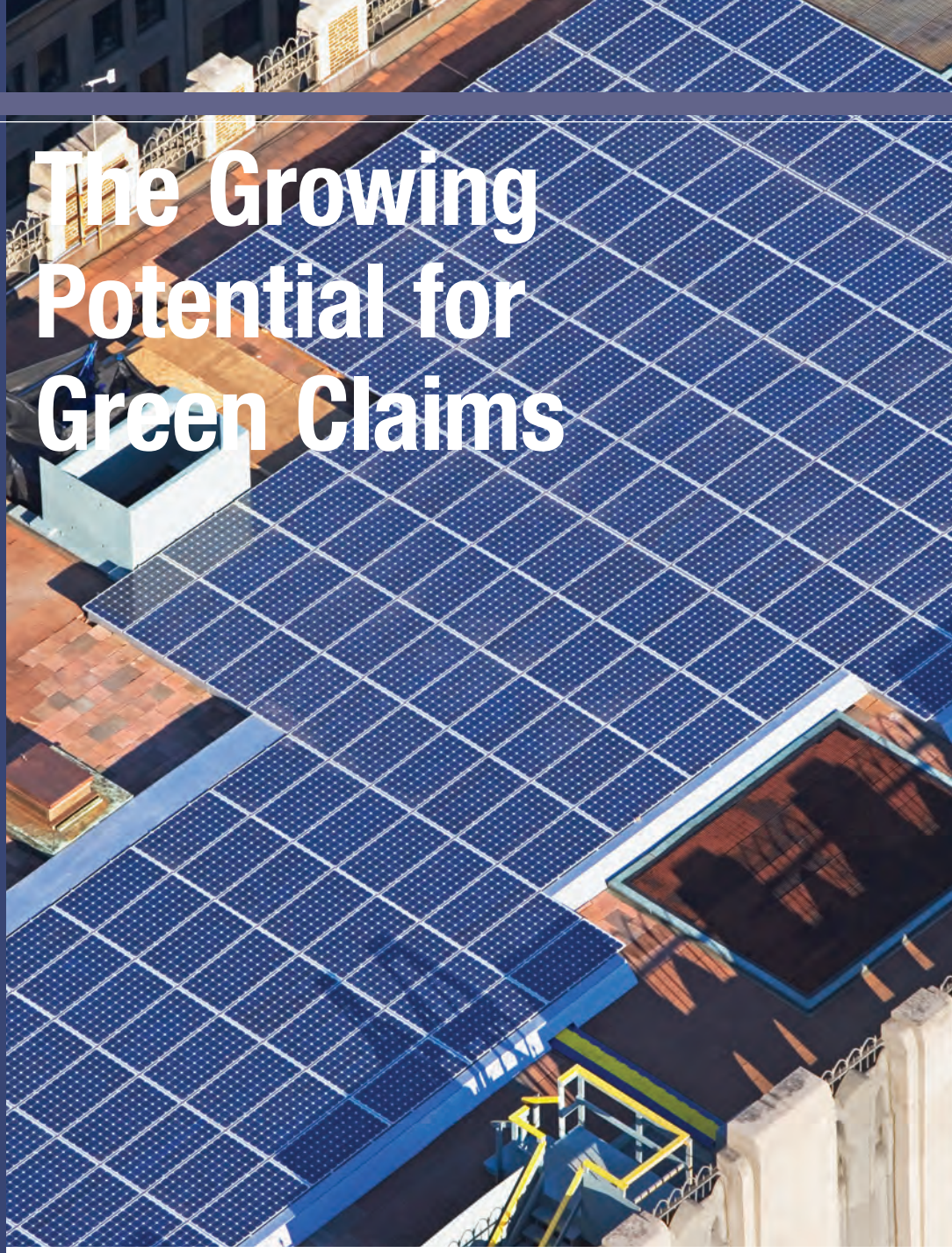
It's Not Easy...

The Growing Potential for Green Claims



By Daniel W. Gerber
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Insurers underwriting professional liability policies for architects and engineers or providing coverage to contractors must anticipate that claims will arise from attempted "green" construction.

In light of the worldwide concern over global warming, air pollution and environmental conservation, it is no surprise that consumers have a growing interest in building "green." While there is no single accepted

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definition of what constitutes green building, it has been characterized as the practice of, "1) increasing the efficiency with which buildings and their sites use energy, water and materials, and 2) reducing building impacts on human health and the environment, through better siting, design, construction, operation, maintenance, and removal—the complete building cycle." *See Building Design & Construction: White Paper on Sustainability*, at 4 (Nov. 2003), http://www.usgbc.org/Docs/Resources/BDCWhitePaperR2.pdf.

