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Articles contained in this issue of the CLE:

Professional Liability Risk Management for General Contractors in Design/Build Projects

What does a Design/Build Contractor do when his subcontracted design professional (architect/engineer) has an inadequate limit of insurance coverage? The corollary question is how does a Design/Build Contractor protect its bottom line from design-related errors that result in cost overruns, time delays, and reworks? One option is to obtain Contractor's Professional Liability Coverage, which protects a Contractor from uninsured claims from third parties resulting from the negligent act, error, or omission of a design professional under contract.

As an illustration, suppose a subcontracted Architect in a Contractor-led Design/Build delivery system makes a design error that is not discovered until the building has been completed. This design error is safety-related and results in portions of the building being reconstructed at a cost of $2 million. The subcontracted Architect has an aggregate limit of liability coverage of $2 million on its own Errors & Omissions policy. The Owner of the building makes a claim against the Design/Build Contractor. The Contractor attempts to pass the claim on to the Architect, but the Architect's $2 million aggregate limit of liability has been exhausted by claims on other projects. If the Design/Build Contractor has purchased Contractor's Professional Liability Coverage, it can successfully turn the claim over to its own insurer. Furthermore, in this same example, if the Architect's $2 million limit was eroded to $1 million from previous claims

in the same policy period, the professional liability insurance purchased by the Contractor would cover the additional $1 million required to cover the claim (depending on the limits purchased by the Design/Build Contractor).

A third illustration involves similar facts except the Architect has available $2 million of coverage that has not been exhausted but the claim is for $4 million. If the Design/Build Contractor has purchased Contractor's Professional Liability Coverage, it can successfully turn the claim over to its own insurer. Again, assuming there is an error by the design professional that causes damage, the insurer would pay the difference between the available coverage and the total amount of the claim.

While these are basic and general examples in the very complicated world of design claims, they clearly suggest that Contractor's Professional Liability Coverage should be considered on projects performed in Design/Build delivery systems. More particularly, it should be considered on any project where a Contractor holds subcontracts with any design professional. Design professionals in Design/Build delivery systems are most often Architects/Engineers, but can also be Structural Engineers, Mechanical Engineers, and Electrical Engineers.

Contractor's Professional Liability Coverage protects against a specific exclusion for professional services contained in a Contractor's General Liability policy. To avoid the gap in coverage, consider purchasing Contractor's Professional Liability insurance, which provides the excluded coverage on a separate insurance policy form.

It is important to note that the Contractor's Professional Liability Coverage is a **claims-made policy** and not an occurrence policy, which means that the Contractor's Professional Liability policy must be in effect at the time the claim is made for there to be coverage. In other words, if the policy period has expired before the claim is made, then there would not be any coverage. Furthermore, Contractor's Professional Liability covers **design negligence** that results in **economic damages** only. The Contractor's Professional Liability policy does not afford coverage for bodily injury or property damage claims.

Below are set forth some of the advantages and benefits of Contractor's Professional Liability Coverage:

- The Design/Build Contractor maximizes its opportunity for protection against the errors of its subcontracted design professional through a combination of the design professional's limit of liability on its own professional practice policy and the Contractor's Professional Liability Coverage.

- It gives the Design/Build Contractor the opportunity to retain the services of a qualified design professional who would have been rejected otherwise because of the inability of the design professional to obtain an affordable higher limit of professional practice coverage commensurate with the project.

- Contractor's Professional Liability Coverage is priced as though a large deductible was in place, and so the insurance premium is less than if the Contractor purchased the coverage for dollar one exposure.

- Contractor's Professional Liability Coverage is less expensive than Project-Specific Professional Liability Coverage and has the added benefit of keeping the architect/engineer more accountable because the architect/engineer's own professional practice policy is exposed.

- The Design/Build Contractor maintains control over the nature and availability of professional liability coverage.

In conclusion, Contractor's Professional Liability Coverage is a risk management option when the Design/Build Contractor's subcontracted design professional has a low limit of insurance coverage.

Joseph J. Bosick serves as Chair of the Construction Practice Consortium. For questions, you are welcome to contact **Joe Bosick** at 412-263-1828 or e-mail him at JJB@PIETRAGALLO.com .

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Pennsylvania House Bill Would Make Misclassifying Construction Workers as Independent Contractors a Felony

The Pennsylvania House of Representatives has sent legislation to the Senate that would make misclassifying construction workers as independent contractors a felony. The bill, 2007 H.B. 2400, proposes establishing a presumption that construction workers are employees, placing the burden on employers to prove otherwise to the Department of Labor and Industry.

