Dealey, Renton & Associates, *Insurance Brokers*

VOLUME 17 NUMBER 5

a/e RISK REVIEW

A PUBLICATION OF THE PROFESSIONAL LIABILITY AGENTS NETWORK

Indemnities Part 1: Avoiding added and uninsurable liabilities

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.

When times get tough, more and more firms are competing for fewer and fewer projects. In such an environment, some project owners are more apt to put the squeeze on architectural, engineering, and environmental firms. Not only are project fees cut to the core, but these clients are apt to ask for more onerous contract conditions—and design and environmental firms are more willing to accept them when jobs are scarce. Indemnity clauses, in particular, are showing up more often among the list of client demands.

Indemnity agreements between consulting firms and their clients present a minefield of liability risks and legal troubles. By agreeing to a client's onerous indemnity agreement, your firm may be saddled with virtually all project risks—with many of the liabilities uninsured. That's why it is imperative for you to understand the issues surrounding indemnities and to work with your attorney to ensure that your client agreements do not put you in an untenable position.

Why indemnity agreements?

The concept of indemnification originated in the construction industry as a method to hold project owners harmless from liabilities that arise during construction. The basic concept makes sense: since the contractor has control of the jobsite, it should indemnify—or hold harmless—the project owner for any site-related liabilities that arise. If a worker or visitor is injured on a construction site, for example, the contractor is held responsible since it controls jobsite safety.

Over time, the concept of indemnification has been altered in ways that are unfair to design and environmental consultants. Environmental engineers and designers are often asked to sign indemnity agreements that make them assume a large portion of project risks. Indeed, it is not uncommon for firms to find one or more contract clauses requiring them to indemnify the client from substantial liabilities, including those over which the professional exercises no control. The indemnification language may be short and seemingly innocent, or lengthy and complex, but it spells serious trouble either way.

Many design and environmental professionals concede that they have unwittingly encouraged clients to use onerous indemnifications by accepting them so readily. If they balk at an indemnity, the client may say, "Well, XYZ firm

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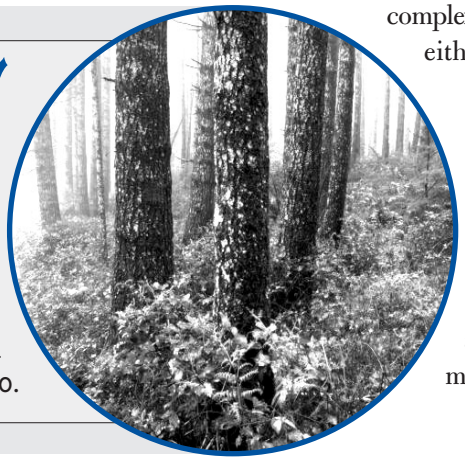

Why Indemnities Leave You Uninsured

Professional liability insurance specifically excludes liability you assume by contract, i.e., liability that would not be yours were it not for the fact that you specifically agreed to accept it. The insurer's position on this issue is understandable. The rates they charge are based on certain assumptions they make about known risks, given the types of services an environmental or design firm performs, types of clients, amount of fees earned and so forth. If insurers were to cover any and all additional risks a firm agrees to assume by contract, the liability exposure could be made one thousand times greater than normal simply by the stroke of a consultant's pen.

However, coverage will usually apply to a limited-form indemnification that does not expand your liability beyond what common law says you must be responsible for in any event.

Nonetheless, whenever a firm is considering acceptance of an indemnification clause, it should have the clause reviewed by an experienced attorney first.

down the street doesn't object to the language." Fearing they might lose the job, the firm disregards better judgment and signs an indemnity-laden contract.

But before signing on that dotted line, consider:

• Client-drafted indemnities ask you to assume liability for others' negligence. Ask yourself: without the indemnity, whose risk would it be? Almost invariably it would be the client's or contractor's risk.

• Most client-drafted indemnities are uninsurable. If you sign an indemnity agreement, more likely than not you are accepting liability beyond that required by law or the prevailing standard of care. Your professional liability policy likely specifies that the insurance does not cover any liability you assume voluntarily by contract unless you would have been liable in the absence of the contract.

• Client-drafted indemnities frequently contain unclear language that can be broadly interpreted—and misinterpreted. For instance, a client may ask for indemnity for your "services." A crafty attorney could interpret virtually any liability on a project as being associated with your services.

• Indemnity agreements may require you to pay for the client's legal defense in the event of a claim or lawsuit. This provision could be interpreted as an obligation on your part to retain an attorney for your client and pay for this defense—even if no negligence has been established. In most states, including California, these legal costs are not considered recoverable damages and therefore are not covered by your professional liability insurance.

• Client-drafted indemnities may include inappropriate parties to be indemnified. You should never agree to indemnify a client's agent, contractor, attorney, consultants, lender, or anyone else who is not directly part of the client entity.

