

Sustainable Building Contracts and the 2012 AIA Documents

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Sustainable building is becoming ever-more popular in the U.S. and around the world. Over the past few years a number of associations, such as the U. S. Green Building Council (USGBC) have championed the topic and are making headway towards governmental requirements and keeping the topic in front of the general public so as to not let the strides made in the past few years subside. As sustainable building practices become more mainstream, owners are requesting, and sometimes requiring, that the design and construction contracts contain some language that addresses the sustainability goals of the owner. This can be as simple as achieving a certain rating by one of the accrediting (or certifying) associations or as nebulous as reaching some level of efficiency.

What happens if the goals set by the owner are not achieved? Who carries the liability if this is the case?

This study will examine the potential damages that may exist if sustainability objectives fall short of their expectations. In addition, the authors will look at model design and construction contracts and the potential damage theories that have evolved over the years. While conclusions of law can only be made by the courts, we will discuss how sustainable contract language fits within the traditional theories of damage and how it does not. Where conclusions of law have been reached by the courts we will include them with our discussion. The goal of this paper is to uncover the different measures of damage that are utilized when a construction team fails to meet its sustainability goals.

In addition, the American Institute of Architects (AIA) recently announced the addition of five new contract forms that will be available during the first quarter of 2012 aimed at minimizing some of the contractual confusion that exist whenever new processes and procedures are in put in place. The authors will provide a synopsis of the changes promulgated by these contracts and how they address some of the potential liability issues that are generally of concern to the contracting parties.

Key Words: Consequential Damages, Contracts, Green, Law, Sustainability

Introduction

When owners begin planning a project, they typically assemble a program to guide their project's design; this can include numerous criteria such as a space needs assessment, preliminary layout, and their desired level of finish. Increasingly in this early planning stage owners identify the sustainability objectives that they want their building to achieve. These objectives may include performance goals such as energy efficiency measures, and/or it may include a third party certification such as LEED®, BREEAM, Green Star or Green Globes. Whatever their sustainability objective may be, if the owner wants to make it more than just an aspiration, they will include it within their contract documents. The question then becomes who is responsible if the contracting parties do not meet this objective and what measure of damages should be assessed.

In the United States a number of organizations provide the construction industry with model contract documents. These organizations tend to be forward thinking and are relatively quick to adapt their model contract documents to

procedural and technological changes within the industry. The three primary organizations which provide this service include: 1) American Institute of Architects (“AIA”); 2) ConsensusDOCS[®]; and 3) Design Build Institute of America (“DBIA”). Their model contract documents can be adopted by a project team and easily tailored to a specific job. Many owners and developers use these documents or at least consult them when forming their agreements between project team members. Since these model documents are regularly consulted when forming agreements they carry a great deal of influence within the industry as it relates to how contracts are drafted and the general rights of the contracting parties.

Each of these three organizations has produced a separate guide to enable a project team to successfully navigate and achieve a certain sustainability goal. There are some commonalities between each organization’s framework for assigning responsibilities and resolving issues, but there are also some notable differences.

The AIA contribution to sustainable construction is AIA D503. This document is not so much a model contract as it is a guide with selected contract language intended to modify their other agreements. The hallmarks of the guide’s suggestions include the project team developing sustainability objectives; then creating sustainability measures and a plan to achieve the sustainability objectives. The guide goes on to suggest specific language it would incorporate with its governing agreement between the architect and owner and it suggests the same for the governing agreement between the contractor and owner. An excerpt from the AIA D503 follows:

The Owner and Architect acknowledge that LEED[®] Certification is awarded by the Green Building Certification Institute (GBCI), an independent third party organization, and is dependent on factors beyond the Architect’s control, such as the Owner’s use and operation of the Project; the Work provided by the Contractor or the work or services provided by the Owner’s other contractors or consultants; or interpretation of credit requirements by GBCI. Accordingly, the Architect does not warrant or guarantee that the Project will be granted LEED[®] Certification by the GBCI.