The employer would have to prove the worker is free from its control or direction and that the worker is customarily engaged in an independently established trade, occupation, profession, or business. The individual's business location must be separate from the "employer's" business and the individual must use his own equipment, whether leased or owned. An office in the individual's home suffices as a separate business location if the individual is licensed to perform the specific type of work by state and/or local authorities.

Other indicia of independent contractor status required include a written contract, the independent contractor incurring the main expenses related to the work, the independent contractor realizing any profit or loss, and the responsibility for the satisfactory completion of the work and consequent liability for failure to complete the work. The worker must also be a U.S. citizen or otherwise authorized to work in the United States. The sanction for a conviction for misclassifying an employee under the act is a fine of not more than $15,000 or imprisonment for not more than 3 ½ years, or both, for the first offense, and $30,000 / 7 years for a subsequent offense.

The legislative intent for the bill is to prevent employers from evading compliance with federal and state tax withholding laws, depriving workers of social security and other benefits, and placing a higher burden on employers who do comply.

For more information about the House Bill, contact **Mark Caloyer** at 412-263-1833 or e-mail him at MTC@PIETRAGALLO.com.

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Federal Government Proposes Rule to Require Contractors to Verify Work Eligibility of Immigrant Employees

The Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council have proposed a rule to amend the Federal Acquisition Regulation. (FAR Case 2007-013, Employment Eligibility Verification). The proposed rule will require certain contractors and subcontractors to use the U.S. Citizenship and Immigration Services' ("USCIS") E-Verify system to verify certain employees' eligibility to work in the United States. If approved, it will affect contractors dealing with the Department of Defense, General Services Administration, and National Aeronautics and Space Administration.

The purpose of the rule is to ensure persons contracting with the Federal government abide by the immigration laws of the United States and do not hire or employ unauthorized aliens. National security was one of the main rationales behind the rule. In addition, it was noted that unauthorized aliens actually render a contractor's workforce less stable and reliable than contractors who do not employ unauthorized aliens. The rule is also designed to enhance the "economy and efficiency" of federal contracts.

The proposed rule only applies to employment in the United States, D.C., Guam, Puerto Rico, and the U.S. Virgin Islands. It does not apply to employment outside the United States or to employees hired prior to November 6, 1986. Certain prime contracts and subcontracts may be exempt if the cost of compliance would likely outweigh the benefit. It will apply generally to contracts $3,000 and up. It requires contractors to enroll in the E-Verify program within 30 days of the contract award, to begin verifying new hires after the contractor enrolls, and to continue to use E-Verify throughout the term of the contract. In order to enroll, the contractor must enter into a Memorandum of Understanding with the Department of Homeland Security and the Social Security Administration. It also requires verification of existing employees directly engaged in the performance of work under the contract.

The E-Verify system is an internet system operated by the USCIS in partnership with the Social Security Administration. It contains the person’s name, date of birth, and social security number derived from various government records. The system is designed to confirm that the employee’s information that is provided to the contractor and, in turn, provided by the contractor to the government, matches existing government records' information for each employee. If there is a discrepancy, the contractor is notified in writing that there is tentatively no confirmation of authorization for that employee to work in the United States. The contractor and the employee must then respond stating that they are or are not contesting the tentative non-confirmation. If the employee

contests the tentative non-confirmation, the contractor cannot terminate or take any other adverse action against the employee. However, the contractor must provide a "Referral Letter" to the employee explaining how to resolve the tentative non-confirmation. The employee then has eight Federal Government work days to visit a Social Security Administration office or call USCIS to resolve the discrepancy. If the employee is unable to resolve the problem, the employer must either terminate the employee or notify the government that it is continuing to employee a person not eligible to work in the United States. Failure to notify the government can result in a fine between $500 and $1,000.

No person or entity participating in E-Verify is civilly or criminally liable under any law for any action taken in good faith based on information provided through the confirmation system.

For more information about the proposed rule (FAR Case 2007-013), contact **Albert Peterlin** at 412-263-1827 or e-mail him at ANP@PIETRAGALLO.com

OSHA Penalty on Steel Erector for Failure to Provide Fall Protection Affirmed

The U.S. Court of Appeals for the Third Circuit affirmed an OSHA citation and penalty of $56,000 against a steel erector for a willful failure to comply with 29 C.F.R. § 1926.760(a)(1) in failing to provide fall protection harnesses and lanyards. Blue Ridge Erectors v. Occ. Safety & Health Rev. Comm., 261 Fed. Appx. 408 (3d Cir. 2008). The employees were working overhead at the time of the inspection and the erectors truck, which contained the harnesses and lanyards, had left for another work site. The court ruled that the crew's failure to seek out and request harnesses and lanyards did not mitigate the employer's failure to "provide" the protection as required by the regulations. To the contrary, the court cited its holding in E & R Erectors, Inc. v. Sec'y of Labor, 107 F. 3d 157 (3d Cir. 1997) that OSHA regulations should be broadly construed in favor of worker protection.

