Don't Let Building Green Leave You in the Red

Identifying and Managing Green Building Risks

By Michael P. Sams

Like almost anything new and developing, green building carries the potential for increased risks.

Green building has become increasingly popular, but it contains legal risks for everyone involved. These risks include, among others, design-delay and payment-related issues. This article discusses green building risks and how the AIA A101 and A201 and the ConsensusDOCS form contracts assign these risks.

The *Shaw Development* Case

In 2009, what is anecdotally referred to as the first green building case, *Shaw Development v. Southern Builders*, provided a glimpse of some of the disputes to come. The dispute in *Shaw* arose from a $7.5 million condominium project located in Crisfield, Maryland, called the Captain's Galley. The development included green design features that were intended to support a LEED Silver Rating. Southern Builders, the general contractor on the job, filed a $54,000 mechanic's lien against the project in 2006, which was subsequently reduced to $12,000 by a Maryland circuit court. The owner counterclaimed for $1.3 million, alleging damages that included $635,000 in lost state tax credits under the state building program.

Specifically, the State of Maryland offered tax credits of up to eight percent of a project's total cost for those that obtained the specified LEED certification. The contract required Southern Builders to deliver a certificate of occupancy within 336 calendar days of the date of the agreement, and this certificate was apparently necessary in that time frame for the owner to apply for the tax credit. The owner also needed a United States Green Building Council certificate confirming the project's LEED certification to apply for the tax credits.

The parties used AIA 1997-A101 and 1997-A201 documents as their contract. The contract failed to specifically identify any tax credits and did not specify that they would obtain a formal certificate from the U.S. Green Building Council. *See* Stephen Del Percio, *Shaw Development v. Southern Builders: The Anatomy of America's First Green Building Litigation*, gbNYC, Aug. 20, 2008, http://www.greenbuildingsnyc.com/2008/08/20/the-anatomy-of-americas-first-green-building-litigation/.

Although the case settled, it provides a preview of future green litigation issues and highlights the need to identify green-related responsibilities in parties' contracts. At minimum, it makes clear the need to understand green risk and to contractually manage that risk.

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The Harvard Law School Environmental Law and Policy Clinic Weighs In

In a cutting-edge report, two authors from Harvard Law School's Environmental Law & Policy Clinic outlined many of the risks posed by green building. *See* Kate Bowers & Leah Cohen, *The Green Building Revolution: Addressing and Managing Legal Risks and Liabilities*, Environmental Law and Policy Clinic, Harvard Law School, Mar. 10, 2008. It is instructive both for lawyers and those performing green construction alike.

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For project owners, the risks that the report cites include:

- failure of a project to achieve certification;
- failure to qualify for tax credits;
- failure to meet loan or incentive program requirements;
- increased soft costs due to delays in construction or requirements for additional documentation; and
- failure to meet or live up to claims in marketing or promotional materials for a development project.

Id. at 6.

For contractors, risks include:

- failure to deliver features as promised by contract;
- construction defects, such as improper installation;
- failure of a structure or system to perform as intended over the lifecycle of the building; and
- insurance coverage exclusions, or more costly insurance policies.

Id. at 7.

Contract Risk Analysis

Most contract risk issues in construction generally involve one of the five "D's," namely, design, delay, damages, disputes, and the dough—getting paid. The following discusses those risks as they apply to green projects.

The Dough—Getting Paid

From a contractor's perspective, a contract always should provide the contractor with the right to obtain reasonable assurances that an owner has sufficient financing in place to satisfy its payment obligations, both before and after work begins. This is true regardless of whether a project is green. One of the risks that the Harvard Law School Environmental Law & Policy Clinic report identified concerning owner financing, however, highlights the importance of this issue in connection with green building.

Specifically, *The Green Building Revolution: Addressing and Managing Legal Risks and Liabilities* report identified the following financing risk for project owners:

> failure to meet loan or incentive program requirements if construction is not as 'green' as originally planned, where loans or incentive programs are tied to achieving certification or sustainability outcomes.

