Special Feature

Damages under the Virginia Uniform Computer Information Transactions Act: *Blue Line v. Redmon Group*

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In December 2008, an Alexandria jury awarded a $1.14 million judgment against a website developer in the first case decided under the Virginia Uniform Computer Information Transactions Act, Va. Code §59.1 - 501.1, et seq. (“UCITA”). The plaintiff, Blue Line Media, Inc. (“Blue Line”) contracted with the developer, Redmon Group, Inc., (“Redmon Group”) to build an enhanced employment website. After the development project went substantially over the contract’s budget and timeline, Blue Line sued Redmon Group for breach of its duties, as stated in the contract and in the UCITA. Redmon Group counterclaimed that Blue Line breached by the contract by failing to pay some invoices. The jury ultimately sided with Blue Line. Despite the contract’s express preclusion of incidental and consequential damages, the award exceeded the contract price by 90 percent.

This article uses the facts and outcome in the *Blue Line* case to discuss the measure of damages under UCITA.

Statement of the Case

From 2000 to 2006, Blue Line owned and operated a business on the internet address lawenforcementjobs.com that catered to job seekers, whom were looking for employment with police and security agencies, and to employers in that same industry. Blue Line earned revenue from employers paying to post jobs on the website and through advertising on the website. In November 2006, Blue Line’s owner, Jason Abend, decided to build an enhanced website that would provide greater services and functionality to Blue Line’s customers and enable Blue Line to host a number of industry specific job sites from a single administrative panel. Blue Line contracted with a third party to develop a requirements document outlining the new website’s proposed functionality. Blue Line then approached Redmon Group.

Redmon Group styles itself as a media firm that develops interactive technology products. Blue Line paid Redmon Group $20,000 to revise the requirements document to include additional functionality. Based on the revised requirements document (“Requirements Document”), Redmon Group proposed a budget and timeline for building the new website. In February 2007, Blue Line authorized Redmon Group to begin work on the new website. Redmon Group proceeded to develop the design document—a detailed blueprint describing how Redmon Group should have implemented the Requirements Document. By April 2007, Blue Line signed Redmon Group’s standard written agreement. The contract called for Blue Line to pay Redmon Group a total of $598,441 in seven fixed payments, with the final payment of $119,688.20 being due on September 10, 2007, about a week after the contract’s stated delivery date. It further stated that the price was a “time & materials estimate” that:

... represents Redmon’s good faith estimate of the work outlined in this agreement. Unforeseen technical difficulties, review delay, or [Blue Line] change requests may impact the budget and or schedule. In such events, Redmon will inform the Client of the cost and schedule driver, provide an estimate for the work required, and seek authorization from [Blue Line] before proceeding.

According to the agreement, Redmon Group agreed to the following milestone delivery schedule: 1) an Alpha Site (mid-July), which was to be the first online version of the website, to include core subsystems; 2) a Beta Site (mid-August), in which the website would be feature complete; and 3) Soft Launch (Monday, Aug. 27), which was to mark the website’s final form. After Soft Launch, the website was to enter a state of “Code Lock” in which...
Blue Line Media was to enter the actual customer data and final content in preparation for the formal launch of the website on September 4, 2007.

The agreement specified that it was expressly subject to Virginia law. Although the agreement was silent on the UCITA’s application, the website’s development was clearly a “Computer Information Transaction” under Va. Code §59.1-502.2(a)(11). As such, the UCITA supplied a number of terms to the parties’ contract.¹

Unbeknownst to Blue Line, at the time the parties executed the agreement, Redmon Group had already exceeded the budget for developing the design document. Redmon Group’s project manager had never managed the development of an application as large as the Blue Line website and he failed to use coherent or effective methodologies for budgeting and managing the development effort. Instead, he managed the project by “burn rate,” i.e., comparing the amount of the time the development team had expended to date on the project against the contract price.

Although Redmon Group was exceeding its estimates and falling behind the development timeline, the project manager informed Blue Line that the effort was on track. On August 21,² Redmon Group finally told Blue Line that it would need to push the site launch back from September 4th to September 10th. The parties agreed to drop certain functionality from the website to speed up the development process.

