Fall 2012

The Bonds that Tie: Will A Performance Bond Require That A Surety Deliver A Certified Green Building?

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As sustainable practices continue to sweep across the country, the federal, state, and local governments chose to further encourage the construction industry through various legislative and regulatory actions. In 2006, the city of Washington, D.C. passed landmark legislation introducing green building requirements for various types of structures into the jurisdiction over a five-year period. A noteworthy aspect of the legislation is that it directed construction projects within the district to purchase green performance bonds up to $3 million to guard against a privately owned project's failure to meet its green building aspirations. Outside of the regulatory requirements associated with the construction of a green building, lawsuits may also occur between the participants of a project because the finished structure failed to attain a third party certification. Given the need by project participants to address the risks stemming from potential litigation issues or environmentally friendly governmental policies, the question remains whether performance bonds will provide sufficient coverage when a project fails to meet a sustainability objective, or if a separate instrument is needed to address the specific perils related to green buildings. This article seeks to address these issues.

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I. INTRODUCTION

In 2006, the city of Washington, D.C. passed landmark legislation introducing green building requirements for various types of structures over a five-year period.[1] A noteworthy aspect of the legislation is that it directed construction projects within the district to purchase green performance bonds up to $3 million to guard against a privately owned project's failure to deliver on its green building promises.[2] In essence, this law placed the burden of compliance on the contractors and sureties of a green building project.[3]

Following the passage of this act, confusion amongst the construction industry and sureties ensued because a green performance bond did not exist and no one knew how to obtain one.[4] Responding to this legislation, the Surety and Fidelity Association of America ("SFAA") and the National Association of Surety Bond Producers ("NASBP") sent a joint letter to the government of the District of Columbia outlining their concerns and explaining that they anticipated great reluctance on the part of sureties to issue such instruments despite the creation of market demand.[5] No matter the motivating source, this new requirement highlighted the need for some type of guarantee against injuries arising from a contractor who did not deliver a green building as promised.[6]

Outside of the regulatory requirements associated with the construction of a green building, lawsuits may also occur between the participants of a project because the finished structure failed to attain a third party certification.[7] Lawsuits may originate out of financial

1. Wash. D.C., Green Building Act of 2006 (codified as D.C. CODE §6-1451-05 (2008)).

2. *Id.* at § 6-1451.05(f). In the event that the project failed to attain its third party certification goals, the legislation stipulated that "[a]ll or part of the performance bond shall be forfeited to the District and deposited in the Green Building Fund," which the city planned to use for technical assistance, education, and an incentive program. *Id.* at § 6-1451.05(g).

3. Chris Cheatham, *What's Your Green Construction Strategy?,* GREEN BUILDING LAW UPDATE (Aug. 15, 2008) http://www.greenbuildinglawupdate.com/uploads/file/DCBONDARTICLE FINAL(1).pdf.

4. *See* Chris Cheatham, *Green Performance Bonds Necessary but Risky,* GREEN BUILDING LAW UPDATE (June 2, 2011), http://www.greenbuildinglawupdate.com/articles/legal-developments/surety.

5. Letter from Matthew Klimczak, Dir. of Underwriting, Sur. and Fid. Ass'n of Am. and Mark McCallum, Gen. Counsel and Dir. of Gov't Relations, Nat'l Ass'n of Sur. Bond Producers to Linda Argo, Comm'r of Dep't. of Consumer and Regulatory Affairs, Gov't of D.C. (Aug. 13, 2007) (on file with author).

6. Chris Cheatham, *Green Performance Bonds Necessary but Risky,* GREEN BUILDING LAW UPDATE (June 2, 2011), http://www.greenbuildinglawupdate.com/articles/legal-developments/surety.

7. *See* Darren A. Prum & Stephen Del Percio, *Green Building Claims: What Theories Will a Plaintiff Pursue, Who Has Exposure, and a Proposal For Risk Mitigation*, 37 REAL ESTATE L.J. 243, 245 (2009) [Hereinafter referred to as Prum & Del Percio 1].

incentives provided by many jurisdictions to encourage the construction of green buildings[8] or due to many other claim possibilities available to an injured party.[9] For example, a lawsuit occurred when one project in Maryland failed to achieve its green building objectives and did not qualify for the state's financial incentives.[10] In that case, some type of contractual guarantee from a surety could have provided accountability and a resolution of the green building issue without the need for legal action.

Given the need for project participants and those associated with environmentally friendly governmental policies, the question remains whether performance bonds will provide sufficient coverage when a project fails to meet a sustainability objective, or if a separate instrument is needed to address the specific risks related to green buildings. This article seeks to address these issues. Section II presents an explanation of surety bonds and some of the motivating factors. It begins with an in-depth discussion of a performance bond and the applicable parties. The examination continues with an evaluation of the claims and defenses of a surety before turning to the regulatory environment.

In Section III, we examine the various issues on a green building project from an owner and surety's perspectives. This analysis includes the validity of a performance bond and third party indemnity claims as well as the issues surrounding default based on standard construction and green designs.

In Section IV, we explore and analyze the contract surety language used in the performance bond forms offered by the American Institute of Architects ("AIA"), the Engineers Joint Contracts Document Committee ("EJCDC"), and ConsensusDOCS. In evaluating the various forms, we also consider ancillary documents like ConsensusDOCS' Green Building Addendum along with the SFAA and NASBP's recommendations for the inserting language in a green building project to eliminate the risk on sureties. Finally, we put forward a proposal in Section V for all participants in a green building project with regard to the handling of performance bonds after carefully considering the pressing issues from both an owner and surety's perspective.

8. *See generally* Darren A. Prum, *Creating State Incentives for Commercial Green Buildings: Did the Nevada Experience Set an Example or Alter the Approach of Other Jurisdictions?*, 34 WM & MARY ENVTL. L. & POL'Y REV. 171 (2009) [Hereinafter referred to as Prum ELPR].

9. *See* Prum & Del Percio 1, *supra* note 7.

10. *See* Shaw Dev., LLC v. S. Builders, Inc., No.: 19-C-07-011405 (Md. Cir. Ct. 2008).

II. EXPLANATION OF SURETY BONDS

The underpinnings of the construction industry continually reveal performance volatility by many contractors and thus require some mechanism to protect an owner against a project failing to finish.[11] One of the easiest and cost effective solutions to reduce this type of threat is to purchase a performance bond to assuage the owner's concerns.[12] In the United States, the performance bond routinely serves as the main instrument for the construction industry to minimize these inherent risks.[13]

While a private developer determines its risk tolerance and need for a construction bond, the federal and many state governments require one as a matter of statute.[14] On the federal level, the Miller Act compels contract surety bonds on construction projects.[15] This legislation requires a contractor to post a bond on performance and one on labor and material payment when the contract award exceeds $100,000.[16]

Following the footsteps of the federal government, many states

11. JUSTIN SWEET, MARC M. SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 32.04 (8th Ed., 2009); David J. Barru, *How to Guarantee Contractor Performance on International Construction Projects: Comparing Surety Bonds With Bank Guarantees and Standby Letters of Credit*, 37 GEO. WASH. INT'L L. REV. 51, 59 (2005). When considering the volatility in the construction industry, the commentators explain that many threats occur towards an owner's goal of completing a project unscathed by contractor performance issues. Sweet & Schneier, *supra*, § 32.04. These contractor related issues may emanate from management and supervision sources or out of the financial realm. *Id*. Frequently, a contracting company relies heavily on the competence of a small number of employees, which can quickly turn into disaster if these individuals become unavailable. *Id*. Other times, a poor or difficult estimate or a streak of money losing projects can cause severe financial crises or even bankruptcy. *Id*. In addition, the difficulties in obtaining credit or insurance policies for the various risks may place a contractor on the financial edge.

12. A performance bond is not the sole solution; but given the further analysis on how constructing a green building differs from a standard one, it provides the main area of suretyship where difficulties will occur. Other types of construction bonds include: a Bid Bond where the guarantor will pay the damages incurred should a successful bidder refuse to perform; a Payment Bond where the issuer agrees to make sure all subcontractors and supplier receive their appropriate compensation; a Subcontractor Bond where the prime contractor receives an assurance from a responsible third party for payment of lower tiered subcontractors or suppliers; a Bond to dissolve a mechanics' lien from clouding an owner's title; and a Warranty Bond to provide assurances based on any warranties given by a contractor. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.04-32.09.

13. *See* Barru, *supra* note 11, at 57. In other parts of the world, the construction industry uses bank guarantees and standby letters of credit to resolve the same issue. *Id*. at 56.

14. Cheryl S. Kniffen, *A Georgia Practitioner's Guide to Construction Performance Bond Claims*, 60 MERCER L. REV. 509, 514–15 (2009).

15. 40 U.S.C. §§ 3131-34 (West 2012).

16. 40 U.S.C. § 3131(b). The federal government requires a payment bond in order to guarantee the subcontractors and suppliers compensation for services rendered because of their inability to lien a public work. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.04.

have also enacted statutes called "Little Miller Acts" with differing contract award thresholds but containing many of the equivalent requirements.[17] In turn, local governments take the identical approach in housing development laws to guard against a developer's failure to make promised improvements.[18]

As such, the use of construction bonds in both public and private projects across the country plays an integral role in guaranteeing the completion of a development while minimizing the amount of risk to an owner.

A. PERFORMANCE BONDS

A performance bond provides an owner of a development with financial backstop against a contractor's ability to complete a given project.[19] A surety then provides contractual assurance to an owner (the bond obligee) should the bonded contractor (the principal) default.[20] The guarantee covers situations where the bonded service

17. *See e.g.,* ALA. CODE § 39-1-1 (2011); ALASKA STAT. §§ 36.25.010, 36.26.020, 36.25.025 (2011); ARIZ. REV. STAT. §§ 34-22, 34-223, 34-224 (2011); ARK. CODE ANN. §§ 22-9-401 to 22-9-405 (2011); COLO. REV. STAT. §§ 24-105-201 to 24-105-203, 38-26-101, 38-26-105 to 38-26-110 (2011); CONN. GEN. STAT. §§ 49-41 to 49-43 (2011); DEL. CODE ANN. tit. 29 § 6962 (2011); D.C. CODE ANN. §§ 2-201.01 to 2-201.11 (2011); FL. STAT. 255.05 (2011); GA. CODE ANN. §§ 13-10-1 to 13-10-2, 13-10-40 to 13-10-65, 36-91-1 to 36-91-2, 36-91-40, 36-91-70 to 36-91-95 (2011); HAW. REV. STAT. §§ 103D-323 to 103D-325 (2011); IDAHO CODE ANN. §§ 54-1025 to 54-1930 (2011); 30 ILL. COMP. STAT. 550/0.01 to 550/3 (2011); IND. CODE §§ 4-13.6-7-5 to 4-13.6-7-12, 5-16-5.5-1 to 5-16-5.5-8 (2011); IOWA CODE §§ 573.1 to 573.27, 616.15 (2011); KAN. STAT. ANN. §§ 16-1901 to 16-1908, 60-1110, 60-1112, 68-410, 68-521, 68-527 (2011); KY. REV. STAT. ANN. §§ 45A.185, 45A.190, 45A.195, 45A.225 to 45A.265, 45A.430 to 45A.440, 341.317 (2011); LA. REV. STAT. §§ 38:2181 to 38:2247, 48:250 to 48:256.12 (2011); ME. REV. STAT. tit. 14, § 871 (2011); MD. CODE ANN., STATE FIN. & PROC. §§ 17-101 to 17-111 (2011); MASS. GEN. LAWS ch. 149, § 29 (2011); MICH. COMP. LAWS §§ 129.201 to 129.212, 570.101 to 570.105 (2011); MINN. STAT. §§ 574.26 to 574.32 (2011); MISS. CODE ANN. §§ 31-5-51 to 31-5-57, 31-5-25 to 31-5-31 (2011); MO. REV. STAT. §§107.170, 227.100, 227.600, 227.633, 229.050, 229.060, 229.070, 522.300 (2011); MONT. CODE ANN. §§ 18-2-201 to 18-2-208 (2011); NEB. REV. STAT. §§ 52-118 to 52-118.02 (2011); NEV. REV. STAT. §§ 339.015 to 339.065 (2011); N.H. REV. STAT. ANN. §§ 447:15 to 447:18 (2011); N.J. STAT. ANN. §§ 2A:44-143 to 2A:44-148 (2011); N.M. STAT. ANN. §§ 13-4-18 to 13-4-20 (2011); N.Y. STATE FIN. LAW § 137 (McKinney 2011); N.C. GEN. STAT. §§ 44A-25 to 44A-35 (2011); N.D. CENT. CODE §§ 48-01.2-01, 48-01.2-09 to 48-01.2-12, 48-01.2-23 (2011); OHIO REV. CODE §§ 153.54 to 153.581 (2011); OKLA STAT. tit. 61 §§ 1, 2, 13, 15, 112 (2011); OR. REV. STAT. §§ 279C.380 to 279C.390, 279C.515, 279C.600 to 279C.625 (2011); 8 PA. CONS. STAT. §§ 191 to 202 (2011); P.R. LAWS ANN. tit. 22, §§ 47 to 58 (2011); R.I. GEN. LAWS §§ 37-12-1 to 37-12-11 (2011); S.C. CODE ANN. § 11-35-3030 (2011); S.D. CODIFIED LAWS §§ 5-21-1 to 5-21-8 (2011); TENN. CODE ANN. §§ 12-4-201 to 12-4-206 (2011); TEXAS PROP. CODE §§ 53.231 to 53.237 (2011); UTAH CODE ANN. §§ 14-1-18 to 14-1-20, 38-1a-501, 63G-6-504 to 63G-6-507 (2011); VT. STAT. ANN. tit., 19 § 10; tit., 16 § 3448 (2011); VA. CODE ANN. §§ 2.2-4336 to 2.2-4342 (2011); WASH. REV. CODE §§ 39.08.010 to 39.08.100 (2011); W. VA. CODE §§ 5-22-1, 5-22-2, 38-2-39 (2011); WIS. STAT. §§ 779.14, 779.15 (2011); WYO. STAT. ANN. §§ 16-6-101 to 16-6-121 (2011).

18. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.04.

19. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.06.

20. PETER S. BRITELL, GREEN BUILDINGS: LAW, CONTRACT AND REGULATION § 10.08 (1st Ed. Law Journal Press 2010).

provider fails to completely accomplish the underlying construction agreement conditional on the penal limit of the bond.[21]

From a practical perspective, two contracts coexist to create the unique surety arrangement in the construction setting.[22] The first contract covers the construction project and binds the contractor with either the owner or general contractor, while the second agreement is for the performance bond.[23] This second agreement brings three parties together: the owner, the contractor, and the surety, such that an obligation inures to guarantee completion of work committed under the first contract.[24]

Moreover, the performance bond will contain limitations to the surety's financial exposure or penal amount. Depending on the circumstances, the surety will issue the bond at 50 percent or 100 percent of the service provider's agreed upon price with the project owner.[25] On federal projects, the contracting officer for the given procurement will ultimately determine the proper amount to protect the government's interest;[26] and in some cases, where a statutory bond becomes necessary under state or local law, the code will dictate a specific amount of coverage.[27]

To provide oversight and help ensure credibility, the U.S. Department of Treasury maintains regulations that determine qualification for federal projects and the state governments provide supervision of the surety companies as well.[28] The government usually regulates the costs of a performance bond, which is calculated as a percentage of the penal limit.[29] Depending on the financial capability of a given surety, a limit will be determined on the size of a bond it can issue.[30] Many sureties try to balance their exposure by placing dollar limits on a given project; and sometimes in larger

21. *See* Barru, *supra* note 11, at 57.

22. *See* J. Harry Cross, *Suretyship Is Not Insurance*, 30 INS. COUNS. J. 235, 236–37 (1963).

23. *Id.* at 236.

24. *Id.*

25. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.06. Sometimes, the courts will hold a surety liable for a sum above the amount issued for the bond. Some of the situations that create this type of liability on a surety occur when it assumes responsibility for construction, it financially supports a contractor, it acts in bad faith, or it receives a directive to disburse prejudgment interest on a bond claim. *See* Barru, *supra* note 11, at 60.

26. Ceclia Carson, *A Lawyer's View of Performance Bond Sureties: Protecting The Government's Interest When Dealing With Performance Bond Sureties Of Defaulted Contracts*, A LAWYER'S VIEW (U.S. Dep't of Comm. Dec. 20, 1992), *available at* http://www.ogc.doc.gov/ogc/contracts/cld/LV/Suretey.pdf.

27. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.06. These commentators note that the statutory bond level in some jurisdictions require coverage at 50 percent of the contract price. *Id.*

28. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(I).

29. *Id.*

30. *Id.*

projects, they split the risk or reinsure a portion of the coverage.[31]

In addition, both public and private owners of projects need to satisfy certain common law requirements for a "facially" regular or valid contract.[32] To satisfy the statute of frauds, a performance bond must be in writing;[33] to avoid the equal dignity rule in agency law, the power of attorney for the bond needs to be written and must convey the proper authority for the specific guarantee being made.[34]

Thus, a well understood and executed performance bond provides the owner of a construction project a viable risk management tool in an environment where there is a high likelihood a contractor will default on its obligations and fails to perform as anticipated.

1. Reimbursements of the Surety

Historically, a surety did not consider itself an insurer, which means it would not expect to take a loss on a claim.[35] With this in mind, a surety will seek certain protections through the bond language prior to issuance in order to minimize its risk of loss.[36] For example, the principal will usually need to indemnify the surety.[37] By taking such an action, the surety shifts all possible claims made upon the bond back to the principal.[38] Building on this principle, some courts have even extended this language to also include the settlement of claims regardless of the contractor's liability.[39]

However, this right of indemnity held by the surety may provide little relief should the defaulting principal lack the capacity to reimburse.[40] In these cases, the surety usually turns to the obligee or

31. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(I).

32. *See* Kniffen, *supra* note 14, at 515.

33. *See* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 19.2 (4th Ed. 1998).

34. WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP §12 (3d. Ed. 2001). One commentator explains an illustration where a performance bond gets issued at a $175,000 penal amount, but the power of attorney only gave authority up to $150,000. *See* Kniffen, *supra* note 14, at 515. She then explains that the bond fails because the law presumes that the obligee (owner) received notice that the power of attorney overstepped its authority. *Id.*

35. *See* Cross, *supra* note 22, at 236.

36. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(H).

37. *See* Cross, *supra* note 22, at 237. The author further quoted a U.S. Supreme Court decision that remarked, "Traditionally sureties compelled to pay debts for their principal have been deemed entitled to reimbursement, even without a contractual promise such as the surety here had. And probably there are few doctrines better established than that a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed." *Id.* (quoting Pearlman v. Reliance Ins. Co., 371 U.S. 132,136-7 (1962)). Another commentator explains that sureties usually include the principal, the principal's owners, spouses of owners, or other key personnel as part of the general agreement of indemnity. *See* Kniffen, *supra* note 14, at 513.

38. *See* Kniffen, *supra* note 14, at 511.

39. *See generally* Gulf Ins. Co. v. AMSCO, Inc., 153 N.H. 28 (2005).

40. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(H).

owner as a source with funds to satisfy its claim.[41]

Based on the circumstances, the surety may request direct payments from the owner when the general contractor defaults, or when the retainage used for security purposes becomes available.[42] The courts tend to support this direct payment mechanism for reimbursement and eschew the notion that the surety's actions become an impermissible interference between the contractor and owner of a project.[43]

Other times, when a surety seeks the retainage from an insolvent general contractor, it must contend with other creditors, any government entities with a claim, and the bankruptcy trustee.[44] As a result, the owner usually transfers the undisputed retainage to the court handling the bankruptcy, allowing the parties to battle each other to garner their share from the judge making the distributions.[45]

Depending on the type of bond, a surety may find itself with superior rights over other claimants.[46] In the performance bond situation, a surety may obtain subrogation rights since it was required to fulfill a principal's obligation by either finishing the work itself, engaging a substitute provider, or supporting the contractor financially.[47] When this occurs, courts hold that a surety maintains superior rights on retainage claims over all other claimants except those by the government.[48]

Hence, this unique characteristic of the bonding contract sets the surety apart from traditional insurance while placing it at the center of any possible performance controversy occurring within the project.

2. Surety Responsibilities

Considering the surety's responsibility in this unique position as a financial backstop, some scholars point out the importance of remembering the context of the arrangement.[49] They begin with noting that a surety's responsibility is no greater than that of the

41. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(H).

42. *Id.* According to these commentators, they define retainage as, "a contractually created security system under which the owner retains a specified portion of earned progress payments to secure itself against certain risks." (*Id.* § 22.03)

43. *See*, *e.g.*, Gerstner Elec., Inc. v. American Ins. Co., 520 F.2d 790 (8th Cir. 1975).

44. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(H).

45. *Id.*

46. *Id.*

47. *Id.*

48. RLI Ins. Co. v. New York Dep't of Labor, 97 N.Y.2d 256 (2002). This same principle does not necessarily hold true for payment bond situations. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(H). In those cases, the surety obtains subrogation rights for the subcontractors and suppliers, which does not surpass the government but may be superior to an owner or general contractor. *Id.*

49. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(D).

principal (contractor) to the obligee (owner) and that the penal amount of the bond provides the financial limitation.[50] Furthermore, the language of the bond dictates much of the performance and limitations, while the surety maintains no obligation to act until the owner declares a breach and serves proper notice.[51]

With these premises in mind, the courts create a distinction between a project with difficulties and one that creates an obligation on the surety based on the need to follow the language contained in the bonding instrument.[52] In those qualifying instances when performance becomes necessary, the language of the bond will determine the surety's explicit responsibilities. One option available to the surety is to provide financial assistance to the principal so that a contractor may complete its obligations without the burden of insolvency.[53] Another alternative for a surety pressed into performance may consist of providing a replacement contractor to complete the remaining commitments.[54]

Finally, the surety may "buy the bond back" by negotiating with the owner to complete the contractor's duties in exchange for a monetary settlement.[55] This typically occurs when the surety determines that the costs to complete the project far exceed those liabilities remaining on the bond.[56] However, the courts maintain that a surety must act affirmatively and not eschew its responsibilities.[57] The surety may not force the obligee to complete performance on its own and then offer to make reimbursements at a reasonable cost because of its lack of ability to make a decision when pressed into performance.[58]

In addition, the issuance of other construction related bonds may affect a surety's responsibilities.[59] An example of this type of situation occurs when a payment bond gets issued as part of the construction project.[60] In those instances, the payment of the principal's suppliers and the subcontractor including its vendors will not be entitled to receive payment under the performance bond.[61]

Accordingly, the surety's responsibilities with regard to

50. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(D).
51. *Id.*
52. *See generally* Bank of Brewton, Inc. v. Int'l Fidelity Ins. Co., 827 So. 2d 747 (Ala. 2002).
53. *See* Barru, *supra* note 11, at 57.
54. *Id.*
55. *Id.*
56. *Id.* at 58.
57. Nat'l Fire Ins. Co. of Hartford v. Fortune Constr. Co., 320 F.3d 1260, 1272 (11th Cir. 2003).
58. *Id.*
59. *See* Barru, *supra* note 11, at 58.
60. *Id.* Of course, the specific language of the performance bond issued by a given surety will dictate the application of this type of situation.
61. *Id.*

performance and its limitations need careful consideration by an owner looking to limit the risk associated with its project.

B. ASSERTING CLAIMS

In order to assert a claim against a surety, the claimant must satisfy three requirements. First, he must show he has standing to pursue a claim. Second the claimant must satisfy the time requirements by showing a sequence of triggering events had occurred before bringing a suit. Finally, he must make a formal declaration of default to provide the appropriate notice when pressing the surety into action. As such, all of these issues need consideration by the parties entering into a performance bond agreement.

1. Standing

Since a performance bond designates obligees, only those parties named in the document receiving the guarantee can invoke a claim. In a private development situation, the owner of a project or a contractor seeking coverage on a subcontractor will generally not face an obstacle since the principal and surety made them an obligee upon issuance.[62] Nevertheless, the current practice of linking multiple parties contractually makes the determination of who can assert a claim in the construction context more complicated.[63]

In the past, many courts evaluated the similar scenario where either a co-prime contractor or a subcontractor brought a claim on a performance bond as an intended or third party beneficiary.[64] The majority of courts in these cases repetitively explained that the bonding document showed no evidence that the plaintiff's claims were contemplated when drafted and denied the claim for relief.[65] A small minority of courts, however, accepted the intended or third party beneficiary claim under limited circumstances.[66]

62. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(A). While this seems straight forward, the initial forays to sort through the standing issues dealt with the predecessor instrument called a "faithful performance bond." *Id.* This combined a performance and payment bond into a single agreement and forced the courts to establish the right of a party to sue on the bond other than the oblige. *Id.* In response to the doctrine instituted by the courts, the industry changed its approach to the present day practice of issuing two separate bonds. *Id.*

63. *Id.*

64. Church of Jesus Christ v. Hartford Accident Indem. Co., 95 P.2d 736 (Utah 1939); VanCor Inc. v. American Cas. Co., 208 A.2d 267 (Pa. 1965); Novak & Co., Inc. v. Travelers Indem. Co., 392 N.Y.S.2d 901 (N.Y. App. Div. 1977); J. Louis Crum Corp. v. Alfred Lindgren, Inc., 564 S.W.2d 544 (Mo. Ct. App. 1978); M.G.M Constr. Corp. v. N.J. Educ. Facilities Auth., 532 A.2d 764 (N.J. Super. Ct. Law Div. 1987); Moore Constr. Co., Inc. v. Clarksville Dep't. of Elec., 707 S.W.2d 1 (Tenn. Ct. App. 1985) *aff'd* Mar. 24, 1986.

