Journal OF Local Government Law

Published by the Local Government Section of the Virginia State Bar

Vol. XXV, No. 2, Fall 2014

Navigating Disputes and Claims on Construction Projects: The Twists and Turns of the *Carnell Construction* Case

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The body of case law born out of the *Carnell Constr. Corp. v. Danville Redevelopment Hous. Auth.* litigation, which has spanned over six years, offers unique lessons to state and local government agencies involved in the procurement and contract administration of construction projects. The *Carnell* dispute was tried before a federal jury three times, and has been remanded by the Fourth Circuit for a fourth trial. The Fourth Circuit and U.S. District Court for the Western District of Virginia have issued seven legal opinions, many of which resolve issues of first impression, including the unique issue of whether a corporation that is minority-owned can have a racial identity for purposes of filing a race discrimination claim. Lessons learned by reviewing the *Carnell* line of opinions include the protections afforded to public owners by the Virginia Public Procurement Act (VPPA) and their limitations, as well as navigating the minefield of contractual terms in complex construction contracts. The *Carnell* litigation demonstrates the "dos and don'ts" for any public owner navigating issues such as changes, contract forms, claims, declarations of default, terminations, and performance bond claims against the surety.

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Chairman's Message

Summer has all too quickly changed to fall. Soon fall will turn into winter. As a friend once reminded me, "Change is good." Sometimes I am not sure I agree, but there is no doubt change is inevitable. Just when I have mastered the use of my cell phone, there is a new model that makes me embarrassed to pull out my suddenly out-of-date version. As soon as I learn to use our documents management system, there is an "upgrade" with the latest "bells and whistles" that allows me to do almost anything except access my stored documents. The knowledge and skills required in almost every profession demand constant updating to stay relevant and effective. Change may not come as rapidly to the legal profession as it does in fields like medicine and information technology. After all, lawyers are bound by precedent and even cite such venerable authority as the Magna Carta. The structure of our legal system rests on a foundation established by a document that is over 200 years old. Even so, every year brings significant changes in the way we practice law, the challenges we face, and the law itself.

To maintain our effectiveness as lawyers requires that we keep up with changes in the legal landscape and in our rapidly changing world. Keeping current, whether through formal continuing legal education programs, embracing new technology, taking advantage of educational opportunities outside our specific CLE requirements and, yes, even reading the *Journal of Local Government Law*, will enhance our ability to serve our clients and the judicial system which we serve. I offer my sincere thanks to those who have generously shared their time and knowledge by writing articles for the *Journal*.

Bonnie France
Chairman

The many twists and turns of this case present the unique challenges faced by localities when administrating publically-funded construction contracts. There are two main takeaways from what has unfolded and what will continue to unfold in the grueling *Carnell* litigation, which will continue on to trial number four next year. First is the importance of entering into unambiguous contracts that contain harmonious provisions that comply with the statutory requirements of the VPPA. Second is the importance of gaining fluency with the applicable contracts' conditions precedent in order to both properly assert and defend against claims. This article will discuss the legal implications of the following five main topics addressed in the *Carnell* opinions from the public owner's viewpoint: (1) the statutory written notice requirements of the VPPA; (2) the VPPA's statutory cap on change orders; (3) compliance with changes clauses and claims procedures in contracts; (4) termination, default, and properly asserting a claim against the performance bond; and (5) racial discrimination claims. The legal doctrines that will be reviewed here not only cover application of the VPPA to state construction contracts, but also long-standing doctrines for contract interpretation with which every state agent supervising construction projects should be familiar.

Facts and Procedural History

The disputes at issue in this litigation arose from the Blaine Square Hope VI Phase 4 Project (the "Project") to construct 40 single-family and duplex housing units in Danville, Virginia. In April 2008, Carnell Construction Company (Carnell), an African-American owned minority business enterprise, bid to perform the site work for the Project, which was owned by the Danville Redevelopment and Housing Authority (DRHA), a public body formed in 1950 to provide federally subsidized housing and housing assistance to low-income families within the City of Danville, Virginia. *See* DRHA website, available at http://www.drhava.com/about-us.

Carnell was awarded the contract as the lowest responsive bidder and formally executed an agreement with DRHA on May 27, 2008 to perform the Project site work for $793,541 (the "Contract"), with a completion date planned for June 3, 2009. The completion date was later extended by change order to June 4, 2009. After awarding the Contract, DRHA leased the project site and assigned its interest in the Contract to Blaine Square, LLC (Blaine), a limited liability corporation formed as an extension of the DRHA. Blaine was created to obtain and distribute tax credits to private investors. The Housing Authority agreed to provide funds from the Hope VI Program to Blaine and, under a Development Services Agreement (DSA), Blaine agreed that the DRHA would continue to provide actual supervision of the construction, including the site preparation work. *See Carnell Const. Corp. v. Danville Redevelopment & Hous. Auth.*, 745 F.3d 703, 710-11 (4th Cir. 2014).

The applicable, and sometimes conflicting, terms of the agreements at issue in this case are: (1) the base contract for construction between DRHA and Carnell; (2) the EJCDC's Standard General Conditions of the Construction Contract, EJCDC C-700 (2002) (the "EJCDC General Conditions"); (3) HUD's General Conditions for Construction Contracts – Public Housing Programs (2006) (the "HUD General Conditions"); and (4) the AIA A312 Performance Bond issued by the surety, International Fidelity Insurance Company (IFIC), to Carnell (the "Performance Bond"). During the course of the project, the parties' actions ran afoul of the requirements of their contracts in several instances, resulting in the ensuing litigation.

Carnell began its site work in June 2008. Later that year, in December 2008, disputes arose over Carnell's costs. The following month, in January 2009, DRHA informed Carnell and its surety, IFIC, that Carnell was behind schedule and that the site work was not graded to the elevations shown in revised site plans, which DRHA had failed to provide to Carnell. Carnell believed it was entitled to additional compensation to grade the site to revised elevations. Although the parties agreed to submit their disputes to mediation in April 2009, the parties were unable to reach an agreement on Carnell's claimed extra site work costs.

On May 14, 2009, DRHA notified Carnell that it had to demobilize from the project by the June 4 project completion date, even though Carnell had completed roughly 90% of the project work. Carnell demobilized immediately and in early July, submitted 25 change order claims to DRHA totaling $359,084. DRHA rejected these claims. During the fall, DRHA entered into a contract with another contractor to complete the remaining 10% of Carnell's work, without notifying the surety. In late November, Carnell gave notice to DRHA that it was intending to file suit against DRHA to pursue its claims for racial discrimination and to recover its contract balance and claims for extra work. Even though DRHA had already asked Carnell to leave the project in May 2009, and had already hired a replacement contractor that fall, DRHA issued a notice to Carnell and its surety on December 14, 2009 stating it was "considering declaring Carnell in default" and requesting a meeting to discuss completion of the work.

A telephone conference between Carnell, its surety, and DRHA was conducted in late January 2010 and Carnell was declared to be in default on February 15, 2010, with demand being made upon the

surety. By this point in time, however, Carnell's scope of work had already been completed by the replacement contractor engaged by DRHA. Carnell filed suit in February 2010, claiming breach of contract and alleging that it was discriminated against during the project because of its status as a minority contractor. Carnell alleged, among other things, that DRHA had made discriminatory comments about it during the prequalification phase prior to the bid and that DRHA engaged in disparate treatment such as prepaying for materials and granting time extensions to non-minority contractors, but denying Carnell similar concessions.

DRHA counterclaimed for breach of contract, and brought a third-party action against Carnell's surety for breach of the performance bond. After a two week trial, a jury awarded Carnell more than $3.1 million in damages for racial discrimination. *See* Verdict; Docket No. 198 in *Carnell Const. Corp. v. Danville Redevelopment & Hous. Auth.*, Case No. 4:10CV00007, (Feb. 17, 2011). The jury found in favor of both Carnell and DRHA on their breach of contract claims but did not award either party any damages. The jury gave a complete defense verdict to the surety, finding no liability on its part for the reprocurement effort. However, in post-trial filings, the Court ordered a new trial based on DRHA's submission of an affidavit which persuaded the Court to impeach certain critical testimony of Carnell's president. The judge also recused himself, finding that he had made an erroneous evidentiary ruling and could not impartially discharge his duties in the retrial.

Before the second trial, the new judge granted summary judgment to Blaine Square on the race discrimination claims, finding that there was no evidence that Blaine Square was actively involved in any allegedly discriminatory conduct. The jury was unable to agree on a verdict at the second trial, which spanned seven days of testimony on liability and four days of deliberations. The Court declared a mistrial, resetting the case for a third trial.

After thirteen days of trial, the third jury found in favor of DRHA on the race discrimination claims but found in favor of Carnell on the breach of contract counts, awarding Carnell $915,000 in damages - $515,000 for extra work claims and $400,000 for termination damages. In post-trial rulings, the District Court reduced the award to a total of $215,000, based upon a determination that the VPPA restricted the amount by which the parties' fixed-price, public contract could be increased without pre-approval, and that Carnell had failed to plead special contract damages.

