Indemnity Agreements: Big Problems for Architects

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Indemnity agreements between design firms and their clients present a minefield of liability risks and legal wrangling. By agreeing to a client's onerous indemnity agreement, your design firm may be saddled with virtually all project risks – with many of them 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.

Many design professionals concede that they have unwittingly encouraged the use of onerous indemnifications by accepting them so readily. If they balk at an indemnity, the client may say, "Well, the design firm down the street doesn't object to the language." Fearing they might lose the job, the design firm disregards better judgment and signs an indemnity-laden contract.

But before signing on that dotted line, consider:

- Client-drafted indemnities typically 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 that is not limited to indemnifying the client against your own negligence, 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 assumed by you under 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 "intentional acts." A crafty attorney could interpret virtually any of your acts as "intentional."
- Client-drafted indemnities may require you to pay for their 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 before your liability for negligence has been established.
- Client-drafted indemnities may include inappropriate parties to be indemnified. You should never agree to indemnify a client's agent, contractor, attorney, contract employee, lender, volunteer or anyone else who is not directly part of the client entity.

Client-drafted indemnities used in the design and construction industry can be separated into three general types: broad-form, intermediate-form and limited-form.

- ***Broad-Form Indemnities*** create the greatest problems. Such an indemnity can make a design firm responsible for almost any problem that befalls its client during the project, whether or not the designer was negligent. A typical broad-form indemnity requires the consultant to agree to hold harmless and indemnify the client from any and all liability including cost of defense arising out of performance of services.
- Note that broad-form indemnities do not limit the indemnification to liability that is the result of the design 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. But even in states where such 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 strength 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.
- ***Intermediate-Form Indemnities*** are not much better than a broad-form one, but it is legal in many jurisdictions. They provide that a design professional will cover the client's risk whenever the design professional shares some of the liability due to negligence. A typical intermediate-form indemnity requires the design 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 and, as long as the designer is at least 1% at fault, the consultant could pick up 100% of the tab. And in the event of a project upset, there is a very good likelihood that

a design consultant would be held partly at fault. In fact, virtually any attorney could convince a jury that a design professional had at least a minor role in a project upset.

- ***Limited-Form 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 limited-form indemnification the consultant agrees to hold harmless and indemnify the client from and against liability arising out of consultant's negligent performance of services. While this limited-form 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.

Regardless of how attractive a potential project may be, your guiding principle should be that you will not accept unlimited liability imposed by 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 increases your liability beyond the liability you already have for your negligence, errors and omissions. Specifically, be sure you:

- **Know the law**. Working with your attorney, find out whether your state 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 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. We'll explain that an indemnity is unnecessary and may cloud the issue of your insurance coverage and legal responsibilities.
- **Plead for fairness.** Explain that to hold you legally responsible for another's liability is simply unfair. Reaffirm your willingness to accept responsibility for your own errors and omissions 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 since they assume control over the work site. Explain how it is unfair to hold a design firm responsible for liabilities that are completely out of its control.

Professional liability insurance (No matter what carrier you are with) 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 insurers' 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 a design firm performs, types of clients, amount of fees earned and so forth. If insurers were to cover any and all additional risks a design firm agrees to assume by contract, the liability exposure could be made one thousand times greater than normal simply by the stroke of a designer's pen.
For the same reason, commercial general liability (CGL) insurers also disallow coverage of contractual liability. Note, however, that either usually will cover a limited-form indemnification that does not expand a design firm's liability beyond what common law says it 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 agent or attorney first.