Dealey, Renton & Associates, *Insurance Brokers*

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a/e RISK REVIEW

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Indemnities Part 2:
Where agreements may make sense

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Indemnity agreements originated in the construction industry to hold project owners harmless from liabilities that arose during construction. Since the contractor has virtually 100 percent control of the jobsite, it's only fair that the contractor should indemnify (i.e., hold harmless) the owner for any site-related liabilities that arise from the construction work.

Over time, however, the fairness concept behind indemnification has been corrupted. Today, design and environmental consultants are often asked to sign contracts that make them assume a large portion of their client's risk—even though they do not have control over those risks. Worse yet, this significant increase in liability assumed through a contractual indemnity is typically uninsurable.

PART 1 of this two-part report examined the dangers of client-drafted indemnities, identified the three major types of such indemnities and demonstrated techniques to persuade a client to abandon the use of these onerous agreements.

But what if a client is insistent upon including an indemnity in your contract? In PART 2, we'll examine alternative forms of client indemnities that have only limited drawbacks. We'll also address situations in which you may want to ask for a reasonable indemnity from the client, the contractor or your subconsultants.

The mutual indemnity?

The proportionate-negligence indemnity discussed in PART 1 is definitely the least of the three evils examined previously. An even better alternative, however, is a mutual indemnity that calls upon the client and the consultant to indemnify the other, but only for each party's negligent acts.

If a client presents you with one-sided indemnity language and refutes your efforts to remove the clause altogether, you and your attorney may counter with a mutual indemnity. Here, you agree, to the fullest extent permitted by law, to indemnify the client against liability for damages to the extent caused by your negligent performance of professional services under your contract with the client.

In return for your indemnity agreement, your client must also agree, to the fullest extent permitted by law, to indemnify you against liability for damages to the extent caused by the client's

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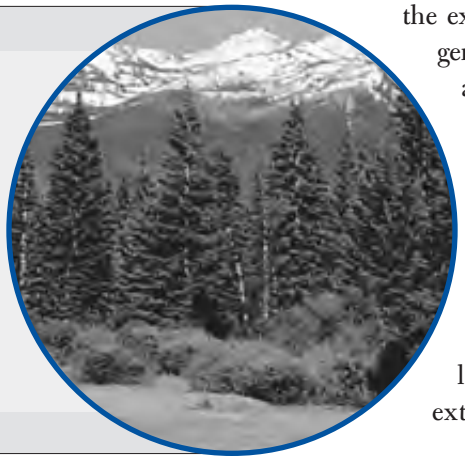

negligent acts in connection with the project. Also, have the client agree to indemnify you against the acts of its contractors, subcontractors, consultants or anyone for whom the client is legally liable.

At the end of the mutual indemnity, reiterate that neither your client nor you shall be obligated to indemnify the other party in any manner whatsoever other than for each party's own negligence. A fair-minded client who asks you to hold them harmless for your negligent acts should be willing to provide you the same protection.

The insurable indemnity

As a less desirable alternative to the mutual indemnity, you and your attorney may consider giving an insistent client some type of unilateral indemnity that limits the indemnity to your acts that are insurable. Tie the indemnity to your negligence and insurance coverage and purge any onerous language. Include the concept of comparative negligence, which holds you liable for only the portion of the damages for which you are responsible (unless your state law has an even more protective provision). Finally, see that the indemnity is limited to the services called for under the agreement.

"...YOU SHOULD AVOID TRYING TO PASS ON LIABILITIES THAT RIGHTLY BELONG TO YOU TO ANOTHER PARTY."

Under such an insurable indemnity you could agree, to the fullest extent permitted by law, to indemnify your client against damages caused by your insured negligent acts in the performance of professional services under the client agreement, to the extent that you are responsible for such damages, liabilities and costs on a comparative basis of fault and responsibility between you and the client and third parties. Specify that you shall not be obligated to indemnify the client for the client's own negligence.

