

The Changing Face of Indemnity

Recent developments in indemnity law and a closer look at the defense obligation lurking in contractual indemnity provisions

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Introduction

An unfavorable indemnity clause signed today can create a catastrophic risk that will not come to pass until some unknown time in the future. There is an alarming trend with regard to the scope, breadth, and dangerous risk transfer associated with the insistence by owners (both private and public) to include onerous indemnity clauses in their contracts with design professionals. This trend has accelerated over the past 10 to 20 years to the point where design professionals know that in just about every form of contract that an owner prepares, it will include some form of indemnity clause.

It is a virtual certainty that design professionals will be faced with indemnity clauses of all stripes running from the relatively benign to the catastrophic in terms of the implications they present to the design professional and their firm in the event of a claim. These clauses only become significant when litigation arises. The problem is, they were negotiated long before any claim arises, and when the clauses are triggered, they are then for the first time placed under a microscope by the professional, their insurance carrier, and their counsel. Then it is much too late to do anything about the language of the clause except pray for an interpretation by the court that will result in salvation; or the interpretation could end up providing the proverbial noose around the neck.

On this point, the number one piece of advice is to not sign contracts that contain onerous and potentially uninsurable indemnity clauses.

Recently in California, Former Governor Arnold Schwarzenegger signed Senate Bill ("SB") 972, which signaled a change in California indemnity law that offers some protection for design professionals regarding the defense obligation of indemnity agreements in some limited circumstances. The enactment of SB 972

in California will allow California to join two other states, Texas and Florida, as the three states that have some protections in place related to the scope of indemnity provisions for design professionals in their contracts with public agencies.

This issue of "Practice Notes" details recent significant events regarding the development of indemnity law in California and the probable resulting effect on design professionals in comparison to the indemnity law in select other states in the U.S. that have indemnity statutes similar to California. As is often said, for better (think of right-hand turns on red lights, the Hula Hoop, the Frisbee, and beach music) or worse (bad faith law, the law of indemnity, Charles Manson, and certain Hollywood types who shall remain nameless), what starts in California usually spreads to the rest of the country. Therefore, the intent of this article is to provide some guidance with regard to how to lessen the impact of this dangerous trend.

What is Indemnity?

Simply stated: Indemnity is the obligation of one person to pay a liability incurred by another. We see indemnity every day in things as simple as our car insurance. If you get into a car accident, your insurance company "indemnifies" you for the liability you incur. Note that the liability you incur is imposed from a third person, such as the other driver in the accident.

Putting this in a construction context, if a contractor sues the owner on your project, the owner might decide you share responsibility for the particular problem at issue and seek indemnity from you. That is, the owner may demand that you pay for some or all of the damages claimed by the contractor.

Indemnity agreements typically contain two parts: the indemnity clause (money to pay for a claim) and a defense component (money to pay for the attorney and expert fees incurred by your client).

Imagine on a typical construction project that Party A agrees by contract to indemnify Party B for claims stemming from Party A's negligent actions. Thereafter, Party C sues Party B making a claim related to Party A's involvement in the project. The first thing Party B is going to do is to tender his defense and indemnity to Party A pursuant to their contract. If Party A ultimately pays any money to Party B for the claims made by Party C, that is the very definition of an indemnity arrangement.

The defense component in this example is the cost Party B pays to defend against the claims made by Party C for attorney and expert fees. The problem with the defense component is that depending on the language in your contract, a party could be made to defend another party with whom they contracted even though the first party is found by a jury to not be negligent and/or not in breach of contract.

Indemnity - Some History

For purposes of our discussion we will initially focus on certain recent developments in California statutory and case law that may well indeed create a tsunami effect on the rest of the country. As indicated above, many things, both good and bad and both social and economic tend to start in California and then spread across the country not unlike fires in the California hillsides when fed by the hot Santa Ana winds pushing the fire to engulf more and more real estate.

As with many states, the basic principles of indemnity law were codified in California many, many years ago. In California, the basic law of indemnity is codified at Civil Code Section 2778 (CC 2778) which was enacted way back in 1872 (Think about it. These rules were written a mere 23 years after the California Gold Rush!).

