



Disputes and Litigation of Energy Savings Performance Contracts

By Aaron P. Silberman

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The federal government incurs billions of dollars in energy and water costs annually. Recent statutory mandates compel government agencies to conserve energy and water and reduce these costs. While there are available measures for the government to do so, many of these measures would be prohibitively expensive using appropriated funds. A way in which agencies increasingly have solved this dilemma is through energy savings performance contracts (ESPCs). State and local governments' and commercial owners' use of ESPCs is growing as well.

ESPCs are authorized by statute and regulation. They enable the government to obtain energy- and

water-saving measures through private investment. The government only pays the contractor, or energy savings company (ESCO), to the extent that promised savings are realized. While it does not take ESP to see that the future of ESPCs is quite bright, these contracts also pose many challenges—some unusual or unique—that may lead to disputes between project participants.

What Are ESPCs?

Under an ESPC, the government hires an ESCO to perform a "detailed energy survey" to identify areas in which a government facility can reduce its energy

Continued on page 10

Advising Clients in Green-Building Disputes: Four Steps for Defining Roles in LEED Projects

By Jennifer Grippa



Jennifer Grippa

Sustainability has hit the construction market, and sustainable practices and policies are becoming a battleground for owners, architects, contractors, subcontractors, and engineers, among others. Parties attempting to incorporate green-building standards into their construction contracts are having difficulty

allocating responsibility, particularly when standards like Leadership in Energy and Environmental Design (LEED) call for an integrated process that requires input from the owner, architect, contractor, mechanical engineer,

Continued on page 14



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Message from the Cochairs



Patrick J. Greene



Charlotte Wiessner

We are pleased that so many of you volunteered to assist with the committee's newsletter, *Construct!*, and our ever-expanding website, and we look forward to working with you.

The committee continues to be active in sponsoring and presenting CLE programs and creating networking opportunities for our members. This year the Section Annual Conference will be held at the Hilton Hotel in New York City from April 21 to April 23. We will be hosting a networking lunch with the Real Estate Litigation Committee and invite you to attend. We will also have the table at the Committee Expo and reception and hope to see you there.

We also continue to strengthen our ties with the ABA Forum on the Construction Industry. The committee will be presenting a plenary program focusing on tort and statutory claims in construction litigation at the Forum meeting in Austin, Texas, this April. Also at the Forum meeting, Patrick Greene will be assisting with the program on construction accounting, and Ed Gentilcore, a new cochair of the Programs Subcommittee,

will be participating in a program on infrastructure.

New members welcome! If you have friends or colleagues that might be interested in the Construction Litigation Committee, please encourage them to join and get involved. The committee's achievements are solely the result of its members, and we appreciate your efforts.



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Brian J. Furniss

Most everyone in the construction industry says he or she understands what the critical path of a project schedule is and what it means. The majority of the time, the understood definition of the critical path is correct, but that definition is often based on traditional scheduling methods. As computers and scheduling software have become more common, anyone can create a schedule, click a few buttons, and get a printout of the critical path. However, the evolution of project scheduling requires that schedulers and project managers gain a much more thorough understanding of the definition of the critical path. Because today's software packages are more robust and allow us so many more options to schedule our project more accurately, the art of scheduling has evolved tremendously from when schedules were created by hand. As a result, the definitions of some of the most frequently used terms in construction project management, including "critical path," have evolved. Consequently, today's project managers must develop a more sophisticated view of what the critical path of a project schedule is and how it is most effectively used as a management tool. Project managers and schedulers must understand how scheduling has changed and how this affects their management of time on the construction project.

The general understanding of the term "critical path" is that it is in reference to controlling project *time*. Let's look at some of the published definitions of "critical path."

The Associated General Contractors of America (AGC) defines the critical path as:

... the longest path through the network that establishes the

The Critical Path: Definition vs. Understanding

By Brian J. Furniss & Theodore J. Trauner



Theodore J. Trauner

minimum overall project duration. The critical path is composed of a continuous chain of activities through the network schedule with zero total float. All activities on the critical path must start and finish at their planned times or the project will not complete on the calculated early/late finish of the last activity in the network.

The AGC's explanation of the critical path goes on to state:

Failure of a critical path activity to start or finish at the planned early and late finish times will result in the overall project duration being extended. For the classical schedule calculation, it is both necessary and sufficient for an activity to be on the critical path if the activity's total float is zero.

The AGC's statement that, "For the classic schedule calculation, it is both necessary and sufficient for an activity to be on the critical path if the activity's total float is zero," is true, but it is important to understand the "classical" or "traditional" era of critical path method (CPM) scheduling. This was the era before the advent, or at least the widespread use, of constraints, multiple calendars, and other features now available in scheduling software. Because these features are now used frequently in project scheduling, the "classic schedule calculation" definition that relies on zero total float (float) no longer reliably defines the critical path of many project schedules. Because multiple calendars and constraints are commonly used in project scheduling, it is not uncommon to have activities on or off the

critical path of the project that have zero float, positive float, or even negative float. The float-based portion of the AGC's definition also implies that *any* activity with a float value of zero should be on the critical path. Many software programs actually allow the scheduler to assign a "zero float constraint" to any activity in the schedule. This constraint has the effect of making the float value of an activity equal zero. By using this type of constraint and the float-based portion of the AGC's definition, any activity in the schedule could be put on the critical path. Therefore, although the float-based portion of the AGC's definition of the critical path *may* be true for some projects, it is not necessarily true for all projects.

Let's look at a few other definitions of the critical path. The following definition of the critical path is from Oracle's Primavera 6.0 (P6):

The critical path is a series of activities that determines a project's completion time. The duration of the activities on the critical path controls the duration of the entire project; a delay to any of these activities will delay the finish date of the entire project.

Oracle's Primavera SureTrak 3.0a, another version of CPM scheduling software, defines the critical path as:

... the longest path of activities through your project. Each activity on the critical path has zero or negative total float. The duration of the critical path controls the duration of the entire project; any delay to any activity on the critical path delays

the completion of the project.

Even if a person did not have these software packages, entering “critical path” into Wikipedia will lead to “critical path method,” with the following definition:

In project management, a critical path is the sequence of project network activities which add up to the longest overall duration. This determines the shortest time possible to complete the project. Any delay of an activity on the critical path directly impacts the planned project completion date (i.e. there is no float on the critical path).

There are many other variations of the definition of the critical path, in addition to the four definitions that are identified in this article. Putting these definitions aside, let’s review two common elements that often appear in definitions of the critical path. The two common elements are:

1. The critical path of the project controls when the project will complete.
2. If you delay an activity on the critical path, you will delay the project-completion date.

The first element is true. The critical path of the project always controls when the project is planned to finish because it is a measurement of the longest path through the schedule and, therefore, defines the earliest date when the project can finish. The same could be said for measuring the critical path through a milestone completion date (i.e., the critical path to any milestone on the project controls when the milestone is planned to be completed.) However, the second common element in the definition of the critical path is only true *sometimes*. The objective of this article is how to identify when the second element is not true, and then to provide an example where the path that must be progressed, to prevent delays to the project completion date, is actually (at least initially) a non-critical path.

