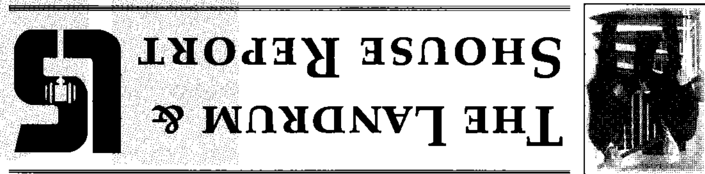
Kentucky Worker's Compensation Act, Continued from Page 2

One very important consideration may explain the differences in the Sherman & Fletcher and Cain holdings, and that is the nature of the party seeking to be a contractor. As noted above, a building general contractor by nature does not have "employees" who perform specialized building projects, and may actually not have any employees at all. The Cain facts, though, revolved mainly around factory owners seeking contractor status. The factories had maintenance staffs which performed routine repairs on equipment, and the Plaintiff was an employee of a specialty construction company who came into the factories to perform larger demolition or replacement projects. The Court evaluated whether or not the work performed by the Plaintiff was substantially similar to the work performed by the maintenance staff, and whether the factory could be expected to conduct the work performed by the Plaintiff with its own employees. The difference between these two cases is that Cain involved potential contractors with employees who could be compared to the Plaintiff. No such comparison could be made between the general contractor's "employees" and the Plaintiff, who was a rough carpenter. This distinction could explain the seeming disparity between the tests enumerated in the two opinions.

The first interpretation by the Court of Appeals of the Cain decision should provide more clarity to the applicability of up-the-ladder immunity. As this defense evolves and receives more attention from the Courts, it will become increasingly certain and defined and its real benefits to employers and contractors can be more fully evaluated.



THE LANDRUM & SHOUSE REPORT

The Landrum & Shouse Report is a quarterly publication and contains news and general information about the firm. It is not meant to be viewed as a legal research tool or as legal advice.

Landrum & Shouse, LLP, is dedicated to serving the needs of its clients. Our professional and support staff have extensive litigation experience and are able to prepare and execute top quality trial presentations in any forum in the Commonwealth of Kentucky. Our computerized systems support productivity in research and include sophisticated communication networks, while the firm's extensive use of modern accounting methods and budgetary controls maintain the most effective approach for our clients. We are well prepared to meet your legal needs. Please give one of our legal professionals a call for an introduction to the tradition of Landrum & Shouse.

You can also visit us on the web at www.landrumshouse.com for additional information about our attorneys and the firm.

The Landrum & Shouse Report is edited and compiled by: Tyler G. Smith
tsmith@landrumshouse.com

Assistant Editor: Cheryl Tingle
ctingle@landrumshouse.com

© Copyright 2009, Landrum & Shouse, LLP

LANDRUM & SHOUSE LLP
L A W O F F I C E S
P.O. Box 951
Lexington, KY 40508-0951

ADVERTISEMENT

Presorted Standard
US Postage Paid
Lexington, KY
Permit #44

Return Service Requested

This is an Advertisement

THE LANDRUM & SHOUSE REPORT

Welcome to the Landrum & Shouse Report, a newsletter designed to keep you informed on current events and legal issues. Landrum & Shouse, LLP, traces its history from pre-World War II legal service. For nearly 40 years following military service, the late Weldon Shouse and Charles Landrum, Jr., together with their firms, practiced law throughout Kentucky before merging in 1984 to become what is now known as Landrum & Shouse, LLP. The resulting firm is built upon the well-deserved reputations of its founders as experienced, knowledgeable, and hard working trial lawyers.

Winter 2010

The Economic Loss Rule: A Valuable Defense for Your Arsenal

By: Jessica D. Stewart

Almost every jurisdiction has adopted some form of the economic loss rule. The economic loss rule is a judicially created doctrine that protects the boundary between contract law and tort law. As described by Justice Keller, Kentucky's strongest proponent of the rule, "the crux of the doctrine is not privity but the premise that economic interests are protected, if at all, by contract principles, rather than tort principles." Presnell Construction Managers, Inc. v. EH Construction, LLC, 134 S.W.3d 575, 583 (Ky. 2004)(Keller, J. concurring) (internal citation omitted).

In its broadest form, the economic loss rule prevents recovery in tort when a product or service is defective, but causes no personal injury or property damage. The court in East River S.S. Corp. v. Transamerica Delaval, Inc., a leading case in the development of the rule, described its rationale as follows: "When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong. The tort concern with safety is reduced when an injury is only to the product itself." East River, 476 U.S. 858, 871 (1986). In other words, parties to a contract are presumed to have allocated the risk of economic loss. Unless the product injures a person or property other than itself, the parties must suffer the allocation of risk to which they agreed.