For both the architect and contractor the guide suggests that these parties should include a mutual waiver of consequential damages which is intended to insulate them from consequential damages flowing from their failure to meet a sustainability objective. As illustrated below, D503 goes on to provide another layer of protection from potential liability flowing from a failure to meet sustainability objectives. This liability limitation is a type of umbrella coverage for the contracting parties.

Neither the Contractor, Contractor’s consultants, nor their agents or employees shall be jointly, severally or individually liable to the Owner in excess of _____ (\$_____), for any failure to perform a Sustainable Measure or failure of the Project to achieve the Sustainable Objective, including breach of contract or negligence not amounting to a willful or intentional wrong. Add the following Section 15.1.6.3 to A201–2007:

The ConsensusDOCS[®] organization addresses sustainability through an addendum to ConsensusDOCS[®] 310. As with the AIA publication this addendum is not intended to operate on its own; but is to be used to modify the underlying governing agreements. ConsensusDOCS[®] sustainability goals are referred to as green measures. These “measures” are similar to what was defined as sustainability objectives in the AIA documents. The ConsensusDOCS[®] make the “green measures” the general responsibility of the project team with ultimate responsibility resting with the Green Building Facilitator (“GBF”). The documents allow the drafter to select the “GBF” from among the architect, engineers, contractor, or presumably a third party such as a sustainability consultant.

The ConsensusDOCS[®] 310 does a great job of allowing the contract drafter to specifically define the “green measures” as either a certain “elected green status” meaning a third party certification (LEED, BREEAM, Green Star, Green Globes) and/or some performance based criteria such as a specific energy efficiency level.

After the ConsensusDOCS[®] 310 sets the table for the project team in regards to goals, roles and responsibilities, it discusses liability. In a fashion similar to its other provisions, it allows the drafters to elect how best to transfer the

risks between the team members of the project. It first tries to define any damages resulting from a failure to meet green measures as consequential damages and then subjecting those damages to applicable mutual waivers of consequential damages in the governing contract. See language below from section 8.2

Owner's loss of income or profit or inability to realize potential reductions in operating, maintenance or other related costs, tax or other similar benefits or credits, marketing opportunities and other similar opportunities or benefits, resulting from a failure to attain the Elected Green Status or intended benefits to the environment, shall be deemed consequential damages subject to any applicable waiver of consequential damages in a Governing Contract unless specifically excluded from such a waiver in the Governing Contract.

Under the ConsensusDOCS[®] addendum the default protection applies to all parties except the GBF. See language below.

Unless otherwise expressly provided in a Governing Contract, no Project Participant other than GBF shall be liable or responsible for the failure of the Elected Green Measures to achieve the Elected Green Status or intended benefits to the environment or natural resources. This Paragraph 8.3 does not relieve any Project Participant from any obligation to perform or provide Elected Green Measures as required by its Governing Contract.

The DBIA is another organization that provides model contract documents to the construction industry. Like the AIA and ConsensusDOCS[®], the DBIA has created an addendum to be used as a guide with its governing document. The DBIA addendum has a provision for defining sustainable project goals but allows the drafters to select from three remedies in the event that any of these goals are not met. The three remedies are: 1) the parties can agree to a waiver of claims, such that the failure to achieve the desired sustainable goals (including the targeted level of certification) will not be deemed a breach of contract and will nullify any such claims; 2) the parties have the option to agree that the failure to meet the sustainable goals for the project will cause the Design-Builder to be liable for liquidated damages in an amount agreed to at contract formation; and 3) the parties can agree that the Design-Builder has an obligation to cure any failure to achieve the desired sustainable goals through the addition, replacement or correction of materials, configurations, systems or equipment in order to obtain the third party certification or certain sustainable performance measure (Kelley & Vornehm, 2009).