For several years, scheduling software has allowed schedulers and project managers to place activities under separate work calendars. This is also referred to as using “multiple calendars” to schedule a project. Multiple calendars become extremely useful options for project managers when subcontractors on the job are planning to work different schedules (five-day

The critical path of the project always controls when the project is planned to finish.

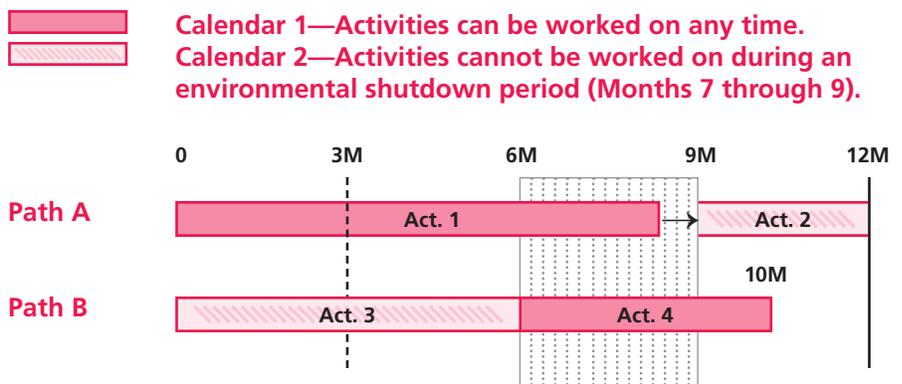
workweek vs. six-day workweek) or if the project is susceptible to other work constraints like environmental shutdowns (no work in riverbeds during certain times of the year, wildlife constraints, winter shutdowns, etc.). Multiple calendars may affect the float value of activities in the schedule and, therefore, activities on the critical path may have varying float values. That

is why any definition of the critical path should not contain a reference to the “zero float path” or the “path with the least or most negative float.” These kinds of definitions were more applicable in the “classical” era of CPM scheduling, before the inclusion of constraints, multiple calendars, and other features of modern scheduling.

Let’s look at a scheduling example that contains activities using two different calendars. Path A contains Activity 1, which has a duration of 8 months and is planned to progress based on Calendar 1. Activity 1 has a finish-to-start logic tie to Activity 2, which has a duration of 3 months and is planned to progress based on Calendar 2. Path B contains Activity 3, which has a duration of 6 months and is planned to progress based on Calendar 2. Activity 3 has a finish-to-start logic tie with Activity 4, which has a duration of 4 months and is planned to progress based on Calendar 1. Figure 1 is a graphical layout that is similar to a bar chart.

The vertical lines on the graphic identify the end of the corresponding month shown above the line. The shaded region between the end of Month 6 and the end of Month 9 identifies when Activities 2 and 3 cannot progress because of the environmental-shutdown period. Based on the work calendars for Activities 1 and 2, there is a 1-month period (all of Month 9) where Activity 1 is expected to be finished but Activity 2 cannot start because of the environmental shutdown. If Activity 2 was not susceptible to the environmental

Figure 1



shutdown, Path A would be expected to finish 1 month earlier at the end of Month 12.

Now, let's determine the critical path of the project shown in Figure 1. Let's start with the definition that the critical path is that path of activities that determines when the project will complete. Path A is expected to finish at the end of Month 12. Path B is expected to finish at the end of Month 10. Therefore, the expected time to complete Path A is two months longer than Path B, and Path A is the critical path of the project. Based on our previous discussion of the two common elements of the critical path, along with the known projected durations, logic, and work calendars of each activity, Element 1 has been validated because "the critical path controls when the project will complete."

Element 2 of many of the definitions of the critical path states, "If you delay the critical path, you will delay the project completion date." Is this true, based on the information in Figure 1? No! What happens if the contractor does not progress Path A on Day 1? Activity 1 will be delayed 1 workday, but because of the non-work time between the end of Activity 1 and the start of Activity 2, the project is still expected to finish at the end of Month 11. Therefore, because of the multiple calendars in this example, it should be apparent that it is possible to delay the critical path of the project without delaying the scheduled project-completion date.

Now, let's say that Path B also did not progress on Day 1. Does this

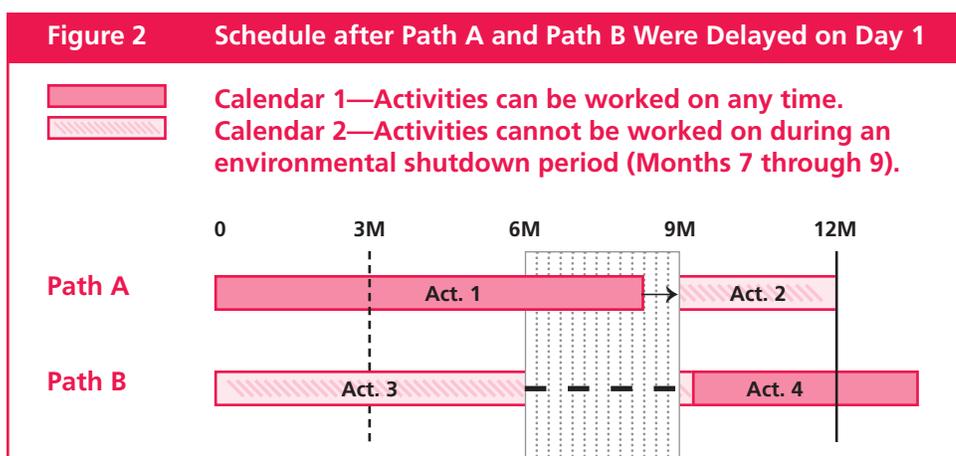
have any effect on the scheduled project-completion date? Activity 3 was expected to finish on the last day of Month 6, but because it did not start, it is now expected to finish at the beginning of Month 7, right? No! Remember, Activity 3 is susceptible to an environmental shutdown between Months 7 through 9, and as a result, Activity 3 would now be expected to finish at the beginning of Month 10. How does the delay to Activity 3 affect Activity 4? Because of the finish-to-start logic between Activities 3 and 4, Activity 4 would not be expected to start until Activity 3 finished at the beginning of Month 10. Therefore, Activity 4 would not be expected to complete until the beginning of Month 14. This is shown graphically in Figure 2.

So, if the project manager could only allocate resources to either Path A or B, which path should the project manager choose to not delay the project? Clearly, Path B, the non-critical path (based on durations) at the beginning of Day 1, would be the more logical path to progress to not delay the project. If Path B is delayed on Day 1, its delay to the project will be greater than if Path A were delayed on Day 1. Therefore, it appears that Element 2 of the definition of the critical path would apply to Path B, and not to Path A. However, Path B is not the critical path based on Element 1 of the definition of the critical path. Before any work has occurred on the project in Figure 1, Path A is controlling when the project is scheduled to complete; Path B is not controlling when the

project is scheduled to complete. The critical path based on durations, Path A, could be delayed without affecting the scheduled project-completion date, while any delay to Path B would delay the scheduled project-completion date by at least 2 months. In fact, if Activity 3 on Path B had progressed as expected, Activity 1 on Path A could have been delayed an entire month before there would have been a delay to the scheduled project-completion date. Therefore, the statement "If you delay an activity on the critical path, you will delay the project-completion date," (as stated in Element 2) is not absolute. It also shows an example of how controlling the project-completion date and avoiding critical-path delay may be dependent on the progression of a non-critical path instead of the progression of a critical path.