Carnell appealed the final order reducing its damages and applying the VPPA, and DRHA cross-appealed as to various adverse rulings. The Fourth Circuit in March 2014 ruled on these issues finding that: (1) a corporate entity such as Carnell had standing to bring a race discrimination claim under Title VI, (2) the Contract was subject to the VPPA and Carnell's damages were properly capped at 25% of the base contract, and (3) the notice requirements of the contract served as strict conditions precedent barring all of Carnell's claims for additional compensation on the job for which notice was not properly provided. Based upon the partial affirmation and partial reversal of the District Court, the case has been remanded for a fourth trial.

Legal Analysis

The Protections Afforded to Sovereign Entities by the VPPA

Sovereign Immunity Bars Contractual Claims for which Written Notice was not Specifically Provided

The Fourth Circuit opinion in *Carnell Const.*, reaffirms the continued strength of the Virginia Public Procurement Act's written notice of claim requirements in shielding the Commonwealth's agencies from liability for unnoticed claims. Although the VPPA creates the substantive right to file an action against a sovereign agency such as the DRHA, it imposes a special "written notice" limitation on that right that is strictly construed as a condition precedent to filing suit.

In Virginia, any notice of a claim for additional compensation on a construction contract submitted for purposes of satisfying the VPPA's requirements

must identify specifically each claim for damages and "conspicuously declar[e] that, at least in the contractor's view, a serious legal threshold has been crossed," and that the contractor intends to claim reimbursement for the particular damages. *Commonwealth v. AMEC Civil, LLC*, 54 Va. App. 240, 677 S.E.2d 633, 641 (2009), *rev'd in part on other grounds*, 280 Va. 396, 699 S.E.2d 499 (2010). Although most construction contracts contain express provisions for providing written notice of claims within a certain time frame for any event or condition believed to affect the cost or time of performance, if not separately addressed by the contract, the VPPA states the contractor must submit written notice of "the contractor's intention to file a *claim*" for payment or other relief, "at the time of the occurrence or beginning of the work upon which the claim is based." Va. Code § 2.2–4363(A) (emphasis added). Additionally, contractual claims must be submitted no later than 60 days after final payment. *Id.*

In the *Carnell* case, both sets of general conditions included in the Contract required certain written notices and DRHA claimed on summary judgment that Carnell failed to provide the required notices. The District Court examined the VPPA's requirement for notice and concluded that Carnell's written notice of intention to file suit in November 2009 met the VPPA's requirement that the contractor provide written notice at the time of the occurrence of the contractor's intention to file a claim. The Fourth Circuit on appeal held that this ruling incorrectly confused the requirement to give notice of intent to pursue a claim at the time of the occurrence of the claim (found in Va. Code §2-2-4363(A)) with a different requirement (found in Va. Code §2-2-4363(C)(2)) that a contractor must give notice of its intent to file suit after a public body denies or fails to respond to a claim. The former requirement, that a contractor must give notice of its intent to pursue a claim at the time the claim arises, was extensively discussed in *Commonwealth v. AMEC Civil, LLC*, 280 Va. 396, 699 S.E.2d 499 (2010) and other cases.

The Fourth Circuit *Carnell* opinion reaffirmed that the VPPA's written notice requirements must be satisfied as a "mandatory procedural requirement" before a court can reach the merits of a claim against a public body. *Carnell Const. Corp.*, 745 F.3d at 721-22 (quoting *Dr. William E.S. Flory Small Bus. Dev. Ctr., Inc. v. Commonwealth*, 261 Va. 230, 541 S.E.2d 915, 919 (2001)). The Fourth Circuit held that during the third trial, Carnell had failed to offer into evidence a November 2009 letter notifying the Housing Authority of "claims arising from Carnell's work on the [project]." Instead, Carnell offered into evidence an October 2008 letter which sought reimbursement for two particular instances of uncompensated work, specifically, cleaning out the sediment pond and removing sediment from the north side of the specified construction site.

The Fourth Circuit disagreed that the October 2008 letter independently supplied adequate proof of notice under the VPPA for Carnell's numerous claims for unpaid work, including damages for performing additional seeding, relocating a fire hydrant, implementing various plan revisions, correcting environmental deficiencies, incurring additional surveying costs, and performing work on sidewalks, ramps, and driveway entrances. The Fourth Circuit held that Carnell satisfied its notice requirements under the VPPA only with respect to the claims for which Carnell specifically requested reimbursement and signified an intent to file a claim. Moreover, the Court vacated and remanded the lower court's judgment with respect to the contract claims for unpaid work due to the fact that the particular amounts that the jury awarded as compensation for the work for which specific written notice was provided were undiscernible from the record.

Therefore, the *Carnell* Fourth Circuit opinion, along with *AMEC*, reaffirms that if written notice of the contractor's intention to file a claim (for each claim that may be the subject of the suit) is not given at the time of the occurrence and in the manner provided by the construction contract, then the contractor waives any associated claims and the Court has no jurisdiction to hear those claims.

Change Orders may not Exceed 25% of the Contract Price

The VPPA affords a second protection to the Commonwealth and localities that Carnell unsuccessfully attempted to circumvent, and that is the 25% cap on change orders. The VPPA states that no "fixed-price contract" may be increased by more than 25% of the amount of the contract or $50,000, whichever is greater, without the advanced written approval of the Governor or his designee, in the case of state agencies, or the governing body, in the case of political subdivisions. *See* Va. Code § 2.2-4309(A). The VPPA further states that the amount of a contract cannot be increased for any purpose without adequate consideration. *Id.* For example, a public body may not increase the amount of a contract to help an offeror who has an error in its bid or offer without first seeking the advanced written approval summarized above.

Carnell opposed any effort to apply the VPPA to the Contract. The thrust of its argument was that shortly after entering into the contract with Carnell, DRHA assigned the contract to Blaine Square, a private entity that was formed to develop, own, maintain, and operate the housing development. Before the first *Carnell* jury trial, Judge Kiser granted Defendants' motion for summary judgment on the grounds that the VPPA set a mandatory ceiling on the amount that Carnell could recover for extra work under the construction contract, and that the contract precluded a *quantum meruit* claim because Carnell's alleged extra work was within the scope of the governing contract. *Carnell Const. Corp. v. Danville Redevelopment & Hous. Auth.*, 4:10CV00007, 2011 WL 285694, at *7 (W.D. Va. Jan. 27, 2011).

Judge Kiser reasoned that DRHA is a public body under the VPPA, Va. Code § 2.2–4301, and that its assignment of its interest in the Contract to Blaine Square, a private entity, worked no change on the applicability of the VPPA. *Id.* at *6. This was because the assigning instrument itself, which assigned DRHA's obligations and rights in the Contract, *included* those required and secured under the VPPA. *Id.* The Court held that "[i]t is well settled that an assignee of a contract obtains his rights from the assignor and, thus, 'stands in the shoes' of the assignor and acquires the same rights and liabilities as if he had been an original party to the contract." *Id.* (citing to *Pollard & Bagby, Inc. v. Pierce Arrow, L.L.C.*, 258 Va. 524, 528 (1999)). Judge Kiser also found unavailing Carnell's argument that DRHA was no longer a party to the contract after it assigned its interest to Blaine Square because DRHA was the 100% managing member of Blaine Square and DRHA continued to supervise the project after the assignment. Therefore, simple assignment of a publically procured contract to a private entity does not obviate the strictures of the VPPA.

Accordingly, Va. Code § 2.2-4309(A) created a statutory cap on Carnell's claims. The Carnell opinions strictly applied the statutory language and held that the maximum damages Carnell could recover for extra work was $142,557.57, a figure equal to 25% of the original contract amount. The first jury did not award Carnell any contract damages so the cap did not come into play. In post-trial motions following the third trial, in which the jury awarded Carnell $515,000 in extra work contract damages, Carnell sought to avoid the law of the case and imposition of the statutory cap by asserting that: (1) its contract was a unit-price contract and not a "fixed-price contract;" (2) it was not a contract with a state agency or political subdivision; and/or (3) that the cap was unconstitutional and did not apply to contract disputes or legal actions.

The Court's opinion by Judge Conrad rejected all three contentions, reducing the damages awarded to Carnell to $142,557.57. The Court defined a "fixed-price contract" as 'an agreement by the contractor to furnish to the government the supplies or services called for at a specified price." *Carnell Const. Corp. v. Danville Redevelopment & Hous. Auth.*, No. 4:10CV00007, 2013 WL 101687, at *7 (W.D. Va. Jan. 8, 2013) *aff'd in part, vacated in part, remanded*, 745 F.3d 703 (4th Cir. 2014). Judge Conrad referred to the Contract which states that Carnell shall be paid "the sum of $793,541.00" for

its "performance of the Contract." *Id.* at *6. Moreover, the Court held that provisions in the contract in the case of unit priced work did not transform the contract into a unit-price agreement. *Id.* at *7. On Carnell's second argument that § 2.2-4309 was inapplicable to housing authorities like the DRHA, the Court cited to Virginia law expressly classifying redevelopment and housing authorities as political subdivisions. *Id.* (citing to Va. Code § 36-4). The Fourth Circuit affirmed the District Court in all respects related to these first two issues.