CIVIL CODE SECTION 2778 contains the rules of interpretation of a contract of indemnity. These rules are to be applied, unless a contrary intention appears:

Rule	Interpretation
<p>1. Upon an indemnity against liability, expressly, or in other equivalent terms, the person indemnified is entitled to recover upon becoming liable;</p> <p>2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified is not entitled to recover without payment thereof;</p> <p>3. An indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands, or liability incurred in good faith, and in the exercise of a reasonable discretion;</p> <p>4. The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so;</p> <p>5. If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former;</p> <p>6. If the person indemnifying, whether he is a principal or a surety in the agreement, has not reasonable notice of the action or proceeding against the person indemnified, or is not allowed to control its defense, judgment against the latter is only presumptive evidence against the former;</p> <p>7. A stipulation that a judgment against the person indemnified shall be conclusive upon the person indemnifying, is inapplicable if he has a good defense upon the merits, which by want of ordinary care he failed to establish in the action.</p>	<p>The person being indemnified is entitled to recover against the other party once that person is found liable;</p> <p>The person to be indemnified based on a claim against them is not entitled to recover unless they have to pay on the claim;</p> <p>Indemnity includes the cost of defense (i.e. attorney and expert fees and other costs of defense);</p> <p>The person to be indemnified can allow the other party to defend them or defend themselves and recover the cost of their defense from that party;</p> <p>If the party to indemnify the other person refuses to do so and the person loses, their ability to recover should not be litigated as it is now conclusive against that party and that party will have to pay the loss.</p> <p>If the party to indemnify the other person does not get notice or is not allowed to control the defense, then it is only presumptive, not conclusive, that the party has to indemnify the other person.</p> <p>A stipulation of judgment against the the person to be indemnified is not applicable as a judgment against the the other party if that other party has a defense on the merits but failed to raise it.</p>

This statute is the backbone of all indemnity law in California and forms the foundation for all the other indemnity statutes that have followed. It has also provided generations of attorneys and judges/courts of appeal with the necessary guidance to wrestle with the always complex and arcane world of indemnity not only in terms of drafting of these clauses but also in interpreting them in a litigation context.

Recent Amendments to Deal with Unreasonable Client Expectations

Design professionals in California (as has been true across the country) were continuing to be faced with indemnity clauses that were not only onerous and unfair in terms of how they shifted risk from the owner onto the shoulders of the design professionals but were also presenting situations which, depending on the facts and circumstances of a claim, presented circumstances where the design professional might not have insurance coverage for a particular problem.

As a result, design professionals in the State of California through their professional associations, notably The American Council of Engineering Companies of California (ACEC-CA formerly known as CELSOC) as well as the American Institute of Architects-California Council (AIA-CC) became involved in attempting to pass legislation that was designed to prevent the use of onerous, unfair, and potentially uninsurable indemnity clauses from being utilized in any construction contract. As the legislation was in its infancy, it became immediately apparent that certain very powerful and well-financed groups would so vigorously oppose the proposed legislation that the legislation was narrowed in terms of its breadth. No longer would the legislation deal with private contracts but would limit it only to contracts between design professionals and public entities. Furthermore, there was a strong implication that the State of California would vigorously oppose the legislation, and in its final form, the State of California was exempted from the scope of the statute.

Starting in 2006, California saw the enactment of AB 573 that is now codified as California Civil Code Section 2782.8 (CC 2782.8). This statute was intended to make it clear that design professionals need not defend and indemnify local public entities for anything other than the design professional's own negligence or other wrongful conduct.

While the passage of CC 2782.8 was a success, as originally envisioned, it was intended to target a much broader group of commercial transactions and client types. In its earliest drafts, it was designed to take on ALL indemnity agreements where there was an attempt to unfairly shift an indemnification obligation onto the shoulders of a design professional. Due to some stiff opposition by certain well-funded lobbying groups, the scope of the law was eventually narrowed down to include only LOCAL PUBLIC agencies within its scope. In other words, it does not include indemnity agreements between design professionals and ANY private entity, the state of California, or any of its political subdivisions - - and is only limited to counties, cities, city and county districts, school districts, public authorities, municipal corporations, other political subdivisions, joint powers authorities, or public corporations in the state.

