



# AGC Legal Brief

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## Minding the Statute of Limitations: The Court of Appeals Clarifies Limitations Periods in Construction Cases

by Jeffrey S. Theuer

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The Court of Appeals weighed in on important statute of limitations issues in two construction cases of note in 2009. These decisions suggest that contractors should carefully review their contracts and supplier invoices, and object to unreasonable contractual limitations periods or performance guarantees.

### *Characterizing the Claim as Malpractice or Breach of Contract*

In *Consoer Townsend Envirodyne Engineers, Inc. v City of Grand Rapids*, Docket No. 283563 (Unpublished September 22, 2009), the Court clarified the difference between a malpractice claim and a contract claim for purposes of applying the appropriate statute of limitations. This can be an important issue since malpractice claims are subject to a two year statute of limitations (MCL 600.5805(6)), while the limitations period for contract actions is six years under MCL 600.5807. Contractors with unlitigated claims more than two years old should be advised to review those claims to determine whether a limitations defense may apply.

The case involved the breach of an engineering services agreement. The City of Grand Rapids ("City") needed to update its wastewater treatment plant. Its current system, the "Zimpro heat treatment process" was nearing the end of its life cycle, and the City was looking for options to replace it. In March of 1996, Consoer Townsend Envirodyne Engineers, Inc. ("CTE") and the City entered into an engineering services contract, which divided work to be completed in three phases: (1) a study phase; (2) a design phase; and (3) a construction phase. Initially, CTE was only authorized to pursue the study phase, which was to be completed on August 31, 1996. The engineer was to "proceed diligently" with the design and construction phases as the project schedule required, "or as mutually agreed to" by the City and CTE. Phase 1 was satisfactorily completed. However, in early 1998, while CTE was completing its Phase 1 services, the existing Zimpro system failed, which required the City to landfill its sludge at considerable expense, rather than treating and selling the sludge as fertilizer. CTE completed a preliminary design report ("PDR") which increased the scope of work for the project, and the City subsequently approved an increase in compensation for CTE based on the PDR. The "kick-off" meeting for Phase 2 occurred on October 27, 1998, and the parties agreed that Phase 2 would be completed when CTE submitted completed and biddable drawings for all facilities included in the project. Sludge storage facility drawings were to be completed by December 1, 1998 so that tanks could be completed and ready for use by October of 1999. Drawings for cogeneration facilities and rehabilitation of the existing digester were due in January 1999. Drawings for the new digester were due in April of 1999. The timing of all of these drawings was intended to allow the City to take advantage of the 1999 construction season.

Final sludge storage facility drawings were not delivered until May 1999, about a half a year after the December, 1998 deadline. At the same time, CTE informed the City that the cost of the sludge storage tanks had doubled from the original PDR. It was subsequently discovered that the final drawings for the storage tanks were not biddable because they did not meet regulatory requirements. CTE then notified the City that it was already over budget for the total Phase 2 services and would need an additional \$766,000 to complete Phase 2. The project was suspended, and in June of 1999, the City hired another engineering firm. The City never terminated its contract with CTE, but received no more professional services from CTE after December 1, 2000. CTE never completed the additional Phase 2 drawings.

CTE filed a complaint against the City on July 23, 2002. The City denied the allegations of the complaint, and filed a counter-claim on January 7, 2003, more than



## Minding the Statute of Limitations *(continued)*

2 years after receiving the last services from CTE. The counter complaint asserted one count of breach of contract and two counts of negligence for failure to design a suitable plan. Subsequently, CTE's claims were dismissed on the City's motion for partial summary disposition, except for a portion of its contract claim limited to the amounts authorized by the City for the completion of Phase 2 services. CTE asserted that all of the City's claims were barred by the two year statute of limitations for malpractice actions, and that the City's breach of contract claims were merely disguised malpractice claims which should be barred under the two year statute.

After a seven day bench trial, the trial court ruled in favor of the City on its contract claim, and entered judgment in favor of the City for \$1,002,399.

