Freedom of Contract and the Time for Accrual of Claims for Breach of Construction Contracts

By Alfred J. Gemrich

Rare is the case heard by the Michigan Supreme Court.[1] Rarer yet is the case that twice makes it to that level of review. For upwards of a decade, a construction case, *Miller-Davis Company v Ahrens Construction Incorporated*,[2] rode the appellate roller coaster to the Michigan Supreme Court, producing four appellate decisions referred to by decision order as CA1, SC1, CA2, and SC2.[3]

The case presented a number of issues, but this article deals only with the question of when a claim for breach of a construction contract accrues. It highlights the importance of understanding the construction process, the clash between two competing views of contract completion, the application of the appropriate statute, the extent to which the decisions comport with industry practice, and the viability of accrual claim provisions found in standardized construction documents.

The problem of contract or project completion

The question of when a claim for breach of contract accrues in the context of the construction industry presents practical and conceptual problems. The construction process involves big dollars, multiple parties, and complex contractual relationships. Projects may take years to complete and require collaboration of hundreds of subcontractors and suppliers coordinating like bees in a hive performing intricate sequencing of tasks. To order the process, the industry employs a series of standardized documents containing time-tested customs and practices, the distilled wisdom of the industry, and what it considers reasonable, fair, and practical.[4] Such documents, developed over many years, combine logic and experience and are the foundation for administration of complex construction projects. They are premised on the assumption that parties should be free to contractually allocate risks, rights, and responsibilities among themselves and that those allocations should be respected by the courts.

Two competing views of the construction process and completion

The construction industry generally uses the date of "substantial completion" of the "project"—as defined by agreement and generally determined by a certificate of the project architect—to determine when an action for breach of contract accrues. This date is of key importance because it establishes when final payment is due, when the project is ready for the owner's beneficial intended use, when the risk of loss and obligations for maintenance transfer to the owner, and the date from which contractors' warranties start to run.[5] The substantial completion standard is an implicit recognition that an owner contracts for a completed project and places all subcontractors and suppliers on an equal footing by providing a uniform accrual date for the running of warranties, guarantees, and actions for breach of contract.

Contractual "accrual claim provisions" govern "not the time in which an action, once accrued, may be brought, but rather establish the moment at which an action accrues."[6] The statute of limitations is viewed as a "default statute" that operates only if the parties fail to define the accrual events. For example, MCL 600.5827 provides that a claim accrues "at the time the wrong upon which the claim is based was done regardless of the time when the damage results," but is prefaced by

Fast Facts:

A claim for indemnity for damages resulting from a breach of contract creates an obligation separate and distinct from the original contractual obligation. The indemnity claim may accrue at a different and later date than the original action for breach of contract, and the indemnity action may be timely even though the statute of limitations may have run on the original breach of contract action.

Contractual accrual claim provisions govern not the time in which an action once accrued may be brought, but rather establish the moment at which an action accrues. A contractual accrual claim provision establishing a single date for accrual of claims for breach of a construction contract, such as the date of "substantial completion" of a project, should be enforceable.

the words "*Except as otherwise expressly provided*" (emphasis added), suggesting the parties may contractually define the accrual event. This is consistent with freedom of contract and the idea that parties are in the best position to determine what is fair and practical.

In contrast to the industry's use of substantial completion, there is the view of the construction process that dissects a project into a series of discrete standalone tasks or activities. This approach derives from the language of the statute of repose, MCL 600.5839(1), which refers not to a project, but to the "occupancy," "use," or "acceptance" of "an improvement to real property." A project becomes a series of "improvements" or "components." When a "component approach" is combined with MCL 600.5827's contract accrual provision stating that a breach occurs when the *wrong* is done, the applicable period is considered to run from the date the *improvement* is in place irrespective of whether other work remains to be performed by a party or whether the project is complete. Determining what is an improvement and when a project is complete or occupied, used, or accepted is like trying to catch a frog in a bag. A component approach to project completion produces multiple unmanageable accrual dates. It has been criticized by at least three different panels of the Court of Appeals in applying the statute of repose as "artificial, unrealistic, and impractical."[7]

Setting the stage for the clash of competing views and the applicable statute

The stage was set for a clash between the competing views in a suit by an at-risk construction manager, Miller-Davis, against a bonded defaulting subcontractor, Ahrens, that had a $1.6 million "general trades package," which included installation of a "roof-system" on a natatorium as part of an $8.8 million project for YMCA recreational facilities. Suit for breach of contract and indemnification for damages resulting from defective installation of the roof-system was filed within six years of (1) substantial completion of the project; (2) the contractually defined time for accrual of an action; (3) final payment; and (4) Ahrens' last work, written guarantee, and failure to perform corrective work, but *not* within six years of installation of the roof-system. The circuit court held that Miller-Davis's suit was timely, and awarded judgment for $348,850 for breach of contract and on the bond for the cost of the corrective work. The bonding company settled for 97 cents on the dollar. Ahrens appealed, claiming that the statute of repose time-barred the suit. Miller-Davis cross-appealed denial of its indemnity claim.

