Managing your Risk and the Duty to Defend Q&A

AIA used to have the "go-to" contracts that had "reasonably" fair indemnity clauses - established based on insurable risk. Now it seems the industry abandoned all precept of risk management and is dumping it into the architect's lap. The real question: since insurable losses end up back at re-insurers, why haven't those lawyers figured out the DTD/indemnity language THAT CAN BE insured?

- The AIA still has one of the industry-leading family of contracts that tends to be more designer focused than other industry agreements, while striving to provide an agreement that can be signed by both parties with little back and forth negotiation. If our insureds did nothing but sign AIA docs, we'd have far fewer claims. With that said, some design firms will mark-up AIA docs with their own specific contract requirements, which is totally acceptable.
- In general, there are several problems with making the duty to defend insurable:
    1. This exposure is difficult for insurers to calculate and thereby underwrite, because it is so open-ended.
    2. General liability carriers for contractors do offer contractual liability defense coverage that covers some of a contractor's duty to defend. However, a general liability policy covers far less than a professional liability policy. A GL policy excludes damage to the contractor's work as well as all economic loss. By contrast, a professional liability policy covers bodily injury (like a GL policy) and also all forms of property damage and economic loss, like delay damages and lost profits. A GL policy is an occurrence-based policy, which means for continuous and progressive losses, like water intrusion into a building wall assembly, multiple policies are triggered. A contractor owing a duty to defend might have 10 GL policies (representing 10 years of coverage) pitching in a fraction of a client's defense. This fraction gets smaller when other contractors and their carriers are involved. This is different than a professional liability policy that is claims made and reported, meaning that only one policy will ever respond to a claim.
    3. Firms that owe a third-party an upfront defense in a claim will also find it very difficult to settle out of a claim early with the plaintiff. Even if a design firm agrees to pay a plaintiff's demand to settle a case, if the firm owes a contractual defense to a client, they will be unable to settle out of the case without the client's consent, which is rarely given in this situation. Even if there were commercially viable coverage for the design firm's contractual duty to defend, it would keep design firms in cases longer, which would erode the practice policy quicker with defense costs, leaving less money for settlement. With many insurers already writing business at a loss, providing contractual defense coverage would not be viable. The ability to reinsure these losses would diminish as a result. Reinsurance, which is really just insurance for insurance companies, would cost more and the attachment points (the dollar amount where the reinsurance treaty kicks in) would likely rise. These additional costs would likely be passed on to the policy holder and could make professional liability insurance cost prohibitive.

While the focus is on design professionals, I work for a planning work where our contracts are primarily with public agencies. Thoughts on how to negotiate proportional responsibility for non-design contracts will be helpful.

- There has been discussion around design firms that are providing services to clients that do not require registration under the applicable Business and Professions Code for

architects, landscape architects, engineers, and land surveyors. There are a couple ways to look at this:

1. Licensed architectural and engineering firms should obtain the benefit of this statute whether or not the actual service they are providing requires a stamp. To argue otherwise would result in an unworkable statutory framework where someone providing site visit observations would not be covered under the Civil Code section 2782.8, but the final stamped CDs are covered. It would be impossible to parse out the damages in a claim from each individual alleged negligent act, error or omission and then determine the duty to defend from there.
2. Regardless of whether the duty to defend complies with California law, public agencies (and all clients) should focus on how their damages will be paid. Having a reputable insurance company stand behind the obligation to reimburse the client its reasonable defense costs caused by the firm's negligence is worth far more than a firm's promise to pay an unknown and open-ended uninsured obligation. This argument does not always gain traction, but some public agencies are starting to understand the importance of insurability, especially given their unique role as guardians of the public trust. We are seeing some public agencies agree to bifurcated indemnities or otherwise agree to reimbursement of defense costs proportionate to the designer's degree of fault.

When a public contract goes above and beyond the Civil Code, is it enforceable? Have seen contract language that the architect must prove that they have 0% liability for indemnity to be avoided.

- We have seen this trend for some public agencies where they are hedging their bets and requiring that firms sign contracts that appear on their face unenforceable under Civil Code section 2782.8. We believe they are doing this, because the issue of whether Civil Code section 2782.8 requires an upfront defense or reimbursement of defense costs is unsettled – there are no appellate decisions in California on this issue yet. The problem with this approach is that if they are wrong, they run the risk of having the entire indemnity provision struck as "unenforceable."

Have the AIA documents been modified to reflect the current law?

