MANAGING LEGAL PITFALLS IN GREEN CONSTRUCTION

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INTRODUCTION

Green building is more relevant today than ever before. It is increasing in popularity every day and during the election both presidential candidates discussed various methods they would employ to encourage environmentalism.

A study performed by CoStar and the University of Southern California found that nationwide, "green" buildings earn rent premiums between $2.38 to $11.24 per foot *more* than their non-green counterparts. And, green buildings sell for an average of $61 to $171 *more* per foot than their non-green counterparts.

Even Wal-Mart, the poster child of corporate scorn, has announced that it looking into ways of requiring its vendors to observe certain minimum standards of environmental care.

If these figures are even half correct, this means that green building is here, and it is here to stay.

But from a legal perspective, green construction projects raise a number of special issues such as defining what exactly is a green project, who is responsible for delivering the "green" to the project, what is my exposure, and how do I protect myself?

I. WHAT IS GREEN BUILDING?

There is a new home being constructed in Hyde Park and the "For Sale" sign states that it is a green house – I pulled over and looked at the house, but it looked just like any other house to me. So I looked at the advertisement and it only stated that the home was green and energy efficient. There is a lot of discussion in today's market place about green living and construction. However, defining what exactly is "green" is somewhat more elusive.

When engaging in colloquial discussion with our peers, it is often not necessary to specify exactly what may or may not be a green issue. But, in the legal arena, the scope and specificity of what is or is not green is of significant importance. Although constructing a carbon free building for altruistic reasoning is applaudable, it will not become the norm or industry standard unless it is economically and commercially feasible. A property developer that is entitled to receive tax credits or other energy savings associated with green construction will want to know exactly what green elements are being incorporated into their project.

Leadership in Energy & Environmental Design (LEED) and Energy Star are the two primary standards for certifying or measuring the green in a project. LEED is a voluntary, consensus-based standard to support and certify successful green building design, construction and operations. It is a point based system where projects earn LEED points for satisfying specific green building criteria. Energy Star looks more at the overall energy consumption of a building and seeks to reduce the building's energy consumption through various techniques typically employed by the building manager. According to the U.S. Green Building Council the two systems are complimentary of each other because they focus on different areas.

Other possibilities to add "green" to a project are through ad hoc government programs which may offer various energy saving incentives such as cash rebates for achieving certain energy standards or buying a hybrid vehicle.

Just because a project is referred to as being green, though, doesn't necessarily mean the contractor is going to employ all of the techniques or even some of the above referenced techniques. **Thus, when considering the legal liability associated with green projects, a critical initial inquiry is going to be exactly how to define and determine what is going to make the project green.**

II. KEY CONSTRUCTION CONTRACT CLAUSES

The contract provisions should specify what does and does not exactly make a project green. One can easily state that they are constructing a green building, but without specifically identifying how it is green, the words are essentially meaningless. In other words, like almost every other construction issue, if it is not addressed in the contract there may be significant risks of misunderstanding between the parties.

The following are some of the key contract provisions to pay attention to:

A. FLOW DOWN CLAUSE

A contract's flow down clause is generally found on the first or second page and it incorporates all the project documents into the contract. Typically, this is the paragraph that defines what the term "Contract" means in the contract. By way of example, the flow down clause in the A201-1997 is in the very first paragraph titled, The Contract Documents, and states that the contract documents consist of the agreement between owner and contractor, conditions of contract, drawings, specifications, addenda, etc.

In other words, if you're a subcontractor, all of the project documents are a part of your contract whether you've read them or not. If you are bidding a green project, it is critical to obtain and review all the contract documents so that you know exactly what is expected in your scope of work. **While it may normally be acceptable to simply review the subcontract, in a green new world, you absolutely must obtain the project manual and prime contract and actually review your scope of work to make sure what is expected of you.**

Problem Example: A subcontractor bid a green commercial office building in Southwest Austin that had certain green HVAC requirements that were very clearly outlined in the project specifications. However, the subcontractor did not request a copy of the relevant prime contract documents or project manual, even though he was repeatedly told it was a green project, and simply assumed he knew what needed to be done. Unfortunately, he installed the wrong A/C system and the building owner and property manager began making legal threats. After several letters, significant attorney time, and about $50,000.00, the subcontractor corrected its mistake out of pocket to bring the HVAC system into compliance with the project specifications.