This example demonstrates four important points:

1. The longest path of activities through a CPM schedule determines the date when the project is expected to finish.
2. The longest path in this example can be delayed without delaying the scheduled completion date of the project (at least some of the activities on the path can be delayed).
3. Path B, what we would "classically" consider as the non-critical path, is not the longest path on the project. However, if the first activity on this path is delayed, the scheduled project-completion date will be delayed. In that context, some may say this path is also the critical path. Remember, once Path B experiences a delay on Activity 3, Activity 4 is affected by that delay, and Path B does become the longest path. Therefore, whether you consider Path B the critical path because it cannot experience a delay without delaying the project or you observe that once a delay occurs on Path B, it immediately becomes the longest path, the argument is academic. If



Path B is delayed, the project-completion date is delayed, whether or not you consider Path B to be the critical path before any progress, or lack thereof, occurs on the project.

4. The project manager/scheduler's understanding of CPM scheduling must not be based solely on definitions. They must think! They must understand how CPM scheduling works to effectively manage the project.

Conclusion

Project managers and schedulers must comprehend what the critical path truly means, and also recognize how it may or may not affect the project-completion date. Regardless of how one defines the critical path, the important aspect is that the CPM scheduling tool is designed to assist the project participants in completing the project in the most efficient manner possible, thereby preventing delays to the end date of the project. To do this requires a thorough understanding of the schedule to make sound management decisions. In addition, the critical path is dynamic in nature and may change, or shift, frequently. Critical-path shifts depend on how a project is scheduled and how the project is or is not progressing. Critical-path shifts can and very often do occur while the project is ongoing. Therefore, the project manager and scheduler need to monitor the other paths of work to determine how and when they may become critical and, as a result, affect the scheduled project-completion date. As demonstrated in Figures 1 and 2, the *potential* delays may become *actual* delays sooner than anticipated, and they may have nothing to do with the existing project critical path prior to the delay.

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Joshua Shaw

Recent Developments with the "Risk of Harm" Exception to the Economic-Loss Rule

By Joshua Shaw

According to one state supreme court in a recent construction case, the economic-loss rule "is falling out of judicial favor."¹ If this is in fact the case, practitioners of construction law around the country should remain informed of developments and trends involving this controversial doctrine. The so-called risk-of-harm exception challenges the policy underpinnings of the economic-loss doctrine and has been at the center of heated debate in a number of jurisdictions.

The traditional economic-loss rule, famously articulated by Justice Traynor in *Seely v. White Motor Co.*,² took root following the Supreme Court's decision in *East River S.S. Corp. v. Transamerica Delaval, Inc.*, wherein the Court explained as follows:

The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the "luck" of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products. When a product injures only itself the reasons for imposing a tort duty are weak and those for leaving the party to its contractual remedies are strong.³

East River found its way to the Supreme Court as an admiralty case, and the decision is not binding on states; nevertheless, the Court's reasoning has proven persuasive, as most jurisdictions recognize the general rule that "there is no recovery in tort for purely economic loss."⁴

However, as all product-liability and construction practitioners know, this rule is fraught with exceptions.⁵ One of the most divisive exceptions, the risk-of-harm exception, essentially provides that a plaintiff can recover in tort for purely economic loss where the condition created by the defendant poses a serious risk of bodily harm. Despite the Supreme Court's belief that approaches that "essentially turn on the degree of risk . . . are too indeterminate to enable manufacturers easily to structure their business," advocates of the risk-of-harm approach have not gone away.⁶

A Risky Decision

In *Colleton Preparatory Academy v. Hoover Universal, Inc.*,⁷ a private school in South Carolina alleged negligence and unfair trade practices against the manufacturer of a fire retardant, after determining that fire-retardant-treated wood was deteriorating. According to the plaintiffs, the deterioration created structural problems that would eventually result in truss failure and roof collapse. Despite arising in the construction context, the following broad question was certified to the South Carolina Supreme Court: "Can the user of a defective product recover in tort when only the product itself has been injured and when the product either violated generally accepted industry standards or posed a serious risk of bodily harm?" In a 3-2 decision, the court answered "yes" in the latter situation: Where a product poses a serious risk of harm, a plaintiff is permitted to recover against a manufacturer in tort even though the product has merely injured itself.

The reasoning of the majority in *Colleton Prep* is initially attractive. The court noted its historic "uneasiness" with a rule that focuses on

consequences rather than action and saw no reason why parties should have “to wait until a dangerous and defective product causes serious bodily injury before seeking a tort action.”⁸ The dissenting justices, however, were not convinced. Drawing on the traditional statement of the economic-loss doctrine, the dissenting opinion characterized the majority opinion as “a wholesale revision of the law of products liability” and explained that the “risk of harm” exception is unsound because it blurs the line between tort and contract recovery and misapprehends the policy considerations underlying the economic-loss doctrine.

In December 2009, just 14 months after *Colleton Prep* came down, the South Carolina Supreme Court revisited the risk-of-harm exception. In *Sapp v. Ford Motor Co.*,⁹ the court was confronted with consolidated appeals in two cases involving vehicle fires that did not result in injury. Upholding the dismissal of both actions pursuant to the economic-loss rule, the court expressly rejected the risk-of-harm exception it had adopted only 14 months earlier.

In our view, the traditional economic loss rule provides a more stable framework and results in a more just and predictable outcome in product liability cases. . . .

Furthermore, like the dissent in *Colleton Prep*, we, too, are cautious in permitting negligence actions where there is neither personal injury nor property damage. Imposing liability merely for the creation of risk when there are no actual damages drastically changes the fundamental elements of a tort action, makes any amount of damages entirely speculative, and holds the manufacturer as an insurer against all possible risk of harm.

The Maryland Balancing Test

South Carolina’s recent flip-flop on the risk-of-harm exception has returned the spotlight to the policy debate

surrounding the economic-loss rule. In adopting the risk-of-harm exception, the majority in *Colleton Prep* acknowledged the “concern that manufacturers would essentially become insurers against every remote threat of harm.”¹⁰ Responding to this concern, the majority sought to limit the situations where the exception would apply, by adopting a balancing test from the Maryland case *Morris v. Osmose Wood Preserving*.¹¹ In *Morris*, the Maryland Court of Appeals¹² synthesized the holdings of two earlier Maryland cases to create

The court was confident it had articulated a rule that was not susceptible to the classic criticisms.

a “two part approach to determine the degree of risk required to circumvent the economic loss rule.”¹³ This approach was stated as follows: “The nature of the damage threatened and the probability that the damage would occur should be examined to determine whether there is a ‘clear, serious, and unreasonable risk of death or personal injury.’” Perhaps recognizing the amorphous nature of its approach, the court in *Morris* further explained the contours of the exception:

If the possible injury is extraordinarily severe, i.e., multiple deaths, we do not require the probability of the injury occurring to be as high as we would require if the injury threatened were less severe, i.e., a broken leg or damage to property. Likewise,

if the probability of the injury occurring is extraordinarily high, we do not require the injury to be as severe as we would if the probability of injury were lower.

