



Robert K. Cox

Construction Law

Dear Fellow Bar Members:

As the chair of the Construction Law and Public Contracts Section, I am particularly pleased that this edition of the *Virginia Lawyer* includes articles on some of the more important issues facing construction law practitioners and their clients. These articles are timely, written by colleagues experienced with the issues. I highly recommend them.

On a related subject, if you are not already a member of the Construction Law and Public Contracts Section, now is a great time to call Elizabeth L. Keller at the Virginia State Bar (804-755-0500) and sign up. As a section member, you will periodically receive the section newsletter, which includes summaries and reports on recent construction law cases, particularly unpublished circuit court rulings, as well as articles on developments and issues in construction law. Also, as a section member, you will receive this spring a copy of the newly revised section handbook. The handbook includes summaries of over 700 construction cases under Virginia law. The case summaries have been reviewed and updated, the index has been expanded and, most importantly, the handbook will be issued in disk format to ease your research. The newsletter and handbook are great resources for Virginia attorneys practicing construction law everyday as well as for those attorneys who only have the occasional need to research construction law.

Finally, whether you are a section member or not, I hope you will consider attending the section's Fall CLE Seminar to be held on November 5 and 6, 1999, at the Boar's Head Inn in Charlottesville. The seminar will include presentations on surety bond issues, VDOT claims, false claims, alternatives to standard form contracts, insurance coverage for construction projects, defense of an OSHA complaint, two hours of ethics, as well as other topics. The fall seminar is a unique opportunity to earn all twelve hours of required CLE credits (including ethics), learn from knowledgeable speakers and mingle with other members of the bar. In addition, because this year is the twentieth anniversary of the section, we will be recognizing past-chairs at the Seminar. If you would like to register for the seminar, please contact the Virginia CLE at 800-979-8253 or via the Internet at <http://www.vacle.org>.

Enjoy the reading.

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Y2K Liability In Virginia Construction and Public Contracting



Thomas R. Folk

Many commentators predict massive litigation due to the Y2K or Year 2000 problem. How massive the litigation will be remains to be seen. Certainly, however, a number of disputes will arise in Virginia involving Y2K problems, including disputes involving construction projects and information technology purchased by Virginia public bodies.

The Problem and Implications for Construction and Public Bodies

The Y2K or Year 2000 problem arises from a design choice made by computer software developers early in the information technology era. Computer memory then had very high costs, and the Year 2000 was still far off. By using two-digit rather than four-digit year fields, software developers could save considerable memory. This design choice initially made a great deal of sense—both in terms of economics and computer capability. However, as the Year 2000 approached and the cost of computer memory decreased exponentially, the design choice made less and less sense.¹ Many software developers began to address the issue, some by using four-digit year fields. Not all did at the same time. Further, many “legacy” systems remain in use with two-digit year fields.²

As computers begin processing dates for the Year 2000 and beyond, use of unremediated, two-digit year fields poses grave problems. One such problem is out-of-order sorting caused by the fact that the two digits representing early years of the 21st Century precede the two digits representing later years of the 20th Century, but the years that the corresponding digits represent do not. For example, the two-digits “00” precede the two-digits “99”,

but the Year 1999 precedes the Year 2000. With a two-digit year field, the Year 2000, represented by “00”, would be incorrectly read as preceding the Year 1999, represented by “99”. Another such problem is that time calculations can end up giving incorrect, negative results. For example, in a two-digit year field, the Year 2000 minus the Year 1999 becomes “00” minus “99”, which is negative 99, rather than the correct answer of one. Other related problems include date data field overflow, leap year recognition, and the impact on dates of some programmers’ use of numbers such as “9” as dummy variables or infinity. The net result of these problems could include computer system “crashes” or corruption of data within systems. Further, corrupt data exchanged with other information systems can cause a ripple effect.³

No industry-standard Y2K remediation exists, and Y2K remediators have taken a variety of approaches. These remediation approaches have included: the “field expansion technique” or expansion of the year-field to four digits, the most expensive method; the “windowing technique”, whereby certain, higher, two-digit year field numbers are assumed to be in the 21st Century, and other, lower, two-digit year field numbers are assumed to be in the 20th Century (e.g., all numbers less than 29 are assumed to be in the 21st Century, so 28 is 2028, etc.); the “bridge technique”, which employs a date data bridge that converts date data formats between system elements (e.g., a program that converts a two-digit date field in a sending application to a four-digit date field in a receiving application); and the “encoding technique,” which uses various forms of date format conversion, such as encryption or hexadecimal notation, to allow data compression techniques to be applied to the existing date field to allow century data to fit.⁴ Since no standard remediation approach exists and no industry standards exist even for the same general remediation technique, remediated information technology systems may face problems in the Year 2000 due to interface problems, or inconsistent date handling by other information technology systems. Further, any software coding or recoding is subject to error. Depending on the quality of the programmers and quality assurance/quality control measures, the percentage of errors may vary, but they will generally always be present. Thus, even remediated software likely will have two-digit date fields that have been missed, or errors or “bugs” introduced by the remediation process itself.⁵

Within recent years, use of information technology in construction and by the government has become the norm. Wherever information technology has been used, a potential Y2K problem may exist. Even ordinary building construction may use information

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technology to control systems such as security; heating, ventilation, and air conditioning ("HVAC"); elevators; and fire protection.⁶ More complex construction, such as in water and wastewater treatment plants, prisons, and industrial plants, may use information technology in process controls and sensors.⁷ Information technology used in construction may include a combination of computer systems and embedded processors or controllers.⁸ Government use of information technology is widespread, extending beyond construction. It may include large client-server or mainframe systems that service high-volume transaction programs such as Medicaid, child-support, and unemployment compensation. Thus, Y2K problems potentially could have a widespread impact on important systems used in construction and government operations in Virginia.

Potential Theories of Liability

In Virginia, tort and contract law offer the principal potential bases for recovery by one damaged by the Y2K problem.⁹ However, both approaches have their limitations. Moreover, Federal and Virginia legislation pose significant obstacles to Y2K claims.

Tort Theories

Theories of tort liability available in Virginia include products liability, negligence, and fraud, both actual and constructive. In Virginia, products liability is a more limited basis for potential recovery than in many jurisdictions because Virginia does not recognize strict products-liability in tort,¹⁰ Virginia likely does not recognize products liability based upon a duty to warn about a dangerous condition that becomes reasonably recognizable only after the sale of a product,¹¹ and the economic loss rule eliminates liability for damages other than for physical injury or physical damage to property when there is no privity of contract.¹² Negligence and, possibly, constructive fraud theories are also subject to the limitations posed by the economic loss rule.¹³ Statutes of limitations may also present obstacles. Products liability and negligence claims would be subject to a two-year limitations period for personal injury¹⁴ and a five-year limitations period for damage to property.¹⁵ Accrual would be at the time of injury rather than discovery.¹⁶ Virginia does not have exceptions for "latent defects."¹⁷ Fraud claims would be subject to a two-year statute of limitations, with a discovery rule for accrual.¹⁸ To the extent the claim arises from information technology incorporated into construction that is an "improvement to real property" and that is deemed an "ordinary building material", the five-year statute of repose may apply to bar claims against certain parties, such as the design professional and the general contractor.¹⁹

Significant issues that would likely arise in products liability and negligence cases would include contributory negligence,²⁰ assumption of risk,²¹ proximate causation,²² and mitigation of damages.²³ In certain fraud cases, some of these same issues

may exist, along with the issues of reasonable reliance²⁴ and of whether the representation involved actionable fact or nonactionable opinion.²⁵ These legal issues in tort cases might often consider: When was the information technology developed and acquired and what were reasonable practices within the industries involved at that time? How reasonable was the information technology user's continued use of the technology at a later date? What steps did the information technology provider and the user take to address the Year 2000 problem? And, how reasonable were those steps? Resolution of these issues would likely require examination of extensive documentation of each party's efforts and their reasonableness, examination of extensive documentation of knowledge within the relevant industries at various times, and expert testimony, perhaps in several areas, including causation, standard of care, and knowledge available within relevant industries concerning Y2K issues during certain times.

Contract Theories

The principal contract theory available to make Y2K claims in Virginia is a breach of warranty claim.²⁶ Important threshold issues concern whether the transaction at issue is subject to the Uniform Commercial Code and whether the contract is with a public body and subject to any special government procurement rules. A breach of warranty claim for a Y2K problem may often be difficult to pursue in Virginia.

Implied Warranties

Article 2 of the Uniform Commercial Code (UCC) applies to sales of goods.²⁷ UCC Article 2 contains provisions on both express warranties and implied warranties, including the implied warranty of merchantability and the implied warranty of fitness for a particular purpose.²⁸ Virginia law does not imply these particular warranties to sales other than of goods, although it may imply some limited warranties in certain other circumstances.²⁹ Thus, implied warranties may not often apply in construction or government procurement.

For example, UCC warranties typically become inapplicable once "goods" are incorporated into construction.³⁰ Further, UCC warranties would typically not apply to an information technology project including systems integration in which customized applications are being developed, as this would be considered a sale of services.³¹ Thus, in Y2K claims involving Virginia construction and public contract situations, UCC warranties would generally become an issue only upon failure of some off-the-shelf item of hardware or software that was not deemed to be incorporated into construction.

The information technology industry typically limits warranties and remedies severely so that the seller's only warranties are express warranties contained in the license agreement or sales contract itself, and the buyer's exclusive remedy is for the seller to "repair or replace" a defective product. However, limitations on remedies or damages do not apply to claims for personal injury or in other circumstances where the limitation would be unconscionable.³² Further, under UCC § 2-719(2), "[w]here circumstances cause an exclusive or limited remedy to fail of its essential purpose," the buyer may resort to other UCC remedies.

The limitations period for breach of UCC warranties generally accrues at the date of tender of delivery of the good and runs for four years thereafter.³³ Just as with tort claims, the statute of

repose could apply in some circumstances.³⁴ Further, in claims of breach of implied warranties, as with the tort claims discussed previously, significant factual issues may exist as to whether, at the time of purchase, one would expect the goods to have been free of the particular Y2K problems at issue in order to be "fit." This is so because information technology quickly becomes outdated and typically is upgraded or replaced frequently. Certainly, the further away the purchase date is from the Year 2000, the more problematic the issue becomes for the buyer.

Thus, Y2K claims for breach of implied warranties likely will be limited in Virginia. Essentially, in most circumstances, the claims would only apply to "goods" sold in 1996 and thereafter. Also, in many cases, these implied warranties will have been excluded, and the exclusion will be effective unless unconscionable.³⁵

Express Warranties

Express warranties typically can be found in the express wording of contracts or license agreements. In addition, for sales of goods under the UCC, express warranties may be made by affirmation, promise, description, or use of a sample that becomes a "basis of the bargain."³⁶ Further, even non-UCC sales can have warranties created by other than an express written warranty contained in the written contract.³⁷

A complete discussion of potential issues relating to Y2K claims in Virginia of breach of an express warranty is beyond the scope of this article. However, consider three general scenarios—one in which a general express warranty exists that does not specifically address the Y2K problem, the second in which there is a specific warranty that purportedly specifically addresses the Y2K problem but without a definition of Y2K compliance, and the third in which there is a specific warranty that defines Y2K compliance in detail.

As an example of the first scenario, consider paragraph 3.5.1 of AIA Document A201-1997,³⁸ found in many construction contracts in Virginia, including those of local public bodies. Paragraph 3.5.1 provides in part:

3.5.1 The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless otherwise required or permitted by the Contract Documents, that the Work will be free from defects not inherent in the quality required or permitted, and that the Work will conform to the requirements of the Contract Documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective.

If a Y2K problem later develops from equipment furnished or work done under a contract with this clause, would the Owner have a claim against the Contractor? This would depend in part on determinations of whether the equipment was "of good quality" and whether the work was "free from defects not inherent in the quality required or permitted." These determinations may turn in part on the same questions that arise with tort and implied warranty claims regarding the reasonable practices at the time the equipment was furnished and the work performed. Further, what if the Contract Documents specified particular equipment or software that is a source of the Y2K problem? Can the Contractor argue that the equipment or software is covered by the

Owner's implied warranty of suitability of its plans and specifications,³⁹ not by the Contractor's warranty?⁴⁰ Is the design professional liable to the Owner for specifying items that have a Y2K problem? As some of these questions and points suggest, a breach of warranty claim under this first scenario, where there is only general warranty language, may not be simple.

As an example of the second scenario, consider an express warranty that specifically addresses Y2K issues but does so simply by using an undefined phrase such as "Year 2000 compliant" or "Y2K ready." Whether any generally accepted definitions of "Year 2000 compliance" or other such phrases exist is debatable. Various groups have formulated definitions or standards. The information technology industry, as represented by the Information Technology Association of America, has a definition of Year 2000 compliance⁴¹ that is similar to that adopted by the Institute of Electrical and Electronic Engineers, Inc. (IEEE)⁴² and incorporated in the Federal Acquisition Regulation's Year 2000 compliance clause.⁴³ Significantly, that definition limits responsibility for year information processing to within the system furnished by the vendor and properly exchanged by other systems. It does not make the vendor responsible for its system being unable to process or screen out errant year information from other systems.⁴⁴ The British Standards Institute ("BSI") has promulgated a definition of Year 2000 compliance that does not include the limitation present in the ITAA and IEEE definitions.⁴⁵ The International Standardization Organization ("ISO") only recently adopted a standard, which is essentially the same as the IEEE standard with a minor modification.⁴⁶ However, numerous definitions abound of "Y2K ready," "Year 2000 compliant," and like terms. Accordingly, many express warranties that purport to specifically address Y2K problems but do not define compliance are likely to be ambiguous. Thus, a breach of warranty claim under this second scenario also may not be simple.

Consider two examples of the third scenario where Year 2000 compliance is defined in detail. On the one hand, consider Supplemental General Condition 51 to the Commonwealth of Virginia General Conditions of the Construction Contract.⁴⁷ That provision has a tough, well-drafted, and specific Y2K warranty.⁴⁸ Establishing liability for its breach will still require expert proof of causation, but otherwise will not have the complications associated with scenarios one and two. On the other hand, consider the warranties given by some software vendors. Such warranties may warrant only that the software has passed a certain company's Y2K test and may make no warranty that the test has any relationship to actual operation of the software. Establishing liability for this kind of useless warranty's breach would be an exercise in futility. Thus, the ability to pursue claims under this third scenario will depend greatly upon the specific definition of Year 2000 compliance given.

