

## Legal Issues Associated with Building “Green”

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State and local governments have enacted a variety of incentives to encourage energy efficient “green” design and construction practices. Projects owned or leased by government authorities are often subject to mandatory green requirements. Private development is often encouraged to go “green” through contractual or tax-related incentives. Promoters of green building features often tout the cost savings associated with energy-saving features or the increased marketability of a property if it is able to achieve a certain green building certification standard.

But, as Kermit the Frog once remarked, it isn’t easy being green. Well-intentioned efforts to promote green building projects can often go astray in a number of different ways, with adverse legal consequences for the project participants. This Client Alert summarizes in a high-level fashion, some of the more common legal issues affecting green building participants that have emerged in recent case law in this developing field. These issues are divided into a few broadly-defined categories, based upon the position of the project participant involved.

### **Background: Green Building Standards**

Many of the legal issues associated with green building construction projects relate to efforts to obtain certification of a project or a building as meeting a green building standard set by an independent organization. Perhaps the best known “green standard” is the U.S. Green Building Council’s (USGBC) Leadership in Energy and Environmental Design (LEED) rating system. The LEED system provides for four possible levels of certification: Certified, Silver, Gold and Platinum. The certification level achieved is based upon certain specified prerequisites and a minimum threshold of possible points. The actual ability of a project or a building to achieve a desired LEED certification level can often be uncertain, and may depend upon a number of factors, including the design and materials used, the skill of the contractors involved and the quality of the supporting documentation. The USGBC has created a number of LEED rating systems based upon the type of structure or construction. Under the LEED system, buildings get “certified” as meeting a particular standard, and are then subject to periodic reviews thereafter. Other green building rating systems include the Green Building Initiative’s Green Globes and the Environmental Protection Agency’s Energy Star program.

Although initially established by independent organizations, many of these green building standards have found their way into building codes or have been adopted by governmental agencies. For example, the USGBC now reports that LEED initiatives including legislation, executive orders, resolutions, ordinances, policies, and incentives are found in 442 localities (384 cities/towns and 58 counties and across 45 states), in 34 state governments (including the Commonwealth of Puerto Rico), and in 14 federal agencies or departments. California’s Green Building Standards Code (“CALGreen”) went into effect on January 1, 2011, Illinois has its

Green Building Act and Green Building Guidelines, and a proposed International Green Construction Code will be rolled out in the Spring of 2012.<sup>1</sup>

## Legal Issues Affecting the Owner/Developer

*Failure to Achieve Desired Certification:* While green building design features are often touted based upon non-economic considerations of environmental responsibility, the failure of a building or project to achieve a specified certification level, or to incorporate certain green building features into the project, can have real adverse financial consequences for a project where such green features are part of the tax or development incentives used to finance the project.

The case of *Southern Builders v. Shaw Development*, No. 19-C-07 11405, Somerset Co. (MD) Cir. Ct. (Feb. 7, 2007) is the first instance of green building litigation, or “LEEDigation”, involving private parties. The suit was driven in part by the fact that the owner failed to receive tax credits from the Maryland Energy Administration (MEA) because the project did not achieve LEED certification in a timely manner. In response to an initial contractor monetary claim, the developer asserted a counterclaim that the contractor had promised that the project would achieve the required LEED certification standard. The parties ultimately settled out of court, so it is unclear which party would have prevailed if the case had gone to trial, but the details of the pleadings filed reflect that neither party clearly communicated at the time of contracting an understanding of the importance of LEED certification to the project financials and who bore the risk of an adverse determination.

More recently, the Destiny USA project in Syracuse, New York has been the subject of regulatory scrutiny by federal tax authorities. The American Jobs Creation Act of 2004 authorized up to \$2 billion of tax-exempt private activity “green bonds” to be issued by state or local governments for qualified green building and sustainable design projects. In 2007, the developer of this large-scale mall project received \$228 million from the federal green bonds program in exchange for installing green building and renewable energy technologies. After receiving this tax-exempt financing, in February of 2010, the developer advised the federal tax officials that, due to economic changes affecting the project, many of the green building and renewable energy features that were originally contemplated for the project when the green bond financing was obtained, would not be included in the completed project and that the project’s ability to obtain LEED certification was uncertain. The IRS opened an audit. An adverse ruling for the developer potentially could have meant that the developer would have faced the forfeiture of a reserve account containing over \$2 million, the revocation of tax exemptions, and angry bond investors for recourse. Recently, on March 15, 2012, the IRS notified the developer that it closed its audit of the bonds, without any adverse impact to their tax exempt status. The agency apparently accepted the developer’s argument that the failure to include the renewable energy features that were promised at the time the financing in the finished construction should not impact the bonds’ tax exempt status.

Promises by developers that a certain green building certification level will be achieved can form the basis for a misrepresentation suit if the desired certification is not achieved. In *Keefe v. Base Village Owner, LLC*, Pitkin Co. Dist. Ct. (CO) (Filed Feb. 25, 2011): 61 condominium unit purchasers brought suit against the condominium developer, alleging in part that in marketing

the condominium, the developer represented that the condominium would be a LEED-certified building within a LEED-certified neighborhood. The purchasers further alleged that neither the building nor the neighborhood are LEED-certified and sought to rescind the purchase contracts. Ultimately, the case was resolved on other legal grounds, but the case demonstrates the risks that developers face when marketing properties based upon the anticipation that the project will be able to achieve LEED certification, but then are unable to do so.

