Welcome to

HALL & COMPANY

Serving Architects, Engineers and Environmental Consultants

AE Resource Webinar

Contractual Transfer of Risk for Professionals:

Mastering Indemnity, Insurance and The Standard of Care?

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WARNING

LAWYERS AHEAD

- Disclaimer: This is intended to be a general overview of legal issues. Nothing in this presentation is intended to be legal advice as to any specific person, company, or situation. The most important part of any legal issue is the specific facts, and you should consult with an attorney about your specific situation before directly acting on the information gained in this seminar.

Learning Objectives:

- How your contract can change your professional standard of care
- How the standard of care is applied in negligence claims and lawsuits
- What indemnity and the duty to defend means in your contracts
- Contractual risk transfers of indemnity and insurance

Why the Standard of Care Matters

Breach of standard = Negligence = Malpractice

California Jury Instruction:

An architect is negligent if he or she fails to use **the skill and care that a reasonably careful architect would have used in similar circumstances**.

This level of skill, knowledge, and care is sometimes referred to as 'the standard of care.'

You, the jury, must determine the level of skill and care that a **reasonably careful architect** would use **in similar circumstances** based only on the testimony of **the expert witnesses** who have testified in this case.

AIA

"The Architect shall perform its services consistent with the professional skill and care ordinarily provided by architects practicing in the same or similar locality under the same or similar circumstances. The Architect shall perform its services as expeditiously as is consistent with such professional skill and care, and the orderly progress of the Project."

The "standard of care" is not perfection.

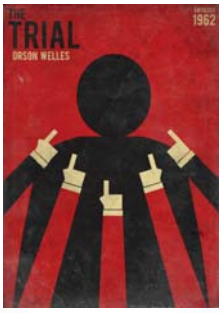
It's being average.

What is Negligence?
Legal Elements:

Plaintiff must prove all of the following:

1. The architect owed **a legal duty** to plaintiff to **meet the standard of care**;
2. The architect **breached that duty**;
3. That plaintiff was harmed; and
4. That the architect's negligence was a substantial factor in causing plaintiff's harm.

To whom does an architect owe a legal duty?



In other words, *who can sue you?*

Duty depends on many factors:

1. Intended to affect plaintiff;
2. Foreseeability of harm to plaintiff;
3. Degree of certainty that plaintiff suffered injury;
4. The closeness of connection between defendant's conduct and the injury suffered;
5. Moral blame attached to the defendant's conduct; and
6. The public policy of preventing future harm.

Judicial Council of California Jury Instruction

Success Not Required:

"An architect is not necessarily negligent just because his or her efforts are unsuccessful or they make an error that was reasonable under the circumstances. An architect is negligent only if they were not as skillful, knowledgeable, or careful as another reasonable architect would have been in similar circumstances."

Errors and Omissions

Judicial Council of California Jury Instruction

"A person is negligent if he or she **does something** that a reasonably careful person would not do in the same situation or **fails to do something** that a reasonably careful person would do in the same situation."

California Supreme Court
Gagne v. Bertran (1954)

"[T]he general rule is applicable that those who sell their services for the guidance of others in their economic, financial, and personal affairs are not liable in the absence of negligence or intentional misconduct."

- This means **no strict liability** or **breach of implied warranty**
- If your **contract** expressly warrants your services, you **create risk** exposure

Swett v. Gribaldo (1974)

"Those who hire such persons are not justified in expecting infallibility, but can expect only reasonable care and competence. They purchase services, not insurance."

- The law does not require perfection
- So you should not promise perfection
  - An impossible standard
- To err is human…

But how is negligence measured?

- Number of RFI's?
- Number of Change Orders?
- The Value of Change Orders?
- The Total Cost of the Project?
- The value of E/O change orders as a percentage of the total project cost?

Reality

- Dueling Experts
  - Your expert will argue your services were reasonable, and you met the standard of care
  - Their expert will argue it was unreasonable and negligent
- Result will depend on size of the alleged error and its actual impact on project

Who then decides if you met the "standard of care"?

When you go into court you are putting your fate into the hands of twelve people who weren't smart enough to get out of jury duty. ~Norm Crosby

"guaranteed"

"best"

"highest"

"unique"

"expert"

"specialized"

"will perform in a non-negligent manner"

Contractual Impact on Insurance:

- Insurance is for normal negligence
- For the normal standard of care
- Heightened standard = potential loss of coverage
  - Your carrier does not want to insure a promise of perfection!
- Loss of coverage = your argument against changing the standard in your contract negotiations

Indemnity

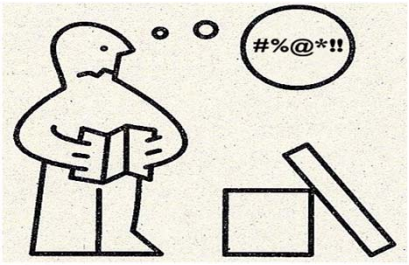
Indemnity - Defined

in-dem-ni-ty

1. **a**. security against hurt, loss or damage.
   - **b**. exemption from incurred or future penalties or liabilities.
2. Plain English – a way to get someone else to pick up the tab

- A risk-shifting mechanism
- Insurance is a classic form of indemnity
- How to make my problem your problem

INDEMNITY IS A 4 LETTER WORD!



