

## AN OVERVIEW OF INDEMNIFICATION AND THE DUTY TO DEFEND

Indemnification & Duty to Defend Subcommittee,  
ACEC Risk Management Committee

### Subcommittee Chair

Theodore D. Levin, P.E., Attorney  
Morris Polich & Purdy LLP

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Albert Rabasca, Director of Industry Relations  
XL Specialty Insurance Company

Homer Sandridge, Underwriting Director, Professional Liability  
Travelers Insurance

Creighton Sebra, Attorney  
Morris Polich & Purdy, LLP

### *Principles and History*

One of the most basic principles of tort law is that every person should be responsible for damage that they have caused. Many states have reduced this concept to statute, each stating almost word for word that “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.”<sup>1</sup> In many lawsuits, a plaintiff’s damages are caused by the convergence of several contributing factors originating from several different sources. To give one common example, a plaintiff homeowner alleging property damages resulting from construction defects may assert claims in one lawsuit against any of the diverse parties that contributed various scopes of work to the project, including the general contractor, subcontractors and trades that contributed to the defective work, as well as design professionals such as civil engineers, architects, and structural engineers. To put it even more bluntly, the owner files one suit against everyone in sight.

In practice, however, the plaintiff more often merely sues the party or parties with whom he or she contracted, and lets the named defendant(s) do the legwork to identify and sue other parties that may also be responsible. The classic example of this approach

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<sup>1</sup> See, e.g., Cal. Civ. Code § 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”); 15 Okla. St. Ann. § 421 (same); S.D.C.L. (South Dakota) § 56-3-1 (same); M.C.A. (Montana) § 28-11-301.

is the homeowner who sues his or her general contractor, who then sues the subcontractors with whom the general contractor contracted to perform the work, alleging that these “cross-defendants” are liable for the damages alleged by the plaintiff.

This is where indemnity comes in. Indemnification occurs when one party—the “indemnitor”—agrees to protect another party—the “indemnitee”—from a legal consequence of the indemnitor’s or some other party’s conduct. In its most fundamental form, indemnity shifts payment or liability for payment, in whole or in part, from one party to another party, whether due to principles of fairness or equity or by express agreement between the parties. An insurance contract is probably the most well known type of indemnity agreement, in which the insurance company agrees to indemnify the insured against another party’s conduct.

As discussed below, “indemnity” is commonly thought of in general terms as the indemnitor’s duty to save the indemnitee in all respects; the duty to indemnify does not arise unless there is an adverse claim against the indemnitee, or in practical terms a money judgment. Only then does the duty to indemnify (as opposed to the duty to defend, discussed below) truly arise.

Indemnity can take many forms, but the most common types of indemnity claims are comparative equitable indemnity (based on principles of fairness), implied contractual indemnity (implied from the terms of a contract) and express indemnity (stated within the “four corners” of a contract). Since express indemnity clauses often cause a contracting party to inadvertently “bite off more than it can chew,” potentially exposing that party to unforeseen and unanticipated liability, this white paper deals primarily with legal developments relating to these types of agreements, and the duties, dangers and pitfalls arising from those types of agreements. However, because a contracting party may be liable under equitable indemnity theories even absent an express indemnity provision, a discussion of these types of arrangements is also useful for an overall understanding of the various concepts and how they might interrelate.

The historical bases of indemnity are the related legal theories of unjust enrichment and restitution. At least as to comparative equitable indemnity, and to some degree implied contractual indemnity, courts have determined that it would be unfair for one of several parties causing damage to another to be “unjustly enriched” by not having to compensate the injured party for the damage that they did cause, and allowing for restitution to the party that actually did pay. In other words, if you were partly responsible for damage that somebody else paid for, it’s only fair that you pay them back. (See *Miller v. Ellis* (2002) 103 Cal.App.4th 373, 380; *City of New York v. Lead Industries Ass’n, Inc.* (N.Y. 1996) 222 A.D.2d 119; *Illinois Cent. Gulf R. Co. v. Deaton, Inc.* (La. 1991) 581 So.2d 714, 717.) As a matter of fairness and equity, two or more persons responsible for another’s damages should share the burden of paying the injured party for the damages caused by their mutual negligence. At the same time, the doctrine (as it has evolved through the legal system) also seeks to impart fairness as between the mutual wrongdoers by generally limiting their contribution to the injured party in direct proportion to their fault. That is, you should only pay your fair share. (See *B & B Auto*

*Supply, Sand Pit, and Trucking Co. v. Central Freight Lines, Inc.* (Tex. 1980) 603 S.W.2d 814, 816.)

