

Managing Indemnity Risk



Panel Discussion

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P. Douglas Folk, Attorney – Clark Hill PLC

Jeff Gerrick, Independent Agent – Professional Underwriters of Arizona, Inc.

Creighton Sebra, Attorney – Clark Hill PLC

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The Challenge of Contractual Indemnities

- When presented as a “take it or leave it” offer, engineers face difficult choices in negotiating contractual indemnities
- Owners have gone overboard in shifting risk of liability and economic loss to their engineers and contractors
- They often demand a defense on first notice of the claim
- But problems arise when indemnity is not covered by your professional liability insurance because:
 - Owner is not an “Insured” under PL policy
 - Liability is not based on a “wrongful act” (fault) of the engineer
 - Duty is assumed by contract, not imposed by law of professional negligence

Challenge Worsened With “Unintended” Duties To Defend in CA

Crawford/CH2MHill court cases imposed liability for owner’s defense costs

- Contractual indemnities required a defense, but tender was refused
- Jury found indemnitors not at fault, but court required payment of indemnitee’s defense costs
- Held: Duty to defend upon receipt of tender and reimburse costs was required by Cal.Civ.Code §2778(3) to (5)
 - Indemnity “embraces ... costs of defense”
 - Indemnitor “bound, on request ... to defend”
 - If tender declined, “recovery against [indemnitee] suffered by him in good faith, is conclusive ... against indemnitor”

California Solved “Duty To Defend” Problem

SB496 amends Cal.Civ.Code §2782.8

- Applies to contracts (except state level agencies) signed on or after 1/1/2018
- Duty to defend is unenforceable “except to the extent that the claims against the indemnitee arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional”
- Defense costs reimbursed in proportion to share of fault—If no fault, then no duty to reimburse defense costs
- If one or more defendants cannot pay their allocated share of defense costs, remaining defendants directed to “meet and confer about unpaid defense costs”
- Not applicable where project-specific general liability policy insures “all project participants” and “covers all design professionals for their legal liability arising out of their professional services on a primary basis”
- Does not apply to design professionals in a written design-build joint venture agreement



DESIGN PROFESSIONALS LIABILITY COVERAGE

I. INSURING AGREEMENT

The Company will pay on behalf of the **Insured, Damages and Defense Expenses** for any **Claim** first made during the **Policy Period** that is caused by a **Wrongful Act** committed on or after any applicable **Retroactive Date** set forth in **ITEM 5** of the **Declarations**, provided that no **Principal Insured** on the **Knowledge Date** set forth in **ITEM 5** of the **Declarations** had any basis to believe that such **Wrongful Act** might reasonably be expected to be the basis of a **Claim**.

IV. DEFINITIONS

Wherever appearing in this policy, the following words and phrases appearing in bold type will have the meanings set forth in section IV. DEFINITIONS:

K. **Insured Person** means any natural person who:

1. is the sole owner of, or is or was a partner in, the **Named Insured or Predecessor Firm**;
2. was or is a member of the board of managers, director, executive officer, or shareholder of the **Named Insured or Predecessor Firm**;
3. was or is an employee of the **Named Insured or Predecessor Firm**; or
4. was or is an **Independent Contractor**,

provided that such person is acting within the scope of their duties on behalf of the **Named Insured or Predecessor Firm**.

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- E. **Damages** means money which an **Insured** is legally obligated to pay as settlements, judgments and compensatory damages; punitive or exemplary damages if insurable under the applicable law most favorable to the insurability of punitive or exemplary damages; or prejudgment interest and postjudgment interest.
- F. **Defense Expenses** means reasonable and necessary fees, costs and expenses, incurred by the Company, or by the **Insured** with the Company's written consent, that result directly from the investigation, defense, settlement or appeal of a specific **Claim**, provided that **Defense Expenses** do not include any payments made pursuant to section II. SUPPLEMENTARY PAYMENTS of the **Professional Liability Coverage**.
- Y. **Wrongful Act** means any:
 - 1. actual or alleged act, error, omission, or **Personal Injury Offense** in the rendering of, or failure to render, **Professional Services**; or
 - 2. **Network and Information Security Offense**,by any **Insured**, or by any person or entity, including any joint venture, for whom the **Insured** is legally liable.