Although aware of its departure from the majority rule, the *Morris* court was confident that it had articulated a limited rule that was not susceptible to the classic criticisms of similar exceptions: “[T]his approach easily withstands the criticisms of the United States Supreme Court, which characterized approaches based on the degree of risk as ‘too indeterminate to enable manufacturers easily to structure their business behavior.’” The court explained: “[B]ecause of the extreme nature of the risk required to trigger it, [our rule] limits liability to, predominately, those situations in which either liability would inevitably be created by actual physical injury or the manufacturer’s exposure to liability is so great that it cannot be ignored.”

This statement highlights the central issue concerning the risk-of-harm approach: predictability. The South Carolina Supreme Court embraced the *Morris* court’s reasoning in *Colleton Prep*, only to reject it less than a year and a half later in *Sapp*, where it opted for the “more stable framework” and “more just and predictable outcome” afforded by the traditional economic-loss rule. The tension between these two opinions frames the issue simply enough: Does the risk-of-harm analysis create predictable results? The question is of the utmost significance, as the chief justification for the retention of the economic-loss rule is efficiency and predictability. The following section is designed to answer the question; you be the judge.

Torts 101 (or Should That Be “Contracts 101”?)

This is a test. Seriously. Following are the facts in four construction cases brought in Maryland. In each instance, the plaintiff sought recovery in tort although no personal injury was alleged; and in each instance, the court applied the risk-of-harm exception at the pretrial stage to determine if the plaintiffs’ tort claims could

proceed. If in fact Maryland's risk-of-harm exception easily withstands the classic criticism of unpredictability, the reader should have no difficulty predicting the application of the rule. With respect to each fact pattern, answer true or false to the statement "the allegations trigger the risk of harm exception."

1. Condominium residents bring suit against the general contractor, developer, and architects involved in planning, inspection, and construction of their building. Residents allege that the defendants negligently failed to construct and install the utility shafts and related electrical work in accordance with the plans and specifications and the building code. Specifically, the residents complain that the defendants failed to construct "ten vertical utility shafts with materials having a fire resistance rating of two hours."¹⁴
2. Owners of townhomes bring suit against plywood manufacturers for defective plywood on their townhomes. According to the complaint, a chemical reaction occurring in fire-retardant-treated plywood caused the plywood to deteriorate and lose strength capacity, resulting in impairment of strength and structural integrity of the roofs.¹⁵
3. Condominium owners bring suit against the developers of the condominium project, alleging structural problems with the balconies, inadequate railing supports on the balconies, compromised fire-rated walls and slabs, and improper installation and operation of a building fire-protection system.¹⁶
4. General contractor on a bridge project brings suit against the firm that engineered and supplied steel formwork. The general contractor seeks recovery for negligent design of the formwork, alleging the defective formwork "often buckled, bowed, moved, and at times blew out."¹⁷

Admittedly, this is an overly simplified exercise, but it nonetheless illustrates a point. In each of the foregoing fact patterns, the traditional economic-loss rule would apply to bar tort recovery; end of story, no lengthy analysis or balancing required. But in Maryland, where the risk-of-harm exception is available, the economic-loss rule barred tort recovery in two cases, and permitted it in two others. Let your answers to the test be the judge of whether application of the exception created predictable results.

Lloyd provides additional evidence that this analytical framework creates a slippery slope.

The answer to (1) is true: The allegations were sufficient to trigger the risk-of-harm exception, and the economic-loss doctrine was no bar to recovery in tort. *Council of Co-Owners Atlantis Condo. Inc. v. Whiting-Turner Contracting Co.* is typically cited as creating Maryland's risk-of-harm exception. Curiously, *Whiting-Turner* came down only a few months after the Supreme Court decided *East River* (one wonders whether the court had the benefit of the *East River* analysis when deciding the case). Although decided well before *Morris*—the case that outlined the risk-of-harm balancing test—*Whiting-Turner* offers a useful analysis of the risk-of-harm approach. Referring to the alleged failure to use certain fire-resistant materials in the utility shafts, the plaintiffs alleged that these latent conditions created a fire hazard that "presents a threat to the safety and welfare of the owners and

occupants of the [condominium]."¹⁸ The court was satisfied that the plaintiffs had alleged facts showing a risk of death or personal injury resulting from the alleged negligence of the defendants. In so doing, the court emphasized the "serious nature of the risk" required to trigger the exception, and distinguished "conditions that present a risk to general health, welfare, or comfort but fall short of presenting a clear danger of death or personal injury. . . ."

The answer to (2) is false: The allegations were insufficient to trigger the exception and the economic-loss rule barred recovery in tort. The court in *Morris v. Osmose Wood Preserving* ultimately rejected the plaintiffs' product-liability tort claims against plywood manufacturers for defective plywood on their townhomes. The plaintiffs maintained that a chemical reaction occurring in fire-retardant-treated plywood rendered the roofs "unsafe and dangerous" and "at risk of premature failure," thereby placing in danger those with cause to be on the roofs, as well as all occupants under the roofs.¹⁹

The court held that the plaintiffs alleged "mere possibilities" and, as a result, failed to "meet the required legal threshold of pleading the existence of a clear danger of death or serious personal injury." The court expounded on its holding: "[T]o lower the threshold to encompass mere 'possibilities' of injury . . . is to 'cheapen' the legitimacy of the exception to the economic loss rule and thereby invite an avalanche of such tort claims in future cases."

The answer to (3) is false: The allegations were insufficient to trigger the risk-of-harm exception, and the economic-loss rule barred recovery in tort. *Heritage Harbour, L.L.C. v. John J. Reynolds, Inc.* apparently heeded the admonition of the *Morris* court not to "cheapen" the risk-of-harm exception. The procedural posture of *Heritage Harbour* is more complicated than presented above. The actual case heard by the Maryland Court of Special Appeals²⁰ involved contribution and indemnification claims brought by the condominium's

developers against multiple contractors and subcontractors. The original suit, described above, was brought by condominium owners against the developers. The underlying suit became significant on appeal because the court reasoned that if the economic-loss doctrine barred recovery in the underlying claim, then the contribution and indemnification claims would be precluded by the same doctrine.²¹ After quoting *Morris* extensively, the court held:

No allegations of imminent risk of personal injury or death can be associated with the alleged defects claimed by the plaintiffs in the Underlying Suit, as “conditions that present a risk to general health, welfare, or comfort but fall short of presenting a clear danger of death or personal injury do not suffice.”²²

The answer to (4) is true: The allegations were sufficient to trigger the exception, and the economic-loss doctrine was no bar to recovery in tort. In *Potomac Constructors v. EFCO Corp.*, the plaintiff general contractor entered into a purchase-order agreement with the defendant to engineer and supply steel formwork, which was used to cast concrete segments that would be incorporated into the bridge’s support structure.²³ Although the plaintiff did not allege that the formwork created a “substantial and unreasonable risk of death or personal injury,” the court concluded that based on the evidence, “a reasonable jury could hold that this unstable concrete formwork posed a substantial threat to the safety of the workers.” The court found there were genuine issues of material fact regarding “whether the defendant was negligent in designing and building the formwork and whether the formwork was so poorly designed that it created a substantial and unreasonable risk of death or personal injury.”