After the law became effective, it became quickly apparent that there were a number of local public agencies that consistently failed to follow the dictates of this law. Organizations such as ACEC-CA and AIA-CC have been vigilant in responding to local public agencies that violate this law, whether in their RFP's/RFQ's or in their "standard" contract terms by advocating on the local level through the professional organizations to get the local agencies to amend their documents to comply with both the letter and spirit of CC 2782.8. On this point, the professional organizations have enjoyed some degree of success in getting certain local public agencies to amend their contracts to comply with AB 573. Design Professionals must continue to be ever vigilant in reporting violations to their professional associations so as to protect their membership against local public agencies that for whatever reason are not following the law.

New Chapters in the Indemnity Saga Are Being Written by the Courts

As indicated above, much like a tsunami, California courts have issued a number of decisions that directly deal with indemnity issues and more particularly the “duty to defend” which is part and parcel of virtually every indemnity agreement that parties enter into throughout the United States. Like the proverbial tsunami, and the tendency of other states to follow California’s lead, it is feared that the holdings in these recent decisions will begin to move inland and across the country with potentially dire consequences.

The next chapter in indemnity law was written when two significant cases were decided, the first in 2008 and the other in 2010. Each of these cases have attracted national attention and for good reason.

It is important to note that the holdings of the cases we are about to discuss affect thousands upon thousands of commercial transactions entered into by parties with indemnity clauses contained within the contracts that were executed, in many instances, long before either of these cases were decided.

The first of these cases was Crawford v. Weathershield Manufacturing (2008) 44 Cal.4th 541, where the Supreme Court of California held that the contractual duty to defend was immediate and mandatory under the wording of the indemnity agreement contained within the contract at issue. In that case, the court held that the subcontractor had to pay all of the general contractor’s attorney fees even though the subcontractor itself was found by the jury to be NOT negligent. The court interpreted CC 2778(4) as requiring a subcontractor to defend any suit brought against the general contractor founded upon a claim of damage caused by the subcontractor and imposed a duty upon the subcontractor to provide a defense, even though the subcontractor was later found NOT negligent and thus owed no indemnity or contribution to cover the loss under the subcontract.

There is an old saying among lawyers that applies in the Crawford case, and it is “bad facts make bad law.” This could not be more accurate when applied to the Crawford case which involved the California State Supreme Court being presented with a case based on a terrible and one-sided contract. Therefore, before railing against the court for its seemingly non-sensical decision, you are encouraged to read the contract or at least the operative terms at issue in Crawford. Suddenly, although the courts ruling may seem unfair, the result in that case will make more sense upon reading the contract at issue.

The operative language that can appear in any contract in any state is as follows: Weathershield (subcontractor) agreed

“To indemnify and save (developer) harmless against all claims for damages to persons or to property and claims for loss, damage and/or theft ... growing out of the execution of (contract) work.”

Additionally, contractor made a separate and specific promise “at (its) own expense to defend any suit or action brought against (developer) founded upon the claim of such damage ... loss, ... or theft.”

The holding in this case is based upon a fundamental rule of contract law which actually applies to situations that go beyond the unique circumstances of the law of indemnity. The contract that the California Supreme Court was to construe in the Crawford case has terribly onerous and unfavorable language to the contractor who most probably signed the contract hoping to get the work and did not give any consideration to the ramifications of the indemnity clause. What is significant about the Crawford case is that the contractor was also found to be not negligent or fault-free.

The sole reason that the court imposed a responsibility upon Weathershield to pay for the attorney's fees of the developer was the terrible contract language that Weathershield signed years before the litigation started and the eventual ruling and published decision by the California Supreme Court. The language in the Crawford case at issue and cited above is, unfortunately, precisely the type of language that many readers of this article may have signed in the past, and while decisions by various state trial courts across the nation differ in terms of how they interpret these types of clauses, the lesson to be learned from the Crawford decision should apply across the country and that is IF YOU SIGN BAD CONTRACTS, BAD THINGS CAN HAPPEN TO YOU!

To Make Matters Worse. . . A California Case Holds Against an Engineering Firm

The next chapter was recently written in the case of UDC v. CH2M-Hill (2010) 181 Cal.App.4th 10 that was decided in 2010. This case hit closer to home for purposes of design professionals because it involved a fellow design professional, CH2M-Hill, as the party stuck in the legal "vise" that got squeezed by that ruling. This case also held that even in situations where a design professional is found to be NOT negligent, there could still be a duty to defend in a particular lawsuit. In this case, the court agreed with the Crawford court's interpretation of CC 2778(4) and held that the defense obligation of the engineer to the developer arose when a homeowners association alleged harm resulting from deficient work that was within the scope of the services for which the developer had retained the engineer. This is "shorthand" for the engineer gets to pay all the attorney and expert fees and all court costs for the owner because the engineer signed a bad contract with excessively broad and one-sided indemnity language.