B. INTENT OF THE PARTIES

Another important contract provision contained in the A201-1997 which is also common in other construction contracts is a simple paragraph stating the intent of the parties. In this paragraph, the parties intent is briefly outlined and sometimes states all the necessary items for the proper execution and completion of the work.

For developers and general contractors, I would recommend amending this paragraph to include a sentence or two stating that the parties intend to have this be a

green project to be rated by either Leed, Energy Star, or some other objective method. I would also suggest that the parties state who is responsible for obtaining the green certification in this paragraph, so there is no confusion later in the project. For subcontractors, I would strongly recommend reviewing this paragraph to see what the developer and builder wrote. Although these *intent* clauses may not necessarily be enforceable, but it gives you an opportunity to state in plain language that the goal is to design and build a green building. Importantly, if one of the contractors on the job fails to meet the necessary green standards and states that it was not aware of the provisions in the flow-down clause, this provision will add credibility to the claim that there was not a mutual mistake or other problem.

C. WARRANTIES

The law on construction warranties is complex and easily confusing. A full discussion on how construction warranties and warranty disclaimers operate can easily exceed several hours, and a lawsuit regarding green construction is all but guaranteed to involve a breach of warranty. Therefore, we need to at least briefly discuss how warranties work and how they may apply to green projects.

Regardless of the disclaimer or construction contract, certain warranties exist on all projects. Some warranties are imposed by law while others are created through the language of the contract documents. As a practical matter, the very act of advertising a project a green project could create an express warranty thus greatly elevating the importance of construction warranties.

Basically, there are 2 types of construction warranties: express warranties and implied warranties. Express warranties are simply those promises written into a construction contract, while implied warranties arise in the absence of a contract provision governing a particular performance standard.

Warranties are created by sellers when they make statements or acts that induce the purchaser into buying their products or services. Stated another way, warranties are representations that are made the basis of the bargain between the purchaser and a seller. Thus, when a seller makes a statement that induces the purchaser to buy that product or service, that statement is a warranty. Legally, the idea is that the warranty was an essential element to the contract and the purchaser would not have entered into the contract without the warranty. For example, if you hire a subcontractor to erect the steel frame for a building, his warranty that it will be performed in a good and workmanlike manner is an essential part of the contract. It is unlikely that you'd hire that subcontractor, if his contract stated the work would not be good and workmanlike.

1. Express Warranties

Express warranties are made by the affirmative representations of a seller to a purchaser prior to the execution of a contract that induces the seller into purchasing. There are no special terms or forms necessary for creating an express warranty.

Additionally, contracts are not the only way an express warranty can be created. Indeed, a warranty can be created through letters, advertisements, models or even oral statements. **Moreover, privity of contract is not a necessary element to enforce an express warranty.** In other words, an express warranty can be created through an advertisement and then enforced by a subsequent or second purchaser.

The purpose of an express warranty is to guaranty to the purchaser that a particular standard or quality of construction will be reached and it provides the seller with an effective way of defining or limiting its liability in a sale. Importantly, statements made by the seller *after* the contract has been made are typically not considered to be express warranties unless it changes the basis of the contract. This is because the buyers have already agreed to the bargain written in the contract and he cannot later argue he relied on that statement when he entered into the contract.

The characterization of express warranties given above and cited by numerous Texas courts appears to be deceptively simple. Warranties can be ambiguous and their application is not always clear. For example, consider a common express warranty to repair any leaks or failures and to guaranty the workmanship and materials for a period of one year. In an appellate case decided about 20 years ago, the court found much more specific warranties based on the language of the warranty. *See generally, Frye v. Applebee Water Supply Corp.*, 608S.W.2d 798(Tex.Civ.App — Tyler, writ ref'd nre).