With the marketplace for green building expected to grow from $7.4 billion in 2005 to between $19 and $38 billion by 2010, there is a rapidly growing demand for architects and engineers with the ability to design and/or build green construction. *See* Anderson, Brian D.; *Legal and Business Issues of Green Building*, 79 Aug Wis. Law. 10 (Aug. 2006).

Notably, architects and engineers are not the only groups looking to jump into the green building revolution. Insurance companies are now developing and marketing policies providing coverage for "green" buildings. Property owners can buy insurance that will pay the costs of returning damaged property to its previous "green-certified" condition and cover the cost of a professional certified by Leadership in Energy and Environmental Design (LEED) to supervise the repairs.

Given this backdrop, insurers underwriting professional liability policies for architects and engineers or providing liability coverage to contractors must anticipate that claims will arise from attempted "green" construction and consider whether current liability policies appropriately deal with such potential claims.

Everyone Is Going Green

To date, there is no universally accepted standard defining what constitutes a green building, nor a universally established education curriculum or certification process for green architects and engineers. As a result, the green marketplace remains fluid, undefined and relatively wide open.

The most widely accepted standard for green building is the Leadership and Energy in Environmental Design (LEED) rating system. This system was originally created by the U.S. Green Building Council in the mid-1990s. The LEED program was characterized as a "National consensus based market driven building rating system designed to accelerate the development and implementation of green building practices." *See Building Design and Construction*, at 8. LEED is a point-based certification system that is divided into five categories related to siting, water conservation, energy, materials, and environmental quality, plus innovation and design. A building is assigned credits based on these categories. The credits translate into points. A building that earns 26 points can become LEED-certified. As additional points accumulate, buildings move up the rating system scale to silver (33 points) or gold (39 points), to the highest standard, which is platinum (52 or more points). *Id.* It was estimated in 2003 that 948 projects were registered with LEED, and that for every LEED-registered project in progress, architectural firms were designing two or three times as many unregistered projects that met or exceeded LEED guidelines. *Id.* at 11.

Despite the rapid growth in green construction, its marketplace and interest from consumers, there is little discussion of risks that arise from such construction or whether architectural and engineering firms have the appropriate professional liability coverage. Given the nature of this expanding marketplace, litigation is inevitable. Various websites have reported on the "first" green building litigation. *See* Del Percio, Stephen: "*The Anatomy of America's First Green Building Litigation*, http://www.greenbuildingsnyc.com.

The first green building lawsuit concerned the construction of a 23-unit condominium project in Crisfield, Maryland. The development was intended to support an application for a LEED Silver rating. In response to a mechanic's lien filed by the contractor, the owner filed a countersuit alleging negligence and breach of contract for the failure to "construct an environmentally sound green building." *Id.* The owner sought damages in excess of $600,000 for lost tax credits.

Given that such litigation will only increase, there are two issues businesses and insurers must anticipate. First, consideration must be given to the inevitability of malpractice or negligence claims arising from green construction, or more likely, failed green construction. Second, current professional and general liability policies, as written, must be examined to assess whether they provide proper coverage and/or limit an insurer's exposure for potential green building claims.

Under a typical professional liability policy, the insuring agreement provides:

> COVERAGE A:
> PROFESSIONAL LIABILITY
> We will pay DAMAGES and CLAIM EXPENSES in excess of YOUR Deductible, subject to all other provisions of this policy, that YOU become legally obligated to pay because of CLAIMS

that arise from YOUR negligent act, error or omission in the performance of YOUR professional services anywhere in the world, provided suit for DAMAGES is brought within the United States of America, its territories or possessions or Canada. Upon prior request, WE may agree to pay DAMAGES and CLAIM EXPENSES for suits brought in specific countries outside of the United States of America, its territories or possessions or Canada. OUR duty to pay DAMAGES and CLAIM EXPENSES ends when OUR Limit of Liability has been exhausted by the payment of any combination of DAMAGES and CLAIM EXPENSES on YOUR behalf or when WE have deposited with a court the amount of OUR remaining Limit of Liability.

