



**National Association of  
Surety Bond Producers (NASBP)**



**The Surety & Fidelity  
Association of America (SFAA)**

## **Performance Bonds on Green Building Construction**

The number of green building construction projects<sup>1</sup> continues to grow. Federal, state and local governments increasingly seek to mandate consideration of and adherence to green building requirements through enactment of new codes and incentives. According to the United States Green Building Council, the value of green construction is expected to increase to \$60 billion by 2010. Estimates of the value of green construction starts by 2013 approximate \$140 billion. Among the many drivers in the expansion of green building are: reduced operating costs, tax incentives and goodwill. Requirements associated with green building construction continue to evolve and grow in public and private sectors, creating new risk implications for contractors that build these buildings and sureties that provide performance bonds to secure contractor performance. This document briefly addresses these risk issues.

Green building construction projects should entail greater planning and communication and earlier participation among project parties than in traditional projects. Multiple project parties typically share green building responsibilities. The project owner, the design professional, the construction contractor, and specialty contractors all may have responsibilities that bear upon the fulfillment of green building requirements. Many choices and decisions are made to attain a desired green building certification status, and those choices or decisions may involve other than strictly design or construction decisions. As a result, achieving a green building certification status will depend on the collective decisions and actions of the project team, not just one project participant. For example, one of the prominent green rating systems, Leadership in Energy and Environmental Design ("LEED"), involves a point system for attaining certification. Points may be attained in areas that involve decisions or activities of the project owner, of the design professional, engineer, the contractor and even subcontractors. Failure to achieve a point or points by one project participant may mean that the building does not achieve the LEED rating sought or is delayed in achieving that rating. The

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<sup>1</sup> "Green construction" is a term susceptible to a variety of definitions, each carrying certain risk implications. The term encompasses meanings that range from the use of recycled construction materials to a high-performance building whose systems provide savings in energy and resources.

involvement of multiple parties raises the issue of the proper risk allocation with regard to the consequences of a building failing to attain the desired rating.

A performance bond guarantees the performance of the construction contractor's contract obligations by the surety company to the construction project owner. The contractor's obligations are determined by the contract documents. In the event of a default by the construction contractor, the surety has an opportunity to remedy the default by performing the contract or by covering the costs to complete the project in excess of contract balances, up to the penal sum of the bond.

An owner undertaking a green building construction project likely has heightened expectations for the project. The owner may be expecting a building with systems operating at a specified performance level, enhanced goodwill and market differentiation created by the green building and special tax incentives. These increased expectations, particularly if they are translated into contractual guarantees and warranties, may mean an increased liability exposure in the event the project fails to be completed or to attain the certification or performance standards expected by the owner. Further, the owner may view the contractor and its surety as the "deep pocket" to rectify such issues, regardless of the contractor's responsibility for the failure. The owner may attempt to seek damages from the contractor that allegedly result from the failure to obtain certification of a "green building" (e.g. loss of expected tax credits, increased operating costs, and the loss of goodwill and profits in leasing the building). The contractor and surety should be aware of this heightened risk so that it can be managed appropriately.

Adding to the heightened risk profile of green building projects is the fact that some green building construction materials and technology are relatively new or untested for commercial applications, creating unknowable risks. How will "green" building materials fare over time? Is the design professional familiar with the long-term durability of the specified material? Does the contractor possess the knowledge and expertise to properly install "green" materials? Who should assume the warranty responsibilities for these materials? How should requests for material or equipment substitutions be handled? These are but a few of the questions that should be considered by the contractor and surety.

Just as the contractor should not assume responsibility for risks that are not properly within the contractor's control, the surety, through the issuance of its performance bond, should not assume responsibilities beyond the control of its principal. Both the contractor and surety should assess the risks above and determine how they can be managed.

One way to manage the additional risks is to exclude them. The surety bond could extend only to the contractor's obligation to construct the work in accordance with the contract documents. A guarantee or warranty that the building will achieve a

desired green building certification status, and liability and damages for any failure to achieve such status could be excluded from the scope of the construction contract or the performance bond.

The following language is an example of language that might be inserted into the contract and performance bond to exclude the risk and confine the surety's liability solely to the contractor's construction obligations:

**"NO LIABILITY FOR GREEN BUILDING REQUIREMENTS.**

The condition of the Bond does not include any obligation to achieve any green building certification, status, level of performance, water usage or energy usage, whether mandated by statute, ordinance or otherwise. The Principal and Surety shall not be liable under the Bond for any damages or costs caused or allegedly caused by, arising out of, or related to the project's failure to achieve such certification, status, level of performance, water usage or energy usage, including, but not limited to, attorneys' fees, unrealized cost savings, lost profits, lost tax credits, or other costs, expenses, fees, or benefits."

Of course, other approaches may be taken. For example, the parties contractually could establish the roles and responsibilities of owner, architect and contractor with respect to the green building obligations. A clear identification of the parties' roles helps to mitigate risk and enhance the opportunity for project success. An example of such an approach is the ConsensusDOCS® Green Building Addendum. With the clear identification of the contractor's obligations, the surety can evaluate the contractor's qualifications and financial means and its ability to carry out its green building obligations successfully. The exposure to additional damages can be managed with a contractual waiver of consequential damages. In making a decision to provide the performance bond, the surety must consider the nature and extent of the contractor's undertaking and whether the principal, through its qualifications and financial means, can carry out the undertaking successfully. From the perspective of complying with green building requirements, the developer's, the design professional's or the contractor's responsibilities will not involve the complete undertaking. Typically, the construction contractor's actions and decisions play only a small role in attaining LEED criteria and performance standards, and the contractor may not have sufficient control to ensure that the building will meet green building certification requirements.

How a contractor undertakes any additional green building obligations and whether the surety bonds it depends on the facts and circumstances of each case. From the surety's perspective, the issue is whether the risk can be underwritten prudently. In some cases, the contractor has the ability and resources to undertake well-defined green building obligations. In other cases, the best course of action is to

exclude the risk from the contract and the performance bond. In all cases, the contractor and surety must be aware of the additional risks in "going green."

*This paper was developed by NASBP (phone: 202-686-3700; web: [www.nasbp.org](http://www.nasbp.org)) and SFAA (phone: 202-463-0600; web: [www.surety.org](http://www.surety.org)).*