When your client won't budge

If your client refuses to accept any alteration to an onerous indemnification, you have a business decision to make. You can accept the clause and the risk, hoping that the client will not ever have to apply the indemnity. Realize, however, that you are opening yourself up to an unlimited financial exposure that no professional liability insurance policy will likely cover. This option should only be considered with a very low-risk client and a project type with which your firm is thoroughly familiar and has had a claim-free record of work.

If you are faced with an insistent client, another possible option could be to provide them with two options. Agree to perform your services at one fee without the indemnity and at a higher fee with the indemnity in place. Explain that it is only fair that you offset your increased risk with an increased fee. Sometimes, clients may agree to eliminate or revise an indemnity in exchange for a lower fee.

The foolproof approach, of course, is to decline any engagement that includes an onerous indemnity provision. This is a decision that may lose you an otherwise attractive client or badly needed project, but it may be the prudent choice to ensure your long-term survivability. And who knows: your willingness to hold your ground and walk away from the work because of the indemnity clause may just earn you the client's respect and perhaps result in an eleventh hour change of heart in demanding an unfair and uninsurable contractual agreement.

When you want an indemnity from your client

As stated, the original concept of indemnity is based in fairness, and no consultant should be overly reluctant to indemnify a client from the firm's own negligence, errors or omissions. Likewise, there are certain instances where a firm should not accept work on a project unless the client is willing to indemnify the consultant from unusual risks. Such instances may include projects involving hazardous waste, asbestos, condominiums or renovations, or the possible unauthorized reuse of your plans and documents.

Indeed, there are times when an indemnity from your client is the only prudent approach. With high-risk projects, your firm did not create the

hazards and your role is to help the client overcome them. An indemnity from the owner should be a requirement for your services.

Work with your attorney to draft an indemnity agreement in which your client agrees, to the fullest extent permitted by law, to indemnify and defend you and hold you harmless against all damages, liabilities or costs arising out of or in any way connected with the project or your performance of services under the client agreement, except those damages, liabilities or costs attributable to your negligent acts or negligent failure to act.

When to consider a waiver

For additional protection on very risky projects, particularly those involving hazardous conditions that you can't control or properly insure, talk to your attorney about the viability of asking your client for a waiver—an agreement from the client not to sue you. A waiver is one of the most difficult provisions to obtain and to enforce, and some states have strict statutes applying to waivers. Therefore, keep the waiver and any indemnity agreement separate so that if the waiver is ruled invalid the indemnity isn't thrown out with it.

A simple waiver drafted by your attorney may stipulate that in consideration of the substantial risks to you in rendering professional services in connection with a risky project, the client agrees to make no claim and waives, to the fullest extent permitted by law, any claim or cause of action of any nature against you or your subconsultants, which may arise out of or in connection with the project or the performance of services under the client agreement. A limitation of your liability is more likely to be upheld under California law.

Third-party indemnities

In the event of jobsite injuries to workers or others, architects, engineers and environmental consultants are often included in the resulting claims. For protection against these and other third-party claims, discuss with your attorney adding a clause to your client contract that requires the client to include provisions in its client-contractor contract requiring the contractor to 1) have adequate insurance and 2) indemnify you and the owner for claims by the contractor's employees.

In such a third-party indemnity the client would agree to require all contractors to carry statutory workers compensation, employers liability insurance and appropriate limits of commercial general liability insurance (CGL).

The client would further agree to require all contractors to have their CGL policies endorsed to name the client, you and your subconsultants as "additional insureds" and to provide contractual liability coverage sufficient to insure the hold harmless and indemnity obligations assumed by the contractors.

The contractor would be required to furnish the client and you certificates of insurance as evidence of the required insurance prior to commencing work and upon renewal of each policy during the entire period of construction.

In addition, the contractor would, to the fullest extent permitted by law, indemnify and hold harmless the client, you and your subconsultants from all claims by employees of the contractors.