In *Frye* the project specifications stated that a well would produce 200 gallons of water per minute with less than 1 ounce of sand per 100 gallons of water. *See Frye,* 608 S.W.2d at 800. Additionally, the contractor provided an express warranty to repair any leaks or failures. **Although the well was constructed in accordance with the plans and specifications, the well exceeded the maximum sand intake per 100 gallons of water, and the owner filed suit.** The builder counter-claimed and alleged that he fully performed the contract in accordance with the plans and specifications and was due the remaining balance of the contract. The builder further argued that his warranty was limited to only the materials and workmanship and did not extend to the quality of the water. In other words, the builder asserted that because the well was built in a good and workmanlike manner and in accordance with the project specifications, he was not liable for the water quality (i.e., the performance of the well).

Following litigation, the court held that even though the project was constructed in accordance with the plans, the contractor warranted to repair any failures in the performance of the well and also warranted the water production and sand requirements as stipulated in the project specifications. *See Id.* at 802. This makes sense from an owner's perspective because they contracted to purchase a well that would perform at a certain operating level. However, the contractor probably did not intend to create this warranty as he had previously told the owner that the well would *not* operate properly as it was designed. *Id.* at 799. Moreover, the contractor advised the project owner in writing that he did not think the project would perform as designed. **The court found in**

favor of the project owner holding that the project specifications and other documents created express warranties.

Express warranties can also work to a contractor's advantage when they are properly drafted. In the example given above, if the water/sand specifications had not been expressly stipulated, then the plaintiff might have argued it was entitled to a greater performance level than which the contractor had contemplated. Express warranties regarding performance specifications can bring certainty to a project and allow a contractor to either define or limit his liability to that which is in the contract.

Accidental Creation of Express Warranties

It is possible to accidentally create an express warranty. The problem arises when express warranties are unintentionally created by sellers. Perhaps the advertising of a "green" project without actually defining it in writing, could create an express warranty.

Several years ago, a real estate developer almost accidentally created a warranty in advertising a subdivision as a "master-planned" community. *See Parkway Company v. Woodruff*, 901 S.W.2d 434, 440 (Tex. 1995); s*ee also, Parkway Company v. Woodruff*, 857 S.W.2d 903, 911 (Tex. App.—Houston [1st Dist.] 1993) (reversed on other grounds) (originally holding that public policy should mandate an implied warranty because developers should be in business to develop property in a good and workmanlike manner). After reviewing a series of transactions, the Texas Supreme Court refused to find and uphold an express warranty from a subdivision developer because no services were conveyed or promised as part of the initial transaction between the builder and the developer. *Id.* at 440. Although it is somewhat unclear how the court reached this conclusion, the court stated that the phrase "master planned community" does not mean a developer warrants it will never develop part of a planned community which may adversely affect any other homeowner in the community. *Id.* However, under a slightly different set of facts, the court could have easily created an *implied* warranty that property must be developed in a good and workmanlike manner. *See Parkway*, 901 S.W.2d at 439.

In a case discussed in more detail later, the Ft. Worth court of appeals held in 1992 that a developer provides an implied warranty to develop in a good and workmanlike manner. *See Luker v. Arnold*, 843 S.W.2d 108 (Tex. Civ. App.—Ft. Worth 1992, no writ). Interestingly in the *Parkway* case 3 years later, the Texas Supreme Court did not say an implied development warranty does not exist, only that it didn't exist under the facts of that case. *See Parkway*, 901 S.W.2d at 439. Thus, if the issue presents itself again, the Texas Supreme Court could create an implied warranty to develop in a good and workmanlike manner. *See Luker v. Arnold*, 843 S.W.2d 108 (Tex. Civ. App.—Ft. Worth 1992, no writ).

It is also important to understand that courts can enforce warranties on behalf of subsequent purchasers. *See Edwards v. Shuh*, 5 S.W.3d 829, 833 (Tex. App.—Austin 1999, no pet.). In *Edwards v. Shuh*, the court held that a letter written by the contractor to the "owner" wherein he agreed to repair any defects, constituted a warranty to the

second purchaser. *Id.* at 832; *see also*, *PPG Industries, Inc. v. JMB/Houston Centers Partners, Ltd.*, 2004 WL 1533274 (Tex. 2004) (not designated for publication). The court found important that the letter creating the warranty was directed to the "owner," and not specifically to the original purchaser. *Id.* at 833. More broadly speaking, it is a general rule of law that privity is not required to enforce an express warranty. *Id.* at 833. Therefore, it is possible to be sued under a warranty theory by a plaintiff who was not even the original purchaser. S*ee PPG Industries, Inc. v. JMB/Houston Centers Partners, Ltd.*, 2004 WL 1533274 (Tex. 2004) (not designated for publication).

