

CONSTRUCTION LAW UPDATE

March 2009

WILL THE “BAIL OUT” POSITIVELY IMPACT YOUR FUTURE?

With adequate planning and preparation, you may be able to capture a portion of this initiative.

By Charles F. Behler and Brian M. Pearson, Attorneys

Unless you lived in a bubble for the last two months, you have heard about the spending initiatives flowing out of Washington, D.C. Up until this point, the key question has been, “Where will all the money go?”

The Center for American Progress recently broke down Michigan’s portion of the federal stimulus package. Over \$1 billion of federal money has been earmarked for construction projects in this state, with over \$847 million specifically directed toward infrastructure investment. These figures represent welcome news and opportunity for an industry ready and willing to improve Michigan.

However, with this influx of capital comes new and additional risk. Contracting for construction with the government is a different creature than private construction contracts. Government contracts typically have unique obligations, bidding requirements, and terms. Due to the special aspects of government contracts, it is important for companies seeking government

funds to be well-prepared to face different contracting and claim requirements. Whether the stimulus funds come from the federal or state government, they will impact the nature of construction contracts and claims.

The federal money is on its way to Michigan. Our state is in the process of accepting these funds, identifying viable projects, and creating contracting procedures and criteria. This process is happening quickly, so now is the time to adequately prepare to reap the rewards of contracting with the government by addressing the unique risks and challenges of this process. We will continue to follow this process and keep you advised of further developments.

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RENEWABLE ENERGY: CATCHING THE WIND

By: Anthony J. Quarto, Attorney

In 2007, almost 35% of all new electric generating capacity installed across the United States was wind generated. Michigan is 14th in the ranking of states with the most potential annual wind energy. In an era of increasing energy needs, wind power clearly is a significant part of supplying our energy needs. As T. Boone Pickens, the well-known Texas billionaire oilman and wind energy proponent puts it:

“Wind power is...clean, it’s renewable. It’s everything you want. And it’s a stable supply of energy. It’s unbelievable that we have not done more with wind.” (CNBC interview July 8, 2008).

How It Works

Wind-generated electricity is produced through the use of wind turbines. Wind projects generally fall into two categories: “large wind,” and “small wind.”

“Large wind” development generally consists of multiple wind turbines located on large areas of land. The turbines used are large commercial turbines, whose combined tower and blade height can range up to 400-500 feet. Typically, on “large wind” projects, wind development companies seek to obtain property leases from large land owners, such as farmers, for construction and placement of these commercial wind turbines. These companies often seek to negotiate leases with multiple land owners who have adjoining properties. In return for the use of their land, the land owners receive payments, which may consist of lump sum payments, or royalty payments made on a per-turbine basis. The wind development companies ultimately sell the wind-generated electricity to local utility companies.

Large wind development can also be accomplished through local community ventures. In these ventures, land owners proactively come together, to form a business for the generation and sale of wind-produced energy. These ventures may take several forms: cooperatives, corporations, limited liability companies, or partnerships.

“Small wind” projects generally involve residences and businesses. The wind turbines are much smaller, and are mounted either on short wind towers, or on the roofs of homes or businesses. The turbines are intended to produce a sufficient amount of electricity to cover all of, or a substantial part of, the daily electricity requirements of a home or business. The small wind turbines are also sometimes used as a part of a wind back up-power system for a home or business.

Legal Considerations

Both “large wind” and “small wind” projects require consideration of potential legal issues. For example, in a large wind project, the wind development company and a land owner generally enter into a lease agreement, which is a legal contract addressing the relationship between the parties, and the respective obligations of the parties during the life of the lease. A lease would include such issues as:

- Length of the lease
- Compensation to the land owner
- Liability for damage or injuries to third parties
- Zoning law compliance

“Small wind” projects also involve potential legal issues. These issues may include:

- Compliance with zoning laws and ordinances
- Insurance
- Compliance with property covenants

Renewable energy is blowing into Michigan on the wings of wind turbines. As they seek to catch the wind, participants in both large wind and small wind should ensure that they do not get caught in legal turbulence.