Indemnities with subconsultants

Finally, when you are the prime consultant do not forget to address these concerns in your subcontracts with your sub-consultants. Make certain that any indemnification you provide to your

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client in the prime contract also flows down to the subcontract so that your subconsultant assumes the same obligation. Conversely, when you receive indemnity protection from the client be sure to include your subconsultants as indemnitees so that they enjoy the same protection your firm does.

Conclusion

Client-written indemnities seem to be more prevalent when the project owner holds the upper hand due to poor market conditions. It is critical to discuss the language of such indemnities with your legal counsel and try to remove the indemnity or, at the least, strike out onerous and unfair language. As professional liability specialists, we can help you determine the insurability of such indemnities and help you build a case with your clients as to why an indemnity may be unenforceable, uninsurable and undesirable.

Likewise, before you consider asking a client, contractor or subconsultant for an indemnity, make sure any such agreement is within the laws of your state or project jurisdiction. While there are certainly instances where indemnities can help reduce your liabilities in high-risk projects, you should avoid trying to pass on liabilities that rightly belong to you to another party.

Editor's Note: **Included in this newsletter is an insert regarding recent developments in California law that significantly increase the risks associated with indemnity agreements.**

Can we be of assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain precautions, from construction observation through the development and application of sound human resources management policies and procedures.

Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN).

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Special Update

a/e Risk Review **Volume 18, Number 1**

UDC vs. CH2MHill decision spells disaster for design professional consultants

In California courts have declared war on small business. Last month a California Court of Appeal issued a decision in the case of *UDC-Universal Development, LP vs. CH2M Hill*. Relying on the decision the California Supreme Court issued in July of 2008 in the *Crawford vs. Weathersheild Mfg. Inc.* case, the court ruled that despite the fact that the defendant, CH2M Hill, proved they had no liability for the matters complained of, the indemnity provision in the contract with their client required them to pay for the client's defense costs incurred contesting litigation brought against them by the homeowners association at the Valle Vista Condominium project. The decision requires CH2M Hill to pay over $400,000 of their client's defense costs in that underlying litigation.

While the indemnity language from the Weathershield case clearly obligated Weathershield, the indemnitor, to defend Crawford regardless of fault, language in the CH2M Hill-UDC contract appeared to be much less objectionable. It specifically referred to an obligation to protect UDC to the extent of CH2M Hill's negligence. However, the appellate court ruled that this language was trumped by the findings of the Crawford case and the requirements of California Civil Code 2778, which states that indemnitors have an obligation to provide such a defense to those they agree to indemnify.

We cannot overestimate the adverse effect imposed on design consultants by these rulings given the fact that professional liability insurance excludes coverage for such contractual assumed obligations. Needless to say, the most recent case has caused a significant uproar in the consulting and legal communities. It is no longer possible to finesse the language in an indemnity provision to avoid the uninsurable duty to defend.

> "...ACEC-CA HAS SPONSORED LEGISLATION, SENATE BILL 972, TO AMEND THE CIVIL CODE TO HELP MITIGATE THE NEGATIVE RESULT OF THIS CASE."

The only rational response to this case is to specifically state that an indemnity clause does not include the duty to defend or pay defense costs of the indemnitee. A fallback position could be to agree that no duty to defend attaches unless and until actual fault is proved against the consultant and that the duty to pay such expenses shall be in proportion to such proven liability. In addition, the option of employing a bifurcated indemnity, including a broader obligation for non professional liability, and one more limited for professional services, should be considered.

In response to this extraordinarily adverse holding ACEC-CA has sponsored legislation, Senate Bill 972, to amend the civil code to help mitigate the negative result of this case. We urge all professional consultants to contact their state legislators to support this important bill.

In the meanwhile, the only option which will eliminate the possibility of your firm being put into the same situation as CH2MHill, will be to cease agreeing to any indemnity provision in agreements for professional services unless they are strictly limited to your share of actual fault for both the defense and indemnification obligations. "Business as usual" will no longer work in this regard. It is time for professional consultants to advise their clients that such agreements imposing unlimited, uncontrollable and uninsurable obligations that can easily bankrupt many small and mid-sized firms are no longer a reasonable commercial proposition.