not conditional if the reference is merely to another record for a statement of rights with respect to collateral (such as a real estate mortgage), prepayment or acceleration or if payment is limited to a particular source. KY. REV. STAT. ANN. § 355.3-106 (LexisNexis 2008).

46. Id. § 355.3-106 cmt.1 which reads in part “[f]or example, a note would not be made conditional by the following statement: ‘this note is secured by a security interest in collateral described in a security agreement [such as a mortgage] . . . between the payee and maker of this note. Rights and obligations with respect to collateral are stated in governed by the security agreement.’”

47. U.C.C. § 3-301 (2002).

of the instrument, [a] nonholder in possession of the instrument who has the rights of a holder,"50 or a person not in possession of the instrument because it was lost, stolen, or destroyed, but who is nevertheless entitled to enforce the instrument.51 Moreover, a person may be entitled to enforce an instrument even though he is not its owner52 or is in wrongful possession of it.53

As to the first part of the definition, the code defines the holder of an instrument as the person in possession, if the instrument is payable to bearer; in the case of an instrument payable to an identified person, the identified person is a holder so long as that person has possession of the note.54 To simplify, if the instrument is made payable to bearer then merely possessing the instrument makes one a holder and entitled to enforce the instrument.55 A promise is payable to a bearer if it states it is payable to the bearer, does not state a payee, or indicates it is not payable to an identified person.56 If the instrument is made payable to an identified person, then that specific identified person must usually be in possession in order to enforce the instrument as a holder.57 The second part of the definition refers to a non-holder in possession of the instrument with the rights of a holder and includes transferees of the instrument.58 Section 3-203 of the UCC states that “[a]n instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.”59 The transferee obtains any rights the transferor had to enforce the instrument.60

Court of Appeals concluded that the holder-servicer of a note was the real party in interest and therefore entitled to enforce its terms. Id.

50. KY. REV. STAT. ANN. § 355.3-301(1-2) (LexisNexis 2008).
51. Id. § 355.3-309 (a person who wants to enforce a lost instrument must prove both the terms of the instrument and that he was entitled to enforce the instrument when the loss occurred, or that he acquired the rights of a person who was entitled to enforce the instrument when the loss occurred).
52. Frequently this is the case because a foreclosure case may be brought by a servicer who does not own the note, but can enforce it by the terms. See infra Part III.B.1 discussing Green Tree Servicing LLC v. Sanders, No. 2005-CV-000371-MR, 2006 WL 2033668, at *3 (Ky. Ct. App. July 21, 2006).
53. KY. REV. STAT. ANN. § 355.3-301(3) (LexisNexis 2008).
54. Id. § 355.1-201(2)(u).
55. See id. § 355.3-201(2) (stating that if an instrument is payable to bearer, it may be negotiated by transfer of possession); see also Mt. Sterling Water, Light & Ice Co. v. First Nat’l Bank of Wyalusing, Pa, 144 S.W. 370, 370-71 (Ky. 1912) (holding that in a suit on bearer instrument, possession of bonds established the right to sue).
56. KY. REV. STAT. ANN. § 355.3-109(1) (LexisNexis 2008).
57. Id. § 355.1-201(2)(u).
59. Id. § 355.3-203(1).
60. Id. § 355.3-203(2). Note that the transferee cannot acquire rights from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument. Id. See also Lawyers’ Realty Co. v. Bank of Ludlow, 76 S.W.2d 920, 920-21 (Ky. 1934) (noting an example of when a transferee of a note acquiring the rights of a transferor, specifically the right to enforce, holding that the note was subject to all defenses that the maker would have if it were still in the hands of Ludlow Savings Bank and that without the indorsement of the note the Bank of Ludlow could sue upon it).
A holder may negotiate an instrument by indorsement and a transfer of possession, or by possession alone if the instrument is payable to bearer. An indorsement is a stamp or signature that is made for the purpose of negotiating the instrument, restricting payment, or incurring indorser’s liability on the instrument. “[A] signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement.” Therefore, indorsement is “defined in terms of the purpose of the signature.”

Article III places indorsements into two main categories. A special indorsement is made by the holder of an instrument and identifies a person to whom it makes the instrument payable. A blank indorsement does not identify a person to whom it makes the instrument payable. When an instrument is indorsed in blank it becomes payable to the bearer and may be negotiated by transfer of possession alone. A blank indorsement may be converted into a special indorsement by writing above the signature of the indorsing party words identifying to whom the instrument is payable. Additionally, an anomalous indorsement is one made by a person that is not the holder.

If an instrument is transferred for value and the transferor fails to indorse, the transferee has an enforceable right to the unqualified indorsement of the transferor, however negotiation does not occur until the indorsement is made. Therefore, if an instrument is payable to an identified person, a successful negotiation of the rights to another party requires possession of the instrument and indorsement. A transfer without an accompanying indorsement will vest the transferee with any right the transferor possessed to enforce the instrument.

In applying the foregoing authority to a foreclosure case, it becomes clear that a plaintiff may rely on several categories of properly authenticated documentary evidence to prove that it is entitled to enforce the note upon which it sues and is therefore a real party in interest. For example, a plaintiff may produce a copy of the original note indorsed in blank or specially indorsed to the plaintiff to demonstrate that it is the holder of the note.

61. KY. REV. STAT. ANN. § 355.3-201(1) (LexisNexis 2008).
62. Id. (negotiation is defined as a means of transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder).
63. Id. § 355.3-204(1).
64. Id.
66. KY. REV. STAT. ANN. § 355.3-205(1) (LexisNexis 2008).
67. Id. § 355.3-205(2).
68. Id.
69. Id. § 355.3-205(3).
70. Id. § 355.3-205(4) (“An anomalous indorsement does not affect the manner in which the instrument may be negotiated.”).
71. Id. § 355.3-203(3).
72. KY. REV. STAT. ANN. § 355.3-201(2) (LexisNexis 2008).
A plaintiff may also introduce business records that identify the date upon which the plaintiff acquired an interest in the note. Such records can be properly authenticated through the testimony of an appropriate custodian. The records would demonstrate that the plaintiff is a transferee of the note and therefore vested with all enforcement rights of the transferor.

Depending on the facts of the case, other documentary evidence may be available to a plaintiff to show that it is entitled to enforce the note. For example, the plaintiff may have acquired the note from the Federal Deposit Insurance Corporation ("FDIC") after the FDIC seized a failed bank that formerly held the note.73 In that situation the plaintiff can rely on the agreement between the plaintiff and the FDIC that effectuated the transfer of the note as evidence that the plaintiff is the real party in interest.74

A plaintiff may also introduce a copy of the pooling and servicing agreement governing the enforcement rights of the note and identifying the plaintiff as the trustee or servicer entitled to enforce those rights. If the plaintiff relies on a pooling and servicing agreement to establish that it is a real party in interest, the agreement should be accompanied by a schedule of mortgage loans governed by the agreement and the plaintiff should be able to identify the particular loan that is the subject of the lawsuit within the schedule.

A recent Kentucky appellate decision provides an excellent example of a foreclosure plaintiff who relied on a pooling and servicing agreement to establish that it was a real party in interest.75 In Green Tree Servicing LLC v. Sanders, the issue before the court was whether a servicer of a mortgage loan that is part of a pooling and servicing agreement has standing to bring an action in its own name or, whether the trustee of the pooling and servicing agreement is the only real party in interest.76

In 2000, Curtis and Cynthia Sanders executed a note and mortgage identifying Conseco Finance Corporation as the lender.77 Later that year, the Sanders’ mortgage loan was securitized and transferred to U.S. Bank National Trust Association as Trustee of Conseco Finance Home Equity Trust.78 The terms of the transfer were set forth in a pooling and servicing agreement.79 In that agreement, Conseco was identified as the servicer; Conseco eventually transferred its servicing rights to Green Tree.80 The pooling and servicing

73. See, e.g., Ninth RMA Partners, L.P. v. Krass, 746 A.2d 826, 830-31 (Con. App. 2000) (FDIC, as receiver of failed bank, had power to transfer promissory notes held by the failed bank and the FDIC’s transferee was entitled to enforce said notes).
74. Id.
76. Id. at *2 ("The predominate issue is whether a servicer of a loan obligation has standing to bring an action in its own name, or whether the holder and owner of the obligation is the sole real party in interest.").
77. Id. at *1.
78. Id.
79. Id.
80. Id. at *1-2.
agreement included a clause that vested the servicer with the ability to sue to enforce or collect upon the loans in its own name. The agreement further provided that commencement of an action to enforce the loan shall cause an automatic assignment of the loan to the servicer, thereby, making the servicer the holder of the note for purposes of collection.

In 2003, Green Tree, after acquiring the servicing rights to the Sanders’ loan from Conseco, was substituted as the plaintiff in a foreclosure action filed against the Sanders. The Sanders filed a motion to dismiss on the basis that Green Tree, as the servicer, was not the holder of the note and mortgage and thus, not the real party in interest. The trial court dismissed the complaint concluding Green Tree was not the real party in interest.

The Kentucky Court of Appeals reversed and found that Green Tree was a real party in interest. In reaching this holding, the court cited Kentucky Rule of Civil Procedure 17.01 which provides:

> [e]very action shall be prosecuted in the name of the real party in interest, but a . . . person with whom or in whose name a contract is made for the benefit of another . . . may bring an action without joining the party or parties for whose benefit it is prosecuted.

The court noted that the pooling and servicing agreement was made for the benefit of the trust and specifically permitted Green Tree to enforce the loan obligations. Pursuant to the terms of the pooling and servicing agreement, once the foreclosure action was commenced, the loan was automatically assigned to Green Tree. Therefore, the court concluded that at the time the foreclosure action was filed “Green Tree became the holder and owner of the note and mortgage” and was the real party in interest. In reaching this conclusion the court recognized that Green Tree was the real party in interest despite the fact that it was the securitization trust, and not Green Tree as the servicer, that would ultimately benefit from the recovery of the debt.

82. Id. Such terms are commonly found in agreements between the entity that possesses legal title to a mortgage loan and the entity responsible for servicing the loan. See, e.g., Announcement written by Michael A. Quinn, Senior Vice President of Single Family Credit Risk Management (March 23, 2008), available at https://www.efanniemae.com/sf/guides/sgg/annltrs/pdf/2008/0812.pdf.
84. Id.
85. Id.
86. Id. at *3.
87. Id. (quoting KY. R. CIV. P. 17.01).
88. Id.
90. Id.
91. Id. at *3-4.
Of particular importance to the *Green Tree* court was the provision in Kentucky Rule of Civil Procedure 17.01 that allows a “person...in whose name a contract is made for the benefit of another [to] bring an action without joining the party or parties for whose benefit it is prosecuted.” In *Green Tree*, the “contract made for a benefit of another” was the pooling and servicing agreement made for the benefit of the securitization trust.92

*Green Tree* stands for the proposition that a pooling and servicing agreement may be considered a “contract made for the benefit of another,” thus making the servicer named therein a real party in interest to prosecute a foreclosure suit.94 In *Green Tree*, the pooling and servicing agreement provided that:

The Servicer may sue to enforce or collect upon Loans, in its own name, if possible, or as agent for the Trust. If the Servicer elects to commence a legal proceeding to enforce a Loan, the act of commencement shall be deemed to be an automatic assignment of the Loan to the Servicer for purposes of collection only.95

Presumably, the drafters of the pooling and servicing agreement realized the importance of clearly identifying the servicer as a party that may foreclose in its own name in satisfaction of state law real party in interest requirements. The Kentucky Court of Appeals found that the language chosen by the drafters of the agreement was sufficient to conclude that Green Tree as servicer and holder of the note was a real party in interest.96

2. A Mortgage Follows a Note

While Article III will usually govern the creation, transfer, and enforcement of promissory notes secured by real estate mortgages, the accompanying mortgage itself is not a negotiable instrument and therefore not governed by Article III.97 However, a foreclosing plaintiff need only demonstrate that it is entitled to enforce the note in order to foreclose the associated mortgage.98 Such demonstration is sufficient because the mortgage is incidental to the debt evidenced by the note; and the mortgage is therefore automatically transferred when the interest in the underlying debt is transferred.99 This long-standing principle was recognized in *Arnett v. Salyersville National Bank* where the court plainly stated, “the mortgage given to secure payment of the note followed the

92. *Id.* at *3* (quoting Ky. R. Civ. P. 17.01).
93. *Id.*
94. *Id.* at *3-4.
96. *Id.* at *3*.
97. First Commonwealth Bank of Prestonsburg v. West, 55 S.W.3d 829, 838 (Ky. Ct. App. 2000) (“A mortgage, while it may provide security for a negotiable instrument, is not a negotiable instrument.”).
98. See *infra* note 100.
99. *Id.*
The notion that a mortgage is inextricably linked to the note it secures is all but universal. In fact, the most recent iteration of the Restatement of Property provides that “[a] transfer of an obligation secured by a mortgage also transfers the mortgage unless the parties to the transfer agree otherwise.” In light of this authority, it is axiomatic that a party seeking to foreclose a mortgage need only demonstrate that it is entitled to enforce the corresponding note to show that it is a real party in interest.