Regarding Carnell's third contention that the statutory cap was unconstitutional and did not apply to contract disputes, Judge Conrad, and later the Fourth Circuit, reasoned that the VPPA only affects the remedies available for certain breach of contract actions under the common law, not the validity of the underlying contractual obligations. *Carnell Const. Corp.*, 745 F.3d at 724. The Fourth Circuit added that Carnell had no fundamental right, nor "property, in the constitutional sense," to a particular remedy in contract. *Id.* (citing to *Gibbes v. Zimmerman*, 290 U.S. 326, 332, 54 S. Ct. 140, 78 L. Ed. 342 (1933)). And since the VPPA statutory cap was reasonably related to the legitimate government purpose of promoting fair procurement procedures by which public bodies in Virginia obtain goods and services at a reasonable cost, the statutory cap was not demonstrably arbitrary or irrational in order to be deemed unconstitutional. *Id.* (citing to Virginia Code § 2.2–4300(C)).

Understanding Contractual Terms in Order to Preserve Affirmative Claims Against the Contractor and Surety

Compliance with Changes Clauses and Claims Procedures in Contracts

The major contractual dispute in the Carnell case concerns compliance with and enforceability of the contracts' requirements for changes and Carnell's requests to be compensated for performing extra work on the project. The terms and conditions applicable to change orders were included in not only the base construction contract, but also the EJCDC General Conditions and the HUD General Conditions. DRHA argued that the changes requirements in these documents were conditions precedent to filing suit and, in sum, barred Carnell from being compensated for extra work without a written change order. Carnell attempted to argue that these conditions were waived based on the parties' actions, mainly the parties' agreement to mediate their dispute.

The law in Virginia has established that failure to follow the specified methods for submitting change orders for extra work bars recovery for the work performed. *See e.g., Main v. Dept. of Highways*, 206 Va. 143, 149-152, 142 S.E. 2d 524, 529-30 (1965). Although the contract's change order requirements are conditions precedent to filing suit, the Carnell Court confirmed that they can be modified or waived. *Carnell Const. Corp.*, 2011 WL 285694, at *3. Prior to the first Carnell trial, the Court ruled on summary judgment that DRHA had waived its right to enforce the conditions precedent of the change order requirements by agreeing to mediate all of Carnell's claims. *Id.* Between the first and second trials, DRHA again moved for summary judgment, adding that DRHA was acting in its governmental capacity and was entitled to sovereign immunity and, therefore, the waiver doctrine did not apply to DRHA. *Carnell Const. Corp. v. Danville Redevelopment & Hous. Auth.*, No. 4:10CV00007, 2012 WL 178341, *4 (W.D. Va. Jan. 23, 2012). The District Court denied the motion holding that since DRHA had agreed in writing to mediate all of Carnell's claims for extra work, it had waived the written change order requirements of the contracts. *Id.*

This teaches an important lesson that even if participating in dispute resolution processes, the public owner must insist on enforcement of the contractual conditions precedent of the contract as barring recovery. DRHA lost valuable rights by agreeing to mediate Carnell's change order disputes without any qualifications. A good practice when agreeing to mediation is to commit to writing that the owner is preserving all rights and/or that the agreement to mediate cannot be deemed to be a waiver of any rights, including the right to assert that

the other party has failed to satisfy the contract's written change order requirements as a condition precedent to recovering those claims.

On the other hand, the Court held that mediation of Carnell's change order dispute did not mean that Carnell had waived the claims procedure requirements of the contract as stated in DRHA's counterclaims against Carnell and the surety for Carnell's alleged defective performance of work and failure to complete the Project. Citing *Winn v. Aleda Const. Co.*, 227 Va. 304, 307, 315 S.E.2d 193, 195 (1984), Judge Conrad held that the DRHA's failure to satisfy the claims procedures set forth in the contracts required the dismissal of one of DRHA's claims against Carnell and its surety.

DRHA presented two counterclaims against Carnell and the surety, the first for defective work, and the second for failure to complete the project. Carnell moved for summary judgment, asserting that DRHA failed to comply with the contract's claim and dispute resolution procedures. DRHA asserted that the procedures only applied to Carnell, and not to itself. The Court found that there was no evidence that the parties waived or modified the contract's claims or disputes procedures with respect to DRHA's claims, and that DRHA at no time during the project or the mediation raised any allegation that Carnell's work was defective. The claims procedures in the EJCDC General Conditions required that submission of claims by either party must first be submitted to the Engineer for a decision as a condition precedent to recovery. *Id.* at *23. The HUD General Conditions required both parties to submit their claims to the contracting officer for a decision. *Id.* Finding that the contract provisions applied as equally to DRHA as to Carnell and that there was no basis upon which a reasonable jury could find that the parties agreed to mediate DRHA's later-submitted claims for defective work, the Court barred the claim due to DRHA's failure to follow the conditions precedent provided by the contracts for submission of the claim. *Id.*

Carnell also involved an intricate legal dispute over resolution of the ambiguities and conflicts between the various contracts' requirements for submission of claims. The various contract forms which comprised the contract contained multiple contractual and statutory procedures to follow in the event of claim. In order to avoid this unnecessary legal debate, Owners should review contracts to analyze each for ambiguities or conflicts. If a standard set of terms and conditions cannot be altered, then a precedence clause should be included to establish which set of the terms and conditions controls in the event of an ambiguity or conflict.

Termination, Default and Properly Making a Claim Against the Performance Bond

The multiple and conflicting sets of conditions in Carnell's contract made the Court and juries' evaluations of the propriety of Carnell's default and termination extremely difficult. In the vacuum created by the VPPA concerning contract default, the terms of the parties' contract will control. Here, contractual language concerning default and termination was addressed in three different documents: (1) the EJCDC General Conditions; (2) the HUD General Conditions; and (3) the Performance Bond.

The EJCDC General Conditions required DRHA to give Carnell and its surety seven days written notice of its intent to terminate. Upon provision of this notice, DRHA was entitled to remove Carnell from the site, complete the work, and charge Carnell for the costs to complete in excess of the remaining contract price. Where, as here, a performance bond was provided by the contractor, the EJCDC General Conditions provide that the bond's termination procedures supersede the EJCDC termination procedures.

The performance bond, an AIA Form A312 – 1987 Edition, contained four conditions to terminate and trigger the surety's liability: (1) notice to Carnell and the surety of an intent to default; (2) requesting and holding a conference within 15 days of the notice; (3) declaration of default and formal termination; and (4) agreement to pay to the surety the balance of

the contract price. The HUD General Conditions, on the other hand, only required that once Carnell failed or refused to prosecute the work with diligence to ensure timely completion, DRHA was to give written notice to Carnell that it was terminating its right to proceed. While the HUD 5370 was silent as to the notice provisions set forth in the performance bond, the general conditions, C-700, stated in pertinent part that the Owner is entitled to terminate the Contractor for cause under Section 15.02. Section 15.02(F):

> If and to the extent that Contractor has provided a performance bond under the provisions of Paragraph 5.01A, **the termination procedures of that Bond shall supersede the provisions of Paragraphs 15.02(B), and 15.02(C)**.

(Emphasis added.) The language of the parties' Contract, therefore, appeared to set forth that the Performance Bond notice provisions are operative and should govern a default scenario between Carnell and DRHA.

DRHA first attempted to comply with the EJCDC requirements by issuing a notice on May 14, 2009 stating that Carnell was to remove itself from the project site by the original completion date. Several months later, DRHA attempted to comply with the terms of the bond by issuing another letter declaring its intent to place Carnell in default and requesting a meeting with the surety, and then, after the meeting, declaring Carnell in default.

Although the Court granted summary judgment in favor of DRHA in *Carnell Constr. Corp. v. Danville Redevel. & Housing Auth.*, No. 4:10CV00007, 2011 WL 320574 (W.D. Va. Jan. 27, 2011) on the surety's liability finding that DRHA had complied with the contract, namely the HUD General Condition requirements for termination, the jury did not award any damages to DRHA against the surety. The jury also answered affirmatively to verdict questions finding in favor of both Carnell and DRHA on their contract claims, but awarding neither party any damages. This seems to suggest that the first jury was not convinced that DRHA had complied with the contract in terminating Carnell. As discussed in *Carnell Constr. Corp. v. Danville Redevel. & Housing Auth.*, No. 4:10cv00007, 2013 WL 101687 (W.D. Va. Jan. 8, 2013), the third jury awarded Carnell $400,000 in termination damages, affirmatively finding that DRHA failed to comply with the contract's termination provisions. The desirability of only having one set of applicable termination procedures could not be more evident than the torturous history included in the *Carnell* opinions of DRHA's efforts to terminate Carnell for default.