For more information about the case, please contact **Mark Caloyer** at 412-263-1833 or e-mail him at MTC@PIETRAGALLO.com.

Federal District Court Explains Economic Loss Doctrine

In Waynesboro Country Club v. Diedrich Niles Bolton Architects, Inc., 2008 U.S. Dist. LEXIS 18746 (E.D. Pa. 2008) the architects designed a new clubhouse for the Waynesboro Country Club. After the structure was built, water leaks developed throughout the building. The club sued the architects for professional negligence and breach of contract, and the architects joined the builder for contribution and indemnity, alleging negligent construction. The builder sought to have the architects' third party claims against it dismissed, asserting, among other things, that the Pennsylvania

economic loss doctrine prevented the claim. That doctrine will not recognize a cause of action between parties not in contractual privity for negligent acts that result only in economic loss, as opposed to personal injury or property damage. The district court denied the motion to dismiss, holding that architects could seek indemnification or contribution from the builder for property damage caused to the clubhouse due to water damage. The court also held that the architects could not seek indemnification or contribution from the builder for any loss of use damages suffered by the country club.

For more information about the case, contact **Mark Caloyer** at 412-263-1833 or e-mail him at MTC@PIETRAGALLO.com.

Drafting Effective Broad Form, Intermediate Form, and Limited Form Indemnity Clauses

Simply put, indemnity clauses enable the owner, designer, or contractor to allocate to other parties certain risks associated with the project. Often, indemnity clauses are used to insulate those parties from the costs to defend and settle claims resulting from injuries to workers or third parties in the course of the project. This method of contractual risk transfer is generally upheld by courts, provided that proper precautions are taken in the drafting of the indemnification provisions. Indemnification is supported by the logical proposition that those parties that exercise the most control over a project should bear the burden of maintaining a safe site. The "higher-ups" in a project, including the owners, designers and general contractors, may exercise very little actual control over the day-to-day operations of the job and may rarely visit the job site. It follows then that failure to maintain safe conditions during a project should result in liability for the party in control: the sub-contractor. Such contractual risk transfers are also an inherent part of the economic realities of the modern construction industry, as more powerful players, such as owners or general contractors, may dictate the terms and conditions under which sub-contractors must perform.

Pennsylvania courts recognize three types of indemnity clauses: broad form, limited form and intermediate form. These three forms of indemnity agreements differ most importantly in the types and extent of risks that they allocate to the sub-contractor and the proportion of the total damages that the sub-contractor may have to bear.

Broad Form Indemnity Clauses

Broad form indemnity agreements allocate all of the risk of the liability associated with a project, including liability resulting from the sole negligence of the owner, designer, or general contractor, to the sub-contractor. This type of indemnity clause makes the indemnitor (sub-contractor) liable for *all* damages resulting from any cause, *including* the sole negligence of the indemnitee (owner or general contractor, for example). Currently, more than half of the jurisdictions in the United States have anti-indemnity statutes in place that invalidate broad form indemnity clauses. Pennsylvania does not have such a statute in place, but common law rules present a significant hurdle to the proponent of a broad form indemnity clause.

In Perry v. Payne, 66 A. 553 (Pa. 1907), the Supreme Court held that a contract that indemnifies against the sole negligence of the indemnitee (e.g., owner or general contractor) will not be enforced unless it is expressed in unequivocal terms. The court reasoned that allowing the principal to transfer all of the risks resulting from its own negligence to a sub-contractor would put the sub-contractor in the place of an insurer. Id. at 555. The relatively small profits the sub-contractor stood to collect from the project were insufficient to justify its assumption of such a substantial risk. Therefore, the court held that two parties would rarely intend to agree to shift all of these risks to the indemnitor (sub-contractor). When this intent was present, the court reasoned, it would be evidenced by clear language in the agreement.

Nearly 100 years later, the Supreme Court affirmed the Perry decision in Ruzzi v. Butler Petroleum Co., 588 A.2d 1 (Pa. 1991). The Ruzzi case reiterates that, in order for a broad form indemnity clause to be enforceable, it must use clear and unequivocal language. No inference from words of general import can be used to establish broad form indemnity. Ruzzi, 588 A.2d at 5.

