

## Indemnification: How to Identify Unacceptable Risks and Get Them Out of Your Agreements

© 1991 by F. David Shipley\* and David W. Lakamp\*\*

To indemnify means to stand in the shoes of someone else--to assume a responsibility that would otherwise be theirs. An insurance contract is an indemnity agreement. In return for the payment of a premium, your insurer agrees to stand in your shoes in the event of a covered loss.

When you agree to indemnify one of your clients, you become, within the scope of the indemnity provision you sign, an insurer of your client's losses. Your own insurance may or may not respond to the obligations you assume. Knowing this, most architects and engineers approach indemnification agreements with great care.

It is, nevertheless, common for clients to hand over drafts of those agreements demanding that you assume an unhealthy or an uninsurable portion of their risk of loss. It makes no sense to do either. In fact, there are times when it would be far more appropriate for your client to indemnify you.

Everything is negotiable, and the indemnification provisions served up to you by your clients are no exception. The key lies in knowing where (and how) to draw the line. The last issue of ***ProNet Practice Notes (Vol. 4, No. 1)*** gave you the skills to identify the coup counted through indemnification. This issue stakes out the limits of the insurance available for your financial security and gives you tools for holding the line at those limits in your negotiations with your clients.

### I. WHERE INSURANCE ENDS

Indemnity language can be convoluted and arcane, but the intent is clear: It is to shift risk. The stakes can be high, and the terms and conditions of indemnity obligations you are asked to undertake are vitally important to you.

There is no reason to assume the first terms offered will be fair. Indemnification provisions are drafted by attorneys whose principal concern lies in advancing the interests of their clients (who, paradoxically, also happens to be yours). Fairness generally emerges only when you make it a specific issue.

Consider this typical example:

*To the fullest extent permitted by law, the Architect/Engineer shall hold harmless, indemnify, and defend the Owner, its officers, directors, representatives, designees, agents, and employees from and against any and all claims, demands, actions, suits, losses, liabilities, expenses, and costs, including, without limitation, attorney's fees and costs, directly or indirectly caused by, connected with, attributable to, or alleged to be caused by, connected with, or attributable to:*

1. the performance of services under this Agreement by the Architect/Engineer,

- its officers, employees, agents, and consultants,
2. willful misconduct by any of them,
  3. infringement of any copyright, trade secret, or patent,
  4. breach of any term or condition of this Agreement, or
  5. violation of any state, Federal, or local law, code, ordinance, or regulation, including, but not limited to the Americans with Disabilities Act of 1990.

Excepted from the foregoing shall be only those claims, demands, actions, suits, losses, liabilities, expenses, and costs caused by the sole, active negligence of the Owner.

Good Grief! You do not need an advanced degree in a dark science to know there are problems here. The difficulty lies in separating the wheat from the chaff, and we will tackle this problem in Chapter II. But, before we do, we need to examine the principles involved.

### ***Something is Not Quite Right***

Let's start with what your intuition already tells you. This provision is not one you can reasonably accept. It expands your potential liability well beyond your responsibilities under the common law, it establishes a requirement (defense of the owner) you are unlikely to be able to meet, it invites the owner to sue you at your expense, and it places you in an untenable position of responsibility for negligence on the part of your client. It imposes, in other words, risks no professional liability insurance carrier in the United States will insure.

To understand why, it is important to keep this in mind: Your professional liability insurance is intended to protect you against the consequences of your negligence. This is the limit of your professional obligations under the law. Your policy is not intended to protect your clients (or anyone else) against the consequences of theirs. As a result, it will not protect you against liability of others you voluntarily assume under contract, liability which would not be yours in the absence of that contract.

Under the common law, it generally takes more than a mere error in professional judgment to establish liability for damages. The law requires the proving of negligence. Under most circumstances, only after the experts have convinced the court of your failure to provide usual and customary professional care is a finding of negligence justified. It is against this eventuality (and only this) that your professional liability insurance indemnifies you.

The law affords you significant protection, for professional negligence can be extremely difficult to prove. But you can cast that protection aside (and the protection of your professional liability insurance along with it) with the stroke of a pen. You need only sign a contract which makes you responsible, not just for losses and costs arising out of your negligence, but for losses and costs arising out of anything that might somehow be attributable to something you do.

## ***Will Your Insurance Respond?***

Your professional liability insurance is carefully tailored to remain within the limits of your obligations under the law. It will not venture beyond that. What if your indemnity strays beyond legal fences? Let's take a look at what can happen.

Indemnification is enforced, first, with a demand. When confronted with a claim or a loss believed to fall within the scope of your agreement to indemnify, the indemnitee (the party you signed up to protect) will demand that you undertake its defense and pay any eventual loss. If your insurance company accedes to the demand, the company will have been responsive to your needs. You are inside legal fences. If the demand is rejected, you and your attorney must decide if you are best served by accommodating the demand on your own. The insurance company will have seen the fence and decided not to cross it.