Redmon Group’s internal numbers showed that the developer had exceeded its budget in August. During a September 5th lunch meeting, Redmon Group informed Blue Line that it was over-budget and wanted additional compensation for the extra hours it believed it was putting into the website. Blue Line agreed to advance a portion of the final scheduled payment and to increase the contract price by $75,000 because 1) Redmon Group threatened to stop work if Blue Line did not agree, and 2) Redmon Group represented that it would complete a “full site launch” by October 8.

In September and October of 2007, Redmon Group made several versions of the draft website available for Blue Line’s review. The versions lacked major subsystems and components. The portions of the site that were present contained hundreds of errors and inconsistencies. By early October, Blue Line finally lost faith in Redmon Group’s ability to complete a functional website. Blue Line ceased making payments according to the revised payment schedule and demanded that Redmon Group finish the site without further delay. Redmon Group refused, claiming that the agreement was a “time and materials” contract and that the developer would complete the site only if Blue Line paid the outstanding payments and agreed to pay for any additional hours Redmon Group expended on a monthly basis.

After Redmon Group refused Blue Line’s request to permit a third party to inspect the source code to determine the status and quality of the website, Blue Line sent a Notice of Termination to Redmon Group. Blue Line sued the developer and sought damages under the Uniform Computer Information Transactions Act.² Blue Line asserted that Redmon Group’s breaches proximately caused Blue Line to suffer damages because Blue Line had paid money to the Redmon Group and received nothing of value. Pursuant to Va. Code §59.1-508.9, Blue Line asserted Redmon Group’s breaches caused Blue Line to suffer damages, representing the market value of Redmon Group’s performance, in the amount of $2.3 million. Alternatively, pursuant to Va. Code §59.1-508.9, Blue Line claimed it was entitled to a refund of its payments to Redmon Group, namely $543,000. Redmon Group filed several counterclaims, asserting that the agreement was a time and materials contract and that Blue Line breached the agreement by failing to make further payments. Redmon Group also claimed that it would have delivered a complete website, had Blue Line not refused to continue payments.

Under UCITA, Redmon Group had a duty to exercise good faith in building and delivering the website in accordance with industry standards.³ Redmon Group also expressly warranted that the website was “of merchantable quality in accordance with the description on the face of this Agreement or any schedules attached hereto.”⁴ Redmon Group also appeared to fail to disclaim the implied warranties of merchantability and fitness for a particular purpose.

At trial, Blue Line called industry standards expert Todd Trivett to testify that Redmon Group failed to build and deliver the website in accordance with industry standards and practices. Specifically, Mr. Trivett found, after functional validation testing, that the vast majority of the website’s promised functionality was missing, incomplete or defective. Mr. Trivett further opined that the causes of Redmon’s failures were their material deviations from Project Management and Software Engineering standards. Redmon Group presented expert testimony that it had employed appropriate standards in developing the website. However, Redmon Group’s primary argument was that it could have fixed all of the defects, if Blue Line had paid Redmon to do so.

**UCITA vs UCC in calculation of damages**

The UCITA was drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in recognition that there are fundamental differences between a computer information transaction and a sale of goods.⁴ The UCITA was originally intended as an amendment to Article 2 of the Uniform Commercial Code (“UCC”), but after the American Law Institute withdrew its support, the NCCUSL took on the UCITA as freestanding leg-
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isolation. To date, only Virginia and Maryland have passed the statute. The other 48 states apply either the UCC or common law to software transactions.

The UCC approach to damages in software cases is best exemplified in Chatlos Systems, Inc. v. National Cash Register Corp. Chatlos, decided under New Jersey law, held that the correct measure of damages was the fair market value of the software that the developer had failed to deliver. While the UCITA parallels the UCC in many respects, the two codes differ in some aspects of damages calculations.

Virginia Code §8.2-713 sets forth the buyer’s damages for non-delivery or repudiation of goods under the UCC, stating:

1) Subject to the provisions of this title with respect to proof of market price (§8.2-723), the measure of damages for nondelivery or repudiation by the seller is the difference between market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this title (§8.2-715), but less expenses saved in consequence of the seller’s breach.

The market price referenced in §8.2-713(1) is “the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.”

Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as to the place of arrival.

