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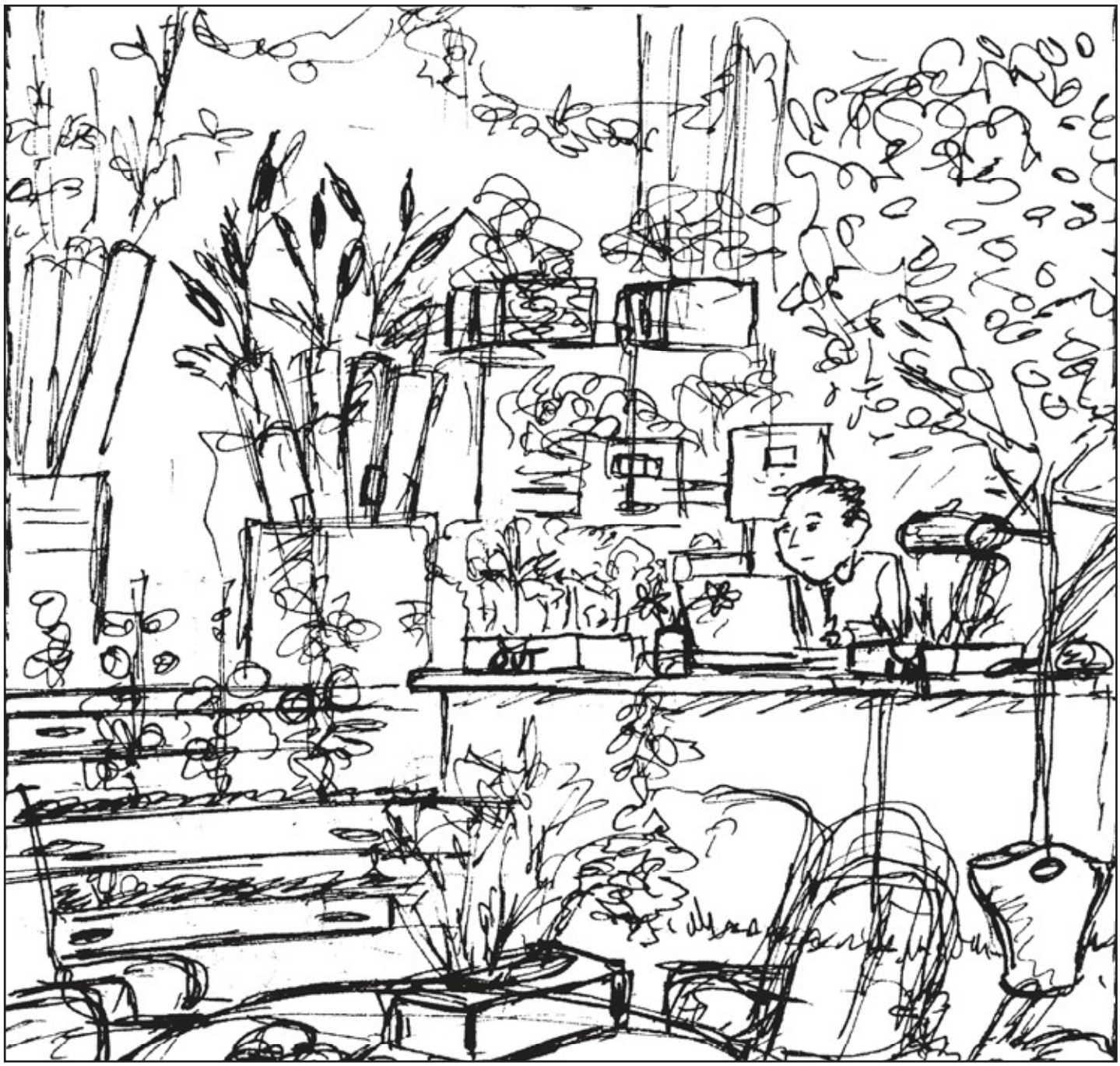

