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Contracts Bulletin # 104 – It's Not Easy Being Green: Legal Pitfalls of Green Construction

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Introduction

Dozens of municipalities have adopted "green" building standards within the past few years. Many of the "green" standards were hastily enacted, with little forethought into the resulting legal problems. Unfortunately, no universal standard for "green" construction has been adopted, and this patchwork of "green" standards presents contractors with significant challenges.

This Contracts Bulletin addresses some of these challenges and presents a checklist to consider before bidding on "green" projects.

What is "Green"?

There is no commonly accepted definition of a "green building" or "green construction." The United States Environmental Protection Agency ("EPA") defines a "green building" as a building that:

(1) increases the efficiency in which the building uses and harvests energy, water, and materials, and

(2) protects and restores human health and the environment throughout the building life–cycle, which includes the building's siting, design, construction, operation, maintenance, renovation and deconstruction.

Other definitions of "green" commonly include other elements, such as using sustainable and renewable energy sources, or reducing unnecessary building materials, usage of fossil fuels, consumption of energy, and pollution.

Being "green" may be thought as a subjective ideological belief of being environmentally friendly, but as seen above, the definition of "green" cannot be objectively measured. However, some organizations have instituted objective measures that allow a building to become "green" certified.

"Green" Certification

The leading organization on "green" certification in the United States is U.S. Green Building Council ("USGBC"). USGBC created the Leadership in Energy and Environmental Design ("LEED") certification, which is the most well–known "green" certification program in the United States. "Green" regulations enacted by municipalities often adopt or track closely with LEED certification standards.

LEED is a process that certifies building construction/renovation as "green." The current, 2005 version of the LEED certification, "LEED for New Construction and Major Renovation Projects – Version 2.2" is based on a point system, where a maximum of 69 points may be obtained.

For new building construction, points are awarded in six categories, which include: sustainable sites, water efficiency, energy and atmosphere, materials and resources, indoor environmental quality, and innovation and design process. Theoretically, the more LEED points obtained, the more "green" a building.

However, a new point rating system will be introduced in April 2009 as "LEED Version 3 (v3)" is instituted. This new version only applies to commercial buildings and there will be three new LEED 2009 systems: Green Building Design and Construction; Green Interior Design and Construction; and Green Building Operation and Maintenance. These changes will also affect the LEED AP (accredited professional) exam process for those individuals seeking certification in LEED.

Legal Pitfalls of "Green" Construction

Contractors must consider numerous legal issues before undertaking the risks associated with "green" construction. Many legal issues are triggered because "green" buildings and certification are relative recent phenomenon. For instance, the LEED certification program has only been in existence for approximately 10 years, and has come into greater acceptance only within the past few years.

Defining "Green"

The ambiguity of the term "green" presents one of the largest problems contractors will face. At the outset of any construction project, contractors should understand the developer's goals. At a minimum, contractors should have written agreements with the developer that outline the specifications of the work to be performed. Written agreements need to contain specific definitions of work that needs to be performed, rather than some amorphous reference to "green" standards. Enumerating specific tasks will minimize future conflicts.

Do Not Rely Too Heavily on Form Contracts

AIA and ConsensusDOCS forms provide a standardized, inexpensive, and relatively easy way for contractors enter into construction agreements. Unfortunately, neither AIA nor ConsensusDOCS provide the level of detail required to adequately contract many "green" construction projects.

When using AIA or ConsensusDOCS, contractors should incorporate additional terms that are unique to the "green" project, including the requisite "green" building requirements and applicable local building code. Once again, contractors should also convert any ambiguous "green" concepts from abstract principles into objective criteria (i.e. "Contractor will install an air conditioner with a SEER 15 or greater rating" versus "Contractor will install an air conditioner pursuant to LEED guidelines").

