



SB 496 and Design Professional Indemnities in California

Not a Free Pass, but a Major Step Forward

By Mike Olson and Brett Stewart

California Governor Jerry Brown recently signed into law Senate Bill 496 (SB 496) representing a major step forward in reducing the uninsurable burden of indemnity provisions and the duty to defend for most public and private contracts signed by design professionals in California.

SB 496, which amends California Civil Code Section 2782.8, is the result of several years' effort spearheaded by ACEC California, including direct support by the authors of this article whose companies focus exclusively on providing insurance and risk management solutions for design professionals

The genesis of SB 496 was the watershed 2010 California Court of Appeals case, *UDC-Universal Development v. CH2M Hill*, which held that an engineer who agrees to contractually defend its client from a third-party lawsuit owes an immediate defense obligation – even if the engineer was ultimately found not to be negligent. The case expanded upon the 2008 *Crawford v. Weather Shield Manufacturing* decision rendered by the California Supreme Court, which held that a contractual duty to defend arises immediately when a claim is made for contractual indemnity.

In 2010, much was publicized about the landmark case, bringing further attention to the increased risk in contractual indemnity clauses. Aside from representing a significant risk for design professionals, indemnity provisions in design professional agreements have created insurability issues. The duty to defend a third-party is uninsurable, as are most obligations not founded upon negligence.

After the 2010 decision, ACEC California and other industry groups, including the Structural Engineers Association of California (SEAOC), embarked on a mission to address the indemnity laws in California. Both SB 972 (2010) and SB 885 (2016) represented mixed efforts on behalf of these industry groups to enact change in California. Senate Bill 496 built upon the success of these earlier bills, culminating in the successful passage in 2017. The resulting legislation is good news for design professionals, as it limits the contractual duty to defend to the comparative fault of the design professional.

For contracts entered into on or after January 1, 2018, SB 496 amends California Civil

Code Section 2782.8 and contains the following key provisions:

- 1) Civil Code Section 2782.8 now applies to all contracts (except those involving State of California entities). Previously, it only applied to public contracts. Under the amended code section, indemnification clauses in both public and private contracts are unenforceable except to the extent they arise from, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional.
- 2) Design professionals can no longer be obligated to pay an indemnitee's defense costs beyond the design professional's proportionate share of fault. However, design professionals may still be legally responsible to pay for the up-front duty to defend an indemnitee.
- 3) The restrictions on the duty to defend do not apply to members of a design-build joint venture. Under California law, members of a joint venture are jointly and severally liable for the acts and omissions of the other members. Contractor industry groups understandably wanted to avoid situations where SB 496 shifted all of the risk to them.
- 4) The duty to defend provisions of SB 496 also do not apply where there is a project-specific general liability insurance policy, such as an Owner Controlled Insurance Program (OCIP) that insures all project participants for general liability exposures on a primary basis and also covers all design professionals for their legal liability arising out of their professional services on a primary basis.
- 5) And, under the newly enacted SB 496, if multiple parties owe a contractual defense obligation, and one of those parties is bankrupt or dissolved, then the design professional is obligated to meet and confer with the other parties regarding unpaid defense costs.

What is the practical impact for design professionals? Insurability of contractual indemnification clauses has been a critical risk management issue for design professionals. Civil Code Section 2782.8 now applies

to all contracts (except for State of California entities), and indemnification obligations must be founded upon negligence, an essential element triggering professional liability insurance coverage. Some professional liability insurers provide coverage for reimbursement of an indemnitee's reasonable defense costs to the extent caused by the design professional's negligence as determined by a court of competent jurisdiction. The authors of this article are not aware of any professional liability policy which will insure the immediate duty to defend a third party.

As noted, SB 496 does not address the up-front duty to defend demands and therefore needs to be the subject of careful negotiation. We are hopeful that, with this new law, contract negotiations will be more productive relative to this issue. The best negotiation result would be a contractual declaration that the design professional has no obligation to defend a third party. A fallback position could be contract language clarifying a design professional's defense obligation that applies only "after the fact." For example:

Consultant has no obligation to pay for any of the indemnitee's defense related costs prior to a final determination of liability or to pay any amount that exceeds Consultant's finally determined percentage of liability based upon the comparative fault of Consultant.

SB 496 is a big step in securing a fair allocation of risk between design professionals and their clients. While other states have enacted more stringent anti-indemnity legislation, California has long remained one of the most difficult contracting environments for design professionals. Design professionals are pleased with this outcome and are optimistic that the passage of SB 496 will ultimately reduce design professionals' future uninsurable risk. ■

Mike Olson is a Vice President at Dealey, Renton & Associates, Inc., an insurance agency serving the interests of design professionals. Mike can be reached at molson@dealeyrenton.com.

Brett Stewart is a Risk Manager in the Design Professional Unit of XL Catlin, a specialty provider of professional liability insurance for design professionals. Brett can be reached at brett.stewart@xlcatlin.com.