Express indemnity on the other hand relies less on fairness and focuses solely on the language to which parties agreed to be bound in their contracts. Accordingly, express indemnity law developed under the rules governing general contract law where the court's focus is on the expressed intent of the parties, rather than principles of fairness and equity (although express indemnity clauses will be strictly construed as narrowly as possible to prevent overreaching).

### ***Types of Indemnity***

As noted, the three most common forms of indemnity are comparative equitable indemnity, implied contractual indemnity, and express (or contractual) indemnity.

Under comparative equitable indemnity principles, each party reimburses the claimant in relatively proportionate shares, based on percentages of liability attributed to each defendant or cross-defendant. Equitable indemnification arises due to the particular considerations, or equities, of a given case, and the duty arises by operation of law (basically, a court or jury determines what is equitable or fair). Although the complete body of law on the comparative equitable indemnity doctrine is beyond the scope of this white paper, it is notable that the theory evolved over many years from a rule holding that a defendant who was even one percent liable was liable for all of the damages to the plaintiff regardless of any other party's fault, to the current, much more equitable rule (hence the name) that limits each defendant's liability to its allocated percentage of fault.<sup>2</sup>

In general terms, the defining hallmark of an equitable indemnity claim is the presence of two or more parties both liable in tort to the injured party. In other words, you have multiple parties who should pay damages. Absent joint liability, there is no comparative equitable indemnity. Courts have synthesized this concept into the oft-stated shorthand rule that "there can be no indemnity without liability." (*Prince v. Pacific Gas & Elec. Co.* (2009) 45 Cal.4th 1151, 1159.)

The second type of indemnity is implied contractual indemnity. Oddly enough, despite its name, implied contractual indemnity does not actually rely on contractual terms to require a duty of indemnity. In fact, a claim for implied contractual indemnity is more closely related to a claim for comparative equitable indemnity than express indemnity, the latter of which in fact requires, and is based on the express terms of, a valid, enforceable contract. In the simplest of terms, the implied contractual indemnity doctrine is grounded upon one contracting party's failure to properly perform contractual duties owed to the other contracting party. That is, if one party did not do what it was supposed to under the contract, that party should pay something on the grounds of

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<sup>2</sup> However, under the joint and several liability theory, which provides that each defendant is liable for the whole of the claimant's economic damages regardless of fault, a "judgment-proof" defendant may also turn out to be "indemnity proof" since all other claimed indemnity defendants would have to take up the slack.

fairness. Under this indemnity theory, equitable considerations are brought into effect by contractual language not expressly dealing with indemnification.

The last and potentially most pitfall-laden form of indemnity is express contractual indemnity. A typical express contractual indemnity clause may read as follows:

Party A hereby agrees to indemnify, protect, defend and hold harmless Party B from and against and with respect to any and all claims, demands, actions, losses, obligations, damages, expenses and liabilities, (including without limitation attorneys' fees, penalties, interest and costs) incurred or suffered, or may incur or suffer, arising or resulting from Party A's negligence.

For years, indemnity provisions have been cavalierly considered part of a contract's "boilerplate" provisions that could be easily cut and pasted from one contract to another without much thought or impact. However, recent court decisions have imposed substantial and considerable liabilities — including as discussed below the obligation to reimburse another party for their attorneys' fees, even if the reimbursing party is found to be without any fault — on unsuspecting parties that likely never gave much thought to the content or consequences of their express indemnity provisions in their standard contracts. These cases have forced parties and their counsel to re-visit this practice, and require a very careful examination of these terms in order to avoid these previously unanticipated liability obligations.