Risk of Obtaining "Green" Certification

Developers of certified "green" construction projects may be eligible for lucrative tax incentives and other rebates; however, the certification process can often be arduous. Certification can be time consuming, expensive, subject to indefinite delays, and present significant administrative burdens. For instance, one study found a relatively innocuous project (a several thousand square foot building) required nearly 600 man–hours dedicated exclusively to administrative work relating to LEED certification. Due to the heavy administrative burden of obtaining certification, contractors should ensure the contract adequately reflects which party bears the burden for obtaining the certification.

The contract should also reflect which party bears the risk for delays in obtaining certification. Since many construction projects have incentive payments that are tied to particular deadlines, the contract should state which party bears the risk for any delays in obtaining certification.

For example, in one of the first “green” building lawsuits, the developer had generous tax incentives that were tied to obtaining “green” certification by a particular date. The contract (a standardized AIA form) did not include details about which party bore the risk for construction delays. Due to delays in the construction process, the developer was unable to meet the deadline and collect the incentive payments. The developer then sued the contractor. This litigation was eventually settled, leaving open the possibility that a contractor may be liable for the loss of incentive payments due to construction delays.

Avoid Making Unintended Warranties

Avoid making representations about a product’s ability to obtain “green” certification. When possible, defer to the manufacturer’s warranty and specifications, allowing developers to make decisions about what products should be installed.

In addition, more information is needed to determine if “green” certification consistently results in a “higher performing building”. A perception that building owners may have is that “green” and LEED certification will always result in higher performance and energy efficiency.

However, some of the “green” requirements for areas such as energy, water, and indoor air quality may not add significant energy efficiency to a building. Contractors need to be diligent and precise about what customers’ energy savings expectations are, and how those savings are measured and reported.

Understand Surety Bond Requirements

A contractor may have to warrant its work after a project is completed. Surety bonds are often required as part of construction contracts (e.g. 20% of the total contract) in order warranty the completed construction work. Bonds may remain in place for several years after the completion of a project, creating additional cost for the contractor.

“Green” construction presents heightened risk and cost associated with obtaining bonds.
First, some lenders may not provide bonds related to “green” construction, making the bonds more difficult to obtain.
Second, due to the perceived risk of greater material and equipment failures in “green” construction, a greater bond may be required (e.g. higher percentage of the total construction contractor). Third, the cost of “green” construction is more than traditional construction, so contractors can expect higher bond requirements as well. Fourth, the cost of maintaining a bond (e.g. interest payments) may be more expensive due delays in obtaining “green” certification.

Maintain Adequate Insurance

In a depressed economy, some contractors look for cost savings by reducing their insurance coverage. This is imprudent. Instead, contractors should maintain adequate insurance at all times especially when working on “green” construction projects that may carry an increased threat of litigation. For example, many property owners do not realize their insurance many not cover the full cost of rebuilding a “green” building in the event of casualty loss. (Many insurance companies now offer endorsements to fully cover “green” buildings, but property owners do not always obtain such an endorsement). In a situation where a property owner has an uninsured loss, there is a stronger likelihood that the contractor’s work will come under close scrutiny and litigation may ensue.

In addition to having a standard insurance policy covering loss to “green” building standards, contractors who advise clients on “green” certification or construction matters should obtain professional liability insurance. Professional liability insurance generally provides coverage related to professional advising and consulting services. Standard insurance policies, such as general commercial liability policies, usually provide coverage for occurrences of property damages but exclude coverage for professional advising and consulting activities.

Without a professional liability policy, a contractor could be exposed to uninsured liability if an owner asserts the contractor provided negligent advice regarding "green" construction. Overall, maintaining adequate insurance will mitigate financial liability and help ensure a business's future viability.

It is important to remember that insurance does not provide coverage for defending against breach of contract claims. Accordingly, it is extremely important to understand contractual responsibilities and to satisfy such obligations.

Install "Tried and True" Equipment

There are a plethora of new "green" products on the market. Many of these products boast of incredible performance and quality; however, contractors should be leery of using products that are not "tried and true." Regardless of the quality of the installation or workmanship, if an HVAC product fails or does not operate to specifications, there is a strong likelihood the contractor will be sued.