Concerning the surety's liability, IFIC argued that there was no liability under its performance bond because DRHA failed to comply with the express terms of the bond which required DRHA to: (1) give notice to the surety of its intent to declare a default; (2) conduct a meeting with the surety during which the surety is given options to perform; (3) formally declare a default and terminate the contractor's right to complete the contract; and (4) agree to pay over to the surety the balance of the contract price. DRHA, on the other hand, relied upon Article 32 of the incorporated HUD General Conditions for the proposition that the only requirement to trigger the surety's liability under the performance bond was a failure by the contractor to prosecute the work to completion within the time specified in the contract and issuance of a written notice to the contractor terminating the contractor's right to proceed with the work. The Court held that it was required to read the bond and contract together, but that in doing so, an ambiguity was created which must, under general principles, be construed against the surety. *Id.* at *8. As discussed above, the Court then resolved the ambiguity within the contracts as to which the contractual termination provisions applied in favor of the less complicated default procedure in the HUD General Conditions. *Id.* Accordingly, the Court ruled in favor of DRHA regarding the surety's liability under the bond, with the issue of damages to be resolved at trial. No damages were ever proven against the surety, and DRHA ultimately dismissed the surety from the case after the second trial.

Application of Title VI of the Civil Rights Act to Contract Administration with Minority-Owned Businesses

In addition to the breach of contract claims, Carnell's complaint against DRHA accused DHRA of racial discrimination in violation of Title VI. To state a claim under Title VI, a plaintiff must demonstrate that the decision to exclude the plaintiff from a federally-financed program was motivated by race and that race was a determining factor in the exclusion. *Buchanan v. City of Bolivar*, 93 F.3d 1352, 1356 (6th Cir. 1996); *see also Gierlinger v. Gleason*, 160 F.3d 858, 868 (2d Cir. 1998) (noting that, under Title VI, "plaintiff's burden is to show that that the impermissible factor was a 'substantial' or 'motivating factor' in her adverse treatment").

Carnell's claims for discrimination and disparate treatment centered around the following facts: (1) that DRHA pre-paid another non-minority contractor for materials before it started work without providing Carnell the same opportunity; (2) that DRHA withheld 10% retainage from Carnell and only 5% from other, non-minority contractors; (3) that DRHA denied Carnell's change order requests and pay applications while granting the same from other non-minority contractors; (4) that emails from the Project Manager referred to Carnell's minority status in a negative light; and (5) that while DRHA accepted the majority of Carnell's work, DRHA later claimed Carnell's work was inadequate in retaliation for Carnell's notice to the owner of race discrimination.

DRHA challenged Carnell's racial discrimination charges by asserting that a corporation lacked standing to assert a claim under Title VI, that the notice and dispute resolution procedures provided for in the Contract and the VPPA barred Carnell's claims, and that lost profits were consequential damages that could not be recovered under Title VI. The Fourth Circuit rejected DRHA's challenges. The Fourth Circuit found that Carnell elicited sufficient evidence for a reasonable jury to conclude that DRHA intentionally discriminated against Carnell, that DRHA's proffered explanations were not credible, and that DRHA's shifting explanations were probative of pretext. *Carnell Const. Corp.*, 745 F.3d at 726. The Fourth Circuit resolved an issue of first impression in the circuit that a corporation that is minority-owned and that has been properly certified as such under applicable law can be the direct object of discriminatory action and has standing to bring an action under Title VI. Moreover, the Court held that the notice and dispute resolution procedures provided for in the Contract were inapplicable to the racial discrimination charges and, therefore, would not be binding to bar the Title VI claim, as that would essentially place DRHA in the position of judging a discrimination claim against itself. *Id.* at 715. The Court also permitted damages for non-pecuniary injuries such as loss of reputation and lost profits because "DRHA should have foreseen that intentionally discriminating against Carnell could harm Carnell's name, reputation, and good will." *Id.* at 726.

Although this case involved a federally-assisted public housing program, its holding applies to the delivery of any program or activity for the benefit of the public that includes federal funds. From the point of soliciting bids or proposals, to selecting a contractor, to overseeing the contractor's performance of work related to the delivery of a federally-assisted program or activity, the nondiscrimination mandates of Title VI of the Civil Rights Act of 1964 apply. This means the state or local government agency, or any instrumentality of the agency, cannot treat one contractor differently from another contractor in this process (solicitation, selection, payment, or performance oversight) based on race, color, or national origin.

Conclusion

The lessons learned from the Carnell litigation are multi-fold. First, owners should be intimately familiar with the written notice and claims procedures required by the contract, especially as applicable to the owners' rights to declare a default, terminate the contract, substitute performance, and present or defend claims. To the extent ambiguous and conflicting contractual terms can be resolved during the contract negotiation stage, prior to commencing performance, this will save public agencies endless headache on the back-end when parties are initiating the dispute resolution process. Special care should be taken to ensure the proper order of precedence if multiple documents are incorporated into the contract, and the impact and consistent incorporation of the VPPA should be carefully coordinated in the contract documents.

Regarding surety claims, notice of default and notice to the surety of a claim are key for owners to successfully engage the surety to complete the contractor's performance, along with providing the surety with the opportunity to cure the contractor's default. Here again, careful coordination and proper care to ensure the proper precedence of notice and default provisions will ensure that owner representatives have a clear path to follow in the event of contractor default. Actions by public bodies that could adversely affect the contractor-surety relationship should be carefully considered by public bodies since the long-term implications can lead to diminished competition if the effect lessens the contractor's bonding capacity. Lastly, since the Fourth Circuit opinion confirms that a corporation (as opposed to a person) can possess a racial identity, it is equally important that special considerations be given to ensure that construction contracts are administered fairly and equally, without regard to race, color, or religion.

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Hydraulic Fracturing in Virginia: Can Localities Ban or Strictly Regulate Fracking Operations Where Concurrent Jurisdiction Exists?

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Introduction

Induced hydraulic fracturing – commonly known as "fracking" – has emerged as one of the more controversial energy-producing technologies in recent memory. Simply stated, hydraulic fracturing is a well-stimulation technique in which large quantities of water and/or chemicals (typically mixed with sand) are injected into deeply drilled wells to "fracture" the surrounding rock and release suppressed oil or gas reserves. Hydraulic fracturing, along with horizontal drilling, has opened the door for the potential proliferation of new wells sites in areas of the Commonwealth that are currently free of such activities. The impacts that fracking might have on water quality and supplies, subterranean stability, the natural environment, and the quality of life are hot-topics in Virginia and many other states. And the question that typically follows is "What can local communities do to limit or prevent such impacts entirely?" This article is intended to discuss the relationship between state and local authority over fracking operations and the extent to which localities can regulate or prohibit fracking operations where state permits approving such operations have been granted.

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Use of Hydraulic Fracturing in Virginia[1]

Since the 1950s, fracking has been used in approximately 2,100 wells in Southwest Virginia.[2] While exploratory wells were drilled in the eastern part of Virginia during the 20th century, all of these wells were plugged because commercially viable quantities of hydrocarbons were not found. There are currently no gas or oil wells producing outside of Southwest Virginia.[3] With the advent of horizontal drilling and hydraulic fracturing, however, there is now a renewed interest in some of these areas, including areas underlain by the Marcellus Shale and the Taylorsville Basin. The Marcellus Shale is a sedimentary rock formation that is located beneath some of the mountains and valleys of western Virginia.[4] The Taylorsville Basin is located beneath the counties of King George, Westmoreland, Caroline, Essex, and King and Queen. It is believed that natural gas companies have already secured leases on approximately 84,000 acres of land in these eastern counties upon which drilling operations may occur.[5]

Land Use Impacts of Hydraulic Fracturing

For the communities underlain by these long-captive resources, concerns have arisen as to the type and scope of impacts that might be caused if hydraulic fracturing is introduced to these areas. In addition to the typical impacts associated with heavy-industry, *e.g.*, truck traffic, visual impacts, noise, reduced property values, etc., fracking raises additional concerns as to ecological impacts on the quantity and quality of aquatic resources due to the extraction of water from aquifers (in the first instance) and the subsequent injection of chemical-laced water back into the ground.[6] For areas in the eastern part of the state, impacts on the Chesapeake Bay and its tributaries are of particular concern. There are fears of blowouts and explosions, earthquakes and subterranean instability, effects on climate change, and the list goes on.

Local Authority to Regulate Hydraulic Fracking

Given the concerns raised by potential hydraulic fracking operations, it has been questioned whether and to what extent localities may regulate or prohibit fracking operations in Virginia. From a local government perspective, the answer should depend on the application of the Dillon Rule, and whether local authority has been preempted by or is exercised inconsistently with state law.