The Court of Appeals stepped boldly into the gray area between malpractice and contract claims, breathing new life into the status of contract claims when design malpractice is also alleged. The Court first acknowledged the general rule that "a malpractice claim may not be recast as a contract claim in order to avoid the time-bar under the two-year statute of limitations for malpractice." In other words, when allegations of contractual duties are indistinguishable from the duty to render services in accordance with the applicable standard of care, the action sounds in malpractice, not in contract, and the two year limitations period for malpractice will apply. However, even where malpractice has properly been asserted, in certain instances, a "special agreement" may arise "under which the professional has guaranteed a particular result or has agreed to act above the basic standard of professional care required." In that case, a breach of contract may also be asserted, with the applicable six year statute of limitations. The Court's description of when a contract claim may be asserted leaves a great deal open to interpretation within the facts of a particular case:

The key to distinguishing between a malpractice action and a contract claim, and thus determining whether it is governed by a particular statute of limitations, is to look to the basis of the allegations and the type of interest that has allegedly been harmed.

\* \* If a reading of the claim as a whole indicates that the defendant failed to exercise the requisite skill, the action is one in malpractice, but if the claim indicates that the professional failed to perform a special agreement, then the action is one in contract. \* \*

Thus, a claim regarding inadequate or faulty engineering services, in the absence of any breach of some sort of professional agreement, sounds in malpractice and must be governed by the malpractice statute of limitations, even if a claimant couches his complaint in breach of contract terms.

The Court concluded that on the surrounding factual record, the City's claim was one for breach of contract, and therefore, not time barred by the two year malpractice limitations period. The Court determined that the City's damages stemmed not from failure to provide adequate engineering services, but from failure to abide by the specific requirements created by the contractual agreement between the parties. This factually-based standard may increase the time in which claims may be brought against design and engineering professionals on construction projects. Contractors and other construction professionals should carefully review their contracts to determine whether they contain obligations to perform specific obligations, such as guaranteeing a particular result, or acting above the basic standard of professional care. Examples might include language requiring the contractor to "proceed diligently" with services, or providing services to an owner's "satisfaction". In such a case, the contractor or design professional may not be able to rely upon the two-year malpractice statute of limitations.

### *Contractual Limitations Period In a Supplier Invoice Upheld*

The Court of Appeals upheld a contractual limitations period much shorter than allowed by statute in a recent published opinion. In *Liparoto Construction, Inc. v General Shale Brick, Inc.*, 284 Mich App 25 (2009), a home construction company, Liparoto Construction, Inc. ("LCI") filed suit against a brick manufacturer, General Shale Brick, Inc. ("GSB"), and a brick supplier, Lincoln Brick and Stone ("Lincoln Brick"), asserting breach of contract and breach of warranties for discoloration of bricks used to construct a home, as well as claims against an insurer for denial of coverage. The homeowners filed an administrative proceeding against LCI, during which it was concluded that the bricks were discolored due to a latent defect that occurred during manufacturing or warehousing. LCI subsequently agreed to correct the problem and sought to recover the cost of those corrections against GSB and Lincoln Brick.

The trial court granted summary disposition in favor of Lincoln Brick on grounds that the action was barred by a one-year contractual limitations period contained in Lincoln Brick's invoice. The Uniform Commercial Code provides a four year statute of limitations for the purchaser of defective goods seeking to recover economic loss and incidental and consequential damages. MCL 440.2725. However, the Court recognized that parties to a contract may agree to a shortened limitations period, unless the provision violates the law or public policy, or is otherwise unenforceable under traditional contract defenses, including duress, waiver, estoppel, fraud, or unconscionability. *Id.*, at 30. LCI asserted that the one-year contractual period contained in Lincoln Brick's invoice was procedurally and substantively unconscionable, and alternatively that equitable tolling should preclude Lincoln Brick from relying on the one-year statute of limitations. The Court noted that for a contract provision to be considered unconscionable, both procedural and substantive unconscionability must be present. Procedural unconscionability exists "where the weaker party had no realistic alternative to acceptance of the term." Substantive unconscionability exists "where the challenged term is not substantively reasonable." A provision is not substantively unconscionable, however, simply because it is foolish for one

## **Minding the Statute of Limitations** *(continued)*

party or very advantageous to the other.” Instead, the inequity must be so extreme as to “shock the conscience.”

