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NOT TO BE PUBLISHED

Commonwealth of Kentucky
Court of Appeals

NO. 2014-CA-000835-MR

WILLIAM MARK SMITH
AND MARSHA SMITH

APPELLANTS

v.

APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE BRIAN C. EDWARDS, JUDGE
ACTION NO. 08-CI-010022

JAMES ARNETT AND
LESLYE ARNETT

APPELLEES

OPINION
AFFIRMING IN PART, REVERSING IN PART
AND REMANDING

** ** * ** * ** *

BEFORE: DIXON, TAYLOR AND THOMPSON, JUDGES.

DIXON, JUDGE: Appellants, Mark and Marsha Smith, appeal from an order of the Jefferson Circuit Court granting summary judgment in favor of Appellees, Jim and Leslye Arnett. For the reasons set forth herein, we affirm in part and reverse

in part the trial court's judgment, and remand for further proceedings in accordance with this opinion.

In May 2007, the Smiths and the Arnetts entered into a contract wherein the Arnetts agreed to purchase the Smiths' investment property for \$325,000. The contract was "contingent upon completion of addition and renovation according to the plans and subject to a final home inspection," as well as the Smiths conveying "unencumbered, marketable title." At the time the contract was signed, the Arnetts paid the Smiths a deposit of \$2,500. Significantly, the Smiths obtained both the purchase and construction loans in their name through PNC Bank. In September 2007, the Arnetts paid an additional \$10,000 for bricks used in the renovation of the property. At the same time, the Smiths and Arnetts entered into an addendum to the contract adjusting the sales price to \$329,600, and recognizing the \$10,000 as an additional down payment.

A home inspection was performed as scheduled on June 8, 2008. The inspection report noted that the dishwasher, hot water heater, HVAC system and basement electrical were not inspected because the installation of the items was not complete at the time of inspection. Additionally, the report indicated that there was no power to the basement electrical circuits or the sump pump and that joist hangers and a handrail to the basement stairs were missing. Of the 173 items inspected, 6 items were marked "marginal" (defined in the report as "[i]tem is not fully functional and requires repair or servicing"); 9 items were marked "Not Present" (including kitchen appliances, basement insulation, and central air unit);

and 4 items were marked “Not Inspected” (defined in the inspection report as “[i]tem was unable to be inspected for safety reasons or due to lack of power, inaccessible, or disconnected at time of inspection.”).

Prior to completion of the construction, the Smiths defaulted on the loans and, on September 24, 2008, PNC filed the instant action in the Jefferson Circuit Court to foreclose on the property. The Arnetts filed an answer and counterclaim against PNC asserting a \$12,500 lien on the property, as well as filed a cross-claim against the Smiths on the grounds that they failed to deliver clear and unencumbered title. The Smiths, in turn, filed a cross-claim against the Arnetts seeking specific performance/enforcement of the purchase contract. By order entered on September 3, 2009, the trial court upheld the priority of the Arnetts’ lien in the amount of \$12,500, but ordered the money be paid into court pending resolution of the claims between the Smiths and the Arnetts. The Smiths were also granted leave to amend their cross-claim against the Arnetts to assert breach of contract on the grounds that the Smiths substantially performed under the terms of the contract.

In September 2011, the Arnetts filed a motion to release the \$12,500 and/or grant summary judgment in their favor. Therein, they argued that the Smiths could not prevail on their breach of contract claim because the plain language of the contract made the Arnetts’ purchase of the property contingent upon completion of the renovation and a final home inspection. The Arnetts contended that, in asserting that the home was substantially completed thus satisfying the contingent

upon completion requirement of the contract, the Smiths ignored the fact that the home failed the third-party inspection. Furthermore, the Arnetts argued that the Smiths were unable to provide clear title to the home due to several mechanics' liens that had been asserted against the property for unpaid construction work.

Subsequently, in November 2011, the Smiths filed a response to the Arnetts' motion as well as their own motion for summary judgment. Therein, they essentially argued that the project was substantially complete and that the Arnetts refused to close solely because they were seeking a divorce and no longer wished to purchase the property. Contrary to the Arnetts' interpretation of the home inspection, the Smiths maintained that the items that were incomplete at the time of the home inspection were minor "punch list" items that would be completed before the Arnetts moved into the home. By separate motion, the Smiths also sought to amend their cross-claim to include a claim for fraud in the inducement on the grounds that had they been aware of the Arnetts' marital difficulties they would not have entered into the contract.

By order entered September 27, 2013, the trial court granted the Arnetts' motion to release funds as well as granted summary judgment in their favor.