3. The Role of Recording Statutes

Pursuant to Kentucky law a mortgage must be recorded in the county clerk’s office where the property is located to charge third parties with notice of its existence; but, the failure to record a mortgage does not affect its validity or enforceability as between the parties. Nevertheless, a prudent mortgagee will record its mortgage immediately after execution to avoid any challenge to its priority from competing lien holders or a bankruptcy trustee. A properly recorded mortgage will contain the mortgagee’s address, the date the obligation it secured was created as well as the maturity date, a scrivener’s stamp showing the name of the individual that prepared the instrument, and the mortgagor’s acknowledgement under one of the statutory methods. Proper recordation of the mortgage is made in the county clerk’s office in the county where the property is located.

Because recordation of a mortgage establishes its priority in relation to other liens on the property its importance cannot be overstated. But, a failure to record any subsequent assignment of that mortgage does not present the same problems. This is because the failure to record a mortgage assignment does not affect the perfection and priority of the mortgage lien itself, or the assignee’s ability to enforce the mortgage lien. Thus, the mere failure to record an assignment of mortgage does not impair the assignee’s ability to foreclose as the real party in

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100. Arnett v. Salyersville National Bank, 46 S.W.2d 124, 126 (Ky. 1931).
102. See Robertson v. Sebastian, 99 S.W. 933, 934 (Ky. 1907) (finding that because no rights of a third party intervened, the mortgage was good between parties as though it had been recorded).
104. Id. § 382.330.
105. Id. § 382.335(1).
106. Id. § 382.130. This section states five methods of acknowledgement: (1) before the proper clerk, (2) by two subscribing witnesses or one who also proves the attestation of the other, (3) by two witnesses that the subscribing witnesses are both dead, (4) by proof both subscribing witnesses are out of state, (5) on certificate of a county clerk or any notary public. Id.
107. Id. § 382.110(1).
108. In re Cook, 457 F.3d 561, 567 (6th Cir. 2006) (citing Federal Nat’l Mortgage Assoc. v. Kuipers, 732 N.E.2d 723, 726 (Ill. App. Ct. 2000) (holding “that the assignee of a mortgage was not required to record the assignment because the assignee ‘stood in the shoes’ of the mortgage company, which had recorded its interest”) (here, the Sixth Circuit applied Kentucky law in the context of a bankruptcy trustee’s attempt to avoid a mortgage on real estate held by Bank One).
This is not to say that a mortgage assignee does not expose itself to significant risk when it fails to record the operative assignment of mortgage. For example, where a junior mortgage is assigned, but the assignment is not recorded, and a senior mortgagee commences a foreclosure action and joins the record owner of the assigned mortgage (but not the assignee), and the property is then sold at foreclosure sale to an innocent purchaser, that purchaser will take title to the property free and clear from the claim of the assignee of the junior mortgage.

IV. CONCLUSION

Judge Boyko’s opinion in In re Foreclosures prompted the foreclosure plaintiff to reexamine what documentation it must produce to support its claim that it is the real party in interest, and thereby, entitled to maintain the foreclosure action. In Kentucky, the UCC as adopted in the Kentucky Revised Statutes, authorizes one who is entitled to enforce a promissory note secured by real estate mortgage to prosecute a foreclosure case as an appropriate real party in interest. Therefore, a Kentucky practitioner representing a foreclosure plaintiff should possess a strong grasp of the methods by which a party may demonstrate that it is entitled to enforce a note as informed by Kentucky Revised Statutes §§ 355.3-101 through 355.3-605.

109. See id.; see also JP Morgan Chase v. New Millennial, LC, No. 2D07-5937, 2009 WL 691187, at *4 n. 3 (Fla. Dist. Ct. App. 2009) (“We simply conclude that the failure to record the assignment here was not fatal to JP Morgan’s right as a matter of law to pursue the remedy of foreclosure.”).
110. See Pinney v. Merchants’ Nat’l Bank of Defiance, 72 N.E. 884, syllabus ¶ 2 (Ohio 1904); see also Federal Nat’l Mortgage Ass’n v. Kuipers, 732 N.E.2d 723, 729 (Ill. App. Ct. 2000) (in applying Illinois law governing perfection of mortgage liens, court held that “[w]hile an assignee that fails to record an assignment may find itself in the unenviable situation of having its lien extinguished as an ‘unknown owner or nonrecord claimant’ in a mortgage foreclosure, the mere failure to record the assignment does not, by itself, extinguish the mortgage lien or negate the priority position”).
111. See supra notes 3-9 and accompanying text.
112. See supra notes 36-71 and accompanying text.
REAL ESTATE BROKER LIABILITY

Robert L. Raper, Esq.* and Andrew J. Vandiver*

I. INTRODUCTION

This survey article provides both practitioners and real estate brokers with a guide to liability imposed upon real estate brokers involved in the sale and purchase of residential property in Kentucky. This survey looks both retrospectively at where the law once stood, and how it has evolved over the past century. Furthermore, this survey considers grounds for claims in other jurisdictions and discusses why Kentucky should maintain its restrictive approach to imposing liability upon real estate brokers.

Section II of this survey focuses on liability from a historical perspective and is broken down into two subsections. Subsection A discusses the role of caveat emptor in real estate broker litigation and how Kentucky courts have moved to a more restrictive approach of applying caveat emptor, but have not disregarded the rule all together. Section B focuses on how the Kentucky General Assembly has relaxed the rule of caveat emptor by imposing disclosure requirements on real estate transactions involving real estate brokers.

Section III of this survey provides modern grounds for recovery against real estate brokers in Kentucky and highlights examples in case law where claims have been brought under the theories discussed. Subsection A discusses real estate broker liability under agency theories. Subsection B discusses liability grounded in negligence and fraud.

Section IV explores theories existing in other jurisdictions but not yet recognized in Kentucky. Subsection A examines negligent misrepresentation as it has been applied in Kentucky and its possible application to real estate brokers. Lastly, Subsection B considers whether Kentucky law supports imposing a duty to inspect on real estate brokers and if such a rule would be wise.

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II. HISTORICAL PERSPECTIVE OF REAL ESTATE BROKER LIABILITY

A. The Application and Restriction of Caveat Emptor in Kentucky

In order to understand the current state of real estate broker liability in Kentucky, it is important to look back over its development as an exception to the doctrine of caveat emptor. Historically, caveat emptor protected real estate brokers and agents from liability.\(^1\) Caveat emptor is an ancient rule rooted in common law.\(^2\)

The maxim “caveat emptor” (“let the buyer beware”) . . . implies that the buyer must not trust blindly that he will get value for his money, but must take care to examine and ascertain the kind and quality of the article he is purchasing, or, if he is unable to examine it fully or intelligently, or lacks the knowledge to judge accurately of its quality or value, to protect himself against possible loss by requiring an express warranty from the seller.\(^3\)

For many years, Kentucky courts used this doctrine to insulate real estate brokers from liability.\(^4\) However, this rule was not without exceptions. Courts have held real estate brokers liable to purchasers if: (1) there was a confidential relationship, such as principal and agent, between a real estate broker and the purchaser; (2) the purchaser had no reasonable opportunity to visit and examine the property; or (3) where a real estate broker by fraud prevented inquiry or investigation by the purchaser.\(^5\) Thus, some Kentucky courts did not hold real estate brokers liable for fraudulent misrepresentation affirmatively made to purchasers.\(^6\)

For many years courts struggled with the injustices that arose under the doctrine of caveat emptor and began to take a more restrictive approach to its

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2. Ball Homes, Inc. v. Volpert, 633 S.W.2d 63, 64 (Ky. 1982) (citing Osborne v. Howard, 242 S.W. 852, 853 (Ky. 1922)) (noting that caveat emptor is an ancient rule derived from common law).
5. McAlister, 262 S.W. at 285 (citing Ripy, 115 S.W. at 793-94) (“[T]he rule of caveat emptor applies as between the broker and the purchaser, except where there is a confidential relationship existing between them, or fraud or artifice is used by the broker to prevent the purchaser from inquiring or investigating whether the property may be bought for a less price.”).
6. Ripy, 115 S.W. at 793 (quoting German Nat’l Bank’s Receiver v. Nagel, 82 S.W. 433, 435 (Ky. 1904)) (“It is a well-settled rule that mere commendation or even false representation by the seller of property as to its value, when the purchaser has an opportunity to ascertain for himself such value by ordinary vigilance or inquiry, has no legal effect on the legal rights of the parties, even when made with the intention to deceive.”).
The court in *Bunch v. Bertram* summarized this trend when it set forth that:

It is well settled that, where a representation is made in positive terms as to a fact actually within the knowledge of the one making the representation, and when the representation itself contains nothing so unreasonable as to create a doubt in the mind of the one to whom it is made, the hearer may rely upon it without an investigation when an investigation would be so difficult as to render it improbable that the hearer would ascertain the falsity of the representation by such an investigation. The tendency of modern decisions is to restrict, rather than to enlarge, the doctrine of caveat emptor.  

In weighing the policy between suppressing fraud and discouraging inattention by purchasers, the court reasoned that “it is the lesser of two evils to encourage negligence in the foolish than to encourage fraud in the deceitful.”

Therefore, despite the many years in which courts placed responsibility on purchasers to protect themselves, Kentucky courts have carved out exceptions to the general rule of caveat emptor. Generally, exceptions under common law require that real estate brokers refrain from affirmatively making fraudulent misrepresentations. However, this shift in policy did not impose any duties of disclosure on real estate brokers. Thus, real estate brokers could theoretically remain silent and allow a purchaser to buy property with substantial defects without fear of liability. However, the Kentucky General Assembly changed the rules of disclosure for residential real estate transactions in 1992.

**B. The General Assembly’s Relaxation of Caveat Emptor**

In 1992, the Kentucky General Assembly relaxed the “strict adherence to the concept of buyer beware” by passing a law which imposed a duty to disclose on all sellers of single family residential dwellings which are listed by real estate brokers. The law requires that real estate brokers provide the seller with a form pertaining to the following:

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8. 294 S.W. 805, 807 (Ky. 1927) (involving an action for damages against the vendor for misrepresentation that the basement of the property purchased did not leak and was dry).
9. Id. at 808.
10. See Craig v. Keene, 32 S.W.3d 90, 91 (Ky. Ct. App. 2000) (citing Bryant v. Troutman, 287 S.W.2d 918, 921 (Ky. 1956)) (“Fraud, if proven, is an exception to caveat emptor.”).
11. See United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 469 (Ky. 1999) (“Fraud may be committed either by intentionally asserting false information or by willfully failing to disclose the truth.”).
12. See McAlister, 262 S.W. at 285 (noting that absent the element of fraud there is no liability for the broker).
13. Id.
15. Id. at *2.
(a) basement conditions and whether it leaks,  
(b) roof condition and whether it leaks,  
(c) source and condition of water supply,  
(d) source and condition of sewage service,  
(e) working condition of component system, and  
(f) other matters the commission deems appropriate.  