As noted by Justice Keller, the Supreme Court of Kentucky and Court of Appeals have applied the economic loss rule's principles without expressly naming the rule. Presnell at 586. In Falcon Coal Co. v. Clark Equipment Co., 802 S.W.2d 947 (Ky.App. 1990), Falcon Coal purchased a front-end loader from Clark Equipment, the manufacturer. The loader was destroyed by a fire caused by a manufacturing defect, and Falcon Coal brought a strict liability claim against Clark. The court denied Falcon Coal's tort claim, citing Section 402A of the Restatement (Second) of Torts, which provides that "[o]ne who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer". The Court held that Section 402A did not permit recovery for harm caused only to the product itself. Falcon Coal at 947. Falcon Coal could therefore only recover for economic loss pursuant to the contractual remedies available.

The Supreme Court addressed the economic loss rule in Real Estate Marketing, Inc. v. Franz, 885 S.W.2d 921 (Ky. 1994). In that case, the second purchasers of the house sued the builder for structural defects in the home, seeking only the diminution in the house's value. The Court denied the purchasers' negligent construction claims, holding that "tort recovery is contingent upon damage from a destructive occurrence as contrasted with economic loss related solely to diminution in value, even though, as to property damage, both may be measured by the cost of repair." Id. at 926. The Court of Appeals clarified that the economic loss rule will not

This is an Advertisement

continued on page 3

Kentucky Worker's Compensation Act

Elizabeth J. Winchell

The Kentucky Worker's Compensation Act ("the Act") is designed to strike a balance which favors both employees and employers in the case of a workplace injury. Injured employees forego their right to a common law trial for unlimited damages and opt for the exclusive remedies provided under the Act, and employers give up common law defenses such as contributory fault. In return, the injured employee is not required to prove fault on the part of the employer, and the employer is not exposed to all damages available to a Plaintiff through litigation. The result is a system intended to protect and benefit both employee and employer.

One protection afforded by the Act is statutory up-the-ladder immunity, which is easy to overlook because of the lack of a traditional employer-employee relationship between the parties. An up-the-ladder immunity situation is created when a party who qualifies as a "contractor" under KRS 342.610(2) hires a subcontractor. Contractor under this section is defined as "[a] person who contracts with another... [t]o have work performed of a kind which is a regular or recurrent part of the work of the trade, business occupation, or profession of such person..." The subcontractor is, naturally, the person who performs such work. In such a situation, the subcontractor and its employees become the statutory employee of the contractor, and the contractor is required to provide worker's compensation benefits for the subcontractor and its employees.

This relationship forms the basis for the defense of up-the-ladder immunity. If a contractor hires a subcontractor, and the subcontractor provides worker's compensation benefits to its employees, the contractor is protected by the exclusive remedy doctrine stated above in the same way as the subcontractor. This creates an incentive for a contractor to hire a responsible subcontractor who offers worker's compensation benefits.

Sounds simple, right? Of course it isn't.

A number of issues arise when determining who classifies as a "contractor" and what kind of work is "regular and recurrent". There is substantial case law on what parties actually qualify as "contractors" under the Act. The 1986 case of Fireman's Fund Ins. Co. v. Sherman & Fletcher, 705 S.W.2d 459 (Ky. 1986) has provided the standard for more than 20 years, and defines a contractor as "a person who engages another to perform a part of the work which is a recurrent part of his business, trade or occupation…Even though he may never perform that particular job with his own employees, he is still a contractor if the job is one that is usually a regular or recurrent part of his trade or occupation." *Id.* at p. 462. This provided protection for one of the most common contractor-subcontractor relationship, which exists in construction where a general contractor is responsible for hiring plumbers, carpenters, electricians, and other specialty subcontractors to perform the actual building of a house. That protection could be in jeopardy, though, based upon the Kentucky Supreme Court's 2007 decision in General Electric Co. v. Cain, 236 S.W.3d 579 (Ky. 2007).

This recent decision of the Kentucky Supreme Court provides further definition of what constitutes a "regular and recurrent part of the work of the trade, business, occupation, or profession" so as to render a party a contractor. According to General Electric Co. v. Cain, regular or recurrent work is "work that is customary, usual, or normal to the particular business…or work that the business repeats with some degree of regularity, and it is of a kind that the business or similar businesses would normally perform or be expected to perform with employees." Id. at 588. Factors to be considered in this test include the nature, size and scope of the project, and whether the potential contractor has the skilled manpower and tools or equipment to handle the job that was given to the subcontractor. Under this test, a building general contractor would not qualify for protection, because a building general contractor does not normally perform electrical work, plumbing, etc. with its own employees. Whether this decision will be interpreted so strictly as to exclude this category of "contractors" remains to be seen.

The newer, more limiting factors have not yet been tested in the Court of Appeals. There is the potential for a near nullification of this protection if the Court requires the work performed by the subcontractor to be identical to the work performed by the contractor. There is also the possibility that the Sherman & Fletcher test could remain relatively unchanged by the newer ruling if the Court of Appeals applies a broad interpretation of the Cain language. The Cain decision was reached by reviewing a number of prior Kentucky opinions on up-the-ladder immunity and the justification for the rulings in those cases. The Cain court used those prior cases, including Sherman & Fletcher, as precedent for its holding. Thus, a strong argument exists that the Cain decision does not affect prior decisions, but rather attempts to enumerate the standards created in prior cases.