The UCITA provisions dealing with a licensee’s direct damages for non-delivery or repudiation are found in §59.1-508.9(a)(1), which provides in relevant part,

(a) Subject to subsection (b) and except as otherwise provided in §59.1-508.7, a breach of contract by a licensor entitles the licensee to recover the following compensation for losses resulting in the ordinary course from the breach or, if appropriate, as to the whole contract, less expenses avoid as a result of the breach to the extent not otherwise accounted for under this section:

(1) damages measured in any combination of the following ways, but not to exceed the market value of the performance that was the subject of the breach plus any restitution of any amounts paid for performance not received and not accounted for within the indicated recovery:

... (B) with respect to performance that has not been rendered or that was rightfully refused or acceptance of which was rightfully revoked:

(i) the amount of any payments made and the value of other consideration given to the licensor with respect to that performance and not previously returned to the licensee;

(ii) the market value of the performance less the contract fee for that performance;

(iii) the cost of a commercially reasonable substitute transaction less the contract fee under the breached contract, if the substitute transaction was entered into by the licensee in good faith and without unreasonable delay for substantially similar information with the same contractual use terms; or

(C) damages calculated in any reasonable manner.

Although this section fails to set forth the damages with formulaic precision, it appears that the maximum amount of direct damages that a licensee can recover in the case of non-delivery, repudiation or rightful revocation of acceptance is the “the market value of the performance that was the subject of the breach plus any amounts paid for the performance not received and not accounted for...”

In comparing the statutes, there are a number of similarities between the damage provisions in the UCC and UCITA. Both statutes reduce the calculation of damages by any amount the buyer/licensee saved as a result of the seller/licensor’s breach. As in the case of the UCC, “market value is determined as of the date of breach of contract and the place for performance.” Additionally, both statutes provide for incidental and consequential damages, the ability to disclaim or limit incidental and consequential damages, the ability to liquidate damages, the ability to define alternate or exclusive remedies, and a right to recover damages associated with the exercise of the right of cover.

While many of the damage concepts in the UCC are replicated in the UCITA, there are subtle differences. Most notably, the UCC references “market price” while the UCITA references “market value.” There are also differences in the definitions of incidental and consequential damages and in the manner in which cover may be had as a result of differences in goods and information.

Despite numerous similarities, the UCITA’s Official Comments indicate that the General Assembly may have intended to adopt more dramatic changes in the manner in which damages are calculated under UCITA than reflected in the language of the statute. Official Comment 2 to §59.1-508.9 states that “Market value refers to what would be the fee in a similar transaction for the performance.” The Comment further states that:

“Direct damages” are the difference in market value between the performance promised and performance received, not counting lost expected benefits from anticipated use of the expected performance.
This rejects cases such as Chatlos Systems, Inc. v. National Cash Register Corp., 670 F.2d 1304 (3d Cir. 1982), cert. dism., National Cash Register Corp. v. Chatlos Systems, Inc., 457 U.S. 1112 (1982), which, under a rule referring simply to “value”, incorporate in direct damages an assessment of how valuable use of the performance would have been to the aggrieved party. If recoverable, those are consequential, not direct damages.

According to the Comment drafters, “market value” is largely equivalent to the contract price. The Comment drafters claim that any difference between the value of the performance and the value of the use of the performance in the licensee’s hands represents consequential damages. Based on Official Comment 2, therefore, one may argue that the UCC’s “market price” rather than “market value” serves as evidence that the General Assembly rejected the UCC’s “market price” measure of damages. The General Assembly’s failure to include a provision in the UCC explaining how to determine “market value,” as it did for “market price” in §8.2-723 only heightens the issue. Thus, the damages issue was fertile for debate.

**Calculation of Blue Line’s damages**

Blue Line hired an expert in business valuation, Mark Vogel, to analyze Blue Line’s damages. Mr. Vogel opined that to give an evaluation of the “market value” of the failed performance, he needed to analyze all three approaches to valuation; namely, the income approach, the market approach and the cost approach.

First, based on the cost data involved in building the website, he opined that the Redmon Group created website would have had a value of $1 million under the cost approach.