65. *See* cases cited *supra* note 64.

66. Hanberry Corp. v. State Bldg. Comm'n., 390 So.2d 277 (Miss. 1980); Amelco Window Corp. v. Fed. Ins. Co., 317 A.2d. 398 (N.J. Super. Ct. App. Div. 1974). A later New Jersey court

Likewise, an Illinois court examined a situation where an authorized public entity contracted for construction services on behalf of the ultimate governmental user and owner of the project.[67] The contractor's agreement delineated the beneficiary of the project as the ultimate user and owner, while the performance bond incorporated the construction contract into its language.[68] In resolving this situation, the Illinois court denied an attempt by the beneficiary to assert a claim for performance because the bond's language specified that only the entity named as an obligee could maintain an action to compel the surety's guarantee.[69]

Solving a similar issue, a Georgia court considered a case where a lender provided financing to an owner on a specific project and required obligee status as part of its agreement.[70] In turn, the lender attempted to make a claim under the performance bond; however, the court found that the lender only obtained the status of an assignee to the obligee instead of a successor.[71] This clarification allowed the court to hold that the language of the bond explicitly limited standing to sue to the obligee or its successors, which denied the lender's ability to make a claim.[72] As a result, a party looking to make a claim against a surety must verify that the performance bond specifically names it as an obligee or risk an adverse judgment from a court using a strict contract construction approach.

2. Time Requirements

Equally important, the claimant must also pay attention to the time requirements specified in the contractual language in order to make a claim against a performance bond. If the bond is government mandated, then the statutes will usually dictate when and where the notices must occur.[73]

In the federal government environment, the contracting officer will notify the contractor and interested parties of terminations for

followed the majority and distinguished this approach. *See* M.G.M Constr. Corp., 53 A.2d at 770. In its opinion, the court further clarified that the earlier decision arose out of a situation where the language creating the guarantee intertwined both a payment and performance component into a single paragraph of the document. *Id.* If noted that the statute that created the bonding requirement and the language used in the document at issue did not show an intent to create standing with "non-party co-primes." *Id.* at 774.

67. Bd. of Educ., Sch. Dist. No. 15, DuPage Cnty. v. Fred L. Ockerlund, Jr. & Assoc., Inc., 519 N.E.2d 95 (Ill. App. Ct. 1988).

68. *Id.* at 97–98.

69. *Id.*

70. TRST Atlanta, Inc. v. 1815 The Exch., 469 S.E.2d 238 (Ga. Ct. App. 1996).

71. *Id.* at 240.

72. *Id.*

73. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(G).

cause pursuant to the Federal Acquisition Regulations.[74] The first step begins with a "cure notice" where a contractor receives a 10-day warning to resolve any issues identified as problematic by the government.[75] Besides the contractor, the government will also furnish a copy of the notice to the surety, so that it may decide on whether to make arrangements to complete the work.[76]

Should the contractor not remedy the deficiencies, the contracting officer may issue a notice of default for failure to cure after the time period elapses.[77] Meanwhile, the surety may elect to complete the contract for the principal after receiving the cure notice.[78] In these cases, the surety and the government enter into a takeover agreement that details the terms and conditions for performance.[79]

In the private development situation, two different time periods may effect the notice requirements in a performance bond. This may occur when satisfying any condition precedents in the bond, like cure notices, or by not delaying too long so as to avoid any limitation period for a claim that discharges performance.

Often, the language contained in the performance bond will specify the number of days and manner needed to place the principal and surety on notice to cure the defects and create a condition precedent under the contract. When the obligee fails to follow these requirements, the courts will discharge the surety's obligations and bar recovery.[80] In cases where the language lacks specificity with respect to these requirements, the courts follow the opposite approach and allow recovery from the obligee.[81]

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74. 48 C.F.R. § 49.4 (2010). The Federal Acquisition Regulations emanate from a collective effort by the Department of Defense, the General Services Administration and the National Aeronautics and Space Administration to provide guidance when acquiring goods and services and are available for use by other executive agencies. *See* U.S. GENERAL SERVICES ADMIN., REGULATORY REFERENCE OVERVIEW, http://www.gsa.gov/portal/category/21220 (last visited Sept. 19, 2011).

75. 48 C.F.R. § 49.402-3(d) (2010).

76. 48 C.F.R. § 49.402-3(h) (2010).

77. 48 C.F.R. § 49.402-3(d) (2010). Interestingly, a commentator points out that the contracting officer needs to proceed cautiously when terminating a contract under a default situation because several boards of contract appeals held the government liable for "appropriate and reasonable costs" under the takeover agreement with a surety. *See* Carson, *supra* note 26.

78. *Id.*

79. *Id.*

80. *See* Seaboard Sur. Co. v. Town of Greenfield, 370 F.3d 215, 219-20 (1st Cir. 2004); Nat'l Fuel Gas Distrib. Corp. v. Hartford Fire Ins. Co., 814 N.Y.S.2d 436, 436–37 (N.Y. App. Div. 2006)

81. *See* RLI Ins. Co. v. St. Patrick's Home for the Infirm & Aged, 452 F. Supp. 2d 484, 488 (S.D.N.Y. 2006); Dooley & Mack Constructors, Inc. v. Developers Sur. & Indem. Co., 972 So.2d 893 (Fla. Dist. Ct. App. 2007). In the *RLI Insurance Company* case, the court examined the totality of the language from a bond using a form document and determined it lacked the requirement to serve written notice to the surety, which made the claim enforceable. *RLI Ins. Co*., 452 F. Supp. 2d at 488. This article will further explore the issues associated with using a form document in a later section.

Depending on the jurisdiction, statutory requirements and court procedures may also provide either a floor or ceiling on the length of time a claimant has to file the claim. One court reasoned that allowing a surety to contractually reduce the statutory timeframe stipulated in the law was unconscionable and that it would reasonably permit longer periods if asked to do so.[82] Another court took the opposite approach and allowed a shorter period than stipulated in the language of the performance bond even though a statutory provision permitted a longer timeframe.[83] Providing a third interpretation, a different court upheld language from a form contract that created a two-year restriction to bring forward a claim after the final payment on the construction contract as acceptable because the claimant specifically required the performance bond and knew of the limitation.[84]

Thus, the time requirements play a crucial role in notifying the appropriate parties of deficiencies and default so that a court does not have to make a determination that causes a surprising outcome.

3. Declaration of Default

Finally, the formal declaration of default by the obligee serves as an important point of no return for a surety because its relationship with all parties involved in the construction project dramatically changes after the assertion.[85] This act by the obligee immediately transforms the surety's obligations[86] from a passive participant to an active one in the construction project. It entitles the surety to any retainage and unpaid balances on the construction agreement because its contractual duties require it to make payments to all laborers and material-men in order to discharge the principal's obligations.[87]

Because the declaration of default prompts such serious consequences, this decision and notice requires the owner to do so in a "sufficiently clear, direct, and unequivocal" manner.[88] This means the magnitude of the action requires such specificity that would otherwise create a situation where very few sureties would agree to accept the possibility of unknown liabilities associated with a construction agreement.[89]

Furthermore, there is no defining point at which a surety may get

82. City of Weippe v. Yarno, 486 P.2d 268, 270 (Idaho 1971).
83. Rumsey Elec. Co. v. Univ. of Del., 358 A.2d 712, 714 (Del. 1976).
84. Gateway Commc'n, Inc. v. John R. Hess, Inc., 541 S.E.2d 595, 599 (W. Va. 2000).
85. L & A Contracting Co. v. S. Concrete Serv., Inc., 17 F.3d 106, 111 (5th Cir. 1994).
86. *See* Zoby v. U.S., 364 F.2d 216, 218 (4th Cir. 1966); Phoenix Ins. Co. v. Lester Bros., Inc., 203 Va. 802, 807 (VA. 1962); Howell v. Comm'r of Internal Revenue, 69 F.2d 447, 450 (8th Cir. 1934).
87. Henningsen v. U. S. Fid. & Guar. Co., 208 U.S. 404, 411 (1908).
88. *L & A Contracting Co*., 17 F.3d at 111 (5th Cir. 1994).
89. *Id.*; *Elm Haven Constr. Ltd. P'ship v. Neri Constr. LLC,* 376 F.3d 96, 99-100 (2nd Cir. 2004).

involved in the construction project. Absent a unilateral right to intervene, the surety faces a situation where any actions it takes to avoid a default may serve as the basis for a lawsuit by a contractor.[90] In the few instances when a surety chose to get involved with the performance of the construction contract prior to the declaration of default, the contractors pursued legal action under a wrongful interference claim in torts.[91]

However, a federal court in Illinois noted the lack of legal support for such a claim in its decision when it stated that the defendant "failed to cite a single case of a payment bond surety being subjected to liability from its principal for interceding in the principal's contract with the obligee before the obligee declared the principal in default."[92] While a lack of historical success shows the difficulty in pursuing the claim, it does provide a warning to the surety that it may end up in a factual scenario where a court decides a case differently or may suffer great legal costs in addition to those associated with a construction project defending such a lawsuit.

In addition, the declaration of default may place the surety in the difficult position of having to choose between the obligee and the contractor. Should the surety later determine that the obligee's declaration of default was in error, the courts will allow a piercing of the bond's penal sum due to the breach of duty if a cost increase occurs.[93] However, when the opposite occurs, and the surety affirms the obligee's decision to declare default, the contractor may file a claim based on a breach of the covenant of good faith and fair dealing.[94] In such a situation, one court supported the business judgment of the surety, provided that the underlying decision came out of dealings in good faith.[95] The court also rebuffed a contractor's argument that precluded a surety from settling the obligee's claims prior to the

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90. *See L & A Contracting Co*., 17 F.3d 106, 111 n. 15 (quoting ROBERT F. CUSHMAN, ET AL., *Representing the Performance Bond Surety*, *in* CONSTRUCTION DEFAULTS, § 5.2 (1989)).

91. *See e.g.,* Gerstner Elec., Inc. v. American Ins. Co., 520 F.2d 790 (8th Cir. 1975); Nat'l Surety Corp. v. Prairieland Constr., Inc., 354 F. Supp. 2d 1032 (E.D. Mo. 2004); U.S. *ex rel.* James Cape & Sons Co. v. Am. Home Assur. Co., 2004 U.S. Dist. LEXIS 24212 (N.D. Ill. Dec. 2, 2004).

92. *U.S. ex rel. James Cape*, 2004 U.S. Dist. LEXIS 24212, at *14.

93. *See*, *e.g*., Republic Ins. Co. v. Prince George's Cnty*,* 92 Md.App. 528 (1992); Riva Ridge Apartments v. Robert G. Fisher Co.*,* 745 P.2d 1034 (Colo. App. 1987).

94. Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp.*,* 534 F.Supp.2d 1290, 1306 (S.D.Fla. 2008).

95. *Id.* at 1312–13. In making its decision, the court explained, "This situation places the surety in an unacceptable dilemma: if it does not honor the claim on the bond, the owner sues the surety and the surety incurs the cost of litigation and of a potential judgment. On the other hand, if the surety honors or settles the claim on the bond, the principal sues under a bad faith theory in an attempt to avoid its obligation to indemnify the surety and the surety once again has to absorb, or at least advance, the cost of the litigation and a potential judgment. This lose-lose situation is not a reasonable interpretation of the Indemnity Agreement or the Bond." *Id*. at 1312.

resolution of pending litigation determining whether the declaration of default occurred appropriately.[96]

Accordingly, a surety must proceed carefully when getting involved in the construction project or possibly face legal action from the contractor for tortious interference with a contract; but when it receives a clear, direct, and unequivocal declaration of default from the owner, a significant chain of events follows.

As such, an owner looking to a surety to provide a financial backstop for a project needs to pay special attention to the notice requirements to avoid any unanticipated difficulties with asserting a claim, while likewise, ensuring the bond both properly names the obligees in its language and recognizes the requirements and serious legal consequences of declaring a default against a contractor.

C. Surety Defenses

Beyond the procedural and contractual arguments available to a surety, additional defenses are also available through the law and by the nature of its guarantee. By virtue of the performance bond arrangement, the surety gains nearly all of the defenses available to a contractor against an owner; but depending on the controlling language, most guarantees provide a limitation too.[97] These usually state that a surety's duty to the owner will not exceed those of the contractor.[98] They continue with a reciprocal statement that limits an owner's obligations to a surety to those under the construction contract.[99]

One example where a surety asserts the defenses of a principal is the expiration of a statute of limitations to bring forth a claim. The Alabama Supreme Court explained that a surety may assert the same defenses as a principal, which in this case limited claims to two years against "architects, engineers, and builders."[100] Similarly, the Iowa Supreme Court disallowed a request for performance by a surety made five years after dissolution of the business organization named as principal in the original bond because the statutes required claims against a dissolved entity within a two year time period.[101]

In addition, the nature of a construction project makes the contract between and owner and contractor very fluid. An owner may make changes to the project, which will modify the contractor's

96. Liberty Mut. Ins. Co., 534 F.Supp.2d at 1312.

97. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(C).