To limit liability, contractors should: 1) refrain from endorsing products; 2) ensure that insurance will provide necessary coverage; and 3) identify substitute products to use in the event of a product's unavailability.

"Green" Laws Create Legal Vulnerability for Contractors

"Green" laws place contractors in an uncomfortable situation: comply with the law or be assumed to be legally negligent. In normal situations where a plaintiff claims a contractor performed negligent work, the plaintiff must establish the elements of negligence, which often is a difficult and expensive endeavor. However, in situations where there is a law or regulation (e.g. that LEED certification must be achieved on new buildings), the plaintiff does not need to establish the elements of negligence. The plaintiff must merely demonstrate that the requisite LEED certification was not met, and, therefore, the contractor is assumed to be negligent.

Put simply, "green" laws make it easier and less costly to assert claims against contractors. In order to reduce the chances of litigation and to bolster defenses to any prospective claims, contractors should carefully research and understand the applicable building code and "green" requirements.

Federal versus State/Local Laws

On a positive note for contractors, there is a possibility that some state law and local regulations may be invalidated to the extent they conflict with federal law. Last summer, organizations representing HVAC contractors sued the City of Albuquerque regarding the City's standards relating to HVAC equipment. The city attempted to raise its standards for the installation of HVAC equipment on new and retrofitted buildings (commercial and residential) above the minimum AFUE and SEER ratings allowed by the U.S. Department of Energy.

As of the date of this Contracts Bulletin, the litigation is still pending in the United States District Court for New Mexico. However, the outcome could have a profound impact on other local "green" legislation nationwide.

Contractor Checklist

The following is a checklist of items to remember when considering a "green" construction project:

Pre–Bid

- Research the local building code and applicable "green" laws.
- Understand the "green" certification process and possible delays.
- Obtain adequate insurance.

Bidding Process

- Understand the scope of construction work to be performed.
- Understand time deadlines.
- Identify potential delays and which party bears the risk for such delays.
- Understand which party has the burden of obtaining "green" certification.
- Research the necessary building materials/equipment.
- Estimate the availability of the building materials/equipment.
- Identify (and price) substitute building materials/equipment.
- Determine whether a surety bond is needed.

Contract Negotiation

- Manage expectations of the property owner/developer.
- Resolve ambiguities regarding "green" standards.
- Identify and define deadlines.
- Identify which party assumes the risk for "green" certification.
- Create a written contract uniquely tailored to construction project that addresses the legal issues discussed in this article (using AIA and ConsensusDOCS forms as a template is acceptable).
- Understand the terms of material and equipment warranties.
- Avoid making unintended warranties or representations.

During Construction

- Ensure the work performed does not void material or equipment warranties.
- Communicate any delays in writing.

For a more in−depth discussion of the "green" construction issues, refer to the following publications:

- SMACNA Bidding Green Task Force, "HVAC Contractor's Guide to Bidding Green Building Projects" (Oct. 2007)
- The United States Green Building Council website
- Stephen T. Del Percio, "Legal issues arising out of green building legislation", Focus on Green Building (Fall 2008).
- Ujjval K. Vyas, and Paul D'Arelli, "Managing Expectations and Risk: Be Clear That Green Buildign Certification is Not a Proxy for Performance", Florida Engineering Society Journal, March 2009.
- Ujjval K. Vyas, "Green, Sustainable or High Performance? Knowing the Difference and Managing the Risks", Construction Briefings (Sept. 2008).
- J. R. Steele, "Green Construction: Initiatives and Legal Issues Surrounding the Trend", Business Law Today, v. 17, n. 2 (Nov./Dec. 2007).
- Frank D. Musica, Don't Let Green Design Cause Red Ink, AIA 2007 Convention.

SMACNA wants the Contracts Bulletin to serve our members. Your feedback or topic suggestions are welcomed by contacting Steve Yoch at syoch@felhaber.com or (800) 989−6321 or Mike McCullion at 703−995−4027 or mmccullion@smacna.org.

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