Next, given that Blue Line, or its predecessors, had operated a similar business on lawenforcement jobs.com since 2000, Mr. Vogel had actual income numbers directly related to the operation of a similar website. Additionally, Blue Line had prepared forecasts of additional revenue it would receive. These forecasts were created in preparation for deciding whether to build a new website and identified how much revenue Blue Line might expect from expected increased functionality in the website. Using this data, and using the discounted cash flow method, Mr. Vogel derived a value of $1.853 million under the income approach for the value of the failed website.

Then, Mr. Vogel analyzed the market approach. He tracked and compared comparable sales of similar websites, reviewed a sales report on job boards, and reviewed offers to purchase the existing website. He opined that under the Market Approach, the website had a value of $3 million.

After reviewing all three approaches, Mr. Vogel concluded in his expert report that “the Market and Income Approaches produce better indicators of the actual fair market value of the website than the Cost Approach because the value of an intellectual property asset . . . is dependent on the unique qualities and the cash flow it can generate.” Considering all three approaches, Mr. Vogel opined that the fair market value of the website that Redmon Group failed to deliver was $2 million.

**Redmon Group’s Motion in Limine**

Redmon Group moved to exclude Blue Line’s expert, arguing that Blue Line’s calculation of “market value” damages included “consequential damages” expressly barred by the contract. In the UCITA, “consequential damages” are defined as “loss of anticipated benefits as a result of not being able to exploit or rely on the expected contractual performance such as lost profits.” Pointing to Official Comment 2, Redmon Group asserted that “market value” under UCITA is simply the competitive market price for the construction of a similar website and does not take into account the future value of the asset.

Therefore, Redmon Group argued, Blue Line’s expert was not entitled to use the income approach or to use projections of future income in evaluating the market approach. Additionally, Redmon Group argued that the “best indication of the ‘market value’ of performance is the agreed-upon price for performance under the contract between parties,” extrapolated from Official Comment 3(a), which states “[v]alue is generally measured by the contract fee.” Essentially, Redmon Group sought to cap Blue Line’s damages at the $598,441 contract price.

**Damages analysis**

There were two fundamental defects with Redmon Group’s arguments. First, Virginia Code §§59.1-508.7 and 9 were clear and unambiguous without resort to reading the comments which are in conflict with the UCITA’s unambiguous language. Second, UCITA expressly defines market value damages as “direct damages,” not “consequential damages.”

**The Comments conflict with the unambiguous language of the Code**

None of the words in the relevant statutes, such as “market value,” “consequential damages,” “speculative,” or “performance” are ambiguous. The court must give a statute’s words “their common, ordinary, and accepted meaning absent a contrary intent by the legislature.” Additionally, if the meaning of a word is well known at common law, the court should interpret the statute with the common law meaning. Legislative history cannot alter a statute’s plain meaning.
Thus, where the statutes are plain on their face, as here, the court is not permitted to resort to rules of construction, legislative history or other extrinsic evidence such as the Comments.28

Moreover, the language of Comment 2 to §59.1-508.9(a)(1) flies in the face of the statute’s specific language. Subparagraph (a)(1)(B)(ii) references “market value” and “contract fee” as distinct concepts.29 Given that the licensee is entitled to “the market value of the performance less the contract fee for that performance,” (emphasis added), it is evident that the General Assembly contemplated that the “market value” could exceed the contract fee and it specifically defined this excess as direct damages.30 If the General Assembly had intended a radical departure from existing law and cases like Chatlos, as claimed in Comment 2, the General Assembly certainly would have written this change in the statute’s body. Comment 2 is inconsistent with the unambiguous language of the statute and cannot be relied upon as authority for contradicting the statute.

Blue Line’s damages were not consequential damages

Blue Line did not seek lost profits, which are consequential damages. To the contrary, Blue Line sought the “market value” of the website Redmon Group failed to deliver. In determining the website’s market value, Virginia Supreme Court precedent required Blue Line’s expert to consider all three commonly accepted approaches to determine market value.31 The income and market approaches specifically require the analysis of projected future income. Thus, while Blue Line’s expert did consider the website’s future income in forming his opinion of the website’s market value, Blue Line did not seek the actual lost income as damages.