As noted, the law of express indemnity developed through traditional contract law principles, in which each party is bound to the terms and obligations to which they have agreed. This results in a few key distinctions between express indemnity and the equity-based forms of indemnity. The first major distinction is that courts will interpret express indemnity clauses very strictly, and construe them only to the extent necessary to effectuate the parties' clear intent as set forth in the contract. Absent fraud or some applicable overriding public policy set forth in a statute (such as voiding express indemnity agreements in certain contracts that seek to indemnify a party against their sole negligence), the court will generally not be concerned with issues of fairness. Thus, precise drafting of these terms is of paramount importance. Another distinguishing hallmark of express indemnity is that there is no requirement that there be two or more parties liable to the indemnitee. All that is required is the expression of an agreement that one party will indemnify the other party. This is in stark contrast to the shorthand rule above that there can be "no indemnity without liability." Moreover, the terms of an enforceable express indemnity provision will generally override any obligation due under a comparative equitable indemnity claim based on the same acts for which express indemnity is sought.

Thus, unlike equitable theories under which a court or jury will assign liability based upon what is fair or right, express contractual indemnity seeks to enforce the actual agreement of the parties. Under the law of contracts, contracting parties are free to voluntarily define their duties toward one another, including clauses requiring one party

to pay, or indemnify, the other against certain claims or losses. The parties may even assign one party the responsibility for the other's attorneys' fees incurred in defending third-party claims. Although these concepts are often separately described as the "duty to indemnify" and the "duty to defend," and attorneys drafting agreements have for years continued to think in terms of this dichotomy, the statutory definition of the term "indemnity" actually often includes the cost of defense.<sup>3</sup> Thus a sloppily drafted contract term requiring one to "indemnify" another may unwittingly impose a duty on a contracting party to pay the other's attorneys' fees. And, as discussed below, this may be true *even if* the party paying the fees is ultimately found to be without any liability at all in a court of law!

### ***The Duties to Defend And Indemnify – Related But Distinct***

As noted, a duty to indemnify arises upon the imposition of an adverse judgment requiring the payment of money. For all practical purposes then, an indemnitor's (the one who pays the indemnity)'s liability on an indemnity obligation does not even arise until the underlying litigation is concluded (even though for administrative purposes, indemnity claims are commonly brought at the same time, as a part of the underlying litigation, in order that all potentially responsible parties are before the court in one proceeding, saving the courts and parties from two trials on the same subjects).

Most indemnity provisions, however, also include a related duty to defend, which requires the indemnitor to defend the indemnitee against covered third-party claims and potentially first party claims depending on the language included in the provision.<sup>4</sup> Similar to indemnity provisions, the scope of a defense obligation can range from a narrow obligation, which limits the duty to a specific claim or claims, to a broad obligation, which requires the indemnitor to defend the indemnitee against an entire action where damage is related to or attributed to the indemnitor's scope of work, design, or construction administration services.

Statutory and case law principles related to interpreting indemnity contracts and defense provisions permit wide latitude and great freedom of the contracting parties to assign rights and responsibilities in the contract. This latitude includes the right to allocate risk through indemnity and defense provisions and, if desired, to impose conditions or limitations on the applicability of those provisions. The intent of the parties is to be ascertained, if possible, from the contract alone, so the key question of whether an indemnity or defense provision applies in a given case will vary depending on the language of the provision in the contract.

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<sup>3</sup> For example, California's Civil Code section 2778(4) states that "an indemnity against claims . . . embraces the costs of defense against such claims . . ."

<sup>4</sup> The 5<sup>th</sup> Circuit recently held that an indemnity provision, allowed an indemnitee (the one being paid the indemnity – in this case, Wal-Mart) to recover attorney's fees against an engineer for Wal-Mart's first-party claim. (*Wal-Mart Stores, Inc. v. Qore Inc.* (2011) 647 F.3d 237). Typically, the duty to defend arises when the indemnitee incurs a loss or responds to some legal liability as a result of a third-party claim. However, the *Wal-Mart* decision illustrates that an indemnity provision may trigger a duty to defend a first party claim.

In addition, it is important to understand that the duty to defend does not depend on the outcome of the claim, whereas the duty to indemnify does not arise unless the outcome of the claim is adverse. The duty to defend and duty to indemnify are separate and distinct obligations. Because the duty to defend and the duty to indemnify are distinct obligations, the contract may impose a duty to defend the underlying claim even in the absence of a duty to indemnify. (*Hollingsworth v. Chrysler Corp.* (Del. 1965) 208 A.2d 61.) In other words, the contractual duty to defend a claim may be broader than, and arise more often than, the duty to provide indemnity from a loss or judgment.