Electronic Communications on Construction Projects

Illustration: Garrett Kallenbach

Joint Defense Agreements Between Owners and Design Professionals

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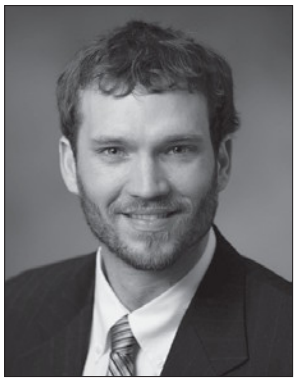

Marcus Eyth

Although the real estate market has slowed, construction claims continue to be filed every day. Building owners, design professionals, general contractors, subcontractors, and others will never be able to eliminate construction claims or disputes. But fortunately there are tools to manage such disputes so that the underlying focus remains completing the job on time while maintaining profit margins. The joint defense agreement (JDA) is such a tool. This article examines the use of JDAs, particularly JDAs between owners and design professionals, entered into in response to contractor claims.

The parties to a JDA agree to cooperate in defending or bringing claims against another party while they reserve the right to bring claims against each other at a later time. One of the primary benefits of the JDA is that it allows parties communicating and strategizing with one another to take advantage of the confidentiality and privilege benefits similar to those of the attorney-client and work product privileges. Although the concept of a JDA has been around for decades,[1] some parties may be initially reluctant to cooperate with another party, when it may well be adverse to that party in the future. There also may be some negative stigma associated with a JDA because parties could be viewed as not acting in the best interest of their companies if their decision making with respect to claims appears to be influenced by another party. Nevertheless, companies involved in construction disputes, together with their counsel, should temper such initial negative reaction and consider the practical advantages of JDAs. As discussed below, well-drafted JDAs between owners and designers, implemented as part of an overall legal strategy in the defense of contractor claims, can help resolve contractor claims on favorable terms while avoiding years of litigation.

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A Typical Claim Starts With a Contractor's Allegation of Defective Design

The following series of events presents a typical example of how a dispute evolves in a design-bid-build contracting setting. After the owner puts its design professional's design out to bid and awards the general contractor the construction contract based on that design, the contractor begins to build. As construction progresses, the contractor realizes problems with the results of the construction (for example, unacceptable cracking of concrete, leaking windows, nonfunctioning systems, or other problems) and notifies the owner of the issues. Though the contractor will typically blame these problems on defective design, the design professional will blame the contractor's defective estimating, construction, or management. Because there is no contractual link between the contractor and the design professional in the design-bid-build setting, the contractor usually looks to the owner for relief. In fact, the economic loss doctrine, which is recognized to various degrees in a majority of states, frequently precludes the contractor from suing the engineer for economic loss associated with negligent design because of the absence of a contractual link to the designer.[2] As such, the only viable option the contractor may have to recover is to seek recourse against the owner. The owner, in the meantime, assumes the role of managing the sparring between the designer and the contractor by forwarding the contractor's claim letters to the design professional for review and comment, and forwarding the design professional's responses to the contractor.

Although the lack of contractual privity between the design professional and the contractor may initially shield the design professional from exposure to claims of negligent design asserted by the contractor, the contrac-

tor's pursuit of the owner puts the design professional and the owner in an adversarial position. Upon receipt of the contractor's claim, the owner will typically tender defense of the claim to the design professional. Once that occurs, the three parties have set the stage, whether formally joined in one lawsuit or not, for an expensive and time-consuming dispute resolution process.

It is prudent for parties with leverage in contract negotiations to negotiate a favorable indemnification provision.

The Owner May Attempt to Tender Defense of the Contractor's Claim to the Engineer Pursuant to the Indemnification Provision

As part of the engineering services agreement (ESA) with the owner, the engineer will almost always agree to indemnify the owner from losses associated with defective (negligent) design. That is standard in the industry.[3]

In a nutshell, indemnification is an obligation whereby one party (indemnitor) agrees to make good another party's (indemnitee) loss caused by an act or omission of a specified nature. For example, the contractor will typically indemnify the owner from losses associated with the contractor's negligent acts and omissions.[4]

It is prudent for parties with leverage in contract negotiations to negotiate a favorable indemnification provision. This important and often heavily negotiated provision ties directly to the standard of care the design professional agrees to meet by setting out under what circumstances the design professional will be responsible to the owner for problems with the design. More often than not, the indemnification provision does not provide for when the tender of defense or indemnity is triggered or whether it covers costs associated with the defense of unproven claims. Once defective design allegations surface, the scope of the indemnification provision and the timing of when the indemnification obligation is triggered commonly become the subject of dispute.

