SURVEY OF RECENT DEVELOPMENTS IN MICHIGAN CONSTRUCTION LAW

Construction Law, Construction Site Accidents, Contractors' Legal Issues, OSHA/MIOSHA Issues Practice Groups

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With the November 2008 elections behind us and new legislators, judges and Supreme Court Justices taking the reins, Michigan construction law is in a period of transition.

That is no more evident than in the three legal developments outlined in the foregoing article. Some of the developments were the result of shifting judicial ideologies, while others are attributable to the troubled economic climate. In fact, we have seen the possible erosion of a significant defense available to contractors in defending personal injury claims sustained by individuals on construction sites.

The Michigan Legislature has also jumped into the fray by passing legislation that provides tax breaks to entities involved in construction projects. Not to be outdone, the Michigan Supreme Court recently addressed questions surrounding the enforceability of risk transfer provisions, such as indemnity clauses, found in construction contracts. As members of the new legislature and judiciary take hold, there is no doubt that there will be significantly more modifications in Michigan construction law.

IS THE "PRIVITY OF CONTRACT" DEFENSE FOR TORT CLAIMS BROUGHT AGAINST CONTRACTORS ON THE RETREAT?

The Michigan Supreme Court's decision in *Funk v. General Motors Corp*, 392 Mich 91 (1974) addressed the potential liability of project owners and general contractors for construction site injuries involving hands-on workers, but did not rule on the potential liability of subcontractors, nor the potential liability of general contractors and subcontractors to third-party strangers to the construction contract.

That's where the defense of privity of contract comes into play. "Privity of contract" is a legal term that, in essence, prohibits parties that are not signatories to a contract from bringing a lawsuit based upon that contract. Beginning in the late 1950s, privity disappeared as a viable defense for personal injury cases. While privity of contract still remained for certain actions, on the whole, privity was a rarely viable way to contest claims, especially on construction sites.

In 2004, the Michigan Supreme Court resurrected the defense in a garden variety slip-and-fall case. In *Fultz v. Union Commerce Assoc.*, 470 Mich 460 (2004), the Supreme Court held that a snow removal contractor ,hired by the parking lot owner, could not be sued by the injured plaintiff ,who had no contractual relationship with the snow removal contractor or the premises owner.

Since the decision in *Fultz*, a fair number of cases have been decided in favor of construction contractors by the Michigan Court of Appeals and Michigan Supreme Court.

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One of the more interesting cases was *Banaszak v. Northwest Airlines, Inc.,* 477 Mich 895 (2006). The case arose out of the construction of the McNamara terminal at Detroit Metropolitan Airport in 2001. The project owner, Northwest Airlines, had entered into a contract a general contractor for construction of the new terminal building. However, Northwest Airlines had a direct contract with an elevator company to construct the elevators, escalators and moving walkways throughout the new terminal. The plaintiff was an employee of an electrical subcontractor, one of the general contractor's subcontractors.

On the day of her injury, the plaintiff was working in the vicinity of a moving walkway being installed by the elevator company. At the end of each walkway was a hole in the floor in which the elevator company installed all of the motors for the walkways. When the plaintiff's accident occured, there was a piece of plywood covering the hole at the end of one of the walkways. She walked across the piece of plywood, which collapsed beneath her, resulting in serious injuries.

In its contract with Northwest Airlines, the elevator company agreed to comply with all applicable OSHA regulations for safety on the job site. It was undisputed that the piece of plywood, which collapsed beneath plaintiff ,was only about ¼" thick, at variance with OSHA rules.

Among others, the plaintiff sued the elevator company, but the trial court dismissed her case against the elevator company on the basis that the plaintiff was a stranger to the contract between Northwest Airlines and the elevator company. The Michigan Court of Appeals subsequently reversed the trial court's ruling, relying on a previous decision that allowed a stranger to a contract to maintain an action against a contractor when the contractor creates a "new hazard" that was not within the scope of work delineated in the contract.

The appellate court asserted that its decision was consistent with the *Fultz* analysis, which the court interpreted as permitting tort claims against contractors, which create a new or increased hazard to the injured party.

In ruling for plaintiff, the appellate court concluded that when employees of the elevator company laid down an inadequate piece of plywood over the machinery hole, a "new hazard" was created, therefore validating the plaintiff's suit against the elevator company. The Michigan Supreme Court ultimately rejected the "new hazard" analysis and found that the elevator company was not liable to the plaintiff.

Underscoring its repudiation of the "new hazard" analysis, the Supreme Court reversed another opinion of the Michigan Court of Appeals in 2007 decision. In that case, the plaintiff slipped and fell on ice in a parking lot, which she claimed was the product of melting/re-freezing snow piled high on landscaped curb islands in the parking lot owned by her employer. She sued the snow removal company on the theory that the piles of snow created a "new hazard" because of their proclivity for melting and re-freezing.

The snow removal company was ultimately dismissed from the litigation and the plaintiff appealed. The Michigan Court of Appeals reversed the trial court, finding that the defendant had created a "new hazard" during the course of its work. Like the appellate court had done in

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previous cases, the court relied upon the Supreme Court's opinion in *Fultz.*

After *Fultz,* and its progeny, construction attorneys latched on to the privity of contract defense and used it to defend general contractors, subcontractors, architects and engineers from personal injury claims suffered on construction sites when the claimant was a stranger to the contract. By and large, those in the construction industry, especially subcontractors, greatly benefited from the *Fultz* ruling.

The protection provided by *Fultz*, however, may slowly be eroding. The U.S. Court of Appeals for the Sixth Circuit recently issued a somewhat scathing opinion criticizing the *Fultz* decision. This decision could have major implications in the construction industry.