Indemnity – Common Law Approach

- In construction contracts, parties to a contract were free to negotiate *any* indemnity agreement between them
- The court would not interfere with the contractual agreement between a contractor and subcontractor
- FREEDOM OF CONTRACT!
  - Fairness was not a concern
- New laws have slightly modified this standard
- Generally the law depends on the State, with wide variety across America and constant changes

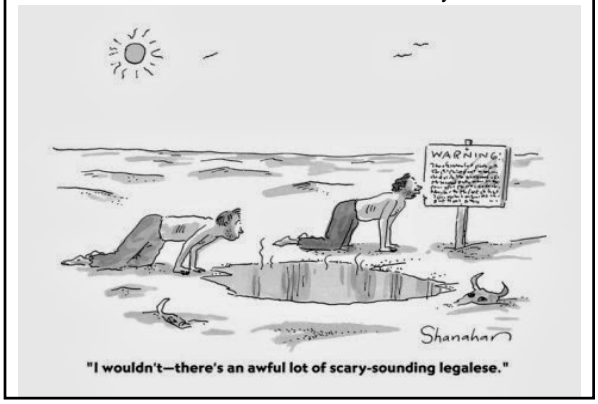
Case Study: Indemnity in California Defined by Statute

California Civil Code section 2772

Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person.

- A very, very old concept and statute…
- Enacted in 1872 and unchanged

Review of California Indemnity Statute



"I wouldn't—there's an awful lot of scary-sounding legalese."

Indemnity Example – Statutory Language

California Civil Code sec. 2778.
In the interpretation of a contract of indemnity, the following rules are to be applied, ***unless a contrary intention appears***:
[Remember: Freedom of Contract]

1. Upon an indemnity against liability, expressly, or in other equivalent terms, the person indemnified is entitled to recover upon becoming liable;
   [Think – Insurance]
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;

EVEN WORSE IS INDEMNITY'S UGLY PAL…

…THE DUTY TO DEFEND!

Indemnity – Statutory Language

California Civil Code sec. 2778 (Cont.)

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;
   [Again – Think Insurance]
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…

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Tough California Cases

- CRAWFORD V. WEATHERSHIELD
- UDC V. CH2M-HILL

- A legal earthquake upsetting indemnity assumptions

Pre-Crawford/CH2M-Hill

Some believed that the duties (defense and indemnity) were TIED TOGETHER and required a finding of negligence by the trier of fact.

Some jurisdictions thankfully still maintain this link

Indemnity Variety

- Texas = Indemnity limited to design professional's negligence on Government jobs per statute
- Florida = Indemnity also limited to design professional's negligence on Government jobs per statute
- See also - Montana, North Dakota, South Dakota, and Oklahoma for almost identical statutes as California

Crawford v. Weather Shield (2008) 44 Cal.4th 541

- Weather Shield supplied windows to Developer, J.M. Peters, for a big residential project in Huntington Beach
- Contract required Weather Shield to defend and indemnify Peters for "all claims. . . growing out of" WS's work.
- Construction defect lawsuit filed by 220 owners
- Peters sought indemnity from WS
- Jury found WS was not negligent (no indemnity) **BUT** the court ordered WS to pay part of Peter's defense costs
- Calif. Supreme Court found WS *had an immediate duty to defend* Peters and this *duty was independent of the duty to indemnify.*

Bad Facts Make Bad Law!

- *Stare decisis* is Latin for "we did it that way before so we will continue to do it that way"
- Otherwise known as "precedent"
- Courts can only deal with facts before them
- Crawford held the duty to defend is independent of negligence – no longer tied!
- Crawford was for subcontractors – will it apply to design professionals?

UDC - Universal Development v. CH2M Hill (2010) 181 Cal.App.4th 10

- CH2M Hill a designer for UDC's condo development
- Contract obligated CH2M Hill to indemnify UDC and to defend UDC against "any suit, action or demand" brought against UDC "on any claim or demand herein."
- UDC sued by homeowners and UDC tendered to CH2M Hill for defense and indemnity
- The jury found CH2M Hill was **not negligent**
- BUT court ordered CH2M Hill to pay $550,000 of UDC's defense costs

UDC - Universal Development v. CH2M Hill (2010) 181 Cal.App.4th 10

- Lessons from UDC:
  - A promise to indemnify "implicitly embraces the cost of defense" *(unless a contrary intention appears)*
  - Duty to defend is separate from the obligation to indemnify and not contingent on a finding of negligence
  - Duty to defend "necessarily arises as soon as such claims are made"

Civil Code § 2782 - Construction Contracts

- Enacted in 1967
  - No indemnity for the other party's SOLE negligence or willful misconduct
    - Exception: Insurance or worker's comp
  - No indemnity for a **public agency's** active negligence
- Amended for contracts after Jan. 1, 2013:
  - No indemnity for active negligence of a **private owner** or their employees
    - EXCEPT for homeowner of a single family dwelling

Public Agency & Designers

- 2782.8 - For contracts after Dec. 31, 2006:
- Public agency clauses that require design professional to "indemnify, including the duty and the cost to defend"
- Are Unenforceable!
- EXCEPT (big exception!)
  - "for claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional"
- Ties indemnity and defense back to claims of negligence
  - Does "Claims" mean "allegation" or "finding" of negligence?