• Market Value Calculation

Virginia Code §59.1-508.9(a)(1) allowed Blue Line to recover as damages “the market value of the performance that was the subject of the breach . . . .” Section 59.1-508.9(a)(1)(B)(ii) entitled Blue Line to the “market value of the performance less the contract fee.” Furthermore, §59.1-508.9(a)(1)(C) allowed Blue Line to calculate its damages “in any reasonable manner.” Blue Line read these statutes to mean that it was entitled to the market value of Redmon Group’s performance ($2 million), plus the amounts it paid to Redmon Group ($543,000) less the contract fee ($598,000) for a total damages estimate of $1,965,000.

Under Virginia law, one proves “market value” of property in Virginia by proving the “fair market value” of property.32 The Virginia Supreme Court has defined “fair market value” of a property to mean the “sale price when offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who has no necessity of having it.”33

In Keswick Club, the Supreme Court discussed that, in evaluating the fair market value of an asset, real property in that case, one must at least consider the three common approaches to valuing an asset, the income approach, the cost approach and the sales (or market) approach in forming an expert opinion as to fair market value.34 So long as the expert appraiser considers each of the three approaches, even though the appraiser may settle on one approach as the best one, or reject an approach as improper, the court should not review the opinion of the appraiser regarding the utility or non-utility of each approach.35 The court in Keswick Club reversed the trial court for allowing an opinion as to fair market value that only considered one approach to determining fair market value.36

In a case valuing corporate stock, Lucas v. Pembroke, the Supreme Court affirmed a lower court ruling that the statutory term “fair value” with respect to corporate stock meant the intrinsic worth of the stock based upon an appraisal of all the elements of value, including market, net and investment value, and earning capacity, which elements the lower court’s opinion had considered.37 The Lucas court also determined that one determined “fair cash value” under the prior statute in the same manner one determined “fair value” under the then current statute.38

In interpreting a later version of the same statute, Fairfax Judge Stanley Klein opined that absent controlling authority, he must determine “the full panoply of elements of value.”39 In that case, Judge Klein reviewed the accepted approaches to determining value, (cost, income and market) and noted that in determining the income approach, appraisers used two separate methods (capitalization of cash flow method and the discounted cash flow method).

According to Judge Klein,

“the discounted future cash flow method (DCF), measures value as (1) a forecast of future cash flows for a set period of time, discounted to present value, plus (2) the anticipated residual value of the company at the end of the period of projected future cash flows, again reduced to present value.”40

Ultimately, Judge Klein’s choice of value stemmed from the discounted cash flow method.41

the approach and methodology used by Blue Line’s expert. Therefore, Blue Line argued that to determine “market value,” the plaintiff must show its expert analyzed all three approaches to valuation.

• Direct v. consequential damages under UCITA

Section 59.1-501.2(a)(25) specifically defines the “market value” damages set forth in §59.1-508.9(a)(1) as “direct damages.” In contrast, §59.1-501.2(a)(13) defines “Consequential Damages” as:

(i) any loss resulting from general or particular requirements and needs of which the breaching party at the time of contracting had reason to know and which
could not reasonably be prevented, and (ii) any injury to an individual or damage to property other than the subject matter of the transaction proximately resulting from breach of warranty. The term does not include direct damages or incidental damages.

Blue Line argued that Redmon Group’s breach caused Blue Line to lose profits on contracts that Blue Line could not service without the new website. These lost profits were consequential damages, barred by the contract, and the Court struck them on demurrer.

At trial, Blue Line did not seek profits it would have made on sales that it lost as a result of Redmon Group’s breach and the expert’s report did not calculate any such damages. A party seeking recovery of lost profits must establish to a reasonable certainty the gross amount it would have earned if the contract was performed minus the ordinary costs associated with its efforts to generate the earnings. For example, the Supreme Court has upheld an award of more than $1.5 million in lost profits based upon the plaintiff’s owner’s testimony that the plaintiff would have generated a gross profit of 40 percent on several contracts that would have generated sales of over $2.2 million but for the defendant’s interference with the contracts. Also, the Supreme Court reversed a judge for improperly excluding the plaintiff’s expert’s testimony on lost profits, even though the expert calculated lost profits by first calculating estimated gross revenues and then subtracting the costs of goods sold.