Express warranties, when well written, can serve to greatly limit a builder's liability on construction projects; however, it is equally important to not unintentionally or accidentally create warranties where none are intended. The more specific the language in the warranty, the narrower its scope of enforcement; but, writing a warranty too narrowly could allow a court to impose liability under an implied warranty theory.

2. Implied Warranties

Implied warranties are created by the legal system to fill in gaps or act as a default standard in the absence of express contract provisions. *See Centex Homes v. Buecher*, 95 S.W.3d 266, 273 (Tex. 2003). Such warranties may be imposed either by statute or through judicial creation. *Rocky Mountain Helicopters, Inc. v Lubbock County Hosp. Dist.*, 987 S.W.2d 50, 52 (Tex. 1998). Implied warranties are by definition not written into the contract, but exist because the legislature or the court says they exist. The courts are likely to create an implied warranty when it will serve the public interest by protecting consumers from inferior services. It is assumed that the builder is in a better position to prevent a loss more than a consumer, and consumers generally need to rely on the expertise of the builder. And, the builder is in a better position to absorb the cost of damages associated with the defective construction through insurance or price manipulation.

The courts are likely to create an implied warranty when it will serve the public interest by protecting consumers from inferior services. *See Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 353-54 (Tex. 1987). It is assumed the builder is in a better position to prevent the loss than a consumer, and consumers generally need to rely on the expertise of the builder. And, the builder is in a better position to absorb the cost of damages associated with the defective construction through insurance or price manipulation. *Id.* Additionally, the Texas Supreme Court has expressly stated that the purpose of implied warranties in new home construction is to protect the average home buyer who lacks the expertise necessary to discover defects. *See Centex Homes v. Buecher*, 95 S.W.3d 266, 274 (Tex. 2003).

a. Implied Warranty of Good & Workmanlike Performance

The implied warranty of good & workmanlike performance is an ambiguous warranty standard that is alleged in almost all construction defect cases. It originated in a

residential construction context, but has over the years expanded into the commercial arena.[1] Untold hours and millions of dollars have been spent litigating over the merits of this warranty. In short, the implied warranty of good and workmanlike performance focuses on the builder's conduct in construction and guarantees the work will be performed in a skillful and workmanlike manner. *See Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987); s*ee also, Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2003).

The phrase 'good and workmanlike manner' is defined to mean the quality of work which is "performed by one who has the knowledge, training, or experience necessary for the successful practice of a trade or occupation and performed in a manner generally considered proficient by those capable of judging such work." *See Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 354 (Tex. 1987). It is an abstract standard that is not always easily identified. Examples of breach by the builder range from walking off of the job to improperly installing roof tiles. *See Continental Dredging, Inc. v De Kaizered, Inc.*, 120 S.W.3d 380 (Tex. App.—Texarkana 2003, no pet.); s*ee also, Barnett v Coppell North Texas Court, Ltd., NTC*, 123 S.W.3d 804 (Tex. App.—Dallas 2004, no pet.).

This warranty is implied in all construction projects and historically could not be disclaimed. *See Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987); s*ee also, Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2003); *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968). However, parties can agree to a different standard of construction when their agreement provides for the manner, performance or quality of desired construction. *See Centex Homes v. Buecher*, 95 S.W.3d 266, 274-75 (Tex. 2003). Thus, what actually happens is the builder and purchaser may contract for a low or high standard of construction, and then the warranty insures that the builder will construct the project in a skillful and workmanlike manner commensurate with the agreement. In other words, a contract may specify that a building is to be framed at 24 inches on center, but not specify the nailing pattern. Thus the warranty will act to insure that the appropriate nailing pattern is used. Or, if the contract is silent on the exact project specifications, the warranty works to guarantee that it will be built in accordance with standard industry practices.

