

Design Professional Industry Trends

Contract Trends: Duty to Defend

Of all the provisions in a contract, indemnities have the most far-reaching liability implications.

Find out why you should expressly exclude the duty to defend your client and limit any indemnity obligations to claims that arise solely out of your own actual negligence.

The decision of the California Court of Appeal in the *UDC v. CH2M Hill* case has once again raised red flags and will have serious implications for parties to contracts with indemnity provisions in California. In fact, the impact of this decision and its predecessor case, *Crawford v. Weather Shield Mfg., Inc.* may reach into other states as California precedents are often cited in other jurisdictions.

If you are a customer of the Design Professional group of XL Insurance, please refer to these policyholder publications for risk management advice and recommended contract provisions from *The XL Insurance Contract Guide for Design Professionals*:

- XL Insurance Trend Alert: UDC v. CH2M HILL
- XL Insurance Trend Alert: Indemnity Language and the Crawford Case

For our other readers, consider the following excerpts that could be of great benefit to your firm:

One might not have thought it possible, but the California legal environment just became even more hazardous for design professionals.

In a January 2010 decision, *UDC v. CH2M Hill*, the California Court of Appeal held that a design professional owed a duty to defend its developer/client under an indemnity agreement even though the jury found that the design professional had not been negligent in performing its services.

This case illustrates and expands upon the stunning *Crawford v. Weather Shield Manufacturing* decision rendered by the California Supreme Court, which held that a contractual duty to defend arises immediately when claim is made or tendered for any claim covered by the indemnity.

WHAT THE DECISIONS MEAN TO DESIGN PROFESSIONALS

These decisions are clear reminders that ambiguous contract language can have dramatic and very expensive consequences. When taken together, they mean that when a design professional gives a client an indemnification in a contract, unless the contract specifically excludes the duty to defend or pay the client's defense costs;

- The defense obligation arises immediately when the client tenders the defense to the designer, or notifies the design firm of the claim alleging design defects;
- The obligation exists regardless of whether or not the design professional is proven to be negligent;
- The duty applies to design professionals, contractors or anyone else giving another party indemnity rights.

Both courts applied this provision retroactively, meaning that contracts in progress or even completed contracts containing indemnities are subject to these revised rules of interpretation.

It sets up a perfect legal storm. In complex construction cases, plaintiff attorneys will generally draft a complaint broadly to include generic allegations of "design and construction defects" in an effort to include all possible causes of action and all possible defendants and to avoid having to amend the complaint at a later date. This in turn triggers the duty to defend if the parties have agreed to overly broad indemnity clauses. But this imposed duty to immediately

defend could expose a design professional to hundreds of thousands of dollars in legal fees. These legal costs are, in most cases, excluded from insurance coverage under the contractual liability exclusion in professional liability insurance policies, unless they are claimed outside of the contract as the result of the negligence of the design professional.

HOW TO PROTECT YOUR FIRM

The good news is that there are some steps you can take. Both the *Crawford and CH2M Hill* cases provide some guidance as to how you can avoid the exposure of potentially unlimited and uninsured defense costs. Remember, in the *Crawford* decision, the court said that in order to avoid a defense obligation, the duty to defend has to be expressly excluded.

What should you do? First, talk to your attorney. He or she may recommend that you review your existing contracts in progress and attempt to clarify any indemnity language by amendment or correspondence to exclude any defense obligation. It may be difficult to sell to your clients, but worth the effort, especially if you have any leverage with them.

Next, going forward on new agreements, your best solution (as always) is to delete any provision that requires you to indemnify the client.

If your client insists on some form of indemnification, counter with a mutual indemnity in which each of you indemnifies the other—but only for the direct result of your own negligent acts—and which specifically excludes any defense obligation.

“Before you agree to any indemnity provision, check with your professional liability insurance specialist and with an attorney familiar with construction contracts and the laws of the jurisdiction under which your contract will be interpreted and enforced.”

The information contained herein is intended for informational purposes only and does not constitute legal advice. For legal advice, seek the services of a competent attorney. Any descriptions of insurance provisions are general overviews only.

"XL Insurance" is the global brand used by XL Group plc's (NYSE: XL) insurance companies. Coverages underwritten by Greenwich Insurance Company, Indian Harbor Insurance Company, XL Specialty Insurance Company, and XL Insurance Company Limited—Canadian Branch. Coverages not available in all jurisdictions.

© 2010, X.L. America, Inc. All rights reserved.

Visit our Loss Prevention Library at xldp.com for risk management information on this and other topics.



XL INSURANCE

30 Ragsdale Drive, Suite 201
Monterey CA 93940
800-227-8533 ext. 2102508
www.xldp.com