Contract Damages

A brief review of the common law of contract damages would be instructive as to potential liabilities facing the project participants who are responsible for the success or failure of a sustainability objective. These are the typical contract damages that a breaching party may be liable for if they fail to achieve a sustainability goal. As stated in American Jurisprudence 2nd, under a general allegation of damages resulting from a breach of contract, a plaintiff may recover those damages that naturally and necessarily result from the alleged breach. The plaintiff must show a compensable injury resulting from the alleged breach (American Jurisprudence, 2008a). In a breach-of-contract action, a plaintiff may recover the amount of damages necessary to place him in the same position he would have occupied had the breach not occurred. This is measured by a combination of 1) direct damages; 2) consequential damages; and 3) any offset for not having to perform (Restatement 2nd, 1981a).

Direct (or "general") damages are those that are the natural and necessary result of the wrongful act or omission. Said another way, direct damages are those which are traceable to, and the probable and necessary result of, the injury. They are the direct, natural, logical, and necessary consequences of the injury, or usually flow from the breach (American Jurisprudence, 2008b).

Consequential (or "special") damages, denotes damages that arise from the special circumstances of the case, which, if properly plead, may be added to the direct damages which the law presumes or implies from the mere invasion of the plaintiff's rights. Consequential damages are the natural, but not the necessary, result of an injury. Thus, they are

not implied by law, and while they need not be the necessary and usual result of the wrong, they must be a proximate result thereof (American Jurisprudence, 2008c). This rule is generally derived from the holding in *Hadley vs. Baxendale* (156 ER 145, 1854).

In a more modern interpretation of this rule within the construction environment, the Supreme Court of Virginia weighed in on the difference between direct and consequential damages and found for the plaintiff on the issue of whether extended interest cost related to a job being finished late was a direct damage (*Roanoke Hospital Association v. Doyle & Russell, Incorporated*, 215 Va. 796, 1975). In that same case the Supreme Court of Virginia found that some interest expenses were consequential damages.

Many owners choose to pursue a green building for a variety of reasons, including the fact that they wish to capitalize on higher rents and asset value that are perceived to derive from third-party green building certification, as well as potentially lucrative financial incentives offered by state and local governments. If the party responsible for attaining third-party certification fails to accomplish the goal as required by contract, the damages that flow from that breach may be deemed both direct and consequential damages (Prum & Del Percio, 2010). Because of the green building arena's novelty, courts have yet to set a precedent as to whether the damages should be considered direct or consequential (Prum & Del Percio, 2010).

Case Law

Looking at reported case law to establish the legal precedent can help to conclusively answer some of the questions that have been referred to above. Unfortunately reported cases on this aspect of green building law are sparse to non-existent. In the course of researching the current legal precedent some initial pleadings and factual background were uncovered on a state trial court case which is related to this subject and provides some insight. This case is *Shaw Development vs. Southern Builders*. The following facts concerning the lawsuit were uncovered by a blogger working at gbNYC magazine. The lawsuit in question relates to the construction of a \$7.5 million condominium complex in coastal Maryland. From what can be gleaned from the initial pleadings it appears that the specifications included a stated goal for the project to achieve a LEED silver certification issued by the United States Green Building Council. The owner's interest in this LEED silver rating was not purely altruistic, as there were state tax incentives related to new buildings achieving LEED certification. In this case the state of Maryland was offering tax credits up to 8% of the total project costs for projects which achieved a LEED certification. These tax credits were not specifically mentioned or claimed in the contract but the LEED certification was clearly stated in the specifications as a sustainability objective. As it turns out the performance of the project team delayed the receipt of LEED certification which subsequently disqualified the owner from receiving the tax credits; and, as such, the owner pursued a cause of action against the builder based partially on these lost tax credits (Del Percio, 2008).

Unfortunately for legal commentators and academics this case never proceeded to trial and was settled out of court. But the facts of the case illustrate the types of disputes and claims that will undoubtedly be seen in the future related to one party's failure to achieve a sustainability objective.

Discussion

Without established legal precedent some common threads may be uncovered from the model contract documents and the basics of contract law. It appears that contract drafters are managing their risk using a few common strategies. It is also clear that owners are looking for ways to ensure their project participants meet the sustainability measures.