98. *Id.*

99. *Id.*

100. Hous. Auth. of City of Huntsville v. Hartford Accident & Indem. Co., 954 So.2d 577, 582 (Ala. 2006).

101. State of Iowa v. Bi-states Constr. Co., 269 N.W.2d 455, 456–57 (Iowa 1978).

agreement; or both parties may mutually decide to adjust the original contract.[102] In these situations, courts traditionally follow a policy of *stricti juris* where any change in the original contract released the surety.[103]

Modern courts have begun to erode this approach for sureties receiving compensation for their guarantee.[104] The newly adopted exception for paid sureties in many jurisdictions disallows a discharge unless the underlying construction contract has a material change as well as causes some injury, loss, or prejudice.[105] As such, the courts will still discharge a surety when a material change to the original construction contract occurs.[106]

In other situations, courts have refused to allow a surety's defense to avoid performing due to the lack of prejudice or injury. The first scenario occurs when a claimant fails to fully comply with the numerous requirements set forth in the bond or by statute.[107] When courts feel the surety tries to avoid its obligations to perform based on the failure of the part of the claimant to comply with a technical necessity, a liberal interpretation applies and requires a showing of prejudice before allowing the defense.[108]

Thus, an owner looking to avoid an affirmative defense by a surety on a project must pay particular attention to the materiality of the change orders and the performance ability of the contractors as well as the statute of limitations for filing a claim.

D. REGULATORY ENVIRONMENT

Over time, attitudes towards sureties have changed from friendly to unsympathetic. This shift in viewpoint occurred in both the treatment sureties get from the courts and the ability for a claimant to receive fair dealing in the settlement process.

102. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(C).

103. Winston Corp. v. Cont'l Cas. Co., 508 F.2d 1298, 1302 (6th Cir. 1975). The court details that the rule of *stricti juris* provided severe and undeserved outcomes for technical breaches in the underlying contract between the owner and contractor. *Id.*

104. *Id.* This court explains that in its instant case applying Georgia law, no authority exists making the distinction between paid and unpaid surety with relation to applying equitable principles to achieve more fair outcomes. *Id.* The court notes that the precedent in Georgia allows for a surety's release when the principal and obligee increase its risk without consent but fails to explain situations where a change does not raise its exposure. *Id.*

105. *See e.g.,* C. S. Luck & Sons v. Boatwright, 157 Va. 490, 494–95 (1932); City of Montpelier v. Nat'l Sur. Co., 97 Vt. 111 (1923); Sch. Dist. No. 1 of Clark Cnty. v. Mass. Bonding & Ins. Co., 92 Kan. 53 (1914); Bross v. McNicholas, 66 Or. 42 (1913).

106. *In re* Liquidation of Union Indem. Ins. Co., 632 N.Y.S.2d 788, 789 (1995).

107. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(G).

108. *See Winston Corp.,* 508 F.2d at 1304; U.S. *ex rel.* Kelly-Mohrhusen Co., Inc. v. Merle A. Patnode Co., 457 F.2d 116, 117–18 (7th Cir. 1972); Am. Bridge Div. of U.S. Steel Corp. v. Brinkley, 255 N.C. 162, 166 (1961).

1. Judicial Treatment

Once considered a "favorite" of the law, sureties now receive a less than warm reception from the courts. This prior beneficial treatment emanated out of the practice in which a private individual decided to assist a principal in gaining work by eliminating any credit issues through a guarantee to complete the work in the event he failed to finish.[109] Generally, the person furnishing the guarantee did not receive compensation or a benefit for assuming the risk; so the law rewarded the good deed with a "favorite" status.[110]

As a more commercialized economy evolved, the development of professional sureties occurred with the change in times.[111] As such, many of the protective rules afforded the uncompensated surety regularly got revisited with a professional one.[112] As discussed earlier, the split in authority and continued erosion on whether to follow the policy of *stricti juris* provides notable examples on the change in direction.[113] The Nebraska Supreme Court illustrated this notion when it stated, "A builder's bond is construed most strongly against the surety and in favor of the indemnity which the obligee has reasonable grounds to expect."[114]

Hence, this philosophical shift by the courts now casts doubt on the common law precedent and may limit the predictability of legal outcomes for professional sureties moving forward.

2. Surety Bad Faith and Bond Limits

Similar to the abuses of the insurance industry in settling claims, sureties now face inquiries into their practices. When a surety uses improper settlement methods, the bad faith claim may get resolved differently depending on the claimant. When a surety's conduct does not meet the standard imposed by the law and the jurisdiction permits bad-faith claims, a court may reduce contractual obligations or award damages that surpass the penal limit on the bond.[115] This usually

109. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.03.

110. *Id.* These commentators point out an example of this favored position comes from the Statute of Frauds. *Id*. The English enacted the Statute of Frauds in 1677 and required a writing for any contract that guarantees the debt of another person. *Id*. Absent the written document, a claimant could not hold a surety liable as mentioned in Section II(a). *Id*. This policy decision was made to protect a surety from giving an oral promise without due deliberation and to discharge them when changes between the principal and obligee occurred. *Id*.

111. *Id.*

112. *Id.*

113. *See supra* notes 74 to 79.

114. Sch. Dist. No. 65R of Lincoln Cnty. v. Universal Sur. Co., 178 Neb. 746, 748 (Neb. 1965).

115. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(E), § 32.10(I). In order to achieve a bad faith claim against a surety, the court must find that a tort occurred that substantiates damages on both the punitive and normal tort levels. Riva Ridge Apartments v. Roger J. Fisher Co., 745 P.2d 1034, 1037 (Colo. App. 1987). Nervous about obscuring the line between torts and contracts,

occurs once the obligee declares the principal in default.[116] The surety then finds itself under a duty to investigate the situation and to come to a swift resolution with all claimants.[117]

As discussed earlier, a surety usually requires indemnification from the principal as a condition for providing its guarantee.[118] However, when the surety chooses to use various tactics like delay and self-serving offers to avoid a settlement, the courts will use bad faith theories to nullify the indemnification rights or reduce them to the extent of the losses.[119]

Other times, the courts will award judgments beyond the penal limit when it disagrees with a surety's settlement practices towards an owner.[120] Examples of this type of behavior include a situation where a surety decided against cooperating in the settlement discussions concerning an award of prejudgment interest and an instance where the owner was forced to finish the project with its own funds because the guarantor threatened lengthy delays for the investigation phase as well as to complete its obligations to perform.[121] As such, several courts did not hesitate to reign in dubious settlement practices from a surety trying to avoid its contractual obligations by borrowing the bad faith remedy used to deter insurance companies.[122]

Furthermore, the Massachusetts Supreme Court even allowed the application of the state's Deceptive Trade Practices Act to a surety.[123] In this case, the court explained that the Massachusetts "statute provides a remedy of multiple damages where an insurer 'forces plaintiffs to litigate clearly valid claims . . . the surety] in its answer to the amended complaint, made an 'insincere response calculated solely to avoid the inevitable day of reckoning,' and then extended a 'monetarily inadequate' offer."[124]

Thus, as the regulatory environment continues to shift with

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many courts do not support tort claims of bad faith against sureties. *See, e.g.*, Cates Constr., Inc. v. Talbot Partners, 21 Cal. 4th 28 (Cal. 1999); Republic Ins. Co. v. Bd. of Cnty. Comm'rs of Saint Mary's Cnty., 68 Md. App. 428 (1986); Ins. Co. of the W. v. Gibson Tile Co., 122 Nev. 455 (Nev. 2006); Masterclean, Inc. v. Star Ins. Co., 347 S.C. 405 (S.C. 2001); Great Am. Ins. Co. v. N. Austin Util., 908 S.W.2d 415 (Tex. 1995).

116. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(E).

117. *Id.*

118. *See supra* Part II (A)(2).

119. *See* Republic Ins. Co. v. Prince George's County, 608 A.2d 1301, 1304 (Md. Ct. Spec. App. 1992).

120. *See generally* U.S. Fid. & Guar. Co. v. Braspetro Oil Serv., Co., 369 F.3d 34 (2nd Cir. 2004); Cont'l Realty Corp. v. Andrew J. Crevolin Co., 380 F.Supp. 246 (S.D.W.Va. 1974); Ins. Co. of N. Am. v. U.S., 951 F.2d 1244 (Fed. Cir. 1991).

121. *See* Ins. Co. of N. Am. v. U.S., 951 F.2d 1244 (Fed. Cir. 1991); U.S. Fid. & Guar. Co. v. Braspetro Oil Serv., Co., 369 F.3d 34 (2nd Cir. 2004).

122. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(I).

123. R. W. Granger & Sons, Inc. v. J & S Insulation, Inc., 435 N.E.2d. 668, 678 (Mass. 2001).

124. *R. W. Granger & Sons, Inc.*, 435 N.E.2d. at 678.

regard to the differentiation of paid and unpaid sureties and the investigation and settlement practices begin to resemble those of the less upstanding members of the insurance industry, the courts will no longer continue the "favorite" status and will continue to expand many of the equitable approaches to serve as a deterrent.

III. ISSUES ON A PROJECT

Given the legal parameters in which a performance bond exists, the different participants and stakeholders in a construction project must also take into account their respective positions when relying on such an instrument. To address these risks, this section considers the additional and unique legal issues attached to a green building project from both the owner's and surety's perspective.

A. FROM AN OWNER'S PERSPECTIVE

Due to the complexities and risks inherent in green construction, an owner who relies on other participants and form contracts to ensure a building's certification by a third party may face many unanticipated issues when the project falls short of the standard, which may translate into substantial financial losses.[125] However, when looking to place the responsibility upon other participants, the owner may find the law and the underlying contracts that were supposed to protect against these losses unaccommodating to the recovery of such damages.

1. Validity of Bond

Considering the performance bond, itself, as a source of risk, an owner faces the possibility that a surety gets released from its obligations because a court finds grounds to invalidate it or deem it unenforceable. Evaluating the scenarios where a court invalidates the performance bond, fraud may occur by the contractor and/or owner.[126] When a contractor for a green building project makes a material misrepresentation on its application for a performance bond, the surety generally remains obligated to perform its contractual duties.[127] Any claim the surety maintains against the contractor's deceitful conduct cannot include the owner unless it participated or knew about

125. *See* Prum & Del Percio 1, *supra* note 7, at 244.
126. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(B).
127. *Id.* Of course, the withholding a material fact also creates an issue of nondisclosure in addition to material misrepresentation. RESTATEMENT (THIRD) OF SUR. & GUAR. § 47 (1996). *See* Prum & Del Percio 1, *supra* note 7, at 248.

the fraudulent misrepresentations.[128] In those situations that implicate the owner, the surety may invalidate the performance bond entirely.[129] In green building projects, an owner needs to take this risk seriously; since the undertaking of constructing such structures includes inherently sparse experience and/or knowledge by many of the participants as to the materiality of information during the contracting process.

In other situations, a surety may pursue legal action to have the performance bond declared unenforceable.[130] These situations occur when the surety asserts defenses such as mistake[131] or impossibility.[132] Unilateral[133] or mutual[134] mistakes made in the agreement by the owner or contractor regarding the green building project, even if unintentional, can result in a court finding the underlying construction contract or performance bond unenforceable.[135]

Furthermore, a surety may seek a court's approval to deem the underlying construction contract impossible or impracticable.[136] Proving impracticability requires that one party show: performance cannot be completed under the contract because of some unexpected event outside the control of the contractor;[137] the contract did not explicitly make the contractor liable for the risk of the unexpected event;[138] and performing the contract will be much more difficult or expensive now.[139]

Finally, a court will not compel the enforcement of the performance bond where the underlying construction contract requires a surety to perform illegal work or the purpose runs contrary to public policy.[140] One set of commentators believes that the courts

128. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(B).

129. *Id.*

130. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(B).

131. RESTATEMENT (THIRD) OF SUR. & GUAR. § 12 (1996).

132. RESTATEMENT (SECOND) OF CONTRACTS § 36 (1981).

133. *See, e.g.,* Market St. Assocs. Ltd. P'ship v. Frey, 941 F.2d 588 (7th Cir. Wis. 1991) (A unilateral mistake is a valid defense to contract formation when the non-mistaken party had reason to know of the mistake of the other party).

134. *See, e.g.,* Sherwood v. Walker, 66 N.W. 568 (Mich. 1887) (Contract rescission is possible in light of a mutual mistake of a material fact concerning the bargain).

135. RESTATEMENT (SECOND) OF CONTRACTS § 160 (1981).

136. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(C).

137. RESTATEMENT (SECOND) OF CONTRACTS § 261 cmt. a (1981). Though an event was foreseeable or was foreseen in fact, nonoccurrence of the event may still have been a basic assumption of the contract.