As with implied warranties, the limitation period for express warranty claims subject to the UCC is four years and generally accrues upon tender of delivery of the goods.⁴⁹ Breach of warranty claims for damage to property not falling under the UCC are generally subject to a five-year statute of limitations.⁵⁰ However, the limitations period may be shortened by agreement.⁵¹ As with tort and implied warranty claims, Virginia's five-year statute of repose may apply.⁵² Further, as with implied warranty claims, express warranty claims may present issues with respect to limitation of remedies and the ability to overcome such limitations

when the limited remedy fails of its essential purpose. Y2K claims for breach of warranty would also be subject to significant mitigation of damage defenses given the extensive publicity given to the Year 2000 problem and to the need for everyone to act prudently before the Year 2000 to identify Y2K problems and plan to address them and mitigate against their potential adverse effects. Thus, Y2K claims for breach of express warranties, with the exception of ones under a well-drafted, specific warranty, such as Commonwealth of Virginia Supplemental General Condition 51, may be difficult to pursue.

Statutory Developments Affecting Y2K Disputes in Virginia

A number of federal and state statutes may significantly affect Y2K claims in Virginia, adding further to the difficulty of making such claims. These statutes generally are extremely protective of information technology providers and of state and local government. Some of these statutes, particularly the Virginia statutes, go so far as to: eliminate Y2K liability for persons not in privity of contract or not extending an express warranty when death, personal injury or property damage are not involved, eliminate claims for delay damages caused by a third-party's Y2K problem, eliminate consequential and punitive damages in certain cases, and immunize state and local governments and government officials from most suits. A certain tension exists between the federal and state statutes because of preemption issues. Also, issues may arise as to whether certain Virginia statutes are intended to apply to claims that already have accrued, and if so, whether this is permissible under the U.S. and Virginia Constitutions. A brief discussion of the statutes and these issues follows.

Federal Y2K Statutes

The Information and Readiness Disclosure Act of 1998 ("IRDA")⁵³ was intended to encourage the disclosure and exchange of information about the Year 2000 problem. Among other things, IRDA makes inadmissible any "year 2000 readiness disclosure" in any "covered action" to prove its accuracy or truth except in limited situations.⁵⁴ It creates for any "covered action" higher federal standards of liability for claims of fraud, defamation, trade disparagement and the like based upon a "year 2000 statement,"⁵⁵ and precludes, with certain exceptions, a "year 2000 statement" creating "an amendment to or alteration of a contract or warranty."⁵⁶ The statute preempts state law in covered actions, which include civil actions in state courts.⁵⁷ The principal practical effects of IRDA for Virginia disputes appear to be that no constructive fraud claims based on year 2000 statements are allowed in "covered actions", including in Virginia state court, and no warranty or breach of contract actions can be based upon or bolstered by "year 2000 statements", except in the very limited circumstances that IRDA allows.⁵⁸ Interestingly, with all the emphasis today on alternative dispute resolution, IRDA does not purport to apply to arbitrations.⁵⁹

On July 20, 1999, President Clinton signed into law the Y2K Act,⁶⁰ which is an amended version of H.R. 775.⁶¹ The Y2K Act significantly affects Y2K claims in Virginia and elsewhere. This legislation would generally place significant limitations on Y2K claims.⁶²

The legislation would require prelitigation notice and an opportunity to correct Y2K problems. It would limit punitive damages in certain cases, eliminate joint and several liability in many cases and establish proportionate liability in its stead, require more specific pleading by plaintiffs, create a pre-loss duty to mitigate, limit recovery of economic losses, encourage alternative dispute resolution, and discourage class actions.⁶³ The Y2K Act has fairly complex federal preemption provisions that appear to leave aspects of Virginia statutes protective of prospective Y2K defendants in place.⁶⁴

Virginia Y2K Statutes

Probably the most significant and drastic Virginia Y2K statute is Va. Code §§ 8.01-227.1 to 227.3. This statute, effective July 1, 1999, places severe limitations on Y2K liability and damages in any civil action against a person in which the claim for damages is based upon a "Year 2000 problem." Section 8.01-227.2 defines "Year 2000 problem" extremely broadly. Except for damages in connection with wrongful death, personal injury, or "property damage," section 8.01-227.3 eliminates in such actions: a person's liability to any person not in privity of contract, not in a beneficiary-trustee relationship or to whom a warranty has not been extended, damages for delay in performance or delivery caused by a Year 2000 problem of, or caused by, a third-party, consequential and punitive damages, and total damages in excess of "direct" damages.

Significant questions the statute raises include: Does it apply to claims that already have accrued but have not yet been filed or prosecuted to judgment, and if it does, is this consistent with the U.S. and Virginia Constitutions?⁶⁵ What does the undefined phrase "property damage" mean?, and what does the undefined phrase "direct damage" mean (e.g., would it include or exclude liquidated damages)?

Va. Code § 8.01-418.3, effective July 1, 1999, makes any "Year 2000 assessment or document" not discoverable or admissible in evidence except in limited circumstances. Discovery or admission of such assessments or documents is only allowed after an in-camera review and for "good cause" shown. In essence, this section creates an expansive and mandatory critical self-evaluation privilege for the Y2K problem.

During its 1998 session, the General Assembly limited the Commonwealth's waiver of sovereign immunity for tort claims to exclude certain "Year 2000" date change claims against the state, state agencies, and their employees.⁶⁶ During its 1999 session, the General Assembly extended similar immunity to counties, cities, towns, and certain other entities except in cases of "gross negligence or willful misconduct".⁶⁷

Preemption And Statutory Interpretation Issues

IRDA preempts state law in any "covered action", which includes civil actions in state court. The Y2K Act has various provisions preempting and referring to state law.⁶⁸ The real issues this federal legislation raises are to what extent and in what specific contexts preemption occurs and how the Y2K Act and state law will work together. Y2K lawsuits thus will likely have preemption and statutory interpretation arguments as a standard feature.

Constitutional Issues

The potential application of Va. Code §§ 8.01-227.1-227.3 to causes of action that have already accrued, particularly to eliminate consequential damages or damages in excess of "direct" damages that may even have been expressly agreed upon by contract, raises constitutional issues. Article I, clause 10, of the U.S. Constitution prohibits states from passing laws that impair the obligation of contracts. Further, due process limits retroactive legislation, and Virginia courts look suspiciously upon retrospective legislation, particularly when that legislation affects substantive rights retroactively.⁶⁹

Conclusion

The Y2K problem certainly will give rise to a number of disputes in Virginia involving construction and government procurement. While claims potentially are available under both contract and tort theories, the nature of the problem will make many of these claims relatively more complex than ordinary claims. Further, recent legislation will add to the difficulty of pursuing such claims. This legislation not only creates significant protections against Y2K claims but also will add significant complexity to litigation, including issues of statutory interpretation, federal preemption, and even constitutionality of various provisions. Ultimately, most Y2K claims in Virginia will be relatively complex, expensive, and difficult to pursue. ☹

- 1 See, e.g., R. Weickers & G. Racho, "Y2K State of the Art & Who Knew What, and When?" 1 *Countdown 2000*, No. 9 (Lexis Oct. 1998) (Arguing that proposed standards for four-digit year fields in the early 1980s in organizations such as ANSI made use of two-digit date fields unreasonable after then).
- 2 See *id.*
- 3 See, e.g., L. Kappelman, *Year 2000 Problem: Strategies and Solutions from the Fortune 100*, Ch. 1. (1997).
- 4 See, e.g., IEEE Std 2000.1-1998, IEEE Standard for Year 2000 Terminology, Annex A, ¶ A.1, Remediation (16 Oct. 1998 SH94667), visited at <http://standards.ieee.org>, on July 22, 1999. Other techniques include retirement or replacement of the system. *Id.*
- 5 See, e.g., L. Kappelman, *Year 2000 Problem: Strategies and Solutions from the Fortune 100*, 2-3, 13, 21-26, 34-39, 67-69 (1997).
- 6 See, e.g., Building Owners and Managers Association (BOMA), *Meeting the Year 2000 Challenge: A Guide for Property Professionals* (1998). See also G. Saporito, "Infestation of the Millenium Bug: Contractor Liability for Failure to Exterminate," No. 98-11, *Construction Briefings Second Series* (Fed. Pub. Oct. 98). Based upon surveys, a typical 12-story commercial building may have 50 to 100 systems.
- 7 See, e.g., *Year 2000 Law Report No. 8*, 381-82 (BNA Nov. 1998); See also "Not a Test: The war against Y2K is being fought one RTU at a time," *Wired* (Apr. 1999).
- 8 See, e.g., BOMA, *supra* note 6; See also D. Lefkon, "The Practical Engineer: Making Embedded Systems Year 2000 Compliant," 85 *IEEE Spectrum* No. 6 (June 1998). The Gartner Group has estimated that approximately 25 billion embedded controllers have been deployed and that some 50 million may be affected by Y2K problems.
- 9 Statutes, such as consumer protection laws, may provide bases for recovery in some cases but generally would not provide claims in a construction setting not involving a "consumer product" or in a public contract law setting. See Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301-2312; Virginia Consumer Protection Act, Va. Ann. Code §§ 59.1-196 to 59.1-207. Also, Virginia has a statutory warranty that applies to construction of new dwellings. See Va. Code Ann. § 55.70.1.
- 10 See, e.g., *Harris v. T. L. Inc.*, 243 Va. 63, 71, 413 S.E.2d 605, 609-10 (1992); *Stockbridge Community Assoc. v. Star Enterprise*, 27 Va. Cir. 82, 83-84 (Fairfax Cir. Ct. 1992).
- 11 See, e.g., *Ambrose v. Southworth Prods. Corp.*, 953 F. Supp. 728 (W.D. Va. 1997).
- 12 See, e.g., *Sensenbrenner v. Rust, Orling & Neale Architects Inc.*, 236 Va. 419, 374 S.E.2d 55 (1988).
- 13 See *Rotonda Condominium Owners Ass'n v. Rotonda Associates*, 238 Va. 85, 380 S.E.2d 876 (1989) (party could not pursue negligence claim; contract afforded exclusive remedy); *Virginia Transformer Corp. v. P.D. George Co.*, 932 F.Supp. 156, 162 (W.D. Va. 1996) (fraud exception to economic loss rule is solely for actual fraud, not constructive fraud).
- 14 See Va. Code Ann. § 8.01-243A.
- 15 Va. Code Ann. § 8.01-243B.
- 16 Va. Code Ann. § 8.01 - 230.
- 17 See, e.g., *Comptroller of Virginia ex rel. Virginia Military Institute v. King*, 217 Va. 751, 232 S.E.2d 895, 900 (1977).
- 18 Va. Code Ann. § 8.01-243A, - 249.1.
- 19 See Va. Code Ann. § 8.01-250.
- 20 See, e.g., 13B Michie's Jurisprudence, *Negligence* § 26 (1988).
- 21 *Id.* § 43.
- 22 *Id.* §§ 20-23.
- 23 See, e.g., 5C Michie's Jurisprudence, *Damages* §§ 16-17 (1998).
- 24 See, e.g., *Van Deusen v. Snead*, 247 Va. 324, 327, 441 S.E.2d 207, 209 (1994). See also *Meridian Title Ins. Co. v. Lilly Homes, Inc.*, 735 F.Supp. 182, 195 (E.D. Va. 1990), *aff'd*, 934 F.2d 319 (4th Cir. 1991).
- 25 See, e.g., *Watson v. Avon Street Business Center, Inc.*, 226 Va. 614, 618, 311 S.E.2d 795, 798 (1984) (description of roof as "25-year roof" or "good roof" nonactionable opinion).
- 26 A Y2K problem could also present a breach of contract claim. However, the issues, other than possibly the statute of limitations when the UCC applies, would be virtually the same. See Va. Code Ann. § 8.01-246 (4-year UCC limitation period rather than 3-year and 5-year limitations periods for breach of oral and written contracts applies when a breach of warranty claim is made except in certain products liability actions for injury).
- 27 Va. Code Ann. § 8.2-102. See also Va. Code Ann. § 8.2-2-105(1) (defining "goods").
- 28 Va. Code Ann. §§ 8.2-314, -315.
- 29 As to the general lack of implied warranties in sales other than of goods, see *Bruce Farms v. Coupe*, 219 Va. 287, 289, 247 S.E.2d 400, 402 (1978). As to limited implied warranties in some construction contracts, see *Hall v. McLeod*, 191 Va. 665, 62 S.E.2d 42 (1950). As to statutory warranties for construction of a new dwelling, see Va. Code Ann. §§ 55-70.1 B & E; *Davis v. Tazewell Place Associates*, 254 Va. 257, 492 S.E.2d 162 (1997).
- 30 See, e.g., *Winchester Homes, Inc. v. Hoover Universal, Inc.*, 30 Va. Cir. 22 (1992).
- 31 See, e.g., *RRX Industries, Inc. v. Lab-Con, Inc.*, 772 F.2d 543 (9th Cir. 1985).
- 32 Va. Code Ann. § 8.2-719(3).
- 33 Va. Code Ann. § 8.2-725. An exception to the rule that accrual is upon tender of delivery is "where a warranty explicitly extends to future performance of the goods." *Id.* § 8.2-725(2).
- 34 Va. Code Ann. § 8.01-250.
- 35 Va. Code Ann. § 8.2-719.
- 36 Va. Code Ann. § 8.2-313.
- 37 See, e.g., *Hall v. MacLeod*, 191 Va. 665, 62 S.E.2d 42 (1950) (implied warranty of fitness and good workmanship in construction contracts).
- 38 American Institute of Architects, AIA Document A201, "General Conditions of the Contract for Construction" (1997 ed.).
- 39 See *Chantilly Construction Corp. v. Department of Highways and Transportation*, 369 S.E.2d 438, 444 (Va. Ct. App. 1988); *United States v. Spearin*, 248 U.S. 132, 136 (1918).
- 40 See, e.g., *Trustees of Indiana University v. Aetna Casualty & Surety Co.*, 920 F.2d 429, 435-37 (7th Cir. 1990), *overruled in part on other grounds*, *Weston v. Amedio Steel*, 29 F.3d 274 (7th Cir. 1994).
- 41 See "ITAA's Year 2000 Compliant Definition," <http://www.itaa.org/definition.htm>, visited on July 22, 1999.
- 42 See IEEE Std 2000.1-1998, IEEE Standard for Year 2000 Terminology (16 Oct. 1998 SH 94667), visited at <http://standards.ieee.org>, on July 22, 1999. That standard was recently revised. See IEEE Std 2001.1-1999(R), visited at <http://standards.ieee.org>, on July 22, 1999.
- 43 See clause at FAR 39.002. See also FAR 39.106.
- 44 See IEEE Std. 2000.1-1998, IEEE Standard for Year 2000 Terminology, ¶ 3.4.b;

(16 Oct. 1998 SH94667), visited at <http://standards/ieee.org> on July 22, 1999.

