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INSIDE THIS ISSUE:

Contractors Can Assist Municipalities to Build Infrastructure Through IPA's

Don't Be Late with Miss Dig

General Contractor Liability for Subcontractor Negligence

Highlights of the Recent 2007 Version of A201, The "General Conditions of the Contract for Construction"

Saving Labor Costs with Prevailing Wage Projects

These articles were prepared by Foster, Swift, Collins & Smith, P.C. with offices in Lansing, Grand Rapids, Farmington Hills and Detroit. They are intended to highlight a specific area of the law. This communication is not legal advice. The reader should consult an attorney to determine how the information applies to any specific situation.

CONTRACTORS CAN ASSIST MUNICIPALITIES TO BUILD INFRASTRUCTURE THROUGH IPA'S

by David M. Lick dlick@fosterswift.com

Municipalities have been permitted by statute for many years to purchase real and personal property through installment purchase agreements (IPAs). IPAs have traditionally been used to finance fire trucks, police cars, and other personal property. A less-known use of IPAs is for the financing of water and sewer infrastructure projects, or for public buildings, such as fire stations and township halls. An IPA for these kinds of projects can have unique attributes and advantages over traditional bond financing, including greater flexibility and lower cost.

Contractors can assist a municipality that desires to obtain a project that has been stalled for one reason or another. In one scenario where a municipality does not have the up front cash to obtain a design or pay for bond financing, a contractor can provide a design build-construction-financing approach to build the project. The contractor's overall design construction financing and construction costs will be built into the ultimate price that would be submitted through an RFP proposal or in some instances, sole sourced. At the completion of the project, the contractor would issue a bill of sale of the finished project to the municipality in exchange for the municipality's unconditional obligation to pay. The terms of the unconditional obligation to pay as to amount, interest and term of repayment would be negotiated with a financial institution and the municipality prior to commencement of the project. Upon completion of the unconditional obligation to pay, the contractor would assign it to the financial institution in exchange for full payment for the project. Once the contractor is paid, the municipality would begin its installment payments of principal and interest to the financial institution.

The above-described financing and construction model has been used successfully many times throughout the state. The details of the financial arrangement are described below. The bank or broker will generally accept the assignment of the IPA obligation without security if it is backed by a municipality's limited-tax full faith and credit. However, the obligation is generally viewed as secure even though no security attaches to it because the unconditional obligation of a municipality is a debt of a municipality that would ultimately be funded by tax dollars.

The interest rate of the unconditional obligation to pay by the township can be negotiated or could be a rate set by a brokerage firm that would market the payment obligation to ultimate purchasers of the unconditional obligation to pay. The installment interest rate could contain a cap tied to the revenue bond index.

Certain projects financed under the installment purchase method have the ability to result in an interest rate lower than the revenue bond index. When the obligation is less than \$10 million, it qualifies under a small issuance provision of the IRS Code, which permits any financial institution that purchases the obligation to receive an 80% deduction for its carrying charges. This Internal Revenue Code provision enhances the obligation in the bank's portfolio and usually mitigates the interest rate that a municipality would be required to pay. It is also attractive to local banks who have an obligation to invest in the community in which they do business and in some instances fulfills their regulatory requirements relating to community reinvestment.

Financing through the installment purchase method reduces administrative fees and underwriting costs that are typically associated with traditional bond financing methods. The method also permits capping the cost of the purchase, capping the interest rate, and can be utilized without regard to a bond rating. Typical installment purchase contracts are able to be commenced and completed in a shorter period of time than occurs utilizing the traditional bond method. Installment financing would not require a vote of the citizens of the municipality, is exempt from the Municipal Finance Act, and does not require review by the Michigan Finance Commission.

However, in order to qualify for the installment purchase contract method, (i) the contract payback shall not exceed 15 years, or the useful life of the property, and (ii) the total of all indebtedness contracts of the municipality shall not exceed one and one-quarter percent of the equalized assessed value of all real and personal property within the municipality.

The above method is an excellent way for contractors to assist municipalities to develop infrastructure projects.



