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California Construction Law Update

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How it is Possible for a Design Professional to Win at Trial but Still Wind Up Losing

The recently reported Appellate case of UDC-Universal Development L.P. v CH2M Hill 181 Cal.App 4th 10(2010) is an example of winning yet losing and highlights the critical importance of negotiating appropriate contract terms. In this case, UDC (later to become Shea Homes) was the developer of a residential condominium project. UDC retained CH2M Hill to provide planning services in relation to the project. The contract between UDC and CH2M Hill, undoubtedly of UDC's drafting, required CH2M Hill to not only indemnify UDC under certain circumstances, but also to defend UDC if it got sued over the project. The Homeowner's Association of the complex (HOA) sued UDC for property damage from defects allegedly caused in part by negligent planning. UDC cross-complained against numerous subcontractors including CH2M Hill. UDC's cross-complaint included a cause of action for indemnity and a tender of its defense to subcontractors, including CH2M Hill. CH2M Hill answered the cross-complaint denying it was negligent and refused to accept UDC's tender of its defense. Eventually, all claims were settled except UDC's cross-complaint against CH2M Hill, which went to trial. At trial, UDC was seeking reimbursement for money it paid to the HOA allegedly due to CH2M Hill's negligence, and also its costs of defense, including attorneys fees it incurred in the suit brought by the HOA.

At trial the jury returned a verdict completely exonerating CH2M Hill. The jury explicitly found that CH2M Hill had not been negligent. Therefore, CH2M Hill was not obligated to indemnify UDC for any money it paid to the HOA. So far so good, right? But the story is not over. UDC argued that even though CH2M Hill was found not negligent, it still had to reimburse UDC the defense costs, including attorney's fees, UDC incurred defending the HOA claim. The trial court agreed with UDC, and so did the Appellate Court.

The trial court and Appellate Court followed the reasoning of the California Supreme Court in the 2008 case of Crawford v Weather Shield Mfg. Inc. 44 Cal.4th 541 (2008). In that case the Supreme Court reasoned that the duty to indemnify is separate and apart from the duty to defend. And further, the duty to defend arises immediately upon tender of the defense and is not dependant on a finding of negligence against the party with the duty to defend.

Crawford involved a window supplier's contractual obligation to defend and indemnify the developer. Although Weather Shield, the supplier of the windows, was ultimately determined NOT to have been negligent, nevertheless, it was obligated to pay a portion of the developers defense fees it incurred defending against the leaky window claims. The UDC v CH2M Hill case is a natural extension of that reasoning to a design professional's contractual obligations.

What makes this result particularly onerous for CH2M Hill is that while the judgment against Weather Shield was probably paid by its insurance carrier under provisions of its Comprehensive General Liability insurance policy, the typical Architect's and Engineer's Professional Liability policy does not contain a similar provision and specifically excludes coverage for liability assumed by contract. So, most likely, CH2M Hill will have to pay the judgment itself without contribution from its insurance carrier.

Because there are many statutes within the California Civil Code regulating indemnity clauses and because limitation of liability clauses can generally be effective if properly drafted, it is recommended that design professionals not extremely familiar with the statutory scheme pertaining to indemnity clauses consult with a qualified legal professional before entering into contracts. Ultimately, the level of risk to incur is a matter of business judgment, but decisions to accept or reject a given level of risk should be make from a position of knowledge, not ignorance.

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