- 45 See BSI DISC PD2000 - 1:1998, "A Definition of Year 2000 Conformity Requirements," visited at <http://www.bsi.org.uk/bsi/disc/year2000.html> on July 22, 1999.
- 46 ISO 16509. Per July 21, 1999, conversation with Kevin Lewis, editor for the ISO Year 2000 Project.
- 47 (Oct. 5, 1998). Available from the Commonwealth of Virginia, Department of General Services.
- 48 That warranty states in part as follows:
- (a) Contractor represents and warrants that all computer controlled facility components . . . are or will be 4-digit Year 2000 compliant, as herein defined
- (b) "Computer controlled facility component" or "CCF component" shall mean all systems components, products, or modules which utilize software driven technology or embedded microchip technology. This shall include, but not be limited to, programmable thermostats, HVAC controllers, auxiliary elevator controllers, utility monitoring and control systems, fire detection and suppression systems, alarms, security systems and any other facilities control systems utilizing microcomputer, minicomputer or programmable logic controllers.
- (c) "Year 2000 compliant" or "4-digit Year 2000 compliant" shall mean that each CCF component both individually and when working with other parts of a system, must at a minimum meet the following requirements when used before, on or before January 1, 2000: (1) accurately interpret, recognize, calculate, compare, sequence, store, retrieve, display, transmit and otherwise accurately process and act on all date information; (2) experience no crash, interruption, degradation of performance or requirement for human intervention as a result of processing or acting on date information; (3) correctly recognize and handle all leap years and calendar logical; (4) structure and store date data in a format to accommodate the 4-digit range; (5) provide all necessary interfaces or other appropriate means for assuring that non-compliant date data are automatically corrected before entering or leaving the system.

Supplemental General Condition 51 to Commonwealth of Virginia Conditions to the Construction Contract.

- 49 Va. Code Ann. § 8.2-725.
- 50 Va. Code Ann. §§ 8.01-243B, -246.
- 51 See, e.g., *Board of Supervisors of Fairfax County v. Sampson*, 235 Va. 516, 520, 369 S.E.2d 178, 180 (1988) (non-UCC). See Va. Code Ann. § 8.2-725(1) (UCC).
- 52 Va. Code Ann. § 8.01-250.
- 53 Pub. L. No. 105-271, 112 Stat. 2386 (1998), at 15 U.S.C. 1 note.
- 54 *Id.* § 4(a).
- 55 *Id.* § 4(b) & (c).
- 56 *Id.* § 4(e).
- 57 *Id.* § 3(4).
- 58 Some of these limited circumstances include that a year 2000 readiness disclosure, including a year 2000 statement therein, may be used (1) to claim anticipatory breach, repudiation, or a similar claim against the maker, or (2) if a court, in its discretion, determines that the maker's use of the statement amounts to bad faith or fraud "or is otherwise beyond what is reasonable to achieve the purposes of this Act." *Id.* § 4(a).
- 59 See *id.* § 3(4) (defining "covered action" to include any "civil action"); Fed. R. Civ. P. 2 (using term "civil action" to denote a lawsuit). See also *Black's Law Dictionary* 311-12 (4th ed. 1968) (defining "civil action").
- 60 See <http://www.pub.whitehouse.gov/urires/12R?urn:pdi://oma.eop.gov.us/1999/7/21/10>. text.1 viewed on July 22, 1999.
- 61 Pub. L. No. 106-0037, 113 Stat. 135, to be codified at 15 U.S.C. §§ 6601, *et seq.* See <http://www.senate.gov/~commerce/legis/0630h775.pdf> viewed on July 22, 1999. This is the full text of the bill as transmitted to the President and signed on July 20, 1999.
- 62 See "Bill Summary," viewed at <http://www.senate.gov/~commerce/legis/y2ksum.pdf> on July 22, 1999.
- 63 See Y2K Act and Bill Summary, *supra* notes 61 and 62.
- 64 See Y2K Act, *supra* note 61, 4(e), 6(g), 7(h)&(j), 11, 12(a)&(c), 13(a)&(b), 15(a), 16. Section 16 provides:
- Nothing in this Act shall be construed to affect the applicability of any state law that provides stricter limits on damages and liabilities, affording greater protection to defendants in Y2K actions, than are provided in this Act.

- 65 See generally 17 Michie's Jurisprudence, *Statutes* § 73 (1994).
- 66 See Va. Code Ann. § 8.01-195.2.8.
- 67 Va. Code Ann. § 15.2-108.
- 68 See note 64, *supra*.
- 69 See generally 17 Michie's Jurisprudence, *Statutes* § 73 (1994).



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V I R G I N I A S T A T E B A R

Why All of Your Construction Clients Need to Worry About The Americans with Disabilities Act



Timothy R. Hughes

Construction industry clients need to be familiar with the terms of the Americans with Disabilities Act (the "ADA"). The ADA is a piece of sweeping civil rights legislation that may change the obligations of all of the parties to the construction process. Many aspects of the ADA are unclear or susceptible to multiple interpretations in light of the manner in which courts are construing the terms of the ADA and accompanying enabling regulations. As such, clients need to take a broad view to evaluate and minimize the liability risks posed by the ADA.

There are several critical features of the ADA that need to be emphasized. First, it is currently unsettled as to exactly who may be liable pursuant to the ADA. Second, the ADA is essentially a "civil rights" statute rather than a building code. The ADA is thus different in application than the traditional measures of minimal construction and design performance. Third, the ADA creates exposure for not only repair costs and injunctive relief, but also civil penalties and recovery of legal fees and expenses. Finally, judicial interpretations of the ADA have been extremely inconsistent even on simple questions. These facets of the ADA warrant both a need for a healthy respect for the ADA on the part of clients and the usefulness of an outline of some of the major points of the ADA, accompanying regulations, and interpretive caselaw.

What is the Purpose of the ADA?

The broad, sweeping purpose of the ADA can be seen from its general mandate. The ADA was

enacted, "To provide clear and comprehensive national mandate for the elimination of discrimination against individuals with disabilities." *See*, 42 U.S.C. § 12101(b)(1). The broad nature of the statute is further intended, "[t]o invoke the sweep of congressional authority, including the power to enforce the fourteenth amendment and to regulate commerce, in order to address the major areas of discrimination faced day to day by people with disabilities" *See*, 42 U.S.C. § 12101(b)(4).

The express "sweeping" nature of the ADA has important ramifications. Courts interpreting such legislation tend to resolve questions by resorting to this express purpose of Congress. The premise that owners, contractors, and design professionals need to understand is that the ADA is not a building code. Rather, the ADA is a sweeping piece of civil rights legislation. Courts thus tend to construe the statute in a broad fashion.

What Types of Structures are Governed by the ADA?

Title III of the ADA provides that the ADA applies to all "public accommodations". "Public accommodations" are defined within the ADA to include a broad range of types of structures and businesses. *See*, 42 U.S.C. § 12181(A)-(L). Given the sweeping intent of the ADA, and the extremely broad definitions of "public accommodations" found within the ADA, counsel should probably view any structure that invites the public to enter as a "public accommodation" subject to ADA.

What are Prohibited Activities Pursuant to the ADA?

The ADA provides that no individual shall be discriminated against on the basis of disabilities from the full and complete enjoyment of the goods, services, facilities, advantages, or accommodations of any public accommodation. *See*, 42 U.S.C. § 12182(a). Discriminatory activity includes affording differential benefits due to disabilities. *See*, 42 U.S.C. § 12182(b)(1)(A)(ii). Goods, services, advantages, and accommodations must be afforded to individuals in the "most integrated setting appropriate to the individual". *See*, 42 U.S.C. § 12182(b)(1)(B).

For public accommodations, discrimination pursuant to the ADA includes the failure to remove

architectural barriers in existing facilities where such removal is "readily achievable". See 42 U.S.C. § 12182(b)(2)(A)(iv). Where removal of such barriers is not readily achievable, it is discrimination if the party does not pursue alternative methods of providing access, goods, or services to the disabled if those alternative methods are readily achievable. See, 42 U.S.C. § 12182(b)(2)(A)(v). The term "readily achievable" is defined as, "easily accomplished and able to be carried out without much difficulty or expense." See, 42 U.S.C. § 12181(9). Factors to consider include the cost of the specific action, the overall financial resources of the entity involved, and the type of operations engaged in by the covered entity. Id.

What are the Provisions Relating to New Construction?

Discrimination pursuant to the ADA includes the failure to "design and construct" new facilities that are "readily accessible to and usable by individuals with disabilities". See, 42 U.S.C. § 12183(a)(1). The issue of who can be liable for failures to "design and construct" accessible facilities has resulted in extensive, and often inconsistent, litigation. Determining who may be liable under the ADA is currently unclear.

The ADA contains an exception from compliance where it is "structurally impracticable" to meet requirements. Id. The question of structural impracticability is factual in nature. In addition to new facility construction, the renovated portions of renovated facilities are also subject to compliance with the "new construction" requirements of the ADA. See, 42 U.S.C. § 12183(a)(2). The ADA also provides that improvements be made to the path of travel to the renovated portion of the facilities to make the renovated portion accessible. Id.

What are the Available Remedies Pursuant to the ADA?

Injunctive relief is available under the ADA, including the issuance of court orders to alter facilities to make facilities readily accessible. See, 42 U.S.C. § 12188(2). With regards to enforcement actions, the United States Attorney General may commence civil action against a discriminating party upon reasonable cause to believe a person is engaging in a "pattern and practice" of discrimination. See, 42 U.S.C. § 12188(b)(1)(B)(i). The Attorney General may also file suit if particular discrimination, "raises an issue of general public importance." See, 42 U.S.C. § 12188(b)(1)(B)(ii).

In cases brought by the Attorney General, the court may order equitable relief, including making facility readily accessible and usable to individuals with disabilities. See, 42 U.S.C. § 12188(b)(2)(A). Further, the court may award other relief, including monetary damages to aggrieved parties, in cases filed by the Attorney General. See, 42 U.S.C. § 12188(b)(2)(B). The court may assess civil penalties up to \$50,000 for a first violation of the ADA and may issue civil penalties of up to \$100,000 for subsequent violations. See, 42 U.S.C. § 12188(b)(2)(C).

The ADA expressly provides that civil remedies pursuant to 42 U.S.C. §§ 2000a-3(A) are also available, including injunctive relief. See, 42 U.S.C. § 12188(a)(1). Thus, private litigants may seek direct redress in court for alleged violations of the ADA. The ADA permits a private litigant to seek redress in situations of not only being subjected to discrimination, but also having "reason-

able grounds for believing that such person is about to be subjected to discrimination" Id. Finally, the court or agency may award, in its discretion, a reasonable attorney's fee to the prevailing party. See, 42 U.S.C. § 12205. This provision applies to actions before administrative bodies and court cases. Id.

Miscellaneous Provisions of Interest

The Attorney General may review and certify local and state buildings codes for compliance with ADA upon request. See, 42 U.S.C. § 12188(b)(1)(A)(ii). According to the DOJ website dealing with the ADA, DOJ has certified accessibility guidelines and building codes in Florida, Maine, Texas, and Washington states as meeting or exceeding the ADA as of August 24, 1999. In addition, similar statutes and regulations for California, Indiana, Maryland, Minnesota, New Jersey, New Mexico, North Carolina, the county of Hawaii, and several model building codes are currently under review.

In addition, the Attorney General and other agencies are authorized to provide technical assistance. See, 42 U.S.C. § 12206. The ADA does not excuse parties from compliance for failure to receive accurate technical assistance, including failure of agencies to develop technical assistance manuals required by the Act. See, 42 U.S.C. § 12206(e). As such, this technical assistance may be of limited utility.

Who Drafts the Applicable Regulations?

The ADA directs the Architectural and Transportation Barriers Compliance Board (the "Board") to develop minimum guidelines to provide for accessibility of various structures. See, 42 U.S.C. § 12204(a). The ADA also expressly provided for the Attorney General of the United States to promulgate regulations that implement the act. See, 42 U.S.C. § 12186(b). The ADA requires that regulations issued by DOJ be "consistent with" the minimum guidelines and requirements issued by the Board. See, 42 U.S.C. § 12186(c).

According to this statutory mandate, the Board created a set of guidelines for design and construction guidance to facilitate accessibility. DOJ in turn adopted these guidelines and re-issued its own set of regulations to effectuate Congress' intent with respect to the ADA (the "DOJ Regulations"). See, 28 C.F.R. §§ 36.101 et seq. These regulations provide specific guidance as to when removing existing barriers in "public accommodations is "readily achievable." See, 28 C.F.R. § 36.304. The removal of barriers includes: installing ramps; making curb cuts; repositioning shelves, tables, and other items; widening doors; installing grab bars; installing accessible door hardware; creating designated accessible parking spaces; and removing high pile carpets. See, 28 C.F.R. § 36.304.

Regarding new construction and renovations to existing facilities, the DOJ Regulations included an express adoption of compliance with the standards for accessible design developed by the Board. See, 28 C.F.R. § 36.406. Most of the construction standards developed by the Board and incorporated by DOJ into the DOJ Regulations parallel ANSI A 117.1, the hallmark initial standards for accessible design and construction. There are some alterations, and counsel is well advised to seek assistance on interpretation from experts, in accessible design and building codes on this point.

The DOJ Regulations provide similar guidance regarding required improvements to the path of travel on renovation or improvement projects. See e.g., 28 C.F.R. § 36.403. Finally, the DOJ Regulations define “structural impracticability” as instances where an entity, “[C]an demonstrate that it is structurally impracticable to meet the requirements “[these situations] will be considered only in those rare circumstances when the unique characteristics of terrain prevent the incorporation of accessibility features.” See, 28 C.F.R. § 36.401(c) (emphasis added).