Negotiating the Scope of Indemnification

In negotiating the applicable standard of care, the owner will attempt to negotiate the broadest indemnification possible. The owner may wish to require the engineer to be responsible for all acts and omissions associated with the design, even though that level of exposure may exceed the engineer's typical standard of care. On the other hand, the engineer will attempt to minimize the scope of the indemnification and attempt to limit open-ended exposure. Generally, the appropriate standard is for the engineer to indemnify the owner for losses resulting from *negligent* acts, errors, or omissions. The following language has proven acceptable to leading insurance carriers of professional engineers:

> ENGINEER hereby indemnifies and holds harmless Owner from and against any and all claims, damages, losses, and expenses arising out of ENGINEER's negligent acts, errors or omissions in the performance of the Engineer's professional services under this agreement.

To the extent the owner seeks to expand the scope of the indemnification beyond that of *negligent* acts, errors, or omissions, the engineer and owner should address the scope of the engineer's professional liability. Priority consideration should be given to the engineer's agreement to mitigate the assumed additional risk.[5] Where, for example, the engineer is being asked by the owner to assume liability for *all* acts associated with the design (negligent or not), that would include losses not proximately caused by the engineer's breach of its duty of care, thereby expanding the engineer's scope of liability. If a professional liability insurance carrier is willing to insure beyond negligent acts, the parties could procure the additional insurance and increase the ESA price accordingly. If not, the owner should be willing to increase the ESA price and pay the engineer for the additional assumed risk.

Who Defends and Pays for the Defense of Alleged But Unproven Claims?

In conjunction with negotiation over the scope of the indemnification, it is also common for the owner and engineer to spar over their respective responsibilities to defend alleged, but unproven, negligence claims. Once the dispute surfaces, the owner may attempt to rely on the indemnification provision to tender defense of the contractor's claims to the engineer.

In a perfect world, the parties' agreement would spell out the timing of any tender and the responsibility to pay for the ongoing defense. In practice, however, those points are frequently not spelled out, resulting in disputes.

On the one hand, the owner may argue that the indemnification provision subsumes a duty on behalf of the engineer to accept the owner's tender of defense as soon as the contractor launches a defective design claim, thereby reading into the ESA a presumption that the contractor's claims have merit. On the other hand, the engineer may argue that the indemnification obligation is not triggered until the contractor has proven its claims, reflected by a final judgment against the owner finding the owner liable to the contractor for providing a defective design. Thus, according to the engineer, it should not pay for ongoing legal and consulting fees or for the alleged damages before a court or other adjudicator has conclusively determined that the engineer was negligent.

To determine the parties' intent under the agreement with respect to who assumed responsibility to defend the contractor's allegations, judges will look for certain buzzwords contained in the provision, such as "defend" and "claims." An owner would argue that these words indicate that the engineer agreed to pay for the defense of alleged, but unproven, defective design claims. By way of an example of a particularly broad, that is, owner-friendly, indemnification provision, the owner may insist that the engineer agree to "indemnify, *defend* and hold the owner harmless from and against any *claims*, losses and damages associated with the engineer's breach of the engineering agreement, *whether proven or unproven*, including, without limitation, any of the engineer's acts or omissions with respect to its work on the project."