The seller has three options when he is presented with the form by a real estate broker.  

When the licensee requests the seller to complete the form, the seller may complete the form and sign it. If the seller chooses not to complete the form, he may sign the section that states: “THE SELLER REFUSES TO COMPLETE THIS FORM AND ACKNOWLEDGES THE AGENT SHALL SO INFORM THE BUYER.” Or, the seller may decide not to either complete or sign the form. In this event the licensee signs the form after the statement that reads: “THE SELLER HAS REFUSED TO COMPLETE THIS FORM AND HAS REFUSED TO ACKNOWLEDGE HIS FAILURE TO COMPLETE THE FORM.”  

The passage of this law imposed a duty of disclosure on sellers that previously did not exist under common law. This responsibility of disclosure is primarily placed on the sellers, who have the choice as to whether to complete the form or leave it blank. The real estate broker’s only responsibility is to deliver the form to the purchaser, who can then make a decision based on its contents. It should be noted that Kentucky has recently changed the law and now allows real estate brokers to fill out the form with the express permission of their client. However, in order to avoid liability based on a theory of misrepresentation or fraudulent concealment, discussed later in this article, a real estate broker should refrain from filling out any portion of the seller’s disclosure form.  

This form has impacted the area of liability both for sellers of property and their real estate brokers. Regardless of how the form is filled out, this law represents a clear departure from Kentucky common law, which does not require any type of affirmative disclosure to purchasers. Liability arising from issues regarding the seller’s disclosure form will be discussed in more detail under the section of this article concerning fraudulent concealment.  

16. KY. REV. STAT. ANN. § 324.360(3) (West 2008).  
17. VIRGINIA L. LAWSON, KENTUCKY REAL ESTATE LAW 146 (Dave Shaut ed., Thomson South-Western 2004).  
18. Id. at 146-47 (citing KY. REV. STAT. ANN. § 324.360(8) (West 2008) and 201 KY. ADMIN. REGS. 11:121(5) (2008)).  
20. Id. § 324.360(5).  
21. Id. § 324.360(9).  
22. See id. § 324.360.
III. MODERN APPROACHES TO REAL ESTATE BROKER LIABILITY IN KENTUCKY

A. Real Estate Brokers and Agency Law

1. Relationships between Principal Brokers, Sales Associates, and their Clients

When a brokerage firm represents a client, whether it is a buyer or a seller, an agency relationship is formed.\(^{23}\) The seller or buyer is called the principal while the real estate broker is referred to as an agent.\(^{24}\) When an agency relationship is formed, the principal is required to fulfill certain fiduciary duties.\(^{25}\) A breach of fiduciary duty can lead to liability for both a real estate broker and the sales associates under his or her supervision.\(^{26}\)

2. Liability Arising from an Agency Relationship

Once a fiduciary relationship, such as a principal and agent, exists, Kentucky law imposes certain fiduciary duties upon the agent (and/or the principal). However, agents have historically represented the seller as opposed to the buyer.\(^{27}\) Thus, real estate brokers typically have owed fiduciary duties to the seller but not to the purchasers.\(^{28}\)

Recently, the trend in Kentucky has been to allow real estate brokers to determine the types of agency relationships that his or her office will offer to clients.\(^{29}\) Thus, real estate brokers may represent buyers or sellers exclusively or represent both types of customers.\(^{30}\) Furthermore, Kentucky law permits dual agency relationships, where the real estate broker represents both the buyer and the seller simultaneously in a transaction.\(^{31}\)

Kentucky law imposes several duties owed by real estate brokers to their principal. A real estate broker must: (1) exert best efforts and exercise best judgment; (2) advise the principal fully of facts within his knowledge; and (3) possess and employ that degree of skill in the business that is usually possessed and exercised by persons professing that particular calling.\(^{32}\) Furthermore, real

\(^{23}\) Lawson, supra note 17, at 153.
\(^{24}\) Id.
\(^{25}\) Id. at 154.
\(^{26}\) See id. at 100-01.
\(^{27}\) See Dallon, supra note 1, at 415.
\(^{28}\) Id. at 416.
\(^{29}\) Lawson, supra note 17, at 158.
\(^{30}\) Id.
\(^{32}\) Smith v. Fid. & Columbia Trust Co., 12 S.W.2d 276, 277 (Ky. 1928).
estate brokers have an obligation of mutual good faith and fair dealing. Lastly, a real estate agent must act in compliance with the principal’s instructions and in accordance with customs prevailing in the community.

Additionally, the Kentucky Administrative Regulations lists several fiduciary duties owed to clients, which mirrors those duties created under common law. The Kentucky Real Estate Commission has power to punish violations of fiduciary duties as improper conduct. Therefore, a real estate broker who breaches his fiduciary duties may face both damages under Kentucky common law, as well as disciplinary action taken by the Kentucky Real Estate Commission.

3. Litigation arising from Agency Relationships with the Seller

A seller agency relationship is usually formed when the parties enter into a listing contract. Once this relationship has been formed, an agent who fails to act in accordance with his fiduciary duties may face claims from a dissatisfied customer. The following section provides guidance to real estate brokers who represent sellers, and the practitioners who represent real estate brokers, by pointing out areas in which litigation has arisen and giving case specific examples as to how courts have approached these disputes.

a. Authority of the Real Estate Broker

There are three categories of agency relationships: (1) general, (2) special, and (3) universal. While general and special agents have broad authority, a special agent’s authority is very narrow. A real estate broker is considered a

33. Crabtree v. Bd. of Trs. of Immanuel Baptist Church, 512 S.W.2d 311, 313 (Ky. 1974) (citing Odem Realty Co. v. Dyer, 45 S.W.2d 838, 840 (Ky. 1932)); see also Johnson v. Lowery, 270 S.W.2d 943, 944 (Ky. 1954) (“[A] real estate broker is the type of agent who owes his principal absolute good faith and utmost fair dealing in transactions between them.”); Jones v. Todd, 256 S.W.2d 533, 534 (Ky. 1953) (finding that a broker owes principal duties of absolute good faith and utmost fair dealing and was required to advise principal fully of all facts within his knowledge); Hurt v. Sands Co., 33 S.W.2d 653, 654 (Ky. 1930) (“The broker is an agent, and owes to his principal absolute good faith and the utmost fair dealing.”).

34. Shatz Realty Co. v. King, 10 S.W.2d 456, 458 (Ky. 1928).


36. Id. (noting the agent is in violation if he fails “to satisfy one or more of the following fiduciary duties owed to the licensee’s client: (a) loyalty, (b) obedience to follow lawful instructions, (c) disclosure, (d) confidentiality, (e) reasonable care and diligence, and (f) accounting”).


38. Lawson, supra note 17, at 158.

39. See Johnson, 270 S.W.2d at 945.

40. Harris, supra note 37, § 4:3.

41. Id. (citing Charleston Elec. Supply Co. v. Keyser Coal Co., 281 S.W. 185, 186 (Ky. 1926)) (“A universal agent is one authorized to transact all of the business of his principal of every kind. A
“special agent of limited authority.” Thus, a real estate broker is “strictly confined to his instructions, and has only such powers as are actually given or implied from those given.” In a typical situation, a real estate broker only has authority to show the property and receive offers, but does not have authority to bind the seller to a contract. However, as evidenced below, real estate brokers sometimes take on additional duties within a real estate transaction.

In Crabtree v. Board of Trustees of Immanuel Baptist Church, the court found that a real estate broker who exceeds his authority breaches his duty of good faith and fair dealing owed to his principal and is thus not entitled to commission. The court also implied that the seller might have had grounds for damages against the real estate broker under such circumstances. The real estate broker in Crabtree brought suit against his principal for the commission he claimed was owed for his services in the facilitation of a real estate transaction. The prospective purchaser paid a deposit in accordance with the sales contract which provided that the deposit was to be held as liquidated damages if the purchaser failed to pay the total price of the property upon delivery of a good, fee simple title. The real estate broker returned the purchaser’s deposit without the seller’s permission, and, thus, prevented the seller from obtaining the deposit as damages when the prospective purchaser subsequently breached the contract. The court found that the real estate broker’s actions amounted to a breach of good faith and fair dealing, and held that the seller might have had grounds for damages, but lost the right to recover by releasing the purchaser from his obligations under the contract.

Given the potential for liability, real estate brokers should take care to abide by their principal’s instructions. However, it may not always be clear when a real estate broker is acting in accordance with his principal’s orders, especially when additional duties are taken on by the broker. Therefore, to avoid liability, a real estate broker should ask his principal to specifically outline the parameters of his authority, preferably in writing.

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42. Id. (quoting Gaines v. Murphy, 239 S.W.2d 453, 455 (Ky. 1951)).
43. Gaines, 239 S.W.2d at 455 (citing Crowe v. McLear, 255 S.W. 261, 262 (Ky. 1923)).
44. Lawson, supra note 17, at 154.
45. Crabtree, 512 S.W.2d at 313.
46. Id.
47. Id. at 312.
48. Id.
49. Id. at 312-13.
50. Id. at 313.
51. See Lawson, supra note 17, at 154.
b. Negligence in an Agency Relationship

To recover under a claim of negligence, a plaintiff must establish: “(1) a duty on the part of the defendant; (2) a breach of that duty; and (3) consequent injury.”\textsuperscript{52} Kentucky courts have held that a real estate broker has a duty to exercise the standard of care that a reasonable professional would exercise in the same or a similar situation.\textsuperscript{53}

The court in \textit{Smith v. Fidelity & Columbia Trust Co}. recognized that a breach of a real estate broker’s principal duties could give rise to an action for negligence when it set forth that:

> [L]ike any other agent for pay, it is the broker’s duty to advise his principal fully of all the facts within his knowledge affecting the matter in hand reasonably calculated to influence his judgment, and to make an honest and diligent effort to accomplish the purpose of the agency. The broker is likewise under a duty to possess and employ that degree of skill in the business that is usually possessed and exercised by persons professing that particular calling.\textsuperscript{54}

However, the court held that as long as a real estate broker acts in good faith, there can be no liability for a “mistake of judgment that did not result from a failure to know or do that which a person of ordinary prudence under similar circumstances would know or do.”\textsuperscript{55}

In this case, the seller claimed that the real estate broker advised him to part with a piece of property for a lower price than what the purchaser would have paid.\textsuperscript{56} The court found that the real estate broker did not act negligently, since the purchaser never indicated that he would have paid considerably more for the property.\textsuperscript{57} The court based this decision, in part, as a matter policy in that such a ruling would hinder a real estate broker’s willingness to assist and advise their clients during transactions, thus depriving the public of their expertise.\textsuperscript{58}

A fiduciary relationship represents one of the few areas in which a real estate broker can be held liable for negligence, thus exposing him or her to a greater degree of liability than found under other types of business relationships. Outside of a fiduciary relationship, a real estate broker has no duties under which a claim of negligence can be brought. Thus, while real estate brokers should always exercise a great deal of care in their endeavors, they should make additional efforts to know and practice within the standards that are custom in their community and profession when acting in a fiduciary relationship.

\textsuperscript{52} Mullins v. Commonwealth Life Ins. Co., 839 S.W.2d 245, 247 (Ky. 1992).
\textsuperscript{53} See Smith, 12 S.W.2d at 277; Shatz Realty Co., 10 S.W.2d at 458.
\textsuperscript{54} Smith, 12 S.W.2d at 277.
\textsuperscript{55} Id.
\textsuperscript{56} Id. at 276.
\textsuperscript{57} Id. at 277-78.
\textsuperscript{58} Id. at 278.
c. Fraudulent Representation of the Purchasers Financial Standing

A fraudulent misrepresentation of a material fact by the real estate broker to his principal constitutes a breach of his fiduciary duties. Such actions represent a clear failure on the part the real estate broker to deal in good faith with the seller. This type of breach has arisen when a real estate broker misrepresents the financial standing of a potential purchaser in order to hasten a real estate transaction.