Appendix A to the DOJ Regulations offers some specific construction details that govern various individual situations presented by construction design. The Regulations are very detailed and include dimensions and details for providing various elements of accessible design and construction. All designers and contractors should be familiar with these requirements to minimize potential exposure to claims.¹

Who Can Be Liable? The Ellerbe Becket Cases

The question of precisely who is exposed to liability pursuant to the ADA has been addressed in multiple cases throughout the country. Courts have reached widely varying results on the question of who can be liable for a failure to “design and construct” accessible facilities. For example, the architectural firm of Ellerbe Becket was sued by an advocacy group with regards to the design and construction of the MCI Arena in Washington, D.C.

Courts have reached widely varying results on the question of who can be liable for a failure to “design and construct” accessible facilities.

The United States District Court for the District of Columbia granting Ellerbe Becket’s Motion to Dismiss holding that the architect only designed the facility and thus could not “design and construct” the MCI Arena. Paralyzed Veterans of America v. Ellerbe Becket, et al., 945 F. Supp. 1 (D.C. 1996). In contrast, the United States District Court for the District of Minnesota held differently with respect to the same architectural firm as defendant. The Department of Justice filed suit against Ellerbe Becket in Minnesota alleging that the architectural firm engaged in a pattern and practice of discrimination by designing inaccessible facilities. The Minnesota court overruled Ellerbe Becket’s Motion to Dismiss and expressly disagreed with the Paralyzed Veteran’s case. United States v. Ellerbe Becket, 976 F. Supp. 1262 (D.C. Minn. 1997). The Ellerbe Becket court held that the ADA could apply to architect’s on these facts. Id.

The court’s rejection of the defendant’s argument rested on a distinction between public accommodations, where only owners could be liable, and “commercial facilities” which required a party to “design and construct” the facility to create liability. According to the trial court, the distinctions between the “commercial facilities” section and the “public accommodations” section could leave no one liable on commercial facilities in the event the court adopted the architect’s interpretation. Id. at 1267. The trial court held that, at the motion to dismiss phase, it was inappropriate to find as a matter of law that the architect could not have participated in the “design and construction” given the potential for construction monitoring by the architect. Id.

Ellerbe Becket eventually entered into a Consent Order dated April 22, 1998 in this case. While not conceding liability, Ellerbe agreed to design facilities in accordance with DOJ requirements for enhanced lines of sight for disabled patrons.²

The Broward Arena is yet another Ellerbe Becket designed arena project. Broward Arena is the home of the Florida Panthers. Johanson v. Huizenga Holdings, Inc., 963 F. Supp. 1175, 1176 (S.D. Fl. 1997). Ellerbe Becket again filed a motion to dismiss plaintiffs’ ADA claims arguing that a “failure to design and construct” under the ADA must include both design and construction. Johanson, 963 F. Supp. at 1177. Like the Minnesota case, the Broward Arena court rejected the argument, holding that for purposes of motion to dismiss, plaintiffs could maintain their action against Ellerbe Becket. Id. at 1178. Thus, different courts have reached different results based on the same facts. Indeed, these three cases involving Ellerbe Becket shared the common issue of who can be liable, involved the exact same party (Ellerbe Becket) and were basically the same type of project (design and construction of a large scale arena).

The Day’s Inn Cases

DOJ filed three separate cases against various Day’s Inn hotel franchisees and the franchisor alleging that the design and construction of various Day’s Inn facilities failed to meet ADA requirements. The Day’s Inn franchisor developed manuals regarding construction, design and operation of Day’s Inn facilities to ensure uniform appearance of the various members of the chain. The question of whether Day’s Inn could be liable, as franchisor, for a facility that it did not own, operate, or contract for construction and/or design was construed in three separate cases with varying results.

In Illinois, the Attorney General sued the national organization that licenses Day’s Inns amongst other parties. United States v. Day’s Inn of America, Inc., et al., 997 F. Supp. 1080 (C.D. Ill. 1998). The trial court analyzed the role of the franchisor in developing plans, manuals, and reviewing construction documents used for construction of the facility in question. The court found that Day’s Inn involvement was sufficient to classify them as designing and constructing the facility to fall within the parameters of the ADA. Id. at 1083. The court expressly disagreed with narrow construction of the statutory “design and construct” language found in the MCI arena case as to the architect, Ellerbe Becket. Id.

In South Dakota, the Attorney General again brought an enforcement action against the Day’s Inn franchisor. In this case, the District Court granted summary judgment to the franchisor holding that the franchisor did not “design and construct” facilities in question. See, United States v. Day’s Inn of America, Inc., et al., 151 F.3d 822 (8th Cir., 1998). The Court of Appeals reversed, finding that a finder of fact could determine that they designed and constructed the facility. Id. at 824.

The court cited various examples of such facts. For example, a Day’s Inn franchise representative recommended the architect and builder who were eventually hired by the franchisee. Id. The franchise agreement included a requirement for submittal and approval of plans by Day’s Inn. The court did find that “design and construct” was conjunctive and thus meant a party

who both designs and constructs the facility. *Id.* at n. 2. Thus, this holding agrees with the logic of MCI Arena while finding that summary judgment was inappropriate on these facts. The court stated that to bear responsibility under the ADA, a party must possess a "significant degree of control over the final design and construction". *Id.* at 826. While Day's Inn did not exercise that control under the facts of the case, it did have the contractual right to control construction and design and thus summary judgment was inappropriate. *Id.* at 826-27.

Finally, the Attorney General brought yet another enforcement action against Day's Inn in Kentucky. The same scenario was presented as the South Dakota and Illinois cases with respect to the franchise agreements, manuals, and the like. *United States v. Day's Inn, Inc. et al.*, 22 F Supp. 2d 612 (E.D. Ky. 1998). The contractor, builder, and owner of facility agreed to remedy allegations of non-compliance with the ADA and were thus dismissed by the Attorney General. The trial court found that only owners, operators, and lessors were liable under Section 303 of the ADA. *Id.* The court found that the manuals placed responsibility for ADA compliance on the franchisee. The court further held that Day's Inn was not an "operator" of the facility because it was not really controlling the facility. As such, ADA liability was inappropriate. *Id.*

The Ellerbe Becket and Day's Inn cases demonstrate a critical point about the ADA. Such simple language applied to the myriad of facts presented by a construction project creates uncertainty. When coupled with the viewpoints of different judges with respect to statutory interpretation and enforcement, it is difficult to determine who may be liable under the ADA.

The best course is to assume that any party that either "designs" or "constructs" portions of a project may be exposed to direct ADA liability. This translates a need for not only design professionals, but also contractors, subcontractors, and owners to concern themselves with ADA compliance.

A Case Study: Enhanced Lines of Sight

The spate of cases throughout the country dealing with "enhanced lines of sight" offers perhaps the most in-depth example of ADA interpretation and enforcement. The biggest question presented in most of these cases is precisely what type of seat is acceptable for a disabled patron in a public facility. At its most basic level, the ultimate question is whether a disabled patron is entitled to a seat which permits viewing an event over a patron who stands up. The cases also discuss the need for dispersion and integration of seating for the disabled within the facility.

A review and analysis of the promulgation of regulations on this point is critical to understanding these cases.³ Initial ANSI A 117.1 standards for accessibility required handicapped seating to have "comparable lines of sight" to those seats for non-disabled patrons. This language was interpreted to mean that seating for the disabled could not have obstructed views. In the interpretation of ANSI, there was no requirement for "enhanced lines of sight" that permitted a wheelchair bound patron to be able to see over the heads of non-disabled patrons who stood up during an event.

When the Board issued ADAAG, it simply incorporated the prior ANSI A 117.1 requirements for "comparable lines of sight".

During the development of ADAAG, there was considerable discussion put forth as to whether specific language for enhanced lines of sight should be included. The final version deleted such language that was present in earlier drafts. The Department of Justice simply adopted ADAAG without any review or comment on the question of what "comparable lines of sight" meant.

In 1994, the Department of Justice issued its supplement to its Technical Assistance Manual ("TAM"). The supplement required enhanced lines of sight to meet the requirement of "comparable lines of sight" under the ADAAG regulations adopted pursuant to 28 CFR §§ 101 et seq. The supplement was issued without a "notice and comment" period typically required pursuant to administrative procedures when an administrative agency engages in a substantive rule change. This chain of events set the stage for significant litigation throughout the country of major, high-profile public stadium projects.

The spate of cases throughout the country dealing with "enhanced lines of sight" offers perhaps the most in-depth example of ADA interpretation and enforcement.

The MCI Arena Case

On the Washington, D.C. MCI Arena project, the owners and designers did not require enhanced lines of sight for all of the seating for the disabled. The owners, developers, and designers were sued by the Paralyzed Veterans of America for failure to "design and construct" a facility that met the requirements for new construction pursuant to the ADA. When faced with the question of facility's compliance with the ADA, the trial court expressly noted that the remaining defendants had acted in good faith. *Paralyzed Veterans of America v. Ellerbe Becket, et al.*, 950 F. Supp. 389, 392 (D.C. 1996)(denying defendants' Motions for Summary Judgment); *see also, Paralyzed Veterans of America v. Ellerbe Becket, et al.*, 950 F. Supp. 393, 394 (D.C. 1996)(granting Plaintiff's request for injunctive relief). The facility even contained a greater number of seats for the disabled than required pursuant to the ADA. *Paralyzed Veterans*, 950 F. Supp. at 401.

Nevertheless, the court ruled, that the original design failed to comply with the ADA. *Id.* 950 F. Supp. at 405. The court held the original design failed to meet DOJ's requirements for enhanced lines of sight. In addition, the original design failed to provide for adequate dispersion of the seating for the disabled to comply with the ADA and DOJ's interpretive regulations. *Id.*

The design of the MCI Arena was selected in January 1995. *Id.* 950 F. Supp. at 396. The Department of Justice issued a supplement to its Technical Assistance Manual in December, 1994 which indicated DOJ would require enhanced lines of sight. *Id.* 950 F. Supp. at 391. The TAM was issued without a review and comment period that is typically associated with administrative rules changes. *Id.* 950 F. Supp. at 399. Despite these issues, the court found that DOJ's interpretations were entitled to agency interpretive deference and enhanced lines of sight were required for compliance.

After the initial ruling, later changes to the design resulted in a higher percentage of seats with enhanced sightlines. The trial court then ruled that "substantial compliance", as demonstrated

in the final design, was sufficient to comply with the ADA. Both sides appealed. Paralyzed Veterans, 117 F.3d 579, 580 (D.C. Cir. 1997). The owners of the facility claimed on appeal that enhanced sightlines were not required due to the lack of notice and comment for administrative rule change. The plaintiff claimed that "substantial compliance" was insufficient; rather, the ADA should require full and complete compliance with 100% of accessible seating having enhanced lines of sight. The Court of Appeals for the District of Columbia upheld the lower court's opinion in toto. *Id.* at 589. The owners eventually appealed to the United States Supreme Court where a writ of certiorari sought by the owners was denied. *Id.*, 118 S. Ct. 1184.

The Rose Center Litigation

The Rose Center is the home of the Portland Trail Blazers. As with the litigation in the MCI Arena case, a significant portion of the litigation was devoted to what requirements were for lines of sight for seating for the disabled. Independent Living Resources v. Oregon Arena Corporation, 982 F. Supp. 698 (D.C. Ore. 1997). Further, the case devotes a great deal of analysis to the question of companion seating locations, dispersion of seating, and integration of seating for the disabled within the overall seating plans. The court found that placement of accessible seating "made a mockery" of dispersal requirements in the ADA. *Id.* at 712. The court found violation of both vertical and horizontal dispersion requirements. *Id.* at 716-717.

In contrast to the MCI Arena case, the Oregon Arena court found that DOJ was bound by its actions to the commentary of the Board when it adopted the ADAAG as part of the DOJ Regulations. Oregon Arena, 982 F. Supp. at 741-42. The issue of whether enhanced lines of sight were required was expressly deferred by the Board when it developed the ADAAG. *Id.* Thus, any attempt to alter the earlier rule would be an interpretive rule change requiring a notice and comment period. Oregon Arena, 982 F. Supp. at 743.⁴

Caruso v. Blockbuster

The Caruso case again analyzed the requirement for enhanced lines of sight. The Caruso trial court granted defendants' motions for summary judgment, holding that the "enhanced lines of sight" requirements set forth in the 1994 Supplement to the TAM were effectively a rule change without notice and comment. Caruso v. Blockbuster-Sony Music Entertainment Center, et al., 968 F. Supp. 210, 214-15 (S.D. N.J. 1997).

The case turned on the court's review and analysis of the regulations. The Caruso court found that the original ANSI A 117.1 requirements were never interpreted as requiring "enhanced lines of sight". *Id.* at 217. When ADAAG was developed, the question of enhanced lines of sight was expressly deferred. *Id.* at 216. DOJ simply adopted the ADAAG as its regulations.

On appeal, the Third Circuit Court of Appeals upheld this portion of the lower court's ruling. Caruso v. Blockbuster, 174 F.3d 166 (3rd. Cir. 1999). Another ruling granting defendants' motion for summary judgment and dismissing plaintiffs' claims related to lack of accessibility lawn seating at the facility was reversed. *Id.*

Conclusion

As demonstrated above, such apparently simple issues as "who can be liable" pursuant to the ADA are unresolved. This lack of

clarity on even basic points makes liability pursuant to the ADA a threat to every party to the construction process.

Non-compliance with accessibility requirements is not just a design issue. When a contractor places a plumbing stack in the wrong location and thus shifts all the toilets in a building too close to a wall, the ADA may be violated. The contractor may find themselves responsible for not only repair costs, but also legal fees and even penalties under the right circumstances. As such, the stakes in this type of litigation are quite high.

All of these factors make accessibility difficult to access. As such, clients need to aggressively manage risks associated with these claims by taking the broadest possible interpretation as to who can be liable. Further, construction clients need to take a proactive attitude and go beyond the apparent requirements of the law to avoid potential entanglement with ADA liability. ☞

Endnotes

- 1 The design details include dimensions and design criteria for such items as acceptable curb cuts, accessible elevators, and compliant handrails, not to mention obstructions to path of travel and the like.
- 2 For more information, you may refer to the Department of Justice Web site on accessibility issues, <http://www.usdoj.gov/crt/ada/ada-home.html>.
- 3 The cases cited below provide detailed treatments of the regulatory and statutory history of the ADA, ANSI A 117.1, ADAAG, and the DOJ regulations regarding accessibility. For a detailed history, see Paralyzed Veterans of America v. Ellerbe Becket, et al., 950 F. Supp. 389, 392 (D.C. 1996)(denying defendants' Motions for Summary Judgment); see also, Paralyzed Veterans of America v. Ellerbe Becket, et al., 950 F. Supp. 393, 394 (D.C. 1996)(granting Plaintiff's request for injunctive relief); see also, Paralyzed Veterans v. D.C. Arena L.P., 117 F.3d 579, 580 (D.C. Cir. 1997).
- 4 The Rose Center litigation was not resolved by merely this reported decision. Other related reported decisions on this project are reported at 1 F. Supp 2d. 1124 and 1 F. Supp. 2d 1159. Given just the number of pages of these decisions, these cases are a testament to the level of detail, legal fees, and efforts that can accompany an ADA based lawsuit.