Moreover, some states like California have enacted statutes which set forth general rules and guidance for interpreting indemnity contracts.<sup>5</sup> California's Civil Code section 2778 provides in relevant part

- “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.” (California Civil Code §2778(3)(4).)

Despite section 2778 subsections (3) and (4), courts in California and other jurisdictions routinely held that the duty to indemnify and the duty to defend were not independent obligations but were tied together, both in the scope of their coverage and by the event that triggers the obligations. Under this guideline, the duty to defend traditionally did not arise until after the underlying case was resolved and an ultimate determination of liability was rendered. Thus, indemnitors with a potential defense obligation could systematically reject an indemnitee's tender of defense and await final resolution of the underlying case. (*Regan Roofing Co. v. Superior Court* (1994) 24 Cal.App.4th 425, 436.) However, as discussed in more detail below, recent California case law has drastically modified the application of the duty to defend.

### ***California Case Law***

The California courts have rendered two decisions, which have directly impacted the duty to defend and the scope of that obligation in an indemnity agreement. The court in *Crawford v. Weather Shield* (2008) 44 Cal.4<sup>th</sup> 541, held that the contractual duty to defend was immediate and mandatory under the terms and conditions of the indemnity agreement as contained in the contract at issue in that case. In addition, the court in *UDC v. CH2M-HILL* (2010) 181 Cal.App.4<sup>th</sup> 10, concluded that a design professional owes a duty to defend even if the design professional is found to be not negligent.

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<sup>5</sup> Other states such as Montana (Mont. Code Ann. Sections 28-11-313 to 317), North Dakota (North Dakota Cent. Code Section 22-02-07, South Dakota (South Dakota codified Laws Section 56-3-10), and Oklahoma (Oklahoma Statutes title 15 Section 427) have indemnity statutes that are identical or nearly identical to California Civil Code section 2778.

### ***The Crawford Decision***

The *Crawford* matter involved a homeowner, Kirk Crawford, and other home buyers who sued the developer/contractor, J.M. Peters Co., claiming a broad spectrum of construction defects, including framing problems and window leakage. J.M. Peters then filed cross-claims for express indemnity against its various subcontractors and design professionals. In addition, Peters claimed that the subcontractors were required to defend Peters against the homeowners' construction defect claims. (*Crawford v. Weather Shield* (2008) 44 Cal.4<sup>th</sup> 541 at 547-548.)

The subcontracts contained a provision under which each subcontractor/designer agreed:

“[1] to indemnify and save [J.M. Peters] harmless against all claims for damages to persons or to property and claims for loss, damage and/or theft of homeowner's personal property growing out of the execution of the work, and [2] at his own expense to defend any suit or action brought against [J.M. Peters] founded upon the claim of such damage or loss . . .” (*Crawford v. Weather Shield* (2008) 44 Cal.4<sup>th</sup> 541 at 553.)

The trial court ruled that Weather Shield was obligated to pay its respective defense costs to JM Peters even though the jury had ultimately found that Weather Shield was not negligent in the underlying action. The trial court further held that Weather Shield's defense obligation to JM Peters had been triggered and arose at the time JM Peters tendered its defense to Weather Shield. The California Supreme Court affirmed and agreed with the trial court, and ruled that Weather Shield had breached its duty to defend JM Peters when it rejected JM Peter's tender. The Supreme Court disapproved of *Regan Roofing* and held that the duty to indemnify and the duty to defend were generally separate and independent obligations, and unless the agreement expressly conditioned or limited the defense obligation contrary to Civil Code Section 2778(4), the duty to defend arose at the time of tender, not after the determination of liability. (*Crawford v. Weather Shield* (2008) 44 Cal.4<sup>th</sup> 541.)

The *Crawford* court appeared to go out of its way to stress that its holding was completely consistent with the general rules of contract interpretation, recognizing that parties have great freedom of action to condition, limit, or disclaim entirely the indemnity and defense obligations. Moreover, the California supreme court acknowledged that every indemnity contract embraces the duty to defend, and unless the agreement provides otherwise, a duty to assume the indemnitee's defense, if tendered, against all claims is included in the duty to indemnify. (*Crawford v. Weather Shield* (2008) 44 Cal.4<sup>th</sup> 541 at 558.)