Types of client-drafted indemnities

Client-drafted indemnities used in the design and construction industry can be separated into three general types.

• ***Broad unilateral indemnities*** create the greatest problems. Such indemnities can make an environmental or design firm responsible for almost any problem that befalls its client during the project, whether or not the consultant was negligent.

A typical broad-form indemnity requires the consultant to agree to hold the client harmless for any and all liabilities, including defense costs, arising out of the performance of services. Note that broad-form indemnities do not limit the indemnification to liability that is the result of the professional's negligent acts, errors or omissions. Obviously, such an all-encompassing indemnification creates enormous and largely uninsurable liabilities.

In some states, broad-form indemnification has been made illegal by virtue of court decisions or anti-indemnification statutes passed by lawmakers. But even in states where such broad indemnities are illegal, a judge might still rule that a given clause will be enforced when the parties to the contract have enjoyed relatively equal bargaining power and the clause is written so clearly that its intent is unmistakable. And, of course, even if a court rules in your favor, litigation always means you have lost valuable time, goodwill, peace of mind and income.

• ***Unilateral negligence indemnities*** are not much better than broad-based ones, but they are more likely to be held as legal in many jurisdictions. These indemnities provide that a design or environmental professional will cover all of the client's risk whenever the professional shares some liability due to negligence. A typical unilateral negligence indemnity requires the firm to agree to hold harmless and indemnify the client from any and all liability, including cost of defense, arising out of the consultant's negligence, whether it be sole or in concert with others, in connection with performance of contracted services.

Given a clause such as this, the client could be 99% at fault, but as long as the designer or environmental engineer is at least 1% at fault, the consultant picks up 100% of the tab.

And in the event of a project upset, there is a very high likelihood that a consultant would be held partly at fault. In fact, virtually any attorney could convince a jury that the consultant had at least a minor role in a project upset.

Proportionate-negligence indemnities assign liability to the parties involved in proportion to the degree of fault. For example, if you are found to be 20% at fault, you will pay 20% of the damages. With a typical proportionate-negligence indemnification, the consultant agrees to hold harmless and indemnify the client from and against liability to the extent arising out of the consultant's negligent performance of services. Damages, however, are shared with the client, contractor and other parties on a proportionate-fault basis as determined by a mediator, arbitrator, judge or jury.

While this limited indemnity is certainly more acceptable than the other two, it is best not to have it in a contract. First, it is unnecessary since you are already liable for your negligence. Second, it could muddy the waters regarding the insurability of your errors and omissions. Third, such provisions can be interpreted to require you to pay for the client's defense costs even in situations where it is ultimately determined that you were not at fault.

Making your stand

Regardless of how attractive a potential project may be, your guiding principle should be that you will avoid a client-written indemnity agreement. You must insist that liabilities remain with those parties who are in the best position to control them. You should do your best to persuade the client to remove any indemnity language that may increase your liability beyond that you already have for your negligence, errors and omissions. If you do agree to indemnify a client always seek to make the provision reciprocal and limited strictly to the extent of your actual negligence. Specifically, be sure you:

Know the law. Working with your attorney, find out whether your state or jurisdiction has anti-indemnification statutes on the books. If so, what do they say and how have the courts interpreted them? Be aware that the law in your state may not apply to your project disputes. Client-drafted contracts frequently require that disputes be settled in the jurisdiction where the client is located and/or where the work is performed. This may be an out-of-state location where indemnities are enforceable.

Educate your client. Perhaps the best tactic for getting rid of an unfair indemnity is to demonstrate to the owner the ineffectiveness of such a contractual stipulation. Point out any anti-indemnification statutes on the books in your state or the jurisdiction where any dispute would be tried. Explain that any indemnification that expands your liabilities will be uninsurable and could even jeopardize coverages that would apply without the indemnification. As your insurance agent, we can help you explain to your client that you are already liable for your errors and omissions and any resulting damages are covered within the available limits of your professional liability insurance policy. An indemnity is unnecessary and may cloud the issue of your insurance coverage and legal responsibilities.

Seek fairness. Explain that to hold you legally responsible for another's liability is simply unfair. Reaffirm your willingness to accept responsibility for your own negligence but state your unwillingness to be liable for the mistakes and oversights of others. Explain that the theory of indemnities applies to contractors on the construction site

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since they assume control over the work site. Make clear that you don't exercise that control and that it is unfair to hold a design or environmental firm responsible for liabilities that are completely out of its control.

Convincing an owner that an indemnification would be unenforceable and/or unfair can be difficult when the client has paid an attorney to draft the contract and the client has been told that another firm will agree to the provision. What do you do when a plea for basic fairness does not work? There are still some options that while not ideal, are far better than accepting a client-drafted indemnity.

Next issue, Part 2 of this two-part report will address those alternatives. We will also examine certain cases where you might want to request indemnities from a client.

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.

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