The Dillon Rule

Any legal analysis involving the scope of local authority in Virginia necessarily begins with the Dillon Rule. Under

the Dillon Rule, local authority is limited to those areas expressly granted by the General Assembly, or those necessarily or fairly implied from the express grant of power, and those that are essential and indispensable.[7] There is no question that the General Assembly has granted localities broad authority to regulate and even prohibit certain land uses within their territories under their zoning powers. In particular, Va. Code § 15.2-2280 provides:

> Any locality may, by ordinance, classify the territory under its jurisdiction or any substantial portion thereof into districts of such number, shape and size as it may deem best suited to carry out the purposes of this article, and in each district it may regulate, restrict, permit, prohibit, and determine the following:
>
> 1. The use of land, buildings, structures and other premises for agricultural, business, industrial, residential, flood plain and other specific uses;
> 2. The size, height, area, bulk, location, erection, construction, reconstruction, alteration, repair, maintenance, razing, or removal of structures;
> 3. The areas and dimensions of land, water, and air space to be occupied by buildings, structures and uses, and of courts, yards, and other open spaces to be left unoccupied by uses and structures, including variations in the sizes of lots based on whether a public or community water supply or sewer system is available and used; or
> 4. The excavation or mining of soil or other natural resources.

As the express language of § 15.2-2280 allows localities to "prohibit" the "use of land" for "…specific uses" and "prohibit…the excavation or mining of soil or other natural resources," authority appears to exist pursuant to which a local government could restrict or prohibit certain mining and well-drilling activities, including fracking, within its jurisdiction.

This language was held to authorize the local prohibition of a particular land use in 1989, when the Supreme Court of Virginia upheld a ban imposed by Prince William County on debris landfills pursuant to its zoning powers. In *Resource Conservation Management, Inc. v. Board of Supervisors of Prince William County*, the Court explained "[w]e think that, by this language, the governing body of a locality is expressly authorized to prohibit a specific use of land."[8] In rejecting the plaintiffs' argument that Prince William lacked authority to ban such uses under the Dillon Rule, the Court noted, "[w]hile the language [of the Virginia Code] does not specify a landfill as one of the uses that may be prohibited, such specificity is not necessary even under the Dillon Rule of strict construction."[9]

Notably, unlike with Prince William's ban on landfills, Va. Code § 15.2-2280 expressly states that localities may prohibit "[t]he excavation or mining of...natural resources" with their boundaries, which would necessarily include hydraulic fracturing operations. With express statutory language from the General Assembly, and prior case law from the Supreme Court, there seems to be little doubt that localities have the authority to regulate, restrict, permit, or prohibit hydraulic fracking under the Dillon Rule.

Preemption

Even where a local government has the authority to regulate or prohibit hydraulic fracking under the Dillon Rule, it may still be precluded from doing so if its authority is preempted by state law. Local authority may be preempted where the General Assembly has expressly preempted the field, or where preemption as shown through legislative intent.[10] While localities may have the authority to regulate or restrict fracking under its zoning powers, it cannot do so if such powers are preempted by state laws regulating in the same area.

In Virginia, the exploration, development, and production of oil and gas resources, including hydraulic fracturing operations, are controlled by the Gas and Oil Act (the "Act").[11] The Act directs the Director of DMME to prom-

ulgate regulations "to ensure the safe and efficient development and production of gas and oil resources located in the Commonwealth."[12] Such regulations are to be designed to:

1. Prevent pollution of state waters and require compliance with the Water Quality Standards adopted by the State Water Control Board;
2. Protect against off-site disturbances from gas, oil, or geophysical operations;
3. Ensure the restoration of all sites disturbed by gas, oil, or geophysical operations;
4. Prevent the escape of the Commonwealth's gas and oil resources;
5. Provide for safety in coal and mineral mining and coalbed methane well and related facility operations;
6. Control wastes from gas, oil, or geophysical operations;
7. Provide for the accurate measurement of gas and oil production and delivery to the first point of sale; and
8. Protect the public safety and general welfare.[13]

In developing regulations under the Act, the Director is required to consider the following:

1. The protection of the citizens and environment of the Commonwealth from the public safety and environmental risks associated with the development and production of gas or oil;
2. The means of ensuring the safe recovery of coal and other minerals without substantially affecting the right of coal, minerals, gas, oil, or geophysical operators to explore for and produce coal, minerals, gas, or oil; and
3. The protection of safety and health on permitted sites for coalbed methane wells and related facilities.[14]

The Director is expressly authorized by the Act to set and enforce standards governing: gas or oil ground-disturbing geophysical exploration; the development, drilling, casing, equipping, operating, and plugging of gas or oil production, storage, enhanced recovery, or disposal wells; the development, operation, and restoration of site disturbances for wells, gathering pipelines, and associated facilities; and gathering pipeline safety.[15] The Director is authorized to issue, condition, and revoke permits and to enforce the provisions of the Act.[16] The Virginia Gas and Oil Regulations (4 VAC 25-150-10 et seq.)(the "Regulations"), which are promulgated by the Director of DMME, implement the provisions of the Act.

While the Act establishes an expansive statutory and regulatory scheme governing the drilling and extraction of oil and gas, it expressly does not preempt local zoning authority to regulate in the same area. Section 45.1-361.5 of the Act, entitled "Exclusivity of regulation and enforcement" states:

> No county, city, town or other political subdivision of the Commonwealth shall impose any condition, or require any other local license, permit, fee or bond to perform any gas, oil, or geophysical operations which varies from or is in addition to the requirements of this chapter. ***However, no provision of this chapter shall be construed to limit or supersede the jurisdiction and requirements of*** other state agencies, ***local land-use ordinances***, regulations of general purpose, or §§ 58.1-3712, 58.1-3712.1, 58.1-3713, 58.1-3713.3, 58.1-3741, 58.1-3742, and 58.1-3743.

(Emphasis added.)

While this section prohibits localities from imposing any conditions or requiring any "local license, permit, fee or bond" on operators seeking to perform gas drilling in the locality over that which is required under the Act, it expressly allows local governments to regulate such activities under their local zoning authority.[17]

Inconsistency

Even where not preempted, however, local zoning ordinances may still be found to be invalid if they conflict with state law. This rule of law is codified in Va. Code § 1-248 which provides "[a]ny ordinance, resolution, by law, rule, regulation, or order of

any governing body or any corporation, board, or number of persons shall not be inconsistent with the Constitution and laws of the United States or of the Commonwealth." Whether local zoning ordinances prohibiting hydraulic fracking operations are inconsistent with state laws that establish the DMME's permitting program and comprehensive scheme regulating drilling and well production is a question not so easily answered. This is particularly true as there are competing cases from the Supreme Court, competing opinions from the Attorney General's Office, and competing statutes – none of which are easily reconciled.

Resource Conservation

As discussed previously, in *Resource Conservation*, the Supreme Court held that localities had the authority to prohibit specific uses of property, *i.e.*, debris landfills, under their zoning powers, even where such land uses were also strictly regulated by the state. Debris landfills were and are still regulated by the Virginia Waste Management Act (VWMA).[18] In seeking to invalidate Prince William county's ban on such landfills the petitioners argued that in adopting the VWMA, the General Assembly had provided "a comprehensive statutory scheme to regulate all aspects of solid waste management" so as to the preempt the field of waste-management regulation.[19] The petitioners further asserted that any local regulation inconsistent with the state scheme was "void ab initio."[20] While acknowledging the creation of the Department of Waste Management and the Virginia Waste Management Board, and the vesting by the General Assembly in the latter of the power to "[e]xercise general supervision and control over waste management activities in the Commonwealth," …to "[p]romulgate and enforce such regulations . . . as may be necessary to carry out its powers and duties," and to "abate hazards and nuisances . . . created by the improper disposal, treatment, storage, transportation or management of [waste] substances," the Court held that this comprehensive statutory regime did not preempt the entire field of waste management regulation.[21]

On the question of whether the General Assembly intended to so invade the field of solid waste management "so as to exclude the localities from exercising their usual control in the field of land use when the two fields overlap," the Court determined that "[n]othing in the [VWMA] displays such an intent."[22] The Court found instead that the VWMA displayed a legislative intent to permit active local involvement in the field of waste management regulation. Key to the Court's determination was language from the Waste Management Act which provided that no permit for the disposal of solid waste could be issued by the Director until he received notification from the governing body of the locality where the landfill was proposed confirming that the location was consistent with all local land use ordinances.[23]

Blanton v. Amelia County

More than a decade after its decision in *Resource Conservation*, the Supreme Court revisited zoning provisions that prohibited particular land use activities that were regulated and permitted by the state. In *Blanton v Amelia County*, the Supreme Court struck down a local zoning ordinance that banned the land application of biosolids.[24] At the time, biosolids were regulated by the state pursuant to Va. Code § 32.1-163 et seq., and the Biosolids Use Regulations promulgated thereunder.[25] Specifically, Va. Code § 32.1-164.5 provided:

> No person shall contract or propose to contract with the owner of a sewage treatment works, to land apply, market or distribute sewage sludge in the Commonwealth, nor shall any person land apply, market or distribute sewage sludge in the Commonwealth without a current [permit from the state] authorizing land application, marketing or distribution of sewage sludge and specifying the location or locations, and the terms and conditions of such land application, marketing or distribution.

