

CONSTRUCTION LAW UPDATE

May 2006

CUTTING OFF CLAIMS AGAINST ARCHITECTS, ENGINEERS & CONTRACTORS

By Steven K. Stawski and Michael J. Roberts

The Michigan Supreme Court's recent ruling in *Ostroth v Warrant Regency* confirms that most claims against architects, engineers, and contractors are extinguished six years after the occupancy, use or acceptance of the improvement.

Two basic legal concepts were at issue in *Ostroth* – the statute of limitations and the statute of repose. A statute of limitation is the time period in which a plaintiff must initiate a lawsuit against a defendant. Formerly, the time frame to sue architects, engineers and contractors (“construction professionals”) depended upon the type of claim plaintiff asserted. For instance architect malpractice, tort (such as a personal injury suit), and breach of contract claims were governed by two, three, or six-year limitations periods, respectively. If 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. In Michigan the statute of repose for construction professionals is six years. That is, 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.

Consequently, the shorter two- and three-year limitation periods for malpractice and tort claims no longer apply.

In *Ostroth*, plaintiff argued that she suffered injuries from being exposed to mold due to an inadequately designed HVAC and plumbing system. The trial court dismissed her suit against the architect based upon the two-year statute of limitation period for malpractice claims. The appellate court and Michigan Supreme Court disagreed, ruling that

plaintiff's claim was timely because it was filed within six years after occupancy, use or acceptance of the improvement. In so ruling, the Supreme Court clarified that the statute of repose for construction professional also serves as the statute of limitations. Consequently, the shorter two and three-year limitation periods for malpractice and tort claims no longer apply.

Because the time periods set forth in the statute of limitations and statute of repose are triggered by the date of first occupancy, use or acceptance of the improvement, it is important to maintain records clearly documenting this event. Like stale bread, stale construction-related claims may be dismissed if the triggering event is documented and the claim is filed to late.

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Construction Contractors Exhale:
*The Student Safety Legislation crisis appears
likely to be averted, for now . . .*

By Matthew L. Wikander

In September 2005, the Michigan Legislature passed Student Safety Legislation which became effective January 1, 2006. The legislation amended various sections of the Revised School Code and obligates school districts, and possibly employers with employees on school property, to verify the criminal history and criminal records of any individual assigned to work in a school on a regular and continuous basis. It also requires that the employees submit to costly fingerprint checks. Under the legislation, if the criminal records reveal that an individual has been convicted of one of the listed offenses under the Code, the school district cannot employ the individual in any capacity and cannot allow the individual to regularly and continuously work under contract in its schools. The legislation defines the term "listed offense" to mean that term as defined by the Sex Offenders Registration Act.

Significantly, this amendment appears to have exempted architects, builders, and contractors who work on school grounds.

Since the legislation went into effect, there have been some unintended consequences. Most notably, a number of employees were identified as possible criminals because their names matched names of criminals. This has resulted in obvious public humiliation and embarrassment for the employees.

While much of the recent public controversy has focused on the reporting inaccuracies exposed by the legislation, an additional consequence reared its head for contractors who work in or around schools. The problem is that the legislation does not define the individuals who "regularly and continuously work under contract" in the schools. Thus, it appears that in order to ensure compliance with the legislation, contractors and others involved in the construction process will be forced to conduct criminal history and criminal record searches on all their employees working in and around schools and, additionally, will incur the notable expense of fingerprinting each one of their employees as the

legislation requires.

The Michigan Legislature Steps In

Fortunately, the Michigan Legislature recently passed a substitute bill to amend and take the place of the legislation. The bill was ordered to take immediate effect and sent to the governor on March 30, 2006. Governor Granholm approved the bill on March 31, 2006, and it became law as on April 18, 2006.