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Under this language, a court could possibly interpret the provision as providing coverage for an architect or engineer's "professional acts" or "services" for a green claim. It has been held that a professional act within the context of a professional liability policy is, "one arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor or skill and the labor or skill is predominantly mental or intellectual rather than physical or manual." *Atlantic Mutual Ins. Co. v. Continental National American Ins. Co.*, 123 N.J. Super, 241, 246 (N.J. Super L. 1973). Further, professional services have been defined as:

> Professional services in its usual connotation, means services performed by one in the ordinary course of the practice of its profession, on behalf of another, pursuant to some agreement, express or implied, and for which it could reasonably be expected some compensation would be due.

Id. at 247.

With these definitions in mind, it is clear that there is an endless list of possible disputes that may arise from an architect or engineer's promise to design or construct a green building. What if, subsequent to completion, a building is not certified as green? What happens if a building does not obtain a platinum-level certification? Who must maintain the building's "green" status if standards change? Is the architect or engineer responsible for maintaining the designation for an undisclosed period of time, and does the failure to do so create a cause of action for negligence?

While every scenario and contingency cannot be considered here, this commentary will analyze one possible hypothetical scenario.

Assume that an entity named Green Builders, Inc., approaches a developer seeking to build a LEED-certified condominium complex. Despite the fact that Green Builders has never previously designed or built a LEED-accredited building, Green Builders advises the developer that it has the expertise to design a condominium complex that will achieve platinum status. Green Builders and the developer sign a contract, and construction begins. In the course of the project, Green Builders encounters a number of problems delaying completion. Additionally, Green Builders does not use recycled materials in constructing the complex. It also approves sealants with chemical components that do not satisfy LEED requirements. As a result of these errors, the building is LEED-certified, but it meets the lowest standard, and it does not achieve platinum status.

The developer files suit against Green Builders. The complaint seeks damages based on fraud, negligence, loss of use and lost profits. Green Builders tenders its defense and indemnity in a timely manner to its professional liability carrier.

The Duty to Defend

The hypothetical complaint against Green Builders contains a number of causes of action for which Green Builders requests defense and indemnity. Initially, an insurer, or its counsel may believe that there is no coverage under a professional liability policy for claims alleging fraud and/or lost profits. Regardless of whether this is true, the proper inquiry is whether a duty to defend has been triggered. The hypothetical complaint alleges that the damages sustained by the developer were the result of negligence on the part of Green Builders. The duty to defend is generally broader than the duty to indemnify. In discussing the obligation to provide a defense, it has been held that:

> [T]he duty to defend comes into being when the complaint states a claim constituting a risk insured against. When the allegations in a complaint correspond with the language of the policy, the duty to defend arises, irrespective of the claim's actual merit. If the pleading is ambiguous, doubts should be resolved in favor of the insured and thus in favor of the duty to defend. When multiple alternative causes of action are stated, the duty to defend will continue until every covered claim is eliminated.

Hampton Medical Group v. Princeton Ins. Co., 366 N.J. Super. 165 (N.J. Super. A.D. 2004).

The broad obligation to defend, even if a complaint contains causes of action clearly outside the policy, is problematic for insurers. In the context of a professional errors and omissions policy, it is almost certain that the complaint will include a claim for negligence. As a result, an insurer will often be called to defend an insured *in the context of a professional liability policy.*

In contrast, while an insurance policy providing coverage for an engineer or architect is procured to protect against negligence claims, most contractors are insured under commercial general liability policies, which do not extend coverage for negligence claims. Generally, a commercial general liability (CGL) policy extends coverage for losses arising out of an "occurrence," which is often defined as an "accident." Courts have generally been reluctant to expand coverage under a CGL policy for claims of breach of contract or negligence. *See George A. Fuller Co. v United State Fid. & Guar. Co.*, 200 A.D.2d 255 (1st Dept. 1994); *see also Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788 (1979).

Additionally, CGL policies include exceptions for losses arising from "your work," which also limits the scope of coverage and generally, precludes coverage for poor workmanship or similar claims. Therefore, in the hypothetical scenario discussed above, there is a good argument that there would be no coverage under a CGL

policy for a contractor facing a breach of contract claim.

A contractor must carefully consider the coverage available under a CGL policy before promising to construct a green building. Similarly, an insurer issuing a CGL policy must review the claims alleged to determine whether any claims actually fall within the scope of coverage. If a complaint references only breach of contract or poor workmanship, there is a strong argument that there is no duty to defend or indemnify.