Therein, the trial court noted:

According to the substantial performance doctrine, upon substantial performance, a builder, or in this case, property owner, is entitled to recovery of the contract price even though the work may have been defective or incomplete. *Meador v. Robinson*, Ky., 263 S.W.2d 118 (1953). Here, the Court finds that because, at the very least, the construction of the addition (the garage

contemplated in the original Contract had not even begun at the time of the initiation of the current litigation, the Smith's performance of the contract was not substantially complete.

The trial court further ruled that the Smiths' fraud in the inducement claim was meritless, noting that "the Contract was not contingent upon the Arnetts securing financing, so the Smiths' unsubstantiated argument that the Arnetts would not have been able to obtain financing if their marital status had been revealed is immaterial to the performance of the contract."

The Smiths subsequently filed a Kentucky Rules of Civil Procedure (CR) 59 motion to reconsider arguing, in part, that the trial court incorrectly based its finding that the contract was not substantially completed on the erroneous belief the parties' contract required the construction of a garage. The Smiths explained that although the parties did originally contemplate a garage, the plans for such were ultimately denied by the Louisville Metro Board of Zoning Adjustment. Thereafter, the contract price was modified for an unrelated purpose demonstrating that the parties both understood a garage was not included in the final contract. In denying the Smiths' CR 59 motion, the trial court ruled:

The argument put forth by the Smiths, at best, indicates a possible factual dispute among the parties; however, it falls short of proving a manifest error of fact on behalf of the Court. Moreover, the Smiths have misinterpreted the importance of this issue with respect to the Court's holding. . . . [T]he construction of the garage was but one of many factors considered by the Court in holding that the contract was not substantially complete. . . . Thus, assuming *arguendo* that the garage was not a component of the parties' agreement, the outcome of this

case would be the same. Simply put, the Court has found that a residential home is not substantially complete where, among other issues, the dishwasher, hot water heater, air conditioning unit, and basement electrical system are in such a state as to be rendered unfit for inspection.

The Smiths thereafter appealed to this Court.

Our standard of review on appeal of a summary judgment is “whether the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law.” *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky. App. 1996). Summary judgment shall be granted “if the pleadings, depositions, answers to interrogatories, stipulations, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law.” CR 56.03. The trial court must view the record “in a light most favorable to the party opposing the motion for summary judgment and all doubts are to be resolved in his favor.” *Steelvest v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 480 (Ky. 1991). Summary judgment is proper only “where the movant shows that the adverse party could not prevail under any circumstances.” *Id.*

On appeal, the Smiths first argue that a material issue of fact existed as to whether the contract was substantially completed, which should have precluded summary judgment in favor of the Arnetts, but that the trial court erroneously weighed the evidence in deciding the issue against them. The Smiths claim that

under the substantial performance doctrine they would have been entitled to recovery even if the construction work was defective or incomplete so long as the performance was substantial. The Smiths contend that the doctrine was intended to prevent exactly what occurred herein – a buyer walking away from a significant undertaking when construction is largely complete. The Smiths point out that nowhere in the home inspection report was there any statement that the construction was defective or not substantially completed. Thus, in relying on the inspection report, the trial court necessarily had to evaluate its contents and weigh the importance of those items that were listed as incomplete, which constituted impermissible fact-finding under the summary judgment standard. We must agree.

As previously noted, according to the substantial performance doctrine, upon substantial performance, a builder, or in this case, property owner, is entitled to recovery of the contract price even though the work may have been defective or incomplete. *Meador*, 263 S.W.2d at 118. Significantly,

Imperfections in matters of detail or comparatively minor items, which do not constitute a deviation from the general plan contemplated for the work, do not enter into the substance of the contract. While such omissions may be compensated in damages, they do not prevent the performance from being regarded as substantial performance. To come under the doctrine of substantial performance, the project's defects must not be so serious as to deprive the property of its value for its intended use or to so pervade the whole work that the deduction of damages will not be fair compensation. The doctrine of substantial performance thus does not apply when the defect cannot be corrected without partially reconstructing the building or when the defect is not easily remedied.

