The Destiny USA Debacle

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When I first described the Destiny USA Debacle to a group of engineers, one of the audience members commented that it was like a 60 Minutes story. Rarely do attorneys get to describe a factual scenario that is both interesting and illustrative of an important legal point. The Destiny USA Debacle is the story of green promises that could not be delivered. Ultimately, though the Destiny USA Debacle is also a warning for the green building industry about the liability that could develop from these types of projects.

The entire story of the Destiny USA Debacle centers around a ballyhooed Green Bonds program created in 2004. The developer of the Destiny USA project qualified for $238 million in Green Bonds investment in 2007. In exchange, the developer promised to obtain LEED certification and install massive renewable energy systems. Four years later, the project is nearing completion but the project has not attained LEED certification or installed the renewable energy systems.

The IRS is faced with a difficult question -- did the Destiny USA project comply with the Green Bonds requirements? If the IRS rules that the requirements were not met, then the project could be penalized millions, the tax-exempt status of the bonds could be stripped, and widespread litigation will likely ensue. If the IRS rules that the requirements were met, then the developer and investors will retain the tax benefits but the public will reportedly not receive the benefit of the promised green building and renewable energy systems.

As you read, think about the potential liabilities the design professionals, contractors, and engineers might face from the Destiny USA project.

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What is Destiny USA?

It is difficult to describe the Destiny USA project because the sheer scope of it boggles the mind. In 2005, the New York Times described the project as follows:

"Robert Congel, a commercial real-estate developer who lives in upstate New York, has a plan to 'change the world.' Convinced that it will 'produce more benefit for humanity than any one thing that private enterprise has ever done,' he is raising $20 billion to make it happen. That's 12 times the yearly budget of the United Nations and more than 25 times Congel's own net worth. What Congel has in mind is an outsize and extremely unusual mega-mall. Destiny U.S.A., the retail-and-entertainment complex he is building in upstate New York, aspires to be not only the biggest man-made structure on the planet but also the most environmentally friendly. Equal parts Disney World, Las Vegas, Bell Laboratories and Mall of America -- with a splash of Walden Pond -- the 'retail city' will include the usual shops and restaurants as well as an extensive research facility for testing advanced technologies and a 200-acre recreational biosphere complete with springlike temperatures and an artificial river for kayaking."[i]

What Are Green Bonds?

In order to get the Destiny USA project off the ground, the developer turned to the United States Government for financial assistance.

In 2004, the United States Congress passed the American Jobs Creation Act of 2004, which is essentially a huge tax bill.[ii] Section 701 of the legislation included a seemingly innocuous provision titled the "Brownfields Demonstration Program for Qualified Green Building and Sustainable Design Projects."

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According to Investopedia, this Section led to the United States Treasury issuing $2 billion in Green Bonds to support green building construction:

"Green bonds in the United States got a major boost from an amendment to the America Jobs Creation Act of 2004. The amendment is officially titled the Brownfields Demonstration Program for Qualified Green Building and Sustainable Design Projects, but for those who prefer to have a little oxygen left at the end of their sentences, this has been shortened to 'Green Bonds'. It was designed to provide funding - in the form of $2 billion worth of AAA-rated bonds issued by the United States Treasury - to finance environmentally friendly development. The objective is to reclaim contaminated industrial and commercial land (brown fields), and encourage energy conservation and the use of renewable energy sources."[iii]

The Destiny USA project was approved for the Green Bonds program. In late February 2007, the Syracuse Industrial Development Agency ("Agency") issued $238 million in Green Bonds. Private investors purchased these bonds and received two benefits: interest paid over the lifetime of the bonds, and tax-free status on the interest paid. Because of the tax-free status, investors accepted lower interest rates. The proceeds from the sale of these tax-free bonds were then provided by the Agency to the developer of the Destiny USA in the form of a tax-free loan. The developer estimated that Green Bonds investment saved the project $120 million.

While not an explicit entity, the taxpayer also plays an important role in the Green Bonds. By waiving the normal tax obligations, the taxpayer is essentially investing in the developer's project. In exchange, the taxpayer is supposed to receive a public benefit in the form of a green building development on a brownfield site. Who represents the taxpayer in this scenario? The word "tax" should have tipped you off -- the Internal Revenue Service (IRS). They are probably the most important party in the entire Destiny USA dispute.