138. RESTATEMENT (SECOND) OF CONTRACTS § 261 cmt. c (1981). *See, e.g.,* Martin v. Vector Co., 498 F.2d 16 (1st Cir. 1974) (A party may, by express agreement, assume a greater obligation).

139. RESTATEMENT (SECOND) OF CONTRACTS § 261 cmt. d (1981). *See, e.g.*, Jennie-O Foods v. U.S., 580 F.2d 400 (Ct. Cl. 1978) (Performance may be impractical from extreme and unreasonable difficulty; mere increase in difficulty is insufficient).

140. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(B).

appear more prone to follow this approach when the public policy becomes stronger against a particular activity.[141]

In considering the possibility that a surety pursues legal action to obtain a court order declaring a performance bond or the underlying construction contract unenforceable, an owner needs to take such risks seriously. While each theory presents different requirements, a green building project includes many of the traits that minimize the opportunities for a surety or contractor to have a court declare a contract void or unenforceable. For example, current government policies tend to promote these types of structures and the sustainable building practices that accompany their construction;[142] so a claim for illegality is unlikely.

Moreover, the participants involved in a green building project frequently agree to utilize advanced construction techniques that classify the outcome as a high performance structure.[143] As with any emerging technology, these contractors must evaluate the project for feasibility before presenting the owner with an offer and agreeing to a construction contract. Likewise, a surety maintains the same opportunities to assess an underlying construction contract for those issues that could support a finding of impossibility at a later date. As such, an owner maintains adequate defenses against a contractor or surety seeking to make a contract unenforceable.

Hence, an owner must take performance bond validity issues seriously when seeking a guarantee for its contractors in order to prevent a situation that jeopardizes the stability such a guarantee provides; but at the same time, it needs to make sure that all participants have ample opportunity to evaluate and assess the unique aspects of the green building project to maintain an assumption of risk defense.

2. *Third Party Indemnity Claims Resulting from a Contractor's Default*

When engaging in a green project, an owner generally expects to achieve green building certification.[144] Failure to achieve the certification goal may generate an unanticipated negative financial

141. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(B).

142. *See generally* Darren A. Prum et. al., *In Third Parties We Trust? The Growing Antitrust Impact of Third-Party Green Building Certification Systems for State and Local Governments*, J. ENVTL. L. & LITIG. (forthcoming Spring 2012) [Hereinafter referred to as Prum, Alberts & Del Percio].

143. *See* Darren A. Prum, Roberts J. Aalberts, &Stephen Del Percio, *Green Buildings, High Performance Buildings, and Sustainable Construction: Does it Really Matter What We Call Them?*, 21 VILL. ENVTL. L.J. 1, 25–26 (2010).

144. NAT'L ASS'N OF SUR. BOND PRODUCERS, SUR. AND FID. ASS'N OF AM., PERFORMANCE BONDS ON GREEN BLDG. CONSTR. (2011) [Hereinafter referred to at NASBP & SFAA].

impact of substantial proportions.[145] Potential damages to the owner might include: the loss of a tenant or sale; the loss of government incentives and tax credits; an increase in design and construction costs; rescinded donations on endowed projects; penalties on projects with green mandates; increased utilities costs over the life of the building; and reduced asset value.[146]

Further clouding the issue, other consequential damages stemming from a breach of contract pose an added risk that may also attend a failure to achieve the certification goal.[147] Although a mutual waiver of consequential damages clause is commonly included within some design and construction contracts, an owner could be placed at an unacceptable level of risk by agreeing to this term.[148]

With this in mind, a contractor's default does not normally allow an obligee the ability to pursue a surety for third party indemnity claims, since the performance bond only provides for the completion of the underlying construction contract at the agreed upon price.[149] This means the paramount risk to a surety will occur where a sustainable design fails to produce an intended result, or the contractor defaults to the green construction techniques required in the contract, or for other unrelated reasons.[150] When this happens, the contractor's issues now become those of the surety and require resources to satisfy either the green design or construction techniques included in the underlying construction contract.[151]

Because of these additional perils, sureties view green building projects as more risky than traditional construction undertakings and have responded accordingly.[152] As a result, a contractor's ability to obtain a performance bond, or one that does not adversely affect its bidding price, can impact the mechanism used to provide financial stability to an owner or the project's overall cost.

Therefore, an owner must weigh the risk and return relationship on the various aspects of a green building project to determine the areas where it requires coverage by a surety and these where it can accept more exposure to an issue that may later arise.

145. *See generally* Prum & Del Percio 1, *supra* note 7.

146. *Id.*

147. Darren A. Prum & Stephen Del Percio, *Green Building Contracts: Considering the Roles of Consequential Damages & Limitation of Liability Provisions,* 23 LOY. CONSUMER L. REV. 113, 114 (2010) [Hereinafter referred to as Prum & Del Percio 2].

148. *Id.*

149. *See* BRITELL, *supra* note 20, § 10.08. Because of this contractual relationship, an owner can not normally hold a surety accountable for issues relating to a contractor's failure to meet the terms with the green building requirements even though the project may incur the loss of tax credits, fines, penalties, and other damages. *Id*.

150. *See* BRITELL, *supra* note 20, § 10.08.

151. *Id.* §§ 10.05[3], 10.08.

152. *See generally* NASBP & SFAA, *supra* note 144.

B. FROM A SURETY'S PERSPECTIVE

As discussed earlier, a surety does not expect to take a loss on a construction project because it does not consider itself an insurer.[153] Nonetheless, many issues outside those normally attributed to a construction project occur with a green building. As a result, a surety may find itself in a position where an owner maintains a claim due to the added exposures created in a green building project.

1. Disputes over Green Designs/Methods

When considering some of the unique aspects associated with a green building project, a surety needs to take heed to issues that relate to design and performance. In most construction projects, the owner provides plans and specifications to the contractor.[154] The contractor must follow those documents precisely in the construction of the building.[155]

In *United States v. Spearin*,[156] the court decided: "[I]f the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications."[157] This means that design specifications provide instructions on how to perform the work and what materials to provide; while performance specifications create only a standard, leaving the methods of attaining the requirement to the contractor.

Consequently, the *Spearin* doctrine applies to design specifications but does not include performance specifications,[158] which provides a crucial difference to the surety evaluating a green building project. For instance, if the contractor uses the products specified by the owner and these products fail to satisfy a third party's certification requirements, the contractor bears no responsibility.

By contrast, if the owner establishes a performance specification that directs the contractor to select materials and building systems that satisfy a particular third party certification requirement, then the contractor may choose the appropriate products to meet this objective. Should the product chosen by the contractor fail to satisfy the third party certification requirement, the contractor maintains responsibility for rectifying the issue. As the guarantor of the underlying construction contract, the surety faces the possibility that this issue now becomes its own should the owner declare the

153. *See supra* Part II(A)(1).
154. *See* SWEET AND SCHNEIER, *supra* note 11, § 19.01.
155. *Id.*
156. United States v. Spearin, 248 U.S. 132 (1918).
157. *Spearin*, 248 U.S. at 136.
158. *Id.*

contractor in default.

Therefore, a surety's risk increases under the underlying construction contract when it fails to spell out an owner's expectations and specifications, especially when it relates to meeting green building design and performance requirements.

2. Default for Reasons Unrelated to Green Problems

Outside of the green building issues, a surety maintains other risks by guaranteeing the underlying construction contract. One issue that continually persists in the construction setting focuses on the contractor's ability to perform. This may emanate from technical capabilities or even financial resources. As the guarantor of the contractor's work, a surety must evaluate the principal's ability to perform the underlying construction contract prior to participating in the performance bond. Should an owner declare default, the surety might need to supply adequate replacements as one of its options.

On the financial front, a contractor may need payments from the surety or owner to advance the project.[159] As discussed previously, the contractor may approach the surety to provide financial assistance;[160] but this action also comes with the risk that the owner may file a lawsuit for a torts claim of wrongful interference with a contract.[161]

On the other hand, a contractor may request that the owner advance payment for future work.[162] In exchange for keeping the project moving toward completion, an owner may acquiesce to this request without discharging the surety's obligations.[163] Faced with this situation, a surety will oppose this action because the disbursement of contract funds will reduce the remaining balance available for its use should a declaration of default occur, which increases the project's risk.[164]

However, two courts allowed the owner's payments to the contractor provided that the surety's liability on the performance bond was reduced by applying the funds towards the project's construction.[165] These courts seem to allow an owner reasonable freedom for these types of situations, so that the threat of losing the protections under the bond does not occur.[166]

159. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(c).
160. *See supra* section II(A)(2).
161. *See supra* section II(B)(3).
162. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(c).
163. *Id.*
164. *Id.*
165. *See* U.S. Fid. & Guar. Co. v. Braspetro Oil Serv., Co., 369 F.3d 34, 61-66 (2nd Cir. 2004); John T. Callahan & Sons, Inc. v. Dykeman Electric Co., Inc., 266 F.Supp.2d 208, 238 (D.Mass. 2003).
166. *See U.S. Fid. & Guar. Co.*, 369 F.3d at 61–66; *John T. Callahan & Sons, Inc.,* 266 F.Supp.2d at 239.

Accordingly, the surety takes on the risk of a contractor default from both a financial and performance level, meaning it must complete its due diligence to avoid the potential situation where it suffers a loss.

Therefore, both the green building and traditional construction projects present potential pitfalls for both the owner and surety and require that they allocate the corresponding risks and responsibilities so that all participants recognize their liabilities.

IV. EVALUATION OF CONTRACT AND SURETY LANGUAGE

Given the important role surety contracts play in construction projects, several different organizations offer their own forms and language to assist all of the parties involved. By offering a complete set of form documents, the standard construction contracts provide universal language that does not tie the documents to the laws of any particular state, permitting them to be used virtually anywhere. This allows the parties involved in a construction project to use the form documents collectively to assemble a cohesive series of contracts. As such, the form construction contract is written to work cooperatively with the other agreements so as to minimize gaps, overlaps, and conflicts between documents on a project.

Depending on the language used in the document, varying degrees of treatment for a green building project may occur, which have the potential to create unintended results. With these approaches in mind, each participant needs to understand the perspective of the drafter in crafting the performance bond's language as well as any ramifications it may cause to the parties should a claim arise at a later date.

Since this article mainly focuses on the type of guarantee an owner will receive from a surety on a green building project, we will evaluate the form documents from the AIA, the EJCDC, and ConsensusDocs that create the relationship as well as the SFAA and NASBP's response to green building risk.

A. AIA A312-2010 AND EJCDC C-610 (2010) PERFORMANCE BOND

Generally, an analysis of the documents from the AIA and EJCDC would occur separately, but the most current forms relating to performance bonds from these two organizations provide identical language.[167] While each of these two organizations independently

167. AM. INST. OF ARCHITECTS, FORM A312-2010, PERFORMANCE BOND (2010) [hereinafter FORM A312-2010]; ENG'RS JOINT CONTRACTS DOCS. COMM. C-610, PERFORMANCE BOND (2010) [hereinafter CONTRACT C-610]. Interestingly, the AIA changes made in 2010 became the first updates to the language since 1984. *See generally* SWEET AND SCHNEIER, *supra* note 11, § 32.01.

decide on the content of their forms and when to update them, the decision to use the same language appears to be a desire to shape the industry standard for such documents due to their size and influence. Accordingly, examining the applicable provisions will require evaluating both organizations' forms together.

These two organizations contain sixteen independent sections that make up performance bond forms, with the last section allowing the parties to include any modifications they desire to incorporate into the document.[168] The first section follows the Restatement (Third) of Torts by creating a joint and several liability situation where the contractor and surety owe a dual duty towards the project's owner.[169] This section's language makes the surety's obligation the same as the contractor while also providing both parties the same defenses in the event an owner makes a claim.[170]

In Section 2 of the Restatement, the language clarifies when the surety's responsibility begins.[171] The section uses conditional terminology to terminate the surety's obligations from performance "[i]f the Contractor performs the Construction Contract."[172] However, it leaves open an exception for situations where the owner needs to hold a conference to declare default.[173]

While this language places a heavy emphasis on the contractor's performance of the Construction Contract, it also creates a huge ambiguity that will undoubtedly require a determination at a later time should a dispute occur. This dispute will most likely focus on the level of performance by the contractor based upon the underlying construction agreement. Depending on the particular factual scenario, a court may need to evaluate whether the contractor "perform[ed] the Construction Contract."

Should the obligee need to initiate the surety's obligations under the contract, Section 3 provides the requirements on how to compel performance.[174] The language specifically calls for the obligee to begin the action by holding a conference with the surety and the owner to discuss the contractor's performance.[175] This particular language

168. FORM A312-2010, *supra* note 167; CONTRACT C-610, *supra* note 167.

169. *Compare* FORM A312-2010, *supra* note 167, § 1, *and* CONTRACT C-610, *supra* note 167, § 1, *with* RESTATEMENT (THIRD) OF SUR. & GUAR. § 39 cmt. 1 (1996).