### ***The UDC Decision***

In *UDC-Universal Development, L.P. v. CH2M Hill*, a residential condominium homeowners association sued UDC, the developer of the project, and UDC cross-complained against its design professional, CH2M Hill, seeking to enforce indemnity

provisions in their contracts. At the conclusion of the trial, the jury returned a verdict finding CH2M Hill was not negligent and that it did not breach its contract with UDC. Regardless, the trial court found that, under *Crawford*, the indemnity provision in the contract obligated CH2M Hill to pay UDC's defense costs.

On appeal, CH2M Hill attempted to distinguish *Crawford* by arguing that the plaintiffs in *Crawford* had alleged that the indemnitor was negligent and a cause of their damages, whereas in the UDC case the HOA's complaint did not allege that CH2M Hill was negligent. The Court of Appeal rejected this argument, concluding that the HOA's general description of the defects in the project implicated CH2M Hill's work. CH2M Hill also argued that *Crawford* should not apply retroactively, on the grounds that *Crawford* changed previously existing law and CH2M Hill reasonably relied on pre-*Crawford* law. The Court rejected this argument as well, observing that the general rule is that case law applies retroactively and that none of the narrow exceptions to retroactivity applied.

The provision in the *UDC* matter provided: "Consultant [CH2M Hill] shall indemnify and hold Owner, Developer, and their respective officers, directors, employees and agents free and harmless from and against any and all claims, liens, demands, damages, injuries, liabilities, losses and expenses of any kind, including reasonable fees of attorneys, accountants, appraisers and expert witnesses, to the extent they arise out of or are in any way connected with any negligent act or omission by Consultant, its agents, employees or guests, whether such claims, liens, demands, damages, losses or expenses are based upon a contract, or for personal injury, death or property damage or upon any other legal or equitable theory whatsoever . . . ." (*UDC-Universal Development L.P. v. CH2M Hill* (2010) 181 Cal.App.4th 10, 18-19.)

The California Court of Appeal ultimately held that a design professional owed a duty to defend its developer/client pursuant to a contract of indemnity even though the jury found that the design professional had not been negligent in performing its services. To that end, the court agreed with the *Crawford* court's interpretation of Civil Code section 2778(4) and held that the CH2M Hill's defense obligation arose when the third party claimant (Homeowner's Association) alleged harm as a result of the deficient work that was within the CH2M Hill's scope of services. Moreover, the *UDC* Court disagreed with CH2M Hill's premise that *Crawford* "dramatically changed" previously established law and that its retroactive application would "punish" and "severely prejudice" CH2M Hill and "hundreds" of other litigants. The Appellate Court relied on the Supreme Court assessment that the *Crawford* decision was not a radical departure from existing law because its conclusion resulted from careful examination of Civil Code section 2778, which has remained unchanged since 1872, and sets forth general rules for the interpretation of indemnity contracts, unless a contrary intention appears. (*UDC-Universal Development L.P. v. CH2M Hill* (2010) 181 Cal.App.4th 10, 23.)

### ***California's Response to Crawford and UDC***

Although the Supreme Court and Appellate Court appeared to settle the issue of the proper interpretation of contractual indemnity and defense obligations in the



*Crawford* and *UDC* opinions, new questions have emerged with the passage of California Senate Bill 972. Senate Bill 972 modifies Civil Code section 2782.8 and provides as follows:

“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. . .” (Civil Code section 2782.8).

Even though section 2782.8 was championed as a significant response to the *Crawford* and *UDC* decisions, it will only provide minor benefits in limited circumstances to design professionals. The bill, which was effective on January 1, 2011, only applies to contracts with public agencies. Design professionals working on private projects will not benefit from this statute. In addition, 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 as well as subdivisions of the State such as UC Regents and the Cal State system.