In the *Luker* case previously mentioned, the Ft. Worth court of appeals declared that developers impliedly warranted to develop in a good and workmanlike manner. *See Luker v. Arnold*, 843 S.W.2d 108, 115 (Tex. Civ. App.—Ft. Worth 1992, no writ). In *Luker*, the homeowner's damages were caused by septic problems. The primary problem with the septic system was that each of lots for the subdivision were not designed large enough to support the septic systems. In creating the warranty the court held that there is a strong public interest in protecting consumers from inferior work. *Id.* at 116. It was important to the court to protect the public interest from financial disaster caused by haphazard construction. *Id.* Additionally, the court stated that a developer is in a much

[1] R. Carson Fisk, *Adoption of the Implied Warranty of Good and Workmanlike Performance in Commercial Construction*, CONSTRUCTION LAW JOURNAL, Vol. 4, No. 2, at 14 (2006).

better position to prevent this type of loss than an individual home buyer, as consumers must rely on the developer's expertise in developing the plat and lot sizes. *Id.*

b. Implied Warranty for Repair Services

Departing from the traditional rule of caveat emptor in 1987, the Texas Supreme Court extended the implied warranty theory to service transactions. *See Melody Homes Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 353 (Tex. 1987). The Court stated that applying the traditional rule of caveat emptor was "an anachronism patently out of step with modern service buying practices" because the United States has shifted from a goods to a service oriented economy. *Id.* at 354-55. In doing so, the court found that an implied warranty exists to repair or modify existing tangible goods or property in a good and workmanlike manner. *See Melody Home Manufacturing Co.*, 741 S.W.2d at 353. In other words, a contractor warrants that it will perform repairs in a good and workmanlike manner.

Importantly, the Court expressly stated that *the implied repair warranty cannot be waived or disclaimed.* *See Melody Homes*, 741 S.W.2d at 356. However, it does not require repairmen to guarantee the *results* of their repairs or modifications, only that they will be *performed* in a good and workmanlike manner. *Id.* at 355. The court stated that it would be "incongruous if public policy required the creation of an implied warranty, yet allowed the warranty to be disclaimed and its protection eliminated merely by a pre-printed standard form disclaimer." *Id.* But a builder may be able to limit his liability by expressly agreeing to a different standard of manner, performance or quality in the project. *See Centex v. Buecher*, 95 S.W.3d 266, 273 (Tex. 2002).

Interestingly, a contractor that is not skilled, and discloses his lack of skill for the project, might not create any warranties. *See Mercedes Dusting Service, Inc., v. Evans*, 353 S.W.2d 894, 896 (Tex. Civ. App.—San Antonio 1962, no writ). In *Mercedes Dusting*, the defendant hired the plaintiff to repair the wing of an airplane even though the plaintiff informed him that he was a furniture repairman and not a wing repairman. *Id.* at 896. After failing to pay, the plaintiff brought suit against the defendant for the reasonable value of his services. *Id.* at 895. The defendant responded by asserting the work was defective. *Id.* The court held in the plaintiff's favor stating that because the plaintiff did not hold himself out as a skilled airplane wing repairman and informed the defendant of this, the defective performance defense did not apply. *See Mercedes Dusting Service, Inc.*, 353 S.W.2d at 896. However, the practical application of this concept may be minimal because it is unlikely that a purchaser is going to agree to contract with an unskilled repairman.

3. Design Warranties

In the absence of a contract or contract provision, an owner that provides a contractor with the construction design and specifications, does not warrant the sufficiency of the plans. *See Lonergan v. San Antonio Loan & Trust, Co.*, 104 S.W. 1061 (Tex. 1907). In the absence of an express warranty, no implied warranties attach to plans. The builder however, is liable for the construction of the project and is obligated

to deliver the project in a good and workmanlike manner as contemplated and intended by the parties. *See Lonergan v. San Antonio Loan & Trust, Co.*, 104 S.W. 1061 (Tex. 1907); *see also, Ruberoid Co. v. Scott*, 249 S.W.2d 256 (Tex. Civ. App.—Dallas 1952, no writ); *Alamo Community College Dist. v. Browning Construction Co.*, 131 S.W.3d 146 (Tex. App.—San Antonio 2004, pet. filed); see also, *United States v. Spearin*, 248 U.S. 132 (1918). Thus if a builder constructs a project in strict compliance with the plans, but fails to create the project intended by the parties, the builder may be liable. Consider the following from the Dallas court of appeals:

> The general rules applicable are: Where a contract does not provide to the contrary, the owner does not warrant that the materials and plans and specifications will produce the building intended by the parties. The builder must decide that question for himself and at his peril and is liable to the owner if the intended building is not produced.