Duty to Defend Practical Considerations

- Insurers must carefully weigh the consequences of denying a defense to an insured if a complaint includes a cause of action premised on negligence.
- In many jurisdictions, insurers can only consider the allegations in the complaint. Knowledge of facts and circumstances outside the complaint indicating that there may be no coverage under a policy will not serve to eliminate the duty to defend.
- Insurers may want to consider proactively initiating a declaratory judgment action to determine rights under a policy in situations in which it appears there are both covered and uncovered causes of action.

Fraud

Most professional liability policies contain provisions eliminating coverage for losses originating from the fraudulent actions of an insured. For example,

> WE will not cover YOU for any liability arising out of any dishonest, fraudulent or criminal act or omission committed by YOU or at YOUR direction or for other intentional wrongful acts whether or not YOU also intended the magnitude of the resultant DAMAGE.

In *Grieb v. Citizens Casualty Company of New York*, the insured sought coverage under a professional liability policy in response to a lawsuit claiming conspiracy and fraud. 148 N.W.2d 103 (Wis. 1967). In holding that the insured was not entitled to coverage under the policy, the court stated, "[T]he duty under this clause does not extend to intentional torts such as conspiracy, and furthermore acts constituting a conspiracy are excluded by the exclusion clause even though we construe that clause against the insurer, as we are bound to do." *Id.* at 106.

In the hypothetical scenario provided above, to obtain the contract, Green Builders maintained it had the expertise necessary to design a LEED-certified building despite never having done so. Arguably, Green Builders committed a fraudulent act, and the developer's losses are attributable, in part, to this fraudulent act. To the extent the losses are the result of the insured's fraud, the insurer can disclaim or partially deny obligation to provide indemnity.

If an insurer must assume the defense of an insured akin to Green Builders, it will likely be required to defend every claim, even if there is a strong chance that there is no obligation to provide indemnity if the insured is found liable. While this hypothetical case arises from a green build, in reality, the defense of the fraud cause of action would be the same as a claim arising from any other action. While the genesis of the claim is novel, it remains a fraud claim nonetheless.

To prevail the plaintiff would have to show (1) a misrepresentation, (2) knowledge of falsity, or scienter, (3) intent to defraud, that is, to induce reliance, (4) justifiable reliance, and (5) resulting damage. *Unterberger v. Red Bull North America*, 162 Cal. App. 4th 414 (Court of Appeal, 2d Dist. 2008). Therefore, the same evidentiary standards would apply to the defense of a green build fraud action.

Fraud Practical Considerations

- Given the speed at which the green building marketplace is growing, insurers should watch for cases in which the insured misrepresents its past achievements and/or abilities.
- In several jurisdictions, to the extent that an insured commits a fraudulent act, an insurer can disclaim any obligation to indemnify the insured from any resulting losses. *See*, *e.g.*, *Greenberg & Covitz v. Nat. Union Fire Ins. Co.*, 312 N.J. Super. 251 (N.J. Super. A.D. 1998); *Seskin & Sassone v. Liberty Intl. Underwriters*, 306 A.D.2d 520 (2d Dept. 2003).

Negligence

It is likely that nearly every complaint arising from a green building will include a claim for negligence or malpractice. Given that there is no universal standard governing the construction of green buildings, there are a myriad of scenarios under which a plaintiff's attorney can allege negligence or malpractice.

As already stated, there are four levels of LEED certification. Is the failure to reach platinum, the highest LEED-certification level, alone sufficient to assert a claim for negligence, or is it simply a breach of contract? Could misunderstanding the difference between what is necessary to obtain LEED platinum certification and what a client believes a green building is, give rise to a malpractice cause of action?

There is little discussion of risks that arise from such construction or whether architectural and engineering firms have the appropriate professional liability coverage.

In the hypothetical above, Green Builders failed to ensure that correct materials were used for construction of the building, including proper sealants. As a result of Green Builders' decisions the building did not meet the necessary requirements for LEED-platinum certification. Therefore, the dispositive question is whether these errors amount to negligence or whether they more appropriately constitute breach of contract.

In *Centennial Insurance Company v. Neyer, Tiseo and Hindo*, 207 Mich. App. 235 (Mich. App. 1994), Neyer was a consulting engineering firm that offered geotechnical engineering services. Neyer was insured under a professional liability policy by Imperial Indemnity and Casualty Company and a general liability policy issued by Centennial Insurance Company. Neyer was retained to investigate soil where a proposed building would be placed. While

at the site, a senior engineer attempted to locate underground utility lines based on site plans and checking a manhole. After concluding there were no utility lines in the vicinity, the Neyer employee directed that boring begin. No one gave notice to a state organization created solely for the purpose of receiving notice of proposed excavation.