13 Am. Jur. 2d *Building, Etc. Contracts* § 48 (2d ed 2015).

We agree with the Smiths that “substantial performance” by its very definition, contains a subjective element. “No mathematical rule relating to the percentage of the price, of the cost of completion, or of completeness can be laid down to determine substantial performance of a building contract.” 5 *Bruner & O'Connor Construction Law* § 18:12 (2015). Impairment of aesthetics obviously is subjective, while defects impairing structural stability of safety could more easily be deemed a material breach precluding substantial performance. *Id.* Furthermore,

Whether the defendant exercised the required degree of skill in the performance of a construction contract is to be decided like any other question of fact by the jury. Where there is any doubt from the evidence introduced whether a building contract has been substantially performed by the contractor, the question is one of fact to be determined by the trier of fact. However, where the omissions or defects are clearly substantial and material or if it clearly appears that they were intentional and deliberate, the conclusion is required as a matter of law that the contract was not substantially performed.

Id. at § 128.

Clearly, the parties dispute whether the incomplete items under the home inspection amounted to a mere “punch list” to be finished before the Arnetts moved into the home or involved a more material breach precluding substantial performance. Of the 173 items listed in the home inspection report, 153 were marked “functional,” the highest rating obtainable. Of the remaining items, Mark Smith testified via affidavit that all could be cured at a total cost of \$1,000 or less.

Interestingly, in the second opinion resolving the Smiths' CR 59 motion, even the trial court observed, "[T]he argument put forth by the Smiths, at best, indicates a possible factual dispute among the parties[.]" Although the trial court cited to other deficiencies in support of its summary judgment in favor of the Arnetts, we are of the opinion that the decision was based largely on the trial court's belief that the contract required a garage and that such construction had not yet begun. Had that been the case, we would likely agree that the omission was substantial and material thus precluding a finding of substantial performance as a matter of law. However, we are of the opinion that there is a material issue of dispute as to whether the contract was completed and the trial court's statement that "the Court has found that a residential home is not substantially complete where, among other issues, the dishwasher, hot water heater, air conditioning unit, and basement electrical system are in such a state as to be rendered unfit for inspection" was clearly the result of fact-finding which is outside the purview of a summary judgment analysis. Given the disputed evidence of record, the Arnetts failed to demonstrate that the Smiths could not prevail on their breach of contract claim under any circumstances, and thus summary judgment was improper.¹ See *Steelvest* 807 S.W.2d at 480.

¹ The dissenting opinion states that the majority has omitted "key, undisputed facts" including that the building, electrical, and HVAC permits had expired (in August, September, and October of 2007) and that stop work orders had been issued. The record reveals, however, that the stop work orders were issued because the building plan initially provided for an attached garage which required a variance that the parties were unable to obtain. Documents from the Louisville Metro Codes and Regulations Department indicate that new permits were issued (that did not expire until 2008) and that work (and city inspections) did progress after the stop work orders. We believe this is yet another material issue of fact that should have precluded summary judgment.

In their brief, the Arnetts argue that the Smiths did not substantially perform under the contract because they could not have conveyed clear title to the property due to outstanding balances owed to other claimants in the foreclosure action. The record reveals, however, that the trial court previously had ruled that no subcontractor had a valid lien on the property. As the trial court did not discuss this issue in its summary judgment order, we will not do so herein.

The Smiths next argue that the trial court erred in concluding that the absence of a “contingent upon financing” provision in the contract renders the Arnetts’ misrepresentation regarding their marital status immaterial as a matter of law. The Smiths contend that a misrepresentation of marital status is tantamount to a misrepresentation of financial status and, but for the Arnetts’ misrepresentation, the Smiths would not have entered into the contract with them. We disagree.

To prevail on a claim of fraud, a party must establish by clear and convincing evidence six elements: (1) a material misrepresentation; (2) that was false; (3) that the declarant knew to be false or that was made recklessly; (4) made with inducement to be acted upon; (5) that was reasonably relied upon; and (6) that caused injury. *United Parcel Service Co. v. Rickert*, 996 S.W.2d 464, 468 (Ky. 1999); *Radioshack Corp. v. ComSmart, Inc.*, 222 S.W.3d 256 (Ky. App. 2007). Other than their unsubstantiated claims that they would not have entered into the contract had they known the Arnetts were separated, the Smiths produced no evidence that the Arnetts knowingly misrepresented their marital status and that such was a material fact. There is absolutely nothing in the record to support the

Smiths' contention that the Arnetts' marital status affected their ability to obtain financing. Furthermore, as the contract was not contingent upon financing, we must agree with the trial court that the Arnetts' marital status and how or if it would have affected the ability to obtain a loan is of no consequence. As such, the trial court properly granted summary judgment in favor of the Arnetts on this issue.

For the reasons set forth herein, the order of the Jefferson Circuit Court is reversed in part, and this matter is remanded for further proceedings consistent with this opinion.

TAYLOR, JUDGE, CONCURS.

THOMPSON, JUDGE, DISSENTS AND FILES SEPARATE OPINION.