In this sense, both the Crawford and CH2M-Hill cases have a common theme - bad facts made bad law. To add insult to injury, there is a good chance that if a design professional is faced with Crawford or CH2M-Hill contractual language on indemnity and duty to defend, the design professional's insurance company might deny insurance coverage for this element of the claim as it arguably arose out of a "contractual" liability and may not be a type of "damage" contemplated to be covered under the contract of insurance or policy terms.

In other words, since the attorney and expert fee exposure arises ONLY from the BAD contract, it is a purely "contractual liability" or liability assumed under a contract. Per the terms of many, if not all, professional liability insurance policies, the insurance carrier could well refuse to cover that portion of any award that resulted from a grant of the attorney fee award under the subject contract. It is NOT a situation that any design professional wants to find themselves in under any circumstances.

The Next Chapter in the Evolving Book of California Indemnity

Now we turn our attention to the latest chapter in the book of indemnity in California involving the successful effort of getting SB 972 enacted. The new law provides some protection in California against the court rulings of Crawford and CH2M-Hill with regard to contracts involving the issue of having to pay the attorney fees of a local public agency in the event of litigation and a tender of a claim in a construction dispute.

A short outline of SB 972's benefits is as follows:

- Applies to any and all contracts with local public agencies (i.e., not the state of California or its political subdivisions) such as the UC Regents, Cal State system, Administrative Office of the Courts, etc.);
- Makes illegal and unenforceable any contract terms mandating that a design professional DEFEND a local public agency for anything other than the negligence of that design professional;

- The amendment is designed to prevent the local public agency from seeking an immediate obligation for the design professional to pay for its defense costs;
- Provides protection to engineers, surveyors, architects, and landscape architects; and
- Applies to any professional service contract entered into on or after January 1, 2011.

While this particular law will have no effect on professionals practicing in states other than California, it is illustrative on the issue of how the professional associations in California are trying to tackle head-on the problems of onerous indemnity clauses and the problem presented by a duty to defend assumed by contract, which need not necessarily be triggered by negligence. In other words, an obligation to pay for all of the attorney's fees of an owner can be triggered simply by signing a bad contract and having nothing at all to do with whether or not the design professional fell below the standard of practice. This situation presented by signing bad contracts exists in all 50 states. In other words, California has no corner on the market when it comes to onerous indemnity provisions.

Case Study: Why this New Chapter Will Help Design Professionals

Let us take a look at a fact scenario and how things might play out before SB 972, and under SB 972, to see the different results. Again, while SB 972 does not apply to professional contracts other than in the State of California, the analysis and potentially problematic results are illustrative on the problem of what happens when one signs a bad contract.

Before SB 972

The ABC Engineering Firm signed a contract with the city of Sideriver in 2008 to do a study, make recommendations, and ultimately design a proposed street improvement project. The contract included a provision whereby ABC was to defend, indemnify, and hold harmless the City from and against any claims arising out of ABC's negligence.

The project was put out to public bid, and the low "responsible" bidder was a firm well known in the community for finding ways to make its desired profit on the low bid through change orders. Indeed, the contractor on this project tried to do just that. At the end of the job, the City was presented with a total change order request of \$260,000 on a job where the successful bid price was \$1,240,000.

Immediately after the claim hit the City, the City tendered its defense to ABC. Privately, the City did not really feel that ABC did anything wrong. However, publicly, the City Attorney and City Council were demanding that a formal tender be made because they had an obligation to "protect" the City and its taxpayers.

The ensuing litigation was long and contentious, and the City and ABC incurred substantial attorney and expert fees. By the time the case got to trial, the contractor's claim had ballooned from \$260,000 to \$400,000 through some creative expert work by the contractor's "hired gun" experts.

The case was tried to a jury, and the result was a finding that the contractor was to be awarded \$150,000 of its claim. The jury had determined that the City was 90% responsible for the \$150,000, and they found that ABC was 10% responsible, meaning that the indemnity obligation of ABC on the verdict amounted to only \$15,000.