Senate Bill 972 essentially allows a public agency to enter into a contract with a design professional that includes an obligation to defend and indemnify the public agency from any claims that arise out of, pertain to, or relate to the negligence, recklessness, or willful misconduct of the design professional. Therefore, the *Crawford* and *UDC* decision will remain and a design professional will still be obligated to defend an owner or developer if the claim arises out of the design professional’s scope of services. Consequently in the vast majority of cases, since there will be an allegation of negligence, the statute really offers very little protection for the design professional. However, the bill will benefit the design professional as a design professional will not have to defend the public agency for claims that arise out of the public agencies’ negligence or other parties’ negligence. However, the courts have yet to determine whether the duty to defend arises at the time the claim is made or after negligence is determined.

### ***Jurisdictions Have Enacted Similar Statutes to Senate Bill 972***

Both Texas and Florida have enacted statutes similar to California’s Senate Bill section 972. The Florida statute precludes indemnity provisions between public agencies and design professionals, except for provisions that would require a party to indemnify or hold harmless the other party to the extent of negligence caused by the indemnifying

party. (Florida Stat. §725.08.) The Texas statute bars contracts between licensed engineers and/or registered architects with government that require indemnification or defense beyond the design professional's negligence. (Texas Local Gov't Code § 271.904.) The Texas and Florida statutes were enacted prior to California Senate Bill section 972, but very limited judicial interpretation of these statutes has made it difficult to determine how each jurisdiction will interpret these sections in the future.

However, the Florida Court of Appeals did review Florida statute section 725.08, in *Barton-Malow Co. v. Grunau* (2002) 835 So.2d 1164. In this matter, the Florida Court determined that the relevant language in the subcontract at issue required the subcontractor to defend the general contractor. The contract provision provided that the subcontractor was obligated to "protect, defend, indemnify and save harmless ... Barton-Malow Company ... from and against all losses, claims, demands, payments, damages, suits, actions, attorney's fees, recoveries and judgments of every nature and description brought or recovered against . . . Barton-Malow Company." (*Barton-Malow Co. v. Grunau* (2002) 835 So.2d 1164 at 1167.) The Florida Court of Appeal ultimately ruled that the duty to defend was not severable from the remainder of the duties in the indemnity provision. The Court further found that the indemnity provision intertwines the duty to indemnify and the duty to defend. Ultimately the Florida Court of Appeals held that the indemnity provision was unenforceable because it violated section 725.08 and the subcontractor was not obligated to defend the general contractor.

The Florida court's determination obviously had the opposite effect of the *Crawford* and *UDC* decisions. The subcontractor in this case was not obligated to pay the general contractor's attorney's fees and defense costs. This result further illustrates the importance of drafting clear and concise indemnity provisions that expressly manifest the parties' intent with respect to the duty to defend. Results and outcomes can certainly vary between jurisdictions and each individual State law will fluctuate. However, one constant is that the courts will generally attempt to enforce the contract pursuant to the plain meaning of the contractual language, provided that the contractual obligations do not violate a State statute. As a result, careful drafting and interpretation of each contract provision is essential to ensure that the design professional is not required to defend an owner even if the design professional is found to be not negligent.

### ***Other Jurisdictions***

As mentioned above, four jurisdictions have enacted statutes similar to California Civil code section 2778. Montana, North Dakota, Oklahoma, and South Dakota all have statutes that are similar to California. However, even though these States have similar statutes, very little case law interpretation has been produced from these jurisdictions.

North Dakota and South Dakota courts have not been presented with an issue similar to the issues presented in *Crawford* and *UDC* and thus it remains to be seen if these two jurisdictions will follow the California court in its application of the duty to defend. Montana's statute precludes indemnification in construction contracts related to any negligence of the part of the indemnitee. Contractual provisions that obligate the

indemnitor to defend and indemnify related to the indemnitor's fault or negligence are permissible.

Oklahoma, on the other hand, when faced with an indemnity clause that contained a defense obligation ruled contrary to the *Crawford* court. In *Estate of King v. Waggoner County Board of County Commissioners* (2006) 146 P.3d 833, the Oklahoma court refused to impose a defense duty independent of an indemnification obligation. The court ruled that the agreement in this matter did not anticipate indemnity in favor of the indemnitee for its own negligence. The agreement provided that the indemnitor "shall indemnify and defend [indemnitee] against any claim for damages, liability, costs, or expenses, including attorney's fees, arising out of any breach by [indemnitor] of its warranties, representations, or covenants under this Lease." (*Estate of King v. Waggoner County Board of County Commissioners* (2006) 146 P.3d 833 at 844.) Not only does the indemnity clause not mention indemnitee's negligence; it does not make it "unequivocally clear" that the parties intended to provide for indemnity against the indemnitee's own negligence. (*See id.* at 844.) Also, it should be noted that this decision was prior to *Crawford* and it is difficult to determine if the outcome would have been different if the *Crawford* decision was prior to the Oklahoma decision.