In *Croxton’s Executors v. Henry & Fleenor*, the court set forth that a real estate broker who “represents to the seller that the purchaser is financially able to perform his part of the contract, when in fact he is not, is not entitled to his commission” if the purchaser abandons the contract. Moreover, the court held that the rule applied if the real estate broker either knew of the purchaser’s financial standing or recklessly made representations to the seller “in ignorance of the facts.” In *Croxton’s Executors*, the real estate broker produced a purchaser who entered into a contract for sale with the owners of the property. The sellers paid the real estate broker $500 in commission. Within a few days after the creation of the contract, the purchaser informed the seller that he was not capable of purchasing the property. The sellers then sued the real estate broker for return of the commission. The trial court held that the plaintiff failed to state a claim upon which relief could be granted. However, the court of appeals remanded the case to trial court for determination of the truth of the seller’s allegations.

Statements affirmatively made by real estate brokers are held under a great deal of scrutiny under Kentucky law. This reflects the general policy, which protects the public from fraudulent misrepresentations, even under circumstances in which the recipient of such representations could have used greater care. Thus, a real estate broker can almost always be held liable under circumstances in which his or her statements are not in accordance with the truth.

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59. *See Croxton’s Ex’rs v. Henry & Fleenor*, 235 S.W. 753, 754 (Ky. 1921) (“Any fraud or misrepresentation on the part of the broker which misleads or deceives the seller about a material element in the sale will destroy the broker’s right to the commissions from sales which are not consummated . . . .”).
61. *Croxton’s Ex’rs*, 235 S.W. at 754.
62. *Id.*
63. *Id.* at 753.
64. *Id.*
65. *Id.*
66. *Id.*
67. *Croxton’s Ex’rs*, 235 S.W. at 753.
68. *Id.* at 754.
69. *Bunch*, 294 S.W. at 807-08.
4. Litigation arising from Agency Relationships with the Purchaser regarding Breach of Good Faith and Fair Dealing

Historically, the agency theory was not helpful to purchasers because real estate brokers, as agents of the sellers, owed no fiduciary duties to the purchasers. However, today it is more common for real estate brokers to also represent buyers. As a buyer’s agent, the real estate broker owes fiduciary duties exclusively to the buyer. Kentucky law also permits dual agency relationships, where the real estate broker represents both the buyer and the seller in a transaction. Under this type of relationship, the real estate broker would owe fiduciary duties to both parties. As previously discussed, a real estate broker must not breach his/her fiduciary duties good faith and fair dealing in a fiduciary relationship. Therefore, due to the duties that have arisen under the types of relationships mentioned above, real estate brokers must now also be on guard against liability to purchasers under agency law.

The court in Jones v. Todd relied on precedent to establish that due to the agency relationship involved, a real estate broker owes the purchaser a duty of absolute good faith and utmost fair dealing and is required to advise the purchaser of all facts within his knowledge. Furthermore, the court held that a purchaser is “entitled to rely upon the representations made by his agent, and [is] not required to make an independent investigation.”

Jones v. Todd involved a real estate broker employed by man seeking a suitable tract of timberland. The real estate broker told the purchaser that he knew of a tract of land which was about 1,000 acres and that the owner had refused an offer of $100,000 for the land. The real estate broker arranged a meeting between the purchaser and the alleged owner of the tract. After observing the land for himself, the purchaser decided to enter a contract for sale for the property. However, it turned out the alleged owner only owned 250 acres of the land and that several people asserted ownership over the entire property. As a result, the purchaser became involved in several lawsuits.

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70. See Dallon, supra note 1, at 416.
71. See Lawson, supra note 17, at 159.
72. Id.
74. See Lawson, supra note 17, at 159.
75. See Johnson v. Lowery, 270 S.W.2d 943, 944 (Ky. 1954); Jones v. Todd, 256 S.W.2d 533, 534 (Ky. 1953); Hurt v. Sands Co., 33 S.W.2d 653, 654 (Ky. 1930).
76. Jones, 256 S.W.2d at 533.
77. Id. at 534.
78. Id. at 533-34.
79. Id. at 534.
80. Id.
81. Id.
82. Jones, 256 S.W.2d at 533-34.
83. Id.
The real estate broker sued for a commission of $500. The trial court found that the real estate broker acted fraudulently during the transaction, and relieved the purchaser from liability. On appeal, the real estate broker claimed that he could not be sued for fraud because: (1) the purchaser went onto the land himself and thus did not rely on his representations; (2) he merely acted as agent in finding an owner of timberland willing to sell; and (3) the purchaser should have surveyed the land and title before purchasing. The appeals court affirmed the trial court’s decision and dismissed the real estate broker’s claims. The court of appeals considered him to be an agent of the purchaser, and as such he was under a duty to act in good faith and share information within his knowledge.

Further, the court in *Johnson v. Lowery* held that a fiduciary relationship will protect a principal from the deceitful acts of her real estate broker, even under circumstances in which the principal had “equal opportunity” to investigate. The real estate broker in *Johnson* had a long-standing business relationship with the plaintiff, and agreed to sell the plaintiff a home he owned. The real estate broker told the plaintiff that the value of the property was $26,000.00. After purchasing the property, the purchaser later learned that the property’s true value was $17,000. The plaintiff sued the real estate broker for fraudulent misrepresentation and recovered $9,000. The plaintiff brought suit for the difference between the value as represented by real estate broker and alleged actual value of property. The trial court found that the real estate broker violated his duty to act with absolute good faith and utmost fair dealing by falsely representing that the property was worth more than its actual value.

On appeal, the real estate broker argued that, even in cases involving a fiduciary relationship, a misrepresentation as to value is not a substantial basis for a lawsuit based on deceit, especially under circumstances in which the purchaser had equal opportunity to ascertain the value of the property for himself. The real estate broker claimed that his assertion concerning the price of the property was "sales talk" or "puffing" and that puffing is a routine sales practice, hence purchasers must exercise his/her own judgment when assessing opinions expressed during a sales transaction. Nevertheless, the court of
appeals affirmed the lower court’s decision and held that “when the rule pertaining to false representation concerning value comes in conflict with the rule requiring utmost good faith by a fiduciary, the former rule must yield.”

The cases above demonstrate that the duty owed to purchasers to act in good faith is just as far reaching as the duty found in situations where the real estate broker represents a seller. Thus, the representations made by a real estate broker under these circumstances are held to a higher standard than what would be found in a situation in which no fiduciary relationship existed. Furthermore, while a duty to disclose information typically does not exist when a real estate broker deals with a purchaser, it would appear that such a duty exists when the real estate broker represents a purchaser as his client. Therefore, it is incumbent upon real estate brokers to recognize the duties placed on them in their fiduciary relationships with both buyers and sellers. In order to avoid breaching these duties, a real estate broker should disclose all information within his or her knowledge regarding the real estate at issue in a transaction.

5. Conclusion

The preceding section represents liability claims, which have been brought under agency law in Kentucky. Real estate brokers should take note that when they represent a client in a real estate transaction there is the possibility that they could incur liability for fraud, negligence, and failure to act in accordance with the seller’s instructions. Furthermore, real estate brokers should also disclose all information within their knowledge and represent the value of property as clearly and accurately as possible to their principal. Nevertheless, this section does not represent all circumstances in which a real estate broker could be held liable under agency law, but instead represents a few scenarios, which have been published by the Kentucky court system. Therefore, to further guard against liability, real estate brokers should always understand and recognize the duties placed on them in their agency relationships and be familiar with the practices commonly used within their community and profession.

B. Litigation in Non-Agency Relationships

The majority of litigation involving real estate brokers arises between purchasers and real estate brokers in non-agency relationships. Thus, this section of the article is representative of the current state of real estate broker liability in Kentucky. Under the current state of the law, liability to purchasers is
limited to fraudulent misrepresentation and fraudulent concealment, as will be discussed below.

1. Fraudulent Misrepresentation

Kentucky courts have held real estate brokers liable for fraudulent misrepresentation. The tort of fraud, also known as misrepresentation or deceit, requires an intentional misrepresentation of material fact.\(^{103}\) Under Kentucky law, the plaintiff “must establish six elements of fraud by clear and convincing evidence, as follows: (1) material representation; (2) which is false; (3) known to be false or made recklessly; (4) made with inducement to be acted upon (5) acted in reliance thereon and; (6) causing injury.”\(^{104}\) The following sections explain each element of fraud in Kentucky and provide examples in case law of how these elements have been applied in real estate transactions. It should be noted that not all of the following cases involve real estate brokers, but some instead deal with disputes between sellers and purchasers of property. However, these cases still serve as examples of how courts have applied the law in this area, and presumably how the law would be applied to real estate brokers in the same situation.

a. Material Representation

The materiality of a representation refers to whether it “is likely to affect the conduct of a reasonable man and be an inducement of the contract.”\(^{105}\) In simpler terms, the determination hinges on whether a person “would have purchased the property for price paid had they been apprised of these conditions.”\(^{106}\)

Some of the conditions that courts have determined to be material includes: water quality or supply,\(^{107}\) zoning,\(^{108}\) the adequacy of the septic system,\(^{109}\) termite

\(^{103}\) Restatement (Second) of Torts § 525 (1977).
\(^{104}\) United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 468 (Ky. 1999) (citing Wahba v. Don Corlett Motors, Inc., 573 S.W.2d 357, 359 (Ky. Ct. App. 1978)).
\(^{105}\) McHargue v. Fayette Coal & Feed Co., 283 S.W.2d 170, 172 (Ky. 1955).
\(^{106}\) Kaze v. Compton, 283 S.W.2d 204, 207 (Ky. 1955).
\(^{107}\) See Isaacs v. Cox, 431 S.W.2d 494, 496 (Ky. 1968) (“Misrepresentations, if any, as water quality or supply, were material.”).
\(^{108}\) See Amaro v. Drees Co., No. 2001-CA-000179-MR, 2003 WL 1786463, at *2 (Ky. Ct. App. Mar. 28, 2003) (citing Evergreen Land Co. v. Gatti, 554 S.W.2d 862, 864 (Ky. Ct. App. 1977)) (“[A] misrepresentation regarding the zoning of a land contract is not material per se unless the variance is such that the buyer will obviously be unable to use the property for its intended purpose. When homebuyers have specific concerns about the nature of the surrounding land due to the health of their child and desire to live in a rural suburb, the fact that a development restriction is not as it was represented could very well be material to the homebuyers.”).
\(^{109}\) See Young v. Vista Homes, Inc., 243 S.W.3d 352, 363 (Ky. Ct. App. 2007) (“We conclude Vista Homes’ representations concerning the number of bedrooms imposed upon it a duty to disclose material facts concerning the adequacy of the septic system.”).
damage and water leakage,\textsuperscript{110} damage to the foundation,\textsuperscript{111} and misrepresentations as to compliance with administrative requirements.\textsuperscript{112}

It can also be presumed that since the Kentucky legislature enumerated specific conditions in Kentucky Revised Statutes § 324.360, information pertaining to those conditions are considered material.\textsuperscript{113} 

\textit{Blackshire v. Remax Realty} supports this notion.\textsuperscript{114} Blackshire held that failure to meet the disclosure requirements under Kentucky Revised Statutes § 324.360 would support a claim of fraud.\textsuperscript{115} Sellers obviously are liable for fraud in concealing or misrepresenting material conditions regarding the property at issue.\textsuperscript{116} Under this line of reasoning, it is highly likely that Kentucky courts would also find fraud under circumstances in which the real estate broker knowingly either misrepresented or concealed the conditions enumerated in Kentucky Revised Statutes § 324.360.\textsuperscript{117} Nevertheless, real estate brokers cannot be held liable for misrepresenting or concealing conditions for which they have no knowledge.\textsuperscript{118}