V. EXCLUSIONS

- C. **Contract Liability**

This policy does not apply to any **Claim** based upon or arising out of liability assumed by an **Insured** under any contract or agreement, whether oral or written, except to the extent that the **Insured** would have been liable in the absence of such contract or agreement.

Insurance Available For Duty to Defend Obligation

- Aspen has contractual defense protection policy
- Requires a primary A&E PL policy that will not pay defense costs
- Coverage must be denied on PL policy because owner is not an “insured” or because indemnity is excluded as “contractual liability”
- Aspen will pay approved defense costs incurred during policy period – No deductible, 80/20 coinsurance obligation
- Long list of exclusions that will prevent coverage from paying

Q: Will it sell?

Other Indemnity Challenges

- Indemnities for claims “arising from or relating to” your work
- Intermediate form indemnities—pay for owner’s fault too
- Large number of third parties indemnified “for free”
- Complex indemnities that are difficult to analyze
- Enforceability varies based on different state indemnity statutes
- Often declared “non-negotiable”
- Q: How do we preserve right to negotiate indemnity in responding to RFP?

Western States That Prohibit Duty To Defend

Alternative: Reimburse defense costs to extent of fault

- Arizona: A.R.S. §34-226, § 41-2586
 - Scope of indemnity of public agency limited to “negligence, recklessness or intentional wrongful conduct” of A/E or contractor
 - Requirement of defense or indemnity for public agency’s fault is void
 - Preempts local ordinances
 - Applicable to all state, county and municipal contracts
- Colorado: C.R.S. §13-50.2-102(8) is similar
 - Scope of indemnity limited to extent of A/E’s fault
 - Duty to defend is void and unenforceable
 - Defense cost reimbursement decided after fault determined

Strategies For Managing Indemnity Risk

1. Delete (affirmatively disclaim) the duty to defend in negotiations
2. Require indemnitee to give prompt notice and cooperate in defense; prohibit indemnitee from admitting fault or offering settlement if tender is accepted; require indemnitor's written authorization to settle or compromise claim or void indemnity
3. Limit indemnity to loss, injury, or damages caused by or directly resulting from indemnitor's fault. Indemnity should not be triggered by any claim or demand "arising from or in connection with indemnitor's scope of services or work on the project"
4. Indemnify only those damages or losses (including defense costs) that indemnitee is "legally obligated to pay"; blocks indemnitee from making collusive settlement with claimant
5. Limit duty to indemnify "to the extent of indemnitor's fault, negligence, breach of contract, or willful misconduct" so that determination of fault required before liability imposed.
6. Disclaim obligation to defend, indemnify, or hold indemnitee harmless for its sole or partial fault or negligence, or for fault of other parties and non-parties

Strategies For Managing Indemnity Risk

7. Restrict indemnity to the other contracting party—and not its lenders, investors, successors-in-interest or other third parties—whenever possible
8. Prohibit assignment of contract or claims arising from or relating to the contract, and prohibit third party beneficiary status
9. Negotiate two-part indemnity: claims covered by GL policy—for which AI coverage allowed—include duty to defend, but indemnity for claims covered by PL policy do not include a duty to defend
10. Limit defense costs reimbursed to “reasonable and necessary attorneys’ fees and taxable court costs” incurred by indemnitee (in addition to the other restrictions in this checklist)
11. When possible and enforceable, include limitation of liability, waiver of consequential damages, and waiver of subrogation rights for claims covered by property insurance
12. Obtain a reciprocal indemnity from other contracting party (particularly useful in prime-sub and joint venture scenarios).

A person wearing a dark blue suit jacket and a white shirt is holding a rectangular white sign with both hands. The sign has the word "QUESTIONS?" written on it in a bold, dark blue, sans-serif font. The background is a plain, light grey color.

QUESTIONS?

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