On the other hand, sophisticated engineering firms (with sufficient negotiating leverage) may insist on eliminating any references to defending claims in the indemnification provision, or clarify that the owner will pay for expenses associated with the defense and evaluation of unproven claims. For example, the ESA may expressly provide that the engineer's services to (i) evaluate alleged claims and (ii) act as a consultant for the owner in litigating or arbitrating alleged claims are *additional* costs not included in the price of the ESA. That approach is found in certain industry form contracts such as the EJCDC[6] engineer-owner agreement, which provides in "Section 2.2. Required Additional Services" (which are "not included as part of Basic Services"):

> Additional or extended services during construction made necessary by . . . (2) a significant amount of defective or neglected work of any Contractor . . . and (4) default by any Contractor.[7]
>
> [and]
>
> Evaluating an unreasonable or extensive number of claims submitted by Contractor(s) or others in connection with the work.[8]

In addition, section 2.1, "Additional Services of the Engineer" (that "will be paid for by Owner"), provides:

> Preparing to serve or serving as a consultant or witness for Owner in any litigation, arbitration or other legal or administrative proceeding involving the Project (except for assistance in consultations which is included as part of Basic Services under paragraphs 1.2.3 and 1.4.2).[9]

While these provisions do not shield the engineer from paying for losses actually proven to have resulted from its defective design, they clarify that the owner pays for these services, such that there is no presumption of defective design.

Consistent with an ESA that does not presume defective design upon a contractor's claim, the majority of jurisdictions hold that the cause of action for indemnity cannot arise until the loss has been suffered, which occurs *after* the indemnitee's liability is fixed by a judgment against it.[10] As a result, in the absence of clear language to the contrary, the engineer's indemnification obligation, including any obligation to pay for defense costs, will not be triggered until a judgment has indeed been entered against the owner in favor of the contractor.

Impact of the Owner's Tender of Defense on Its Relationship with the Engineer and the Project

Assuming the conditions and the timing of a tender of defense are not spelled out clearly in the ESA, the owner and engineer may have set the stage for legal warfare with adverse consequences to (i) the administration of an ongoing project and (ii) their professional relationship.

On an ongoing project, there is a strong possibility that project administration will stall while the owner and engineer focus on legal positioning rather than moving the project forward. Change orders that, prior to any dispute surfacing, may have taken ten days to process and resolve consume much more time. This is because parties will have become wary of signing away rights in the change order process, which may, in turn, prevent the contractor from proceeding with the work in a timely manner.[11]

Parties have taken advantage of the benefits of JDAs for a long time, and courts have recognized them as valid and binding agreements.

In addition, disputes between the owner and the engineer as a result of the contractor's claims will likely result in a deterioration of the professional relationship between the owner and the engineer. Without a plan or strategy in place between the owner and the engineer to defend the contractor's claims, the owner may impose premature, onerous, and often unrealistic demands on the engineer in an attempt to eliminate the problem. For instance, the owner may demand that the engineer immediately pay the contractor's demands to avoid a situation in which the contractor files suit against the owner. If the contractor files suit, the owner may then decide to sue the engineer for unsubstantiated damages associated with the contractor's allegations. At that point, the adversarial nature of the relationship will likely have been exacerbated to the point where neither party trusts one another and every party's action is scrutinized by on-site personnel, company executives, in-house counsel, and

outside consultants and lawyers.

Once the relationship has deteriorated to this point, the parties may have gone past the point of opportunity to reconcile their personal and professional relationships.

Enter the Joint Defense Agreement

To prevent the above-described meltdown, the engineer and owner should consider defending the contractor's allegations with a joint strategy and purpose. As such, the joint defense agreement offers an attractive platform of benefits to both parties.

The parties could discuss the concept of a JDA as early as during contract negotiations.