A CHAPTER OF THE
ASSOCIATED GENERAL CONTRACTORS OF AMERICA

DON'T BE LATE WITH MISS DIG

by Cole Young cyoung@fosterswift.com

Contractors and subcontractors must always remain cautious of every single detail of a project. Whether a general contractor or subcontractor, it is equally important to be aware of the activities and liabilities of the other contractors on a project. This can be a difficult task when there are multiple parties involved. Regardless, it is an important task that will save you time and money in the long run.

A recent example of the interconnectedness of general contractors and subcontractors involved underground transmission lines. The Michigan Court of Appeals in *SBC v Crawford, Inc* made several important decisions regarding the Protection of Underground Facilities Act (MCL 460.701, *et seq.*, also known as the "MISS DIG" Act). In *Crawford*, Consumers Energy hired a general contractor, Henkels & McCoy, to repair several underground gas transmission lines. Henkels then subcontracted with Crawford to do the necessary pile-driving. Before work began, Henkels contacted MISS DIG for the location of underground utility lines; Crawford did not contact MISS DIG. While pile-driving, Crawford transected several SBC cables. Consequently, SBC sued Crawford for damages.

Crawford argued that pile-driving is not a covered activity under the MISS DIG Act because it is not explicitly mentioned in the Act. The Court disagreed, however, and held that pile-driving is included under the Act because it is implicitly part of "excavation," a regulated activity under the Act. Therefore, the Court held that pile-driving activities require compliance with MISS DIG.

Next, Crawford argued that Henkels, not Crawford, was responsible for contacting MISS DIG. The Court agreed with this argument, holding that under the Act, the excavator hired to perform the work is responsible for contacting MISS DIG and obtaining a project ticket. Consumers Energy hired Henkels to perform the excavation services, and accordingly, Henkels was in the best position to provide the necessary information to MISS DIG. The Court held that Crawford, the subcontractor, was not required to contact MISS DIG. Rather, Crawford could rely on Henkels' notice to MISS DIG.

Finally, Crawford was dealt a serious blow when the Court held that because Crawford began the pile-driving one day after the expiration the MISS DIG project ticket, Crawford could be held responsible for the resulting damage to SBC. Even though Crawford could rely on Henkels' request to MISS DIG, the ticket issued by MISS DIG had expired by the time excavation work actually began. The MISS DIG Act requires that notice of intent to excavate must be given no more than 21 days before commencing the excavation. The Court held that excavation work "commences" when machinery or equipment intended for such work breaks the ground. The Act provides an action for liability if underground utilities are damaged and the damaging party failed to give the required notice. Here, Crawford was just one day late. Crawford commenced pile-driving 22 days after notice was given to MISS DIG, and accordingly, had violated the 21-day notice requirement. This seemingly insignificant mistake subjected Crawford to costly liability under the Act.

The holding of this case serves as an important reminder to contractors and subcontractors. "Excavation" under the MISS DIG Act includes pile-driving, and therefore, requires compliance with the Act. Where a general contractor is hired to perform excavation, it is that contractor's responsibility to contact MISS DIG. A subcontractor can rely on the general contractor's notice given to MISS DIG, but must make sure that the project ticket has not expired. As demonstrated above, courts strictly interpret the MISS DIG Act's 21-day requirement. Thus, all contractors must be aware that if they commence work after the expiration of a MISS DIG project ticket, they may be subjected to liability. A single day may make all the difference.

GENERAL CONTRACTOR LIABILITY FOR SUBCONTRACTOR NEGLIGENCE

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Once upon a time, property owners and general contractors could not be held liable for the negligence of independent subcontractors or their employees. However, as the use of subcontractors increased and subcontractors retained their own subcontractors, those suffering damage due to subcontractor negligence found it harder and harder to find someone to sue who was both solvent and responsible. Thus, the courts developed theories under which owners or general contractors could be held liable for the negligence of subcontractors. These theories usually were grounded on the amount of control retained by the owner or general contractor over the work being done. In July, 2004, the Michigan Supreme Court announced its decision in *Ornsby v Capital Welding*, which went a long way toward clarifying the circumstances under which an owner or general contractor may be held liable for the negligence of subcontractors or their employees. Although the *Ornsby* case involved an accident during the construction of an office building, the Supreme Court's ruling will be applicable to all construction projects where subcontractors are employed.

