

CONSTRUCTION LAW UPDATE

November 2009

UNTIL THE COURTS LEED US...

By: Jonathan J. Siebers, Attorney, Accredited LEED Green Associate

In recent years, the number of LEED-certified building projects have rapidly grown throughout the country, and in Michigan in particular. However, the court system has yet to weigh in on the requirements for LEED rating systems. Until the courts address this issue, there are certain steps that construction professionals should follow to protect themselves from liability and avoid setting an example for their peers and competitors on what not to do on a LEED project.

History and Growth of LEED

In 1998, the U.S. Green Building Council (USGBC) launched its first rating system designed to chart the overall sustainability of a building. That rating system, LEED (Leadership in Energy and Environmental Design) Version 1.0, has evolved over the past 11 years into the following rating systems for commercial properties:

- LEED for New Construction,
- LEED for Existing Buildings,
- LEED for Commercial Interiors,
- LEED for Retail,
- LEED for Schools, and
- LEED for Core & Shell.

During this same time, the USGBC has experienced phenomenal growth both in terms

of the number of members and in terms of public awareness.

The USGBC's growth is not limited to membership and name-recognition, but is also seen in the number of LEED-projects that have been completed in past years. The USGBC estimates that, as of September 2009, 3,855 commercial projects in the United States are LEED-certified, accounting for around 613 million square feet of commercial real estate. Furthermore, according to a report updated as of September 8, 2008 by the Michigan Department of Environmental Quality, there were 383 LEED certified, non-residential projects in Michigan. Thus, approximately 10% of all LEED-certified, non-residential projects in the U.S. are here in Michigan.

LEED and the Law

Despite the growth of the USGBC, the expansion of LEED rating systems and the construction of several thousand LEED-certified projects in the U.S. and several hundred LEED-certified projects in Michigan alone, there is not a single reported decision from either the Supreme Court or Court of Appeals in Michigan, or in the appellate courts of any other state for that matter, that addresses or interprets the requirements of any LEED rating system. For those in the construction industry, this absence of case law is a double-edged sword. It

is an advantage in that no precedents have been set by which construction professionals applying LEED principles can be judged. At the same time, it is a disadvantage in that no precedents have been set by which construction professionals applying LEED principles can gauge their activities, the result of which is uncertainty for the construction professional.

In light of the growth of LEED and the dearth of case law interpreting LEED, construction professionals can be confident that three things (in addition to death and taxes) are certain:

- (1) sooner or later, the courts will delve into LEED issues;
- (2) when that time comes, precedents will be set for the construction industry to follow; and
- (3) you do not want to be the one setting the precedent and teaching everyone else a lesson in what not to do.

Tips for Avoiding Liability

Until the courts get involved, what can construction professionals involved in LEED projects do to protect themselves against liability? Following is a non-exhaustive list of recommendations:

1. Avoid written warranties and covenants that require the attainment of any or a specific level of LEED certification. In other words, make sure written contracts do not require LEED certification in general, or a specific level of LEED certification in particular.
2. Avoid implied warranties that require any or a specific level of LEED certification. In other words, watch what is said to their customers (oral statements and statements in their marketing and advertising materials), because warranties can be implied based on such statements.

3. Avoid representations that the product will perform a certain way. For example, it is not wise to warrant that their building will use 30% less energy and 40% less water than a building constructed with traditional materials.
4. If materials must be substituted for those required in the project's specifications, make absolutely certain that the substitute materials will receive the same treatment under the LEED rating system. Keep in mind that the source of substitute materials or the ingredients within those materials could have a significant impact on LEED certification, even if the substitute materials otherwise perform the same as those called for in the specifications.
5. Understand:
 - i. the contract and the plans and specifications,
 - ii. how the work fits into the project as a whole,
 - iii. the roles and responsibilities of each other party working on the project; and
 - iv. how the work fits into the LEED rating system.
6. When selecting contractors, subcontractors and suppliers, consider the LEED knowledge and experience of each. Dig into the claims made by those considered for selection to determine who is the real thing and who is just talk.
7. When in doubt, contact an attorney or other professional who is knowledgeable and experienced with LEED. An attorney who understands LEED can help anticipate and avoid problems before they ever arise. When problems do arise, a LEED-familiar attorney can help examine problem and determine the best resolution.

These tips are not an absolute guarantee that construction professionals will avoid legal

problems on their LEED project. However, until the courts provide guidance on what to expect in LEED projects, following these tips can help construction professionals avoid becoming an example of what not to do on a LEED project.