A Risky Argument

I once had a friend tell me that whenever somebody launched into a “slippery slope” argument, she knew

she was about to hear a bad argument. At the risk of offending those readers with similar sensibilities, the *Morris* risk-of-harm balancing test appears to have replaced the flat, sturdy landscape afforded by the economic-loss rule with a steep, icy incline. As a first line of defense to this contention, the court in *Morris* even seemed to recognize this possibility. Recall the potential “avalanche” of tort claims that concerned the court. To prevent against greatly expanded tort liability, Maryland’s highest court admonished that “to lower the threshold to encompass mere ‘possibilities’ of injury . . . is to ‘cheapen’ the legitimacy of the exception.”²⁴ But the question may rightly be asked, how can any jurisdiction be expected to consistently apply a test that calls upon judges to determine whether the plaintiff has sufficiently alleged a “clear, serious, and unreasonable risk of death or personal injury”?

If your answers to the test above do not satisfactorily answer the question in the negative, consider *Lloyd v. General Motors*.²⁵ Although arising outside the construction context, *Lloyd* is easily the most significant application of the risk-of-harm exception in Maryland. The plaintiffs in *Lloyd* brought a class-action lawsuit against several vehicle manufacturers on behalf of all owners of “class vehicles.” According to the pleadings, the plaintiffs sought to recover for the cost of repair or replacement of the front seats in the class vehicles, which were allegedly unsafe because they were prone to collapse rearward in moderate and severe rear-impact collisions. Significantly, the class was limited to only vehicle owners who had not suffered any injury as a result of the alleged defect.

Applying the two-part balancing test from *Morris*, the court cited allegations of frequent seatback malfunctions and serious injuries associated with malfunctions in concluding, “it is exactly the risk of serious bodily injury involved in this case that the exception to the economic loss rule was intended to remedy, ‘to encourage people to correct dangerous conditions before tragedy results.’”²⁶

The *Lloyd* court’s application of the threshold test for the exception is susceptible to criticism. Given the number of class vehicles on the road and the variety of factors present in any accident, one may well question whether the plaintiffs’ allegations were sufficient to meet “the required legal threshold of pleading the existence of a clear and extreme danger of death or serious personal injury” as a result of the alleged defect, or, conversely, whether the court “lower[ed] the threshold to encompass mere ‘possibilities’ of injury.”²⁷ Indeed, a recent law-review article characterized *Lloyd* as an “unfortunate, unwarranted, and unnecessary extension of tort law,”²⁸ (as opposed to “unprecedented, unwarranted, and unwise,” the reaction of the dissenting opinion in *Colleton Prep* to the “risk of harm” exception).

As the most recent application of the risk-of-harm exception by Maryland’s highest court, *Lloyd* provides additional evidence that this analytical framework creates a slippery slope. One judge’s perception of a “serious threat of bodily injury” will differ from another’s, and the exception fails to provide a “principled way to categorize types or degrees of risk for the purpose of establishing liability.”²⁹

Presenting criticism of the risk-of-harm approach is not intended to exalt the economic-loss rule or diminish Maryland’s effort to focus on “action” instead of “consequences.” Indeed, it must be acknowledged that the economic-loss rule is capable of neglecting justice for the sake of efficiency.³⁰ Rather, the intent of this article is to illustrate one reason for the adherence of most jurisdictions to the traditional rule that serves to keep tort and contract law in separate spheres.³¹ Given the prominence of the economic-loss doctrine in construction litigation, all practitioners are wise to understand the doctrine and its exceptions. Moreover, if the economic-loss rule is in fact “falling out of judicial favor,” judges and lawyers around the country should be prepared to encounter their colleagues advocating for the risk-of-harm exception to the economic-loss rule.

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Endnotes

1. Colleton Preparatory Acad. v. Hoover Universal, Inc., 666 S.E.2d 247, 253 n. 8 (S.C. 2008).
2. 403 P.2d 145 (Cal. 1965).
3. 476 U.S. 858, 871 (1986) (quoting *Seely*, 403 P.2d at 151).
4. 63B AM. JUR.2D *Products Liability* § 1912.
5. See 6 BRUNER & O'CONNOR CONSTRUCTION LAW § 19:10 (listing 11 exceptions).
6. Although *East River* ended the debate over risk-of-harm approaches in many jurisdictions, the debate has remained lively in some. *Compare* *KB Home v. Superior Court*, 5 Cal.Rptr.3d 587 (Cal. App. 2 Dist. 2003) and *In re Chi. Flood Litig.*, 680 N.E.2d 265 (Ill. 1997) with *Pratt & Whitney Canada, Inc. v. Sheehan*, 852 P.2d 1173, 1181 (Alaska 1993) and *Touchet Valley Grain Growers, Inc. v. Opp & Seibold Gen. Const., Inc.*, 831 P.2d 724, 733 (Wash. 1992).
7. 412 F. Supp.2d 560 (D.S.C. 2006).
8. 666 S.E.2d 247, 251.
9. ___ S.E.2d ___, 2009 WL 4893648 (2009) (not yet released for publication at time article was written).
10. 666 S.E.2d at 253.
11. 667 A.2d 624 (Md. 1994).
12. Maryland's highest appellate court.
13. 667 A.2d at 631 (citing *Council of Co-Owners v. Whiting-Turner*, 517 A.2d 336 (Md. 1986) and *U.S. Gypsum v. Baltimore*, 647 A.2d 405 (Md. 1994)).

14. *Council of Co-Owners*, 517 A.2d at 338.
15. *Morris*, 667 A.2d at 629.
16. *Heritage Harbour, L.L.C. v. John J. Reynolds, Inc.*, 795 A.2d 806, 811 (Md. Spec. App. 2002).
17. *Potomac Constructors v. EFCO Corp.*, 530 F.Supp.2d 731, 738 (D. Md. 2008).
18. *Council of Co-Owners*, 517 A.2d at 338.
19. *Morris*, 667 A.2d at 629.
20. Maryland's intermediate appellate court.
21. *Heritage Harbour*, 795 A.2d at 811.
22. *Id.* at 811–812 (quoting *Morris*, 667 A.2d at 631) (emphasis added).
23. *Potomac Constructors*, 530 F. Supp.2d 731, 734.
24. *Morris*, 667 A.2d 624, 633.
25. 916 A.2d 257 (Md. 2007).
26. *Id.* at 270 (quoting *Morris*, 667 A.2d at 632).
27. *Morris*, 667 A.2d at 633.
28. *Rebecca Korzec, Lloyd v. General Motors Corporation: An Unfortunate Detour in Maryland Products Liability Law*, 38 U. BALT. L.F. 127, 141 (2008).
29. *Colleton Prep*, 666 S.E.2d at 258 (Pleicones, J., dissenting) (quoting *Carolina Winds Owners' Ass'n v. Joe Harden Bldr.*, 374 S.E.2d 897, 905–06 (S.C. Ct. App. 1988)).
30. See Gary T. Schwartz, *The Economic-loss Doctrine in American Tort Law: Assessing the Recent Experience*, in *CIVIL LIABILITY FOR PURE ECONOMIC LOSS*, 130 (Efsthathios K. Banakas ed., 1994).
31. *East River*, 476 U.S. 858, 871 (referring to the “need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages”).

Disputes and Litigation

continued from front cover

and/or water usage and cost and, based on that survey, to design, procure, construct, install, and arrange financing for energy/water conservation measures (ECMs). Common examples of ECMs include energy-efficient windows and doors, improved insulation, automated controls (e.g., for lights and thermostats), reduced-flow plumbing fixtures, updated HVAC equipment, and even on-site energy generation (e.g., solar, photovoltaic, and geothermal).