*Owner's Responsibility for Owner-Retained Consultants:* Project owners should also be aware that they can be charged with the conduct of owner-selected green building consultants. Given the importance of LEED certification to marketing efforts, project owners will often recommend that a particular LEED-accredited professional assist the architect or the owner will retain such a professional directly in order to maximize the likelihood obtaining LEED certification. Such a consultant will typically recommend specific materials and systems. If increased costs, questionable construction quality or construction delays are then encountered on the project, the owner may be charged with the consequences of the conduct or recommendations of that consultant, either in the form of affirmative contractor claims for additional compensation, or in the form of defenses asserted by the contractor or architect to owner-initiated claims.

## **Legal Issues Affecting the Design Professional**

Architects now advise owners on green building and sustainable design features as a normal part of their architectural services on a project. The most commonly-used design agreements published by the American Institute of Architects (AIA), in their current formulation, now include standard contract provisions requiring design professionals to consider and to present the owner with green building options.<sup>2</sup> The extent to which an owner may want a design professional to pursue green building design elements or to pursue certifications invariably involves cost-benefit tradeoffs. The industry standard contract forms often provide additional specificity for green building services in separate contractual riders.<sup>3</sup>

For the design professional, these green building services can pose potential pitfalls because it is unclear whether or not such green building issues affect the architect's customary standard of care. Architects, and insurance professionals who provide errors and omissions insurance for architects, often are wary of contractual clauses or warranties that would obligate the design professional to a heightened standard of care. The concern is that the architect may be charged with producing a result that may not be wholly within its control, such as obtaining LEED certification for a project, or that the architect may be committing to a contractual duty of care that may be beyond that covered by standard professional liability policies, which are typically limited to damages resulting from the design professional's negligence. Perhaps reflecting this growing concern among architects for such "green" liability, at least one insurer now offers a policy providing coverage for architects related to LEED certification.<sup>4</sup>

The available case law on the green design issues is still in its infancy. In *Bain v. Vertex Architects*, No. 2010 L 012695, Cir. Ct. Cook Co. (IL)(Complaint Filed Nov. 4, 2009), the plaintiff homeowner outside Chicago, Illinois filed suit claiming that the architect failed to pursue and obtain project certification from the USGBC LEED Program for a farm house renovation, when the stated objective of the architectural contract was to "create a sustainable green modern single-family home." That case remains pending with the outcome uncertain. But, the *Bain* case,

and the *Southern Builders* case highlight both the importance of having clearly-communicated expectations regarding green building certification issues at the outset of a project, and the difficulties associated with determining who should bear responsibility when the desired certification is not obtained.

## Legal Issues Affecting Contractors

When a construction project is delayed, has quality issues, or experiences cost-overruns, claims by or against contractors invariably follow. The *Southern Builders* case previously mentioned highlights the risks associated with performing construction work on green projects where the expectations of the participants are not clearly defined. Even without the initiation of actual litigation, however, green building issues can arise and be the sources of conflict. For example, owners and contractors often will be involved in disputes about release of retainage funds at the completion of a project. Given the extended period for the LEED certification process, which will typically exceed the actual completion of construction by a considerable margin, the opportunities for conflict are obvious unless the parties do not have a clear understanding on the project goals to be achieved and their timing.

Finally, one of the first areas in which “green” litigation has arisen has not involved the actual construction work itself, but the right to bid on public projects containing LEED-related qualification criteria that are increasingly working their way into project specifications. In *Burchick Construction Company v. Pennsylvania State System of Higher Education*, 2010 Pa. Commw. Unpub. LEXIS 749 (Pa. Commw. Ct. Nov. 3, 2010), the Commonwealth Court of Pennsylvania upheld a bid protest by a contractor who challenged unconventional procurement procedures used on a public project. The project’s owner attempted to justify the departure from standard bidding procedures based upon its desire to obtain LEED certification, which the owner contended required coordination and cooperation of the prime contractors and a different procurement procedure. The Commonwealth Court disagreed, apparently concluding that traditional public bidding procedures were not inconsistent with a desire for LEED certification. By contrast, in *Hampton Technologies, Inc. v. Department of General Services*, 22 A.3d 238 (Pa. 2011), the Pennsylvania Supreme Court rejected a disappointed bidder’s protest alleging that the Commonwealth of Pennsylvania had inappropriately considered the awardee’s experience on LEED projects, reasoning that LEED criteria has been included in the project documentation supplied to bidders. These cases illustrate the tension in marrying new green building considerations, which often involve subjective evaluations, to the objective financial framework normally utilized in public bidding and lowest responsible bidder evaluation laws.

## Conclusion

These cases and disputes that are only now beginning to emerge are likely to be just the tip of the iceberg of the sort of “green” litigation that will arise as owners, design professionals and contractors confront the demands of a marketplace that is increasingly focused on sustainability and efficiency issues. Careful attention to the drafting and negotiation of the contract documents for green building projects up front can help reduce the risk to project participants of becoming embroiled in such disputes. Please contact one of the authors of this article or the Reed Smith attorney with whom your regularly work for assistance in planning your next green building project.

<sup>1</sup> See, e.g., USGBC's website; CalGreen's website ([www.bsc.ca.gov/home/calgreen.aspx](http://www.bsc.ca.gov/home/calgreen.aspx)); Illinois' Green Building Act, 20 ILCS 3130/1 *et seq*; and International Code Council website.

<sup>2</sup> See AIA Document B101 – 2007, Standard Form of Agreement between Owner and Architect, §§ 3.2.3, 3.2.5.1 (2007).

<sup>3</sup> For example, the American Institute of Architects has its AIA B214 LEED Certification Services, which ties into the base contract as an "Additional Service." The ConsensusDOCS contract forms utilize a ConsensusDOCS Document 310, which is a Green Building Addendum to the base contract documents.

<sup>4</sup> See Susanne Sclafane, *Argo Brokerage Tackles Architect, Design Risks with Green Building Endorsement*, P&C NAT'L UNDERWRITER (Jan. 11, 2010).

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