

Client Alert

Latham & Watkins

Environment, Land & Resources Department

Green Building Projects: The Growing Trend Brings Both Opportunities and Potential Liability Risks

The "green building" trend is gaining momentum. According to McGraw-Hill Construction, the value of the green building market is expected to grow from \$55-\$71 billion in 2010 to \$135 billion by 2015.¹ Notably, nonresidential green building is expected to triple during this time, ultimately estimated to represent 40-48 percent of the nonresidential construction market by 2015.²

Green building is defined by the US Environmental Protection Agency as "the practice of creating structures and using processes that are environmentally responsible and resource-efficient throughout a building's life-cycle from siting to design, construction, operation, maintenance, renovation and deconstruction."³ While there are clear advantages to building "green," as is often the case, along with opportunity comes the potential for risk. As the number of green buildings increase, so too does the likelihood that claims may be filed related to the design, construction, certification, operation and marketing of these projects. Companies involved with green buildings at any stage should therefore be aware of the potential risks and actively manage and make efforts to mitigate them.

This *Client Alert* will highlight the potential legal claims that may arise related to green building projects, including claims for breach of contract, false advertising, personal injury and product liability. The positions and contentions discussed herein are merely that, contentions made by various groups that illustrate the potential risks of building green which should be considered when evaluating green building design and construction opportunities.

Green Building Certification Programs and Related Building Codes

Even in the face of an economic downturn, the proliferation of green building projects has continued, driven by several factors, including: (i) the implementation of new government policies promoting energy efficiency; (ii) an increased public awareness of the environment; (iii) the belief that green buildings are more economical to operate⁴ and (iv) the priority permit processing and tax incentives often available as a way to encourage industry to build green.⁵

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Green building certification programs and regulatory structures now span the globe. Interestingly, the various certification programs each have their own standards to measure what makes a building “green.” These programs generally evaluate sustainability and efficiency, along with decreasing impacts on the environment.⁶

Leadership in Energy and Environmental Design — “LEED®”

The most prominent green building certification program is Leadership in Energy and Environmental Design, known as “LEED,” developed by the US Green Building Council.⁷ LEED is a scoring system that awards points to green building projects based on the sustainability of a site, water efficiency, energy performance, materials used, indoor environmental quality, innovative designs and other regional priorities.⁸ LEED has been incorporated into law at various governmental levels in 45 states, including 442 localities, 35 state governments and 14 federal agencies or departments.⁹

LEED certifies new buildings as green at the time of construction, based on the buildings’ predicted performance.¹⁰ LEED provides certification for existing buildings based on a snap-shot in time assessment.¹¹ As discussed below, during the course of 2010 some groups criticized the LEED system as not properly taking into account a building’s performance over time, or for alleged false advertisements.¹²

California’s New, Mandatory, Green Building Code — “CALGREEN”

Beginning January 1, 2011, the California Green Building Code went into effect, labeled “CALGREEN.”¹³ This is the first mandatory statewide green building code. The stated goal of CALGREEN is to ensure that “every new building in California is built using environmentally advanced

construction practices” by requiring reduction in indoor water use, diversion of construction waste from landfills, inspection of energy systems and use of low-pollutant emitting interior finish materials.¹⁴

CALGREEN represents a new approach to green building standards because, in contrast to LEED certification which looks at a project at one point in time, CALGREEN looks beyond its completion. CALGREEN requires a 20 percent mandatory reduction in indoor water use, mandatory inspections of energy systems for nonresidential buildings over 10,000 square feet and separate water meters for nonresidential buildings’ indoor and outdoor water use.¹⁵ CALGREEN also mandates field inspections while LEED and most point-based systems use paper audits to award points.¹⁶ Whether California’s approach represents an emerging trend in green building standards remains to be seen.

Criticisms of the LEED System

While much of the feedback regarding LEED has been positive, some groups have criticized LEED for failing to address certain concerns and for providing a false sense of security.¹⁷

For example, in October 2010 a lawsuit was filed against the US Green Building Counsel in the Southern District of New York, alleging that “USGBC’s LEED rating system is supplanting building codes in many jurisdictions, undermining marketplace competition and obscuring other building standards that *are* proven — unlike LEED — to reduce energy use and carbon emission.” [emphasis in original]¹⁸ The lawsuit contends that LEED fraudulently misleads consumers and the market by concealing and misrepresenting the performance of LEED buildings.