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Determining Enforceability of Liquidated Damages: A Prospective or Retrospective Analysis?



William R. Mauck, Jr.

It is not unusual for construction contracts to provide for the assessment of liquidated damages against a contractor for each day the contractor is late in completing a project or a portion of the project beyond a specified deadline. Liquidated damages provisions of this sort are designed to facilitate recovery of an owner's losses for delay in completion by permitting the owner to withhold a fixed sum, typically accrued on a daily basis, from payments otherwise due the contractor.

The Virginia Supreme Court has upheld the enforceability of liquidated damages for delay in completing a construction project.¹ Indeed, since at least the late 1800's, the Court has accepted the general concept of liquidated damages that parties can stipulate in advance the damages to be assessed in the event of future breach:

[I]t is competent for parties entering an agreement to avoid all future questions of damage which may result from a violation thereof, and to agree upon a definite sum as that which shall be paid to the party who alleges and establishes the violation. In such a case the damages so fixed are termed liquidated, stipulated, or stated damages.²

Liquidated damages serve two fundamental purposes: (1) to permit parties to a contract, armed with peculiar knowledge of the risks associated with their agreement, to agree in advance on reasonable compensation for breach of their contract, and (2)

to save the time of courts, juries, parties and witnesses and reduce the expense of litigation.³

Parties to a contract are never free, however, to agree on a penalty for the breach of their contract. Punishment for breach of contract is contrary to public policy.⁴ Hence, liquidated damages provisions which seek to punish the breaching party rather than compensate the injured party for its losses are void and unenforceable.

An occasional question arising in disputes over the enforceability of a given provision is whether its validity is measured from the parties' intent and perspective when they entered into their agreement, or at a later date when the breach occurs and the actual damages incurred can be compared to the liquidated sum.⁵ Recent decisions of the Virginia Supreme Court make it clear that a liquidated damages clause can be challenged based upon a comparison with the actual damages suffered in consequence of the breach. This article examines Virginia law regarding liquidated damages and the implications these recent decisions may have on the very purposes of liquidated damages.

Professor McCormick in his treatise on damages has stated that it is the parties' prediction, rather than the actual loss, by which liquidated damages are tested:

If the parties to a contract estimate the probable damages from a breach of \$1,000 and agreed upon that sum as liquidated damages, but when the breach in fact occurs the actual damage suffered is only \$100, in a sense it is a harsh thing to require the payment of the agreed amount. Nevertheless, if when the contract was made the prediction was a reasonable one, the fact that events might turn differently was only an ordinary "business risk." Conceivably it was quite as likely that the actual damages should in fact be larger as that they should be smaller than the stipulated sum. . . .

* * *

[I]f in the light of the facts known to the parties at the time of the making of the contract, the sum agreed on was a reasonable forecast of the probable damages, the liquidated

damages clause is enforceable, regardless of what later turns out to be the amount of the actual damages.⁶

The view of Professor McCormick appears to be the majority rule according to the Eighth Circuit Court of Appeals:

We believe that the cases holding that the situation existing at the time of the contract is controlling in determining the reasonableness of liquidated damages are based upon sound reasoning and represent the weight of authority. Where parties have by their contract agreed upon a liquidated damages provision as a reasonable forecast of just compensation for breach of contract and damages are difficult to estimate accurately, such provision should be enforced. If in the course of subsequent developments, damages prove to be greater than those stipulated, the party entitled to damages is bound by the liquidated damage agreement. It is not unfair to hold the contractor performing the work to such agreement if by reason of later developments damages prove to be less or nonexistent. Each party by entering into such contractual provision took a calculated risk and is bound by reasonable contractual provisions pertaining to liquidated damages.⁷

In the leading case of Taylor v. Sanders, the Virginia Supreme Court pronounced the test for determining the validity of a liquidated damages clause:

[P]arties to a contract properly may agree in advance upon the amount to be paid for loss which may result from a breach of contract. When the actual damages contemplated at the time of the agreement are uncertain and difficult to determine with exactness and when the amount fixed is not out of all proportion to the probable loss, the amount is deemed to have been intended as enforceable liquidated damages.⁸

The underscored wording in this statement suggests that the validity of a liquidated damages agreement be determined by examining the parties' intent and perspective at the time their contract was made. Indeed, Taylor specifically requires that "construction of such stipulations depends upon the intent of the parties as evidenced by the entire contract viewed in light of the circumstances under which the contract was made."⁹

Taylor also describes when a liquidated damages provision is unenforceable:

[w]here the damage resulting from a breach of contract is susceptible of definite measurement (as when the breach consists of failure to pay a sum of money) or where the stipulated amount would be grossly in excess of actual damages, courts of law usually construe such a stipulation as an unenforceable penalty.¹⁰

By using words such as "contemplated," "probable," and "would be," the test in Taylor thus appears consistent with the majority rule and seems to require a court to put itself in the position of the parties when their contract was made.

In 301 Dahlgren Limited Partnership v. Board of Supervisors of King George County,¹¹ decided three years after Taylor, the Supreme Court relied in part on evidence of actual damages to determine the validity of a forfeiture provision. In 301 Dahlgren, a partnership had applied for water and sewer service connec-

tions and made a deposit of the total fee with the remainder payable within 180 days. During the 180-day period, the partnership decided not to pursue the application and requested a return of its deposit. Pursuant to a forfeiture provision in its ordinance, the Board returned only one-half of the deposit. The Court determined the forfeiture provision to be an unlawful penalty, finding that "the record is devoid of any evidence that the Board sustained damages as a result of the Partnership's default in payment of the remainder of the fees."¹²

The issue of whether liquidated damages clauses should be assessed from the parties' perspective when they made their agreement or in hindsight was the subject of two opinions in Gordonsville Energy, L.P. v. Virginia Electric and Power Company,¹³ decided by the Circuit Court of the City of Richmond. There, plaintiff Gordonsville Energy, L.P. contracted with Virginia Power to produce and sell electric power to Virginia Power on demand. The parties' contract allowed Gordonsville a certain number of days of outage, defined as "Forced Outage Days." If Gordonsville exceeded this allowance, the contract permitted Virginia Power to withhold \$600,000 from payments otherwise due Gordonsville for each excess Forced Outage Day. When the facility was rendered inoperable on two separate occasions because of a lightning strike and an equipment breakdown, Virginia Power determined that excess Forced Outage Days had occurred and withheld \$6,000,000 as liquidated damages. Gordonsville brought suit claiming, among other things, that the liquidated damages provision was an unenforceable penalty because Virginia Power had not incurred actual damages as a result of the outages. Both parties relied on language from Taylor to support their position on how the trial court should test the validity of liquidated damages:

It is Virginia Power's position, based on the first quotation, that the only relevant factor is what was in the minds of the parties when they entered into the contract; that is, that no matter what the situation is with regard to actual damages, it is what the parties contemplated that matters. [Gordonsville] relies on the second quotation to argue that no matter what the parties *contemplated* at the time of their bargain, liquidated damages cannot be recovered if they are grossly in excess of *actual, quantifiable* losses. The court rejects both arguments and holds that what the parties contemplated and what the nonbreaching party actually lost are *both* relevant.¹⁴

In the recent case of O'Brian v. Langley School,¹⁵ the Court made clear the role of actual damages in a liquidated damages analysis. In O'Brian, the O'Brians enrolled their daughter in Langley School by paying a deposit and executing a written agreement. The agreement provided that the entire yearly tuition would be forfeited if a written notice of withdrawal was not given to the school by a certain deadline. The O'Brians decided to withdraw their daughter from enrollment after the deadline and refused to pay the full tuition. The school sued to recover the full tuition.

During the pendency of the action, the O'Brians served a written interrogatory on the school that asked what efforts the school had made to fill the spot made available by the withdrawal of their daughter. The trial court denied the O'Brians' motion to compel discovery and granted summary judgment to the school.

On appeal, the Virginia Supreme Court reversed, stating that the fact that a party enters into a liquidated damages clause does not prevent that party from later challenging the validity of the clause.¹⁶ The challenging party “is entitled to conduct discovery and present relevant evidence that the damages resulting from the breach are susceptible of definite measurement or that the stipulated damages are grossly in excess of the actual damages suffered by the non-breaching party.”¹⁷ There is no suggestion in this latter statement that the Court is referring to “probable” actual damages forecast by the parties in reaching their agreement. Rather, the Court is inviting a hindsight weighing of actual damages against the forecasted amount.

The O’Brian Court also decided that the party challenging the provision, the O’Brians, had the burden of proving that the liquidated damages provision was unenforceable. “We believe this allocation of the burden of proof is appropriate since the O’Brians initially assented to the clause when they signed the Agreement.”¹⁸ The Court explained that the purpose of a liquidated damages provision is to obviate the need for the non-breaching party to prove actual damages. However, said the Court, if the provision is proved a penalty, the non-breaching party “must then prove its actual damages as in any breach of contract action where the contract does not contain a liquidated damages provision.”¹⁹

The O’Brian decision does not give insight into how a plaintiff seeking liquidated damages might put on its case for actual damages. At a minimum, a plaintiff seeking liquidated damages should be prepared to prove its actual damages at trial if confronted with a defense that the provision is unenforceable.

The most recent pronouncement on liquidated damages from the Virginia Supreme Court came in February this year in Gordonsville Energy, L.P. v. Virginia Electric and Power Company,²⁰ an appeal from a second action between Gordonsville Energy and Virginia Power arising out of liquidated damages withheld by Virginia Power because of excess Forced Outage Days. The parties’ contract contained a waiver of the right to contest the enforceability of the liquidated damages provision:

The Parties agree that Virginia Power will be substantially damaged in amounts that will be difficult or impossible to determine if . . . the Facility exceeds the allowance for Forced Outage Days. . . . Therefore, . . . the Parties have agreed on sums which the Parties agree are reasonable as liquidated damages for such occurrences. It is further understood and agreed that the payment of the liquidated damages is in lieu of actual damages for such occurrences. [Gordonsville] hereby waives any defense as to the validity of any liquidated damages stated in this Agreement as they may appear on the grounds that such liquidated damages are void as penalties or are not reasonably related to actual damage.²¹

The Virginia Supreme Court rejected Gordonsville’s argument that this waiver provision violated public policy and held the waiver enforceable to bar Gordonsville’s attack on liquidated damages.²² The Supreme Court in Gordonsville also reiterated the tests for determining whether a liquidated damages provision may constitute a penalty. Citing Taylor, the Court noted that a provision will be unenforceable when the amount agreed to is “out of all proportion to the probable loss”—an analysis of whether the parties’ forecast was reasonable.”²³ Citing O’Brian,

the Court stated that a provision is also unenforceable if the agreed amount is “grossly in excess of actual damages,”—a hindsight comparison of actual damages to the liquidated sum.²⁴ Presumably still in effect, although not mentioned in Gordonsville, is the second criterion from Taylor that liquidated damages are not enforceable if damages from a breach are “susceptible of definite measurement” at the time the contract is made.²⁵ Thus, after O’Brian and Gordonsville, there are three criteria on which to establish that a liquidated damages provision is an unenforceable penalty, two of which require examining the parties’ intent and understanding when they made their agreement and one of which permits a post-contract examination of actual damages. Proof of any one criterion will invalidate liquidated damages.

Testing liquidated damages in hindsight against actual damages from a particular breach seems to undercut the fundamental purpose of liquidated damages. Such hindsight analysis has the potential for setting aside a bargain struck by the parties who, in advance of a breach and armed with peculiar facts and circumstances existing at the formation of their agreement, undertook the risk of ascertaining and settling future, uncertain damages in order to avoid subsequent litigation over damages. Rather than saving time of the courts, litigants and witnesses, retrospective analysis opens each case, indeed each breach, to additional discovery and perhaps an after-the-bargain analysis of whether actual damages are grossly excessive or proportionate to the liquidated sum.

Perhaps Professor McCormick was right: if two arms-length parties agree on a liquidated sum as a reasonable forecast of probable damages resulting from a future breach of their contract, and in so doing assume the risk that their estimate may be too high (or too low) when an actual breach occurs, why should a court be permitted to undo that agreement? And what if the liquidated sum is disproportionately lower than actual damages? Should the injured party be entitled to recover additional compensatory damages to make himself whole? Professor McCormick would leave the parties with the risk they assumed in liquidating their damages. Yet, if actual damages can be used to determine the validity of a provision where the liquidated sum is contended to be excessively large and therefore penal, a case might well be made that a disproportionately small sum is also penal and therefore void.

The bottom line is that parties seeking to recover liquidated damages must be aware of the various ways in which liquidated damages provisions can be attacked. Where liquidated damages are asserted for delay in the completion of a construction project, plaintiffs should not naively assume that they need only prove breach of contract. These plaintiffs should give careful thought to the range of losses, economic and otherwise, which result from late delivery of the project and be prepared for detailed discovery on both the type of damages incurred and the monetary amount of such damages. Fundamentally, however,

The bottom line is that parties seeking to recover liquidated damages must be aware of the various ways in which liquidated damages provisions can be attacked.

parties entering liquidated damages agreements should consider including a clearly worded waiver provision such as the one agreed to in Gordonsville to eliminate future disputes about the enforceability of their agreement. ☪

- 23 257 Va. at 355, 512 S.E.2d at 818.
- 24 *Id.*
- 25 233 Va. at 75, 353 S.E.2d at 747.