ECMs may be self-funded by the ESCO or financed by a third party under a separate financing agreement (either through separate construction-and-operations loans or through escrow financing). Until recently, a defining characteristic of ESPC projects was that they were never financed by the government,¹ but in the Energy Independence and Security Act of 2007 (EISA), Congress authorized ESPCs in which ESCOs are paid in part with appropriated funds.² For the non-appropriated portion of an ESPC, the ESCO provides in its proposal to the government a certified Selection Memorandum and financing offer, describing how it and/or a third party will provide financing for the project.

Under the National Energy Conservation Policy Act of 1978 (NECPA), the ESPC must specify cost savings expected as a result of the ECMs, and the ESCO must guarantee those savings as a term of the ESPC.³ The NECPA defines “energy savings” as a reduction in the agency’s cost of energy as compared to a base cost established through a methodology set forth in the contract.⁴ The expectation is that the ECMs implemented by the ESCO will lower the agency’s utility bills, so the agency will spend less appropriated funds on utilities after the construction and free up those funds for other uses.⁵

Unless mixed-funded, the ESPC does not obligate the government to commit any appropriated funds or to pay any of the project’s capital costs up front. Rather, the ESPC provides

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that the contracting agency will pay the ESCO a specified share of the energy-cost savings guaranteed under the ESPC.⁶ Usually, the ESPC provides that the government will pay the ESCO an “annual-in-advance” payment at the start of each year in the amount of the ESCO’s share of the guaranteed savings for that year. The ESCO in turn uses these payments to pay for the financing (i.e., debt service) and to fund any performance-period services, such as operations and maintenance (O&M), repair and replacement (R&R), measurement and verification (M&V), and training.

ESPCs are long-term contracts, lasting up to a maximum of 25 years.⁷ While they may be shorter, agencies may not establish policies to limit ESPC projects to less than the maximum 25-year term.⁸ After the contract ends, all subsequent savings accrue to the government.

The NECPA requires that ESPCs provide that, at least once per year, the ESCO will submit an M&V report to the agency, showing whether the guaranteed cost savings for the year have been realized. If not, then the ESCO is required to pay the difference to the government. Moreover, the aggregate annual amount of agency payments to the ESCO and for utilities cannot exceed the amount the agency would have paid for utilities without an ESPC.⁹

Federal government ESPCs are regulated in the Federal Acquisition Regulation (FAR)¹⁰ and Department of Energy (DOE) regulations.¹¹ DOE regulations trump any inconsistent FAR provisions. The DOE has established the Federal Energy Management Program (FEMP), which has issued qualified-contractors lists, implementation procedures, standard terms and conditions, and conditions of payment.¹²

The DOE and other government agencies, including the Army and Air Force, have awarded indefinite-delivery, indefinite-quantity (IDIQ) ESPCs, dubbed “super-ESPCs.”¹³ Like other government IDIQ contracts, super-ESPCs allow agencies to award delivery orders without a full-blown contract competition, and they establish general terms and conditions that

apply to all orders issued under them.¹⁴ In December 2008, DOE awarded 16 super-ESPCs for up to \$80 billion in projects at federal facilities. As with traditional ESPCs, many states have also authorized use of super-ESPCs.

Protesting ESPC Awards

Like other government contract awards, awards of ESPCs and super-ESPCs are subject to agency-level protests and protests at the government Accountability Office (GAO) or Court of Federal Claims (COFC).¹⁵

Any delay in completion necessarily will shorten the energy-performance period.

Prior to May 2008, almost no delivery orders awarded under super-ESPCs were subject to protests.¹⁶ The 2008 Defense Authorization Act changed that by authorizing the GAO to hear protests of delivery orders in excess of \$10 million under IDIQ contracts awarded since May 23, 2008.¹⁷ So, since then, when an agency awards a delivery order of over \$10 million under a super-ESPC, any other ESCO with a DOE super-ESPC may challenge that award by filing a GAO protest.

The burden on the protestor in such challenges will be difficult to meet, as government agencies have broad discretion in selecting the firms with which they will negotiate delivery orders.¹⁸

Contracting Issues

Many critical issues to the success and risk allocation of ESPC projects are left to the parties’ discretion in

negotiating their particular ESPC or delivery order. The ESCO ultimately will be responsible for the selection, design, installation, and performance of the equipment it installs. But the parties get to decide, and the contract should make clear, whether the ESCO will carry these responsibilities only through construction and government acceptance, for a limited trial performance period, or for the entire contract term.

The parties also may negotiate their respective responsibilities for O&M and R&R. Typically, the agency will operate the equipment with ESCO oversight, and the ESCO will be responsible for R&R. A significant issue is whether the ESCO assumes R&R responsibility under contract-warranty provisions, which typically expire after one year, or extend to the end of the energy-performance period, which may last 20 years or more.

Changes

Because ESPCs cover such long periods, the government often changes its use of subject facilities in ways that affect its energy usage and savings, the equipment it needs, and the ESCO’s ongoing service obligations. The most extreme examples are when the government decides to demolish the facility. In those cases, the ESPC should provide that the ESCO will be entitled to continuing payment based on savings achieved before demolition and ideally should provide details on which savings will be used for that calculation (e.g., those achieved in the year before demolition, the most recent three-year average, the average over the energy performance period up to demolition).

More frequently, the government will make significant changes to its facilities during the ESPC term, and those changes will impact ESCO performance obligations and/or achieved energy savings. Again, the ESPC should provide that, to the extent that government changes reduce energy savings, the ESCO still will be entitled to payment based on the savings achieved before the changes. With a traditionally funded,

fixed-price government contract, to the extent that government-imposed changes increase the contractor's cost of performing its obligations, the Changes clause provides for an equitable adjustment to the contract price. This approach usually will not work under ESPCs because of the lack of contract funding. Instead, ESPCs will typically provide that, when the government adds or changes equipment to the facility, it will award a sole-source service contract, called a "companion service contract," to the ESCO for the O&M and R&R of the new or changed equipment.

Scheduling and Delay Issues

The pricing structure of ESPCs places higher schedule risk on ESCOs than traditional contracts do for contractors. An ESCO's recovery under an ESPC depends on the government's realization of guaranteed cost savings during the *post-construction* energy-performance period. Where the term of an ESPC is the statutory maximum 25 years (as is often the case), these savings may be projected out over 20 or more years. Any delay in completion of construction necessarily will shorten the energy-performance period (which the parties are legally precluded from extending) and consequently reduce the government's energy-cost savings and the ESCO's compensation.

All of this puts a premium on scheduling. If the ESCO is too ambitious in its planning and proposal, or if the party responsible for scheduling after contract award gets it wrong, the consequences of delay may be severe. Even a modest delay may quickly put the ESCO in an overall loss position. And, unlike contractors under traditional contracts, which may find extra time to be an adequate remedy for non-disruptive delay, ESCOs under ESPCs will almost always suffer monetary damage because of lost energy-cost savings from any critical-path delay.

One way to lower the ESCO's schedule risk is for the ESPC to allow commissioning of individual ECMs prior to completion of the entire installation. This provides the agency

earlier savings and the ESCO earlier cash flow. This method was used, for example, on the delivery order issued by the National Aeronautics and Space Administration under a DOE super-ESPC for the Johnson Space Center.