The Biosolids Use Regulations promulgated by the Virginia Department of Health (VDH) were adopted to ensure that (1) sewage sludge applied on land was

properly treated prior to land application, (2) land application would be performed in manner so as to protect public health and the environment, and (3) state waters would not be polluted by sludge discharge.[26]

In striking Amelia County's outright prohibition on the land application of biosolids, the Supreme Court held that the county's ordinance was inconsistent with state law because the county could not "forbid what the legislature has expressly licensed, authorized, or required."[27] The Court decided that permits issued pursuant to [former] Va. Code § 32.1-164.5 were express authorizations from the state to land apply biosolids on the farms identified in the permits. The Court noted that while the Biosolids Use Regulations contemplated that local governments would have some involvement in the field of biosolids use regulation, this did not mean that localities could ban the land use entirely. In fact, the Court recognized that the Biosolids Use Regulations [in effect at the time] required that "conformance to local land use zoning and planning" should be resolved between the local government and the permit holder.[28] The Court also noted that the regulation's requirement that the "minimum information required for completion of a biosolids management plan utilizing land application" required the applicant to comply with "local government zoning and applicable ordinances."[29] Still, the Court struck down the county's zoning ordinance finding that local bans on such activities were inconsistent with state law and, specifically, with permits "authorized" by Va. Code § 32.1-164.5.

Notably, the Court's opinion in *Blanton* does not even refer to the Court's earlier holding in *Resource Conservation*.[30] Thus, it is unclear why a biosolids permit issued by the Commonwealth cannot be effectively superseded by local land use laws while a landfill permit issued by the state can. If the answer depends solely on the inclusion of the word "authorized" in the biosolids statute, or the lack of an express requirement in state law conditioning the issuance of a biosolids permit on the notification from the local government that the land application would conform to all local land use ordinances, then neither case provides reliable guidance on whether local bans on fracking will be deemed by the courts to be inconsistent with state law. Moreover, such a narrow application of statutory construction is itself inconsistent with the broader jurisprudence on concurrent jurisdiction which has long established that

> "[w]hen the State, in the exercise of its police power, enacts certain regulations, a political subdivision may, if it acts within its delegated powers, legislate on the same subject unless the General Assembly has expressly preempted the field. [Citation omitted]. In so doing, the locality may impose additional requirements not contained in the state law."[31]

It also ignores the fact that when the General Assembly intends to invade the field, it knows how to do so.[32]

Following the *Blanton* decision, the United States District Court for the Western District of Virginia went a step further than *Blanton* by holding that localities could not adopt zoning regulations imposing additional requirements on operators seeking Biosolids Use Permits where the General Assembly had (after *Blanton*) amended the biosolids use statute to allow localities to adopt regulations related to the testing and monitoring of biosolids materials to be land applied.[33] In *O'Brien v. Appomattox County*, the District Court held that the amendment to state law was intended to limit local authority over biosolids solely to matters of testing and monitoring. As such, Appomattox County's zoning regulations were found to be inconsistent with state law.[34] The court held "[i]n sum, it appears that counties have no authority to regulate biosolids beyond their powers to conduct testing and monitoring."[35]

Remarkably, the Federal court noted that "permit holders must [still] comply with previously existing zoning regulations. That is, a permit holder cannot land-apply biosolids in areas zoned for non-agricultural uses. It is no different than acknowledging that the holder of a permit to operate a

stationary air pollution source under Va. Code Ann. §§ 10.1-1300 et seq., cannot use that permit to construct a power plant in the center of a residential neighborhood."[36] Thus, even while the court invalidated the county's zoning ordinance on the grounds that local authority over biosolids was limited to testing and monitoring, the court nonetheless acknowledged that local zoning authority existed to restrict such uses to agricultural zoning districts. Given what appears to be an inherently contradictory opinion (zoning authority either exists or it doesn't), the *O'Brien* decision raises more questions than it answers, and is of little, if any, aid when attempting to ascertain Virginia's law on concurrent jurisdiction.

Attorney General Opinions

Given the mixed outcomes of these key cases, it is uncertain whether or to what extent localities may strictly regulate or prohibit fracking operations under the Gas and Oil Act. There are at least two opinions from the Attorney General's Office that address local authority under the Act, but, not surprisingly, those opinions reach different conclusions.

In 1993, Attorney General Stephen D. Rosenthal opined that the holder of a permit issued under the Gas and Oil Act for a natural gas well was still required to obtain a special use permit for operation of a well located in an agricultural zoning district in Montgomery County. Citing *Resource Conservation*, the Attorney General determined that "the Virginia Gas and Oil Act does not exempt the permit holder from a requirement under a local zoning ordinance to obtain a special use permit for operation of the well in the location specified in the state permit."[37]

More recently, Attorney General Kenneth T. Cuccinelli opined that Washington County's delay of its decision to allow gas drilling was the legal equivalent of a permanent ban on the exploration for, and drilling of, oil and natural gas, and that such ban was invalid under the Dillon Rule and the doctrine of preemption.[38] The Attorney General determined that although a local governing body can adopt zoning provisions that place restrictions on the location and siting of oil and gas wells that are reasonable and consistent with the Gas and Oil Act and the Commonwealth Energy Policy, it could not ban such activities outright.[39] Citing *Blanton*, the Attorney General opined that local governments cannot "'forbid what the legislature has expressly licensed, authorized or required," and that a ban would violate the Dillon Rule because "no statute expressly empowers a locality to adopt a ban on oil and gas exploration or drilling."[40] The Attorney General concluded, "a locality's delegated power is limited to the ability to adopt reasonable siting regulations" for gas and oil development activities.[41]

Given the contrary opinions issued by the Attorney General's Office, neither opinion provides clear guidance on how far localities may regulate fracking operations under their zoning powers.

Other Applicable Statutes

Finally, while Va. Code § 1-248 provides that "[a]ny ordinance, resolution, by law, rule, regulation, or order of any governing body…shall not be inconsistent with the Constitution and laws of the United States or of the Commonwealth," Va. Code § 15.2-2315 [Conflict with statutes, local ordinances or regulations] appears to grant supremacy to local zoning ordinances where they are more stringent than state law. Section 15.2-2315 provides:

> Whenever the regulations made under authority of this [zoning] article require a greater width or size of yards, courts or other open spaces, require a lower height of building or less number of stories, require a greater percentage of lot to be left unoccupied ***or impose other higher standards than are required in any other statute or local ordinance or regulation, the provisions of the regulations made under authority of this article shall govern***…"

(Emphasis added.) If zoning ordinances adopted pursuant to Title 15.2, Chapter 22 of the Va. Code (which includes Section 15.2-2286), restrict or ban activities otherwise permitted or regulated under other sections of the Code, then the General Assembly has plainly expressed which law should control - the more

restrictive law. While neither the Supreme Court of Virginia nor the Attorney General of Virginia has addressed the effect of Va. Code § 15.2-2315, the statute may be the clearest statement yet of the General Assembly's intent.[42] That is, where concurrent jurisdiction is the issue, more stringent requirements, including bans, adopted pursuant to a locality's local zoning authority should supersede a state-issued permit, unless expressly preempted by state law.

If the General Assembly does not intend for localities to be able to prohibit hydraulic fracturing operations where local health, safety, welfare and good zoning practices might otherwise warrant such a prohibition, it would be far better for the legislature to make its intention clear than for this important issue to be decided by the courts which have much on which to base a decision…yet nothing at all.

[1] This background has been summarized from information located at http://www.dmme.virginia.gov/DGO/HydraulicFracturing.shtml.

[2] In addition, more than 6,000 methane wells are producing from coal seams that have become fractured by post-mining subsidence or which have been fracked using water, chemicals, and nitrogen mixed with sand. This type of fracturing is known as a "foam frac." *See id.*

[3] *Id.*

[4] While the Marcellus shale is the primary target for recent horizontal drilling and hydraulic fracturing in Pennsylvania and West Virginia, in Virginia, the Department of Mines, Minerals and Energy (DMME) had indicated that much of the natural gas once present in the Marcellus shale may have escaped. *See id.*

[5] *See* Cathy Dyson, Fracking company officials to visit K.G. Free-Lance Star (Fredericksburg, Va.), April 11, 2014, http://news.fredericksburg.com/newsdesk/2014/04/11/fracking-company-officials-to-visit-k-g/.