Bowers & Cohen at p. 6.

Accordingly, when financing or incentives that aid financing require that a project meet certain green conditions, it adds another condition that a project owner must meet to receive funding. Obviously, the more conditions placed on funding, the greater the risk that an owner will not secure funding or that it will experience interruption. As a basic principle of green building then, a contractor must understand the financing contingencies.

Section 2.2.1 of the A201 typically governs a contractor's right to obtain confirmation of owner financing. In the 1997 standard version, an owner is required upon the contractor's written request to provide reasonable evidence of the financial arrangements that it has in place to fulfill its obligations, whether the request is made before *or* after work begins. Although the 2007 version of the A201 entitles a contractor to obtain this information before beginning the work, the contractor can only obtain this information after beginning work when (1) the owner fails to make payments, (2) the contract sum changes materially, or (3) the contractor identifies in writing a reasonable concern regarding the owner's ability to make payment when due. Section 4.2 of the ConsensusDOCS is akin to the 1997 AIA A201, providing a contractor with the right to obtain reasonable evidence of sufficient financial arrangements both before and after work commences. Further, pursuant to the ConsensusDOCS an owner is required to notify a contractor before any material changes in its funding conditions occur.

A contractor should carefully review these "financial assurances" provisions and modify them as necessary to provide the contractor with a right to confirm that the project has adequate financing in place throughout its life. Since the risk of interrupted funding can be greater in green building than other construction, a contractor has a correspondingly greater interest in nailing down its contractual right to obtain reasonable assurances of financing. The contractor should, therefore, insist in the contract on a broad right to review owner financing, both before and after work begins. Additionally, the contract should define as clearly as possible what constitutes *adequate* financial assurances so that no dispute arises during the course of the project about whether adequate financing is in place.

Design Risk

Generally, the AIA A201 and the ConsensusDOCS Lump Sum contracts do not assign design risk to a contractor. Pursuant to the 1997 and 2007 A201 documents, a contractor is required to carefully study and compare the contract documents, to take field measurements, and to observe site conditions affecting the work. A contractor is liable if it fails to perform these obligations, and the failure results in damages to the owner. A contractor is not required, however, to ascertain whether contract documents accord with applicable law or to discover design flaws. Pursuant to the ConsensusDOCS, a contractor has no obligation to perform field measurements, and the contractor is not responsible for design criteria specified in the contract documents.

Sometimes, however, the standard provisions are modified. The following are couple of modifications to A201 documents from real projects through which owner shifted design responsibility to contractor, even though the contractor did not design the work and the owner red the architect:

Section 3.2.1: ...the Contractor shall carefully study and compare the various Drawings and other Contract Documents relative to that portion of the Work.... These obligations are for the purpose of discovering errors, omissions, or inconsistencies in the Contract Documents; however, any errors, inconsistencies or omissions discovered... shall be reported promptly to the Architect...Having discovered such errors, inconsistencies or omissions, ***or if by reasonable study*** of the Contract Documents the Contractor ***should have*** discovered such, the Contractor shall bear all costs arising therefrom.

Section 3.2.2: *...the Contractor* ***is required*** *to ascertain that the Contract Documents are in accordance with applicable laws, statutes, ordinances, building codes, and rules and regulations....* ***or if by reasonable study*** *of the Contract Documents and other conditions, Contractor* ***should*** *have discovered such...*

Section 3.5.2: *The Contractor shall be solely responsible for determining that all materials furnished for the Work meet all requirements of the Contract Documents.* mphasis added).

Obviously, the modifications above could ake a contractor liable for various design sues. Because green building is in the early ages of development, making oneself potially liable for design issues poses a particularly grave risk. This risk is especially rious if a standard commercial general bility policy does not provide coverage a contractor for design errors and omisons. Further, *Spearin* doctrine protection lost when a contractor assumes design sponsibility. *See United States v. Spearin*, 8 U.S. 132 (1918). Accordingly, assuming ntractual responsibility for design issues ll remove this defense.