- The AIA documents are updated every 10 years, and the AIA Documents Committee spends considerable time updating these contracts. I am unaware of the AIA or any other industry documents being modified specifically to address changes to California law. If you are an AXA XL Design Professional insured, you will see that our Contract Guide does make a distinction for California law in the chapter on Indemnities. We always recommend that firms consult with legal counsel prior to negotiating, executing or amending any agreement so you can ensure that you are current with the law.

Sometimes the client sells the project to others in the middle or at the end of process. How do we protect ourselves and prepare for it?

- The client you decide to enter into a contract for design services is based in part on your internal client selection and project evaluation (go no/go) processes. To safeguard against having the project sold and inheriting a new and unknown client, consider contract clauses that address the following:
    1. Non-assignment clauses that prohibit either party assigning the contract without the express written consent of the other. Lender consents to assignment may be acceptable to the extent no material changes are made to the agreement.

2. Ownership of instruments of service language that either keeps ownership of the plans with the design professional or provides a revocable license to a specific client.
3. Language that prohibits unauthorized reuses of instruments of service, limits your designs to the particular project in your contract, and has a self-executing indemnity.
4. The definition / description of the client is clearly defined in the agreement.

- Certain project types, like condos or apartment to condo conversions, can amplify the risk of taking on a new and unknown client in the middle of a project. Having a conversation early on with your client about their goals and expectations is a good idea.

Many public agencies and institutions have produced requests for proposals that include their "boilerplate" contract language and have indicated that they will not entertain ANY modifications to the contract and the indemnification clause. The insinuation to interested firms is that they must "fall in line" and accept whatever that agency's lawyers have presented, or that they will be "blackballed"...not considered for hire. Is this legal for a public agency or institution, such as a California Community College district? What recourse to Architects have with this growing trend?

- While it is difficult to opine on the legality of this practice, it does happen frequently. As a result, many qualified firms do not bid on projects, or those that do are forced to sign contracts they would never otherwise agree to. Industry groups like the AIA California Council are good resources to report this information to. AIA CC often collaborates with other industry groups like ACEC California who are seeking to further and enforce QBS selection requirements and fairness in contracting. But they can't help you if they don't know about it. Your involvement in AIA CC is a great way to communicate these issues and stay on top of any developments.
- Educating these public agencies takes time and is not always successful. But having an insurable indemnity is a win for both clients and design professionals.

Can we apply these rules to Interior Design professionals?

- Yes, you can apply these rules to interior design. Anyone can agree to contractually disclaim the duty to defend and provide for reimbursement of reasonable defense costs proportionate to the design professional's degree of fault. Firms that provide pure interior design services and are not licensed architects may find some reluctance from clients who say that the statute does not apply to them. But the same principles about insurability (for insurers who provide this coverage) still hold true.

Is there a similar talk for the Design-Build space? Clearly different indemnity/DTD issues...

- Yes, this conversation is happening in the design-build space, especially as this project delivery method is gaining in popularity. Civil Code section 2782.8 applies to design build contracts. The design-build carve out in the statute only applies to design build joint ventures – something that is rare but does happen on larger project types.

Referring back to the idea that on we negotiate getting added as additional insured on GC's GL policy, given the A/E agreement comes well in advance of selecting/contracting a GC, what is best approach to get this into our A/E agreement?

- Given a design professional's early involvement in a project, it would be a good idea to have this conversation with a client and then consider making this a contractual requirement. The problem with a contractual requirement is that if the general contractor's carrier does not name your firm as an additional insured, your only recourse,

should you choose to do so, is to sue your client for breach of contract. The firms that have been successful negotiating this requirement in the owner / contractor agreement tend to be the ones that have a really good long-standing relationship with the owner – someone who you may not want to sue. But having this provision in your agreement will not hurt, and a breach of this provision does not require you to sue for breach of contract.

What has been the trend over the past 10-20 years in the number and $ amount of claims against architects?

- This is a difficult question to answer because it depends on the type and size of the project, who the other project participants are, and the venue where a dispute is located. Claims against design professionals have been on the rise in terms of both frequency and severity over the last 20 years. Across our entire book of design professional insureds we are seeing an increase in claim severity over the last five years or so. This is due in part to:
    1. Projects have become increasingly larger and more complex, which translates into bigger problems and bigger claims.
    2. Firms have struggled to keep pace with staffing and training as the economy was strong prior to the pandemic. The failure to do this has resulted in more claim frequency and severity.
    3. Social inflation is on the rise where people in our society, including jurors, have become desensitized to large dollar amounts. Some juries tend to entertain arguments of an expanded standard of care (especially in bodily injury cases where “reptile” tactics are employed by plaintiff counsel). This can translate in some jurisdictions to juries handing out extremely large verdicts.