Some critics have been encouraged by the most recent version of the LEED standards, but questions remain.¹⁹ Risk management experts warn against over-

reliance on LEED standards, particularly where there may be inconsistencies with local law.²⁰ The important take-away for the business community is that even though LEED standards are being incorporated into law, stakeholders must not rely on a false sense of security and thereby make unsupported promises regarding energy savings or other attractive building features. Rather, stakeholders should carefully evaluate contract terms and building performance independently, at a minimum taking into account the following:

1. The Potential for Design, Construction and Product Defect Claims

As with any new building, in green buildings there is a potential for design, construction and/or product defect claims. Since green building standards have spurred a proliferation of new high efficiency products, some building forensic groups and risk management experts are warning that some green products have not been rigorously tested for performance over time, or tested as part of a complex system of materials.²¹ Liberty Building Forensics Group, for example, suggests that certain green materials may not be appropriate for the geography or climate where a particular building is located, and that the result may be a higher risk of building failure.²² One example can be seen in the increased use of new products in wall and roof assemblies which can "dramatically increase the overall potential of moisture problems within the envelope."²³

Builders, designers and product manufacturers should recognize that there are risks when making claims regarding specific levels of energy savings or building performance when relying on new products. The fact that a product is appropriate for LEED or other green building programs does not ensure performance, or that the product is the best choice for a particular building design in a particular geographic location.

Critics note that LEED certification is based on performance predictions, not results.²⁴ Similarly, regulations like CALGREEN restrict water use and require inspections of energy systems, but do not guarantee that products approved in the initial design will achieve these goals.²⁵ Thus, failure to achieve promised levels of performance because of climate differences or other issues could result in costly repairs and other liabilities. Before making decisions, stakeholders should carefully weigh the risks and anticipated benefits of using untested materials in projects where performance is critical.

2. Products Developed for Green Building Certification May Not Meet the Test of Time

Another potential problem that some groups associate with green building design and construction is the lack of time-tested results.²⁶ Many green building products have been developed within the last five years, but are intended for use in buildings that should last for 50 or more years.²⁷ Questions remain about the long-term viability and performance of these materials. To the extent that other jurisdictions follow California's lead and mandate energy performance and water use limitations over time, long-term performance of materials raises additional liability risks. Because of the uncertainties arising from the use of relatively new materials, parties should subject new products with specific "green" benefits to more rigorous scrutiny than time-tested products. This is especially true for owners and occupants who may have a long term horizon for their investment in a green property.

3. Alleged Health Effects Associated With Green Buildings

While green buildings are often touted as being beneficial for the occupants' health, at least one group has criticized the LEED system for its alleged failure to adequately address impacts on

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human health.²⁸ A recent report by one advocacy group, Environment & Human Health, Inc. (EHH), contends that LEED fails to address health threats in green buildings because it prioritizes energy efficiency over human health.²⁹ The report argues that only seven of the 110 points available in LEED certification programs have the primary intent of limiting hazardous chemicals within the built environment, and the highest certification level can be achieved without a single point in this area.³⁰ EHH further contends that the LEED certification standards do not pay sufficient attention to potential health effects of chemicals used in buildings.³¹ These contentions preview the types of personal injury claims that green buildings may generate.

Another area of debate involves changes to mechanical design precipitated by green building standards. Reports analyzing green building standards and indoor air quality present divergent theories about how green building designs may impact human health. Some reports criticize green building standards for encouraging tighter buildings with lower levels of exchange between indoor and outdoor air.³² These reports note that less air exchange can intensify exposures to more contaminated indoor air and, if combined with the use of harmful chemicals, potentially increase the risk of unintended health consequences.³³ Other reports argue that green building standards provide incentives to increase the amount of outside air introduced into buildings, and that increased rates of ventilation are directly correlated with increased moisture problems, which may lead to mold growth and other potential health and indoor environmental quality concerns.³⁴

Rather than rely on a false impression that a LEED certified building, or any building with a "green" certification, is "healthy," parties should find out how changes to traditional building design impact the indoor air quality and, if

pertinent, take steps to minimize the risk of personal injury, product liability, breach of contract and false advertising claims.³⁵ Additionally, specific warranties about a building's performance may lead to fraud-related claims. Although many green facilities do offer benefits such as improved indoor environmental quality, increased worker productivity, and reduced energy costs, parties should be careful to accurately represent these areas of performance.³⁶

The Need to Allocate Certification and Financial Incentive Risk

The process of allocating risk in green building design and construction contracts is complicated by regulatory requirements that are in flux, valuable incentives that increase the stakes, and innovative designs that make the performance of a building even more difficult to predict.³⁷ To complicate matters, at least one court has found that federal energy efficiency laws may preempt state and local green building ordinances.³⁸ Similar arguments have been presented in other jurisdictions.³⁹