Some Good News

- §2782.5
- Nothing…shall prevent a party to a construction contract from negotiating and expressly agreeing with:
  - Allocation, release liquidation, exclusion or limitation between the parties
  - Of any liability
  - For design defects or
  - Promises arising out of or relating to the contract
- So free to try and limit that indemnity

Onerous Contract Language

Architect agrees, **at its own expense** and **upon written request** by Developer, **to defend** any suit, action or demand brought against Architect based in whole or in part upon a matter covered by the foregoing indemnity. Consultant's duty to defend applies regardless of whether the issues of negligence, liability, default or other obligation on the part of the Developer or Consultant have been determined.

- Result? Architect becomes insurance company

Sample Indemnity Clause – Private Entity

•"Consultant agrees to indemnify Owner, but shall not be responsible for the cost of their defense, from liability for damages arising out of the performance of Consultants services on this project unless and **only to the extent** that such liability **is actually determined** to have been caused by the negligent acts, errors or omissions of Consultant, its principals, employees or sub consultants."

•Goal: Indemnity triggered by jury verdict or other end to a legal proceeding
•Not triggered by mere claim or allegation at the start of the claim

Sample Indemnity Agreement – Another Version

•"Consultant agrees to indemnify the Owner, from liability for damages arising out of the performance of Consultants services on this project to the extent that such liability is actually caused by the negligent acts, errors or omissions of Consultant, its principals, employees or sub consultants. Consultant has no obligation to pay for any of the indemnitee's defense related cost 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."

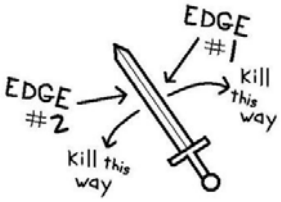
•Comparative Fault = We pay our fair share

Sample Indemnity Agreement – Further Language

Appended to the end of an indemnity clause:
"Notwithstanding the foregoing, for any claim alleging Consultant's negligent performance of professional services, Consultant's obligations regarding any indemnitee's defense under this paragraph shall be limited solely to the reimbursement of such indemnitee's reasonable defense costs incurred **to the extent of** Consultant's actual indemnity obligations hereunder."

Indemnity is a Double Edged Sword

- Others can indemnify and defend you
  - Owners
  - Subconsultants
  - Contractors



Indemnity From Owner

- Owner can indemnify and defend you
  - In general (broad indemnity and defense for anything related to owner, owner's consultants, or contractors)
  - For copyright violations
  - For unauthorized changes to the plans
  - For claims arising out of failure of Owner to follow your recommendation
  - For defects caused by the contractors
  - From information supplied by Owner
  - For any subsequent alterations to the Project or repairs
- Have contract require Owner to obtain indemnity for you with general contractor

Subconsultants

- Require them to indemnify and defend you
- At a minimum, incorporate bad owner provisions
  - Subconsultant agrees to be bound by and comply with the provisions of the Prime Agreement between Architect and Owner to the extent that such provisions apply directly or indirectly to the services provided
  - In the event of a conflict the provisions of the Prime Agreement shall govern and be controlling
  - Subconsultant agrees to be bound to Architect in the same manner and to the same extent as Architect is bound to Owner under the Prime Agreement
- Misery loves company!

Indemnity from General Contractor

- AIA indemnity for injuries on site
- How can you get GC to pick up your bill?
  - Include indemnity and defense provisions in contract
  - Indemnity to design professional for claims arising out of alleged defective workmanship
  - Include indemnity and defense provisions in specs and plan notes
    - GC "contract documents" = legal contract and part of bid unless excluded

Additional Insurance?

- Essentially non-existent for professional liability
- Many Owners still ask for it
  - Tell them "if your broker can find a PL policy that provides for AI coverage, let us know…"
- General Liability?
  - If a contractor or subcontractor agrees to indemnify you, the insurance carrier may pick up the defense
  - Often an exclusion for "professional services"
  - Argue claim arose from contracting work and products, not "professional services"

Additional Insured?

- Contract can call for an Additional Insured
- Named Insured: Receives policy; pays premium
  - Greatest rights and responsibilities
- Additional Insured: Added to the policy as a free rider
  - Certificate of Insurance – Meaningless!
  - Additional Insurance Endorsement needed
    - Can be blanket – "any contract AI requirement"
  - Get copy of endorsement and policy for coverage limits

Thank You from

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QUESTIONS & ANSWERS

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