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CONTRACTORS' OBLIGATIONS UNDER THE MICHIGAN BUILDERS TRUST FUND ACT

By Daniel M. Morley, Attorney

The current U.S. and Michigan economies are being compared to those of the Great Depression. Under these circumstances it is easy to understand that a contractor's financing can become stretched and stressed. It is important for contractors, their officers and employees in charge of financial matters, to keep in mind their responsibilities under the Michigan Builders Trust Fund Act in order to avoid both civil and criminal liability. More important, a corporate officer or employee in charge of payments to subcontractors and suppliers may find him or herself facing personal civil and criminal liability for what may otherwise be considered corporate debts. What makes these types of prohibited transfers equally troubling is that they may also be deemed "non-dischargeable" and survive a personal bankruptcy.

The Michigan Building Contract Fund Act, commonly referred to as the Michigan Builders Trust Fund Act ("MBTFA") has been in existence since 1931. The MBTFA was enacted as a Depression-era measure to afford protection to subcontractors and material suppliers supplemental to the construction lien laws. The MBTFA is designed to prevent contractors from juggling funds between unrelated projects. While the MBTFA does not proscribe any particular method for doing so, it mandates that funds for a particular project are to be first used for payment to subcontractors, laborers, and supplies on that particular project. The statute prohibits the "Robbing Peter to pay Paul" concept. In general terms, funds received by the contractor on one project cannot be used by the recipient to pay for expenses related to another project. Section 2 of the MBTFA provides that violation of the Act is a felony punishable by a fine of not less than \$100, or more than \$5,000; and not less than six months, or more than three years imprisonment.

In a nutshell, funds that are paid to a general contractor are to be held in trust for payment to subcontractors and material suppliers who provide labor and material for the general contractor on that particular project. Upon payment by the general

contractor to first tier subcontractors, the funds held by the first tier subcontractors are held in trust for the benefit of its subcontractors, suppliers, and material providers, and so on down the line. The MBTFA applies only to private construction projects, although there have been recent legislative proposals to broaden its application to include public projects as well.

In those cases where a general contractor or subcontractor is organized as a corporation, limited liability company, or a limited partnership, the provisions of the MBTFA may be available to impose personal liability upon those persons who participate in misappropriation of building contract funds. For example, in *Au Bon Pain Corp v Arctec, Inc*, the owner hired a general contractor to construct three bakery shops. Two of the shops were located in Michigan. During the course of construction, the president of the general contractor signed certifications that were required for obtaining progress payments. The certifications stated that all amounts paid pursuant to previous certificates had been distributed to subcontractors, laborers, and material suppliers. However, the owner soon discovered that a number of the subcontractors, laborers, and material suppliers remained unpaid despite the certifications.

The owner filed suit against the president of the general contractor as a co-defendant based on common law fraud and breach of fiduciary duty under the MBTFA. The Second Circuit Court of Appeals held that the president could be held personally liable under the provisions of the MBTFA for failing to use advances to reimburse subcontractors, laborers, and material suppliers. Generally, a director of the "trustee" contractor must know or approve of the misappropriation to be personally liable.

Although the MBTFA's provisions may provide a civil remedy to a myriad of other situations, it is perhaps most beneficial to an owner or unpaid subcontractors, laborers and subcontractors where

the contractor files for bankruptcy protection after receiving funds from the owner. The court interpreting the MBTFA in a bankruptcy context has held that the statute renders the debts to owners and unpaid subcontractors, laborers, and suppliers non-dischargeable. Section 523(a)(4) of the U.S. Bankruptcy Code exempts from discharge certain debts created when a debtor acts in a fiduciary capacity. The Sixth Circuit Court of Appeals has long held debts created by a breach of the fiduciary duty imposed by the MBTFA satisfy the requirements for the non-dischargeability of debts created by a bankrupt's defalcation while acting in a fiduciary capacity. Thus, where a general contractor incurs debts that fall within the purview of the MBTFA, those debts will survive the debtor's bankruptcy.

It is recommended that contractors and subcontractors handle funds paid to them with due care. It is important to remember that construction funds received on a project must first be used to pay the subcontractors, laborers, and material suppliers on that particular project and be able to prove that they did. In these ever-challenging economic times, corporate officers handling such funds should keep in mind their responsibilities under the MBTFA.

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ROAD COMMISSION AUTHORITY TO VACATE ROADS

By Jason R. Thompson, Attorney

A recent victory for the Benzie County Road Commission helps illustrate the authority granted to road commissions in decisions to vacate or relocate county roads.