Termination Issues

Special issues also arise when the government terminates an ESPC for default or convenience.

The standard default-termination

ESPCs are well suited to addressing the government's environmental concerns.

clause in fixed-price federal construction contracts provides that, in the event of a contractor default, the government is entitled to take over the work and recover or offset against the contract balance all resulting damages, including its excess procurement costs.¹⁹ ESPCs are different because there is no "contract balance." So, does this mean that, in the event the government terminates the ESPC for default, the government has no further obligation to pay the ESCO? Such a rule would often lead to inequitable results because the government's post-termination energy savings in many cases will exceed its excess procurement costs for the O&M and R&R services the ESCO would have provided, and, as such, the government would receive a windfall.

In *Enron Federal Solutions, Inc. v. United States*, the COFC denied a default-terminated contractor's claim for its pre-termination expenses under a similar type of contract. In that case, the Army Corps of Engineers terminated a utility-privatization contract. Like an ESPC,

that contract required the contractor to pay substantial up-front costs and to provide ongoing O&M services, and it entitled it to payments that would amortize the initial costs over an extended term (10 years). The Corps terminated the contract after less than three years, at which point the contractor had spent about \$11.6 million and been paid about \$4.2 million. The court denied the contractor's claim for the asserted value of the improvements, which reverted to the Corps. The court found that, because the contract allocated the risk of the capital improvement costs to the contractor, its default entitled the government to enjoy those improvements without paying for them.²⁰ While it is unclear whether a court would reach the same result in an ESPC default-termination case, this is a risk the parties should take into account.

With regard to convenience terminations, the parties should, and typically do, tailor ESPCs to account for special issues they present. For example, the ESPC should include pre-negotiated terms for retirement of the ESCO's financing debt in the event the government terminates the ESPC for convenience.

When it terminates an ESPC for convenience, the government might argue that, because the contract does not entitle the ESCO to payment unless and until guaranteed energy-cost savings are realized, the ESCO will only be entitled to recover its costs under a termination settlement if and when, and to the extent that, the work performed prior to the termination generates those savings. This argument likely would fail. *Jacobs Engineering Group, Inc. v. United States*²¹ is instructive, even though it involved a cost-reimbursement development-and-construction contract with a cost-sharing provision, rather than an ESPC. In *Jacobs Engineering*, the Federal Circuit held that the cost-sharing provisions in Jacobs's contract, which obligated the government to pay Jacobs only 80 percent of its actual costs during performance, did not apply in the context of a termination for convenience. Under

the termination-for-convenience clause, Jacobs was entitled to recover “all costs reimbursable under the contract.” In the case below, the COFC granted summary judgment for the government, concluding that the contract’s termination-for-convenience and cost-sharing provisions, read together, meant that Jacobs was entitled only to 80 percent of its costs incurred as of the termination. The Federal Circuit reversed, holding that the “all costs reimbursable” language in the termination-for-convenience clause described the type, rather than the amount, of costs Jacobs could recover, such that it was entitled to all, rather than 80 percent, of the types of costs that were specified as reimbursable under the contract.

Bonding Issues

One bonding issue for ESPCs is whether and to what extent the Miller Act applies. The Miller Act requires contractors to obtain performance and payment bonds on all projects for “the construction, alteration, or repair of any public building or public work of the Federal government.”²² Miller Act bonds are not required, however, for service contracts. Because the scope of work on ESPC projects includes both construction and services (i.e., the initial energy audit and post-construction O&M, M&V, and R&R), application of the act to such contracts is unclear.

If a federal agency chooses to treat an ESPC as a service contract, rather than a construction contract, this may deprive subcontractors of Miller Act protections. *Department of Army v. Blue Fox* is instructive. In that case, the army contracted for installation of a telephone switching system at an army depot, including construction of a concrete-block building to house the telephone system and installation of certain safety and support systems. The army treated the contract as a service contract and so did not require that the general contractor obtain a Miller Act bond. The Supreme Court held that the subcontractor was not entitled to an equitable lien on the government property, leaving the subcontractor

without an effective remedy.²³ Subcontractors under ESPCs should be aware of the risk that, as in *Blue Fox*, the government might treat an ESPC as a service contract, and, if it does so, the ESCO will not be required to obtain a payment bond for the protection of its subcontractors.

Even if the Miller Act applies, how should the required bond amount be calculated? The act provides that the prime contractor (here, the ESCO) must obtain a bond for 100 percent of “the total amount payable by the terms of the contract” for any project over \$100,000.²⁴ But, under an ESPC, no one will know the contract price until the end of the energy-performance period—up to 25 years after the contract term started. Typically, the agency will require a bond in the amount of the ESCO’s share of the total guaranteed cost savings, even though this will include the amount payable for services.

Another issue is how long the ESCO should be required to maintain the bond. It is unclear whether agencies *must* require bonding through the energy-performance period or only through the construction period (i.e., until the agency accepts the installed ECMs). While agencies certainly *may* do so, especially if the ESCO will be subcontracting out any of its M&V, O&M, or R&R work, typically they do not. Miller Act bonds should not be required for that work because it is not predominantly construction, alteration, and repair.

Where ESCOs obtain performance and payment bonds, ESPCs present several other issues. First, ESPC subcontractors and suppliers face a dilemma regarding the statute of limitations for payment-bond claims. The Miller Act provides that a bond claimant may not maintain an action on the bond unless (a) it “has not been paid in full within 90 days after [it] did or performed the last of the labor or furnished or supplied the material for which the claim is made” and (b) the action is filed within one year “after the day on which the last of the labor was performed or material was supplied by [it].”²⁵ But what triggers the statute

if a subcontractor performs services after construction is completed, such as M&V? A subcontractor that performs both construction and post-construction work could end up in a position where it will be unclear whether it should sue before it has completed its post-construction work and risk being premature, or wait until it completes that work and risk being too late.

Second, where the surety has to either take over under the performance bond or pay a subcontractor or supplier under the payment bond, the general indemnity agreement in the bond will entitle the surety to recoup its costs from any remaining balance on the ESPC. But, because the ESPC does not state a firm contract price, how will the surety determine the contract balance? To obtain the protections it would enjoy under bonds for traditional projects, the surety often will require an escrow agreement with the ESCO’s financing company that will ensure the surety access to the project funds.

Finally, with the substantial investment that financing companies provide on ESPCs, they typically want to be protected under the ESCO’s bonds. While the standard bond only protects the owner (i.e., the government) as an obligee, the financing company will often require that the surety agree to name it as a dual obligee (along with the owner).

Conclusion

The federal budget deficit and the environment are two of the most pressing and difficult issues facing the government today, and that is not going to change any time soon. ESPCs are well suited to addressing the government’s environmental concerns, and they work in the fiscal confines of even the most cash-strapped agencies. For these reasons, it is hard to see ESPCs going away in the near future. To the contrary, use of ESPCs is rising and likely will keep on doing so for some time to come, and counsel for participants in ESPC projects need to be aware of the unusual issues and risks these unique contracts present.