Thus, under Perry and Ruzzi, a valid broad form indemnity clause must specifically state that it applies to the negligence of the party being indemnified.

Limited Form Indemnity Clauses

Limited form indemnity clauses allocate the least amount of risk to the sub-contractor. In a limited form indemnity clause the sub-contractor only indemnifies the owner, designer, or general contractor for damages resulting from the negligence of the sub-contractor. See, e.g., Fulmer v. Duquesne Light Co., 543 A.2d 1100 (Pa. Super. 1988). Under such an agreement, the sub-contractor will only be liable for the portion of the damages attributable to his own negligence. Therefore, a comparison of negligence is made and the principal is only indemnified to the extent that the sub-contractor is negligent.

Intermediate Form Indemnity Clauses

Intermediate form indemnity clauses are a hybrid between limited form clauses and broad form clauses. Intermediate form clauses provide that the sub-contractor assumes *all* of the responsibility for liability resulting from an event caused by him, *in whole or in part.* An intermediate form clause allows the general contractor, designer, or owner to be indemnified for his own negligence, as long as the sub-contractor contributed to the cause of the liability. Note that if the sub-contractor were not even partly at fault (i.e. the general contractor or owner was solely negligent), the general contractor would then have to convince the court to interpret the agreement as a broad form clause in order to achieve indemnity. The full force of the Perry – Ruzzi doctrine would then stand in the way of the general contractor, designer, or owner, leading to a finding of unenforceability unless the language in the agreement was clear and unequivocal.

In determining whether an intermediate form indemnity clause is enforceable, Pennsylvania courts have applied a modified version of the clear and unequivocal test derived from the Perry and Ruzzi cases.

In Urban Redevelopment Authority. of Pittsburgh v. Noralco Corp., 422 A.2d 563 (Pa. Super. 1980), the court enforced an intermediate form indemnity clause when both the owner/indemnitee and the contractor/indemnitor were negligent. The court found the following facts: 1) that Noralco (the indemnitor) contributed to the liability; 2) that Noralco had sole control and possession of the project site; 3) that the Urban Redevelopment Authority (URA) (the indemnitee) was found to be only "passively" negligent (i.e., it did not create the dangerous condition); 4) that the construction contract stated that URA was not responsible for the condition of the building; 5) that Noralco agreed to inspect and familiarize itself with the building and its condition; and finally, 6) that the indemnity provision stated that Noralco was responsible for *all* damages resulting from its negligence in connection with the performance of the contract.

The court followed the rule set forth in Perry, and upon consideration of the facts listed above held that it was the clear intent of the parties to indemnify the Urban Redevelopment Authority for its own passive negligence. In reaching this conclusion, the court held that it was clearly within the boundaries of Perry to consider the circumstances surrounding the language of the agreement in addition to the language itself.

On this premise, the court finally held that in a similar factual scenario the concern with enforcing indemnification for the indemnitee's own negligence (namely unfairly putting the indemnitor in the place of an insurer), is non-existent.

It is worth noting that the vitality of the Noralco decision has been questioned after the Perry rule was bolstered by Ruzzi in 1991. In City of Pittsburgh v. American Asbestos Control Co., 629 A.2d 265 (Pa. Cmwlth. 1993), the court refused to apply Noralco, holding instead that the City of Pittsburgh was not entitled to indemnity because the clause did not clearly state that the City was to be indemnified for its own negligence. Also note, however, that the injured party in American Asbestos alleged that the City's *sole* negligence caused his injuries. Although not clearly articulated by the court, it would appear then that the important distinction between Noralco and American Asbestos is simply that the facts in the latter suggested that the party seeking indemnity was solely negligent. In other words, the American Asbestos indemnitees sought the protection of a broad form clause requiring the strict application of Perry - Ruzzi, while the Noralco indemnitees sought the enforcement of an intermediate form clause.

Conclusion

The enforceability of the various types of indemnity clauses in Pennsylvania depends greatly upon both the express and inferred intent of the parties to the agreement. When an indemnity clause fails to express through its language the parties' intent to indemnify the principal for any liability beyond that caused by the sub-contractor, and the circumstances similarly fail to indicate such an intent, Pennsylvania courts are likely to interpret the clause narrowly. Accordingly, it would be prudent for a party seeking indemnity for its own negligence to express the intent of the parties clearly when drafting an indemnity agreement.

For questions about indemnity clauses, contact **Louis C. Long** at 412-263-4395 or e-mail him at LCL@PIETRAGALLO.com.

If you would like to be added to or removed from our electronic mailing list, please let us know by e-mailing us at INFO@PIETRAGALLO.com or by calling 412.263.2000.

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