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NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-000067-MR

JOHN MULLINS — APPELLANT

v.

APPEAL FROM KENTON CIRCUIT COURT
HONORABLE MARTIN J. SHEEHAN, JUDGE
ACTION NO. 03-CI-02372

NORTHERN KENTUCKY INSPECTIONS, INC. — APPELLEE

OPINION
REVERSING AND REMANDING

** ** ** ** **

BEFORE: LAMBERT AND THOMPSON, JUDGES; HENRY,[1] SENIOR JUDGE.

THOMPSON, JUDGE: This case concerns an action for the negligent inspection of a residence. As a matter of first impression in this Commonwealth, we hold that a contract clause limiting the damages recoverable from a home inspector for negligent inspection is not part of an arm's-length agreement and is void as against public policy.

[1] Senior Judge Michael L. Henry sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

The facts are undisputed. John Mullins entered into a purchase contract on a residence and subsequently contracted with Northern Kentucky Inspections (NKI) to perform a home inspection on the residence for a $200 fee. Included in the agreement was that NKI would inspect the home's structural condition, including the basement for any defects. Also included in the contract was a clause that limited the amount of damages in any action initiated as a result of NKI's negligent performance of the contract to the cost of the inspection.

Mullins accompanied the inspector during the inspection and, at that time, questioned the inspector regarding a crack in the basement wall. He was told that it was inconsequential. After NKI issued its final report in which it concluded that there were no structural defects, Mullins purchased the residence. Soon thereafter, significant water accumulated in the basement and, as a result, Mullins was required to pay $7,400 to repair the residence.

Mullins initiated this litigation seeking to recover the entire amount paid for repairs. Following a bench trial, the trial court found that NKI's conduct was not willful or wanton and that the limitation of damages clause was enforceable as it was not against public policy.

The parties agree with the trial court's finding that NKI's conduct was not willful or wanton. The sole issue presented is whether the limitation of damages clause is void as against public policy. Because there are no factual issues in dispute, our standard of review is *de novo* review. *Speedway Superamerica, LLC v. Erin*, 250 S.W.3d 339 (Ky.App. 2008).

We preface our discussion with the proper characterization of the contract clause. The $200 potential recovery is nothing more than a refund of the fee charged and is *de minimus* when compared to the damage Mullins incurred as a result of NKI's negligence. Because the clause effectively immunizes NKI from its own negligence, the limitation clause is tantamount to an exculpation clause and its enforceability is based on the same public policy considerations applicable to exculpation clauses. *See Speedway Superamerica,* 250 S.W.3d at 341(holding that an indemnification provision used to defend a party's own negligence was effectively a pre-injury release and would be analyzed as an exculpatory clause).

Generally, the doctrine of freedom to contract prevails and, in the absence of ambiguity, a written instrument will be enforced strictly according to its terms. *Frear v. P.T.A. Industries, Inc*., 103 S.W.3d 99, 106 (Ky. 2003). The law was aptly recited in *Jones v. Hanna*, 814 S.W.2d 287, 289 (Ky.App. 1991):

> [C]ontracts voluntarily made between competent persons are not to be set aside lightly. As the right of private contract is no small part of the liberty of the citizen, the usual and most important function of courts is to enforce and maintain contracts rather than to enable parties to escape their obligations on the pretext of public policy or illegality. If the legality of the contract can be sustained in whole or in part under any reasonable interpretation of its provisions, courts should not hesitate to decree enforcement.

Id. at 289.

Despite the adherence to the right of the parties to voluntarily agree to the terms of a contract, exculpatory clauses have been subject to scrutiny by our

courts. If a party has contracted away any legal right to be compensated for personal or economic loss caused by the other party's negligence, we will not enforce the provision if to do so would violate public policy. *Cobb v. Gulf Refining Co*., 284 Ky. 523, 145 S.W.2d 96, 99 (1940).

Recognized for over a century as an exception to the freedom of contract doctrine, the concept of public policy emerged in the context of contract law and the enforcement of exculpatory clauses in *Greenwich Insurance Co. v. Louisville & N. R. Co*., 112 Ky. 598, 66 S.W. 411 (1902). The question there was whether the railroad could contract away its liability for its own negligence toward a brewing company which leased land located in the railroad's right-of-way. The Court upheld the exculpatory clause on the basis that the contract was entered into by parties dealing at arm's-length and there was no necessity for either party to enter into the contract. *Id*. at 412-413. However, the Court added the caveat that the railroad could not contract away wanton or willful negligence and, significant to our present case, could not contract away its negligence against passengers or freight shipping customers as a matter of public policy because they did not have equal bargaining power. *Id*.