Jon is accredited as a LEED Green Associate by the U.S. Green Building Certification Institute.

He represents general contractors, subcontractors, suppliers and owners with respect to negotiation, drafting, and review of construction documents, and with lien and permitting issues. In addition to construction law, Jon also practices in the areas of business law and real estate law. He can be reached directly at jsiebers@shrr.com or 616.458.5298.

APPELLATE COURT RULING STRENGTHENS CONTRACTORS FIDUCIARY OBLIGATIONS UNDER THE MICHIGAN BUILDERS TRUST FUND ACT

By Daniel M. Morley, Attorney

Contractors and their officers who are considering filing for bankruptcy are advised to bear in mind the implications of the Michigan Builders Trust Fund Act, as illustrated by the recent ruling by the Sixth Circuit Court of Appeals in the case of *In re Patel*.

The Michigan Building Contract Fund Act, commonly referred to as the Michigan Builders Trust Fund Act (MBTFA), has many applications that can assist unpaid construction subcontractors and suppliers in recovering payment. Two of these applications are:

- 1) the ability to have debts incurred in violation of the statute held non-dischargeable in bankruptcy; and
- 2) to have those responsible for violations of the Act's provisions found personally liable.

The case of *In re Patel* involved the misappropriation of building trust funds by a general contracting corporation's president, Sameer Patel. Shamrock Floorcovering Services, Inc. provided services to the corporation on a construction project as a

subcontractor. When the construction project was abandoned after financial difficulty, Patel paid his own operating expenses on the project – including payroll, utilities, taxes, and wages to himself – before making payments to Shamrock, in violation of the MBTFA. When Patel filed Chapter 7 bankruptcy, he sought to discharge the debt owed to Shamrock.

On appeal, the Court found that the debt was non-dischargeable because Patel, as a corporate officer, was a “contractor” for purposes of the MBTFA and that he breached the fiduciary duty he owed to Shamrock under the MBTFA by his failure to account for and pay funds.

This was not the first time that courts held that debts owed to a subcontractor are non-dischargeable from a general contractor's bankruptcy and that an individual officer could be held personally liable. *In re Patel*, however, is the first case wherein a Michigan court has combined these two factors into a single decision.

The central holding of *In re Patel* reasoned that based on the past cases, corporate officers who are intimately involved with handling their

company's finances are fiduciaries under the U.S. Bankruptcy Code and are capable of committing defalcation. (Defalcation is the term used by the U.S. Bankruptcy Court to describe a category of bad acts that taint a particular debt such that it cannot be discharged in bankruptcy.) Because Patel was the president and 50% shareholder of his corporation and in charge of the financial affairs of the corporation, the Court found that he qualified as a "contractor" under the MBTFA and owed a fiduciary duty to Shamrock.

Establishing a duty, however, is only half of the task. In order for a debt to be non-dischargeable, an actual breach, in this case a defalcation, has to be established. Defalcation is established in the context of the MBTFA when there is evidence that the money paid into the building contract fund was used first for purposes other than to pay laborers, subcontractors, or materialmen. Applying this standard, the Court found that Patel recklessly misallocated funds and failed to pay Shamrock first, as required by the MBTFA, because he paid his own operating expenses before making payments to Shamrock.

In re Patel establishes a new principle that individual corporate officers who participate in the misappropriation of funds and thereby breach a fiduciary duty to subcontractors, laborers and suppliers will not have the specific debt owed to the subcontractor or supplier discharged in their personal bankruptcy. Rather, the integrity of construction contracts and the building trust funds that are established under the MBTFA between contractors and their subcontractors and suppliers is further strengthened with the Sixth Circuit's recent ruling. Contractors and their officers will need to give careful consideration to MBTFA implications before filing for bankruptcy.

Dan is a member of the Smith Haughey Construction Industry Team and practices in the areas of commercial litigation, bankruptcy, banking and finance, and business law. He can be reached directly at dmorley@shrr.com or 231.486.4538.

Summer associate Megan Hard also contributed to this article.

RECENT CASE ILLUSTRATES THE IMPORTANCE THAT THE COURT PLACES UPON ENFORCING CONTRACT PROVISIONS

By Brian M. Pearson, Attorney

In a recent Michigan Court of Appeals case, *Liparoto Construction, Inc., v. General Shale Brick, Inc., et al.*, a construction company sued the supplier and manufacturer of bricks, as well as its insurance provider, to recover expenses incurred fixing discolored bricks.