The Sixth Circuit recently criticized the Michigan Supreme Court's opinions that rejected the "new hazard" analysis. The Sixth Circuit held that when a contractor creates a "new hazard" in the performance of the work described in the contract, the contracting party may be liable to third parties who are at risk of harm stemming from the performance of the contract.

In that case, there was evidence that while the construction project was taking place, a subcontractor's employee removed an interior door and placed it outside the construction zone and in an area that third parties, including the plaintiff, regularly used to enter and exit the building. The door fell on the plaintiff causing her to sustain injuries. Since the door was outside of the construction zone, and within the area that the plaintiff and her co-employees worked, the court determined that the hazard created by the door placement was a "new hazard."

What does this mean for contractors, subcontractors and other entities involved in a construction project? Simply put, privity of contract may no longer shield contractors, architects and engineers from liability claims brought by third parties who are outside the chain of contracts.

Subcontractors are likely to suffer the biggest blow as a result of this decision because Michigan law is not necessarily clear as to their potential liability to third parties. It is quite possible that the Sixth Circuit decision may signal the death knell for the privity of contract defense. Only time will tell how the decision is interpreted by Michigan courts.

TAX RELIEF FOR MICHIGAN CONSTRUCTION CONTRACTORS

Michigan's construction industry, like nearly every other business sector, has not been immune to the troubled economic times. Perhaps in a nod to the dreary economic circumstances that many construction firms have faced, the Michigan Legislature recently enacted legislation allowing construction companies to deduct the cost of materials purchased for specific construction projects on their tax returns.

Previously, the Michigan Business Tax Act imposed a modified gross receipts tax on every contractor that physically performed work in the state for at least one day during the tax year, or if the contractor actively solicited sales in the state and had gross receipts of $350,000 or more sourced to the state.

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The tax was imposed on the modified gross receipts tax base, after allocation or apportionment to the state at a rate of 0.8 percent. The tax base is a taxpayer's gross receipts less “purchases from other firms” before apportionment. An unintended consequence of the Michigan Business Tax Act placed a burdensome tax on materials that adversely affected the construction industry.

The new legislation amended the definition of "purchases from other firms" as it applies to general building contractors, heavy construction contractors and construction special trade contractors that do not qualify for a small business credit.

Under the new law, "purchases from other firms" would also include direct material costs for a construction project under a contract specific to that project. "Direct material costs" would mean the amounts paid for materials that are deductible on the taxpayer's Federal income tax return as purchases under the cost of goods sold. The legislation was remedial in nature and was designed to prevent companies from going out of business, shed jobs and promote growth within the construction industry.

MICHIGAN SUPREME COURT REINFORCES THAT UNAMBIGUOUS CONTRACTUAL RISK TRANSFER PROVISIONS ARE ENFORCEABLE EVEN AFTER TORT REFORM

On construction projects, there are an untold number of things that can go wrong. From accidents involving construction workers to damage to the construction project itself, a variety of pitfalls arise that cause a contractor to incur financial loss.

For these reasons, owners, design professionals, contractors and subcontractors attempt to shift some of their own burdens to others. Express contractual indemnification clauses and additional-insured provisions are the two most common ways of risk allocation in a construction project.

Owners are typically in the driver’s seat. When a design professional, contractor or subcontractor wants to do the work, they are given a contract that contains some form of indemnity or additional-insured obligation.The same holds true when a general contractor asks a subcontractor to bid on a piece of the work. Indemnity typically runs downhill. In other words, the last party in the contract stream will owe indemnity and/or additional-insured obligations to those above them.

As part of the Tort Reform legislation passed by the Michigan Legislature in 1996, the Legislature enacted a statute, MCL 600.2956, which states that in a tort action for personal injury or property damage, each defendant is only responsible for paying damages in an amount based upon their percentage of fault. Prior to Tort Reform, a defendant could be held jointly liable, meaning that a party could be held liable up to the full amount of the relevant obligation, even if another party was primarily responsible for the damages.

The effect of MCL 600.2956 on contractual indemnity provisions often raises the question: If a contractor is found liable for bodily injury or property damages caused by its subcontractor, can

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the contractor seek indemnity from the subcontractor; or, is the indemnity provision unenforceable under MCL 600.2956 because the contractor is only liable for its percentage of fault? In a recent case before the Michigan Supreme Court, the court addressed this issue.

In that case, a grocery store entered into a contract with a general contractor for renovation of a one of its stores. In turn, the general contractor subcontracted with a dry wall subcontractor for the project.

During construction, an employee of the dry wall subcontractor was injured when he fell from scaffolding erected by the dry wall subcontractor. The plaintiff sued both the grocery store and the general contractor for personal injuries.

The general contractor filed suit for contractual indemnity against the drywall subcontractor. The drywall subcontractor, however, claimed that MCL 600.2956 rendered the parties' indemnification clause unenforceable because the drywall subcontractor cannot be held liable for the general contractor's share of the liability. If the drywall subcontractor ultimately prevailed, the notion of transferring risk in construction contracts would have become much more convoluted.

In the end, the Michigan Supreme Court sided with the general contractor. The court determined that when parties reach mutually acceptable agreements, and where the terms of the agreements are unambiguous, the parties can contractually govern themselves by spreading the risk under a contract.

The significance of this case in the construction setting is fairly straightforward. Owners, contractors and subcontractors must ensure that they are aware of their obligations when entering into construction contracts. This is because parties who enter into unambiguous binding contracts will be held to enforceable indemnity clauses.

It is important that an owner, contractor and subcontractor understand the scope of their liability in the event of claims for personal injuries and/or property damage. The statute eliminating joint and several liability in tort applications will not affect those agreements

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