Parties have taken advantage of the benefits of JDAs for a long time, and courts have recognized them as valid and binding agreements. Courts have characterized the JDA as "an extension of the attorney-client privilege which serves to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort of strategy has been decided upon and undertaken by the parties and their respective counsel."[12] It is important to understand that while existing litigation is not a prerequisite for the privilege to apply, only communications made in the course of the ongoing venture are protected.[13] Moreover, parties to a JDA must be aware that the privilege is *not* preserved where parties confer among themselves, outside the confines of the group, or for the purpose of collecting information in order to obtain legal advice.[14]

The parties can structure a JDA in various ways and it need not be an extensive document. While no one size fits all, a ten-page double-spaced document has proven adequate to define the parameters for the joint defense of complex contractor claims. Although all clauses in the agreement are negotiable, the following concepts and features should be intact for the JDA to be meaningful and productive:

- *Privileged Communications*. Communications between the parties, whether written or oral, during the term of the JDA remain privileged and confidential, and cannot be used in any subsequent litigation between the parties.[15]
- *Suspending Disputes*. The parties suspend existing claims and refrain from filing new claims against one another until the dispute being addressed with the contractor is resolved.
- *JDA Termination*. The JDA can be terminated by either party for any reason and within a short period of time, such as thirty or sixty days.
- *Payment for Services to Defend*. The engineer is paid by the owner for its services to defend the contractor's claim as provided in the supplementary services section of the ESA (unless provided otherwise in the ESA); to the extent such payments are in dispute, the owner may seek reimbursement.
- *Cooperation*. The parties' joint obligations for the duration of the JDA include (i) developing a strategy to respond timely and effectively to the contractor's allegations; (ii) considering and approving or denying settlement offers or proposals by any party; and (iii) working together to defend collateral legal proceedings associated with the contractor's claim, such as the issuance of subpoenas and, for public projects, Freedom of Information Act (FOIA) requests.
- *Dispute Resolution*. The dispute resolution provision in the JDA should supersede all prior dispute resolution agreements, if permitted by law. The parties should enter into the following sequence of resolution: (i) Senior principal of the parties should enter into a good faith amicable settlement negotiation including closure with a settlement agreement. If this fails the parties should (ii) enter into a third-party nonbinding facilitated mediation according to the rules and procedures of the American Arbitration Association with a mutually agreed-to mediator to facilitate a settlement including a settlement agreement. If this fails, the parties should (iii) enter into binding arbitration according to the rules and procedures of the American Arbitration Association.

The JDA Should Be Introduced as Early as Possible

The circumstances surrounding the project and the status of the parties' relationship will affect how the parties negotiate the agreement, if at all, and may affect how useful the JDA will be. For example, if the engineer introduces the JDA at a stage when there is already an adversarial culture, the owner may be wary and suspicious.[16] Under those circumstances, the parties are less likely to enter into a balanced and effective agreement that will serve the underlying purpose of best situating the parties against asserted claims. To avoid these problems, the parties should consider introducing the concept of the JDA as early as possible, and in any event before the parties' relationship has deteriorated to the point where cooperation to defend the contractor's claims would no longer be realistic or productive.

The parties could discuss the concept of a JDA as early as during contract negotiations. Some ESAs already contain certain features of a JDA. For example, the EJCDC specifically defines the engineer's providing legal and consulting services to defend the contractor's claims as "additional services."[17] However, the ESA could go a

step further and specifically call for the parties to enter into a JDA in the event the contractor alleges, for example, a defective design claim. Some parties may agree on the general terms of a JDA as part of the ESA, subject to later agreement and execution of a formal document (similar to the concept of a letter of intent). Others may not agree to include any reference to a JDA or its underlying provisions in the ESA whatsoever. In any event, there is no downside in introducing the concept of the JDA at the time of contract negotiations.[18]

Resolving Disputes

In order to resolve construction disputes successfully, company executives and their counsel (both in-house and outside) must remain open-minded and creative, and should carefully consider using the JDA. By entering into a JDA (particularly if implemented during the contract negotiation stage), owners and designers can strengthen their positions in defending contractor claims. That may help prevent owners and design firms from becoming embroiled in protracted litigation with the potential to cost millions in legal and consulting fees. In a time of economic downturn, that should be a welcome approach for those who prefer focusing on completing new construction projects rather than expending time and money on lingering legal disputes.

Endnotes

1. JDAs are frequently used in nonconstruction settings such as criminal cases, including conspiracy cases. *See*, *e.g.*, U.S. v. Zolin, 809 F.2d 1411 (9th Cir. 1987); U.S. v. Bay State Ambulance & Hosp. Rental Serv., 874 F.2d 20 (1st Cir. 1989).