See Ruberoid Co. v. Scott, 249 S.W.2d at 259. The court reasons that it is incumbent on the contractor to build the project in a workable manner as intended by the parties.

A narrow exception exists in the event that the owner misleads the contractor and strictly binds the contractor to build the project in accordance with its plans and specifications. *See United States v. Spearin*, 248 U.S. 132 (1918). In *Spearin*, the United States Supreme Court held that generally a contractor who agrees to perform a construction project for a given price assumes the risk of unforeseen difficulties. *Id.* However, when the contractor is bound to build according to the plans and specifications provided by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. *Id.* Creating a Spearin defense is difficult as the builder must prove that the owner made a misrepresentation through the specifications and that the specifications were defective. *Id.* Thus a contractor who enters into a contract knowing the specifications are defective cannot later claim to have been misled. Additionally, courts commonly deny Spearin-type claims finding that the contractor had a duty to investigate a condition on site and failed to do so. *See* Justin Sweet & Marc M. Schneier, Legal Aspects of Architecture, Engineering, and the Construction Process, 494 (7th Ed. 2004).

As most construction projects are governed by contracts, the more likely result is that either the contractor or owner has guaranteed the plans through some contractual provision. But in a green new world, the design is going to be new for many contractors and thus far more important than before and it may not be clear. If the building is not designed properly with enough specificity, then it may not perform as intended. Developers must pay special care to their design contracts and insist on a design warranty from someone. Moreover, the developer should insist that the design team carry insurance – in Texas it is not uncommon for architects and other design professionals to not have insurance.

The practical green problem here is that sophisticated subcontractors will try to disclaim as many warranties as possible. It is common for a subcontractor to warrant that it will perform its work in strict accordance with the plans/specifications, but does not warrant the sufficiency or the plans or that the design will perform as intended. If that disclaimer had been included in the water pump case discussed earlier and the contractor was not liable for the performance of the well, then the owner would have had to either sue the design team or pay out of pocket to correct the problem. This is a very relevant problem with green construction – if the project does not create the anticipated energy savings, who is going to be liable?

D. Delay Issues

Delay issues are particularly relevant to the construction of green projects. Often green projects have additional environmental safeguards and may cost more on the front end to design and build. Also, the financial savings that owners seek from their green building may not be realized until some years down the road. As such, they need to have the building completed as soon as possible so that the saving may be realized. Also, there may be government programs that require the completion of the building in a certain time frame.

The problem is not finding reasons why projects need to be completed on time, but rather the problem is calculating how to finish on time and if it is not finished, determining the appropriate amount of damages.

In the absence of a 'time is of the essence' clause in a contract, the builder is only required to complete the project in a reasonable amount of time. Defining what amount of time is reasonable, is extremely difficult and nearly impossible to predict. To ensure that there is a date certain for construction, developers and builders should have a clause in their contracts that states *time is of the essence*. The clause should further contain a liquidated damages clause that attempts to capture a realistic amount of anticipated damages based on the relevant criteria. In green projects that criteria could include financing costs and lost cost savings because the doors of the building are not open – if the building is going to save 40% in its energy expenses after 5 years of operation, but the building is 1 year behind schedule, then that means the owner carried the financing an extra year plus was denied an entire year of utility savings. But if this issue is not addressed in the contract, it is unlikely that the owner will recover these damages.

E. Indemnity Clauses

In short, an indemnity clause states that the indemnitor is responsible for paying some or all of the indemnitee's costs which can range from actual damages to attorneys fees. This clause should always be discussed with your attorney any time it is included in a construction contract, but even more so in a green construction project that involves parties that have customized the construction documents.