The clash of statutes on the first appeal

The two competing views of the contract or project completion played out in a clash of statutes in the first set of appeals, CA1 and SC1. The question: Is an action for breach of an express promise between parties to a construction contract governed by the tort statute of repose, MCL 600.5839(1), or by the contract statute of limitations, MCL 600.5807(8)? Underlying the answer was the approach to contract completion. CA1 said that the date Ahrens completed installation of the roof-system triggered running of the statute, applied the statute of repose, and held Miller-Davis's suit time-barred; it was unnecessary to review the indemnity claim.

Serial accrual dates for contract completion are anathema to the industry, and SC1 amicus briefs challenged use of a component approach, but Miller-Davis contended that CA1 made a fundamental mistake by applying the statute of repose to an action between parties for breach of contract that defined completion and contained accrual claim provisions. It argued that application of the statute of repose would have grave consequences for the industry. As a "statute of duration" with a date after which an action no longer exists, whether or not it has accrued by that date, it extinguishes a right of action even before it accrues. "Where the injury occurs after passage of the applicable period, the injured party 'literally has *no* cause of action.' The harm that has been done is *damnum absque injuria* a wrong for which the law affords no redress."[8] In contrast, the statute of limitations bars the remedy without extinguishing the underlying obligation. It's an affirmative defense that can be waived, modified, or tolled by conduct, agreement, or statutory exceptions. Application of the statute of repose eliminates the ability of the parties to contractually define accrual provisions and destroys tolling and indemnity agreements. It adversely impacts construction quality and the enforceability of guarantees, warranties, or obligations extending beyond the limitation period.

The contract statute of limitations governs actions for breach of contract, not the statute of repose

After reviewing the legislative history, language, purpose, and logic of the statutes, SC1 held that the statute of repose, MCL 600.5839(1) as referred to in MCL 600.5805, is confined to "nonconsensual duties" or duties "imposed by law" or tort actions. It's inapplicable to actions for breach of "consensual duties" or express promises contained in written construction contracts—those claims are governed by the contract statute of limitations, MCL 600.5807(8). SC1 overruled CA1 and *Michigan Millers Mutual Insurance Company v West Detroit Building Company*[9] and *Travelers Insurance Company v Guardian Alarm Company of Michigan*,[10] insofar as those cases stand for the proposition that the statute of repose applies to contract actions. SC1 rescued Miller-Davis's claim and preserved the viability of tolling agreements and the opportunity to improve construction quality by using guarantees and warranties extending beyond the limitation period. SC1 left open the question of the viability of accrual claim provisions contained in standard construction documents. It remanded the case to determine the time for accrual of Miller-Davis's claims under the contract statute of limitations.

Multiple contractual promises may have different accrual dates

On remand, CA2 "could not find any reason" to revisit CA1's earlier analysis, despite the fact that CA1's analysis relied on the language in the statute of repose, which SC1 held inapplicable to contract actions. While Miller-Davis's indemnity claim was "clearly brought within the 6 year period of limitations," breach of the indemnity provision could not be used as "an alternative accrual date for its underlying breach of contract claim." Miller-Davis's contract and indemnity claims were time-barred by the contract statute of limitations.

SC2 reversed CA2 and held that Miller-Davis's indemnity claim was timely. A promise to indemnify against damages resulting from a breach of contract is an independent, distinguishable cause of action that may have a different accrual date from an action for the breach of contract. The difference between Miller-Davis's contract and indemnity claims was evident when the trial court later awarded Miller-Davis attorney fees, expenses, and costs—an additional amount 1.77 times greater than the original judgment.

The status of contractual accrual claim provisions

Unfortunately, the order granting leave to appeal in SC2 limited briefing to questions regarding Miller-Davis's indemnity claim and left undisturbed CA2's denial of Miller-Davis's contract claim as time-barred. Thus, the effect of contractually defined accrual claim provisions was never addressed directly by the Supreme Court. However, when the four cases are read together, neither CA1 nor CA2 should be relied on for any of the following propositions:

- A component approach to contract completion controls under the contract statute of limitations.

- Breaches of multiple promises contained in standardized construction contracts may not have different accrual dates.
- Parties may not contractually define accrual claim events.