In addition to requiring reasonable efforts to be taken to ensure the accuracy of school employees' conviction reports and to revising disclosure requirements for conviction reports under the Freedom of Information Act, the amendment also defines the term "regularly and continuously work under contract in a school." Significantly, this amendment appears to have exempted architects,

builders, and contractors who work on school grounds. Under the amendment "regularly and continuously work under contract in a school" is defined as:

"Regularly and continuously work under contract in a school" means either of the following:

(i) to work at school on a more than intermittent or sporadic basis as an owner or employee of an entity that has a contract with a school district, intermediate school district, public school academy, or nonpublic school to provide food, custodial, transportation, counseling, or administrative services, or to provide instructional services to pupils or related and auxiliary services to special education pupils.

(ii) to work at school on a more than intermittent or sporadic basis as an individual under a contract with a school district, intermediate school district, public school academy, or nonpublic school to provide food, custodial, transportation, counseling, or

administrative services, or to provide instructional services to pupils or related and auxiliary services to special education pupils. "School property" means that term as defined in section 33 of the Sex Offenders Registration Act.

While the amendment does not define "custodial" or "administrative services," the legislative intent appears to be the exclusion of architects and contractors providing traditional architectural and contracting services to schools where construction projects are being performed.

It should be noted that one of the primary purposes of the September 2005 legislation was to prohibit anyone registered under the Sex Offenders Registration Act from working in schools. While the Sex Offenders Registration Act does not specifically make employers who have employees registered under the Act liable for the actions of their employees, it does require the individual offender to register under the Act and precludes the registered offenders from working or loitering in a Student Safety Zone (1000 feet or less from a school's property). Thus, if a contractor has knowledge that one of its employees is registered under the Act, it would be prudent for that contractor to preclude the employee from working on any projects within Student Safety Zones. Additionally, because the Michigan Public Sex

Offender Registry website is available to the public at www.mipsor.state.mi.us, employers have the ability to determine if any of their employees are registered offenders. This would further assist an employer seeking to shield itself from any potential liability arising out of the placement of a registered offender in a Student Safety Zone.

In order to minimize liability exposure from handling the situation improperly, an employer should seek legal counsel before taking any actions based on information contained in a background check.

The Bottom Line

The Michigan Legislature appears to have corrected the unintended consequence of originally including contractors' employees in the Student Safety Legislation. However, given the purpose of the original legislation, along with the requirement that registered sex offenders must stay out of any Student Safety Zones, it would be wise for employers to make sure that employees registered as sex offenders are not working in Student Safety Zones. If an employer is facing such a situation, it should contact legal counsel.

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Best Practices: Retention of Insurance Declarations Page

By T. J. Ackert

A company should adopt the "best practice" of retaining a copy of each insurance coverage declarations page for every year the company has been in business. Why? As the courts permit employees and third parties to bring "exposure" claims relating to asbestos, mold, and certain product defects dating back to as early as the 1970's, your company must be able to identify the insurance coverage and carrier for the covered years. Recent experience reveals that companies that had not retained their declarations page, and could not reconstruct from memory the insurance coverage for years dating back to the 1970's, were

required to assume responsibility for some portion of claims brought against them because the company had no proof of insurance.

If you have not retained copies of your declarations pages for all the years you have been in business, start now and also start to re-create your insurance coverage back to 1970 while your employee "memory," or that of your insurance agent, is "fresh". You may just save yourself a headache and money!

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Beware “Final Payment” Checks

By Jason R. Thompson

The Michigan Supreme Court recently ruled that cashing a check marked “final payment,” even after crossing out the “final payment” notation, can release the entire debt in dispute. The case pertained to a dispute over the cost of construction between a homebuilder and the contracting homeowners. There were significant cost overruns and the parties disputed the final amount owed to the homebuilder. The homeowner disputed the homebuilder’s claim that he was due approximately \$32,000. After negotiations began, the homeowners

sent a check for approximately \$5,000 and wrote “full payment” on the comment line of the check. The homebuilder crossed off “final payment,” cashed the check, and subsequently argued the check was only partial payment on the amount due. The Court of Appeals agreed, but the Michigan Supreme Court ruled in favor of the homeowners and held that cashing the check was a settlement of the dispute.