Indemnification is enforced, secondly, by legal action. If you and your insurance company reject your indemnitee's tender, or if your insurance company denies coverage, you may all find yourselves in court to sort it out. At least three law firms will be very pleased. You will not be. Nor will your client.

Plainly, you will both want to know, in advance, whether your insurance company will respond to an indemnity obligation you are asked to undertake. Your best suit can get ripped badly crossing fences. All reputable insurance brokers and carriers offer contract review services, and you should use them. Coverage is a question capable of a reasonably clear answer. Ask for one. In the example above, the answer is clearly, "No. "

Coup is counted here, and where there is coup, there is no insurance.

## ***When the Policy Speaks, Listen***

Professional liability insurance and contractual liability are pieces of a puzzle whose curves and hooks must match.

There are two key features common to all professional liability policies: 1) the manner in which coverage is granted under the Insuring Agreement, and 2) an exclusion of liability assumed under contract. Either feature alone argues against indemnification. But, if you must address it, you will want to proceed with great care. A professional liability policy affords a very narrow scope of protection; it is a rifle shot which picks off the one good agreement in a field of many very bad ones.

Generically, the Insuring Agreement will read something like this:

*The Company will pay on behalf of the Insured all sums in excess of the deductible which the Insured becomes legally obligated to pay as damages as a result of a negligent act, error, or omission in the performance of professional services.*

Note the precision here: Coverage is afforded only for your legal liability for damages and, more particularly, only to the extent that liability is caused by your professional negligence. When you assume the liability of others under an indemnity agreement, the peril is your own.

Insurance companies reinforce their intent by means of an exclusion found in all professional liability policies--an exclusion of liability assumed under contract. The language varies from one policy to the next, but the intent is the same:

*This policy will not provide coverage and will not pay claim expenses or damages for:*

Any liability you assume by contract or agreement, whether written or oral. This includes hold harmless and indemnification provisions and agreements to defend and/or pay the attorney fees of others. We will, however, cover you for any assumed liability that would have been yours in the absence of such contract or agreement.

When you read the Insuring Agreement together with the contractual liability exclusion, you wind up right back where you started: Coverage is afforded only to you and only for your legal liability for damages caused by your negligence in the performance of professional services.

### ***Adding a Little More Coverage***

Most insurers will amend the contractual liability exclusion by endorsement to "broaden " (we use the term advisedly) the coverage afforded by the policy. Some include the broadened language in their basic policy wording, thus eliminating the need for an endorsement. In either case, they afford what is termed "limited contractual liability " coverage. It is, indeed, "limited. " By way of example:

#### **1. An endorsement designed to modify the exclusion set forth above to grant limited contractual liability protection might read as follows:**

*We will cover you for liability for damages you assume under a written contract or agreement, but only to the extent such liability arises from your negligent act, error, or omission in the performance of professional services.*

Except as described above, we will not cover you for liability assumed by you under any contract or agreement, whether written or oral, including, but not limited to, hold harmless and indemnity clauses.

or:

#### **2. Limited contractual coverage can be built into the exclusion itself:**

*This policy will not provide coverage and will not pay claim expenses or damages for:*

Liability of others which you have assumed under a contract or agreement. This exclusion does not apply to the liability of others which you assume under a written contract provided such liability is caused by your wrongful act.

(Note: "Wrongful act" is defined in this particular policy as "a negligent act, error, or omission by you or any entity for whom you are legally liable, arising out of the performance or failure to perform professional services. ")

The principal purpose served by this coverage is to make clear that you need not secure an endorsement for each indemnification agreement you sign. Limited contractual liability coverage may also, depending upon its precise wording, afford protection for an obligation you assume to pay defense costs incurred by an indemnitee--but only to the extent those costs are attributable to your proportionate responsibility for the damages sustained. This eliminates the uncertainty which exists between one jurisdiction and the next about whether those defense costs are, in fact, damages.

Bottom line here: You cannot obtain professional liability insurance except for your legal liability arising out of your negligent acts, errors, or omissions. Damages caused by your client cannot be insured under your policy. The whole of any damage caused by both you and your client can not be insured under your policy. This is an exercise that always takes you back to the place where you began. With the possible exception of your obligation to pay costs of defense attributable to your negligence, it is the same place the common law would leave you even in the absence of an indemnity agreement.

### ***Is There No Good Chain Gang?***

Really, there is none, and there are no truly good indemnity clauses, either. But there are good times and there is hard time, and some indemnity provisions are more acceptable than others. Those which count no coup share characteristics you can identify:

- Indemnity is limited to damages...
- caused by you...
- as a direct consequence of...
- your negligent act, error, or omission.

Every other form of indemnification expands your liability, but it will not expand your insurance company's responsibility to you. Other people's children will go to college, and their parents are attorneys.