The failure to identify and properly allocate risk can lead to costly litigation, as demonstrated by *Southern Builders, Inc. v. Shaw Development, LLC*,⁴⁰ a landmark lawsuit that arose when a condominium project failed to meet the LEED Silver Certification requirements specified in the construction contract. The developer alleged negligence and breach of contract against the builder for failure to achieve certification and failure to obtain tax credits necessary for the financial viability of the project.⁴¹

Though the action settled out of court, *Shaw Development* demonstrates the need to explicitly allocate responsibilities and obligations related to green building certification. As with other contracts, we recommend that green building construction and design contracts clearly identify

green requirements, certifications or expectations that must be met; assign responsibility for meeting requirements, investigating and selecting products, and filing documentation; and define the scope of parties' liability for failing to meet these requirements.

Reevaluating Insurance Solutions

Policyholders engaged in green building projects should also consider the myriad of insurance solutions that may be appropriate for green building projects, and consult with qualified coverage counsel to assess their policies and develop strategies for maximizing coverage in the event of a loss.

For example, owners, occupants and investors in green building projects should evaluate whether green features, such as solar panels or wind turbines, are covered property under their current insurance programs. They should also consider whether failures of green features may be attributable to insurable occurrences such as weather or existing structural defects. Builders' risk policies, commercial general liability policies, and construction bonds may serve as potential sources of coverage with the proper endorsements or specific underwriting of manuscripted policies.

Likewise, professionals should reevaluate their professional liability policies to ensure that they are covered for services associated with green projects. Since the definition of "professional services" will often be the critical coverage component in any professional liability policy, professionals who are now expanding their portfolios to provide services associated with green projects should ensure that their professional liability coverage is broadly worded to protect against errors and omissions associated with the rendering of those services.

Other considerations include whether professionals may be held to a higher standard of care because they hold themselves out as LEED Accredited Professionals. There is currently no uniformity among green building standards, and very little legal precedent exists regarding whether builders and designers specializing in green projects — and specifically, those certified as LEED Professionals — might be held to a higher standard of care for potential tort liability.⁴²

Parties should consider these uncertainties when negotiating and drafting agreements that pertain to green buildings. They should also take care to avoid making claims about being "green" without referencing a specific standard, as this may lead to misrepresentation claims. In the event that such claims do arise, Directors and Officers insurance policies may provide coverage against allegations from shareholders or others purportedly damaged by any incorrect representations.

Conclusions

Evolving green building standards and regulations have incentivized changes in the building industry. These changes have precipitated both opportunities and risks for investors, designers, builders and occupants alike. Risks and shifting regulatory requirements should be carefully addressed and managed, so that the parties can successfully reap the benefits of green building opportunities.

For additional information about Latham & Watkins LLP's litigation experience on construction and engineering matters, please [click here](#).

Coming Soon...

In March 2011, Latham & Watkins LLP's Green Energy Law Report, with insights and commentary on climate change, renewable energy and clean technology, will be available at www.greenenergylawreport.com.