In this case, LCI asserted that the limitations period was procedurally unconscionable because it had no realistic alternative to acceptance of the term. However, the Court rejected this contention because the plaintiff presented no evidence that it was unable to purchase the brick from another supplier or that Lincoln Brick was unwilling to provide the brick under different terms. LCI’s claim for substantive unconscionability was rejected because the record showed that the discoloration was detectable within one year of the construction, and therefore the limitations period was substantively reasonable since the defect could be detected within the time required to bring an action for relief. Finally, the Court determined that equitable tolling did not apply because application of the doctrine to contractual limitations periods would be “inconsistent with the deference afforded to parties’ freedom to contract, including the freedom to avoid, by contract, what might otherwise be an applicable rule of law.”

The Liparoto decision confirms the enforceability of contractual limitations, even where those periods result in a significantly shorter time to bring suit than otherwise allowed by statute. This counsels that contractors closely examine contracts, including terms contained in supplier invoices which might not always be carefully reviewed, in order to determine whether the contractor’s rights have been limited. The case also provides some guidelines for challenging contractual limitations periods. For example, where services or materials are reasonably available only from a sole source, a contractual limitations period may be determined to be unconscionable. Further, if a short limitations provision is discovered within a supplier invoice or contract, contractors would be wise to object in writing to the term in the case of an invoice, or make an express attempt to renegotiate the limitations provision in a contract. Proof of these activities will aid in a challenge to the contractual provision in the event of a later dispute.

## **Stopped Check No Defense to Waiver of Lien**

by Jeffrey S. Theuer

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Most contractors understand that they should not submit a full unconditional waiver of lien until payment is received for their work. Sometimes, however, the form of that payment makes all the difference. In *Structural Engineering Solutions, LLC v Vision Development Properties and Rentals, LLC*, Docket No. 286492 (Unpublished, November 19, 2009), the Court of Appeals invalidated a subcontractor’s lien even though the check for which it exchanged a full unconditional waiver was stopped by the contractor.

Structural Engineering Solutions, LLC (“SES”) filed an action to foreclose on a construction lien for materials supplied to its contractor Echelon Enterprises, LLC (“Echelon”), and the property owners. The property owners moved to dismiss the lien because they made payments to Echelon relying on full unconditional waivers of lien signed by SES. SES argued that the waivers of lien were not valid because it signed the waivers in exchange for Echelon’s payment by check, and that Echelon subsequently stopped payment on the check.

The Court acknowledged that MCL 570.1109(6) requires that an owner make payment pursuant to a waiver of lien or sworn statement before a lien will be deemed unenforceable. In this case, the owner produced a signed waiver of lien. The evidence showed that Echelon stopped payment on the check to SES after Echelon learned that SES had not paid its own supplier, who in turn threatened to place a lien on the development. The Court held that a waiver of lien under the Michigan Construction Lien Act is effective “when a person makes payment relying on the waiver unless at the time the payment was made the person making the payment has written notice that the consideration for the waiver has failed.” This, the Court determined, is the only statutory basis that a waiver of lien is invalid for failure of consideration. Once payment is made to obtain a waiver of lien, the waiver is effective unless the person making the payment had written notice that the consideration was lacking. Accordingly, SES’ claim of lien was invalidated.

The lesson to be taken from SES is that full unconditional waivers should only be exchanged for cash, or after the money is in the bank. Otherwise, the contractor submitting the full unconditional waiver takes the risk that the check will bounce or be dishonored by the bank.

