"Indemnity – Will You Pay For My Problems?"

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The purpose of this Article is to document an alarming trend with which Design Professionals are all too familiar. This trend is Owners trying to impose more and more onerous indemnity provisions on Design Professionals. This trend shows no current sign of abatement. Both private and public owners are increasingly attempting to impose extremely problematic indemnity clauses which can present a difficult dilemma for Design Professionals: sign on the dotted line or walk away from the work.

What Is Indemnity?

Indemnity is legal jargon for a way to shift the risk for a particular problem that might arise on a construction project. The variety that we are concerned with for purposes of this Article is "express indemnity" or Indemnity that arises from a Contract. An Indemnity provision contained within a Contract attempts to shift the risk for paying for the attorney's fees that will go into defending against a claim as well as the cost of fixing and/or providing a remedy for the claim. In most cases for an Architect, this means an Owner trying to shift the risk and cost for problems that can regularly occur on a construction project on to the shoulders of the Architect.

Going From Bad to Worse – An Alarming Trend

Just a few years ago, indemnity clauses appeared to be the exception, rather than the rule. Now they seem to be the rule, rather than the exception.

Historically, indemnity clauses in California were given shorthand titles. The clauses were traditionally labeled as Type I, Type II or Type III Indemnity Clauses. Type I was the most onerous of the clauses and Type III was the least onerous with Type II being somewhere in the middle. The authority allowing for Indemnity Clauses in Construction Contracts in California can generally be found at California Civil Code § 2782(a). Contained within this Code Section are the "magic words" whereby Owners attempt to push the envelope by imposing as onerous an Indemnity Clause as possible on a Design Professional without running afoul of the law. To paraphrase California Civil Code § 2782, an Owner can seek indemnity from a Design Professional so long as the Owner does not try to obtain indemnity for damages arising from the "sole negligence or willful misconduct" of Owner.

It should be pointed out that the Type I versus Type II versus Type III distinctions have generally fallen out of favor with the Courts in California. However, most attorneys still refer to the various clauses in this fashion. A Type III Indemnity Clause is the least onerous of all and generally provides that an Owner will be indemnified, defended and held harmless by a Design Professional from all claims that arise out of the Architect's negligence. The Type III Clause does not mandate that a Design Professional defend, indemnify and hold harmless an Owner from everything under the sun excepting only the "sole negligence or willful misconduct" of the Owner.

From a practical standpoint, the scope of what an Owner can seek indemnity from when it includes everything under the sun except things that arise from the Owner's "sole negligence or willful misconduct" includes just about anything and everything that can possibly happen on a typical construction project. To put it bluntly, if the Design Professional has signed an agreement which includes the most onerous

indemnity language that exists and thereafter there is a claim which triggers a demand by the Owner to the Design Professional for indemnification, the consequences can be dire. Under this scenario, even if an Owner is 99% at fault for a given problem, if the only thing that has been carved out from the scope of the indemnification provision is the "sole negligence or willful misconduct" of the Owner, the Design Professional could have an obligation to defend and indemnify the Owner for such a claim. To put some of this legal jargon in common English, the Design Professional would be exposed to all of the Owner's Attorney's fees as well as any dollars paid in settlement or as a result of a judgment against the Owner even if the Owner is 99% responsible for the problem. While this is clearly not fair, that could be the result under a Type I provision.

What About My Insurance – Won't That Take Care Of The Problem?

Professional Liability Insurers are well aware of the exposure created by these onerous indemnity revisions. Indeed, Professional Liability Insurance Carriers are paying closer attention than ever to contractual liability exclusions that exist within the typical Professional Liability Policy. What these clauses state, in essence, is that a Professional Liability Insurance Carrier reserves the right to not step in, defend, and pay a settlement or judgment on behalf of the Design Professional for liability exposure assumed by Contract. While the Professional Liability Insurance Carriers will still defend the architect or engineer for their own professional negligence, these same Insurance Carriers are not in the business of covering Architects or Engineers for poor decisions made in negotiating a Contract which substantially increases the Insurance Carrier's exposure over what the Insurance Carrier perceives as a reasonable risk to assume for the insurance premium paid.

The bottom line: You cannot sign an agreement with a bad indemnity clause and assume that your insurance will cover you.

What Solutions Are Available?

The simplest and most straightforward advice on the typical indemnity clause that an Owner is trying to impose on a Design Professional is to simply strike the clause. Unfortunately, this may be easier said than done. When this cannot be accomplished, a few other options should be explored.

One alternative is to modify the express indemnity clause so that it provides that the Architect or Engineer will indemnify the Owner for everything except the Owner's negligence or the negligence of the Owner's agents, contractors, subcontractors, etc. Essentially, when faced with the onerous Type I Indemnity Clause, negotiate it to the more equitable Type III Clause. Practically speaking, this is a fair and appropriate way to deal with indemnity clauses because the Design Professional is agreeing to defend the Owner in the event the Design Professional made an error or omission but does not mandate that the Design Professional defend or indemnify an Owner for the negligence of the Owner or its agents or its hired independent contractors such as the general contractor or subcontractors. In many instances, this may be as simple as striking the word "sole" from the clause but be careful! In this regard, it is recommended to consult with your attorney on how to best change the clause to protect your interests.

If the Owner still balks at this type of compromise then one other possible solution is to demand that a reciprocal indemnity clause be put in place such that the Owner will defend, indemnify, and hold harmless the Design Professional from everything except the Design Professional's sole negligence or willful misconduct. Typically, the two indemnity clauses will appear sequentially in any Contract and this should allow some protection for the Design Professional in the event a claim is made which results in a demand

for Indemnity directed to the Design Professional by the Owner. At that juncture, depending on the facts of the given situation, a counter demand can be made to the Owner that it defend, indemnify and hold harmless the Design Professional. This option provides some balance.

Is There A Better Solution To This Problematic Trend?

Given the current trend of onerous indemnity clauses, the best long-term solution is the one where Legislation is enacted in California. As envisioned, such a law would make unenforceable any Type I express indemnity clause. This is the only fair long-term solution. However, getting the Legislature interested in taking on such a cause has been difficult. The fact of the matter is that the Legislature in California has its eyes on so many other important things that it has, thus far, been unable or unwilling to tackle this extremely serious/dangerous trend facing Design and other Construction Professionals in the State. Indeed, Subcontractors face the same type of clauses imposed on them by General Contractors and General Contractors also face the same type of clauses imposed by Owners. Engineers are also facing the same onerous provisions on a regular basis. In the opinion of this author, until such time as those affected band together as a coalition to push this Legislation, all affected parties will continue to face onerous indemnity provisions on a regular basis.

Conclusion

In the short term, when faced with an onerous Indemnity Clause, do your best to negotiate a way out of it. You should always consider consulting with your attorney when dealing with Indemnity clauses as well as other potentially onerous clauses that may lurk within contracts that have been presented to you for consideration. However, the only effective long term solution to the current trend of increasingly onerous indemnity provisions involves legislation.

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NOTE: This article is intended for general discussion of the subject, and should not be mistaken for legal advice. Readers are cautioned to consult appropriate advisors for advice applicable to their individual circumstances.