Why the IRS is the Key Player in Green Bonds

As part of the Green Bonds legislation, the IRS was tasked with ensuring that the federal taxpayer received its end of the bargain: a green building project. In response, the IRS issued Internal Revenue Bulletin 2005-27 to provide “guidance on the requirements a project must meet in order to be eligible for designation as a qualified green building and sustainable design project.”

In order to receive $238 million in Green Bonds financing, the Destiny USA developer had to meet three primary requirements:

1. The applicant had to “demonstrate, and provide written assurances” that the project would receive LEED certification.

2. The project had to include “a brownfield site as defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.”

3. The project had to meet a number of “goals for conservation and technology innovation.”

The conservation and technology goals relate to the following four items:

- the “amount of electric consumption (in megawatt hours) reduced by the project,”
- the “amount of sulfur dioxide daily emissions reduced by the project as compared to coal generation,”
- the “amount of the gross installed capacity of the project’s solar photovoltaic capacity measured in megawatts,” and

- the amount, “in megawatts, of the project’s fuel cell energy generation capacity, which includes the fuel cells’ generation of thermal and electrical energy used by the project.”

In 2004, when this regulation was written, LEED certification was more difficult to obtain. The cost to obtain LEED certification was much higher. Generally, the certification process was a greater unknown and the regulatory language tied to LEED reflected these uncertainties. In order to qualify for Green Bonds, developers had to promise that they “reasonably expected” to achieve LEED certification:

“At least 75 percent of the square footage of commercial buildings that are part of the project is registered for United States Green Building Council’s LEED certification and is reasonably expected by the applicant (at the time of the designation) to receive such certification, based on all the facts and circumstances, including statements of the United States Green Building Council, opinions of independent experts in green building and sustainable design, and relevant experience of the project developer.”

To support statements of expectations, developers were required to submit LEED Letter Templates, documentation demonstrating the design and construction of a LEED-certified building, and information regarding LEED Accredited Professionals working on the project.

What is the penalty for not satisfying the green building and renewable energy requirements?

According to the IRS Bulletin, the bond issuer was to maintain a reserve account equal to one percent of the net proceeds, which would be forfeited if the project failed to comply with the Green Bonds program’s requirements. For the Destiny USA project, the bonds totaled $238 million, so the IRS required that a reserve account contain $2.38 million plus interest. If the IRS were to determine that the Destiny USA project failed to comply with the Green Bonds requirements, then "amounts in the reserve account, including all interest, will be paid to the United States Treasury."

The IRS Bulletin also requires the bond issuer submit reports to the IRS on the qualifying projects 48 months after Green Bonds are issued. The reports must specify whether the project has complied or will comply with the Green Bonds requirements.

Since the Green Bonds were issued for the Destiny USA project in late February 2007, the bonds issuer -- the Syracuse Industrial Development Agency -- had to submit its report by the end of February 2011. Presumably, the report was submitted and the IRS now has one year to decide if compliance occurred.

The IRS is not messing around when it comes to these reports as the Bonds issuer must include the following certification language in the report:

"Under penalties of perjury, I declare that I have examined this document and, to the best of my knowledge and belief, the document contains all the relevant facts relating to the document, and such facts are true, correct, and complete."

Destined for Trouble

After qualifying for the Green Bonds program, the Destiny USA developer began construction in 2007.[iv] By the summer of 2009, construction was reportedly 90 percent complete.[v]

But problems were also simmering that summer. Citigroup pulled financing for the project, and construction ceased:

"Construction came to a halt in June 2009 when Citigroup stopped advancing money on a $155 million loan. The bank said it was concerned about cost overruns, construction delays and a lack of any signed leases for the expansion after nearly two and a half years of construction. It publicly called the project a failure."[vi]

As reported by Stephen Del Percio at the Green Real Estate Law Journal, litigation ensued as a result of Citibank's decision.[vii] Ultimately, Del Percio explained, a New York appellate court upheld a Onondaga Supreme Court decision that Citigroup had to resume funding of Destiny USA's construction loan because the project involved "unique" and "revolutionary" sustainable features.

And that brings us to the present. As first reported by Rick Moriarty in the Syracuse Post-Dispatch, the Destiny USA project has scrapped many of the green building and renewable energy features that were originally promised to the federal government in exchange for Green Bonds financing:

"There is no 45-megawatt electricity generating plant running on 'biofuel' made from soybean oil and recycled cooking grease. If there were, it would be the largest such plant in the nation and consume more than one-third of the total U.S. biodiesel supply.