THOMPSON, JUDGE, DISSENTING: Respectfully, I dissent. I would affirm the circuit court's grant of summary judgment because there was sufficient evidence to establish lack of substantial completion as a matter of law without resolving any factual issues.

When recounting the relevant facts, the majority opinion has omitted key undisputed facts in support of the Arnetts' motion for summary judgment that justify the circuit court's decision. The Arnetts argued that under the terms of the contract their performance was "contingent upon completion of addition and renovation according to plans and subject to final home inspection." They additionally argued that this contractual provision could not be satisfied by fixing items identified during the inspection on June 8, 2008, because the building, electrical and HVAC permits had expired (in August, September and October of

2007), and stop work orders had been issued prior to the independent inspection. Accordingly, no remedial work could be performed to remedy the deficiencies identified and no further inspections by Louisville Metro could take place.

Without a “pass” on each of the three permits, after all required inspections were performed, the house could not legally be used and would not receive approval for a certificate of occupancy. The evidence that was lacking is also important. There was no proof the Smiths sought new permits after they expired, new permits were issued or the stop work orders were revoked. There was no evidence that the house was ever approved for final occupancy.

Instead, the undisputed evidence is that the Smiths stopped all work on the house prior to the inspection, failed to make any progress towards completion after the inspection, stopped paying the mortgage financing for the purchase of the home and construction, and defaulted on the loans. On September 24, 2008, PNC filed its foreclosure action against the Smiths. No further work was ever performed on the house to ready it for occupation until January of 2009, when Mr. Smith installed kitchen appliances before moving into the house himself.

The majority opinion determines there was a factual issue as to whether the house was substantially complete, stating the circuit court in relying upon the inspection report “necessarily had to evaluate its contents and weigh the importance of those items that were listed as incomplete, which constituted impermissible fact-finding under the summary judgment standard.” The majority cites Mr. Smith’s affidavit as supporting the presence of a factual issue because it

states that the deficiencies listed in the inspection report could be corrected for under \$1,000. The majority also discredits the circuit court's explanation that other deficiencies (beside the failure to build a garage, which no longer appears to be required by the parties) were important in making its original decision that the house was not substantially complete.

While the circuit court focused on the lack of a garage in its original opinion, in its opinion on the motion to reconsider it clarified as follows:

[T]he Smiths have misinterpreted the importance of this issue with respect to the Court's holding. In pertinent part, the Order states, "Here the Court finds that because, *at the very least*, the construction of the addition (the garage) contemplated in the original Contract had not even begun at the time of the initiation of the current litigation, the Smith's performance of the contract was not substantially complete." See Order at p. 5 (emphasis added). The above language demonstrates that the construction of the garage was but one of many factors considered by the Court in holding that the contract was not substantially complete. Indeed, the supporting analysis within the Order relies primarily on a litany of other factors, such as the results of a home inspection, whereas the issue concerning the garage was discussed very briefly. See Order at p. 3, 4. Thus, assuming *arguendo* that the garage was not a component of the parties' agreement, the outcome of the case would be the same. Simply put, the Court has found that a residential home is not substantially complete where, among other issues, the dishwasher, hot water heater, air conditioning unit, and basement electrical system are in such a state as to be rendered unfit for inspection.

The original opinion on pages three and four focused on the Arnetts' arguments addressing whether the house renovations were substantially complete and included their arguments about the expired permits and the seriousness of the items

left in an incomplete or defective status. The inspection report indicated the house lacked cooking appliances, microwave, ventilator, and air conditioner system and electrical disconnect for that system; the dishwasher and hot water heater were present but could not be inspected because their installation was not complete; there was no power to the basement electrical circuits, sump pump, attic electrical or lights, so these items could not be inspected; the bathroom fan venting was not installed; joist hangers were needed; there was no handrail going to the basement; and the driveway was incomplete. While the circuit court did not enumerate all the completion issues, it is clear it contemplated them by stating it relied “on a litany of other factors” only specifically listing the items rendered unfit for inspection “among other issues[.]” I submit that the circuit court properly considered all of the Arnetts’ contentions regarding lack of substantial completion before granting summary judgment and there was no factual dispute regarding the lack of permits or the additional failures recounted in the inspection report but not specifically listed by the circuit court.

The important question thus becomes, can the problems of the lack of permits and the problems identified on the inspection report result in a legal determination that the home was not substantially complete when tendered for purchase under the terms of the contract? I agree with the majority opinion that 13 *Am. Jur. 2d Building, Etc. Contracts* § 48 (2d ed 2015) properly sets out the standard for substantial performance. Of particular importance in this standard is that “[t]o come under the doctrine of substantial performance, the project’s defects

must not be so serious as to deprive the property of its value for its intended use[.]”