Therefore, while liability in this area is focused on a seller’s misrepresentation or concealment of material conditions, a real estate broker who has actual knowledge of those conditions might also be held liable for misrepresenting or concealing the conditions.\textsuperscript{119} Real estate brokers should always disclose their knowledge of material conditions to relevant parties in a real estate transaction in order to avoid liability in this area. These issues are more fully discussed below.

b. Knowledge of Falsity or made Recklessly

“Intent to deceive is a necessary element of actionable fraud.”\textsuperscript{120} It is clear under Kentucky law that a person who knowingly makes a false representation

\begin{footnotesize}
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\item \textsuperscript{111} See Davis v. Taylor, No. 2003-CA-001042-MR, 2004 WL 1300032, at *3 (Ky. Ct. App. June 11, 2004) (addressing that the defendant’s representations as to the foundations condition made out the prima facie case for fraud).
\item \textsuperscript{112} See Evola Realty Co. v. Westerfield, 251 S.W.2d 298, 300-01 (Ky. 1952) (holding that fraud could be predicated if statement was made with knowledge that house could not be constructed in compliance with even minimum requirements of F.H.A).
\item \textsuperscript{113} See KY. REV. STAT. ANN. § 324.360 (West 2008) (disclosure form).
\item \textsuperscript{114} See Blackshire, 2004 WL 405732, at *3.
\item \textsuperscript{115} Id. (citing Munday v. Mayfair Diagnostic Lab., 831 S.W.2d 912, 915 (Ky. 1985)) (“KRS 324.360 requires a disclosure of all facts known to the seller regarding the property to be sold on a Seller Disclosure Form. Where, as here, the law requires disclosure of latent defects, failure to disclose such defects is concealment and may give rise to a claim of fraud.”).
\item \textsuperscript{116} See, e.g., Davis, 2004 WL 1300032, at *3.
\item \textsuperscript{117} See KY. REV. STAT. ANN. § 324.360 (West 2008) (disclosure form).
\item \textsuperscript{118} Evola Realty Co. v. Westerfield, 251 S.W.2d 298, 301 (Ky. 1952).
\item \textsuperscript{119} See id. at 300-01.
\item \textsuperscript{120} Farmers Bank & Trust Co. of Georgetown, Ky. v. Willmott Hardwoods, Inc., 171 S.W.3d 4, 11 (Ky. 2005) (citing Smith v. Barton, 266 S.W.2d 317, 318 (Ky. 1954)).
\end{enumerate}
\end{footnotesize}
can be liable for fraud.\textsuperscript{121} \textit{Black's Law Dictionary} defines knowledge as “an awareness or understanding of a fact or circumstance; a state of mind in which a person has no substantial doubt about the existence of a fact.”\textsuperscript{122} Further, a real estate broker can also be held liable for representations made recklessly.\textsuperscript{123} The term recklessness should not be thought of as an extreme form of negligence in this context.\textsuperscript{124} Recklessness under fraudulent misrepresentation is described as a high degree of awareness of probable falsity or serious doubts as to the truth of the matter.\textsuperscript{125} In the real estate context, courts have held that a real estate broker commits fraud when he asserts that something is true when lacking knowledge as to whether it is true or untrue.\textsuperscript{126} Therefore, the plaintiff can establish fraud when a representation is known to be false or made recklessly.\textsuperscript{127}

\textit{In Evola Realty Co. v. Westerfield}, the court held that the real estate broker must have knowingly made false representations in order to be liable for fraud, but would not allow the defendant to escape liability merely because his representations related to future events.\textsuperscript{128} The purchasers in \textit{Evola Realty Co.} brought suit against a real estate broker for falsely representing that their home would be built in accordance with Federal Housing Administration specifications.\textsuperscript{129} There was evidence that the defendant knew he could not perform this promise due to shortages in supplies arising from the war effort at the time.\textsuperscript{130} The plaintiff recovered $2,000 in damages from the defendants.\textsuperscript{131}

On appeal, the real estate broker claimed the alleged misrepresentation relied upon by the purchaser related to the future and contended there was no proof of an intention not to perform in accordance with the representations.\textsuperscript{132} Nevertheless, the court held that a purchaser may bring a claim of fraud under circumstances in which the real estate broker fails to fulfill a promise, if the promise by the real estate broker was made for the purpose of deceiving him or her.\textsuperscript{133} The court set forth that in order to sustain an action for fraud, the plaintiff was required to produce evidence that the real estate broker did not fulfill his promise, and that he knew at the time he made the promise that he could not

\begin{footnotes}
\footnote{122. Black's Law Dictionary 888 (8th ed. 2004).}
\footnote{123. United Parcel Serv. Co., 996 S.W.2d at 468-69.}
\footnote{125. Ball v. E.W. Scripps Co., 801 S.W.2d 684, 689 (Ky. 1990).}
\footnote{126. Bunch v. Bertram, 294 S.W. 805, 808 (Ky. 1927).}
\footnote{127. Crawley v. Terhune, 437 S.W.2d 743, 745 (Ky. 1969); see also United Parcel Serv. Co., 996 S.W.2d at 468.}
\footnote{128. Evola Realty Co. v. Westerfield, 251 S.W.2d 298, 300-01 (Ky. 1952).}
\footnote{129. Id. at 299-300.}
\footnote{130. Id. at 300.}
\footnote{131. Id. at 299.}
\footnote{132. Id. at 300.}
\footnote{133. Id. at 300-01 ("[F]raud may be founded upon the nonperformance of a promise, where promise is made for the purpose of accomplishing deceit.").}
\end{footnotes}
fulfill it.\textsuperscript{134} The court believed that there was ample evidence to support the assertion that the house was not built in accordance with F.H.A. specifications.\textsuperscript{135} However, the case was remanded for a determination as to whether the defendant knew that his statements were false.\textsuperscript{136}

The court in \textit{Crawley v. Terhune} also held that some evidence of fraudulent conduct is required in order to hold a real estate broker liable.\textsuperscript{137} Evidence was presented in this case that while the house was being built, and the plaintiffs were considering its purchase, the real estate broker assured the plaintiffs several times that the house would have a dry basement.\textsuperscript{138} Despite the real estate broker’s promise, the purchasers began experiencing problems with water in the basement within months after moving into the home.\textsuperscript{139} The plaintiffs sued both the builder-owner and the real estate broker predating their claim against the builder-owner on breach of an implied warranty, and their claim against the real estate broker on deceit.\textsuperscript{140} The plaintiffs alleged that the real estate broker made statements "under circumstances that [did] not justify a belief in its truth."\textsuperscript{141} The case went to the jury, which returned a verdict against both defendants, and they were jointly and severally liable for $6,000.\textsuperscript{142} However, the court of appeals held that there was no proof that the real estate broker had knowledge of the basements faulty construction, or that he should have known that it would not be dry.\textsuperscript{143} Thus, the plaintiffs failed to establish the knowledge element of fraud.\textsuperscript{144}

As demonstrated above, fraud requires a plaintiff to not only prove that the defendant’s statements were in fact false, but also that defendant acted in a manner that was fraudulent.\textsuperscript{145} The element of recklessness broadens liability since the real estate broker may not necessarily know whether his representation is true or false. Thus, in order to avoid liability, a real estate broker should refrain from making representations that stray away from facts which are directly within their knowledge or facts which have been disclosed to them by the seller. As it will be discussed later, a real estate broker has a right to rely on statements made by the seller, unless he knows that such statements are false.\textsuperscript{146} Therefore, a real estate broker should always ask when in doubt about a particular fact. Doing so may insulate him against liability for recklessness.\textsuperscript{147}

\textsuperscript{134} \textit{Evola Realty Co.}, 251 S.W.2d at 301.
\textsuperscript{135} \textit{Id.}
\textsuperscript{136} \textit{Id.} at 302.
\textsuperscript{137} \textit{See} Crawley v. Terhune, 437 S.W.2d 743, 745 (Ky. 1969).
\textsuperscript{138} \textit{Id.} at 744.
\textsuperscript{139} \textit{Id.}
\textsuperscript{140} \textit{Id.}
\textsuperscript{141} \textit{Id.} at 745.
\textsuperscript{142} \textit{Id.} at 744.
\textsuperscript{143} Crawley, 437 S.W.2d at 745.
\textsuperscript{144} \textit{Id.}
\textsuperscript{145} \textit{Id.}
\textsuperscript{146} Smith v. Fid. & Columbia Trust Co., 12 S.W.2d 276, 277 (Ky. 1928).
\textsuperscript{147} \textit{See id.}
c. Made with inducement to be acted upon

This element can be established when a real estate broker makes statements recklessly or with knowledge of their falsity for the purpose of inducing the purchaser to buy a home. Proof of this element may be established by testimony, documentation, or entirely from circumstantial evidence.\textsuperscript{148}

\textit{Davis v. Taylor} provides a good example of how a real estate broker can be held liable based on circumstantial evidence alone.\textsuperscript{149} The real estate broker in this instance represented to the purchaser that the house was in great condition.\textsuperscript{150} However, the purchaser later discovered that the foundation of the home was in serious disrepair.\textsuperscript{151} The purchaser confronted the real estate broker about this problem, and was given the response “it’s no longer my problem.”\textsuperscript{152} The following paragraphs highlight a portion of the court’s analysis of the circumstances under which the transaction took place:

Although there is no direct evidence that Taylor knew about the rotten floor joists, there was considerable circumstantial evidence in the record arguably indicating his knowledge. For example, in evaluating Taylor's comment that “it's no longer my problem,” a jury could have reasonably inferred that he knew of the poor condition of the structure. As a result of Taylor's failure to provide Davis with a Seller's Disclosure Statement (a knowing violation of KRS 324.360), a jury also could have believed that he had something to hide from the potential buyer. In noting his experience as a realtor/appraiser, the jury could have been skeptical about his testimony that he failed to make any inquiries about the condition of the property upon purchasing it himself.

Even if a jury were not persuaded that Taylor had actual knowledge of the floor problem . . . [t]he record contains sufficient evidence—including Taylor's own testimony—that Taylor recklessly misrepresented the condition of the property in order to hasten and to induce Davis's purchase . . . When asked during his deposition why he touted the property as being in “excellent condition” in light of his admitted lack of knowledge about its actual condition, Taylor responded, “[It] was a bad choice of words.”\textsuperscript{153}

As evidenced in \textit{Davis}, there are a great number of factors a jury can consider just from the circumstances alone in a case dealing with fraud.\textsuperscript{154} The court in this situation considered both statements made before and after the

\textsuperscript{148} \textit{United Parcel Serv. Co.}, 996 S.W.2d at 468.
\textsuperscript{150} \textit{Id.} at *1.
\textsuperscript{151} \textit{Id}.
\textsuperscript{152} \textit{Id}.
\textsuperscript{153} \textit{Id.} at *2.
\textsuperscript{154} \textit{Id}.
transaction, and inferred knowledge from the defendant’s failure to properly utilize the seller’s disclosure form. Therefore, a jury may nevertheless take such facts into consideration. Therefore, a real estate broker should guard his words carefully at all times during and after the transaction, and strive to act in accordance with the aforementioned statutory law and administrative regulations.

d. Acted in reliance thereon

“[A] claimant may establish detrimental reliance in a fraud action when he acts or fails to act due to fraudulent misrepresentations.” Thus, this is a subjective element that focuses on the purchaser’s belief in the real estate brokers statements. A purchaser will not be able to recover under a claim of fraudulent misrepresentation if he does not believe the real estate brokers statements, or has knowledge to the contrary. Although the case below deals with sellers as opposed to real estate brokers, it effectively illustrates the issue of reliance in a real estate transaction.

The Kentucky Supreme Court in Ross v. Powell, reinforced the reliance element of fraud in a real estate transaction. In this case, both the purchasers’ and the sellers’ real estate agents recommended that the house be inspected for termites due to its age. The inspection showed evidence of termites, but the inspector assured the sellers that there was “no evidence of damage.” The sellers then contacted a pest control company to treat the infestation and signed a seller disclosure form pursuant to Kentucky Revised Statutes § 324.360. The form disclosed evidence of termite infestation, but stated that there was no apparent damage. The form also indicated that a later inspection confirmed a termite infestation but “reported only minor visible damage.” The home was later treated for termites. The form also disclosed that “the roof had leaked, had substantial damage and had been repaired” and “that the basement had leaked and had also been repaired.”