2. The economic loss doctrine, in essence, prohibits tort recovery (for example, for negligent design) when a failure causes damage to itself, resulting in only economic loss, but does not cause personal injury or damage to any other property other than itself. The purpose of the economic loss doctrine is to preserve the distinction between contract and tort law by preventing parties to a contract from avoiding agreed-upon contract remedies and seeking broader remedies under a tort theory than would be permitted under the contract. *See Blake Constr. Co. v. Alley*, 353 S.E.2d 724, 726 (Va. 1987) (In a suit by a general contractor against an architect, the court denied recovery holding: "The architect's duties both to owner and contractor arise from and are governed by the contracts related to the construction project. While such a duty may be imposed by contract, no common law duty requires an architect to protect the contractor from purely economic loss. There can be no actionable negligence where there is no breach of duty 'to take care for the safety of the person or property of another.'"); *see also Santucci Constr. Co. v. Baxter & Woodman, Inc.*, 502 N.E.2d 1134, 1137 (Ill. App. Ct. 1986) (a contractor's economic loss damages against an architect were not recoverable in tort); *Rissler & McMurry Co. v. Sheridan Area Water Supply Joint Powers Bd.*, 929 P.2d 1228, 1235 (Wyo. 1996) (barring contractor's claim for economic losses against engineer).

3. *See* Engineers' Joint Contract Documents Committee (EJCDC) No. 1910-1, § 8.7.1 (1990); ConsensusDOCS 240, § 7.1.1 (2007).

4. A typical contractor indemnification provision is found at section 3.18 of the A201-2007 published by the American Institute of Architects (AIA). Indemnification provisions are commonly found in other construction-related contracts as well.

5. This assumes, however, that the parties have comparable bargaining power. Design professionals frequently accept unfavorably broad indemnification responsibilities in exchange for securing the work.

6. Engineers' Joint Contract Documents Committee.

7. *See* EJCDC No. 1910-1 § 2.2.4 (1984).

8. *See id.* § 2.2.6.

9. *See id.* § 2.1.13; *see also* AIA B101-2007, § 4.3.2 (distinguishing between basic and additional services).

10. *See*, *e.g.*, U.S. v. Skidmore, Owing & Merrill, 505 F. Supp. 1101, 1107 (S.D.N.Y. 1981); Mack Trucks, Inc. v. Bendix-Westinghouse Auto. Air Brake Co., 372 F.2d 18, 20 (3d Cir. 1966); Chicago, Rock Island & Pac. R.R. v. United States, 220 F.2d 939, 942 (7th Cir. 1955); Fed. Reserve Bank of Atlanta v. Atlanta Trust Co., 91 F.2d 283, 286–87 (5th Cir. 1937).

11. Delay in direction to the contractor with respect to a change order also may result in an additional claim by the contractor that, by contract, may not be permitted to proceed with construction until the owner and engineer provide the necessary changes to the design. That, of course, only serves to exacerbate contract administration issues between the owner and the engineer.

12. *See* U.S. v. Schwimmer, 892 F.2d 237, 243 (2d Cir. 1989) (the joint defense agreement, or common-interest rule, is an extension of the attorney-client privilege that "serves to protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel"); Hanson v. U.S. Agency for Int'l Dev., 372 F.3d 286, 292 (4th Cir. 2004) ("[i]n this context the communications between each of the clients and the attorney are privileged against third parties"); *In re* Bevill, Bresler & Schulman Asset Mgmt. Corp., 805 F.2d 120, 126 (3d Cir. 1986); United States v. McPartlin, 595 F.2d 1321, 1336–37 (7th Cir. 1979). *See also* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 76 ("(1). If two or more clients with a common intent in a litigated or nonlitigated matter are represented by separate lawyers and they agree to exchange information concerning the matter, a communication of any such client that otherwise qualifies as privileged under §§ 68–72 that relates to the matter is privileged against third persons. Any such client may invoke the privilege, unless it has been waived by the client who made the communication.").