In the case of *Milarch v Benzie County Road Commission*, the plaintiffs challenged the Road Commission's approval of a proposal to relocate an existing county road (Miller Road). That portion of the road in question ran through property that was used as a campground. Ten to 15 years ago, the owner of the campground had sold former campground lots to individuals as residential lots, and there are now three homes in the midst of the campground. These homes in the campground were accessed by way of Miller Road, which ran between campsites and Turtle Lake. The drive on Miller Road to the plaintiffs' home site was scenic and beautiful. However, there was also evidence that the narrow road presented safety concerns for children at the immediately adjoining campground sites. Citing the safety concerns, the Road Commission approved a proposal by the campground owner to relocate a portion of Miller Road to a new location, away from the lake, allowing the road to be widened to meet Road Commission standards and to no longer run immediately adjacent to campsites.

The plaintiffs appealed the decision of the Road Commission to relocate the road. They also asserted that they had an easement from both the campground owner and the Road Commission.

As to the appeal filed by the plaintiffs, the Road Commission argued that such decisions are legislative functions of the Road Commission, as opposed to administrative or judicial functions, and thus are not subject to judicial review. The governing statute states that County Road Commissions have the ability to absolute abandon or discontinue a public road. There are few reported decisions challenging a Road Commission's decision to abandon jurisdiction a road. Most dealt with property owners who were left without access as a result of the abandonment. No decisions are truly on point concerning property owners left with access to the public road system, even if that access was less scenic or perhaps less convenient.

The Circuit Court Judge found in favor of the Road Commission on appeal, holding that they were granted the discretion to determine which roads should be vacated or abandoned.

The decision may provide some guidance in the future for Road Commissions as to which of their functions may be exercised without the potential for the extra cost of judicial review. Road Commissions are entrusted by Michigan law with responsibility for overseeing public roads. The expertise they gain in the administration of such a system, and their responsibility to the public cannot be replicated by an individual case before a court. A decision in this matter in favor of the Road Commission helps

reaffirm Michigan's commitment to a separation of powers within the government, with authority and jurisdiction over public roads left with the sole discretion of roadway authorities.

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UPDATE ON PROPOSED LEGISLATION TO REDUCE TIME FRAMES FOR FILING LAWSUITS AGAINST ARCHITECTS AND ENGINEERS IN MICHIGAN

By Michael J. Roberts and Benjamin H. Hammond, Attorneys

In 2006, the Michigan Supreme Court ruled that the deadline for filing most claims against architects, engineers, and contractors was six years after the occupancy, use, or acceptance of the improvement. This case marked a significant shift in the law.

Previously, the time period to sue architects, engineers and contractors ("construction professional") and the event that started the running of that time period, depended upon the type of claim plaintiff asserted. For example, claims of malpractice, tort (such as a personal injury suit), and breach of contract were governed by two, three, or six-year limitations periods, respectively after the event giving rise to the claim. If a plaintiff did not file its lawsuit within these time periods, the lawsuit could be dismissed as being "too late."

The statute of repose, a related but different concept, provides that no claim can ever arise after the statutory period has elapsed, no matter when the event giving rise to the claim occurred. Pursuant to the Michigan statute of repose, if more than six years pass before a plaintiff sustains an injury or damage, a plaintiff has no claim against the construction professional. (A narrow exception concerning gross negligence of the construction professional allows a plaintiff to file an action within ten years). The purpose of the statute of repose is to protect construction

professionals from "stale" claims and to eliminate open-ended liability for construction-related defects.

Since the 2006 decision, a plaintiff could bring malpractice and tort actions against architects and engineers up to six years after occupancy, use, or acceptance, instead of two or three years respectively. In 2007, in response, Senator Sanborn introduced Senate Bill 825 which proposed to reestablish the two year statute of limitation period for malpractice claims brought against architects and engineers. The Senate passed the bill in 2008 but the House did not.

On January 27, 2009, Senator Sanborn introduced Senate Bill 35, which is substantially similar to Senate Bill 825.

It appears that this bill would not have any retroactive effect and only apply to claims that accrued after the effective date of the bill. We also note that Senate Bill 35 would only affect malpractice claims and would not affect the statute of limitations for other causes of action, such as tort claims or breach of contract claims.

While the passage of Senate Bill 35 as currently drafted would reduce the time limits for filing malpractice claims against architects and engineers, it would not prohibit plaintiffs from disguising their malpractice claims as torts or

breaches of contract and filing them beyond the two year limitation.

Senate Bill 35 is currently in the Senate Judiciary Committee and we expect it, or a substantially similar version, will become law in the near future. We will report further as this legislation makes its way through the Senate and House.

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CONSTRUCTION LIENS ON PUBLIC PROJECTS?