170. FORM A312-2010, *supra* note 167, § 1; CONTRACT C-610, *supra* note 167, § 1. Section 1 in both documents states, "The Contractor and Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for the performance of the Construction Contract, which is incorporated herein by reference." FORM A312-2010, *supra*; CONTRACT C-610, *supra*.

171. FORM A312-2010, *supra* note 167, § 2; CONTRACT C-610, *supra* note 167, § 2.

172. *Id.*

173. *Id.*

174. FORM A312-2010, *supra* note 167, § 3; CONTRACT C-610, *supra* note 167, § 3.

175. FORM A312-2010, *supra* note 167, § 3.1; CONTRACT C-610, *supra* note 167, § 3.1.

reduces the obligee's leverage over the surety because it disallows the declaration of a default for minor deficiencies as well as requires a conference when the consideration of such an action occurs.[176] Furthermore, this provision allows all of the parties the ability to mutually approve additional time for the contractor to perform its duties without harming the obligee's rights.[177]

However, when reading the provisions of section 3.1 along with Section 4 of the document, an obligee's inability to hold a conference will "not constitute a failure to comply with a condition precedent to the Surety's obligations, or release the Surety from its obligations, except to the extent the Surety demonstrates actual prejudice."[178] By including this additional language, the conference ultimately becomes optional because a surety cannot assert the lack of one as a defense to performance. This makes the conference an effective tool where it will aid in gaining performance from a contractor but will not create an obstacle to declaring default when time is of the essence.

Should a contractor fail to resolve any material issues with the project, then the obligee needs to declare the contractor in default, terminate the agreement for construction services, and notify the surety of these actions in order to proceed further under Section 3.2.[179] The insertion of these requirements creates the previously discussed defining act whereby the obligee takes the affirmative step that delineates a problematic project from one that obligates a surety under the bonding instrument.[180] Likewise, the obligee must then disburse the unpaid portion of the agreement for construction services to the surety or its designee.[181] As such, this creates a situation where the obligee voluntarily cedes control of the performance aspects of the project to the surety.[182]

Once an obligee declares default, Section 5 allows the surety to take one of four courses of action in order to satisfy its obligations.[183]

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176. FORM A312-2010, *supra* note 167, § 3.1; CONTRACT C-610, *supra* note 167, § 3.1.

177. *Id.*

178. FORM A312-2010, *supra* note 167, § 3.1, 4; CONTRACT C-610, *supra* note 167, § 3.1, 4.

179. FORM A312-2010, *supra* note 167, § 3.2; CONTRACT C-610, *supra* note 167, § 3.2. The insertion of this language appears as a response to the requirement articulated by the *L & A Contracting Co.* case discussed earlier. *See supra* Part II(B)(3).

180. *See supra* Part II(b)(iii); SWEET AND SCHNEIER, *supra* note 11, § 32.10(D).

181. FORM A312-2010, *supra* note 167, § 3.3; CONTRACT C-610, *supra* note 167, § 3.3; *See supra* Part II(B)(3).

182. *See supra* Part II(B)(3).

183. FORM A312-2010, *supra* note 167, § 5; CONTRACT C-610, *supra* note 167, § 5. One difference between the private sector and federal government occurs in this area. *Compare* FORM A312-2010, *supra* note 167, § 5, *and* CONTRACT C-610, *supra* note 167, § 5, *with* 48 CFR § 49.404 (2012). While the AIA and EJCDC allow the surety to make the decision on how to proceed, the federal government retains these rights under bond's issued pursuant to its projects. 48 CFR § 49.404 (2012).

The surety may:

1. Arrange for the original contractor to complete the contract, so long as the obligee agrees;[184]
2. Complete the project itself by hiring its own contractors;[185]
3. Obtain bids or negotiated proposals from qualified contractors that the obligee deems acceptable as well as arrange for their performance while providing new performance and payment bonds;[186] or
4. Waive its right to perform or complete the project by either paying the obligee its costs for completion after an investigation, or deny liability in whole or in part with written justifications for the decision.[187]

Furthermore, and as previously discussed,[188] the surety also maintains the option to repurchase the bond by paying the contract balance or the appropriate prorated amount from the obligee.

While the appropriate course of action may take time to decide, a surety must act relatively quickly under Section 6 of the form.[189] Upon receipt of written notice from the obligee to perform, the surety must select a direction with "reasonable promptness" that does not exceed seven days.[190] After that time, the obligee may automatically deem the surety in default of its obligations and pursue legal remedies.[191] The form provides that any proceeding under the performance bond be initiated in court upon the earlier of two years from (1) the contractor's default, (2) the contractor's cessation of work, or (3) the surety's refusal or failure to perform its obligations under the performance bond.[192] Moreover and in conjunction with Section 7, the form also memorializes the previously discussed principle that an obligee may not demand a higher level of performance from the surety than expected from the contractor.[193]

With these provisions in mind, the AIA and EJCDC forms do not appear to distinguish between standard construction practices and those associated with a green building.[194] The language of the

184. FORM A312-2010, *supra* note 167, § 5.1; CONTRACT C-610, *supra* note 167, § 5.1.
185. FORM A312-2010, *supra* note 167, § 5.2; CONTRACT C-610, *supra* note 167, § 5.2.
186. FORM A312-2010, *supra* note 167, § 5.3; CONTRACT C-610, *supra* note 167, § 5.3.
187. A FORM A312-2010, *supra* note 167, § 5.4; CONTRACT C-610, *supra* note 167, § 5.4.
188. *See supra* Part II(A)(2).
189. FORM A312-2010, *supra* note 167, § 6; CONTRACT C-610, *supra* note 167, § 6.
190. *Id.*
191. *Id.*
192. FORM A312-2010, *supra* note 167, § 9; CONTRACT C-610, *supra* note 167, § 9.
193. *See supra* Part II(A)(2).
194. Of course this could change if the parties decide to take advantage of section sixteen's open ended provision that allows the bond's parties to create exclusions such as the one proposed by the SFAA and NASBP, which is part of a discussion in section IV(e) AM. INST. OF ARCHITECTS, FORM A312-2010, PERFORMANCE BOND § 16 (2010); ENG'RS JOINT CONTRACTS DOCS. COMM. C-610, PERFORMANCE BOND § 16 (2010).

performance bond simply defers to the underlying construction contract and the provisions contained within that agreement for the treatment of any additional risks associated with a given project.[195] The underlying AIA and EJCDC contracts and the referenced general condition documents mainly address damages.[196] The language simply focuses on how to treat the damages, which would apply in those situations where the green building failed to gain certification.[197]

Furthermore, neither set of forms provides specific language or a supplemental document to address the issues associated with sustainable construction; so this untested application leaves open to interpretation whether the underlying AIA and EJCDC forms will compel a surety on a green building project to obtain a specific third party certification. However, the organizations did craft their forms to require a surety to complete the project within the original price and terms of the underlying construction contract. Should the project include a third party certification as one of its criteria for completion and an owner can show that this was communicated to the contractor, then a surety would most likely have an obligation to meet this requirement just like any other benchmark.

Thus, the AIA and EJCDC performance bond form appears to provide a flexible set of documents that could require a surety to obtain a third party certification on a green building should the project's owner take the appropriate steps to ensure that the contractor was notified, expected, and required to meet such a standard.

B. CONSENSUS DOCS FORM 260 – PERFORMANCE BOND

To provide an alternative to the AIA and EJCDC, a consortium of owners, contractors, and trade groups introduced a series of standard form construction documents called ConsensusDOCS in 2007.[198] This

195. AM. INST. OF ARCHITECTS, FORM A312-2010, PERFORMANCE BOND (2010); ENG'RS JOINT CONTRACTS DOCS. COMM. C-610, PERFORMANCE BOND (2010).

196. *See* Prum & Del Percio 2, *supra* note 147, at 125–30.

197. *Id.*

198. Larry D. Harris, Brian M. Perlberg, *Advantages of the ConsensusDocs Construction Contracts*, 29 CONSTR. LAWYER 1 (Winter 2009). ConsensusDOCS are the first industry-wide (collaborative) set of form construction documents presented as an alternative to the AIA and EJCDC contract series of the time. *Id.* The ConsensusDOCS, released by the Associated General Contractors of America in September 2007, represent over three years of work by twenty-three leading industry associations, including, without limitation, associations of architects, owners, contractors and sureties. *Id.* Surety industry participants included the National Association of Surety Bond Producers ("NASBP") and the Surety & Fidelity Association of America ("SFAA"). Other industry participants included the following: Associated General Contractors of America ("AGC"); Construction Owners Association of America ("COAA"); The Construction Users Roundtable ("CURT"); Associated Specialty Contractors, Inc. ("ASC"); Construction Industry Round Table ("CIRT"); American Subcontractors Association, Inc. ("ASA"); Associated Builders

new option in standard form construction documents is different in substantive ways from the offerings of other organizations like the AIA and EJCDC; so they provide a real alternative choice in contract terms.[199] With this in mind, the ConsensusDOCS Form 260 Performance Bond supplies another option to the participants on a construction project.[200]

Taking a more minimalist approach, the ConsensusDOCS form contains only three independent provisions in the agreement: General Conditions, Surety Obligations, and Dispute Resolution.[201] Departing from the Restatement (Third) of Torts guidance to create a joint and several liability situation where the surety and contractor owe a duty to the obligee,[202] Section 1 simply establishes a conditional relationship amongst the parties without an attribution of liability between the surety and contractor.[203] The language removes the surety's duty to act when the contractor completes the underlying construction agreement.[204] Until such time when complete satisfaction with the underlying construction contract occurs, the surety's commitment will continue.[205]

While the absence of the "jointly and severally liable" language strongly reduces the risk associated with issuing a performance bond for a surety, it severely limits an obligee's ability to recoup damages. This language allows an obligee to legally pursue both the contractor and the surety equally when a default occurs on the underlying construction contract.[206] Under the ConsensusDOCS language, an obligee may lose the option of pursuing both the contractor and surety for the default of the underlying construction contract, which means an owner might incur unrecoverable damages.[207]

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and Contractors ("ABC"); National Association of State Facilities Administrator ("NASFA"); Lean Construction Institute ("LCI"); Finishing Contractors Association ("FCA"); Mechanical Contractors Association of America ("MCAA"); National Electrical Contractors Association ("NECA"); National Insulation Association ("NIA"); National Roofing Contractors Association ("NRA"); Painting and Decorating Contractors of America ("PDA"); Plumbing Heating Cooling Contractors Association ("PCC"); National Subcontractors Alliance ("NA"); Sheet Metal and Air Conditioning Contractors' National Association ("SMANA"); and Association of the Wall and Ceiling Industry ("AWI"). *Id.*

199. *See generally id.*

200. CONSENSUSDOCS, FORM 260, PERFORMANCE BOND (2009).

201. *Id.*

202. RESTATEMENT (THIRD) OF SUR. & GUAR. § 39, cmt. 1 (1996).

203. CONSENSUSDOCS, FORM 260, PERFORMANCE BOND § 1 (2009).

204. *Id.*

205. *Id.*

206. RESTATEMENT (THIRD) OF TORTS: EFFECT OF JOINT AND SEVERAL LIABILITY § 10 (2012).

207. This situation would occur in the highly probable circumstance where the contractor declares bankruptcy and the surety steps in to finish the underlying construction contract. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(F). An owner would receive the completed building from the surety but would have no ability to redress any damages suffered because of the problems caused by the original contractor. *Id.*

Turning to a contractor default situation, the form also prohibits the obligee from calling upon the surety until it has satisfied its duties contained in the underlying construction contract.[208] By using this language, the form indirectly incorporates the applicable provisions for claims and damages found in the underlying construction contract.[209]

While waiving the right for notice with regard to alterations or extensions of time, the form also requires an obligee to "make the Contract Balance available to the Surety for completion of the Work" when declaring a default situation.[210] This language requires the obligee to make payments as directed by the surety, but it does not compel an immediate tender of the remaining balance for the underlying construction contract.[211]

By taking this approach, the obligee remains in control of the project's finances instead of the surety. An obligee would not need to take early draws on the construction loan or secure immediate financing to complete the project in order to immediately pay the surety. However, the surety assumes the same risk as the contractor with respect to receiving payments from the owner; since the obligee need not provide the remainder of the unpaid balance of the underlying construction contract when declaring default. This would probably mean an obligee could continue to withhold retainage and performance related payments as allowed under the primary construction contract until the project completes a final financial closeout.

When the surety's performance becomes necessary, the form requires the obligee to declare the contractor in default pursuant to the underlying construction contract.[212] At that time, the surety must take action without delay by either choosing to complete the remaining obligations contained in the underlying construction contract or by purchasing the remaining value of the performance bond from the obligee.[213]

Should the surety choose to complete the remaining obligations contained in the underlying construction contract, it may either use the existing contractors and subcontractors on the project or select suitable replacements.[214] No matter the choice, the form language

208. *See* SWEET AND SCHNEIER, *supra* note 11.