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Endnotes

- ¹ McGraw-Hill Construction, *Green Building Market Grows 50 percent in Two Years despite Recession, Says McGraw-Hill Construction Report*, PR Newswire, Nov. 12, 2010, available at <http://www.prnewswire.com/news-releases/green-building-market-grows-50-in-two-years-despite-recession-says-mcgraw-hill-construction-report-107547978.html>.
- ² *Id.*
- ³ US Environmental Protection Agency, *Green Building: Basic Information* (January 11, 2011), available at <http://www.epa.gov/greenbuilding/pubs/about.htm>.
- ⁴ Marsh Inc., *Green Building: Assessing the Risks* iii (2009), available at http://global.marsh.com/documents/GreenBuildingAssessingtheRisks08_09_2009.pdf.
- ⁵ Charles Goulding, Jacob Goldma and Nicole DiMarino, *LEED Building Tax Opportunities*, Corporate Business Taxation Monthly, January 2008, at 19.
- ⁶ Green Globes, Building Research Establishment's Environmental Assessment Method (BREEAM), The Green Building Programme, and GreenPoint Rated are just four of the many programs evaluating sustainability and efficiency of buildings. See Green Building Initiative, *Green Globes Rating/Certification*, available at <http://www.thegbi.org/green-globes-tools/ratings-and-certifications.asp>; Building Research Establishment, *What is BREEAM*, available at <http://www.breem.org/page.jsp?id=66>; European Commission Joint Research Center, *The GreenBuilding Programme*, available at <http://www.eu-greenbuilding.org/index.php?id=163>; Build It GREEN, *GreenPoint Rated: Your Assurance of a Better Place to Live*, available at <http://www.builditgreen.org/greenpoint-rated/>.
- ⁷ Kate Bowers & Leah Cohen, *The Green Building Revolution: Addressing and Managing Legal Risks and Liabilities*, Harvard Law School Environmental Law & Policy Clinic 2 (May 10, 2009).
- ⁸ United States Green Building Council, *LEED® 2009 for New Construction and Major Renovations Project Checklist* (September 24, 2010), available at <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=220>.
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- ¹⁰ Franklyn Cater, *Critics Say LEED Program Doesn't Fulfill Promises*, National Public Radio, Sept. 8, 2010, available at <http://www.npr.org/templates/story/story.php?storyId=129727547>; United States Green Building Council, *LEED® 2009 for New Construction and Major Renovations Project Checklist*, available at <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=220>.
- ¹¹ United States Green Building Council, *LEED® 2009 for Existing Buildings: Operations & Maintenance Project Checklist*, available at <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=221>.
- ¹² See *Gifford v. US Green Building Council*, No. 10-7747 (S.D.N.Y. Oct. 8, 2010); J. David Odom, Richard Scott & George H. DuBose, *The Hidden Risks of Green Buildings: Avoiding Moisture & Mold Problems*, National Council of Architectural Registration Boards Mini-Monograph Series 2, 7 (2007); Marsh Inc., *supra* note 4, at 8; see also Cater, *supra* note 10.
- ¹³ The State of California, *2010 California Green Building Standards Code: Nation's First Mandatory Statewide Standards Code to Green Construction and Fight Climate Change* (2010), available at <http://images.emaildirect.com/clients/govpressoffice847/GreenBuildingCodeOnepager.pdf>; Green Building Standards Code, Cal. Code Regs. tit. 24, part 11 (2010).
- ¹⁴ The State of California, *2010 California Green Building Standards Code: Nation's First Mandatory Statewide Standards Code to Green Construction and Fight Climate Change* (2010), available at <http://images.emaildirect.com/clients/govpressoffice847/GreenBuildingCodeOnepager.pdf>.
- ¹⁵ *Id.*
- ¹⁶ *Id.*
- ¹⁷ See, e.g., Environment & Human Health, Inc., *LEED® Certification: Where Energy Efficiency Collides with Human Health* 49–52 (2010); Odom, et al., *supra* note 12, at 2.
- ¹⁸ Complaint at 8–10, *Gifford v. US Green Building Council*, No. 10-7747 (S.D.N.Y. Oct. 8, 2010).
- ¹⁹ See, e.g., Cater, *supra* note 10.
- ²⁰ Marsh Inc., *supra* note 4, at 9–10.
- ²¹ Odom, et al., *supra* note 12, at 7; Marsh Inc., *supra* note 4, at 8.
- ²² Odom, et al., *supra* note 12, at 2.
- ²³ *Id.* at 3.
- ²⁴ Cater, *supra* note 10.
- ²⁵ Cal. Code Regs. tit. 24, part 11.

²⁶ See, e.g., Marsh, Inc., *supra* note 4; Bowers & Cohen, *supra* note 7, at 6.

²⁷ Odom, et al., *supra* note 12, at 7.

²⁸ Environment & Human Health, Inc., *supra* note 17, at 16.

²⁹ *Id.*

³⁰ *Id.* at 13.

³¹ *Id.* at 16, 26–27, 31–37.

³² California Air Resources Board and California Energy Commission, *Ventilation and Indoor Air Quality in New Homes* 215 (Nov. 2009); Environment and Human Health, Inc., *supra* note 17, at 8.

³³ *Id.*

³⁴ Odom, et al., *supra* note 12, at 9.

³⁵ *Id.* at 46.

³⁶ Bowers & Cohen, *supra* note 7, at 10-11.

³⁷ Marsh Inc., *supra* note 4, at 8.

³⁸ *Air Conditioning, Heating, and Refrigeration Inst. v. City of Albuquerque*, No. 08-633, 2008 US Dist. LEXIS 106706, at *38 (D.N.M. Oct. 3, 2008) (preliminarily enjoining the application of state green building laws because federal law preempts state regulation of HVAC and water heating products).

³⁹ See, e.g., Complaint at 2, *Bldg. Indus. Ass'n v. Wa. State Bldg. Code Council*, No. 10-5373 (W.D. Wash. May 25, 2010).

⁴⁰ Counter-Complaint at 4, *S. Builders, Inc. v. Shaw Dev., LLC*, No. 19-C-07-011405 (Md. Cir. Ct. Feb. 16, 2007).

⁴¹ *Id.*

⁴² Bowers & Cohen, *supra* note 7, at 13.

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