Since *Greenwich Insurance Co*. and its holding that exculpatory clauses in violation of public policy will not be enforced, Kentucky courts have had numerous occasions to address the enforceability of exculpatory clauses on public policy grounds. Although the vast majority of cases that have invalidated exculpatory clauses involved personal injuries, the same policy considerations are

applicable to those involving only property or economic damages. *See Cumberland Valley Contractors, Inc. v. Bell County Coal Corp.*, 238 S.W.3d 644 (Ky. 2007). However, the criterion to be applied when determining whether to invalidate an exculpatory clause has been problematic.

This Court commented in *Jones*, 814 S.W.2d 287, that the law on the subject was in disarray. The most recent pronouncements from our Supreme Court on the subject of exculpatory clauses were made in *Hargis v. Baize*, 168 S.W.3d 36 (Ky. 2005), and *Cumberland County Contractors, Inc.*, 238 S.W.3d 644.

Hargis involved an attempt to contract away damages caused by the violation of a safety statute enacted to protect the injured party. Relying on the expressed intent of the General Assembly, the Court invalidated the exculpatory clause on public policy grounds. However, notably absent from the Court's analysis was any consideration of the bargaining power of the parties to the contract, an omission that could reasonably be interpreted to invalidate any exculpatory clause purporting to contract away a party's duty under a safety statute.

Two years after *Hargis*, the Supreme Court rendered its opinion in *Cumberland County Contractors* and clarified its opinion in *Hargis*. In an attempt to harmonize *Hargis* with the principles of contract law espoused in *Greenwich,* the Court emphasized the bargaining power of the parties. Despite that the parties were equally mandated to comply with mine safety statutes, the Court upheld an exculpatory clause which allocated the risk of loss to one party. *Id*. at 652. Two

factors were pivotal to its decision: The agreement was an arm's-length transaction between two business corporations with equal bargaining power and the exculpatory clause only shifted liability from one party to the other. *Id*. at 654.

This Court again had the opportunity to address the validity of an exculpatory clause in *Speedway Superamerica, LLC*, 250 S.W.3d 339, and did so with the guidance of the Supreme Court's decision in *Cumberland Valley Contractors Inc.*, and its emphasis on the relative bargaining power of the parties. The relative bargaining power of the parties was the key factor when determining whether to enforce the exculpatory clause. *Id*. at 341-342. After reviewing the contract, the Court concluded that an indemnification provision between a general contractor and a convenient store owner in which the contractor agreed to defend the owner and hold it harmless against its own negligence could not be enforced in an action by the contractor seeking damages for his personal injuries incurred while working on the store's premises. The determining factors were the clearly inferior bargaining position of the contractor and that the contract was clearly one-sided in favor of the store owner. *Id*. at 342.

We again rely on the Court's directive in *Cumberland Contactor's* when determining the validity of the exculpatory clause presented. We conclude that it was not an arm's-length agreement between parties with equal bargaining power and that public policy prohibits its enforcement.

We cannot ignore that the contract was a contract of adhesion. It was not executed after negotiations between Mullins and NKI, but was on a pre-printed

form prepared by NKI and presented on a take-it-or-leave-it basis. *Conseco Finance Servicing Co. v. Wilder*, 47 S.W.3d 335 (Ky.App. 2001).

Moreover, NKI is engaged in the business of offering its professional opinion regarding the condition of the home it inspects. Mullins is a consumer with no knowledge of matters involving home construction and relied on NKI's expert opinion when he made the decision to purchase the home. Mullins had every reason to believe that NKI would perform its obligations under the contract with diligence. Indeed, as a result of the clause, NKI had no incentive to act diligently in its inspection and Mullins had nothing to gain by hiring NKI if it did not diligently perform its inspection. To the contrary, Mullins faced expensive repair costs if a substantial defect was overlooked.

The possible economic damage to Mullins, if NKI negligently performed its duties, is correlated to the magnitude of the investment in a residence. The significance of the purchase of a residence is, for the average citizen, the largest investment and, sometimes, the only financial investment of his lifetime. Thus, the purchaser must take the precautionary steps to properly assess that the price of the residence reflects its actual value, an assessment that necessarily depends on the structural soundness of the residence. Additionally, not only is a competently completed home inspection crucial to negotiating the price for the residence, but the financer of the purchase normally requires a home inspection. Thus, not only does the purchaser rely on the opinion of the home inspector, but so does the financial institution that finances the purchase.