To be sure, the City Attorney and ABC felt that while they did not entirely defeat the contractor's claim, it was nonetheless a pretty good result as the contractor got nowhere near the \$400,000 it asked the jury to award.

Two weeks after the verdict, ABC's attorney got a letter that essentially said "Congratulations on verdict, enclosed please find a bill for all of the City's attorney bills and expert fees from the time of the original tender letter sent within a week of the claim from the contractor up to the date of the post-verdict letter from the City Attorney". To put it in simple financial terms, ABC got a bill for \$172,425! ABC immediately huddled with its attorney and insurance representative and was astonished to learn that the insurance carrier would be taking the position that since this bill arose out of an obligation assumed by contract that it was not going to be covered by the insurance carrier.

This story did not have a happy ending...

After SB 972

Now, fast forward to the same facts, same contract, same jury verdict had the contract at issue been entered into on, let's say, January 12, 2011. Thanks to SB 972, there would now be a different result and while not necessarily a happy ending, certainly one that can be managed by ABC from a financial and risk management standpoint. Under SB 972, the City should only be able to recover 10% of the \$172,425 bill or \$17,242.50 since the jury found that ABC was only 10% negligent. This would probably not be a result to be celebrated, but it also would not be a result that could potentially destroy an engineering firm like ABC.

Texas and Florida Both Have Indemnity Statutes Similar to SB 972

Both Texas and Florida have enacted statutes similar to California's SB 972 which provide some protection for design professionals in their contracts with public agencies.

Texas Local Government Code Section 271.904 (2010) bars contracts between licensed engineers and/or registered architects with government agencies that would require indemnification or defense beyond the engineer or architect's negligence.

Florida Stat. Section 725.08 (2010) precludes indemnity provisions between public agencies and design professionals, except for provisions that would require a party to indemnify or hold harmless the other party to the extent of negligence caused by the indemnifying party.

Florida also offers indemnity protection for contractors and subcontractors on construction projects. Fla. Stat. Section 725.06(2) (2010) provides that a construction contract with a public agency may require a party to indemnify or hold harmless the other party to the contract, but only to the extent caused by the negligence of the indemnifying party.

Additionally in Florida, Fla. Stat. Section 725.06 (2010) provides that in construction contracts between owners and architects, engineers, general contractors, subcontractors, sub-subcontractors, or materialmen, indemnity agreements must have either a monetary limit to the extent of damages or specific consideration for the indemnification sought.

The Texas statute was first enacted in 1995, and the Florida statutes were first enacted in 2000. Now, California joins these two states in providing some protection for design professionals who enter contracts with public agencies.

However, even though the Texas and Florida statutes have been around longer, there is not a lot of case law where the courts have interpreted or enforced these statutes. With a lack of precedent, it is somewhat tough to determine how the courts will interpret these statutes going forward.

However, the Florida Court of Appeals did uphold Fla. Stat. Section 725.08 in Barton-Malow Co. v. Grunau Co. (2002) 835 So.2d 1164. In that case, the court found that the “duty to defend” provision in a general contractor’s contract with his subcontractor was not severable from the indemnity provision. However, the indemnity provision was unenforceable because it violated Fla. Stat. Section 725.08. Therefore, because there was no potential for indemnification, the subcontractor had no contractual obligation to indemnify the general contractor for defense costs or attorney fees in the underlying construction defect action.

The Barton-Malow case had the opposite effect of the CH2MHill case in California. Because the indemnity provision in Barton-Malow was unenforceable under the Florida statute, the subcontractor was saved from having to pay the defense costs and attorney fees of the general contractor. However, if the indemnity provision had been enforceable, then the subcontractor would have been on the hook the same as the design professional was on the hook for defense costs and attorney fees in CH2MHill. This is an example of how the specific statutes in place to protect design professionals and construction professionals may actually work in favor of the “little guy.”

Four Other States Have Similar Indemnity Statutes Similar to CC2778, But None So Far Have Faced Crawford or CH2M-Hill Stations

Additionally, four other states besides California have indemnity statutes identical or nearly identical to CC 2778: Montana, North Dakota, South Dakota, and Oklahoma.¹ Time will tell how courts will interpret the potential defense obligation under the indemnity statutes. So far, no courts in these states have interpreted the Crawford or CH2M-Hill situations like the California Courts.

