

Duty to Defend

Recent Court Cases Confirm the Dangers

By Dave Collings

Indemnity provisions in contracts allocate responsibility for third-party claims, usually to the party that caused the claim. If your firm is not careful, these can include all of your client's defense costs. When your firm signs a contract, it probably includes an indemnity provision which can create responsibility for defending your client even if you are not at fault – a significant risk that is not insured. That means your firm, not your insurer, is picking up the tab.

California Appellate Court Ruling

A recent 6th District California Appellate Court ruling highlights the dangers of such indemnity clauses. In *UDC-Universal Development, L.P. vs. CH2M Hill*, 2010 DJDAR 794, the Appellate Court upheld a ruling by the trial court that CH2M Hill owed a duty to defend its client, UDC-Universal Development, even though there was no finding of negligence against CH2M Hill, nor even an allegation of negligence in the underlying homeowner association (HOA) complaint.

In its contract with UDC, CH2M Hill agreed to indemnify the owner and UDC from any and all claims to the extent that they arose out of or were in any way connected with any negligent act or omission of CH2M Hill. CH2M Hill also agreed "at its own expense and upon written request by Developer or Owner of Subject Property to defend any suit, action or demand brought against Developer or Owner on any claim or demand covered herein."

A jury found CH2M Hill not to be negligent. The trial court, however, found that CH2M Hill still owed UDC defense. The court stated that the duty to defend must occur before the duty to indemnify arises. Otherwise, there would be no need for a duty to defend.

Although courts in other states are certainly not bound by this ruling in California, there is always the risk that other states might give serious consideration to California in ruling on contractual indemnity clauses. Logically, if you agree in a contract to defend a client or any other party for claims arising from negligence in the performance of your services, that obligation would be worth very little if it did not begin as soon as the claim is made.

Duty to Defend Uninsurable

Any obligation of the design professional to provide a defense in an indemnity clause exposes the design professional to an uninsurable loss. Professional liability insurers will not agree to honor a duty to defend another party. The insurer agrees only to defend the insured design professional, not any other party.

All professional liability insurance policies are written to insure design professionals provide coverage for liability arising out of negligence. But they only cover all obligations assumed in a contract if the liability would have existed in the absence of the contract language. Since CH2M Hill was found not negligent, the insurer did not pay. CH2M Hill was forced to pay for UDC's defense on its own: around \$500,000.

Could your firm afford to pay such costs to defend a client without the benefit of any insurance?

Points to Remember

When negotiating an indemnity clause in a contract, the following are important points to remember:

- 1) Do not agree to a duty to defend and be sure that you specify in any indemnity agreement that your firm owes no duty to defend. Instead, agree that you will reimburse, but only to the extent that the claim was caused by your negligence.
- 2) Only provide an indemnity for matters "to the extent caused by" your negligence or that of your subconsultants or those over which you have control. If you are not in control of an action or responsibility that might cause a loss, do not agree to accept liability for it.
- 3) Never agree to accept more of the responsibility for liability than is the fault of your firm.
- 4) Indemnity agreements are written to survive for some period of time after completion of the work or termination of the contract. Be sure that time period is *not* longer than the applicable state statute of repose.

- 5) If all else fails and you still want the contract, try to negotiate a cap on how much your firm must spend to defend the client.
- 6) Regardless of the state you are in, always have legal counsel review all indemnity clauses before agreeing to them.

In negotiating with a client to remove a duty to defend in an indemnification clause, point out that the intent of what you are proposing is to keep the clause uninsurable – particularly under the professional liability insurance policy. Also mention that the client is actually better off providing its own defense and controlling how that defense is conducted.

In Closing

The recent decisions in California point out just how dangerous indemnity provisions in design professional agreements can be. These provisions should be reviewed by competent legal counsel and by your insurance broker prior to signing. ■

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