209. *See generally id*. As noted earlier, the form provides an in depth review of the damages clause(s) associated with the ConsensusDOCS underlying construction contract form. Prum & Del Percio 2, *supra* note 147.

210. SWEET AND SCHNEIER, *supra* note 11, § 32.10(F).

211. *Id.*

212. *Id.* § 2.

213. *Id.*

214. *Id.*

reserves the right for the obligee to provide consent to anyone the surety decides to hire in order to complete its obligations.[215] Alternatively, the bond language also allows the surety to surrender its right to complete the underlying construction contract by compensating the obligee "the amount of its reasonable costs, not to exceed the Bond Sum, to complete the Work less the Contract Balance."[216] Disputes with the surety under the performance bond, can be initiated in any court of competent jurisdiction in the location in which the project is located within two years from default of the contractor or substantial completion of the work, whichever is earlier.[217]

Considering these provisions, the ConsensusDOCS form fails to differentiate between standard construction practices and those related to building green; however, the Green Building Addendum we discuss in the next section of this article addresses those issues for this organization's suite of documents.[218] Since the ConsensusDOCS' approach includes only three sections of language in its performance bond form, many parts of the document yield to the primary construction contract.

In looking at the applicable portions of the underlying construction contract without the use of the Green Building Addendum, the form lacks particular language that tackles the issues linked to sustainable construction. Accordingly, it is unresolved whether the ConsensusDOCS performance bond and underlying construction contract, absent the additional form, will require a surety on a green building project to obtain a specific third party certification. The language employed in the performance bond requires the surety to finish the construction project as per the original price and terms of the underlying agreement.[219] If the project included a third party green building certification as part of its specifications for completion and the owner can demonstrate that the requirement was conveyed to the contractor, it follows that a surety would probably have a duty to attain this obligation with the same commitment as any other provision.

Hence, the ConsensusDOCS performance bond form seems to offer an alternative to the AIA and EJCDC documents where a surety could be forced to deliver a third party certification for a green building if the project owner incorporates that requirement into the underlying construction contract absent the inclusion of the Green Building

215. *See* SWEET AND SCHNEIER, *supra* note 11, § 32.10(F).
216. *Id.* § 2(C).
217. CONSENSUSDOCS, FORM 260, PERFORMANCE BOND § 3 (2009).
218. *See infra* section IV(d).
219. *See* CONSENSUSDOCS, FORM 200, GENERAL CONTRACTING (2007).

Addendum but must also be wary that a limitation occurs with pursuing damages against the bond's guarantor should the contractor be in a position that it cannot pay them.

C. Optional Green Building Addendum

Further augmenting the ConsensusDOCS suite of forms, the Green Building Addendum serves as a supplement to the primary design or construction agreement with rating system neutral language.[220] This document recognizes the roles and responsibilities for project participants that assist in attaining the owner's green building goals in addition to assigning risk for the project.[221]

In its capacity to assign roles and responsibilities, the document requires the participants to make a distinction between procedural and physical "green measures" that the participants anticipate accomplishing during the project in order to comply with the green building objectives identified by the owner in another part of the form.[222] Section 6 identifies both the procedural and physical "green measures" needed to accomplish the project's goals as well as potential design and construction alternatives.[223]

To assign responsibility, the owner must designate a "Green Building Facilitator" ("GBF") to manage and assist the process of complying with the owner's desired green building goals.[224] The form specifically allows for the selection of an architect/engineer, contractor, or other corporate entity (or individual) as the GBF.[225]

As for addressing risk, the Addendum contains an entire section dedicated to this subject.[226] Section 8.2 restricts the liability of the participants in the project to those limitations found in the primary agreement and stipulates that an:

> Owner's loss of income or profit or inability to realize potential reductions in operating, maintenance or other related costs, tax or other similar benefits or credits, marketing opportunities and other similar opportunities or benefits, resulting from a failure to attain

220. CONSENSUSDOCS, FORM 310, GREEN BUILDING ADDENDUM (2009). This document should work in conjunction with the other forms and was not designed as a stand-alone agreement. *Id*. The Addendum allows a project to seek certification under any of the various third party certification systems (i.e., LEED, Green Globes, NAHB-ICC 700, etc.) because the form uses rating system neutral objectives. *Id.* § 3.

221. *Id.* §§ 3, 8 (2009).

222. *Id.* § 6. An owner defines the goals for the Addendum in §3.1 where the project elect to be either "an Elected Green Status" or "benefits to the environment or natural resources, either as part of the construction process or during the life cycle, use or maintenance of the Project." *Id.* § 3.1.

223. *Id.*

224. *Id.* § 4.1

225. *Id.*

226. *Id.* § 8.

> the Elected Green Status or intended benefits to the environment, shall be deemed consequential damages subject to any applicable waiver of consequential damages[227]

in any primary design or construction contract.

Furthermore, this section also addresses the liability for the GBF.[228] Within Section 8.3, the form contains detailed language to release all project participants other than the GBF from being "liable or responsible for the failure of the Elected Green Measures to achieve the Elected Green Status or intended benefits to the environment or natural resources"; yet it also expressly provides that this language "does not relieve any Project Participant from any obligation to perform or provide Elected Green Measures as required by its Governing Contract."[229]

In essence, the Addendum, in conjunction with the primary construction contract, addresses several potential risk concerns for a surety when asked to guarantee a green building construction situation. First, it places the liability associated with attaining a third party certification standard upon the GBF.[230] With this assignment of liability distinctly identified, a surety will have the means to assess risk on the construction project while evaluating and distinguish the principal's ability to perform the underlying contract and its green building obligations.[231]

Additionally, section 8.2 recognizes many of the areas a surety would identify as risky and classifies them as consequential damages.[232] While this document is silent on the definition and distribution of consequential damages, the fact that the Addendum serves as a supplement to the primary design or construction contract, which leaves its interpretation reliant upon the other agreement.[233]

Depending on the language contained in the primary design or construction contract, the treatment of consequential damages will vary greatly.[234] Should the parties use ConsensusDOCS' General Contracting documents and choose not to alter the applicable provisions,[235] the clause will create an absolute and mutual surrender

227. CONSENSUSDOCS, FORM 310, GREEN BUILDING ADDENDUM §8.2 (2009).

228. *Id.* § 8.2.

229. *Id.*

230. *Id.*

231. *See* NASBP & SFAA, *supra* note 144.

232. CONSENSUSDOCS, FORM 310, GREEN BUILDING ADDENDUM § 8.2 (2009).

233. *See generally id.*

234. *See* Prum & Del Percio 2, *supra* note 147. The referenced article provides a more in depth discussion on consequential damage and limitation of liability language used by the AIA, EJCDC, and ConsensusDOCS. Each organization maintains its own nuances and approaches to dealing with this issue.

235. CONSENSUSDOCS, FORM 200, GENERAL CONTRACTING §6.5 (2007).

of the consequential damages claims.[236] From a surety's point of view, this combination will greatly reduce or eliminate the additional risk associated with a green building project.[237]

Accordingly, the Green Building Addendum supplied by ConsensusDOCS offers mixed results that depend on the language used in the primary construction contract. As a surety, the possibility of an unexpected claim on a green building project gets reduced partially by placing the liability for attaining a third party certification directly on the GBF and then the Green Building Addendum sets up another layer of risk for reduction by identifying and treating certain situations as consequential damages. This approach ensures that the surety only guarantees the building and not the requirements to meet a certain standard.

In contrast, the owner receives no assurance the project will attain a green building standard other than from the GBF, which may not have as many financial resources as the contractor or surety. In addition, the owner also allows many situations where an injury could occur due to the building failing to attain its green building standard to receive treatment as consequential damages. This leaves the primary construction contract as the last line of defense to recoup any of the possible losses should events turn bad and only receive a guarantee for a building from the surety's performance bond.

Thus, the Green Building Addendum in conjunction with the primary construction contract appears to strongly favor the surety to guarantee delivery of a structure to the detriment of the owner seeking to receive a green building.

D. SFAA AND NASBP GREEN BUILDING APPROACHES TO RISK

In reaction to the Washington, D.C., legislation and the possible situation where a surety becomes the compliance mechanism for an environmentally friendly government policy elsewhere, the SFAA and NASBP responded to these developments by jointly evaluating the permanency and growth of the green building practices as well as identifying the additional risks associated with providing a financial guarantee under such circumstances, while they put forward their own proposals for managing the perils related to those projects.[238] Based on their evaluation, the two organizations advanced the two alternatives of either inserting exclusionary language into the performance bond or for the surety to take a risk management approach.[239]

236. *See* Prum & Del Percio 2, *supra* note 147 at 131.
237. *See* NASBP & SFAA, *supra* note 144.
238. *See* NASBP & SFAA, *supra* note 144, at 1–4.
239. *Id.* at 3–4.

Following a more conservative approach, the SFAA and NASBP offer exclusionary language for those sureties that seek to avoid writing a performance bond that excludes the risk linked to a green building and limit its liability only to the contractor's construction obligations.[240] As such, the two organizations offer the following language for insertion into a performance bond:

> 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.[241]

In contrast, the SFAA and NASBP also recognize an alternative approach for those sureties wishing to participate in green building projects.[242] They suggest a surety take a more active role of identifying the green building risks by assigning responsibility and managing those aspects of a project that pose an issue.[243] A surety could look to some of the various form documents written to facilitate and provide responsibility with green building construction while trying to manage other exposures through contractual waivers of consequential damages.[244] Ultimately, the surety must assess the green building plans, those parties involved in the project, and determine its risk tolerance before proceeding.[245]

In trying to reconcile these issues, the SFAA and NASBP put forward their own proposals for managing and/or eliminating the risks associated with green building construction for a surety while recognizing the fundamental aspects of these projects provide viable business opportunities.

Consequently, the underlying construction contracts for the AIA, EJCDC, and ConsensusDOCS provide the guidance as to whether the respective performance bonds will require a surety to deliver a green building with a third party certification; but other documents like the Green Building Addendum and language supported by the SFAA and NASBP can change the outcome to require only the structure.

240. *See* NASBP & SFAA, *supra* note 144, at 3–4.
241. *Id.* at 3.
242. *Id.*
243. *Id.*
244. *Id.* Specifically, the SFAA and NASBP mention ConsensusDOCS' Green Building Addendum as a form that will accomplish their stated goals of reducing, eliminating, and managing the risks associated with a green building construction project. *Id.*
245. *Id.*

V. PROPOSAL FOR BETTER RESULTS

To an owner endeavoring to complete a green building, the inherent risk in failing to complete the project creates the need for mechanisms that provide stability like a performance bond.[246] The performance bond attempts to assuage an owner's overall concerns related to delivery and cost by transferring some of the project's risk to a surety.[247] In reality, the owner can only shift so much risk as the surety will accept; an agreement represents a compromise as to what level of transfer is deemed acceptable.

In considering the performance bond coverage, the main issue surrounding green buildings appears to focus on whether the owner maintains a single objective in constructing a green building or seeks two separate objectives. The legislation in Washington, D.C.[248] coupled with the *Shaw Development*[249] lawsuit sparked this debate. The *Shaw Development* case appears to further the notion that an owner contracts for a "green building"[250]; while the Washington, D.C. legislation created two separate bond instruments for construction projects with sustainability components.[251]

With this in mind, this section will address the main issues associated with finding a common middle ground where an owner and surety can both feel comfortable that the performance bond will provide appropriate coverage without undue risk.

A. ISSUES FROM AN OWNER'S PERSPECTIVE

As the party initiating the project, an owner looks to a performance bond as protection against contractor default.[252] In utilizing such an instrument, the owner maintains many objectives that need attention within the performance bond and the underlying construction contract. These include making sure all parties involved in the contract understand the project's objectives and complete the proper due diligence on those performing the work and supplying the

246. *See* SWEET & SCHNEIER, *supra* note 11, § 32.04; Barru, *supra* note 11, at 53.

247. *See* SWEET & SCHNEIER, *supra* note 11, § 32.04; Barru, *supra* note 11, at 52. While we explain that a performance bond provides for the transfer of risk, one commentator explains that these instruments do not qualify under a purist point of view because of the indemnity requirements. 4A BRUNER & O'CONNER, CONSTR. LAW § 7:18 (2012). Our earlier discussion on the subject matter recognizes this unique aspect but also explains that a surety may take a loss in those situations where the contractor declares bankruptcy. *See supra* Part II(a)(i).

248. Washington, D.C., Green Building Act of 2006, D.C. CODE tit. 6, § 6-1451.05 (West 2008).

249. *See* Shaw Dev., LLC v. S. Builders, Inc., No.: 19-C-07-011405, Circuit Court, Somerset Co., Md. (2008).

250. *Id.*

251. *See* Washington, D.C., Green Building Act of 2006, D.C. CODE tit. 6, § 6-1451.05.

252. BRUNER & O'CONNER, *supra* note 247, § 12:14.

materials. To this end, we address these issues from the owner's perspective.