The Arizona court declined to follow the *Crawford* rule when faced with a similar indemnity provision.

The contractual language involved in this matter provides that the subcontractor must "[I]ndemnify and hold harmless . . . [MT Builders] . . . from and against all claims, damages, losses and expenses, including but not limited to attorney's fees and court costs, arising out of or resulting from the performance or non performance [sic] of the Subcontractor's Work under this Subcontract . . . **to the extent caused in whole or in part by any negligent act or omission of the Subcontractor** or anyone directly or indirectly employed by him or anyone for whose acts he may be liable, regardless of whether it is caused in part by a party indemnified thereunto." (*MT Builders LLC. v. Fisher Roofing, Inc.* (Az. 2008) 197 P.3d 758, 764-765.)

The Arizona court found that the provision limited Fisher's indemnity obligation because the contract only required a defense obligation to the extent the claim was caused in whole or in part by any negligent act or omission of the Subcontractor. Additionally, the court found that the contract utilized in this matter was an AIA Document A201-1987, which utilized the general conditions of the contract for construction. The indemnity language in this AIA document created what is known as a "narrow form" of indemnification, meaning the indemnitor's obligation only covers the indemnitee's losses to the extent caused by the indemnitor or a person the indemnitor supervises or is responsible for. (*MT Builders LLC. v. Fisher Roofing, Inc.* (Az. 2008) 197 P.3d 758, 765.)

Finally, the Nevada Court followed the standards enunciated in *Crawford* and held that unless a contract specifically provides otherwise, "an indemnitor's duty to defend an indemnitee is limited to those claims directly attributed to the indemnitor's

scope of work and does not include defending against claims arising from the negligence of other subcontractors or the indemnitee's own negligence.” (*Reyburn Lawn & Landscape Designers, Inc. v. Plaster Development Co. Inc.* (Nev. 2011) 255 P.3d 268, 278.) In addition, the Nevada court concluded that because the indemnity clause did not expressly or explicitly state that indemnitor (Reyburn) would indemnify the indemnitor (Plaster) for the indemnitor’s contributory negligence, the indemnitee is required to indemnify the indemnitor only for liability or damages that can be attributed to the indemnitor’s negligence. (*Reyburn Lawn & Landscape Designers, Inc. v. Plaster* (Nev. 2011) 255 P.3d 268, 278.) The Nevada court discussed the holding in *Crawford* and agreed with the reasoning in *Crawford*, but ultimately based its determination of the plain language of the contract provision and reasoned that the indemnity provision did not require a defense obligation for the indemnitor’s own negligence.

As a result, it certainly remains to be seen if other jurisdictions will completely embrace the holdings in *Crawford* and *UDC*. However, given the unjust nature of *Crawford* and *UDC* decisions it is imperative that design professionals take care to modify the defense obligations in their contracts. The California Supreme Court decisions impose a defense liability on parties in the absence of any contractual expression of intent to assume that burden. Left uncorrected, the *Crawford* and *UDC* decisions creates hidden, unexpected obligations that will exist in every contract unless expressly disclaimed.

## ***Practical Applications***

### *Insurance Implications*

Indemnity clauses can create insurance coverage problems for the unwary design professional. Typically, professional liability policies exclude coverage for “liability assumed by contract” unless the insured would be liable even in the absence of any contract. A design professional is responsible for damages caused by his or her failure to perform professional services in conformance with the professional standard of care. Accordingly, those damages will be covered by professional liability insurance. But unless the contract requires it, the design professional generally will have no duty to pay his or her client’s defense costs, so the “liability assumed by contract” exclusion will bar coverage for those costs.<sup>6</sup>

To keep the indemnity clause within the coverage grant of the policy, it is essential that the design professional (i) only accept responsibility for damages to the extent caused by the design professional’s negligence, and (ii) reject language calling for the design professional to defend the client (or anyone else, for that matter).