Typically, indemnity clauses flow from the owner down through the general contractor to each subcontractor. Thus if a general contractor has agreed to indemnify the owner for its negligence in building the project and that includes green certification, then that liability flows to each of the subcontractors and that is a significant amount of liability. Particularly if the general contractor is responsible for the design plans on the project. For the typical subcontractor, this means that it too will be responsible to the owner for the general contractor's negligence – even if the subcontractor did not do anything wrong.

F. Substantial Completion

There are special issues to consider when trying to determine when substantial completion is reached in green projects. Generally substantial completion is reached when a certificate of occupancy is issued or the owner occupies the building. Arguably however, in green building, substantial completion may not be reached until the building has been awarded the desired certification from Leed or Energy Star. How and when substantial completion is reached should be defined in the project documents. If this is not addressed in the contract, then the common law definition of substantial completion is going to control and determining when the green certification attaches to the building goes to the back burner. Conversely, for a contractor, knowing that the green certification signifies substantial completion and requires a date certain will clear up any confusion – a builder that is not experienced in green construction may not consider or contemplate obtaining the certification.

G. Damages

To have a viable lawsuit you must have two elements: liability and damages. With out one or the other, a lawsuit cannot stand. Defining and quantifying the amount of damages is a critical aspect of a legal problem.

Legally speaking, damages are broken down into two types: direct and consequential. Direct damages are those damages that naturally and necessarily occur from the defendant's acts, while consequential damages are those that naturally result from the acts of the defendant, but not necessarily. Although it is legally possible to recover consequential damages in a breach of contract case, *Exxonmobil Corp. v. Valence Operating Co.*, 174 S.W.3d 303, 316 (Tex. App. — Houston [1st Dist.] 2005, pet. denied), they cannot be recovered unless the parties, at the time the contract was made, contemplated the damages sought would be a probable result of the breach of the contract. *Stuart*, 964 S.W.2d at 921; *Mead v. Johnson Gp., Inc.*, 615 S.W.2d 685, 687 (Tex. 1981) (*citing Hadley v. Baxendale*, 9 Ex.Ch. 341 (1854)). In other words, the contract should state that green damages are agreed and understood between the parties and that they will constitute direct damages and outline what damages may be considered.

The line that distinguishes direct and indirect damages is not always clear. Consider a generic non-construction example involving a car accident where vehicle A ran through a red light and hit a pedestrian. It is logical to expect that person to incur medical expenses from the accident – these are direct damages. But if it were stock

broker who didn't make a trade that day because of the accident and lost a million dollars, that is not necessarily a logical result of the accident. Also, losing money for failing to make a trade may occur, but not necessarily – the stock markets go up and down. Thus this would be a consequential damage.

Consequential damages may be permitted in a breach of contract/warranty construction lawsuit unless they are disclaimed in the contract. Almost all construction contracts disclaim consequential damages. This is the clause that states "the contractor and owner waive claims against each other for consequential damages arising out of or relating to this contract..." In a green project, arguably many of the alleged damages can be construed as consequential damages and thus non-recoverable unless stipulated.

III. GREEN CERTIFICATION OF THE PROJECT

When contracting to build a green project, it is imperative that the parties define what objective criteria will be used to certify the project as green. Additionally, the parties must determine in the project documents what role the certifying agency will take and who is responsible for the certification. On a large project, the builder may want to have a LEED professional on-site throughout the project – conversely, if the builder is experienced in green construction, it may only need to have the plans designed in accordance with LEED and only receive periodic inspections and certifications throughout the project.

Additionally, the owner, builder and design team need to determine who will be responsible if the project is not delivered as intended. It is logical to assign liability to the design team if it is not properly designed and to assign liability to the builder if it is properly designed but not properly constructed. Unfortunately, the law is not always reasonable and will not support this logic – please recall the previous discussion on design warranties – the design professional may not be liable for the plans. Most likely the general contractor will be the liable/responsible party.