1. Alignment of the Project Goals with the Coverage

A prudent owner understands that the principal contract is the primary means for dictating a contractor's obligations for a green building project. Owners can be expected to demand a guarantee for obtaining certification from third party organizations. That request can conflict with the architect and contractor's needs to manage their own risks given that many factors impacting certification credits are not within their sole control. Nondisclosures, mistakes and impossibilities related to the contract can also result in its unenforceability and possibly the voiding of the surety bond.

To remedy this issue, the contract documents should begin by explicitly allocating green building certification responsibilities to the appropriate party. As seen in the resulting lawsuit from the *Shaw Development* case,[253] the contract document forms lacked specificity and clarity, which meant that the contractor was only responsible for building according to the plans and specifications. This led to a lawsuit when the contractor did not deliver a green building and the owner lost the corresponding tax credits.[254] While the case settled out of court, the mere fact that a lawsuit occurred illustrates why a wise owner will clearly describe a contractor's obligations with respect to the construction of a green building project.[255]

In concert with this idea, the ConsensusDOCS Green Building Addendum solves many of these issues but provides marginal relief. The ConsensusDOCS document assigns responsibility to someone to manage and assist in the process of fulfilling the owner's green building goals[256] but does not take into account the practical aspect that many of the green building consultants do not maintain professional liability insurance coverage for their projects. For those that purchase insurance, they usually pay their defense and other costs because of their high deductible policies. This presents the likely scenario where an owner maintains a credible cause of action but can recover very little from a defendant that has the capability of becoming judgment proof while the other participants in the project assert a lack of culpability based on the construction contract's language.

At a minimum, specific contractual terms should address

253. *See* Shaw Dev., LLC v. S. Builders, Inc., No.: 19-C-07-011405, Circuit Court, Somerset Co., Md. (2008).

254. *Id.*

255. *See* Prum & Del Percio 1, *supra* note 7, at 246–47; Prum & Del Percio 2, *supra* note 147, at 143–44.

256. CONSENSUSDOCS, FORM 310, GREEN BUILDING ADDENDUM (2009).

responsibility for registering the project, compiling and maintaining documentation to obtain the program specific credits, applying for certification, responding to the certifying organization's requests for additional information or clarification, and prosecuting the appeal process in the event that the initial request for certification is denied.[257] One simple approach for an owner to maintain leverage would be to adjust the terms of retainage to coincide with the issuance of a third party's green building certification. This should leave an owner with adequate funds to pay for any remedial actions in the physical construction of the building to obtain a third party certification; but it would not alleviate any flaws that emanate from the designers.

In terms of assigning liability, it should include all participants in the project, so that an owner avoids the predicament of receiving a noncompliant building but those responsible can use a defense mechanism that makes them judgment proof. A provision that makes all participants "jointly and severally liable" would solve this issue, but may not offer a practical solution because some participants affect the certification outcome more than others. A common middle ground could include a statement that holds all participants liable and uses a comparative negligence type of standard. This would allow for apportionment from those participants in the project based on respective degrees of contribution while yielding a consequence on everyone involved should they not fulfill their obligations of delivering a green building to the owner.

For an owner who views a project singularly, the underlying construction contract should incorporate the green building requirements and aspects into the project in such a manner where it becomes inextricably intertwined with the traditional characteristics while making each participant culpable for the overall outcome.

2. Due Diligence on the Contractor and Its Resources

As mentioned earlier, an issue that may arise in a green building project relates to a contractor's lack of financial resources. Mitigating the risk that a contractor cannot financially afford to complete the project requires performance of due diligence by the owner and, as discussed later, the surety. Due to issues such as growing too fast, or having too many simultaneous projects, variable or unpredictable cash flow, or failure to adequately plan around a budget or to control costs,

257. Ronald S. Cusano, Speech, *When "Green" Turns to "Red" and LEEDs to a Summons and Complaint: Potential Liability on Green Projects*, 2009 FORUM ON THE CONSTRUCTION INDUSTRY (copy of presentation paper on file with the American Bar Association Forum on the Construction Industry).

a contractor may pose a financial risk to the entire green building project.

Financial due diligence by owners should include an assessment of the contractor's backlog growth relative to balance sheet, its history of stable job revenues and profits, disciplined approach to project selection and a matching of resources and expertise with opportunities in order to evaluate whether the contractor's commitment to current, future and prior projects reveals reasonable growth without over-committing itself. Cash flow is another important financial consideration. Rapid backlog growth can place a strain on cash flow as can project start-up costs and financing retainage. Owners and sureties should look for cash flow positive projects in the contractor's portfolio along with strong billing and collection practices, cash reserves to handle unexpected expenses and minimal bank use and/or availability of an adequate bank line of credit.

Additional due diligence into the quality of the contractor includes an evaluation of the business plan and company pro formas, with detailed projections for earnings, balance sheet and cash flow. The contractor should have the ability to (and a history of) consistently meet or exceed projections, with appropriate cost controls, project cost accounting system and the ability to capture cost information "from the field" in real time.

Thus, a prudent owner looking to minimize its issues with constructing a green building needs to evaluate each contractor and its resources to find the best fit in all aspects so that it avoids declaring default and dealing with a surety to complete the project.

B. ISSUES FROM A SURETY'S PERSPECTIVE

When evaluating a surety's duties owed an obligee of a performance bond, the requirements will depend on the underlying construction contract. Generally, a surety's duties to an obligee will remain the same as a typical construction project when the effort includes green scopes of work and contract provisions.[258] When a contractor agrees to accomplish specific outcomes or build innovated designs associated with sustainability, the surety's risk becomes proportionately greater than in traditional construction.[259]

To alleviate many of the risks in a performance bond guaranteeing a green building construction contract, a surety needs to complete its due diligence because of the perceived exposures associated with such projects.[260] The surety must take into account the project's design, the

258. *See* BRITELL, *supra* note 20, § 10.08.
259. *Id.*
260. *Id.*

underlying construction contract requirements, and the contractor's experience with constructing and delivering a green building.[261] Upon reviewing these aspects of the project, the surety may decide to proceed or require exclusions in the performance bond.[262]

1. Underlying Construction Contract Due Diligence

It is critical on a green project for contracts to clearly specify, and for sureties to clearly understand, whether the contractor's duties are driven by design specifications or performance specifications. A likely scenario occurs when the contractor receives a detailed set of plans and specifications to follow, but the documents also require the contractor to accept responsibility for achieving a certain level of certification from a third party organization. This constitutes a mixing of design and performance specifications. Without clear language in the contract, a contractor may unwittingly accept responsibility for the design of the project and any resulting failure to achieve the third party organization's certification. To the extent practicable, the surety should require performance specifications to include design specifications so as to achieve a level of clarity in the contract that places the responsibility for specificity on the owner.

The surety should also be wary of a contractor guaranteeing a specific type of certification.[263] A contractor should generally not guarantee any outcome over which the contractor does not have control. Specifically, many third party certification credits are design credits, and the contractor typically has little to no control over design. Understandably, many owners will want to spread or shift the risk for third party certification to the contractor, at least to some degree. It is optimal from a risk management standpoint to avoid guarantees, but such avoidance is also infeasible. A precise contract can well define the guarantee and thereby mitigate the surety's risk.[264]

2. Contract Performance Due Diligence

Aside from a surety guaranteeing an underlying construction contract that puts it at risk to deliver a third party certification, the default of the principal or contractor with green building requirements

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261. *See* BRITELL, *supra* note 20, § 10.08.
262. *Id.*
263. While the merits of this type of claim are debatable, a lawsuit may occur whereby the contractor or surety becomes liable to an owner under a Uniform Commercial Code Warranty Theory. *See* Prum & Del Percio 1, *supra* note 7, at 251.
264. U.S. GREEN BLDG. COUNCIL, THE LEGAL RISK IN "BUILDING GREEN": NEW WINE IN OLD BOTTLES? A USGBC PANEL DISCUSSION 5, *available at* http://www.seyfarth.com/dir_docs/publications/AttorneyPubs/White%20Paper_DBlake.pdf.

poses issues as well.[265] A surety needs to evaluate the tasks assigned in the underlying construction contract to determine the principal's abilities to perform and whether any suitable replacements exist should a declaration of default occur.[266]

In a given green building project, the contractor may contribute special sustainability expertise or maintain responsibility for supplying hard to find green materials or fabrications.[267] Should the obligee declare this contractor in default, a surety's endeavor to find a suitable replacement may turn very problematical and expensive.[268] In light of this issue, one commentator points out the need for a surety to complete its due diligence with respect to the contractor's obligations on the underlying construction contract and reach a point of satisfaction that the work will be completed without a problem or that suitable replacements exist.[269]

Therefore, a surety that wishes to provide its services must complete its due diligence while evaluating the risks associated with the project's design, the underlying construction contract requirements, and the contractor's experience with constructing and delivering a green building so that the likelihood of an owner declaring default is minimized and an unexpected performance surprise does not occur.

C. A BALANCED PROPOSAL

Given these unique perspectives on a green building project, a middle ground appears within reach. It appears as if two main issues dominate the participants in a green building project with respect to a performance bond and the proper level of coverage. The first issue focuses on whether the surety guarantees delivery of a green building based on the underlying construction contract. Second, the surety needs to determine whether to exclude some of the principal's activities from its performance bond guarantee.

In seeking a middle ground to the first issue, the ConsensusDOCS Green Building Addendum provides a good approach by centralizing responsibility on a GBF to coordinate the green building activities. This will help ensure compliance throughout the whole process and give the project the best chance to attain the owner's green building objectives. However, it appears misguided to place all of the liability on the GBF,[270] since all project participants have a hand in

265. *See* BRITELL, *supra* note 20, § 10.05[3].
266. *Id.*
267. *Id.*
268. *Id.*
269. *Id.*
270. Beyond choosing a scapegoat, this approach runs counter to the guiding principles

accomplishing the owner's green building objectives and the judgment- proof defendant looms large.

We suggest that the underlying construction contract and accompanying documentation utilize a comparative negligence approach by apportioning liability amongst the participants to ensure that an owner receives the expected third party certification. This way each party maintains a stake in meeting the owner's green building objectives and not one party gets singled out for the entire liability. Even an owner could participate by waiving its right to a portion of its claims should the project transform during construction due to an excessive amount of change orders. Moreover, a surety could review the documents to assess the level of risk for its principal and charge a premium for its exposure in the event of a default.

Another option available to the contractor and surety in response to a guarantee situation is to demand a narrowly drawn liquidated damages provision "pertaining only to contractor-related credits" in an effort to equitably shift some of the risk back to the owner. A liquidated amount per construction credit that the contractor fails to obtain will protect the owner's interests without unduly burdening the contractor. Furthermore, and to protect against the mutual waiver situation, an owner could expressly define liquidated damages as any recoverable damages under the contract on a green project because the extent to which consequential damages might be awarded is inherently difficult under today's undetermined case law.[271]

In response to the second issue and aside from performing the necessary due diligence, the owner and surety could jointly determine a succession plan for the contractor instead of using the harsh approach of excluding the green building activities. This succession plan could include a strategy for continued operations after retirement, disability or death, or loss due to termination, of management and key employees. Key employees should be identified, and incentives should be in place for their retention. A buy-sell agreement that can be triggered in the event of owner retirement, disability or death, with and necessary life insurance in place to fund the agreement should be in place as well.

Accordingly, all participants in a green building endeavor need to work together during all aspects of the project to distribute the appropriate levels of risk that allows all those involved to understand their obligations while providing a predictable outcome, should a dispute arise at a later point in time.

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associated with a green building where the project becomes a collaborative approach. *See* Prum VELJ, *supra* note 143, at 5–6.

271. *See* Prum & Del Percio 2, *supra* note 147, at 113. This is especially important in the presence of a mutual waiver of consequential damages. *Id*.

VI. CONCLUSION

Green construction projects, though subject to the same or similar risks as those inherent to conventional construction projects, differ in substantive ways.[272] The owner's expectations may be more singular in a green building project than would otherwise occur due to either the need to meet eligibility criteria for tax credits or other financial incentives or the intrinsic desire to meet a self-imposed standard of outcomes.[273] This means that disputes with architects and/or contractors over green building projects may be more likely than with traditional projects.[274]

In light of these issues, the overriding method to ensure that an owner receives a green building certified by a third party organization requires the inclusion of the applicable standards into a performance specification. With this requirement in place, the language used in the performance bond and standard forms supplied by the AIA, EJCDC, and ConsensusDOCS will most likely comply with an owner's sustainability objectives. However, should an owner allow the use of ConsensusDOCS' Green Building Addendum or the additional language supplied by the SFAA and NASBP, the obligation now changes to the delivery of only a building by the surety.

Consequently, all participants engaging in constructing a green building must review their underlying and supplemental construction documents and agreements with counsel to determine the proper outcome and level of comfort with the given risks for a particular project.

272. *See* Prum & Del Percio 1, *supra* note 7, at 104.
273. *Id.*
274. *Id.*