

## **Current Developments in California Indemnity Law Beazley October 2010 Update**

### **CA Indemnity: Are Design Professionals Punch Drunk?**

Design professionals' contractual indemnity obligations in California, and particularly the duty to defend, are in the news again. In order to understand the current status of indemnity in California, we must review the progression of events over the last couple of years.

#### **Round 1: The Power Punch, Crawford v. Weather Shield**

Beazley has been closely following the developments regarding indemnity in California since July 2008 when the California Supreme Court found that an indemnity provision in a contract between a subcontractor and developer-builder obligated the subcontractor to defend the developer-builder in lawsuits alleging construction defects arising from the subcontractor's negligence even though (1) a jury ultimately found that the subcontractor was not negligent, and (2) the provision did not require the subcontractor to indemnify the developer-builder unless the subcontractor was negligent. *Crawford v. Weather Shield Mfg., Inc.*, 187 P.3d 424, 44 Cal. 4th 541 (2008).

#### **Round 2: Design Professionals Kissed the Canvas with UDC v. CH2M Hill**

In January 2010, *Crawford* was interpreted for the first time by the California Court of Appeals and the Court unfortunately held that a contractual indemnity provision in a contract between an engineer and a homeowner developer required the engineer to defend the developer in a homeowners' association lawsuit for property damage even though (1) the homeowners' association did not allege its damages arose from the engineer's negligence or defective performance, and (2) the jury found the engineer was not negligent. *UDC-Universal Development L.P. v. CH2M Hill*, 181 Cal.App.4th 10, 103 Cal.Rptr.3d 684 (2010).

#### **Round 3: California Supreme Court's Sunday Punch**

In April 2010, the California Supreme Court refused to review the *UDC-Universal Development L.P. v. CH2M Hill* decision, leaving it as the "the law of the land" in California. Thus, a design professional agreeing to defend and indemnify its client was responsible for that defense regardless of whether it is found liable for the underlying claims.

#### **Round 4: Hitting on the Break, SB 972**

On September 29, 2010 the governor of California signed into law Senate Bill 972 which amends California Civil Code 2782.8 and becomes effective January 1, 2011. Pursuant to SB 972, Section 2782.8 is amended to read:

“(a) For all contracts, and amendments thereto, entered into on or after January 1, 2007, with a public agency for design professional services, all provisions, clauses, covenants, and agreements contained in, collateral to, or affecting any such contract, and amendments thereto, that purport to indemnify, including the duty and the cost to defend, the public agency by a design professional against liability for claims against the public agency, are unenforceable, except for claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional. The duty to indemnify, including the duty and the cost to defend, is limited as provided in this section. This section shall not be waived or modified by contractual agreement,

act, or omission of the parties. Contractual provisions, clauses, covenants, or agreements not expressly prohibited herein are reserved to the agreement of the parties.”

## Problems with SB 972

Although SB 972 has been largely touted as a victory for design professionals, Beazley is unconvinced that the bill provides significant protection for the A&E community.

First, the definition of permissible contractual indemnities is overly broad and not appropriately negligence-based, namely with regard to the “recklessness or willful misconduct of the design professional” language. An acceptably worded indemnity provision is one that limits the design professional’s indemnity obligation to the extent the damages are caused by the design professional’s negligent performance of services under the agreement. If the indemnity provision is not appropriately negligence-based, the design professional may be exposed to liability beyond that for which it is insured.

Second, the bill only applies to contracts with public agencies and the bill does not affect contracts between design professionals and private entities. Further, the bill narrowly defines public agency as “any county, city, city and county, district, school district, public authority, municipal corporation, or other political subdivision, joint powers authority, or public corporation in the state” and explicitly excludes the State of California from the definition.

Last, but perhaps most significantly, a design professional arguably is obligated to assume a duty to defend upon mere allegations of negligence, rather than proof of the design professional’s negligence. If the indemnity provision includes an express duty to defend (which we have long recommended design professionals delete in all indemnity provisions), a design professional will likely have an immediate duty to defend the public agency if the claims “arise out of, pertain to, or relate to the negligence, recklessness or willful misconduct of the design professional” which will encompass most, if not all, claims where the public agency seeks indemnity from the design professional.

Moreover, even if the indemnity provision does not include an express duty to defend, design professionals will likely have an immediate duty to defend the public agency since SB 972 does not specifically address California Civil Code 2778, which sets forth the general rules for the interpretation of indemnity agreements, unless a contrary intention appears in the indemnity language. CA Civil Code 2778 confirms the indemnitor’s obligation to reimburse the indemnitee’s legal expenses (subdivision 3) and establishes the indemnitor’s obligation to defend the indemnitee if requested to do so (subdivision 4). The statute provides:

“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;

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;”

Cal. Civ. Code § 2778, subd. 3 and 4.

## Recommendations

We recommend design professionals continue to diligently monitor and negotiate contractual indemnity provisions. Since the California legislature has now weighed in on the subject, design professionals are unlikely to be afforded any additional clarification in the near future on contractual indemnity provisions. Based on our analysis above, we do not regard SB 972 as providing significant protection to design professionals. Accordingly, when negotiating contractual indemnity provisions, design professionals should continue to:

- Delete any express duty to defend language;
- Limit the indemnity obligation “to the extent damages are caused by the design professional’s negligence”; and
- Add express disclaimer of duty to defend, as follows: “The parties expressly agree that this indemnity provision does not include, and in no event shall the Design Professional be required to assume, any obligation or duty to defend any claims, causes of action, demands, or lawsuits in connection with or arising out of this Project or the services rendered by the Design Professional.”

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