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Endnotes

1. 42 U.S.C. § 8287(a)(1) 2007.
2. Pub. L. No. 110-140, § 512 (2007).
3. 42 U.S.C. § 8287(a)(2)(B).
4. 42 U.S.C. § 8287c.
5. "Issues related to share-in-savings contract authorities of the [NECPA] and the Clinger-Cohen Act," B-287488, 2001 U.S. Comp. Gen. LEXIS 217 (June 19, 2001) (citing 42 U.S.C. § 8287; Pub. L. No. 104-52, § 625, 109 Stat. 468, 502-503 (1995)).
6. 2001 U.S. Comp. Gen. LEXIS 217; FAR 23.205(b)(1).
7. 42 U.S.C. § 8287(a)(1); FAR 23.205(b)(1).
8. EISA, § 513.
9. 42 U.S.C. § 8287(a)(2)(B).
10. 48 C.F.R. § 23.205.
11. 10 C.F.R. Part 436.
12. 10 C.F.R. §§ 436.32, 436.33, 436.35 and 436.36.
13. See *Johnson Controls, Inc.*, B-282326, 99-2 CPD ¶6; *Strategic Resource Solutions Corp.*, B-278732, 98-1 CPD ¶74.
14. FAR 16.505.
15. See, e.g., *Johnson Controls*, 99-2 CPD ¶6.
16. Federal Acquisition Streamlining Act of 1994 (FASA), 41 U.S.C. § 253(j) (prohibiting most delivery-order protests).
17. "Enhanced Competition Requirements for Task and Delivery Order Contracts," Pub. L. No. 110-181, 122 Stat. 3, § 843 (2008).
18. *Strategic Resource Solutions*, 98-1 CPD ¶74 at 4-5; see also *Intellectual Properties, Inc.*, B-280803.2, 99-1 CPD ¶83.
19. FAR 52.249-10(a).
20. 80 Fed. Cl. 382 (2008).
21. 434 F.3d 1378 (Fed. Cir. 2006).
22. 40 U.S.C. § 3131.
23. 525 U.S. 255, 257-58 (1999); see also *Arvanis v. Noslo Eng'g Consultants, Inc.*, 739 F.2d 1287, 1289-90 (7th Cir. 1984).
24. 40 U.S.C. § 3131(b).
25. 40 U.S.C. § 3133(b)(1).

Green-Building Disputes

continued from front cover

civil engineer, and/or landscape architect. Because the LEED process involves multiple parties, disputes arise from communication failures and misunderstanding of responsibilities. As LEED construction grows, so too will confusion about the respective roles that each party plays in the process. By advising clients to take the following steps, they can minimize chances of green-building disputes.

1 Assign and communicate responsibilities before work commences. Call a meeting with the parties as early as possible (*before* contracts are signed and work commences) to discuss and identify the owner's LEED-related goals and expectations. Understand the consequences if a LEED certification is not obtained or if a particular level of certification is not achieved. Identify which LEED credits will be sought and who will be responsible for the work associated with achieving each credit. Within each credit, pinpoint specific actions each party is responsible for, and how and when they will communicate with one another to ensure the work necessary to obtain the credit is accurately and timely performed. Be as specific as possible, and make sure each party comprehends what will be contractually expected from them. The green-building process will run more smoothly if respective roles are assigned and communicated early on.

2 Define roles and responsibilities in the contracts. Once the parties have determined who will be responsible for which LEED roles, document it. All too often the parties do not take the time to memorialize their agreement in writing. This common pitfall is one of the most expensive mistakes a client can make. Regardless of how collegial the parties are at the outset, how professional the other parties seem, or how exceptional their reputation is in the industry, a written contract is critical. It should

specify who is responsible for which LEED components. It is also important to identify who will be held accountable if the project fails to achieve the desired level of LEED certification and what each party's rights and remedies are if, for example, someone uses the wrong materials or impairs the owner's ability to obtain a LEED certification. The contract should also address how changes in the scope of work will be handled in light of LEED requirements.

Where subcontractors or suppliers are performing work or providing materials necessary to achieve LEED credits, the subcontract-or-supplier agreement should expressly incorporate the owner's contract, and the subcontractor/supplier should be provided a copy. Contractors frequently fail to supply their subcontractors with a copy of the underlying contract with the owner, making it difficult to hold a subcontractor responsible if the subcontractor does not know the owner's LEED expectations and is not contractually obligated to comply with those known requirements. The contractor should always have a written record of its delivery of the underlying contract to the subcontractor and the subcontractor's willingness to meet the requirements necessary to obtain the desired LEED certification.

The contract is an important means of protecting your client against liability if someone else fails to perform their LEED responsibilities. For instance, if someone else is in charge of LEED online or for determining compliance with intents and requirements, be sure to affirmatively state that it is excluded from your client's scope of work. If your client is not guaranteeing the project will obtain LEED certification at all or even a particular LEED level, be sure to express that in the contract. If your client does not intend to be accountable for lost tax credits or incentives if the project does not obtain LEED certification, note that in the contract. If your client expects final payment before the U.S. Green Building Council (USGBC) makes a decision on LEED certification, the contract should also address this. As green construction becomes

more common, contracts addressing these and other LEED issues will become increasingly important in limiting legal exposure.

3 Be proactive about quality assurance during construction. Once construction is in progress, it is imperative that the parties carefully supervise the work to ensure LEED compliance. Too often owners or contractors discover late in the project that a subcontractor or sub-subcontractor did not install the appropriate materials, or a change was made that has impaired the ability to obtain LEED credit in a certain area. Have your client designate a person on the team to specifically handle LEED compliance. That person should oversee everything that enters and exits the property to make sure that the conditions imposed in the applicable prerequisites and credits are being met. Make sure your client communicates the LEED

requirements early and often. It is not enough to mention them at the outset of the project and expect everyone to know and remember them. Encourage weekly progress meetings to educate the architect, engineers, and all subcontractors and sub-subcontractors regarding the owner's LEED expectations and requirements and to make sure that all parties understand and are carrying out their obligations. Green-building disputes can be obviated if clients are proactive about quality assurance throughout the construction process.

4 Get legal advice when things don't go according to plan. As green building becomes more prevalent, misunderstandings and disagreements will be inevitable. Despite our best efforts, there will be occasions when another party fails to perform his or her obligations and places LEED status in jeopardy or the USGBC denies a credit that was

anticipated resulting in a different certification than expected or worse—no certification at all. These situations will create pressure to hold someone accountable for consequential damages such as lost tax credits, increased operating costs, or a decrease in the property's marketability. There is very little legal precedent on LEED disputes, and mediating and/or litigating these issues will shape the future of green building. Encourage the parties to retain experienced green-building counsel to assist in resolving the dispute and/or obtaining recovery from the responsible parties. Seeking legal advice early on is a small investment for construction clients that will pay for itself in the long run.

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In This Issue

1 Disputes and Litigation
of Energy Savings
Performance Contracts
By Aaron P. Silberman

1 Advising Clients in Green-
Building Disputes: Four
Steps for Defining Roles
in LEED Projects
By Jennifer Grippa

2 Message from the
Cochairs
By Patrick J. Greene
& Charlotte Wiessner

3 The Critical Path:
Definition vs.
Understanding
By Brian J. Furniss &
Theodore J. Trauner

6 Recent
Developments
with the "Risk of
Harm" Exception
to the Economic-
Loss Rule
By Joshua Shaw

HELP RECRUIT NEW MEMBERS for the

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