Endnotes

- 1 Pope v. Guard Rail, 219 Va. 111, 244 S.E.2d 774 (1978); Talbot v. Miller, 232 Va. 289, 350 S.E.2d 596 (1986).
- 2 Welch v. McDonald, 85 Va. 500, 505, 8 S.E. 711, 713 (1888).
- 3 See Restatement (Second) of Contracts § 356, Comment a; 5C Michies Jurisprudence, Damages § 60.
- 4 See Taylor v. Sanders, 233 Va. 73, 353 S.E.2d 745 (1987).
- 5 See, e.g., Gordonsville Energy, L.P. v. Virginia Electric and Power Co., 39 Va. Cir. 292, 40 Va. Cir. 448 (City of Richmond, 1996).
- 6 C. McCormick Handbook on the Law of Damages, § 150.
- 7 Southwest Engineering Co. v. United States, 341 F.2d 998, 1003 (8th Cir. 1965), *cert. denied*, 382 U.S. 830 (1966); see also United States v. Leroy Dyal Co., 186 F.2d 460 (2d Cir. 1950), *cert. denied*, 341 U.S. 926 (1951); McCarthy v. Talley, 297 P.2d 981 (Cal. 1956); Knutton v. Cofield, 160 S.E.2d 29 (N.C. 1968); Arduini v. Board of Education, 418 N.E.2d 104 (I. App. 1981); Quachita Equipment Rental v. Baker Bush Co., 388 S.2d 477 (Ct. App. La. 1980); Chaffin v. Ramsey, 555 P.2d 459 (Or. 1976).
- 8 233 Va. 73, 75, 353 S.E.2d 745, 746-47 (1987) (emphasis added).
- 9 233 Va. at 75, 353 S.E.2d at 747 (emphasis added).
- 10 *Id.* (emphasis added).
- 11 240 Va. 200, 396 S.E.2d 651 (1990).
- 12 240 Va. at 203, 396 S.E.2d at 653.
- 13 39 Va. Cir. 292 (City of Richmond, 1996); 40 Va. Cir. 448 (City of Richmond, 1996).
- 14 40 Va. Cir. at 450 (italics in original).
- 15 256 Va. 547, 507 S.E.2d 363 (1998).
- 16 256 Va. at 551, 507 S.E.2d at 365.
- 17 *Id.* (emphasis added).
- 18 256 Va. at 552, 507 S.E.2d at 366.
- 19 *Id.*
- 20 257 Va. 344, 512 S.E.2d 811 (1999).
- 21 257 Va. at 348-49, 512 S.E.2d at 814.
- 22 257 Va. at 355-56, 512 S.E.2d at 818.



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Application of the Doctrine of Constructive Fraud in Construction Litigation



John S. Norris, Jr.

When Giovanni Mortorino met with me in March of 1994 to discuss a claim he wished to pursue against an environmental engineering firm, my immediate concern was that any cause of action available to him for negligence or breach of contract had long since expired under the applicable statute of limitations. Mr. Mortorino, who was born in Italy, spoke English with a heavy accent. Although an adept entrepreneur, he felt his accent prevented him from being able to negotiate the best possible price for the purchase of real estate if he were to deal directly with the owner. Accordingly, he used a real estate broker as a “straw man” to negotiate a deal and enter into a contract for the purchase of a particular parcel of property, thereafter having the broker assign the contract to him for closing.

Mr. Mortorino had his sights set on one such investment property located in a rural portion of the City of Chesapeake. He had his “straw man” enter into a contract with the owner to purchase this parcel, subject to a satisfactory environmental study and a wetlands report. The contract was dated April 19, 1988. An environmental engineering firm issued its report relative to the property on April 21, 1988. That report indicated an independent wetlands consultant, hired by the engineering firm, had concluded from an examination of the property that only a small area on the southern boundary stood a chance of being declared wetlands.¹ In reliance upon this report, the “straw man” assigned the contract for the pur-

chase of the property to Mr. Mortorino in September of 1988, and a deed conveying the property was recorded in October of 1988. No contract was ever entered into between Mr. Mortorino and the environmental engineering firm or, for that matter, between that firm and the “straw man”.

When Mr. Mortorino felt the time was right to develop the property, he engaged the services of another consulting company that performed a new wetlands study in July of 1992. The new study determined that almost 80% of the property would be declared wetlands, making the property virtually worthless for development purposes. This second report was confirmed by a finding in July of 1993 by the Army Corps of Engineers that the property was jurisdictional, *i.e.*, wetlands.

My initial reaction was that any claim Mr. Mortorino might assert against the engineering firm, the wetlands consultant and/or the “straw man” was likely barred by the statute of limitations. More than five years had elapsed since the initial report was issued and the property conveyed. While I could make the argument that no damages were sustained by Mr. Mortorino until he received a jurisdictional finding by the Army Corps of Engineers in 1993, logic dictated that the damages, though not realized until 1993, first occurred when he purchased the property in 1988. Yet I felt certain that a viable cause of action must afford Mr. Mortorino a remedy for his predicament. That is when I decided to give a closer look to the law of fraud.

As we all know, actual fraud consists of a (1) false representation (2) of a material fact (3) made intentionally and knowingly (4) with the intent to mislead (5) with reliance by the party misled and (6) resulting in damage to the misled party.² Mr. Mortorino had never spoken with a representative of the engineering firm that had performed the initial wetlands study on his property. Nor were any facts available to me indicating that the misinformation in the initial report was an intentional attempt to mislead my client and thereby induce him to purchase the property. Yet the report was misleading and did serve to induce my client to act to his detriment. Wasn't that the scenario encompassed by the doctrine of constructive fraud?

The Virginia Supreme Court has held that:

“Constructive fraud differs from actual fraud in that the misrepresentation of material fact is not made with the intent to mislead, but is made innocently or negligently although resulting in damage to the one relying on it.”³

A cause of action for fraud, whether actual or constructive, does not arise until the fraud is discovered, or by the exercise of due diligence should have been discovered.⁴ Thus, I could assert that Mr. Mortorino’s cause of action for constructive fraud did not arise until the Army Corps of Engineers made a jurisdictional determination in 1993 or, at the earliest, when the second engineering report was issued in July of 1992. Since the statute of limitations for fraud is two years from the date the cause of action accrued,⁵ a window of opportunity remained to pursue Mr. Mortorino’s claim.

The trial court determined that the Motion for Judgment I filed on behalf of Mr. Mortorino failed to state an adequate cause of action for constructive fraud because the initial consultant’s report set forth expressions of opinions, rather than statements of fact. As such, they were not actionable in fraud.⁶

On appeal, the Virginia Supreme Court reversed, holding, as a matter of law, that the representations contained in the initial consultant’s report were factual in nature and not expressions of opinion.⁷ The court determined that the statements in the wetlands report were “. . . unambiguous representations of the present quality or character of the property and, thus, [were] representations of fact, and not mere expressions of opinion.” The qualifying statement in the report that determinations concerning the presence of wetlands were “so opinionated that there is always the possibility that a different interpretation could be made” was “not sufficient to absolve the defendants of any liability that might ensue because of the purported factual misrepresentations contained in this report. For example, this purported disclaimer does not affect [the environmental engineering firm’s] factual representation that [the consultant] “finds nothing [on the property] to indicate that wetlands are present.”⁸ The case settled following remand.⁹

The Mortorino decision has been cited with approval in several subsequent cases.¹⁰ It has also been criticized as “troubling” within the context of the standard of care imposed upon professionals.¹¹ The question is whether the theory of constructive fraud presents a viable cause of action for innocent or negligent misrepresentations within the context of construction projects. For example, a contractor submits applications for payment to the owner containing the express representation that all work performed through the date of the application meets the requirements of the contract documents. In reliance upon those representations, the architect authorizes, and the owner remits, a progress payment to the contractor. Subsequently, the owner discovers, for the first time, that latent defects in the work existed at the time of the contractor’s payment application. Although five years may have elapsed since the work was performed (or three years if no written contract was in place), the owner wishes to pursue a claim against the contractor.

The Virginia Supreme Court appears to have rejected an attempt to couch such claims in the cloak of fraud. In Richmond

Metropolitan Authority v. McDevitt Street Bovis, Inc.,¹² an owner discovered, more than ten years after performance of the work, that the contractor had not complied with the contract documents, in contravention of representations made in its applications for payment. The owner filed suit against the contractor alleging actual and constructive fraud based on the misrepresentations in the payment applications.

The trial court sustained a motion for summary judgment reasoning that “[t]he particular instances of misrepresentation are duties and obligations specifically required by the contract,” and that nothing “establishes that the duty breached is separate and independent from the contract . . . [the contractor’s] failure to perform each and every one of [the contract’s] promises was a breach of its contract, not fraud . . .” The Supreme Court agreed. After citing Mortorino to set out the elements for a cause of action for fraud, the Supreme Court observed that a cause of action can sound in both contract and tort only when “the duty tortiously or negligently breached . . . [is] a common law duty, not one existing between the parties solely by virtue of the contract.”¹³ Noting that the “essence of constructive fraud is negligent misrepresentation” (citing Mortorino), the Supreme Court concluded that the owner’s “allegations of constructive fraud are nothing more than allegations of negligent performance of contractual duties and are, therefore, not actionable in tort. A tort action cannot be based solely on a negligent breach of contract.”¹⁴ The Supreme Court concluded that “in ruling as we do today, we safeguard against turning every breach of contract into an actionable claim for fraud. The appropriate remedy in this case is a cause of action for breach of contract, which unfortunately is time-barred.”¹⁵

It is fortunate, from Mr. Mortorino’s standpoint, that the McDevitt Street case had not been decided when he and I first met in March of 1994. I have no doubt I would have failed to see a distinction between misrepresentations in a wetlands report, which arose out of a contractual (albeit implied) undertaking, and misrepresentations in a contractor’s application for payment. I certainly know of no common law duty breached by the environmental consultant when he rendered the report upon which Mr. Mortorino relied to his detriment. Existing Virginia case law prior to McDevitt Street certainly suggested that an action for fraud arising out of a contractual undertaking could be asserted. In Ward v. Ernst & Young,¹⁶ Justice Poff stressed that economic losses can be pursued in actions for fraud, when privity of contract exists, even though a negligence count might be demurrable.¹⁷ Why would the Court place its imprimatur on a fraud cause of action seeking to recover for economic losses arising out of a contractual undertaking if the contract itself provides the sole remedy?

A tort action cannot be based solely on a negligent breach of contract.

Although not cited in McDevitt Street, earlier Supreme Court opinions had dealt with claims of fraud arising out of the performance of construction contracts. In Boykins Corp. v. Weldon, Inc.,¹⁸ the owner of a plant sued a roofing contractor for breach of contract, alleging the roofer had defectively installed a roof that had leaked over a period of nine years, despite repeated efforts by the contractor to effect repairs. When the trial court

sustained the defendant's plea of the statute of limitations, the owner sought leave to amend to allege fraud, on the grounds that the roofing contractor had misrepresented that the installed roof complied with the contract documents. The owner contended that such misrepresentations served to estop the roofing contractor from asserting a plea of the statute of limitations. The Supreme Court initially noted that constructive fraud was insufficient to toll the running of the statute of limitations.¹⁹ Then, after reviewing the history of the contractor's repeated efforts to repair the roof, and the fact that the leakage problem was readily known to both parties from the beginning, the Court concluded that the plaintiff had failed to adequately plead fraud. "Rather, [the pleadings are] a description of a roofing contractor trying to satisfy a customer and fulfill its contract. Plaintiff admits that [the roofing contractor] enjoyed a good reputation and that it wanted to satisfy and please [the owner]. These representations to the court were wholly inconsistent with plaintiff's subsequent allegations of fraud leveled against [the roofing contractor]."²⁰

The earliest Virginia Supreme Court case I have found in which the doctrine of constructive fraud was applied in the construction context is Atlantic Coastline Railroad Co. v. Walkup Co.²¹ In that case, the parties entered into a contract for the construction of a union station in Ocala, Florida. After commencement of the contract, the United States entered into World War I, causing an increase in the prices of labor and materials. Representatives of the engineer for the project entered into an agreement with the contractor for an increase in labor and material costs. Representatives of the railroad did not participate in these negotiations. The representations of the engineer to the contractor that it would be paid the additional costs were deemed actionable. "If there is no dishonest intent, but a false statement of fact on which the other party acts to his injury, the fraud is constructive."²² As in Mortorino, the defrauded party sought to hold a principal liable for the innocent or negligent misrepresentations of an agent. Although that issue was left unresolved by the opinion in Mortorino, in Atlantic Coastline the Court confirmed that ". . . a principal is answerable for the act of his agent in the course of his master's business, and for his master's benefit" and "no sensible distinction can be drawn between the case of fraud and the case of any other wrong."²³ The Court concluded that the railroad was bound by the agreement entered into on its behalf.

The Fourth Circuit Court of Appeals sought to distinguish between claims arising out of a contractual undertaking which give rise to a cause of action for fraud, and those for which the sole remedy is breach of contract. In City of Richmond v. Madison Management Group,²⁴ the Court noted that "Virginia law 'distinguishes between a statement that is false when made and a promise that becomes false only when the promisor later fails to keep his word. The former is fraud, the latter is breach of contract.'"²⁵ In the Madison Management case, the Court dealt with allegations that defective water transmission lines installed for the owner by a contractor gave rise to a cause of action for, *inter alia*, constructive fraud. The Madison Management Court concluded that the owner's allegations of fraud did not constitute a "thinly-veiled recasting of its claim for breach of contract as a tort." Nor was it an "attempt to dress up a contract claim in a fraud suit of clothes." Rather, the Court determined that the owner alleged that the contractor "violated a duty imposed by tort law, *i.e.*, the duty not to commit fraud. Accordingly, the Pipe Defendants are not entitled to the protection of the economic

loss rule, which protects only those defendants who have breached only contractual duties."²⁶

While Madison Management was not cited in McDevitt Street, the case of Flip Mortgage Corp. v. McElhone²⁷ was discussed. In Flip, allegations of fraud were based, in part, on the submission of false revenue reports almost from the beginning of the contractual relationship. The Fourth Circuit upheld a cause of action for fraud, concluding that there was fraud in the inducement of the contract. The false revenue reports were deemed circumstantial evidence of an intent never to abide by the terms of the contract. The court in Flip cited Colonial Ford Truck Sales v. Schneider for the proposition that "the promisor's intention . . . [w]hen he makes the promise, intending not to perform . . . is a misrepresentation of present fact . . . [that] is actionable as an actual fraud."²⁸ The Court in McDevitt Street distinguished Flip as a case of fraud in the inducement. The Court observed that "[n]othing in the records suggest that [the contractor] did not intend to fulfill its contractual duties at the time it entered into the Design-Build Contract with [the owner]."²⁹

Madison Management is hard to square with McDevitt Street. Although Madison Management was a case of actual fraud, in addition to constructive fraud, the concept that a "duty not to commit fraud" provides an avenue for a claim of fraud arising out of the performance of a contract flies in the face of the reasoning in McDevitt Street. If the cases are to be harmonized, it must be by the fact that Madison Management, like Flip, involved evidence of fraud in the inducement. The opinion in Madison Management suggests that there were misrepresentations concerning the quality of the underground water lines conveyed by the promisor to induce acceptance of the contract. Yet the misrepresentations were known by the promisor to be false at the time.³⁰ Thus, the type of fraud deemed to support a cause of action independent from the contract was actual in nature, not constructive.