Nor are there 290,000 square feet of solar panels on the mall's roofs and other surfaces, enough to blanket six football fields.

The fuel cells that were to make 7 megawatts of electricity, five times more than the nation's largest existing commercial fuel-cell installation? Nowhere to be seen."[viii]

Additionally, the project has also reportedly not received LEED certification.

The project's failure to incorporate green building and renewable energy features puts the Syracuse Industrial Development Agency and the developer in a difficult position. With a looming reporting deadline, the two parties had to decide what to tell the IRS about the project's green promises.

Were Green Promises Enough?

In the aforementioned Post-Dispatch article, Moriarty also disclosed details of a draft letter prepared for the IRS regarding compliance with the Green Bonds regulation. In the letter, the Agency and developer first divulge that many of the green building and renewable energy features that were promised will not be included in the completed project.

The Agency and developer argue that other environmentally-friendly features have been included, like LEED-Gold certification. This last claim is curious since construction is not completed and the U.S. Green Building Council confirmed that the project had not actually received certification.[ix]

The letter then moves to the crux of the compliance argument. The Agency and developer assert that actual installation of renewable energy systems was not required. Instead, the letter claims the developer was only required to make promises related to renewable energy and LEED certification in order to qualify for the bonds. They conclude that the financial benefits of the Green Bonds program and the forfeiture of the Reserve Account do not depend on actual achievement of the green building and renewable energy goals.

Why You Should Take Green Building Liability Seriously

The Destiny USA project is more than just a sordid story. It's a warning to design professionals and contractors that they must take green building liability seriously. The Destiny USA project could result in messy litigation. And due to onerous contract requirements, design professionals and contractors may face penalties if green building certification is not obtained for the Destiny USA project.

The Internal Revenue Service will eventually rule on whether the Destiny USA developer complied with the Green Bonds requirements. How the IRS rules could have substantial financial repercussions for many parties. An adverse ruling could result in the IRS:

- Seizing the Reserve Fund of $2.38 million setup by the Destiny USA developer.
- Revoking the tax-exempt status of the investment received by the Destiny USA developer. The developer estimated the tax-free status amounted to a $120 million savings.
- Revoking the tax-exempt status of the returns received by Green Bonds investors.

It's this last scenario that would result in messy litigation. The investors would likely sue the bond issuer, the Syracuse Industrial Development Agency. The bond issuer presumably has insurance on the bonds. The insurer would then turn around and sue the developer for its losses.

All three of the above scenarios would occur if the IRS were to find that the developer did not satisfy LEED and renewable energy promises. And who do you think the developer might blame for failure to achieve LEED promises? I could envision the developer blaming the design professionals and contractors because the project did not achieve LEED certification.

In addition to messy litigation, the design professionals and contractors may face penalties because the project did not achieve LEED certification. In order to qualify for $238 million in Green Bonds that are now at issue, the Destiny USA developer had to state in its application that it created incentives and penalties for design professionals and contractors to obtain LEED certification:

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“The application must include . . . information on financial incentives and penalties that will be included in the design, construction, engineering and other building contracts and subcontracts to tie a part of the contractors’ and subcontractors’ compensation to their level of success in designing and constructing LEED-certified, sustainably-designed buildings.”

Depending on how the contract was written, the design professionals and contractors may face incentives and penalties because the owner made decisions that negatively impacted the project’s ability to obtain LEED certification.

When negotiating a design or construction contract, it is imperative to negotiate fair terms related to green building certification. Otherwise, you may face stiff penalties because of decisions made by the owner that impeded LEED certification.

About the Author

Chris Cheatham is a construction attorney in Washington, D.C. His professional mission is to prepare remarkable construction claims. Preparing this story was a lot like preparing a construction claims. Much of the Destiny USA Debacle story was based on secondary sources that had to be analyzed, understood and explained, much like a construction claim.

Did You Enjoy This Story?

Then maybe you should consider hiring the author to prepare your next construction claim -- or to address your green building liabilities. Contact Chris today to discuss your issues.

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If you would like to read more about green building legal and regulatory issues, please visit Green Building Law Update (www.greenbuildinglawupdate.com).

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