CA1's analysis and conclusion, which CA2 refused to revisit, is fundamentally flawed. First, it is based on language found only in the tort statute of repose, which SC1 held was inapplicable. Second, it relies on *Michigan Millers* and *Travelers*, which were overruled by SC1. Third, it uses a component approach to contract completion that was rejected by SC2 when it stated that Miller-Davis's claim accrued on "last payment." Fourth, it fails to recognize the principle articulated in SC2 that construction contracts may contain multiple promises, the breach of which may have different accrual dates. Fifth, it fails to address whether the contract statute of limitations is a default statute.

Sixth, and most importantly, it ignores the contractual accrual claim provisions, stating, "Although the documents [American Institute of Architects General Conditions] were admitted at trial, the record is not clear whether they were part of the contract between the plaintiff and defendant." This was expressly contradicted by SC2's specific finding: "The contract incorporated by reference the…American Institute of Architects General Conditions (AIA 201), and a written guarantee of Ahrens Work."

Any conclusion that Miller-Davis's contractual claim was time-barred is difficult, if not impossible, to reconcile with SC2's specific findings that:

- the AIA General Conditions were "incorporated by reference," which defined "Work," the "Project," and "Substantial Completion," and contained accrual provisions establishing the time for accrual of breach of contract as the last to occur of either the date of substantial completion or "any act or failure to act…";
- "Ahrens substantially completed the work on June 11, 1999, at which point its Written Guarantee commenced";
- "A Certificate of Substantial Completion issued on June 25, 1999"; and
- "Ahrens received its final payment on February 17, 2000."

Under every one of these findings, Miller-Davis's contract claim was timely filed. Admittedly, SC2 later said that Miller-Davis's action for breach of contract "accrued by April 1999, when Miller-Davis made its last payment to Ahrens under the subcontract," contradicting its finding of a specific date of "final payment." This may be the result of confusing interim/progress payments with final payment, but it should not be assumed that the Supreme Court is unaware of the industry practice to contractually retain a percentage of each interim billing so that the retention is not released and final payment is not made until after substantial completion.

Conclusion

The Supreme Court did a service to the industry by wisely holding that the statute of repose is confined to tort actions, the contract statute of limitations applies to an action between parties for breach of an express promise, and an indemnity provision against breach creates an independent obligation which may have an accrual date different from the date of an action for breach of contract. It implicitly rejected application of a component approach to contract completion in contract actions. Most importantly, it left open the door to recognition of the fundamental freedom of parties to contractually allocate risks, rights, responsibilities, and provisions contained in standard construction documents that define substantial completion and the time for accrual of claims for breach. ■

Alfred J. Gemrich has a BA magna cum laude in economics from Kalamazoo College, a JD from the Yale Law School, and an MA with honors in communication arts and sciences from Western Michigan University. He served as co-counsel in the case referred to in the article and was designated a "Super Lawyer" before retiring from the firm of Howard & Howard PLLC.

ENDNOTES

1. The Michigan Supreme Court receives annually approximately 2,000 applications for leave to appeal. For the 2005–2014 period, the Court granted leave at the annual rate of 1.5 percent to 2.6 percent.
2. *Miller-Davis Co v Ahrens Constr Inc*, 495 Mich 161; 848 NW2d 95 (2014).
3. *Miller-Davis Co v Ahrens Constr Inc*, 296 Mich App 56; 817 NW2d 609 (2012); *Miller-Davis Co v Ahrens Constr Inc*, 489 Mich 355; 802 NW2d 33 (2011); *Miller-Davis Co v Ahrens Constr Inc*, 285 Mich App 289; 777 NW2d 437 (2009).
4. Standard documents generated by industry or governmental groups include the American Institute of Architects, Association of General Contractors, American Builders and Contractors, Engineers Joint Contract Committee, Construction Management Association of America, and the state of Michigan.
5. Sweet & Sweet, Sweet on Construction Industry Contracts: Major AIA Documents (4th ed), § 8.6, pp 583–585.
6. *Harbor Court Assoc v Leo Daly Co*, 179 F3d 147, 152 (CA 4, 1999).
7. *Citizens Ins Co v Schulz*, 268 Mich App 659, 669; 709 NW2d 165 (2005); *Pendzsu v Beazer East, Inc*, 219 Mich App 405, 411; 557 NW2d 127 (1996); *Fennell v Nesbitt, Inc*, 154 Mich App 644, 650–651; 398 NW2d 481 (1986).
8. *Smith Quality Constr Co*, 200 Mich App 297, 301; 503 NW2d 752 (1993), citing *O'Brien v Hazelet & Erdal*, 410 Mich 1, 14; 299 NW2d 336 (1980).
9. *Michigan Millers Mut Ins Co v West Detroit Bldg Co*, 196 Mich App 367; 494 NW2d 1 (1992).
10. *Travelers Ins Co v Guardian Alarm Co of Mich*, 231 Mich App 473; 586 NW2d 859 (1986).