13. Children First Found., Inc. v. Martinez, 2007 U.S. Dist. LEXIS 90723, at *49 (N.D.N.Y Dec. 10, 2007).

14. *Id.* at *52.

15. For citations and a brief discussion of the rules governing privilege in the JDA context, see note 12, *supra*.

16. The owner may be reluctant to enter into the agreement

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645 (6th Cir. 2002) (citing United States v. Bankers Ins. Co., 245 F.3d 315 (4th Cir. 2001) (requiring federal government to submit to nonbinding arbitration before litigating an FCA claim)).

60. 48 C.F.R. § 31.205–47(b), (c)(2).

61. *See generally* Mark T. Pavkov, *Closing the Gap: Interpreting Federal Rule of Evidence 408 to Exclude Evidence of Offers and Statements Made by Prosecutors During Plea Negotiations*, 57 Case W. Res. L. Rev. 453 (2007).

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for other reasons too. For example, the owner might not want to be perceived by the contractor or an eventual trier of fact as having acted on the project in less than an objective manner. In other words, the engineer's and owner's decisions with respect to claims, change orders, and other matters could be painted by a sympathetic contractor as being part of a conspiracy to harm the contractor. The owner may be even more reluctant where the owner is a public entity that is subject to public scrutiny.

17. *See* E.J.C.D.C. No. 1910-1 § 2.1.13 (1984).

18. Although this article focuses on a scenario whereby the owner and engineer work together to defend a contractor's claim, JDAs can be implemented between and among other parties with aligned interests in construction disputes. For example, the JDA can be used by a subcontractor and a general contractor to team up with respect to disputes against an owner, or by a subcontractor and its supplier or sub-subcontractor bringing claims against the general contractor. Similarly, a design professional may have several subconsultant design professionals who contributed to the design on a project, each of whom may be opportune candidates to work jointly with the principal designer to defend a contractor's defective design claims. In that situation, the various design subconsultants and the designer could enter into a single, multiparty JDA, or the design consultant could enter into individual JDAs with each design subconsultant.

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riod under Tex. Gov't Code Ann. § 2155.077 (Vernon 2008)); 7 Va. Admin. Code § 10-20-80 (two years); Wis. Admin. Code Comm. §§ 105.16(2), 104.65(4) (one year).

27. Cal. Pub. Cont. Code § 10115.10.

28. *Id.*

29. Or. Rev. Stat. Ann. § 200.075(2); *see also id.* § 200.065(5).

30. Mo. Code Regs. Ann. tit. 1, § 30-5.010(5) (2006).

31. Tex. Gov't Code Ann. § 2161.253.

32. Conn. Gen. Stat. Ann. § 46a-56(c) (West 2008).

33. Ga. Code Ann. § 50-5-133 (West 2008).

34. 30 Ill. Comp. Stat. Ann. 575/8 (West 2008).

35. Or. Rev. Stat. Ann. § 200.065 (West 2008).

36. *See* R.I. Gen. Laws § 37-14.1-8 (2008); Wash. Rev. Code Ann. § 39.19.090 (West 2008).

37. Va. Code Ann. § 18.2-213.1 (West 2008).

38. Tex. Gov't Code Ann. § 2161.231; Tex. Penal Code Ann. § 12.34 (Vernon 2008); *see also* 34 Tex. Admin. Code § 20.17(c) (2007).

39. Ind. Code Ann. §§ 35-43-5-9, 35-50-2-7 (West 2008).

40. Cal. Pub. Cont. Code § 10115.10.

41. *Id.*

Hard Hat Case Notes

(Continued from page 49)

top of culvert." Observing that the dictionary definition of "dirt" meant "something in which vegetation should grow," and reviewing photographs of the site showing no vegetation growing in the disturbed areas, the appeals court upheld the trial court's ruling that the contractor breached the contract by using fill instead of dirt.

Short v. Greenfield Meadows Assoc., 2008 WL 2589659 (Ohio App. Ct., June 24, 2008).