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A power line was struck, resulting in over $100,000 in damage. A dispute arose over which insurance policy was required to provide coverage. The court held that the professional services at issue in this case were within the terms of coverage provided by the Imperial policy. Imperial argued that the failure to notify the state agency was not a professional service. The court disagreed stating, "[T]he decision in this case to drill for soil samples before calling [the agency] was preliminary to, and part of, the professional service of conducing a soil investigation." *Id.* at 238.

In contrast, in *Bel Lavalin Inc. v. Simcoe and Erie General Ins. Co.*, 61 F.3d 742 (9th Cir. 1995), Bel Lavalin was retained to design and construct four crude oil tanks. Bel Lavalin retained Conam for construction services. Delays occurred, and the project fell behind schedule. Originally, Bel Lavalin provided a six-month extension to Conam to complete work, however, Bel Lavalin later rescinded, providing only a one-month extension. Conam advised that work could not be completed under the one-month extension and requested that a revised schedule be created. The plaintiff refused to grant the extension and stopped payment on a check of over $800,000. At that time, the work was 87 percent complete.

The Conam complaint against Bel Lavalin alleged breach of contract, abandonment of contract, breach of duty of good faith and fair dealing, fraud and negligent design. At trial, the jury found in favor of Conam under the breach of contract claim and awarded damages in excess of $4 million. Bel Lavalin, in turn, sought indemnity under the Simcoe policy.

Bel Lavalin argued that there was coverage under its policy because, as project manager, it erroneously and negligently breached its contract with Simcoe, and negligently refused to grant the time extension. The court disagreed stating, "[T]he jury did not award damages based on [plaintiff's] failure to grant a time extension; rather, the jury awarded damages based on the value of the unpaid work that Conam already performed." *Id.* at 746.

In the hypothetical discussed in this article, arguably the damages are the result of Green Builders' decision to use the wrong materials. This decision appears to be the result of Green Builders' negligent actions, as opposed the failure to remit payment. The decision to use certain building materials is certainly the type of "professional service" commensurate with professional services provided by an architect or engineer; therefore, it is likely that a professional liability policy would provide coverage for this type of act or omission.

Had Green Builders failed to construct the correct number of floors, failed to start construction on time or simply stopped working before the job was complete, a court would likely determine that Green Builders breached its contractual obligations. If an errors and omissions insurance policy does not include coverage for breach of contract, Green Builders would not be entitled to coverage for losses resulting from these latter actions and/or inactions.

As discussed above, it is important to note the differences in coverage under an errors and omissions policy in contrast to a commercial general liability policy. Generally, there is no coverage for an insured under a commercial general liability policy for breach of contract claims. An insurer can likely rely on the absence of an "occurrence," as well as various "your work" exclusions to deny coverage. A contractor promising to construct a green building may find itself bearing the costs of a defense should litigation result from the failure to meet the contracts terms.

Negligence Practical Considerations

- To the extent that an insurer can show that damages are the result of a breach of contract, as opposed to attributable to an architect's professional services, an insurer may be able to disclaim coverage. In the context of an errors and omissions policy, this analysis would likely be very fact driven and not easily discernible from a pleading.
- For an insurer providing coverage to a contractor under a commercial general liability policy, it is likely that there would not be coverage for a breach of contract or negligence claim. A miscalculation or a failure to comply with the contract requirements would not likely constitute an "accident" and generally is not provided for in such policies.
- For an attorney representing a construction company promising to construct a green building it is important to review the terms of any policies providing coverage to anticipate whether a dispute over the promises made in a contract will fall outside of the scope of coverage.

Loss of Use

In the hypothetical, the complaint against Green Builders seeks recovery for loss of use and loss of profits. The loss of use is based on the inability to sell the individual units during the time period in which the building's completion was delayed. The lost profits claim seeks recovery based on the alleged decrease in value since the units will not achieve a LEED-platinum certification.

Respecting loss of use, obligation to pay damages for this claim will depend on the specific language contained in the policy. Some policies define damages as, "amounts intended to compensate another person or organization for loss or injury to person or property or for economic loss." Under this relatively broad definition of damages, it is arguable that the policy would provide coverage for economic damages resulting from the loss of use.