156. United Parcel Serv. Co., 996 S.W.2d at 469.
157. See, e.g., Wilson v. Henry, 340 S.W.2d 449, 451 (Ky. 1960) (citing Snyder v. Rhinehart, 118 S.W.2d 543, 547 (Ky. 1938); Cox v. Lilly, 254 S.W. 759, 760 (Ky. 1923)) (“The very essence of actionable fraud or deceit is the belief in and reliance upon the statements of the party who seeks to perpetrate the fraud . . . .”).
158. Wilson, 340 S.W.2d at 451.
160. Id. at 329.
161. Id.
162. Id.
163. Id.
164. Id.
165. Ross, 206 S.W.3d at 329.
166. Id.
The purchasers hired their own inspector who inspected the entire home and reported that there was no visible damage to the house. A subsequent inspection by an inspector employed by the purchasers evidenced a carpenter ant infestations and previous treatment for wood destroying insects. The company recommended additional treatment. Despite the results of the inspections, the purchasers went through with the transaction. Following the purchase of the home, they brought suit claiming that the sellers committed fraud by misrepresenting the condition of the leaky roof and the presence of live termites along with extensive termite damage. The circuit court granted the defendant’s motion for summary judgment and the court of appeals affirmed.

The Kentucky Supreme Court also affirmed the grant of summary judgment in favor of the sellers, holding in part that the purchasers did not rely on representations by the sellers. In supporting its ruling, the court focused on the purchaser’s inspections of the premises and its own admissions that it used great care in examining the property, and it had relied completely on its own judgment and the findings of its inspectors. The court held that the purchasers had knowledge of the insect infestations and were on notice of potential problems with the house before the closing.

The above case exemplifies the importance of encouraging the purchaser to make an independent inspection of the property. In many situations this could relieve the real estate broker of liability since a court can look to another basis for the purchaser’s reliance aside from the real estate broker’s statements alone. Thus, it is to a real estate broker’s advantage to encourage as much transparency between the parties as possible.

e. Injury and Damages

In a cause of action based on fraud, the purchaser will claim injury based on the grounds that the real estate broker represented the property at a value higher than what it was actually worth. The purchaser does not have to prove the

167. Id.
168. Id.
169. Id.
170. Id.
171. Ross, 206 S.W.3d at 329.
172. Id.
173. Id. at 331.
174. Id.
175. Id.
176. Id.
177. Evola Realty Co. v. Westerfield, 206 S.W.2d 298, 301 (Ky. 1952); see also Johnson v. Lowery, 270 S.W.2d 943, 944 (Ky. 1954) (involving an action by realty broker’s principal against broker for difference between true value as represented by broker and alleged actual value of property sold to principal by broker; evidence was sufficient to sustain finding by the master commissioner and chancellor that broker, while occupying a fiduciary relationship with principal, had knowingly misrepresented value of such property).
amount of damages with certainty, but only needs to establish with certainty the existence of damages. If all the other elements of fraud are proven, the jury will hold the real estate broker liable for an amount which would “fairly and reasonably” compensate the purchasers for the cost required to make the property “substantially conform to precise representations as they were made” by the real estate brokers.

2. Puffery and Statements Relating to the Future

Real estate brokers have reached mixed results by claiming their statements were puffery or sales talk when a purchaser alleges fraud. “Puffing involves expressing opinions, not asserting something as a fact.” Courts have distinguished facts and opinions by setting forth that “whatever is susceptible of exact knowledge is a matter of fact, while that not susceptible is generally regarded as an expression of opinion.” In order to sustain an action for misrepresentation, the assertion must be a “matter of material fact as distinguished from assertion of or expression of opinion.”

The court in *Davis v. Taylor* held that the real estate broker’s representations crossed the line between opinion and fact. In this case, the plaintiff made allegations that the seller, a licensed real estate broker and the owner of that property, fraudulently represented the condition of the property, and failed to disclose the actual condition of the home. Taylor described the property as being in “excellent condition.” In reality, the house suffered from considerable damage to the foundation. The court held that the defendant “was under a duty to disclose the truth rather than a prerogative “to puff.” The real estate broker’s statements about the house “far surpassed the type of innocuous commentary recognized by the court as ‘mere puffing’ and instead cumulatively constituted a prima facie claim of fraud.”

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178. United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 469 (Ky. 1999) (citing Kellerman v. Dedman, 411 S.W.2d 315, 317 (Ky. 1967)) (“[I]t is not necessary to prove the amount of damages with certainty, but only to establish with certainty the existence of damages. Thereafter, the jury may determine the fair and reasonable estimate of the particular injury.”).
179. *Id.*
182. McDonald v. Goodman, 239 S.W.2d 97, 99 (Ky. 1951) (“[M]ere expression of opinion is not sufficient to sustain a cause of action for misrepresentation or deceit . . . .”)
184. *Id.* at *1.
185. *Id.*
186. *Id.*
187. *Id.* at *3.
188. *Id.*
The facts were not clear as to whether the defendant knew about the condition of the foundation. Thus, this case provides an important example of how a real estate broker should refrain from making broad statements about the condition of the property without any basis in fact. Such actions could easily lead to liability based on recklessness.

Another issue related to puffery and sales talk deals with whether a statement made by a real estate broker is a “future promise or an opinion of a future event” as opposed to “an existing or past fact.” Kentucky courts have held that a misrepresentation must relate to an existing or past fact in order to be used as a basis for fraud. If the alleged misrepresentation relates to a future promise or an opinion of a future event, then it is not actionable.

The court in Pedigo v. Bybee distinguished between the facts of the case under review and another case, Osborne v. Howard regarding opinions of future events and representations relating to existing or past facts. Both cases involved: (1) a sale of real property; (2) inspections of the premises by purchasers who later became suspicious; and (3) purchasers who requested and received assurances from the vendors that their misgivings were groundless.

In the Osborne case the representations were little more than the expression of an opinion of what might happen in the future. There, Howard sold to Osborne a farm. Although the purchaser made only a cursory examination of it, it caused him to suspect that the soil was poor. Both of the men were farmers and competent to judge the quality of the soil. Osborne stated that he thought the soil looked thin but Howard said that it had been a dairy farm for twelve years, was well rested, and had only been worked for two years. He stated that it would make a thousand pounds of tobacco to the acre or ten barrels of corn. This was no more than the expression of an opinion concerning future events and amounted to little more than ‘puffing.’

The court in Pedigo distinguished the case before it from Osborne by pointing out that the:

[A]ppellees requested specific knowledge as to a fact which could have been established by past performance, that is, whether the house leaked when it rained. The only time appellant was present when it was raining

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190. Radioshack Corp. v. ComSmart, Inc., 222 S.W.3d 256, 262 (Ky. Ct. App. 2007) (citing Edward Brockhaus & Co. v. Gilson, 92 S.W.2d 830, 834 (Ky. 1936)).
191. Id.
192. Id. at 262 (citing Rivermont Inn, Inc. v. Bass Hotels & Resorts, Inc., 113 S.W.3d 636, 640 (Ky. Ct. App. 2003)); Church v. Eastham, 331 S.W.2d 718, 719 (Ky. 1960); McHargue v. Fayette Coal & Feed Co., 283 S.W.2d 170, 172 (Ky. 1955).
195. Pedigo, 253 S.W.2d at 23 (citing Osborne, 242 S.W. at 852-53).
196. Id.
and when he might have determined for himself whether the house leaked, he was not requested to make an examination, nor was he invited into the house by Mrs. Pedigo in order that he might see for himself.197

The lower court’s decision in favor of the plaintiff was affirmed.198 The main difference between these two cases was that the seller’s representation in the first case rested on a prediction that could only be proven or disproven in the future, while the latter case dealt with a representation that related to a fact that could have easily been ascertained in the present.199 Furthermore, both cases took into consideration whether the plaintiff had equal opportunity to observe the property, and thus make judgments as to its value.200 The court seemed to lean more in favor of holding the defendant liable under circumstances in which the plaintiff was forced to rely solely on the defendant’s representations.201

The cases above demonstrate that a real estate broker should be careful when making statements about the future if the basis of those statements rests on facts that can be ascertained in the present. If such statements cross the line between puffery and fraud, the real estate broker can then be found liable. Thus, it would be wise for a real estate broker to refrain from speculation about future events, since such assertions can be used against him. A better approach would be to allow the purchaser to inspect the property himself and come to his own conclusions.

3. Fraudulent Concealment

“Where the law imposes a duty of disclosure, a failure of disclosure may constitute concealment,” and may give rise to a claim of fraud.202 The tort of fraudulent concealment arises when there is: (1) duty to disclose; (2) a failure to disclose the facts; (3) the incomplete information induces the buyer to buy; and, (4) the buyer suffers damages as a result of the concealed facts.203 However, this doctrine does have limitations.204 Silence alone is not considered fraudulent in the absence of a duty to disclose.205 Furthermore, silence will not constitute

197. Id.
198. Id. at 24.
199. Id. at 23.
200. Id.
201. Pedigo, 253 S.W.2d at 23.
202. Munday v. Mayfair Diagnostic Lab., 831 S.W.2d 912, 915 (Ky. 1985); Bryant v. Troutman, 287 S.W.2d 918, 920 (Ky. 1956) (“In sale of real estate the intentional suppression of facts known to seller and unknown to purchaser is ground for an action for deceit if purchaser was damaged by reason of the fraudulent concealment.”).
204. Smith, 979 S.W.2d at 129.
205. Id. (citing Hall v. Carter, 324 S.W.2d 410, 412 (Ky. 1959)); see also Kaze v. Compton, 283 S.W.2d 204, 208 (Ky. 1955) (“[A]ctionable fraud or misrepresentation by a vendor may arise
fraud when facts are open to common observation or discoverable by the exercise of ordinary diligence, or under circumstances in which information is equally accessible to both parties.  

a. Sources of Liability for Fraudulent Concealment

The source of liability for real estate brokers in Kentucky arises under statute. Prior to the General Assembly passing legislation concerning disclosure, there was no common law duty to disclose information to a purchaser. Now, Kentucky law imposes a duty to disclose on all sellers of single-family residential dwellings of residential real estate, which are listed by real estate brokers. In turn, the real estate broker is required by law to disclose the information on the form to the purchaser, or if the seller fails to fill out the form, to inform the purchaser that the form was not completed. It has quickly become obvious that the use of the form reduced the risk of claims of nondisclosure for both the licensees and the sellers. Nevertheless, the form has also generated liability for real estate brokers who fail to disclose information on the form.

Kentucky courts have not clearly established any other basis for a duty to disclose. However, the court in Givan did take into consideration authority aside from that found in KRS 324.360. Givan involved a dispute between a seller and a real estate broker concerning breach of fiduciary duties. The plaintiffs alleged that the real estate broker had a duty to ascertain the financial standing of the purchaser. The plaintiffs pointed to National Association of Realtors Code of Ethics, which outlines the duties of realtors in general terms. One of the duties enumerated required the real estate broker to avoid concealment of pertinent facts. Yet, the court did not expressly establish this document as a basis for imposing a duty to disclose. Therefore, it is unclear how much weight a Kentucky court would apply to the National Association of Realtors Code of Ethics when considering fraudulent concealment.

Nevertheless, even if it was used as a basis for imposing a duty, the result would be essentially the same as when courts utilize Kentucky Revised Statute §

from concealment or failure to disclose a hidden condition or material fact if, under the circumstances, there was an obligation to disclose it during the transaction.

206. Bryant, 287 S.W.2d at 920-21.
207. See KY. REV. STAT. ANN. § 324.360 (West 2008).
208. Id.
209. Id.
210. LAWSON, supra note 17, at 146.
211. Id.
213. Id. at 504.
214. Id.
215. Id. at 504-05.
216. Id. at 505.
217. Id.
This is because the current *National Association of Realtors Code of Ethics* sets forth that “[f]actors defined as “non-material” by law or regulation or which are expressly referenced in law or regulation as not being subject to disclosure are considered not “pertinent” for purposes of Article 2.”