IV. *SOUTHERN BUILDERS, INC., V. SHAW DEVELOPMENT, L.L.C.*

To the best of my knowledge, this has been the only green building lawsuit in America to date. It was a 23 unit condominium project in Maryland near the Chesapeake Bay. The design included a number of design features intended to support an application to the U.S. Green Building Council for a LEED silver rating. There were numerous problems on the project and the general contractor filed a lien on the project and sued the developer. The developer countersued and claimed, among other things, a loss of $635,000 in lost tax credits under a state run program.

This particular Maryland program is very popular and can only accept a certain number of projects per year. The State of Maryland offers a state tax credit program where an owner can receive an 8% rebate on the total cost of construction for buildings

over 20,000 square feet that achieve certain LEED certifications. To receive the rebate, the owner submits an Initial Credit Certificate to the State and sets an expiration dates by which the project must receive a Final Credit Certificate. In other words, the developer submits its plan to the state and sets a construction completion and certification deadline. Then after receiving a certificate of occupancy and LEED certification, the owner can apply for the Final Credit Certificate. Importantly though, if the Initial Credit Certificate expires prior to obtaining its Final Credit Certificate, the applied-for credits are put back into the program's pool and the project slides to the back of the line.

Unfortunately, the only statement in the contract documents pertaining to the green nature of this project was a statement in the project manual that the project was designed to comply with the Silver Certification Level of LEED. But the contract did not stipulate who was responsible for obtaining the certification and the contract did not require the builder to formally obtain the certification from LEED – it only stated that the project was designed to comply with LEED.

The owner presumed that it could obtain the tax credits from the state based on the builder's representations of when the project would be completed. Also, it seems that the owner assumed that the builder would just automatically acquire the LEED certification even though it was not specifically required under the contract. In other words, the contract documents that were attached with the publicly available documents are devoid of any assignments of liability. This case is demonstrative of the important need of having a thorough understanding of all the contract documents. Ultimately, the case settled.

Based on all of the contract issues we've discussed today, you can easily see the importance of the contract documents. The project manual contained a reference to the green design of the building and that was incorporated into each contractors contract. Although the parties used AIA documents in this case, they did not amend any of the paragraphs assigning liability to one party of the other, regarding the intent of the parties, substantial completion, or damages to clearly outline their mutual expectations. The contractor warranted the work, but did not make any representations pertaining to the LEED rating or whether the project would deliver as designed – the contractor simply agreed to construct the building in accordance with the design plans. Additionally, the contract did not appear to have a disclaimer of liability for design and as such, the contractor, at least under Texas law, could have been liable for delivering to the owner a building that performed as a green building – even if improperly designed.

Part of the problems with this case were the contractors building delays. The contract did not address liquidated damages and did not beef up the completion date. Although there was a substantial completion, there were no stipulated damages for failing to meet the completion date. Nor was there a requirement that the contractor obtain LEED certification as part of substantial completion. Theoretically, the owner should have had the contractor agree to indemnify it for any lost tax credits for failing to achieve certification and meet the application deadlines.

Finally, the contract documents did not address the issue of the tax credits. As a result, I think that the anticipated tax credits could be classified as consequential damages. It is possible that the owner would have realized significant saving if the project had been delivered as planned, but not necessarily.

V. INSURANCE

The issues related to insurance coverage for these types of claims will be later addressed in this seminar. But for the time being, it is important to say that it is unlikely that a standard commercial general liability policy will provide coverage for most green construction issues.

Typically, a CGL policy only covers property damage and it may or may not cover the contractor's negligence. Additionally, if the contract contains a waiver of consequential damages, an owner will have a difficult time classifying tax credits or other green construction losses as direct damages and the claim may likely be denied by the insurer.

VI. CLOSING

Sustainability is changing the face of the risk management equation and the *Shaw* case will likely go down as just the tip of the iceberg on these types of cases. The lawsuit demonstrates the danger for contractors, owners and design professionals to simply rely on form construction contracts on green projects. Although the claim was asserted against the contractor, a slight twist in the facts above could have easily resulted in a suit being asserted against the architect, engineer, or LEED consultant. While owners obviously want to get their projects out of the ground as quickly as possible and given the deteriorating economic conditions here in the U.S., contractors and design professionals may feel pressure to sign up for work quickly, but *Shaw* clearly shows the need for caution and the need for careful contract preparation.

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