For example, in *Gibraltar Casualty Company v. Sargent & Lundy*, 214 Ill. App. 3d 768 (Ill. App. 1 Dist. 1990), Gibraltar Casualty issued a professional liability policy

to S & L Engineers. S & L Engineers was retained to provide design services for the construction of two nuclear power plants. The policy defined damages as, "compensation for loss or injury to person or property, including compensation for bodily injury, personal injury or property damage…" *Id.* A federal lawsuit was filed as a result of the delays in construction, seeking recovery for loss of use, increased costs and lost profits. Gibraltar Casualty refused to defend S & L Engineers in the federal claim, resulting in a declaratory judgment action.

In the declaratory judgment, S & L Engineers contended that the damages sought were within the scope of the policy, and Gibraltar Casualty was required to provide a defense. The court noted that the loss of use claims were not the same as claims for anticipated profits or lost investment. The characterization of loss of use damages as economic did not remove them from the scope of coverage of an insurance policy that defined property damage as including loss of use. The court held that the allegations of increased costs as a result of the construction delays were sufficient to allege a loss of use within the scope of the policy and, therefore, Gibraltar Casualty was required to defend S & L Engineers. *Id.*

Loss of Use Practical Considerations

- It is possible that an owner seeking to build a green building will incur additional costs to remedy negligent acts of an engineer or architect that result in the building's failure to achieve LEED certification. Accordingly, an insurer could see claims seeking recovery based on loss of use for the building rehabilitation time period. Depending on the definition of damages contained in the professional liability policy at issue, an insurer may be required to indemnify the insured for such losses.

Lost Profits

Generally, lost profits arise from damage to businesses, and these types of disputes concern business interruption provisions. There are few reported cases concerning claims for lost profits originating from professional malpractice. Despite the dearth of reported cases, lost profits claims involving green construction are foreseeable.

It is certainly possible that an owner could contend that a building is less marketable because it has not obtained LEED certification. As a result, an owner may claim that a condominium may sell for less because of the architect or engineer's error. Lost profit claims are not limited to commercial buildings. It is foreseeable that a developer would market a new home subdivision as "green" and buyers would pay a premium for such homes. With this backdrop, a claim that a home or condo is of less value when it cannot be marketed as green seems inevitable.

The example of policy language referenced above defines damages as, "amounts intended to compensate another person or organization for loss or injury to person or property or for *economic loss*." Under this type of language, it is arguable that claims for lost profits are recoverable, to the extent such damages can be proven. Exposure for lost profits will be determined by a policy's language. If a policy provides coverage for economic damages without providing a definition, it is possible a carrier may be required to indemnify an insured for such damages.

An important counterpoint to consider regarding a claim for lost profits arising from a green build is that the burden remains on a plaintiff to establish damages. Certainly, in some instances, such as lost tax credits, damages can be quantified and defined. The reality is, however, it could be difficult for a plaintiff to establish with the required degree of certainty the amount of damages due to failure to obtain a certain LEED certification.

Since the legal issues around green building are not yet in full bloom, courts will likely turn to established case law concerning potential damages and require proof beyond speculative allegations of lost profits, particularly in jurisdictions where there is no precedent of lost profits based on failed green construction. The New York Court of Appeal has held,

> damages may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach not remote or the result of intervening causes…If it is a new business seeking to recover for loss of future profits, a stricter standard is imposed for the obvious reason that there does not exist a reasonable basis of experience upon which to estimate lost profits with the requisite degree of reasonable certainty.

Kenford Company v. Erie County, 67 N.Y.2d 257, 493 N.E.2d 234 (1986).

Lost Profits Practical Considerations

- If an insurer or a contractor is defending a green claim, review the damages sought. As in any litigation, it is important to consider whether the plaintiff can prove the alleged damages or if such damages are vulnerable to attack based on their speculative nature.

Despite the dearth of reported cases, lost profits claims involving green construction are foreseeable.

Conclusion

With the rapid increase in green design and construction, claims originating from such work are simply a matter of time. Insurance carriers and their counsel must consider properly underwriting the risks and limiting exposure to those contemplated by the premium paid.

In light of the growing green market, there is opportunity for an insurance carrier to insure against losses arising from green construction and to market this coverage to architects and engineers. Insurers may seek additional premiums for such coverage and issue endorsements to professional liability policies to provide coverage.

Alternatively, insurers should consider writing exclusions that limit coverage for losses arising from green construction, whether negligent or contractual in nature. As the market for green building grows, carriers and businesses will need to decide how to handle resulting liabilities and whether to embrace or avoid the risk.