Therefore, the National Association of Realtors seems to rely on statute or regulation for imposing disclosure requirements on real estate brokers.

Lastly, Kentucky law authorizes the Kentucky Real Estate Commission to sanction a real estate broker for “failing to disclose known defects which substantially affect the value of the property.” As of now, this statute has not been used by the courts to impose an additional duty on real estate brokers to disclose.

Therefore, as stated above, there is no basis for liability under fraudulent disclosure, except for that found under Kentucky Revised Statute § 324.360. This basis for liability is limited by the fact that the real estate broker only has to facilitate the exchange of information between the parties; the responsibility for inspecting the property and completing the form rest solely on the seller. Limiting liability under this tort is in accordance with Kentucky common law since a real estate broker has never had a duty to independently gather and disclose information to the purchaser.

b. Case Law on Fraudulent Concealment

The court in *Shepard v. Willhite* ruled in favor of the sellers and the real estate broker on the grounds that there was no latent defect for which the plaintiffs were unaware. In this case, the plaintiff toured the home prior to purchasing it and “noticed several dehumidifiers and a dusty, damp type smell.” The plaintiffs then inquired as to possible water damage. They were told about two water incidents, which had been included in the sellers disclosure form. Despite the sellers’ refusal to make repairs to the basement in order to prevent leakage, the plaintiffs closed on the property. There were no problems until several years later when flooding caused severe damage to the home. The plaintiffs then sued both the sellers and the real estate broker on the grounds that they were fraudulently induced to purchase the property.

221. *Id.* at *1.
222. *Id.*
223. *Id.*
224. *Id.*
225. *Id.* at *2.
The court set forth that caveat emptor is the general rule in real estate transactions, but also acknowledged that the rule had been relaxed by the statutory duty to disclose. Thus, the court reasoned that liability for fraud could be found under circumstances in which the purchaser failed to disclose and, as a result, the buyer was induced to purchase the property and damaged as a result of the concealed facts. The court found that the evidence conclusively established that the plaintiffs were provided with the opportunity to find any potential problems with the basement, and were aware that the basement had water problems in the past.

In Blackshire v. Remax Realty, the court held that the circumstances raised material questions of fact as to whether the real estate agents concealed defects in a home he sold. The court relied on Kentucky Revised Statutes § 324.360 and its disclosure requirements in coming to this conclusion. In this case, the homeowner claimed that he informed the real estate agent of a problem with the pool leaking. He testified that the real estate agent assured him that the problem would be taken care of prior to the sale. Thus, the homeowner claimed that this induced him not to put the pool problems on the Seller Disclosure Form. The real estate agent admitted that he and his nephew drained and painted the pool. It was also uncontroverted that the pool was drained and in the process of being painted when the buyers made a final walk-through of the home.

Additionally, the homeowner did disclose that the basement leaked on the seller’s disclosure form, but included the language “contract signed to repair” based on the assumption that the real estate agent would take care of the problem. There was evidence that the agent took only minimum steps which failed to correct the leaking problem. Furthermore, termite damage was not disclosed due to another alleged promise by the agent to take care of the problem. Lastly, there was evidence that water leakage in the pool house was

227. Id.
228. Id. ("[T]he seller fails to disclose and the buyer is thereby induced to purchase the property and is damaged as a result of the concealed fact.").
229. Id. at *3.
231. Id.
232. Id. at *1.
233. Id.
234. Id.
235. Id.
237. Id. at *2.
238. Id.
239. Id.
covered up as well, although it was disputed as to whether the homeowner or the agent was responsible.\textsuperscript{240}

The plaintiffs alleged that the real estate agent warranted to the homeowner “that he would ‘take care of necessary repairs to the home prior to the sale,’” but instead “concealed the defect or performed partial and ineffective repairs,” thus depriving them of the opportunity to inspect.\textsuperscript{241} The plaintiffs also claimed that they relied on the disclosure form.\textsuperscript{242} The trial court granted the defendants’ motion for summary judgment.\textsuperscript{243} However, the court of appeals reversed the lower courts judgment and remanded for determination as to whether the real estate broker concealed and improperly repaired the property at issue.\textsuperscript{244}

The cases above demonstrate two major issues under fraudulent disclosure. First, proper disclosure can effectively limit liability for a real estate broker. As demonstrated in \textit{Shepard}, a purchaser cannot purchase a home with knowledge of defects, and then later claim that the real estate broker acted fraudulently.\textsuperscript{245} Secondly, as demonstrated in \textit{Blackshire}, the more the real estate broker involves himself in the process of completing the disclosure form, the greater the possibility is that he or she can be held liable for fraud.\textsuperscript{246} Thus, a real estate broker should refrain from completing any portion of the disclosure form and act with extreme caution if he or she actually dictates what should and shouldn’t be included in the disclosure form.\textsuperscript{247}

4. Violations of Good Faith and Fair Dealing

Kentucky courts have historically implied a duty on the behalf of a real estate broker to deal fairly and honestly with his clients.\textsuperscript{248} However, at least one Kentucky court has gone a step further and extended this protection to sellers involved in non-agency relationship as well.

In \textit{Givan v. Aldemeyer/Stegman/Kaiser, Inc.}, the court of appeals held that “when a broker acts as an intermediary between a seller and a prospective buyer, a broker is under a duty to deal fairly and honestly with both parties, even in absence of a principal/agent relationship with them.”\textsuperscript{249} The case involved a situation in which the seller and purchaser were represented by different real

\textsuperscript{240} Id.
\textsuperscript{241} Id. at *1.
\textsuperscript{242} Blackshire, 2004 WL 405732, at *1.
\textsuperscript{243} Id.
\textsuperscript{244} Id. at *4.
\textsuperscript{246} See Blackshire, 2004 WL 405732, at *3.
\textsuperscript{247} Id.
\textsuperscript{248} See Hurt v. Sands Co., 33 S.W.2d 653, 654 (Ky. 1930); see also Jones v. Todd, 256 S.W.2d 533, 534 (Ky. 1953).
The purchasers entered into a lease/purchase agreement with the sellers, but later failed to provide the down payment for the home. The sellers evicted the purchasers and subsequently had to make several repairs to the home before it could be sold to another purchaser. The seller sued both their own real estate broker and the purchaser’s broker, claiming that they breached their fiduciary duties in failing to ascertain the financial standing of the purchasers. The trial court dismissed the seller’s claim against the purchaser’s real estate broker for lack of a duty owed to the sellers. Although the real estate broker claimed that he used proper precautionary measure in the evaluation of the purchaser’s financial standing, the court of appeals remanded the case to determine his competency in the transaction.

It is not clear how this cause of action will be applied outside of the situation outlined above involving financially unstable purchasers. Rogers v. Miller is the only state court decision to apply this case to real estate brokers, and it limited its application to allegations of dishonesty, misrepresentation, or unfair dealing. Without any other subsequent decisions to further define the scope of this approach to liability, it can be assumed that this interpretation will govern since it is in accordance with court precedent relating to misrepresentations of financial standing under agency law.

5. Liability Based on Negligence in a Non-Agency Relationship

Under Kentucky law, negligence is defined as a “failure to exercise ordinary care . . . that degree of care which a person of ordinary prudence is accustomed to bestow upon the matter in hand under similar circumstances and conditions.” To recover under a claim of negligence, a plaintiff must establish “(1) a duty on the part of the defendant; (2) a breach of that duty; and (3) consequent injury.” The existence of the duty element of the prima facie case serves as a gatekeeper for the otherwise extremely broad concept of negligence. Although Kentucky law is clear as to the duties real estate brokers

250. Givan, 788 S.W.2d at 504.
251. Id.
252. Id.
253. Id.
254. Id.
255. Id. at 505.
257. See Croxton’s Executors v. Henry & Fleenor, 235 S.W. 753, 754 (Ky. 1921) (“[A]ny fraud or misrepresentations on the part of the broker which misleads or deceives the seller about a material element in the sale will destroy the broker’s right to commissions from sales which are not consummated . . . .”); see also Hurt v. Sands Co., 33 S.W.2d 653, 654 (Ky. 1930); Jones v. Todd, 256 S.W.2d 533, 534 (Ky. 1953); Johnson v. Lowery, 270 S.W.2d 943, 944 (Ky. 1954).
owe to their principals, courts have not set forth any duties beyond those found in a fiduciary relationship between a real estate broker and a seller. Only two cases have directly addressed the issue of negligence in a non-agency dispute between a purchaser and a real estate broker.

In *Sparks v. Re/Max Allstar Realty, Inc.*, the court held that “making a recommendation does not amount to guarantee of performance” and that “professionals make recommendations to their clients.” In this case, the purchasers of a home infested with termites brought a claim against the seller’s real estate broker for alleged negligence in recommending a termite control company to perform an inspection. The court found that the real estate broker had not accepted any responsibility for the work of the termite control company, nor had he provided a guarantee. The court affirmed the lower court’s grant of summary judgment in favor of the real estate broker.

In *Rogers v. Miller*, the court held that the duty imposed upon real estate brokers to “deal fairly and honestly with both parties” did not impose a duty under which a negligence claim could be supported. The sellers in this case wished to retain a portion of the property to be sold. The parties agreed that the real estate agent would provide and complete the necessary documents. However, he failed to incorporate the new boundary lines into the contract. The contract simply stated, “[b]uyer wants property lines to be established in a professional manner.” Consequently, the sellers renounced the contract.

The purchasers brought an action against the seller’s real estate agent and broker alleging that the agent negligently drafted the purchase contract. The trial court granted separate motions for summary judgment in favor of each defendant. The appeals court relied on the precedent set forth in *Givan* and held that the real estate broker was not liable since there were no allegations of dishonesty, misrepresentation, or unfair dealing. Furthermore, the court dismissed the plaintiffs’ negligence claim on the grounds that they failed to

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263. Id. at 345-46.
264. Id. at 349.
265. Id.
267. Id. at *1.
268. Id.
269. Id.
270. Id.”
271. Id.
273. Id.
274. Id. at *1-2.
establish that the real estate broker owed them a recognized duty under current Kentucky law. 275

Kentucky courts have yet to establish any duties existing outside of agency law under which a purchaser can sue for negligence. This is in accordance with Kentucky’s general reluctance to hold real estate broker’s liable to purchasers except under fraud. The issue of negligence will be discussed in more detail under the section of this article dealing with the future of real estate broker liability.

6. The Consumer Protection Act

The Kentucky Consumer Protection Act (KRS § 367.110), defines unlawful acts as “unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or commerce.”276 Kentucky Revised Statute § 367.220(1) provides, in relevant part, that:

Any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment of another person of a method, act or practice declared unlawful by KRS. 367.170, may bring an action . . . to recover actual damages . . . .277

Kentucky courts have been dismissive of claims under this statute against real estate brokers and real estate transactions in general.278 The court in Craig v. Keane emphasized the words “goods or services” within the statute, thus indicating that it did not apply to real estate transactions.279 Hence, there is no indication under Kentucky case law that the Consumer Protection Act applies to real estate transactions. Even so, plaintiffs already have grounds for liability under fraudulent misrepresentation. Thus, it would be unnecessary to apply this statute since purchasers already have means of recovery.

7. Conclusion

Fraudulent misrepresentation and fraudulent concealment are the only grounds under which a purchaser can successfully bring suit in Kentucky, unless an agency relationship exists between the parties. Kentucky law has not established a duty under which a real estate broker can be held liable for negligence, nor is there any basis for liability under statutory authority aside from the seller’s disclosure requirements under Kentucky Revised Statute § 275.