The court affirmed the lower court's dismissal of the claim against the manufacturer because the discoloration was caused by a

subcontractor's use of the wrong cleaning agent. A manufacturer label attached to the product provided a warning against the use of such cleaners and disclaimed any and all responsibility for damage. The court also affirmed dismissal of the claim against the insurance provider because the damage was confined to the insured's work product and did not damage other's property. Therefore, the damage was not covered under the company's policy.

Most notably, the court also affirmed the lower court's dismissal of the claim against the supplier because it was barred by a provision contained in the parties' contract for a one-year period of limitations to bring suit. The court upheld the freedom of parties to draft the terms of a contract so as to avoid otherwise applicable provisions of the Uniform Commercial Code (UCC). Under the Michigan UCC, the default period of limitations to bring suit to recover damages for defective goods is four years. However, parties may agree to a shortened period of limitations of no less than one year. Importantly, here the parties involved both had knowledge of the industry and the ability to bargain for the terms of their agreement.

This case illustrated that clear, unambiguous provision of a contract will likely be enforced by the court as written, unless it violates the law or is otherwise unenforceable. For example, if a contractual provision shortened the period of

limitations to one year, but the product's alleged defect remained undetectable until it was too late to bring a claim, the court may deem the provision unconscionable and unenforceable.

As the standard is high for arguing that a contractual provision is unenforceable, courts are generally reluctant to alter the terms of an agreement. As a result, it is crucial to thoroughly read and understand all documents prior to signing. The terms and provisions agreed to by signing a document can drastically limit the options and remedies down the road.

Brian is a member of the firm's Construction Industry Team. He counsels clients in risk avoidance and litigation matters. He can be reached directly at bpearson@shrr.com or 616.458.3638.

Summer associate Megan Smith also contributed to this article.

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

By Charles F. Behler, Attorney

As previously reported in this newsletter, the Michigan Senate is considering Senate Bill 35 which, if passed, would have a significant impact on construction law in the state.

The bill proposes to reestablish the two year statute of limitation period for malpractice claims brought against design professionals, engineers, and land surveyors. Currently, the statute of limitations (the deadline for filing claims) is six years after occupancy, use, or acceptance of the improvement.

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 may not prohibit plaintiffs from couching their malpractice claims as torts or breaches of contract and filing them beyond the two year limitation.

In the past several months, there has been little change in the status of this bill. On July 15, 2009, the Judiciary Committee reported its analysis of the bill. There has been no other legislative activity concerning this proposed bill, however, Smith Haughey will continue monitor this issue to update you on the evolution of this important piece of legislation.

Chip serves as chair of the firm's Construction Industry Team. He is a seasoned litigator who

represents businesses, construction contractors, subcontractors, and real estate developers in matters involving claims of breach of contract, construction defects, construction accidents, employment claims, and in complex commercial litigation. He also is a well-regarded counselor with extensive experience in risk avoidance and contract drafting and negotiation for those in the construction industry. Chip can be reached directly at cbebler@shrr.com or 616.458.6245.

THE RULES OF CONSTRUCTION:

LEGAL RELATIONSHIPS IN THE DESIGN-BUILD AND INTEGRATED PROJECT DELIVERY ERA (Excerpted from *Michigan Real Property Review*)

By Steven K. Stawski, Attorney

Owners, architects, engineers, and contractors are entering into new contractual arrangements that shift traditional design and construction responsibilities in ways that challenge Michigan's common law and statutes. These recent changes are fueled by industry trends, such as sustainable design and Building Information Modeling (BIM), which broaden planning, design and construction perspectives, force earlier collaboration and coordination among participants, and focus attention on the delivery of a project to owners.

A construction project's overall contract structure is critical to assessment of risk, especially as contracting models continue to evolve. Can an owner sue the architect for defective plans and specifications when the architect is a sub-contractor to the design-builder? Can a contractor sue an architect for negligence in a design-bid-build model? Does a design-builder that promises a certain LEED rating imply a warranty to the owner? Do the common law rules of construction apply to

Integrated Project Delivery? As new project-centered contracting models separate construction law stakeholders from their traditional contracting relationships, it is increasingly important for owners, architects, and contractors to understand their contracts and contractual risks before starting their design and/or construction work.