The *Ornsby* case arose out of a construction accident that occurred during the construction of a Rite Aid store in Troy, Michigan. The owner of the project, Rite Aid, hired general contractor, Monarch Building Services. Monarch subcontracted the steel fabrication and erection to Capital Welding. Capital Welding then subcontracted the steel erection work to Abray Steel Erectors. Ralph Ornsby, an employee of Abray, was injured when part of the structure collapsed due to overloading unsecured joists with bundles of steel decking. Mr. Ornsby was limited to workmen's compensation benefits from his employer, Abray. Therefore, he sued Monarch and Capital Welding arguing that these contractors had "retained control" over and negligently supervised the construction project.

The Supreme Court rejected application of the "retained control" rule to general contractors. Rather, the Court applied a three part "common work area" rule to determine general contractor liability. Under this rule, a general contractor, like Monarch may be found liable if (1) the contractor failed to take reasonable steps within its supervisory and coordinating authority, (2) to guard against observable and avoidable dangers, (3) that create a high degree of risk to a significant number of workers in a common work area. The determination of what constitutes "reasonable steps", "observable and avoidable dangers", "high degree of risk", and "significant number of people" are likely to be subjective assessments made on a case by case basis.

Owners, such as Rite Aid, will still be subject to the "retained control" rule. Where the owner retains sufficient control over the work to have an actual effect on the method or conditions under which work is performed, it will assume the duties and liabilities of a general contractor. Thus, where the owner has "retained control", it will be subject to the three part "common work area" rule.

Under these rules, there may be circumstances where there is both a general contractor and an owner with retained control, and both may be found liable. In such a case, the jury will apportion liability according to the relative fault it assigns to each.

A surprise "winner" in the *Ornsby* case appears to be the subcontractor. The Supreme Court ruling (and a subsequent unpublished ruling by the Michigan Court of Appeals) suggests that a subcontractor, even a subcontractor like Capital Welding, that hires its own subcontractors, will not be subject to "common work area" liability for the negligence of its subcontractors.

¹ *SBC v Crawford, Inc*, unpublished opinion of the Court of Appeals, entered November 27, 2007 (Docket No. 275334)

HIGHLIGHTS OF THE RECENT 2007 VERSION OF A201, THE "GENERAL CONDITIONS OF THE CONTRACT FOR CONSTRUCTION"

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The American Institute of Architects ("AIA") recently published revised versions of some of its key contract documents, many of which had not been revised since 1997. Among the key documents revised is the widely used A201 entitled "General Conditions of the Contract for Construction." A comprehensive analysis of each of the revised provisions of the new A201 is beyond the scope of this article. Nonetheless, the following are some of the key changes to the 2007 version of the A201.

Dispute Resolution

Under the 1997 A201, disputes arising between the owner and contractor were first referred to the project architect for an initial decision. The 2007 A201 now allows the parties to instead hire a third party initial decision maker to attempt to resolve such disputes. If the owner and contractor do not elect to pay the additional fee and hire a third party decision maker, the project architect still may serve as the initial decision maker.

If the initial decision-making process fails, under the 1997 A201, the parties were then required to attempt to mediate the dispute before proceeding to arbitration, which was the default method of binding dispute resolution. Although the parties still are required to submit to mediation before turning to either arbitration or litigation, the 2007 version of A101 allows the owner and contractor to select either mandatory arbitration or litigation as the method of binding dispute resolution. If neither option is selected when the contract is drafted, the default method of dispute resolution is now litigation.

Insurance

The most significant change to the insurance language of the A201 is that the contractor is now required to name the owner and the architect as additional insureds on contractor's liability policies. Additionally, the contractor is now required to obtain completed operations coverage, which must also name the owner as an additional insured.

The Project Management Liability Insurance requirement in the 1997 A201 was removed in the 2007 version. According to the AIA, feedback received during the revision process indicated that this requirement was rarely used by owners and contractors.

Financial Requirements

The 2007 A201 places restrictions on a contractor's right to demand financial information from the owner after the work on the project commences. In the 1997 version, the contractor was permitted at any time during the project to request that the owner provide evidence of sufficient financing for the project. Under the 2007 A201, the contractor still may request such information before the work commences. After the work commences, however, the contractor may only request such information if the owner fails to make payment, if there is a material change in the work or if the contractor identifies, in writing, a reasonable concern regarding the owner's ability to make payment in a timely manner.