275. Id. at *2.
277. Id. § 367.220(1).
279. Craig, 32 S.W.3d at 91.
324.360(3). This is the current state of real estate broker liability under Kentucky law as it pertains to purchasers of property. However, many purchasers have brought suit under claims not yet recognized in Kentucky, arguing that liability should be expanded. The following section discusses whether Kentucky should expand real estate broker liability to encompass claims recognized in other jurisdictions, but not in Kentucky.

IV. THE FUTURE OF REAL ESTATE BROKER LIABILITY IN KENTUCKY

A. Negligent Misrepresentation

The Restatement (Second) of Tort sets forth a definition of negligent misrepresentation:

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.280

The Kentucky Supreme Court recently recognized the tort of negligent misrepresentation in Presnell.281 Presnell dealt with allegations by a contractor that a construction manager negligently supplied false information in its coordination of building renovations, thus costing the contractor a great deal of money.282 The trial court dismissed the plaintiff's claim because the defendants owed contractual duties to the owner of the building in which both parties were working, hence, there was not privity of contract between the plaintiff and the defendants.283 On appeal, the Kentucky Supreme Court dispensed with the requirement of privity because negligent misrepresentation “defines an independent duty for which recovery in tort for economic loss is available.”284 The court remanded the case for a decision consistent with its opinion.285

The Kentucky Supreme Court also cited Seigle v. Jasper286 as a decision in which the tort action of negligent misrepresentation was recognized.287 It was the only case mentioned in which negligent misrepresentation was applied to a real estate transaction. In Seigle, the court held that “[w]here the abstracter knows, or should know, that his customer wants the abstract for the use of a

282. Id. at 576.
283. Id. at 579-80.
284. Id. at 582.
285. Id. at 583.
prospective purchaser, and the prospect purchases the land relying on the abstract, the abstracter's duty of care runs . . . not only to his customer but to the purchaser." The plaintiffs in this case sought to take out a loan to purchase a piece of property. The plaintiffs agreed that the defendant attorney would perform the title examination for their loan, and paid his attorney's fees as a part of their closing costs paid through the bank at the time their real estate loan was closed. The attorney failed to discover that the property was encumbered by the existence of an easement. The plaintiffs brought claims of fraud and breach of warranty against the vendor and alleged that the attorney who prepared the title opinion respecting property acted negligently. The court reversed the lower courts grant of summary judgment in favor of the defendant attorney and remanded the case for further proceedings.

There has been at least one subsequent case which featured parties analogous to those found in a relationship between a purchaser and a real estate broker. In Kentucky Farm Bureau Mut. Ins. Co. v. Blevins., Kentucky Farm Bureau sought a declaration as to whether it owed coverage and a defense to the Blevinses. The Blevinses had been sued by the purchasers of their home who claimed that they negligently misrepresented that the home was free of defects. The phrase "for the guidance of others in their business transactions" was central to the court’s holding. The court held that negligent misrepresentation could not be established because this case involved a private sale of residential property as opposed to a business transaction as required by the definition of negligent misrepresentation in Kentucky.

1. Negligent Misrepresentation’s Application to Real Estate Broker’s in Kentucky

The Kentucky Supreme Court in Presnell provided few policy justifications for its decision, and little guidance as to how negligent misrepresentation will be applied in the future. Consequently, it is necessary to look at jurisdictions outside of Kentucky for guidance. The obvious case for application of this tort in most jurisdictions arises when the defendant has “expressly or implicitly

288. Seigle, 867 S.W.2d. at 482 (citing First Am. Title Ins. Co. v. First Title Serv. Co., 457 So.2d 467, 473 (Fla. 1984)).
289. Id. at 478.
290. Id.
291. Id. at 479.
292. Id.
293. Id. at 484.
295. Id.
296. Id. at 373.
297. Id.
undertaken to exercise care for the benefit of the plaintiff.”299 Accordingly, the ordinary situation in which this tort is applied in other jurisdictions arises when a “defendant is retained for the very purpose of providing accurate information.”300 However, several jurisdictions outside of Kentucky have taken a more expansive approach to this tort and applied it in the real estate broker context.301 The jurisdictions that impose liability on a real estate broker for negligent misrepresentation consider the broker as being “one who in the course of his or her business supplies information for the guidance of others.”302 Therefore, there are two major issues at hand. The first is whether Kentucky law currently supports application of negligent misrepresentation in the real estate broker context. The second issue is whether application of this tort would be necessary considering the grounds for liability currently available under Kentucky law.

a. Application of the Rule Under Current Kentucky Law

Kentucky statutory law defines a real estate brokerage as:

- a single, multiple or continuing act of dealing in timeshares or options,
- selling or offering for sale, buying or offering to buy, negotiating the purchase, sale, or exchange of real estate, engaging in property management, leasing or offering for lease, renting or offering for rent, or referring or offering to refer for purpose of securing prospects, any real estate or the improvements thereon for others for a fee, compensation, or other valuable consideration.303

Additionally, several Kentucky cases indicate that a “real estate broker may earn his commission ‘either by producing a person who is not only then, but at all times, ready, able, and willing to purchase the property on the prescribed terms, or by obtaining from the customer a binding contract which the landowner himself may enforce.’”304 Thus, both statutory and case law supports the notion that a real estate broker’s purpose is locating a suitable purchaser and facilitating the transaction between the parties. There is no indication that Kentucky law views real estate brokers as professionals that are specifically employed to supply information for the guidance of others in their business transactions.

Nevertheless, it cannot be denied that real estate brokers do provide information to purchasers of real estate property. Despite this aspect of the profession, expanding this tort to any person who provides any type of information in a business transaction would impose liability on practically any

300. Id.
301. See Dallon, supra note 1, at 422 n.154.
302. See id. at 422.
303. KY. REV. STAT. ANN. § 324.010(1) (West 2008).
person dealing in business. It would appear that Kentucky courts have abided by a limited application of negligent misrepresentation; hence there is no indication that courts will apply this tort to a broad range of professionals.305

Kentucky Farm Bureau Mut. Ins. Co. provides guidance as to how the rule should be applied to real estate brokers in Kentucky.306 Although real estate brokers do supply information to purchasers of property, their roles are distinguishable from those found in Presnell307 and Seigle.308 Real estate brokers are not acting for the benefit of purchasers of real estate, but are instead acting on behalf of their client in the facilitation of a private transaction. The representations made by real estate brokers are not for the benefit of the purchaser, but instead are made for benefit of the seller in furtherance of a contract to sell the property.

In Presnell309 and Seigle,310 it was very clear that the defendants were “retained for the very purpose of accurate information”, and thus had “implicitly undertaken to use reasonable or professional care.”311 The defendant in Presnell, acting in its capacity as a construction manager, had presumably taken on responsibility for providing truthful information to the contractor for its guidance in carrying out the duties and responsibilities enumerated under the contract with the owner.312 Moreover, the defendant in Seigle was employed specifically to investigate the title to the property, thus taking on the responsibility of exercising due care in the fulfillment of his duties.313 It would have been unjust for the defendants to escape liability under these circumstances, merely because privity did not exist between the parties.

Furthermore, liability under negligent misrepresentation would be a great departure from a long history in which courts have been very reluctant to impose liability on real estate brokers. Currently, Kentucky law has not imposed any duties on real estate brokers beyond the obligation to deal fairly and honestly with all parties to the transaction with the exception of fiduciary relationships.314 Typically, liability can only be imposed when a real estate broker fails to provide

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308. Seigle, 867 S.W.2d at 476.
310. Seigle, 867 S.W.2d at 476.
312. Steven M. Henderson, Walking the Line Between Contract and Tort in Construction Disputes: Assessing the Use of Negligent Misrepresentation to Recover Economic Loss after Presnell, 95 Ky. L.J. 145, 172 (2006-2007) (“[A]cting in the capacity of a construction manager and was presumably responsible for providing truthful information to the contract for his guidance in carrying out his responsibilities under the contract with the owner.”).
313. See Seigle, 867 S.W.2d at 476.
a purchaser with information in which he or she has a statutory duty to disclose, or if he or she makes an affirmative statement that is known to be false or made recklessly.\^{315} This type of liability is in accordance with the general rule in Kentucky which has historically placed responsibility on the purchaser to protect his or her interest in the absence of some type of fraud.\^{316} Therefore, applying the tort of negligent misrepresentation to real estate brokers would expand liability far beyond precedent.

b. Policy Considerations for Applying Negligent Misrepresentation to Real Estate Brokers

Kentucky tort law offers adequate protection for purchasers against the acts of careless real estate brokers. Many cases which support a claim of negligent misrepresentation would also support a claim of fraudulent misrepresentation.\^{317} Fraudulent misrepresentation allows purchasers to bring claims against real estate brokers who make reckless statements as to the condition of the property, but protects a real estate broker from liability who innocently shares representations of the seller to a purchaser without knowledge that information is incorrect.\^{318} The tort of negligent misrepresentation “eliminates the need to prove that intent required to succeed in a fraud claim.”\^{319} Hence, “a broker may be liable even if the broker had no intention to deceive and even if the broker had no actual knowledge of the defective condition” of the property.\^{320} Application of negligent misrepresentation would force real estate brokers to independently determine the veracity of a seller’s statements concerning the property. Otherwise, the real estate broker would be open to liability for unknowingly providing information to a seller that later turned out to be false. As a result, real estate brokers would be less likely to share information with purchasers since they could not solely rely on the seller’s representations. For these reasons, holding real estate brokers liable for negligent misrepresentation would hinder the real estate broker in the performance of his or her role as a facilitator between the seller and the purchaser. Therefore, fraudulent misrepresentation provides better grounds for liability than negligent misrepresentation since it allows sellers to recover from unethical real estate brokers without changing the role of the real estate broker.

\^{315} See United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 468 (Ky. 1999); Munday v. Mayfair Diagistic Lab., 831 S.W.2d 912, 915 (Ky. 1992).
\^{316} Yeager v. McLellan, 177 S.W.3d 807, 811-12 (Ky. 2005).
\^{318} See United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 468 (Ky. 1999).
\^{319} See Dallon, supra note 1, at 425.
\^{320} Id.
B. Duty to Inspect

A few jurisdictions have imposed a duty upon real estate brokers to inspect property listed for sale, and subsequently to disclose material defects that he or she should have discovered in such an inspection.\(^\text{321}\) However, these jurisdictions are in the minority.\(^\text{322}\) There is no indication that Kentucky law imposes an affirmative duty on real estate brokers to independently inspect property listed for sale or verify the truth of representations made by a seller. To the contrary, at least one case has set forth that “[e]very agent has the right to act upon the assumption that a prospective buyer or seller is both truthful and candid, unless he has notice or knowledge to the contrary.”\(^\text{323}\)

Aside from being a great departure from court precedent, the policy considerations as to whether a duty to inspect is reasonable or necessary also support the conclusion that this rule should not be applied to real estate brokers. Imposing a duty to inspect on real estate brokers would change the real estate broker’s current role as a facilitator of a transaction to that of an independent inspector for the purchaser. On the other hand, “[r]equiring purchasers to arrange for their own inspections minimizes any confusion over loyalty, communication of the results, or the scope of the particular inspection.”\(^\text{324}\)

CONCLUSION

Kentucky courts have historically been hesitant to impose liability on real estate brokers outside of fiduciary relationships. Although courts over the past fifty years have been far more willing to impose liability when the real estate broker has conducted his or her business in a fraudulent manner, this growth has been slow and has partially expanded as result of legislative action. Despite this moderate expansion, there is no indication that Kentucky courts will depart from their long held positions that primarily place responsibility on purchasers to protect themselves from economic injury absent fraudulent disclosure or fraudulent concealment. Therefore, it is unlikely that courts will impose a duty to inspect on real estate brokers or allow claims to be brought under the tort of negligent misrepresentation in the near future.

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321. Id. (the duty to inspect the property listed for sale and to disclose material defects that the broker should have discovered in such an inspection).
322. Id. (“[M]ost jurisdictions do not impose a duty to inspect.”).
323. Smith v. Fid. & Columbia Trust Co., 12 S.W.2d 276, 277 (Ky. 1928).
324. See Dallon, supra note 1, at 444-45.