For more information on this topic that Steve recently published in the *Michigan Real Property Review*, please visit:

**www.shrr.com/files/Rules-of-Construction.pdf
or email Steve at sstawski@shrr.com.**

Steve is a member of the firm's Construction Industry Team. He assists businesses, lenders, owners, and individuals in contract and litigation matters concerning the purchase, sale, financing, development, construction, and enforcement rights relating to real estate in Michigan. He currently serves as co-chair of the State Bar of Michigan's Real Property Section's Construction Law Committee. Steve can be reached directly at 616.458.4394.

SMITH HAUGHEY CONSTRUCITON INDUSTRY TEAM NEWS & SUCCESS

Smith Haughey Welcomes Jon Siebers to the firm and the Construction Law Industry Team.

Jon is a well-regarded and experienced business and real estate attorney. Jon assists business clients with entity creation, buy/sell agreements, partner buyouts, and asset acquisitions and dispositions. Jon regularly negotiates, drafts, and reviews a wide variety of contracts for businesses, including equipment leases, service agreements, and intellectual property licenses.

Jon represents real estate clients in the acquisition, disposition, development, leasing and financing of commercial real estate, and in the development of residential real estate. Jon's clients include developers, lenders, health care facilities, physician groups, minority investors, landlords, tenants, retailers, restaurants and other businesses. In addition, he represents lenders and borrowers in mortgage-based loan transactions and work-outs.

His practice also includes construction law and he is accredited as a LEED Green Associate by the U.S. Green Building Certification Institute. He has represented general contractors, subcontractors, suppliers and owners with respect to negotiation, drafting, and review of construction documents, and with lien and permitting issues.

Jon earned a Bachelor of Arts degree in philosophy from Hope College and a Juris Doctor, *magna cum laude*, from Indiana University School of Law, where he was a member of the Indiana Law Journal and Order of the Coif. He is licensed to practice in the state courts of Michigan and North Carolina.

Jon and his wife, Gretchen, live in Grand Rapids with their two young children, Jack and Lily. In his spare time, Jon enjoys spending time with his family, reading, fishing, golf, sailing, hiking, snowboarding, cross-country skiing, and traveling.

Smith Haughey has been selected by *Benchmark Litigation 2010* as having one of the leading litigation practices in Michigan. *Benchmark* has also selected the following four attorneys from Smith Haughey as "litigation stars" in Michigan: **Chip Behler, Mark Bickel, Todd Millar, and Jack Oostema**. *Benchmark* is a national publication that describes itself as "the definitive guide to America's leading business litigation firms and attorneys." Smith Haughey submitted to an extensive research process, which included an evaluation of recent case successes, personal interviews, and client referrals, to be considered for inclusion in this prestigious publication.

Chip Behler has been selected for inclusion in *Best Lawyers in America* in the area of construction law. *Best Lawyers* is regarded as the definitive guide to legal excellence in the United States.

Chuck Judson has been elected chair of the Alternative Dispute Resolution Section of the State Bar of Michigan. In addition, he recently published an article in *Michigan Lawyer's Weekly* titled, "Mediation as a Pre-Foreclosure Procedure Gains Awareness Among State Legal Community".

Craig Noland and **Bill Henn** successfully represented our township client in a case before

the Court of Appeals. In this case, the plaintiff property owner claimed that the “vibrations” from sewer construction activities along the road right of way caused structural damage and rendered the building “unsafe.” The plaintiff attempted to avoid a governmental immunity defense by claiming a “taking” without just compensation. The trial court denied our motion for summary disposition as to the taking claim, but the Court of Appeals held that plaintiff’s claims did not constitute a taking, and that the case against the township should be dismissed.

In a case handled by **Craig Noland** in the trial court and **Bill Henn** in the appellate court, we represented a township that was sued by dozens of plaintiffs whose homes had been damaged by a severe flood of the Grand River. The defendant township, as a matter of public safety, suspended occupancy permits for the damaged houses. The plaintiffs argued that the government had wrongfully taken their property

without just compensation by the suspension of their occupancy permits, and also by the imposition of certain building code requirements relating to structures in flood zones. The Circuit Court denied summary disposition for the defendants, but the Court of Appeals reversed, ordering that all claims be dismissed.

Steve Stawski was elected co-chair of the State Bar of Michigan’s Real Property Section’s Construction Law Committee. In addition, Steve is providing contract review and negotiation services for engineers and contractors specializing in energy efficient designs and applications. For example, he is providing counsel to an electrical subcontractor client that is connecting utility-scale turbines to the grid at the largest utility-scale wind farms in Michigan, and a mechanical contractor that is retrofitting a number of schools with energy efficient systems.

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