

CONSTRUCTION LAW UPDATE

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LACK OF RESIDENTIAL LICENSE ON CONDO PROJECT BARS CONSTRUCTION MANAGER'S CLAIM

By Benjamin H. Hammond

Under the occupational code a “residential builder” must be licensed. A “residential builder” is defined as “a person engaged in the construction of a residential structure or a combination residential and commercial structure, who ... undertakes with another ... the erection, construction, replacement, repair, alteration, or an addition to, subtraction from, improvement, wrecking of, or demolition of, a residential structure or a combination residential and commercial structure”. The definition also includes those involved in prefabricated, preassembled, precut, packaged or shell housing.

Thus, construction managers and others who act as a “residential builder” on a project must be licensed under the occupational code when constructing residential structures or structures that are both residential and commercial. If a contractor does not hold such a license, then that contractor cannot sue the owner for nonpayment.

In April 2007 the Court of Appeals in *84 Lumber Co v Pagel & Frey* reinforced and extended this general rule when it held that a construction manager who was acting as a “residential builder” could not maintain a breach of contract action *or enforce a lien* on a condominium project because the construction manager did not have a residential builder’s license. In that case, the owner, Lighthouse Place Development, hired Pagel & Frey as the construction manager on an upscale condominium project being constructed in Southwest Michigan.

A dispute arose as to the quality of work and Lighthouse Place Development withheld payment to Pagel & Frey. Ultimately, Pagel & Frey recorded a

lien on the project in the amount of \$360,000 and sued the owner for breach of contract. Pagel & Frey also sought to foreclose its construction lien. At the trial court level, Lighthouse Place Development argued that Pagel & Frey could not maintain a breach of contract action or enforce its lien because Pagel & Frey was not licensed as a residential builder as required under the occupational code.

The Court of Appeals agreed with Lighthouse Place and held that because Pagel & Frey was not licensed as a residential builder it could not maintain a breach of contract action against Lighthouse Place Development and it could not enforce its construction lien. There was no dispute that the construction of a condominium development required a residential license. The Court of Appeals reasoned that it was unacceptable to allow Pagel & Frey to receive compensation under the construction lien act for work that required a license under the occupational code.

General contractors and construction managers should be mindful when involved in apartment, condominium or mixed-use (residential and commercial) projects that a residential building license is required if they are acting as a “residential builder”. Failure to obtain a residential building license will prevent them from pursuing a contract claim for payment or from enforcing a construction lien.

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CHALLENGING CLAIMS THAT “SOUND IN TORT”: THE ECONOMIC LOSS DOCTRINE IN THE CONSTRUCTION SETTING

By Steven K. Stawski

Lawsuits against Architects, Engineers, Contractors, and Material Suppliers usually include counts for breach of contract and for negligence. This article identifies the difference between claims that “sound in contract” and “sound in tort,” and explains why the Economic Loss Doctrine may allow a court to preemptively dismiss claims for negligence.

Claims that “sound in contract” are suits that involve the enforcement of promises, or obligations, that are established between identified parties. The expectations of the parties are determined by their mutual agreement. Generally speaking, damages are calculated by placing the non-breaching party in as good a position as if the contract had been fully performed.

Claims that “sound in tort” are suits that involve the enforcement of largely unwritten rules, or duties, that form the larger fabric of our society. Tort duties guide conduct and interactions between companies and people that may or may not have contractual relationships. For example, a breach of certain duties may give rise to a claim of negligence. A plaintiff that proves a breach of such a duty can recover damages that are caused by, and reasonably flow from, the breach.

The Economic Loss Doctrine separates claims that “sound in contract” from claims that “sound in tort.” In Michigan, the Doctrine originates from the sale of products, to provide that, where a purchaser’s expectations in a sale are frustrated because the product purchased is not performing properly or is defective, his remedy is said to be in contract alone because he has suffered only ‘economic’ damages. Presumably, parties to an agreement can assess their potential liability and incorporate those assessments into the price or terms of the agreement.

In the construction setting, the Economic Loss Doctrine has been used to bar tort claims initiated by the manufacturer of glass doors and windows against its upstream component suppliers. In *Sullivan Industries v Double Seal Glass Co*, the Michigan Court of Appeals applied the Doctrine to bar Double Seal Glass Company’s tort claim against its supplier of insulated windows and doors components, as tort claim against the company that supplied the defective sealant that Double Seal used. This case is important because the Court of Appeals extended the use of the Doctrine to bar tort claims between two parties that did not have a direct contract, but were involved in a commercial relationship.

State jurisdictions are divided on the application of the Economic Loss Doctrine in the construction setting, especially as the application of the Doctrine becomes more tenuous as sub-contracting arrangements extend outward and involve the provision of services. Some states, including New York, Pennsylvania, Illinois, Hawaii, and Washington have used the absence of a direct contract to bar negligence claims between a contractor and a design professional. Other jurisdictions hold that a contractual relationship is not necessary for a contractor to sue a design professional in tort. To date, there is no authority in Michigan that addresses a claim for professional malpractice against an architect or engineer where no direct contract exists between the parties.

Recently, courts in Wisconsin, Colorado, and California have applied the Economic Loss Doctrine in the construction setting with different results. A Wisconsin court employed the Doctrine to bar tort claims by an Owner against a Construction Manager, who was obligated to produce a product for the Owner – a finished condominium building with a garage.

A California court also used the Doctrine to bar negligence claims by an Owner against an Architect. However, a Colorado court rejected the use of the Doctrine to allow claims by a residential homeowners' association against contractors based on public policy grounds.