Unlike in the foregoing cases, Blue Line’s valuation expert did not estimate gross revenues and subtract Blue Line’s costs to arrive at a lost profits calculation. Rather, the expert testified to the market value of the website as established through his consideration of the three valuation methods he was required to consider by industry standards and Virginia Supreme Court precedent. The cost approach calculated the cost to replace the website. The market approach compared similar transactions for websites that generated revenues similar to the projected revenues for the website. The income approach calculated value by discounting to present value an estimated stream of cash flows that one could have reasonably expected the website to generate. The expert’s opinion of the website’s market value was formed after his consideration of all three approaches. Thus, it was inaccurate to claim that his opinion incorporated consequential damages in violation of the agreement.

**Court’s ruling and verdict**

The court granted Redmon Group’s motion in limine in part, holding that Blue Line’s expert was not permitted to use future income calculations in his opinions. The judge explained that he thought the calculations included consequential damages to the extent they were based upon projected revenues. This ruling prevented Blue Line’s expert from testifying on the income approach and required Blue Line’s expert to remove projected income for the period following the breach from his consideration of the market approach. Removing this income calculation was simply a mathematical exercise and the court permitted the expert to revise his opinions on the eve of trial. Essentially, Blue Line’s expert was limited to testifying to the cost approach ($1 million) and a watered down market approach analyzing similar transactions using Blue Line’s actual revenues prior to the breach ($1.4 million). Given these limitations, Mr. Vogel testified that the market approach was a better valuation than the cost approach, and at trial, opined that the value of the website Redmon Group failed to deliver was $1.4 million.

After a full three days of testimony, the jury awarded Blue Line $1,140,000 in damages for breach of contract for failing to build and deliver the website within industry standards. After the trial, the jurors explained to plaintiff’s counsel that Redmon Group’s liability was obvious. The only issue for them was how much money to award Blue Line. Given that the trial was just before Christmas, in a difficult economy, the jurors decided to award an amount they hoped would adequately compensate Blue Line, without putting Redmon Group out of business. While both parties noticed appeals, the matter was resolved before any petitions for appeals were filed.

**Final thoughts**

The debate over what is the proper measure of damages in UCITA cases is still open. Plaintiff’s experts in future UCITA cases will need to arm themselves with ample data and market comparables to preserve options for offering a modified opinion in the event a judge prohibits their consideration of projected income or other items in rendering the opinion. Future plaintiff’s experts will need to carefully craft their reports and deposition testimony so as to leave open the possibility that they may rely on the cost or market approaches, if the court rules that they may not consider the income approach. Here, the trial judge thought it was improper to consider the income approach or a full market approach to value. Another trial judge, or the Virginia Supreme Court, may think it is error to fail to do so.
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Endnotes

5. Id.
7. 670 F.2d 1304 (3d Cir. 1982).
8. Id.
12. Va. Code §59.1-508.9(a)(1) (2008); Presumably, a licensee would not be able to recover the contract price to the extent it exceeds the market value of the promised performance plus any payments made in respect to the promised performance.
22. Id. §59.1-508.9 (Official Comment 3(a) at p. 459, Vol. 9, Virginia Code).
23. Although the price quoted in the agreement was $598,441, Redmon Group’s counterclaim for breach of contract asserted that it provided nearly $880,000 in services under the contract. If the parties’ agreement was in fact a time and materials arrangement as advanced by Redmon Group, then the “contract fee” is arguably the value of the services that Redmon Group alleged it provided pursuant to the agreement (nearly $880,000) rather than the initial good faith estimate ($598,411).
28. Id.
34. Id. 273 Va. at 137, 639 S.E.2d at 248.
35. Id., 273 Va. at 138, 639 S.E.2d at 248.
36. Id.
37. 205 Va. 84, 135 S.E.2d 147 (1964).
38. Lucas, 205 Va. at 89, 135 S.E.2d at 150.
40. Id. at 519.
41. Id. at 525.
45. Ironically, this ruling hampered the cross examination of Mr. Vogel. The court ruled that if the defense opened the door, that Mr. Vogel could testify to the stricken opinions.
46. Interestingly, one of the jurors was an accountant, who could not understand why Mr. Vogel did not address the income approach in his testimony.

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