Subsequent to McDevitt Street, the Virginia Supreme Court considered the constructive fraud claim asserted by the buyers of a home against the developer/seller. In Tate v. Colony House Builders, the buyers asserted that the existence of certain construction defects in the home were not revealed prior to the sale. The buyers' motion for judgment alleged that the seller misrepresented that "the new dwelling house was free from structural defects; . . . the new dwelling house was constructed in a workmanlike manner; . . . the new dwelling house was fit for habitation; . . . the new dwelling house was competently designed commensurate with the consideration of \$345,000.00 [and]; . . . the [buyers] would enjoy quiet possession in the sense that apart from minor corrective work, no significant work would be required by way of restoration, rebuilding, or extensive repair."³¹ The buyers purchased the home in 1990; they filed their Motion for Judgment against the seller/developer in 1996. The seller filed a special plea, asserting the claim was barred by the statute of repose³² and also filed a motion for summary judgment on the grounds the alleged misrepresentations were statements of opinion, rather than assertions of fact, and thus not sufficient to support a cause of action for constructive fraud.

The Supreme Court cited case law that provides that the wrongful act involved in a cause of action for fraud is "aimed at the person" and not property.³³ The Court concluded that since a

cause of action for fraud does not seek to recover “for any injury to property, real or personal, or for bodily injury or wrongful death . . .” it was beyond the scope of the statute of repose.³⁴ Turning next to the opinion versus statement of fact dichotomy, the Court concluded that some of the alleged misrepresentations were the former and others the latter. Specifically, the seller’s statements that “the new dwelling house was free from structural defects; . . . the new dwelling house was constructed in a workmanlike manner; . . . the new dwelling house was fit for habitation” were deemed to be “representations of the present quality or character of the property and, thus, [were] statements of fact and not mere expressions of opinion.”³⁵ The remaining allegations were deemed to be either “representations predicated upon future events or promises” or “in the nature of puffing or opinion” and unavailable to form the basis of an action for constructive fraud.³⁶

Yet another constructive fraud case recently decided by the Supreme Court is Blair Construction v. Weatherford.³⁷ In that case, the general contractor brought a claim for constructive fraud against a subcontractor, alleging the latter had misrepresented information in a bid to perform steel erection work. The subcontractor submitted a bid to perform this work for \$260,150. Considering that amount to be low, a representative of the general contractor spoke with the subcontractor to confirm the bid. In reliance upon assurances from the subcontractor that the bid was accurate, the general contractor submitted its bid to the owner and was awarded the construction contract. During a pre-construction meeting, the site engineer for the project discussed OSHA safety standards that would be required for the project. The subcontractor, who was present, expressed no particular concerns about that issue at the meeting. Two days later, however, the subcontractor notified the general contractor that “[b]ased on the stric[t] safety guidelines relating to the above-referenced job, we will have [an] increase [in the bid] by \$75,000. These are extra costs that were not taken into consideration on the bid day. Thank you!” Ultimately, the general contractor expended more than \$600,000 to perform the steel erection work through the use of its own personnel and other contractors.

After citing Mortorino to set forth the elements of constructive fraud, the Supreme Court noted that “fraud must relate to a present or pre-existing fact, and cannot ordinarily be predicated on

The applicability of the doctrine of constructive fraud in a construction contract case is problematic.

unfulfilled promises or statements as to future events.”³⁸ The reason for this requirement is that, otherwise, “every breach of contract could be made the basis of an action in tort for fraud.”³⁹ The general contractor contended it presented, by clear and convincing evidence, a case that the subcontractor “made a false representation to [it] – that being his present intent to construct the . . . building for \$260,150.” The general contractor argued that the finder of fact “could infer from all of this that [the subcontractor] had no intention of performing his original promise to construct this job for \$260,150 but rather getting the job [and] then bleeding [the general contractor] for more funds.” The Supreme Court disagreed. It concluded the general contractor confused the doctrines of actual and constructive fraud, only the latter having been plead in the underlying case. The Court observed that the

record before it was “devoid” of evidence that the subcontractor’s “statements or actions constituted a ‘misrepresentation of material fact . . . made innocently or negligently.’”⁴⁰ In other words, the Supreme Court decided that the general contractor could have proved a case of actual fraud, due to available evidence that the subcontractor never intended to perform the work for the price submitted in its bid, yet there was a lack of evidence that such misrepresentation had been made innocently or negligently. Query whether the Court would have ruled that a sufficient cause of action for constructive fraud had been plead, assuming the general contractor averred that the bid submitted by the subcontractor was innocently or negligently miscalculated. Would not the McDevitt Street principle apply, limiting the contractor to a cause of action for breach of contract?⁴¹

Although not a construction case per se, the decision in Prospect Dev. Co. v. Bershader,⁴² deserves comment. The plaintiffs in the trial court were the purchasers of a lot adjacent to a second lot designated on a plat as “preserved land”. An agent for the developer represented that the “preserved land” designation was attributable to the failure of the lot to “pass” a water percolation test. This representation was repeated in several ways, on several occasions. The purchasers, who were naturalists, purchased the lot in question in reliance upon the representations that it would be adjacent to an undeveloped lot. When the developer subsequently sold and developed the adjacent lot, the plaintiffs filed an action alleging breach of their written sales contract with the developer and asserting, as well, causes of action for actual and constructive fraud. The Supreme Court affirmed those portions of the trial court’s decree which found there had been a breach of the sales contract and which also imposed liability against the developer on the basis of both actual and constructive fraud. No mention was made in the Prospect Development opinion of the decision in McDevitt Street.

The applicability of the doctrine of constructive fraud in a construction contract case is problematic. In the wake of McDevitt Street, it would seem that a party defending a claim for constructive fraud should assert that the law of contracts provides the aggrieved party with its sole remedy, absent some breach of an underlying common law duty. The party asserting a cause of action for constructive fraud should rely upon the rationale in Madison Management, and argue that the underlying common law duty is one “not to commit fraud.” In the alternative, one might argue that the innocent or negligent misrepresentation occurred at the inception of the contract and constituted fraud in the inducement, relying upon the rationale in Flip. Arguably, this rationale would justify the Court’s holding in the Prospect Development case. This assumes, of course, that constructive fraud can form the basis for fraud in the inducement.⁴³ In any event, the lesson of Blair Construction is to plead both actual and constructive fraud, in the alternative, less one pleads one cause of action, only to present evidence in support of the omitted cause of action. Suffice it to say, in view of the unsettled state of the law in this area, I am thankful Mr. Mortorino came to me when he did. ☺

Endnotes

- 1 The actual text of the report stated as follows:

“We contracted with Mr. Clay Bernick who specializes in investigating and consulting civil engineering firms on the existence and extent of wetlands with proposed development. Mr. Bernick’s experience and knowledge in this field is extensive and therefore his findings are quite reliable. However, the presence of wetlands are [sic] so opinionated that there is always the possibility that a different interpretation could be made. However, if that were the case the only location that is remotely possible for a contrary determination to be made is a small area on the southern boundary of the property and the chances of this are only slight. On the vast majority of the property, Mr. Bernick finds nothing to indicate that wetlands are present.”
- 2 Ashmore v. Herbie Morewitz, Inc., 252 Va. 141, 147, 475 S.E.2d 271, 274-75 (1997).
- 3 Evaluation Research Corp. v. Alequin, 247 Va. 143, 148, 439 S.E.2d 387, 390 (1994). The elements of an action for constructive fraud are (1) material, false representations (2) which the hearer believed to be true at the time (3) and which were meant to be acted upon when conveyed (4) and which were, in fact, acted upon (5) to the detriment of the hearer. Nationwide v. Patterson, 229 Va. 627, 629, 331 S.E.2d, 490, 492 (1985). The foregoing elements must be established by clear, cogent and convincing evidence. Id.
- 4 Va. Code § 8.01-249 1.
- 5 Va. Code § 8.01-243 A.
- 6 Poe v. Voss, 196 Va. 821, 825, 86 S.E.2d 47, 49 (1955). However, the Supreme Court has stated “it is not always easy to determine whether a statement is one of opinion or one of fact. In deciding the question, the subject matter, the form of the statement, the attendant circumstances, and the knowledge of the parties must be considered.” Id. at 825, 86 S.E.2d at 49.
- 7 Mortorino v. Consultant Engineering Services, 251 Va. 289, 467 S.E.2d 778 (1996).
- 8 Id. at 294, 467 S.E.2d at 781-82.
- 9 Depositions following remand revealed that the independent consultant never traversed the property, but rather reached his conclusions about the absence of wetlands by “eyeballing” the tract of land, which spanned more than 70 acres, from an adjacent roadway.
- 10 Tate v. Colony House Builders, Inc., 257 Va. 78, 508 S.E.2d 597 (1999); Henderson v. Henderson, 255 Va. 122, 495 S.E.2d 496 (1998).
- 11 “Professional negligence claims and constructive fraud principles do not mix.” Boelzner and Nicholas, Journal of Civil Litigation, Vol. 10, No. 1 (1998).
- 12 256 Va. 553, 507 S.E.2d 344 (1998).
- 13 256 Va. At 558, 507 S.E.2d at 347, citing Foreign Mission Bd. v. Wade, 242 Va. 234, 241, 409 S.E.2d 144, 148 (1991).
- 14 Id. at 559, 507 S.E.2d at 347.
- 15 Id. at 553, 507 S.E.2d at 348.
- 16 246 Va. 317, 435 S.E.2d 628 (1993).
- 17 Id. at f.n.2. In fact, it is unclear whether or not a negligence count to pursue a claim for economic losses is demurrable when privity exists. Compare Ward, supra, at f.n.3 to Copenhaver v. Rogers, 238 Va. 361, 366, 384 S.E.2d 593, 595 (1989).
- 18 221 Va. 81, 266 S.E.2d 887 (1980).
- 19 The Court relied on Housing Authority v. Laburnum Corp., 195 Va. 827, 80 S.E.2d 574 (1954). This too, was a case in which an owner attempted to assert a cause of action for constructive fraud (in addition to actual fraud) for the contractor’s failure to adequately perform pursuant to a written construction contract. As in Boykins, the Court determined that the character of fraud alleged was constructive in nature, rather than an attempt to conceal the discovery of a cause of action by trick or artifice. As such, the statute of limitations defense could not be avoided. Of course, such estoppel analysis has been rendered moot by the enactment of Va. Code § 8.01-249.1.
- 20 Id. at 84-85, 266 S.E.2d at 889.
- 21 132 Va. 386, 112 S.E. 663 (1922).
- 22 (Citation omitted.) (Emphasis in original.) Id. at 394, 112 S.E. at 666.
- 23 Id.
- 24 918 F.2d 438 (4th Cir. 1990).
- 25 Id. at 447, citing Lissmann v. Hartford Fire Ins. Co., 848 F.2d 50 (4th Cir. 1988).
- 26 Id.
- 27 841 F.2d 531 (4th Cir. 1988).
- 28 228 Va. 671, 676, 325 S.E.2d 91, 94 (1985).
- 29 256 Va. at 560, 507 S.E.2d at 348.
- 30 918 F.2d at 449.
- 31 257 Va. at 808, 508 S.E.2d at 598.
- 32 The pertinent portion of the statute of repose provides as follows: “Va. Code § 8.01-250. Limitation on certain actions for damages arising out of defective or unsafe condition of improvements to real property. No action to recover for any injury to property, real or personal, or for bodily injury or wrongful death, arising out of the defective and unsafe condition of an improvement to real property, nor any action for contribution or indemnity for damages sustained as a result of such injury, shall be brought against any person performing or furnishing the design, planning, surveying, supervision of construction, or construction of such improvement to real property more than five years after the performance of furnishing of such services and construction.”
- 33 Pigott v. Moran, 231 Va. 76, 81, 341 S.E.2d 179, 182 (1986). See, also, J.F. Toner & Son v. Staunton Prod. Credit Assn., 237 Va. 155, 158, 375 S.E.2d 530, 531 (1989).
- 34 Query whether a cause of action arising out of a construction project is subject to the statute of repose in any event. The statute of repose is directed to personal injury and property damage. Most construction claims seek to recover damages for economic losses. Adopting the rationale in Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 236 Va. 419, 374 S.E.2d 55 (1988), a statute directed to claims of personal injury or property damage should not be applicable to causes of action to recover for an economic loss. In Sensenbrenner, the statute in question was that which obviated the requirement of privity of contract in actions for personal injury or property damage. Va. Code § 8.01-223. If the nature of the claim is to recover for a “disappointed economic expectation” where “goods purchased failed to meet some standard of quality”, then economic losses, rather than personal injuries or property damage, are at stake and a statute limited to the latter is inapplicable. In Sensenbrenner, the disappointed economic expectation was the alleged defective design and installation of a swimming pool which resulted in structural damage to the pool and an adjacent home. Arguably, most construction defect cases involve similar damage claims. Thus, if a construction claim is for recovery of an economic loss, the statute of repose, which by its wording is directed to personal injury or property damage, should be inapplicable.
- 35 257 Va. at 83-84, 508 S.E.2d at 600.
- 36 Interestingly, the Court’s opinion in Tate attempted to distinguish the case of Kuczmanski v. Gill, 225 Va. 367, 302 S.E. 48 (1983), which held that the seller’s statement that a house was in “excellent condition” was mere sales talk and could not support an action for fraud. The court in Tate determined, as a matter of law, that the representations of the seller in that case “unlike Kuczmanski, . . . made specific representation of the present quality or character of the new house.”
- 37 253 Va. 343, 485 S.E.2d 137 (1997).
- 38 Id. at 346, 485 S.E.2d at 139. Citing Patrick v. Summers, 235 Va. 452, 454, 369 S.E.2d 162, 164 (1988).
- 39 Citing Lloyd v. Smith, 150 Va. 132, 135, 142 S.E. 363, 365 (1928).
- 40 253 Va. at 346, 485 S.E.2d at 139.
- 41 McDevitt Street was decided the year following Blair.
- 42 258 VA. 75, 515 S.E.2d 291 (1999).
- 43 See Colonial Ford, supra, at 677, 325 S.E.2d at 94.