One very important consideration may explain the differences in the Sherman & Fletcher and Cain holdings, and that is the nature of the party seeking to be a contractor. As noted above, a building general contractor by nature does not have "employees" who perform specialized building projects, and may actually not have any employees

continued on page 4

This is an Advertisement

The Kentucky Whistleblower Act Further Defined

Chris J. Gadansky

In the recent "To Be Published" decision of Thornton v. Office of the Fayette County Attorney, 2009 WL 2475329 (Ky. App. 2009), the Kentucky Court of Appeals has provided further clarification of Kentucky's Whistleblower Act (KRS § 61.101, et seq.). This ruling is important since the Court of Appeals has now provided some guidance - favorable to the public employer – for a commonly alleged employment statute that traditionally bears little published authority.

In order to prevail in a whistleblower action and survive summary judgment, a plaintiff must satisfy four elements: (1) that the defendant is an "employer" under the Act, (2) that the plaintiff is an "employee" under the Act, (3) that the employee made or attempted to make a good faith report or disclosure of a suspected violation of state or local law to an appropriate body or authority, and (4) that the employer took action or threatened to take action to discourage the employee from making such a disclosure or to punish the employee for making such a disclosure. In addition to establishing these four elements, the employee bears an additional burden of proving, by a preponderance of the evidence, that the disclosure was a contributing factor in the personnel action.

Unfortunately, Kentucky case law interpreting these elements has been sparse. There is only a handful of decisions setting out the elements, and of those, little guidance on what exactly constitutes a "good faith report." Counsel faced with briefing the matter on summary judgment are left to juggle with only the statutory language at their disposal, asking the circuit courts to interpret these prima facie elements based on the undisputed facts of the case with little citation to relevant or on-point authority. The circuit courts have provided mixed results at best. Thornton now provides guidance on two of the essential elements.

In Thornton, summary judgment was affirmed to the Office of the Fayette County Attorney on a former employee's whistleblower claim following her termination. The Court held that while the employee could satisfy the first two elements, she failed to establish she made a "good faith" report as envisioned under the Act, or that her disclosure was a "contributing factor" in her termination. Specifically, the Court held that a good faith report, at a minimum, must be based on "a reasonable belief of accuracy." In Thornton, the employee's report was based on hearsay. The Court held while hearsay alone does not necessarily mean a report was not made in good faith, with no attempt to corroborate or discover firsthand knowledge or information about the employer's suspected misconduct, plaintiff's report was not made in "good faith."

The Court also provided guidance on the fourth element, stating that the plaintiff failed to provide any evidence her employer had any knowledge she had reported the alleged misconduct to public officials, which was then the "contributing factor" in her termination. In other words, the employee was required to provide specific and direct evidence calling into question her employer's motive for the termination, not circumstantial speculation or innuendo based on secondhand knowledge.

Assuming the Kentucky Supreme Court does not accept discretionary review and overturn this matter, the Thornton decision finally provides guidance on two of the least interpreted elements of the whistleblower claim. Particularly from a public employer perspective, this clarification is significant for the briefing and general defense of such claims.

The Economic Loss Rule, Continued from Page1

In his Presnell concurring opinion, Justice Keller proposed that Kentucky adopt the economic loss rule to establish a boundary between contract law and tort law. Presnell at 589. Five years later, in Industrial Risk Insurers v. Giddings & Lewis, Inc., 2009 WL 1884386 (Ky.App. 2009), the Court of Appeals agreed. In that case, Ingersoll-Rand Co. purchased equipment from Giddings & Lewis. The machines failed, and Ingersoll-Rand's insurance carrier brought claims of negligent design, negligent failure to warn of a defect, breach of contract and breach of warranty. The Court precluded recovery for the claims arising out of negligence and breach of warranty, holding that these claims were contractual in nature and the economic loss rule applied in Kentucky. Furthermore, the rule applies regardless of whether the product failed by small increments or suddenly. However, the Court recognized limitations as well. Noting that the claims arising out of negligent misrepresentation and fraud arise out of common law tort theories, the Court allowed these claims to proceed and held that they did not fall within the economic loss rule.

Kentucky's express adoption of the economic loss rule has significant implications for products liability and construction litigation. In those cases where the Plaintiff alleges damages solely for a defective product (without damage to other property or personal injury), the rule may entirely prohibit recovery in tort. Of course, application of the rule is still evolving, and the Courts will likely provide continuing instruction as to its reach and limitations. In the meantime, the rule is certainly worth considering as a defense in any case where contractual provisions may define the available remedies.

This is an Advertisement