The 2007 A201 also contains more stringent requirements regarding payment to subcontractors and suppliers. The contractor is now required to issue payment to its subcontractors and suppliers within seven days of receipt of payment from the owner. Similarly, the owner now has the right to demand that the contractor provide the owner with satisfactory evidence that it has paid its subcontractors and suppliers. If the contractor fails to provide such evidence, the owner may contact such subcontractors and suppliers directly and has the ability to issue checks made jointly payable to the contractor and the subcontractors and suppliers.

Consolidation and Joinder

The AIA documents have historically prohibited joining arbitration claims by the owner against the architect with claims against the contractor. Owners do not like that arrangement since it prevents an owner from getting its builder and designer into the same arbitration, unless they both consent. The result can be multiple, costly arbitrations and inconsistent outcomes. Owners and their lawyers routinely change that clause. In 2007, this was deleted and the owner can now join builders and designers in one arbitration.

Time Limits on Claims

In Section 13.7 of the 1997 edition of A201, the concept of an internal statute of limitations was introduced. This clause dictated when statute of limitations would begin to run. The result was that some claims were barred before they ever even occurred. The clause was often deleted, especially by owners who argued the clause is unfair, and the parties should stick with State law. The new A201 deletes former Section 13.7 and revises it to state that the applicable State law governs. AIA's new clause says that the time limit for commencing claims is determined by State law, but in any case not more than 10 years after Substantial Completion.

* * *

Readers who wish to fully review all the changes and impacts of the AIA revisions, or would like further information, should consult with legal counsel.

SAVING LABOR COSTS WITH PREVAILING WAGE PROJECTS

by Sherry A. Stein sstein@fosterswift.com

Employers that provide services for public works projects covered by the Davis Bacon Act or state prevailing wage laws are required to pay a "prevailing wage" to employees who work on these projects. The employer may satisfy its prevailing wage obligation by directly paying a higher hourly rate to those employees who are performing work covered by the prevailing wage laws. In that case, both the employer and the employee pay employment taxes on the additional wages. Alternatively, the employer may pay the difference between an employee's current wage rate and the prevailing rate into a qualified pension or deferred compensation plan and receive a credit towards the required prevailing wage rate. The contribution to a qualified deferred compensation plan would be in lieu of paying the differential as an increased hourly wage. Such contributions are not subject to employment taxes by either the employer or the employee and allow the employer to be more competitive in bidding on projects covered by prevailing wage laws. The deferred compensation program is also beneficial to employees because employment taxes are avoided and income taxes are postponed.



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SAVING LABOR COSTS WITH PREVAILING WAGE PROJECTS (continued)

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The advantages of making payments to a bona fide deferred compensation plan in satisfaction of all or a portion of the employer's obligation to pay the prevailing wage for public work projects are summarized below.

Advantages for Employer

- \$ Prevailing wage credit is given for contributions made to a bona fide fringe benefit plan, such as qualified deferred compensation plan.
- \$ Employer recognizes cost savings because the contributions avoid payroll taxes (federal, state, local and social security).
- \$ Allows for more competitive bidding.
- \$ Permits level wages between prevailing and non-prevailing wage work.
- \$ Immediate deduction is given to the employer for contributions made to the deferred compensation plan.

Advantages for Employee

- \$ Immediate participation in a deferred compensation plan.
- \$ 100% vesting in contributions made to the plan.
- \$ Avoids FICA taxes.
- \$ Postpones income taxes on contributions and earnings until benefits are distributed.
- \$ Benefit is portable (i.e., may be transferred to an IRA).

Requirements for Prevailing Wage Contributions

- \$ Made to a bona fide fringe benefit ERISA plan.
- \$ Immediate participation in the plan.
- \$ No age, service or last day employment requirement permitted.
- \$ Immediate vesting.
- \$ Contributions must be made at least quarterly.
- \$ Administrative expenses may not be charged to the prevailing wage contribution accounts.
- \$ Prevailing wage contributions are in addition to any other contributions made by the employer.
- \$ Additional employee and/or employer contributions are permitted under the plan. These additional contributions are not subject to the requirements listed above.
- \$ The prevailing wage contribution may be made to a separate deferred compensation plan established solely for the prevailing wage contribution, or may be a feature added to the employer's current deferred compensation plan.

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