The first and most desired risk avoidance strategy for contractors and architects is a waiver of consequential damages. Most of the sustainability guides attempt to define damages related to the failure to meet a sustainability objective to be consequential, then further rely on the waiver of consequential damages in the governing contract to absolve the parties of liability. It appears that some of the damages flowing from a failure to meet a sustainability objective would be considered a consequential damage (i.e. decreased rents, decreased asset value, failure to acquire lucrative financial incentives offered by state and local governments). However, the danger with relying on this risk

avoidance strategy is that some damages related to a failure to achieve a sustainability goal may be deemed direct damages; and the line is often blurred between direct damages and consequential damages. The AIA has added some umbrella coverage for possible direct damages by adding a limitation of liability provision in addition to the mutual waiver of consequential damages.

As of the date of this writing, the AIA has not formally introduced their new contracts intended for use with sustainable projects. However, the AIA has announced plans for introducing: (1) A101-2007 SP, Standard Form of Agreement between Owner and Contractor, for use on a Sustainable Project where the basis of payment is a Stipulated Sum; (2) B101-2007 SP, Standard Form of Agreement Between Owner and Architect, for use on a Sustainable Project; (3) A201-2007 SP, General Conditions of the Contract for Construction, for use on a Sustainable Project; (4) C401-2007 SP, Standard Form of Agreement Between Architect and Consultant, for use on a Sustainable Project; and (5) A401-2007 SP, Standard Form of Agreement Between Contractor and Subcontractor, for use on a Sustainable Project (AIA, 2011). Until the release of these documents, one can only conjecture that the new documents will incorporate the recommendations outlined in AIA Document D503-2011, Guide for Sustainable Projects. Once these documents are released the sustainable industry will have a much more uniform way of approaching the specific risks and nuances associated with projects having a contractually dictated sustainable component.

The other type of risk sharing strategy which has been mentioned in both the ConsensusDOCS and DBIA addendums is some sort of liquidated damage provision relating to a parties failure to meet a sustainability objective. This may be the most reasonable and balanced approach considering the interest of all parties. It is clear that in these cases, harm has been done to the owner if a sustainability objective is not met. And it further stands to reason that if the owner feels strongly about the sustainability objective that message can be conveyed clearly by putting a price tag on it in the form of a liquidated damage clause when the contract is initially negotiated. This type of liquidated damage would be subjected to the typical legal challenges and as such would have to be drafted carefully. According to the Restatement 2nd of Contracts, "Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof or loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty" (Restatement 2nd, 1981b).

With respect to liquidated damages, no court to date has interpreted a green building-related liquidated damages provision. As a result, a provision that imposes liquidated damages on a party for failing to earn the owner's desired level of LEED certification may in some jurisdictions, be deemed a penalty and thus an unenforceable condition of the contract (Prum & Del Percio, 2010).

A third option addressing this issue has recently been brewing in Washington D.C. In 2006, the city of Washington D.C. passed legislation that would require green performance bonds to be used on construction projects beginning in 2012. This legislation was a bit confusing to industry participants who had never heard of a green performance bond and where uncertain how to acquire one (Cheatham, 2011). According to section 6b of the act:

On or before January 1, 2012, all applicants for construction governed by section 4 shall provide a performance bond, which shall be due and payable prior to receipt of a certificate of occupancy.

The bond, which could be worth up to \$3 million, would be forfeited if a building should fall short of expected green building standards (such as LEED certification) outlined within the act.

It is anticipated that Green performance bonds would function similarly to a normal construction performance bond, with the primary difference being that it covers harm specific to a projects sustainability objectives. Performance bonds guarantee the performance of the principal ("contractor") to their obligee ("owner"). In the event of default under the terms of a performance bond the obligee will require the surety to step in the shoes of the principal and fulfill the obligation or surrender the penal sum of the bond. It is assumed that a green performance bond would function in a similar same way (Cheatham, 2011).