[6] Where much of a locality's water supply originates from the same groundwater sources used for fracking, concerns have been raised that industry needs will critically reduce public water supplies. It has been reported that an initial drilling operation itself may consume from 6,000 to 600,000 US gallons of fracking fluids, but over its lifetime an average well may require up to an additional 5 million gallons of water for full operation and possible restimulation fracking jobs. *See* "Fracking and Water Consumption", http://sourcewatch.org/index.php/Fracking_and_water_consumption#cite_note-1. A 2009 report on modern shale gas by the Groundwater Protection Council, "Modern Shale Gas Development in the United States: A Primer," states that "[t]he amount of water needed to drill and fracture a horizontal shale gas well generally ranges from about 2 million to 4 million gallons, depending on the basin and formation characteristics." A 2010 Harvard study found that, on average, water consumption for natural gas produced through fracking ranges from 0.6 to 1.8 gallons of water per MBtu. *See* Water Consumption of Energy Resource Extraction, Processing, and Conversion, Mielke, et al. (October 2010). Due to the physical properties of the rock formations and the fairly low reservoir pressures in Southwest Virginia, large volumes of water are seldom used in the fracking process because water can hinder or block the flow of gas. *See* http://www.dmme.virginia.gov/DGO/Hydraulic Fracturing.shtml.

[7] *See Bd. of Supervisors v. Horne*, 216 Va. 113, 117, 215 S.E.2d 453, 455 (1975).

[8] 238 Va. 15, 20; 380 S.E.2d 879, 882 (1989). While the Court was construing a predecessor statute, Va. Code § 15.1-486, the relevant language is the same.

[9] *Id.*

[10] *Id.*

[11] Va. Code § 45.1-361.1 et seq.

[12] Va. Code § 45.1-361.27(A).

[13] Va. Code § 45.1-361.27.

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] See Va. Code § 45.1-361.5.

[18] *See* Va. Code § 10.1-1408.1.

[19] *Resource Conservation,* 238 Va. at 21, 380 S.E.2d at 883.

[20] *Id.*

[21] *Id.*

[22] *Id.* at 22-23, 883-84 (citing *City of Norfolk v. Tiny House*, 222 Va. 414, 423-24, 281 S.E.2d 836, 841 (1981)).

[23] *Resource Conservation,* 238 Va. at 21, 380 S.E.2d at 883.

[24] *See* 261 Va. 55, 540 S.E.2d 869 (2001). Biosolids are the treated and stabilized by-product of the municipal wastewater treatment process.

[25] These code provisions and regulations have since been repealed following subsequent legislation enacted by the General Assembly that transferred the biosolids program to DEQ on January 1, 2008.

[26] *See* Va. Code Section 32.1-164.5(B) (1950) (repealed). Currently codified generally at Va. Code Section 62.1-44.19:3.

[27] *See Blanton*, 261 Va. at 64, 540 S.E.2d at 874.

[28] *Id.* at 65, 874.

[29] *Blanton*, 261 Va. at 65, 540 S.E.2d at 874.

[30] After *Resource Conservation*, the Court reaffirmed its decision in *Ticonderoga Farms, Inc. v. County of Loudoun*, 242 Va. 170, 175, 409 S.E.2d 446, 448-49 (1991), which upheld a Loudoun County ordinance requiring all persons operating facilities for the disposal of solid waste to obtain a permit from the county. The Court held that the ordinance's requirements fell within the county's power to regulate the collection, storage and disposal of solid waste because the Virginia Waste Management Act did not preempt local involvement in solid waste regulation. *Id.* The Court explained that the power to prohibit necessarily included the power to regulate and so long as the conditions placed upon an activity are not arbitrary and capricious, they constitute valid exercise of a locality's power to regulate zoning. *Id.* at 174-75; 448.

[31] *Ticonderoga Farms*, 242 Va. at 175, 409 S.E.2d at 448- 49.

[32] *See, e.g.*, Va. Code § 10.1-1425 (Litter Control and Recycling) ("The provisions of this article shall supersede and preempt any local ordinance..."); Va. Code § 2.1-340.1 (Virginia Freedom of Information Act) ("Any ordinance adopted by a local governing body which conflicts with the provisions of this chapter shall be void"); Va. Code § 3.1-296.19 (Noxious Weed Law) ("This chapter shall supersede any local ordinances in the Commonwealth insofar as carrying out its intent."); Va. Code § 35.1-9 (Hotels, Restaurants, Summer Camps and Campgrounds) ("This title and the regulations of the Board shall supersede all local ordinances regulating hotels, restaurants, summer camps, and campgrounds"); Va. Code § 55-248.3 (Virginia Residential Landlord and Tenant Act) ("This chapter shall supersede all other local, county, or municipal ordinances or regulations concerning landlord and tenant relations and the leasing of residential property"); Va. Code § 56-46.1(F) (Public Service Companies) ("Approval of a transmission line pursuant to this section shall be deemed to satisfy the requirements of § 15.1-456 and local zoning ordinances with respect to such transmission line").

[33] These zoning requirements included prohibitions on land application on slopes in excess of seven percent, requiring direct soil injection, and imposing additional setback requirements.

[34] 293 F. Supp. 2d 660, 662-63 (W.D. Va. 2003).

[35] *Id.*

[36] *Id.* at 635.

[37] 1993 Va. AG Lexis 20, *7; 1993 Op. Atty. Gen. Va. 173 (April 16, 1993).

[38] 2013 Va. AG Lexis 4; 2013 Op. Atty. Gen. Va. 4 (January 11, 2013).

[39] *Id.* at *7.

[40] *Id.* at *12.

[41] *Id.* at *14.

[42] Notably, the intent of is statute was raised in both in the *Blanton* and *O'Brien* cases but was inexplicably ignored by both Courts.

Ten Tips for Local Government Attorneys Litigating Before the Virginia State Corporation Commission

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Local government attorneys, by necessity, find themselves litigating or appearing in a variety of forums across the Commonwealth – state courts, federal courts, administrative proceedings, etc. In most of these instances, these proceedings are strictly controlled (or at least strongly guided by) rules of procedure that many attorneys have come to know by heart. And then there are proceedings before the State Corporation Commission (the "SCC").

While initially established to oversee the railroad, telephone and telegraph industries in Virginia, the SCC's authority now encompasses utilities (including electric, natural gas, water and sewer utilities, and member-owned electric cooperatives), insurance, state-chartered financial institutions, securities, retail franchising, and railroads. In addition, the SCC's Division of Public Service Taxation (PST) is responsible for the assessment of all property of public service corporations for local taxation. This includes electric, gas, telecommunications, and water companies. The PST assesses all such property and then distributes the assessed values to each locality in which the property is located for taxation purposes.

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Given the SCC's far-reaching jurisdiction, proceedings and cases established in this forum commonly affect local interests, and typically not in a small way. Transmission power line siting cases, proceedings by natural gas companies seeking certificates of public convenience and necessity (CPCN), rate increase requests by water and sewer utilities serving customers throughout the state, and tax assessment challenges are but a few of the types of cases in which a local government attorney may be asked to participate. And when it is time to come to Richmond for a hearing, preparation (mixed with prayer) will be key in taking on the utility stalwarts of Virginia.

The Rules of Practice and Procedures of the SCC are set forth in the Virginia Administrative Code at (5 VAC 5-20-10 et seq.); however, there are practices unique to the SCC that you will not find in any code and sometimes not in writing at all. Having participated in a number of the types of cases cited above over the years, and having come to know and appreciate "that which is not known," we hope this article will provide some valuable tips to help local government attorneys get their bearings before taking a seat at the SCC.

TIP 1
SCC Practice Takes a Lot of Patience

Rarely are administrative or judicial proceedings in other venues as drawn out as they are at the SCC. To begin with, once an application seeking a particular action or approval has been filed by a regulated entity, notice is generally given to local governing bodies whose localities may be affected. Those localities may choose to file comments on the application or may choose to participate in the proceedings by filing a Notice to Participate. Where such notices are filed, it will be the first of a slew of filings that will follow, particularly where a matter is thereafter referred to a Hearing Examiner (an administrative judge), for a recommendation to the full Commission.

Hearing Examiners like to hear from the parties and give them the opportunity to brief and comment on pretty much every request that is filed (from whether to extend filing deadlines, to allow additional comments, to major substantive issues). Typically these briefs or comments are given a short turnaround time, which sometimes seem to (or do) fall right after a long weekend or other legal holiday. So you need to pay attention and closely read all of the orders of the Hearing Examiner and

note any and all filing deadlines. There will be many.

Ironically, the short timeframe for filing briefs and comments seems often inversely correlated to the long timeframe within which Hearing Examiners can sometimes take to act on a motion or request. So don't be surprised if you find yourself in a "hurry up and wait" scenario. Just dig your heels in and get ready to stay awhile.

TIP 2
SCC Practice Takes a Lot of Dough

Why is it so expensive to participate in an SCC proceeding? See Tip 1 above, and Tip 3 below. In addition, while you might be working on behalf of Bath, Bland or Cumberland County on a limited budget, your counterpart typically works for or is retained by a behemoth utility company with a significant budget for such litigation. These utility companies have "been there, done that" numerous times and have, either as employees or on a contract basis, experts on issues germane, and sometimes not so germane, which are involved or arise as part of the administrative hearing. Consequently, you will need to be prepared to employ experts with excellent credentials and with time to review the matters completely and file testimony to support your position. Such expert's credentials will be challenged along with their testimony and qualified experts are not inexpensive. Additionally, the best practice is to narrow the scope of your experts testimony so it may very well be that you will employ more than one, or two, experts on substantial issues and, additionally, you may find it helpful to have a consultant familiar with the issues to provide guidance in the preparation of your case but who will be used to locate and identify experts on different issues and coordinate testimony and trial preparation, but who will not testify. All this is, to say the least, expensive.