In Montana, Mont. Code Ann. Sections 28-11-313 to -317 (2010) state identical indemnity obligations as CC 2778. However, Mont. Code Ann. Sections 18-2-124 and 28-2-2111 (2010) bar indemnification in construction contracts for the would-be indemnitee’s negligence. Contractual agreements for indemnity and defense of claims caused by the indemnitor’s fault or that of third persons are permissible.

The Montana Supreme Court has held that a party may be indemnified against its own negligence if expressed in clear and unequivocal terms in a contract provision. Sweet v. Colborn School Supply (1982) 196 Mont. 367; Amazi v. Atlantic Richfield Co. (1991) 249 Mont. 355.

There are no more recent Montana decisions which have interpreted the defense duties under Montana indemnity law. Therefore, it remains to be seen if the Montana courts will interpret its indemnity statutes in a similar fashion to California.

North Dakota Cent. Code Section 22-02-07 (2010) and South Dakota Codified Laws Section 56-3-10 (2010) are virtually identical to CC 2778, however, neither the North Dakota or South Dakota courts seem to have faced the issue presented in Crawford.

Oklahoma, on the other hand, ruled opposite of the Crawford court when faced with an indemnity provision that contained a defense clause. Oklahoma Stat. tit. 15, Section 427 (2010) is identical to CC 2778.

In Estate of King v. Wagoner County Board of County Commissioners (2006) 146 P.3d 833, the Oklahoma court of appeals refused to impose a defense duty independent of an indemnification obligation, even though the contract provision at issue contained a defense clause.

Because the Crawford (2008) and CH2M-Hill (2010) cases are so recent, not many courts have had the opportunity to agree or disagree with their rulings. So far, the one court that did face a Crawford situation declined to follow California. When the Arizona court of appeals was faced with a Crawford situation, it expressly did not follow the Crawford case and declined to impose a defense duty independent of the indemnification duty. MT Builders LLC v. Fisher Roofing, Inc. (2008) 197 P.3d 758.

Therefore, it seems that courts simply have not faced or have declined to rule on the defense obligations that go along with indemnity provisions. The few courts outside California that have faced the situation are split.

Potential Insurance Coverage Problems Related to Defense Obligations in Indemnity Agreements

Professional liability insurance covers negligence claims against you; it is not made to cover liability assumed by contract in the absence of negligence. Therefore, even if you are found not negligent or in breach of your contract, your contract may force you to pay all of the other side's attorney fees and costs. Because this is a contract obligation aside from any negligence, this obligation may not be covered by your insurance.

What Should You Do When Negotiating Indemnity Provisions?

Consider the following:

- If possible, eliminate the indemnity provision altogether;
- If this is not possible, another approach is to make the indemnity agreement reciprocal;
- Importantly, any obligation to defend or indemnify needs to be tied directly to a finding of negligence on your part. This means that if the clause is written to create two separate obligations (one to indemnify and one to defend), both obligations have to be tied to a finding of negligence; and
- Lastly, if the owner is insistent on an onerous indemnity clause, at the very least make your intent clear in the language of the clause that there is no immediate duty to defend and that any duty to defend will only be determined at the conclusion of the case as ultimately determined by a court of competent jurisdiction and then the amount of the defense costs incurred by the owner will only be reimbursed on a percentage basis tied to the finding of negligence. For example, if the court finds that the professional is 50% responsible for a given situation then reimbursement for reasonable defense costs will be limited to 50% of those costs incurred.

Here are two examples:

EXAMPLE A

Consultant agrees to indemnify and hold Owner harmless from and against all claims, liens, demands, damages, injuries, liabilities, losses and expenses to the extent determined by a court of competent jurisdiction to have been caused by the Consultant's negligence.

In this example, there is a single clause that requires both defense and indemnity. Although the clause does not say defend, (as indicated above under California statutory law), the duty to indemnify encompasses the duty to defend. In the example above, the single clause is tied to an ultimate finding of negligence.

EXAMPLE B

Consultant agrees to defend, indemnify and hold Owner harmless from and against any and all claims, demands, damages, lawsuits, arbitrations, costs (including reasonable attorneys' fees and expert witness fees) related to, arising out of or connected with any negligent act, error or omission on the part of Consultant. 2) Consultant shall defend Owner against any claim under the foregoing provision.