This is easier said than done. Especially in today’s economic climate, there is tremendous pressure on design professionals to take on liability for damages caused by

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<sup>6</sup> Note that the policy *will* cover the insured design professional’s costs of defense against a covered claim. The coverage problem arises when the insured agrees to defend *another* party, such as the client, who is not and cannot be an insured under the professional liability policy.

others, and to promise a free defense to the client.<sup>7</sup> But the client who demands this of its design professional must at a minimum understand that these promises will not have full coverage under the design professional's professional liability insurance policy.

In discussing and negotiating this with the client, it is important to stress that, not only do you, the design professional, not have coverage for this contractual obligation but this means that *they*, the client, won't have coverage as the cost for such defense obligation is beyond the means of most design professional firms. Accordingly, insisting on and getting such language in the contract is a pyrrhic victory for the client because they are, in essence, transferring risk to an unfunded indemnitor, putting not only the design professional in great financial jeopardy, but themselves and their constituents/shareholders as well.

As this is being written, various insurers of design professionals are considering whether it might be possible to offer some limited coverage for the design professional's obligation to defend another party. But design professionals considering such insurance solutions must carefully investigate how the coverage is triggered, the extent of coverage, and the timing of payment. This will require a careful reading of the proffered policy language, and an in-depth discussion with the insurance broker and perhaps legal counsel as well.

#### *Contract modification issues*

The *Crawford* and *UDC* decisions illustrate that even subtle variations of contract language can have a significant effect on how defense obligations are interpreted and applied. Contract language in indemnity provisions must be drafted with care, so the intentions of the parties are clearly and carefully stated. Indeed, if the obligations regarding the duty to defend are ambiguous or not clearly defined, unsuspecting parties can be exposed to substantial liabilities that were not intended or contemplated at the time of contracting.

Under the prior (*Regan Roofing*) interpretation of contractual indemnity and defense obligations in the construction context, the immediate adverse effects of careless contract drafting were limited because the financial implications of incurring a defense obligation were generally deferred until after the underlying action was resolved. However, in light of *Crawford*, the potential consequences of poorly drafted contracts can expose unsuspecting indemnitors to liability for substantial defense costs that were not contemplated when the contract was negotiated. These costs can be incurred at the beginning of a case, long before—and, in some instances, regardless of whether—there are any findings of underlying liability. Moreover, some parties may have to pay these costs out-of-pocket if their insurance coverage excludes this "contractually assumed liability." Now more than ever, indemnity and defense provisions should be drafted with considerable care so that courts can give effect to the true intentions of the parties.

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<sup>7</sup> Some clients who insist on the "defend" language in an indemnity clause do so because they are familiar with general liability insurance, which provides a defense to additional insureds under the policy. But, as noted above, professional liability insurance does not work this way.

### *Factors for consideration*

Parties may wish to consider the following factors before entering into an indemnity and defense agreement.

Because defense obligations are interpreted more broadly than indemnity obligations, special attention may be warranted for contract language that includes a duty to defend. This language should be prudently drafted with precise terms that identify the parties' intent, both with respect to what event triggers the duty and the scope of its coverage. Any language that is intended to condition or limit the defense obligation, or disclaim it altogether, should be unambiguous; otherwise, the obligation may be broadly interpreted.

If the contract is a standard form contract without room to negotiate the terms, the language setting forth the defense obligation should be analyzed with extra care, in the context of applicable case law, to determine the likely interpretation of the provision should a dispute arise. Only then may parties have a clear understanding of the exposure they are assuming and perhaps not be surprised by unexpected liability.

The language in indemnity and defense provisions should be evaluated for potential insurance-coverage issues and to determine if these "contractually assumed liabilities," including a contractual duty to defend in the absence of fault, would be covered under commercial or professional liability policies.

It would be prudent to consult with experienced legal counsel and insurance professional early in the contracting process to ensure proper drafting. This may reduce the potential for adverse rulings if the meaning of the indemnity and defense language ends up in court and/or not being covered under your professional liability insurance.

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