Incorporation, Indemnity and Statutes of Limitations, Oh My!

(Photo credit: Wikipedia)

We all know that the contract is king in Virginia. We also know that Virginia will allow for a so called "incorporation" clause that will allow for "flow down" of certain prime contract provisions in a way that will make those provisions applicable to subcontractors. We also know that a claim for breach of contract or other contractual claim does not last forever due to certain statutes of limitation found in the Code of Virginia. What happens when all of these elements crash together in one place leading to litigation? Well, a relatively recent case from the Virginia Supreme Court gives at least a partial answer.

In Hensel Phelps Construction Company v Thompson Masonry Contractor, Inc, the Virginia Supreme Court considered a claim that arose from construction at Virginia Tech by Hensel Phelps. The construction concluded in 1998 (remember that date). The Prime Contract included language concerning a one year "Guarantee of Work" as well as fairly typical Warranty of Workmanship" language. However the Prime Contract also stated that the one year guaranty term did nothing to affect any other limitations period for any other action pursuant to the Prime Contract (this is important as well because Virginia Tech was not subject to any statute of limitations due to its status as an agency of the Commonwealth of Virginia). Final payment was made to Hensel Phelps and subsequently to the subcontractors in 1999.

In April of 2012, Virginia Tech asserted a claim for over $7,000,000.00 against Hensel Phelps for defective workmanship and related costs. Hensel Phelps of course demanded that its subcontractors pay their share of these costs and made this demand in October of 2013. Finally, in 2014, Hensel Phelps paid $3,000,000.00 to Virginia Tech to settle these claims and in that same year, more than 5 years after substantial completion, filed an action for breach of contract and indemnity against the subcontractors. The subcontractors filed pleas in bar asking the court to dismiss the claims as barred by the statute of limitations. The Circuit Court dismissed the suit and Hensel Phelps appealed.

Hensel Phelps' two basic arguments were (1) that the flow down provisions of the subcontracts that incorporated the warranty and guaranty obligations of the Prime Contracts acted as a waiver of the statute of limitations for any such claims because of the lack of a statute of limitations as applied to Virginia Tech, and (2) that even if the statute of limitations applied, the statute did not accrue until until the date of the 2014 settlement because the 2014 suit brought an indemnification claim or at the very least the failure of the subcontractors to make good on their indemnification obligations in 2013 was a second breach of the contract aside from the failure to properly construction the building.

The Virginia Supreme Court rejected both of these arguments. As to the waiver argument, the Supreme Court stated that (1) the general incorporation language of the subcontracts was not enough to constitute an express waiver of any statute of limitations and (2) even if such a waiver could be incorporated, the particular "waiver" was not part of any contract, but part of the Virginia Code and therefore by definition could not have been contracted for by Hensel Phelps and therefore could not be incorporated through a flow down provision.

As to the accrual argument, the Court dismissed this argument stating that (1) the claim made by Hensel Phelps was not an action for indemnification that fell within an exception to the statute of limitations, and (2) that the express indemnification provision of the contract was overly broad and sought to indemnify Hensel Phelps from its own negligence in violation of the Uniwest v. Amtech case (recommended reading) and was therefore unenforceable,

and (3) that there was no continuing obligation or option to perform or indemnify and therefore the express indemnification provision, if enforceable, would have created the only obligation.

Therefore, the Court reasoned, because the actual breach (as opposed to damages) occurred more than 14 years prior to any suit by Hensel Phelps and because any indemnification provision was unenforceable, the Circuit Court was correct in dismissing the Hensel Phelps claims with prejudice.

Aside from my usual admonishment to consult with an experienced construction attorney and do so early in the contracting process, my big take away is to draft your indemnification provisions carefully so as to meet the terms of Uniwest, particularly in the case of contracting with a state entity that does not have the same “limitations” on its time for suit as you do. Without doing so, you could be indefinitely exposed to potential un-reimburseable damages.

As always, I recommend that you read the case for yourself. Once you’ve had a chance to review it, please let me know if you have comments.