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Notice of Claim Requirements Under the Virginia Public Procurement Act: Owner's Friend—Contractor's Nightmare



Robert K. Richardson

Claims and construction contracting go hand in hand for attorneys advising either the owner or the contractor in a construction project. Public projects typically have an owner who takes a more active role in project oversight than is seen in private jobs. Such projects also are subject to legislative controls that do not apply in the private context and which cause a more owner friendly interpretation of the claims provisions in the contract. The contractor who fails to read the contract carefully and comply with all notice of claim provisions therein faces a difficult task in pursuing any claims. This combination of the public interest and legislative controls combines with a judicial approach to such claims that should alert contractors to the care they must provide to job administration.

When a construction project goes poorly and costs exceed contract prices, litigation may be a natural consequence as the parties seek to determine the extent to which blame should be allocated”

Brinderson Corp. v. Hampton Roads Sanitation District, 825 F.2d 41, 42 (4th Cir. 1987)

The temptation on the part of contractors to recoup losses on improvident contracts by claims of this kind is frequently present and strong. It is therefore the clear duty of courts to carefully scrutinize such demands and allow them only upon clear and satisfactory evidence sustaining them.

Jefferson Hotel Co. v. Brumbaugh, 168 F. 867, 875 (4th Cir. 1909).

These two excerpts set the tone for the task faced by a claimant on a public construction project in Virginia who has failed to comply with the notice of claim provisions of the contract. Such contracts are subject to the requirements of the Virginia Public Procurement Act, §11-35 *et seq.*, Va. Code Ann. (“the Procurement Act”), which creates added problems for the claimant contractor.

The purpose of the Procurement Act “is to enunciate the public policies pertaining to governmental procurement from nongovernmental sources.” §11-35.B, Va. Code Ann. A “public body” subject to the provisions of the Procurement Act is defined to include “any legislative, executive or judicial body, agency, office, department, authority, post, commission, committee, institution, board or political subdivision created by law to exercise some sovereign power or to perform some governmental duty, and empowered by law to undertake the activities described in this chapter.” §11-37, Va. Code Ann. An exemption from the Procurement Act is provided for counties, cities, towns or school boards that adopt by ordinance or resolution (counties, cities or towns) or by policy or regulation (school boards) alternative policies and procedures that are based on competitive principles and which are generally applicable to procurement of goods and services by such entity. §11-35.D, Va. Code Ann. Care should be taken to investigate the existence of such alternative policies and procedures. The more common approach, however, is to follow the Procurement Act, either by express incorporation in whatever procurement ordinance, regulation, policy or regulation is adopted, or by not adopting a separate policy or procedure for construction contracts. Contract documents frequently leave no doubt as to the contracting authority’s assertion of the application of the Procurement Act by including a specific provision incorporating that statute.

The Procurement Act requires the use of notice requirements as conditions precedent to “(c)ontractual claims, whether for money or other relief.” §11-69.A, Va. Code Ann. Use of the mandatory “shall have been given” makes it clear that the

notice requirement is a condition precedent to a claim, not merely a discretionary step. That it is intended by the legislature that these notice requirements apply not only to monetary claims but also to claims for delay is made clear by §11-56.2.B.2, Va. Code Ann., which approves use of notice requirements for delay claims. Specifically, to preserve a “contractual claim” as contemplated by §11-69.A “written notice of the contractor’s intention to file such claim shall have been given at the time of the occurrence or beginning of the work upon which the claim is based.” §11-69.A (emphasis added) Typically, the applicable contract documents copy or paraphrase this notice of intent requirement. Although not included in the Procurement Act, the contract documents normally add an additional condition requiring documentation of the claim within a stated number of days after completion of the work or cessation of the occurrence giving rise to the claim, and the courts apply the same strict compliance standards to this second notice.

Virginia courts have been very consistent in requiring strict compliance with notice of claim provisions in construction contracts in both the public and the private sector. The standard was set early, in Atlantic & Danville Ry. Co. v. Delaware Constr. Co., 98 Va. 503, 37 S.E. 13 (1900). The court in that case upheld a clause requiring that there be an agreement reached before any extra work was performed and barred claims failing to comply with this requirement. The court’s rationale was that

An obvious purpose of such a provision is to avoid subsequent disagreement, and prevent just such a controversy as has arisen in this case. . . . All are aware of the frequency with which it happens in the construction of buildings and other improvements that claims are made for alleged extra work, which give rise to disputes and litigation. Such a provision is a wise and not an unusual one in building contracts, and it is held by the authorities to be obligatory upon the parties, and not to be disregarded.

Id., 98 Va. at 512, 37 S.E. at 16. This case has been recognized as setting the rule in Virginia that notice of claim provisions in construction contracts will be strictly enforced. See, e.g., U.S. v. Centex Constr. Co., 638 F. Supp. 411, 413 (W.D. Va. 1985); Service Steel Erectors Co. v. SCE, Inc., 573 F. Supp. 177, 178 (W.D. Va. 1983)

The strict application of notice of claim requirements established in Atlantic & Danville v. Delaware Constr. has been followed consistently by Virginia courts. In McDevitt & Street Co. v. Marriott Corp., 713 F. Supp. 906 (E.D. Va. 1989); aff’d in part, rev’d in part, 911 F.2d 723 (4th Cir. 1989); on remand 754 F. Supp. 513 (E.D. Va. 1991), one of the many issues involved a delay/time extension claim for which the contractor had failed to comply with the notice requirements of the contract. Such failure of notice was held to bar the claim. *Id.*, 713 F. Supp. at 919, 922, 926. Arguments that the owner had waived the requirement were rejected by the court, holding that the burden is on the party asserting the waiver of a notice requirement to prove such waiver by “clear and unmistakable evidence.” *Id.* at 919. Similarly, in Service Steel Erectors, supra, waiver of the notice of claim requirement by actual knowledge was asserted by the plaintiff subcontractor on a sewer treatment plant project. The

court found that there is no Virginia doctrine of implied waiver of a notice of claim requirement arising from knowledge by the owner of the performance of the extra work absent “a definite agreement to pay” for such work. *Id.* at 179-180, citing Linneman Constr., Inc. v. Montana-Dakota Utilities Co., 504 F.2d 1365, 1368 (8th Cir. 1974)

In the Virginia public contracts context, the leading Virginia decision is Main v. Dept. of Highways, 206 Va. 143, 142 S.E.2d 524 (1965). In that case, the facts clearly showed that substantial extra work was required of the contractor as a result of numerous errors on the part of the Highway Department and changes requested by the Highway Department. However, the contract contained a notice of claims requirement consistent with the applicable statute with which the contractor had not complied. The court held that failure to comply with the contractual notice requirement was a bar to all claims. Further, despite the fact that the Highway Department clearly knew of its errors and had ordered some of the changes included in the claim, the estoppel and waiver arguments asserted by the contractor to overcome failure of notice compliance were rejected. The very significant basis for such ruling in the public procurement context was that the notice requirements were established by the legislature in the applicable statute, and could not be waived by the public body nor could the public body be estopped from asserting them. “This is so because the legislature alone has the authority to dispose of or dispense with such rights.” *Id.* 206 Va. at 150, 142 S.E.2d at 529. Thus, in addition to the private contracting restrictions on the waiver argument established by McDevitt & Street v. Marriott and Service Steel Erectors, the public contract contractor has the further obstacle of the limitation on the power of the public body to waive the statutory notice requirements even if it wanted to do so.

The Virginia Supreme Court has not yet been called upon to apply the notice requirements of the Procurement Act. There is no reason to believe that its approach would waiver from the general standard set 100 years ago in Atlantic & Danville v. Delaware Constr. and the public contracts rule stated in Main v. Dept. of Highways. The Procurement Act has, however, been addressed on many occasions at the trial court level. The trial courts consistently have recognized the significance of the statutorily proscribed notice requirements in the context of the standard set by Main v. Dept. of Highways. As a result, strict compliance with notice of claim requirements has become the clearly established rule.

In General Excavation, Inc. v. Fairfax County Board of Supervisors, 33 Va. Cir. 120 (Ffx. Co. 1993), the contract contained a notice requirement of within 20 days after the occurrence and the contractor failed to give the requisite notice. The contractor’s failure to comply with the notice requirements was held to bar the claim. The contractor argued constructive notice or actual knowledge on the part of the county, but the court held that “constructive or actual knowledge does not vitiate the requirement of actual, written notice under Virginia law.” *Id.* at 121. The court also followed Main v. Dept. of Highways in rejecting the estoppel arguments of the contractor, holding that estoppel does not run against a public body acting in its public capacity. General Excavation at 122. The same rulings were made on the same issues in R. J. Crowley, Inc. v. Fairfax County School Board, 41 Va.

Cir. 55, 56-57 (Ffx. Co. 1996). The rationale, again consistent with Main v. Dept. of Highways, was that the notice of claim requirements are set by statute. Any attempt by the public body to waive the notice requirement is beyond the powers delegated to the public body, and thus beyond the powers of any employee of that public body. Crowley v. Fairfax County School Board at 56-57.; General Excavating at 122; Main v. Dept. of Highways 206 Va. at 150, 142 S.E.2d at 529. The result of this rule is that no matter how compelling the claimant's facts, if there is a failure of compliance with the notice of claim requirements the arguments of constructive notice, waiver or estoppel are not available because the public body is without power to waive the notice requirements.

This limitation on the power of employees or representatives to waive statutory requirements is emphasized in County of York v. King's Villa, Inc., 226 Va. 447, 309 S.E.2d 332 (1983), which is instructive although not a construction dispute case. In King's Villa, a developer entered into a written agreement with the county administrator setting sewer tap fees for the development at \$750.00 per lot in return for certain concessions by the developer. The board of supervisors later raised the fees, and the developer relied on the agreement to avoid paying the higher fees. The agreement was held to be unenforceable. "King's Villa is in the unfortunate position of having dealt in good faith with a public servant who exceeded the bounds of his authority. This is not an uncommon problem However, we have cautioned in several cases that those who deal with public officials must, at their peril, take cognizance of their power and its limits."

Any attempt by the public body to waive the notice requirement is beyond the powers delegated to the public body, and thus beyond the powers of any employee of that public body.

Id. 226 Va. at 450, 309 S.E.2d at 334. Whether any asserted waiver is by implication or by actual agreement, therefore, it is void and of no effect. As noted in Service Steel Erectors, supra, there is no doctrine of implied waiver of a written notice of claim requirement in Virginia. In the public contracting context, however, it is not even necessary to address that question because the public body may not waive the statutory notice of claim requirement.

Another trial court decision stressing the effect of the failure to comply with notice of claim requirements is R. J. Crowley v. Fairfax County School Board, supra. The school board contract required notice of a claim within 5 days after the occurrence giving rise to the claim and an itemized statement within 20 days after the notice. The contractor failed to give the required notices. "The Procurement Act specifically requires contractors to give written notice of their intent to file a claim against a public body at the time of occurrence or at the beginning of the work upon which the claim is based Failure to follow the requirements of the Procurement Act bars a claim against the public body." Id. at 55-56. Addressing the argument of estoppel in conjunction with waiver, the court again found that estoppel does not apply to a governmental body when acting in its governmental capacity. Id. at 57; General Excavating at 122; County

of York v. King's Villa 226 Va. at 452, 309 S.E.2d at 335. The significant clarification in R. J. Crowley v. Fairfax County School Board was the finding that written communications that raise the issue of the occurrence that forms the basis for the claim but which do not clearly state the intent to assert a claim are insufficient to satisfy the contractual and statutory notice requirement. Id. at 56, 58.

The most cogent example of the strict application of compliance with the notice requirements of the Procurement Act appears in Michael, Harris & Rosato Brothers, Inc. v. Fairfax Redevelopment and Housing Authority, 23 Va. Cir. 272 (Ffx. Co. 1991). In that case, the underlying contract provided that the contractor had one year from final payment within which to file suit on any claims. Under §11-61.D of the Procurement Act, however, suit on a claim is required to be filed within six months from the public body's final decision on the claim. The court held that under the statute it had no jurisdiction to entertain a suit filed after the six months limitation had expired, even though the suit was timely under the contract provision. Although the contractor had complied with the filing requirements of the contract, the contract limitation exceeded the statutory limitation. The statute superseded the contract, the public body was without authority to modify the statute, and the claim therefore was barred. Id. at 274.

Further emphasizing the lack of alternatives available to the contractor who fails to comply with notice of claim requirements is the established rule in Virginia that recovery on a *quantum meruit* basis is not available. Where there is an express contract in place that contains a notice of claim requirement with which the contractor did not comply, recovery in *quantum meruit* is barred. Main v. Dept. of Highways 206 Va. at 152, 142 S.E.2d at 530-531; General Excavating at 121, 122.

Adding to the dilemma of the contractor who has otherwise valid claims but has failed to comply with the notice requirements is §11-56.2.C of the Procurement Act. Under that statute, a contractor asserting a delay claim that is determined to be "false or to have no basis in law or in fact" may be held liable to the public body for the fees and costs incurred in defending the delay claim. The argument is available to the public body that a delay claim that is barred for failure to comply with notice provisions has "no basis in law" and therefore the public body is entitled to recover its fees and costs in defending it. Pursuing the claim thus could have the result of further compounding the contractor's losses.

Any contractor who is awarded a construction contract for a public project in Virginia should study the notice of claim provisions of the Procurement Act and of the contract before commencing performance of the contract. The contractor then should take whatever steps are necessary to adjust their normal procedure for processing claims to comply with the more stringent of the applicable notice provisions appearing in either the contract or the Procurement Act. The attorney representing the contractor also should review the contract, the Procurement Act, and the contractor's notice of claim documents before beginning pursuit of any claims. In the absence of compliance with these notice provisions, a contractor who otherwise has a meritorious claim faces an extremely difficult task in pursuing those claims.

The attorney who recommends pursuit of the claim before conducting the proper analysis may achieve the result of not only losing the claim but also of putting the client in the position of having to pay the public body's costs and fees for defending it. ☹



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