Additionally, if a contractor agrees to sume responsibility for selecting materi- necessary to comply with design specifications, it could very well create potential product liability claims: in particular those for implied warranty of merchantability and fitness for a particular purpose, in addition to express warranty obligations. Again, because the green field, including green building standards, is still developing, and at times seems as if it is a moving target, assuming responsibility for material selection is risky. At minimum, a contractor should discuss with its insurance agent whether it needs errors and omissions coverage when it assumes contractual responsibility for material selection. Consistently, if a contractor finds that a certain product specified in the contract documents is unavailable, it should avoid assuming responsibility for selecting alternative products unless it intends to assume design risk. That is, a contractor should install a comparable alternative only when the owner or its appropriate representative certifies that the substituted product is sufficient and confirms that it and not the contractor, has assumed responsibility for the sufficiency of that particular product.

Accordingly, contractors need to carefully study their contracts and confirm that they are not unintentionally assuming design risk. When a contractor intends to assume the design risk, it is imperative that the contractor not only have the appropriate design expertise to support its venture, but the necessary insurance to provide coverage for errors and omissions risks.

Further, a contractor will need to become an expert in whatever applicable zoning or other legal requirements apply to green building if it assumes this contractual risk. For instance, the Harvard Law School Environmental Law & Policy Clinic report points out that the City of Boston adopted Article 37 on green buildings as part of its municipal zoning code. *See* Bowers & Cohen, *The Green Building Revolution*, at 5. That ordinance requires "large projects" to be "LEED certifiable." *Id.* If a general contractor assumes responsibility for confirming that "the Contract Documents are in accordance with applicable laws, statutes, ordinances, building codes, and rules and regulations," as modified section 3.2.2 above provides, then the contractor will need to become an expert in these types of issues.

Obviously, a contractor should plan carefully for design risk on design-build projects. With standard projects for which a contractor does not intend to assume design risk, it needs to vigilantly avoid that risk through the contract, especially in the green field, with its additional standards and greater than normal risks.

Delay Risk

Pursuant to the standard AIA A101 and A201 and ConsensusDOCS contracts, a contractor is required to complete its work within a specified time frame. It is entitled to a change order extending the completion deadline if it complies with the claims process, when the commencement or progress of the work is delayed by the owner or architect, by changes in the work, or by reasonably unforeseeable conditions. Section 8.3.1 of the A201 provides that the contractor will receive additional time whenever delay is caused by "unavoidable casualties or other causes beyond the contractor's control."

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Some delay issues that potentially pose increased risk to green projects are delay in obtaining materials, potential municipal inspection delays related to the inability to obtain permits because of the new and developing nature of various designs, and delay in gathering paperwork for necessary green certifications. It is imperative, therefore, that a contractor confirm its exact responsibilities, determine whether securing permits will pose problems, and confirm the availability of products before committing to comply with a proposed schedule.

Further, a contractor should vigilantly ensure that a contract provides it with a rather broad right to time extensions. As discussed in more detail in the "Damages"

section of this article below, a contractor involved in a green building project also should vigilantly delete "no damages for delay" provisions from a contract whenever possible. To minimize future disagreements, a contractor should specify in a contract that issues such as materials availability, and delays on government approvals are examples of issues that will allow the contractor to secure time extension related change orders.

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A contractor also will need to comply attentively with the claims process concerning claims for additional time. Typically, as specified in the A201 and the ConsensusDOCS, the claims process for obtaining additional time is the same as that for seeking additional payment. In some jurisdictions, such as Massachusetts, failing to follow a contractually prescribed claims process can constitute a waiver of a claim. *See Sutton Corp. v. MDC*, 667 N.E.2d 838, 843, 423 Mass. 200, 207 (1996); *Chiappisi, et al. v. Granger Construction Co., Inc., et al.*, 223 N.E.2d 924, (1967). Accordingly, it is very important in green building to provide as broad a right as possible for contractor time extensions, and that the contractor comply with the contractually specified claims process to obtain those extensions.