By Benjamin H. Hammond, Attorney

Michigan Legislature Considers Proposal To Allow Construction Liens On Government Property

On January 29, 2009, five state senators introduced Senate Bill No. 140 which would amend the Michigan Construction Lien Act. The proposed amendment would allow construction liens to be recorded on real property owned or leased by a governmental entity.

It is unclear what impact this proposed amendment would have on bonding requirements. Also, there appears to be significant practical hurdles to this proposed amendment, particularly in the context of

foreclosure of a publicly owned piece of land.

This proposed bill was immediately sent to the committee on Economic Development and Regulatory Reform. It will be interesting to monitor this proposed amendment to see what traction, if any, it gains in the coming months.

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INTRODUCING...

SMITH HAUGHEY RICE & ROEGGE'S RENEWABLE ENERGY INDUSTRY TEAM

The renewable energy lawyers at Smith Haughey draw upon the comprehensive legal experience of 90 attorneys in three offices spanning the state of Michigan. Our attorneys can serve the legal needs of anyone looking to take full advantage of the rapidly growing renewable energy industry in Michigan.

Our clients include land owners, governments, construction companies, utilities, equipment manufacturers, investors and project developers. We advise our clients on all phases of project structuring, development, and operation.

With a thorough knowledge of the renewable energy industry in Michigan, as well as a strong

general business and litigation practice, Smith Haughey can help any party at any phase in the renewable energy project achieve their goals.

- From reviewing leases to forming a cooperative, our lawyers often counsel land owners as they venture into the wind energy arena.
- We draft, negotiate, and review ownership agreements, project structuring, ground and equipment leasing, operation and maintenance agreements, sales agreements, and construction contracts.

- We cover the gamut in real estate transactions, including financing, site acquisition, zoning, land use planning, permits needed for the construction of wind and solar farms including special use permits, rights-of-way grants, and greenfield and brownfield permits.
- We advise concerning the formation of business entities, joint ventures, partnership agreements, and financing.
- We advise on issues concerning insurance coverage.
- We thoroughly understand the legal complexities arising from working with

governments. We have substantial practical experience in applying them to real-world situations, such as with the development of wind and solar farms.

- We provide a full and broad spectrum of litigation services, ranging from ordinary tort claims to land use litigation to complex commercial disputes.

Tony Quarto serves as Chair of Smith Haughey's Renewable Energy Industry Team. To learn more about how the team can help you and your business take advantage of the renewable energy industry in Michigan, please contact Tony at 616.458.1336 or aquarto@shrr.com.

SHRR CONSTRUCTION LAW INDUSTRY TEAM NEWS

Ben Hammond has been named a shareholder of the firm.

Brian Pearson recently attended a Federal Government Contracting seminar in Las Vegas, NV. This seminar focused on the government contracting process and the unique nature of government contracts and claims.

Smith Haughey's **annual construction law seminar** in Traverse City will be held on Thursday, April 30, at the Hagerty Center at Northwestern Community College. The program includes a mock arbitration and roundtable discussion. Watch your mail for more details in the coming weeks.

Smith Haughey has recently improved our construction resource with the purchase of **Aspen's Construction eLibrary**. The eLibrary contains a contracting component which includes public construction titles, newsletters and journals, and one smart chart and a construction claims and disputes component which includes newsletters and journals and three smart charts. We also have the American Institute of Architects Contracts Documents software which allows us to draft construction industry forms for our clients.

In *Great Lakes Society v Georgetown Charter Township*, the plaintiff sued the Township under the Religious Land Use and Institutionalized Persons Act (RLUIPA), as well as under a variety of constitutional theories including free exercise of religion, freedom of association, freedom of assembly and equal protection. The essence of the Society's claim was that the Township ZBA improperly determined that a building proposed to be constructed by the Society was not a "church" for purposes of the Zoning Ordinance. Initially, the trial judge granted summary disposition to the Society. The Township filed an immediate appeal, on which **Craig Noland** and **Bill Henn** collaborated. After briefing and oral argument, the Michigan Court of Appeals issued a unanimous, published decision reversing the Circuit Court for the reason that the Township ZBA's denial of the Society's request for a variance from the Ordinance's street frontage requirement was supported by competent, material and substantial evidence, and did not violate any law or constitutional protection. The Court therefore concluded that the Society's RLUIPA and constitutional claims relating to whether the proposed building was a church for purposes of the Ordinance were moot.

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