Michigan law remains unsettled with regard to the reach and application of the Economic Loss Doctrine, particularly in situations involving

contractual and commercial relationships that involve services and products. Regardless, an understanding of claims that "sound in contract" and "sound in tort" may be the first step to a preemptive dismissal of substantial part of a plaintiff's complaint.

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RELIANCE ON A "PAY-WHEN-PAID" PROVISION TO SURVIVE THE STATUTE OF LIMITATIONS REQUIRES A TRUE "PAY-WHEN-PAID" CLAUSE

By Tawanna D. Wright

In *ABC Paving Co v Jenkins Construction*, the Court of Appeals addressed a "pay-when-paid" clause. The main issue in this case concerned the dismissal of the plaintiff's case for failure to sue the defendant contractor before the statute of limitations expired on its claim.

ABC Paving [ABC] and Jenkins Construction [Jenkins] entered into a subcontracting agreement whereby the ABC contracted to perform the excavation work for Jenkins on a middle school project in Detroit. ABC's last day of work on the project was April 3, 1997. ABC filed a lawsuit more than eight years later on December 16, 2005, alleging Jenkins failed to pay \$122,691 for its work on the project. The court granted Jenkins' motion for summary disposition based on ABC's failure to file its lawsuit within the six year statute of limitations. ABC appealed the decision to the Court of Appeals arguing that the motion should have been denied based on the Court of Appeals' decision in *Berkel & Co Contractors v Christman Co*.

In *Berkel*, the court held that a "pay-when-paid" clause in a construction contract is enforceable and that the statute is tolled on a claim for payment under a contract containing such a clause until the general contractor gets paid for the work performed by the subcontractor.

The court reasoned that ABC's reliance on *Berkel* was flawed because the provision it relied upon in its contract with Jenkins was not a "pay-when-paid" clause. "In *Berkel*, the contract stated that "the receipt of such payments [from the owner] by Christman Company [general contractor] [was] a condition precedent to payments to the subcontractor." The court reasoned that the Jenkins-ABC contract did not contain the required conditional language as provided in *Berkel*. "The parties' contract stated merely that the general contractor 'shall pay' the subcontractor 'within seven days' of its receipt of payment from the owner." The court concluded "[t]his language was more in the nature of delineating a time for payment than a condition precedent to payment."

Consistent with the trend developing across all jurisdictions, this case illustrates that a true "pay-when-paid" clause must make payment from the owner an unambiguous condition precedent to a general contractor's obligation to pay the subcontractor in order to be effective.

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BUILDING INSPECTORS BEWARE – RECENT CASE ALLOWS CLAIM OF GROSS NEGLIGENCE TO PROCEED

By Benjamin Hammond

The Court of Appeals in *The Bayberry Group, Inc., d/b/a The Homestead v Novak, et. seq.*, recently affirmed the trial court’s ruling that an owner of a resort in Leelanau County can proceed with a lawsuit under a theory of gross negligence against two building inspectors. The building inspectors performed initial inspections of “B-vent fireplaces” at the rough-in stage of a hotel construction project, and again at the conclusion of the rough-in approved all of the units.

Before the final inspection, the hotel rooms were rented to guests and the B-vent fireplaces emitted smoke and soot in the occupied rooms. At the final inspection, the inspectors failed the B-vents for not being “sealed units”. The Michigan Building Code prohibits installation of B-vent fireplaces which have a glass door opening into and drawing combustion air from the room where it is installed. (2000 MRC M1701.4.) The Building Code requires that fuel burning appliances be vented to the outside according to the manufacturer’s instructions. (2000 MRC M1801.1.)

The plaintiff incurred \$260,000 in damages including having all of the fireplaces removed and replaced. In addition to suing the contractor who installed the fireplaces, plaintiff sued the building inspectors for approving the fireplaces at the rough-in stage because such fireplaces were prohibited by the Michigan Residential Code for hotel rooms.

In order to overcome governmental immunity which is given to building inspectors by statute, plaintiff was required to plead and prove that the actions or inaction of the building inspectors constituted gross negligence. Gross negligence is defined as “conduct so reckless as to demonstrate a substantial lack of concern for whether an injury results”. MCL 691.1407(7)(a). Also, the plaintiff must prove that the building inspectors’ conduct was the

“one most immediate, efficient, and direct cause” of plaintiff’s damages. *Id.* at 5.

The Plaintiff argued that the inspectors were aware the fireplaces violated the Building Code and approved them without inquiring about an alternative, code compliant method to vent. The inspectors were aware that the B-vent fireplaces could not be installed without posing potentially lethal danger. Thus, the inspectors conduct could be found to demonstrate a substantial lack of concern for plaintiff’s own need to comply with the Building Code and also for the health, safety, and lives of plaintiff’s hotel guests.

The Court concluded that the inspectors owed plaintiff a duty at the rough-in stage to approve only fireplaces that were code-compliant. Ultimately, the Court held that the case should proceed to trial because a reasonable jury could conclude that defendants’ conduct in approving the Code-violating B-vent fireplaces at the rough-in stage inspection constituted gross negligence. Also, since the contractor testified that he would have stopped work had the inspectors issued a stop work order at the rough-in stage, a jury could find that the conduct of the inspectors was “the most immediate, efficient, and direct cause” of plaintiff’s damages.

This case is another example of the recent trend in the Court of Appeals to allow gross negligence cases to proceed to trial based on issues of fact. If this trend continues, we expect to see many more lawsuits filed alleging gross negligence against governmental employees, including building inspectors.

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