Damages

Potential damages in cases involving green projects are monumental and as such, the parties will need to negotiate consequential and liquidated damages provisions in the contract. First, green projects increase the potential for delay damages. Green projects also can involve potential municipal penalties, lost sales, claims of missing the market, and claims for diminution in market value, among others. In the *Shaw Development* case, for instance, the developer claimed a lost tax credit worth $635,000 based on the contractor's alleged failure to timely complete the project.

Indeed, although generally dangerous for a contractor, negotiating a liquidated damages provision in exchange for a waiver of some or all of the potential consequential damages may effectively control some risk, depending, of course, on the rate of the liquidated damages. A liquidated damages provision for delay-related damages will, in at least some jurisdictions, preclude recovery of related actual damages. *Schrenko v. Regnante*, 527 N.E.2d 1261, 27 Mass. App. Ct. 282, 285 (Mass. 1989).

The 1997 and 2007 A201 and the 2007 ConsensusDOCS Lump Sum contracts contain a mutual waiver of consequential damages. Generally, this waiver of consequential damages offers good protection to a contractor and a contractor should maintain it. To the extent there is any doubt as to the provision's breadth, it should be clarified to include, without limitation, damages such as loss in sales, diminution in property value, and tax credit related damage claims, to name a few.

Additionally, a contractor needs to make sure that a contract does not limit its right to recover for delay damages. That is, some contracts provide that there shall be no damages for delay suffered by the contractor, and the contractor only can secure an extension of time. Green projects amplify the prospect of delays simply because related technology and designs are still new and developing, which in turn, amplifies the prospect that a contractor will suffer unanticipated delay-related overhead costs. The contractor, therefore, needs to be vigilant about striking 'no damages for delay' provisions in a contract whenever possible.

Disputes

As with any other contract, the process by which the parties agree to resolve potential disputes also is important. The 1997 A201 contains a default provision requiring arbitration. The 2007 A201 contains a default provision requiring litigation. Parties must select arbitration as part of the contract negotiation process if the contract will require it. Both the 1997 and 2007 A201 documents require mediation before parties resort to arbitration or litigation, at least in most instances.

The ConsensusDOCS dispute resolution process is very different from that of the AIA documents. Although, as with the A201, the ConsensusDOCS process requires a contractor to continue to work while a dispute is being resolved (Section 12.1). Pursuant to Section 12.2, party representatives with the authority to resolve matters must work to resolve matters within five business days. Further, if the parties do not resolve the dispute within 15 days of a first discussion, the matter proceeds to dispute resolution. Section 12.3 then requires "mitigation," a nonbinding review either with a dispute review board or a project neutral. If mitigation is unsuccessful, mediation must follow. If mediation is unsuccessful, the parties then will either arbitrate or litigate, depending on which choice they selected as part of the contract negotiations.

Simply put, review the merits of each process, including whether arbitration is an acceptable, ultimate means of resolving disputes, before contractually committing to a process. Not only does a contractor need to understand the process and related time frames, selecting arbitration, without some controls in place, may not adequately protect a party's interests. Because many jurisdictions do not permit reversal of an arbitrator's decision even if the arbitrator made a mistake of law, weighing the benefits of a generally speedy process against the danger of irreversible arbitrator error is a must. If possible, when the parties contractually agree to arbitration as the dispute resolution method, they should attempt to negotiate a list of mutually acceptable arbitrators from which to choose if arbitration later becomes necessary. In this way, the parties can minimize the risk of arbitrator error by selecting a list of qualified arbitrators in advance.

Conclusion

Green building may be a wonderful development for everyone, creating new businesses, new markets, and a potentially healthier environment. Like almost anything that is new and developing, however, it carries new and potentially increased risks. The parties contracting to undertake a green building project need awareness of those risks, and they need to strive to manage them through a contract. FD