When it comes to green performance bonds, the bond would offer a financial guarantee that the principal will adhere to certain green building objectives. If the contractor should fail to do so, the surety would be accountable for making sure the principal fixes the problem (Cheatham, 2011). It is unclear whether the standard performance bond would cover the failure of a contractor to meet an explicit sustainability objective, or if a separate bond device will have to be created to address this risk.

Lastly, in the United States there is a groundswell of momentum behind green building and that has caused regulators and code drafters to take notice. In the near future regulators and code drafters will convert these sustainability goals from a voluntary system enforceable only under the laws of contract, to a mandatory system which becomes part of building codes subject to enforcement by local municipalities and governments. In the event that sustainability objectives become part of building codes; then in addition to the contract damages, violators could face fines and other remedies imposed by governmental authorities. This will add an additional level of risk for project participants to consider and plan for.

Conclusion

It is clear that sustainable construction isn't going away anytime soon, so project participants will have to familiarize themselves with this new reality to navigate its pitfalls and risks. It seems that since the risk of failing to meet a sustainable objective is somewhat new, owners are not rigidly enforcing these conditions and contractors and architects have received a temporary reprieve. As this type of expectation becomes more common place and owners become more sophisticated it seems that owners will become less likely to ignore these provisions and allow project participants to waive all liability related to them. The next logical step for owners seeking some assurances beyond a handshake on their sustainability objectives is to include specifically tailored liquidated damage provisions in the governing contract. A properly drafted liquidated damage provision could serve the dual purpose of putting the project participants on notice of the owner's serious intent to achieve their sustainability objectives and provide the contractor and architect some certainty as to their potential liabilities.

Until such time as standardized contracts are publicly available and become commonly used in the industry, it is up to the individual contracting parties to address the issues addressed in this paper and such other issues that may be appropriate in light of a particular project. Those engaged in drafting contracts will typically address these issues in accordance with recommendations of organizations such as those discussed in this paper. However, even following a set of "standardized" recommendations there will be a wide divergence of how these issues are addressed as individual contract drafters will have their own set of guidelines or procedures that they consider important. With little "standardization" in the industry, the judicial system will have a lack of precedence to fall back on when the failure to meet certain objectives results in legal proceedings between or among the parties. When this occurs, one normally expects to see court rulings based upon traditional measures of relief as briefly discussed in the citations such as American Jurisprudence (AmJur) and Restatement of Contracts.

As noted, the real issue of failing to meet sustainable goals often becomes the level of damages incurred. These damages may be as simple as the loss of a tax credit as seen in *Shaw Development vs. Southern Builders*. But more than likely, if a compromise and settlement is not reached between the parties; and the dispute ends up in a judicial proceeding the issue of damages will become increasingly complex. At this stage, damages may also include much more nebulous areas such as whether or not the owner has incurred additional operating costs, additional maintenance costs, lower worker productivity, lower rental incomes, decreased selling prices, and less marketability; just to name a few.

Construction management programs have always been engaged in educating students for the traditional roles in the construction industry. This typically will include the basics of contracts and a discussion of the risks associated in the industry. However, it is undisputed that sustainable construction will be an increasingly important topic in the years to come. The next question then becomes: do we educate students for the traditional roles in the industry as they have existed in the past or do we educate students for the traditional roles in the industry as they will exist in the future. Some will argue that the role of educational institutions is to concentrate on the former and let the industry concentrate on the latter. Most, however, would agree that this is really just an easy way out and that our educational programs should address the latter position.

How then should construction management programs address these emerging issues of the industry? Awareness is probably much more important than solutions. As the industry has not reached a point of agreement on how such issues should be resolved, it is unrealistic to believe that construction management programs will step forward with a “magic” solution. However, our students should emerge from their educational endeavors with a healthy respect for the issues they will encounter as they enter the industry. Students should be aware of the discussions taking place in the industry and the possible solutions that are being proposed; i.e., well grounded in the traditional aspects of the industry yet prepared to address the changes on the horizon.

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