Despite the potentially adverse economic and safety consequences of negligently performed home inspections, the General Assembly did not take express action on the subject until 2004. At that time, KRS 198B.712 was enacted and now provides that home inspectors be licensed and carry a policy of general liability insurance in the amount of $250,000. Additionally, the General Assembly enacted KRS 411.270-411.282 to provide a statutory scheme for actions filed against home inspectors for deficient home inspections. However, NKI argues that because no statute pertained to home inspections of pre-owned residences before the contract was executed or when this action was commenced, any public policy argument is foreclosed. We are not persuaded.

Long ago it was recognized that "public policy" is a phrase often used but seldom defined. *See Bankers Bond Co. v. Buckingham*, 265 Ky. 712, 97 S.W.2d 596 (1936). However, the relevant inquiry into whether a contract violates public policy has been stated as follows:

> The test is whether the parties have stipulated for something inhibited by the law or inimical to, or inconsistent with, the public welfare. An agreement is against public policy if it is injurious to the interests of the public, contravenes some established interest of society, violates some public statute, is against good morals, tends to interfere with the public welfare or safety, or, as it is sometimes put, if it is at war with the interests of society and is in conflict with the morals of the time.

Hanks v. McDanell, 307 Ky. 243, 246-247, 210 S.W.2d 784, 86 (Ky.1948)(internal

quotations omitted). Based on the accepted definition of the term "public policy," specific legislation is a source from which public policy can be discerned, but it is not the exclusive source. It would be a hollow rule of law if we refused to recognize a public policy based merely on the effective date of a statute.

Borrowing from the reasoning of the Tennessee Supreme Court, as applied in the context of an exculpatory clause in a home inspection contract, the following criteria are relevant: (1) whether the inspector held himself out as willing to perform the service for the public; (2) whether as a result of the contract, the inspector subjected the plaintiff to the risk of loss caused by the inspector's carelessness; and (3) whether the business of home inspection is suitable for regulation and is of great significance to members of the public because it is considered a necessity to its personal or financial health. *Russell v. Bray*, 116 S.W. 3d 1 (Tenn. 2003).[2]

NKI is in the business of home inspections and represents to the public that it has the expertise and knowledge to conduct home inspections. Based on its representations, customers employ its services with the reasonable expectation that it will perform its services and render a professional opinion with diligence.

As to the second criteria, we have previously discussed the serious impact a negligently conducted inspection can have on a homeowner. We reiterate that a purchaser relies on the home inspection to make what is most often the most

[2] Consistent with Kentucky law, the Tennessee Court also considered the relative bargaining power of the parties.

important investment of his lifetime. A negligently performed inspection can have devastating consequences to the homeowner's financial health and, in some instances, physical health.

Finally, we have no doubt that home inspections are a subject suitable to regulation. With the enactment of KRS 918.712 and KRS 411.270-411.782, the General Assembly merely codified the existing public policy that home inspections are a crucial service provided to the public.

We join New Jersey and Tennessee which have held that exculpatory clauses in home inspection contracts entered into in anticipation of a residential purchase are invalid. *Lucier v. Williams*, 366 N.J.Super. 485, 841 A.2d. 907 (2004); *Russell*, 116 S.W.3d 1. In summary, the exculpatory clause in the home inspection contract entered into between NKI and Mullins is unenforceable because it is not an arm's-length agreement and violates Kentucky's public policy that home inspectors be accountable for their negligence in the performance of their duty to inspect the premises and render an opinion as to the structural soundness of the residence.

The judgment of the trial court is reversed and the case remanded for further proceedings consistent with this opinion.

LAMBERT, JUDGE, CONCURS.

HENRY, SENIOR JUDGE, DISSENTS AND FILES SEPARATE OPINION.

HENRY, SENIOR JUDGE, DISSENTING. I respectfully dissent. I read *Cumberland Valley Contractors, Inc. v. Bell County Coal Corp.*, 238 S.W.3d 644 (Ky. 2007), the most recent authority from our Supreme Court on the legal issue we are asked to decide in this case, to say that an exculpatory clause or a damages-limitation clause in a case such as this must be upheld due to the parties' freedom to contract. *See id.* at 654.

I acknowledge that this case presents a close question. Perhaps I am giving *Cumberland Valley Contractors* too restrictive a reading, but I am not persuaded that this case presents the degree of disparity in bargaining power between the parties that requires intervention by the courts. I would affirm the trial court and leave it to the Supreme Court to decide whether such intervention is required.

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