TIP 3
SCC Practice Requires Skilled Experts

Why does a solid SCC practice require skilled experts? See Tip 2 above. Whether the proceeding involves the valuation of millions (or billions) of dollars of specialized telecommunications equipment, or the necessity for a 500KV power line strung across the James River or through pristine farmland, the utility companies' experts will be knowledgeable, smart, experienced, and well-compensated. You will need to find experts who are even smarter, and more experienced, and who are willing to work for…not as much. You see the challenge. A major problem which will arise is that many of the experts that you may identify may already be tied up, either by contract with the utility on the other side, or with other like utilities, and are therefore unable, by contract, to perform work adverse to the industry. Even if an explicit conflict or contract bar does not exist, such experts may be fearful or simply unwilling to testify against a much better funded utility company that, frankly, hires more experts than you do. This shrinks your list of knowledgeable and experienced experts and, therefore, not only increases the compensation that may be demanded, but greatly increases your time spent to locate such experts. This, of course, causes numerous problems with timelines imposed by the Rules of the SCC and the afore-mentioned orders of the Hearing Examiners, which rarely provide as much time as you would like or perhaps need. So, immediately upon becoming involved in a pending matter, you need to start looking for experts as soon as you can, and be able to pay them as much as you can. This may be our most important tip to you.

TIP 4
There Is Strength in Numbers

If you are already feeling overwhelmed, and we are only at Tip 4, remember, you don't have to go it alone. When a utility is seeking a rate increase, or a tax assessment reduction, or the approval of a miles-long power line, multiple jurisdictions in Virginia will likely be affected. So, call on your colleague and try to get your localities to pool their resources. Split the work, and share the cost of counsel, and the cost of your stellar experts. Arrange joint defense agreements and try to ferret out issues with those "on your side of the table" upon which you agree and on which you disagree. If you decide not to pool experts at

least agree that the experts can meet and discuss their opinions. If you decide to pool experts, it is incumbent on you to feel completely comfortable with not only the expert's opinion but his or her qualifications upon which to render such opinion. You do not want any surprises in the hearing from an expert that you are relying upon but did not select.

Also coordinate with your co-counsel the production of the testimony at the hearing, both direct and rebuttal. If you did not pool the expert, you will get to cross-examine your co-counsel's expert and they will get to cross-examine your expert. There may be questions you or they want to raise with these experts which were not raised on direct, but will assist when raised on cross.

Also, in most hearings there is a day, or more, set aside for public comment. This means that essentially anybody can show up and testify on the matter. While parties are prohibited from testifying also as members of the "public," most hearing examiners will err on the side of more testimony if a person affiliated with a party but not testifying on behalf of the party chooses to appear. In representing localities, your local property owners affected by the application can appear and "make their case" without the need for pre-filing testimony. Members of the General Assembly can also appear on this day, as well as business owners who may be affected by the application. Sometimes these hearings are held in the locality affected and can impart to the record and the hearing examiner practical concerns and a "sense of the community" which neither experts nor lawyers can convey. Hearing Examiners will, many times, also visit and walk the site, such as the proposed location of a power line to gain knowledge. Accompany your Hearing Examiner on the site visit when you can. Use these opportunities of public comment and site visits to build your record.

TIP 5
Play Nice With SCC Staff

Like a new kid in high school quickly learns, cliques matter. When practicing in the SCC, it is important to maintain a good relationship with SCC staff. This includes not only the Commission's lawyers, but its analysts as well. In cases before the Commission, staff will also participate and make recommendations to the Hearing Examiner on the application. The Commission analysts will closely analyze financial and other relevant data. They might have their own outside experts. They are typically the first to file discovery, and during any hearing, typically ask a lot of very detailed and relevant questions. As one might expect, SCC staff's positions and recommendations are typically given great weight by the Hearing Examiner. This means staff may likely be your locality's best friend and worst enemy. If staff's position and experts support the utility's application, you will need to fight twice as hard to prove your case. Regardless, staff members are usually quite forthcoming as to their take and/or position on a matter. They can be helpful on the many procedural questions which inevitably arise. Staff will rarely try to "hide the ball." So get to know them early on and you will learn quickly where the strengths and weaknesses of your case lie. Staff members are also pretty generous in explaining the particularities of Commission practice that are unwritten but well known to those that practice there. See Tip 6.

TIP 6
Get to Know What You do not Know

As previously mentioned, the SCC practice is generally governed by the SCC Rules of Practice and Procedures. These rules address motions, pleadings, filing and service, confidential information, discovery, testimony, etc. However, in complying with the rules, there is particular language used in the various orders, motions, and pleadings which is fairly standard and generally accepted by the Commission. Once you learn what language is standard and what is not, you will know better what to fight for and what to leave alone. For example, 5 VAC 5-20-170 (Confidential Information), provides for the protection of confidential information pursuant to a Protective Order entered by the Commission. While not set forth in the Rules themselves, there is standard language that is typically used in the Commission for a Protective

Order. Those not familiar with such orders may find themselves arguing over language that is generally acceptable to the Commission, and have little success in swaying the Commission to modify or strike language that is routinely utilized. Pick your battles.

In addition, there are many unwritten rules and common practices at the SCC that are typically followed but are simply not written down anywhere, except perhaps in a myriad of past orders and other documents that are on file at the SCC. They are tough to find on your own. Seek help from the SCC Staff or an experienced practitioner who can give you a "heads up."

TIP 7
Appreciate and Fear the Shortcuts

While SCC proceedings are much like typical judicial hearings (i.e., discovery, motions practice, exchange and cross-examination of evidence), in some ways it is easier. Pre-trial practice in the SCC is transacted such that direct and rebuttal testimony is "pre-filed" in accordance with a Scheduling Order. Once filed, this testimony will include the exhibits to be relied on during the hearing and evidence to be used in rebuttal. This is good, but it also means that you need to identify early the issues involved and be prepared sooner than usual in most civil cases. This makes earlier stages of the proceeding more expensive, as well. See Tip 2.

Since testimony and exhibits for your witnesses are pre-filed, trial procedure largely goes to cross-examination. And since depositions are not typically allowed in SCC practice, surprise in litigation (largely reduced in the new federal rules) is alive and well in SCC practice. This can be both a tool for and against you and your client's case. Being well-prepared is critical, but is never a perfect science in SCC practice.

TIP 8
Understand it All Comes in Anyway

Recognize that the Hearing Examiner is going to give great leeway in the introduction of testimony. Objections are not usually sustained, or welcomed. The Hearing Examiner will listen and take it all under consideration. The proceeding is typically legislative in nature. Your job is to address the technical defects of the application and to offer alternatives to the plan submitted to the hearing examiner. For instance, as to the location of a major power line, the SCC is going to give great weight to the determination of the utility that the line is needed. Unless you have experts who can prove the utility wrong, your job then becomes one of providing options to the hearing examiner on the location and construction of the line, and establish that there is a less expensive route or a route which is less injurious to the public, and your client.

TIP 9
Electronic Filing and Service is Great When Done Correctly

The Commission allows for the electronic filing of pleadings so long as they do not exceed the maximum page limit. In addition, any attachments that are not standard may not be accepted by the Document Control Center. Where electronic filing is not used, 15 copies of the pleading must be provided to the Commission by the deadline date. So keep close track on everything that you plan to file and plan your date (and your assistant's day) accordingly. If electronic filing is not an option or not desired, be ready to make the number of copies required and serve all parties with a hard copy.

The Commission also allows for electronic service when agreed by the parties. This makes sense, especially when you are already filing electronically. You can simply send the same .pdf document you just filed to all counsel via email. While consent is commonly granted, it must be requested. A common mistake is to begin electronic service before consent is requested and obtained. Although it is always fine to provide a courtesy electronic copy to counsel, get consent first before dropping the paper service.

TIP 10
The Statutes can be Your Friend

While the Commission has extensive discretion, and the public service companies have a significant advantage in this forum, the statutes governing the approvals and assessments of the Commission must still be followed. Like constitutional officers, the Commission is a constitutionally-created and statutorily-authorized entity. The applicable statute may be critical to making your case, and arguing to the Commission that your locality's position should prevail. In the erroneous assessment cases filed at the SCC by Verizon, for example, the clear burden of proof in the statute when applied to the evidence apparently available to Verizon may have been a factor in causing Verizon to ask that its cases be dismissed. Similarly, the mandatory language of the statutes governing the Commission's approval of utility lines may be of assistance to you in making your case against a certain route. Like other public bodies, the Commission is bound to the language of the statutes. And, if the Commission decides against you, a statutory argument will be reviewed *de novo* by the Virginia Supreme Court in an appeal of right.