## **Can a “Time is of the Essence” Clause be Implied? Yes, Says the Court of Appeals**

by Jeffrey S. Theuer

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Most contractors are aware of the general rule that time is not regarded to be of the essence in a contract unless made so by express provision of the parties. This contract provision, known as a “time is of the essence” clause makes contractual deadlines material to contract performance, and supports a claim for breach of contract if such a deadline is missed. There is, however, a second, less known means of creating a time is of the essence provision. This is the implied time is of the essence clause, which may be established by the nature of the contract, or the circumstances under which it was created. This corollary rule has existed since at least 1976, when announced in the case of *MacRitchie v Plumb*, 70 Mich App 242, 246 (1976) (“the general rule is that time is not to be regarded as of the essence of a contract unless made so by express provision of the parties or by the nature of the contract itself, or by circumstances by which it was executed.”). An implied time is of the essence clause was recently allowed in the case *Consoer Townsend*



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**Can a "Time is of the Essence" Clause be Implied? (continued)**

Envirodyne Engineers, Inc. v City of Grand Rapids, Docket Number 283563 (Unpublished, September 22, 2009). The facts of the Consoer case are described in the Statute of Limitations section above. As an alternative to its statute of limitations defense, Consoer Townsend Envirodyne Engineers, Inc. ("CTE") asserted that it did not materially breach the contract because the contract contained no express "time is of the essence" provision. The Court rejected this defense.

The Court acknowledged the general rule, citing MacRitchie. However, the Court went on to determine that on the facts of the case, the parties had agreed to a "deliberatively aggressive schedule", and based on that fact, it was "obvious" that time was of the essence. The Court found it particularly persuasive that the parties set a December 1998 deadline for completion of storage facility drawings so that the City could take advantage of the 1999 construction season. Otherwise, the City would continue to bear the expense of landfilling its sludge at significant cost, rather than treating the sludge and selling it as fertilizer. Because both parties understood the cost implication of the deadlines contained in the contract, the Court implied a "time is of the essence" clause, again citing MacRitchie.

Because most contractual deadlines are imposed for legitimate business reasons, contractors should not assume that contractual deadlines do not constitute material terms of their contracts, even if a "time is of the essence" clause does not appear in the contract itself. Courts may imply such a provision based on the particular facts of each project.

**No Private Cause of Action Under Single State Construction Code Act**

by Jeffrey S. Theuer [jstheuer@loomislaw.com](mailto:jstheuer@loomislaw.com)

The Court of Appeals recently rejected a plaintiff's cause of action based on an alleged violation of the Single State Construction Code Act ("SSCCA"), MCL 125.1501, et seq. See Manning v Iron Horse Country Store, LLC, Docket No. 286787 (Unpublished, December 17, 2009).

In Manning, the plaintiff was injured when she fell over a downspout across defendant's sidewalk. Plaintiff argued that the defendant was liable for her injuries as a matter of law because it had violated a statutory duty to her under the SSCCA. The SSCCA adopted a single construction code applicable throughout the state, and incorporates various national and international residential and building codes. One of the express objectives of the statute is to ensure adequate maintenance of buildings and structures throughout the state, and to adequately protect health, safety, and welfare of the people. MCL 125.1504(3)(e). Plaintiff argued that the construction of a downspout over a sidewalk violated the statute, which in turn created a rebuttable presumption of negligence.

The Court of Appeals rejected plaintiff's claim, holding that a plaintiff must first establish that the cited statute is intended to protect against the result of the violation. The Court then determined that the purpose of the SSCCA is not to protect the public against harm, "but merely to establish the authority. . .to 'prepare and promulgate' a state construction code consistent with, and protective of, the 'health, safety, and welfare of the occupants of buildings and structures.'" As a result, the Court held that the SSCCA was not intended to provide a private cause of action stemming from a violation of the code.

Although an unpublished decision, the Manning case supports the elimination of negligence liability based upon alleged violations of construction codes subject to the SSCCA. It may also be used to limit liability against contractors for alleged violations of other statute-based construction regulations and codes.

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