Id. This is the same basic standard used by our sister courts, whether called substantial performance or substantial completion, adopted through case law, statute or given to the interpretation of such terms in contracts. *Colormatch Exteriors, Inc. v. Hickey*, 275 Ga. 249, 254, 569 S.E.2d 495, 499 (2002); *Russo Farms, Inc. v. Vineland Bd. of Educ.*, 144 N.J. 84, 117, 675 A.2d 1077, 1093 (1996); *Rosso v. Hallmark Homes of Minneapolis, Inc.*, 843 N.W.2d 798, 802-03 (Minn.App. 2014); *Morton Bldgs., Inc. v. Redeeming Word of Life Church, Inc.*, 744 So.2d 5, 12 (La.App. 1998); *J.M. Beeson Co. v. Sartori*, 553 So. 2d 180, 182 (Fla.App. 1989); Or.Rev.Stat. § 12.135(4)(b). For property to be appropriate for its intended use, it must be able to be physically used, inhabitable or move-in ready. *Colormatch Exteriors, Inc.*, 275 Ga. at 254, 569 S.E.2d at 499; *Rosso*, 843 N.W.2d at 803. *See Uhler v. Golden Triangle Dev. Corp.*, 763 S.W.2d 512, 514 (Tex.App. 1988) (approving jury instructions which stated in part that “[t]he term, ‘substantial completion,’ contemplates a degree of completeness such that a reasonable person would be willing and able to make their home in the building.”). This can be demonstrated by the owner taking possession of the building or renting space to tenants. *J.M. Beeson Co. v. Sartori*, 553 So. 2d at 182-83; *RAJ Partners, Ltd. v. Darco Const. Corp.*, 217 S.W.3d 638, 644-45 (Tex.App. 2006); *Grant v. Wester*, 679 So. 2d 1301, 1308 (Fla.App. 1996).

This interpretation is similar to that given in the Court’s decision in *Regalbuto v. Grant*, 473 S.W.2d 833, 840 (Ky. 1971), upholding the denial of

summary judgment to the homeowners for a violation of a contractual provision for lack of tender of a completed structure by the date specified. The trial court's denial of summary judgment was appropriate under the undisputed facts that the owners moved in and the only major deficiency was installation of the air conditioner, but the condenser unit could not be installed until the owners provided an appropriate cement pad. There was evidence the lack of air conditioning did not bother the owners during cooler months, and this and other minor defects were remedied after they moved in. *Id.* at 836.

We face the inverse of the situations recounted in *J.M. Beeson Co., RAJ Partners, Ltd., Grant and Regalbuto*; here the construction was not sufficiently complete for occupancy and normal use. I agree with our sister court in *Ocean Ridge Dev. Corp. v. Quality Plastering, Inc.*, 247 So. 2d 72, 75 (Fla.App. 1971), that while normally whether or not there has been substantial performance is a question of fact, under appropriate cases where the evidence is sufficiently clear the issue can be determined as a matter of law. I submit that this is one of those situations and summary judgment was appropriately granted. While the Arnetts may have been able to purchase and occupy the house without a working dishwasher and an incomplete driveway, they certainly needed a present and working hot water heater, cooking appliances and A/C HVAC system; electrical power to basement circuits, sump pump and attic; the installation of joist hangers; and a handrail on the basement staircase. Mr. Smith's action of installing kitchen appliances before he moved in is evidence that a reasonable person would not

move in without them. The lack of electrical power to certain systems suggests these electrical systems may not have been safe. Because of the lack of inspection to the building, electrical system and HVAC, the Arnetts could not know if their house was fit for occupation and use. Furthermore, these deficiencies could not be legally remedied without appropriate, valid permits.

I disagree with the majority's decision to connect the Smiths' failure to satisfy their loan with misconduct on the part of the Arnetts in failing to purchase the property when submitted in an incomplete state without any assurance of imminent completion. I submit that given the state of the house when the inspection was made and lack of any corrections afterwards, the Arnetts were under no obligation to perform until the house was rendered both physically and legally fit for occupation. At this juncture, when the house has already been sold pursuant to court order prior to the hearing on the summary judgment motion, it is now impossible for the Smiths to correct the deficiencies to the home and bring it to a condition obligating the Arnetts' performance. I believe the circuit court acted appropriately by ordering the Arnetts' deposit returned where they were unable to purchase a substantially completed home.

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