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Case Notes

Edited by Aileen M. Leipprandt

Notice of Furnishing Requirement Relaxed

Generally speaking, the Michigan Construction Lien Act requires that subcontractors and suppliers provide a Notice of Furnishing to an owner and general contractor within 20 days of when the subcontractor/supplier first furnishes labor or materials. The Court of Appeals recently re-affirmed that this requirement is subject to the “substantial compliance” provision of the Act. To that end, the court held that a subcontractor who had not provided a written Notice of Furnishing nevertheless “substantially complied” with the notice of furnishing requirement when its area managers introduced themselves to the owner, told the owner the subcontractor would be doing the paving work, the Owner was present during such work and the owner provided coffee and doughnuts to the subcontractor’s crew.

Delay & Impact Claims Not Recoverable Under Payment Bond

The United States Sixth Circuit Court of Appeals has re-affirmed the general proposition that a subcontractor may recover from a payment bond those labor and material costs caused by project delays. However, other non-labor or non-material

expenses, such as administrative expenses and lost profits (sometimes called “delay or impact” damages), are not generally recoverable under a payment bond, as they are not “labor and material used or reasonably required for use in the performance of the contract.”

Builders’ Trust Fund Claims Against Contractor’s Officers Survives

The Michigan Builders Trust Fund Act imposes a trust on funds paid to contractors and subcontractors for products and services provided under construction contracts. An individual officer of a contractor or subcontractor on a construction project may be found liable for diversion of contract funds contrary to the provisions of the BTFA. Indeed, the Court of Appeals has ruled that a subcontractor’s BTFA claim against the officers and employees of a general contractor is separate and distinct from the subcontractor’s claim against the general contracting corporate entity. Consequently, a subcontractor was permitted to bring separate and succeeding BTFA actions, first against the general contracting corporate entity and then later, against the general contractor’s employees and officers.

Construction Industry Team News & Successes

Craig Noland recently attended a seminar entitled “Hot Topics in Michigan Riparian Law.” The seminar sponsored by the Real Estate Section of the Grand Rapids Bar Association focused on lakefront development issues.

Aileen Leipprandt recently spoke at several seminars. In January, she addressed the Home and Building Association about contract terms, notice of repair, code of ethics, and warranty. In February, she discussed handling threats of contract termination, understanding payment settlement options and effectively resolving disputes at a National Business Institute seminar.

Also, she was recently elected to the Board of Directors of the Associated Builders & Contractors of Western Michigan.

Members of our **Construction Industry Team** have been involved in contract negotiations for virtually all of the major construction projects currently in development in downtown Grand Rapids.

Introducing...

Your Construction Law Industry Team

At Smith Haughey, we don't just know the law, we pride ourselves on also knowing the nature of our client's business. Our 12 construction law attorneys have over 200 years of collective experience. However our Construction Law Industry Team is not only comprised of construction law attorneys. The team also includes business, employment, government, real estate, health law, insurance, and litigation attorneys who have extensive experience in representing owners, general and trade contractors, architects, engineers, manufacturers, suppliers, and consumers of construction materials. For our clients, that means we can serve almost any legal need while being sensitive to the industry trends, regulations, and issues.

Our team members, who are listed on the last page of this newsletter, regularly speak at seminars on construction law topics to local businesses, trade and business organizations, and insurers.

In order to keep abreast of current developments and trends in the industry, our team members also maintain membership in organizations such as the American Institute of Architects, Construction Specification Institute, National Association of Women in Construction, Associated General Contractors, Association of Builders and Contractors, the Home and Building Association, and the Construction Association of Michigan.

We realize that our clients view a legal matter as a business problem. We are sensitive to the issues affecting our clients, and we work to tailor solutions with their business goals in mind. Please keep us in mind for all your legal needs.

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