Under example B, there are two separate clauses. The first clause involves both the defense and indemnity to the owner.

The second clause in example B addresses only the defense of owner. Although there is a reference to negligence, it is not a reference to a finding of negligence. As such, any claim for negligence (not a finding of negligence by a judge, jury, or arbitrator) will trigger the duty to defend.

EXAMPLE C

Consultant agrees to defend, indemnify and hold owner harmless from and against any and all claims, demands, damages, lawsuits, costs (including reasonable attorney fees and reasonable expert witness fees) but only to the extent caused by, and on a percentage basis of fault as ultimately determined by a court of competent jurisdiction.

There is no immediate duty to defend but rather, consultant will agree to reimburse owner for reasonable defense costs incurred in an amount equal to the percentage of fault as ultimately determined by a court of competent jurisdiction. By way of example, if the court determines that consultant is 60% responsible for a particular problem, then consultant will reimburse owner for 60% of owner's reasonable defense costs incurred from the date of tender of the defense by owner to consultant.

Under example C, the specific intent of the parties is made very clear leaving very little, if any, room for ambiguity on the issue of the duty to defend. Importantly, the duty to defend is not immediate and it is a reimbursement situation. Furthermore, reimbursement is limited to the percentage of fault of determined by a court of competent jurisdiction. Additionally, the defense costs to be reimbursed are only from the date of formal tender which further reasonably limits the exposure to the professional. Additionally, while insurance coverage is well beyond the scope of this article and is dependent in every situation on the specific facts at issue, there is a much greater likelihood that an errors and omissions carrier when faced with example C, would cover the costs of owner's defense on a reimbursement basis when it is specifically tied to, and limited by, the percentage of finding of fault.

Indeed, had this language been at issue in both the Crawford and CH2M-Hill cases, the holding in those cases would have been 180 degrees from the findings that were made. As in each situation, Weathershield and CH2M-Hill were found to be not at fault and would therefore not have to reimburse for the attorney's fees expended by the owner.

Conclusion

The best advice and “take away” regarding case law and statutes dealing with contractual terms remains constant: do not sign contracts that unfairly shift disproportionate levels of responsibility for things beyond your control from your client and/or third parties onto your shoulders. You can and should continue to do good work and stand behind your efforts, but you cannot and should not be responsible for the negligence of local public agencies, or worse yet, third parties.

The recent encroachment of onerous indemnity clauses unfairly and improperly shifting the risk of projects onto the shoulders of the design professional can only be stopped if the design professional community remains vigilant in refusing to sign onerous and potentially uninsurable indemnity clauses. On this point, it is extremely important to separate and/or limit the “duty to defend” provision that is included in most, if not all, indemnity agreements. While it is best to strike these clauses all together, the reality is that most design professionals would be out of work if they insisted on completely striking these clauses as the owners would go elsewhere to secure design services.

Therefore, it becomes even more important to surgically repair onerous indemnity clauses when they are presented to avoid the financial hemorrhaging that will surely occur in the event you execute an onerous clause and there is a claim down the road. Indeed, the right facts and circumstances with the wrong indemnity clause could result in a hemorrhaging so severe that it becomes lethal to the design professional and/or the firm.

While not a panacea and certainly not a replacement for negotiating a smart and fair contract, SB 972 writes the next chapter in the book of indemnity in California. SB 972 will afford some protection for design professionals from the results of the Crawford and CH2M-Hill cases.

In other states, the defense obligations in indemnity remain in flux and probably will be for some time. While the indemnity statutes in many states are over 100 years old, there is still not a uniform interpretation. California has followed the lead of Texas and Florida and now at least has some protection in place for design professionals in public agency contracts.

Please contact us at either the South Pasadena or Orange offices to discuss further.

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ProNet Practice Notes

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Nothing contained within this article should be considered the rendering of legal advice. Anyone who reads this article should always consult with an attorney before acting on anything contained in this or any other article on legal matters, as facts and circumstances will vary from case to case.

Footnotes

¹ See The Duty to Defend Under Non-Insurance Indemnity Agreements: Crawford v. Weather Shield Manufacturing, Inc. and its Troubling Consequences for Design Professionals, 50 Santa Clara L. Rev. 825 (analyzing indemnity statutes in all 50 states).