## **II. WHERE INDEMNITY LURKS: WHAT IT PORTENDS**

Indemnification provisions might be boldly positioned in a contract or devilishly hidden. It is up to you and your legal and insurance advisors to uncover them and sort out what they mean. There might be more than one.

Your first challenge is to identify them. Once you do, you have three options: You can reject them, you can satisfy yourself that there is insurance coverage, or you can negotiate for consistency with the scope of your insurance protection. Proceed with caution. Your interpretation of the language and the coverage you have must be correct each time.

The previous chapter defined the limits of the professional liability insurance protection available to you and tied those fence lines to the limits of your common law responsibility. This chapter will help you

distinguish between the onerous and the innocuous in the indemnification provisions with which you find yourself confronted.

## *Separating Wheat from Chaff*

Let's apply a thresher constructed of the principles uncovered in Chapter I to the indemnity provision we harvested there. Then we can see what digestible grains remain.

### **1. "To the fullest extent permitted by law... "**

The problem here is that the law governing contracts for construction in most states is more permissive than the coverage afforded by your insurance. Those who have read "Counting Coup " will understand why: The law generally permits indemnification which extends well beyond your negligence. Your legal liability and your insurance fence the field of your negligence, but the law may enforce a fence which encloses that and the field of harm caused by others, as well.

Some laws prohibit indemnification against the consequences of the sole (and, in some cases the sole, active) negligence of others. If there is no harm in your field, you cannot be made to answer for harm in the field of someone else. But, if there is 1% harm in your field, you could be made to answer for the 99% harm in the field of another. Coup is counted on you at 1%.

Since "the fullest extent permitted by law " is inconsistent with where we are headed in our quest for fairness and insurability, these words have no place in your agreement. Take them out.

### **2. "...and defend... "**

What does it really mean when you agree to defend as well as indemnify? It means that, long before any legal liability is established, you have an obligation to retain an attorney and mount a defense on your client's behalf. Under most circumstances, this is an obligation your insurer will likely refuse to accommodate. Remember, contractual liability coverage may afford compensation for defense costs once negligence is established, but, absent negligence, there is no coverage.

As a practical matter, the problem may well go away once the specific circumstances surrounding a loss are known. It may not be in your client's interest to pursue your obligation to defend. On the other hand, your refusal or inability to retain counsel on behalf of your client could fuel the fires of the dispute. "Add it to the list" is an appropriate response here, but added fuel is not what is needed in a situation in which the interests of the parties might better be served by putting out the fire.

Indemnify your client against costs of defense attributable to your negligence, if you must (and if your insurance stands behind it), but avoid agreeing to mount that defense if you can. That commitment is likely to be contrary to everyone's interests in the long run.



### 3. "...representatives, designees, agents... "

Indemnification is serious business, far too serious in terms of its consequences for the owner's attorney to trivialize it by throwing in the kitchen sink. Who are these fine folks, and why should you stand in their shoes in the event of a loss?

Anyone can be transformed into an agent at any time. "Zap, you're an agent! I designate you " is all it takes. The same holds true for a representative or a designee. Accept this language and you may find you have agreed to indemnify an army of unknown and unwelcome beneficiaries--the construction manager, for example, or the owner's nephew, or a trip and fall victim the owner would prefer to have you compensate regardless of fault.

Delete these words and all like them. If you encounter resistance, ask for a list of those representatives, designees, and agents your client believes to be appropriate recipients of your largesse. At the very least, you deserve to know who they might be. Nor is it stretching the limits of fairness for you to insist on the opportunity to evaluate, in each and every case, the appropriateness of extending the security of your indemnification to any of them.

This is not necessarily a make or break proposition, at least not in states where the protections of privity have long since been swept away. If the balance of your agreement to indemnify is limited to the consequences of your negligence, and if representatives, designees, or agents of the owner are damaged by your negligence, you are likely to have legal liability for those damages, and your insurance is likely to respond.

You might ask yourself, nevertheless, whether you are willing to put your deductible on the line, undertake obligations with potentially serious consequences, and concede significant negotiating leverage in the event of a loss--all for the benefit of some third party with whom you have no contractual relationship, from whom you receive no consideration, and who you do not even know. Probably not.

### 4. "...any and all claims, demands, actions, suits... "

Attorneys are overly fond of absolutes. Otherwise, they would stop using "of every kind, nature, and description" as if it were punctuation. Absolutes leave room for argument where clarity is the only appropriate goal. You know by now that where you have to be when your negotiations are over does not include "any and all" losses, nor does it include "claims, demands, actions, or suits. " It includes only those damages for which you are legally liable.

Losses, liabilities, expenses, and costs are damages for which you could be legally liable if they are caused by your negligence. Even attorneys' fees may be construed to be damages in some states, and, where not, your limited contractual liability coverage may well respond. But claims, demands, actions, and suits, in and of themselves, are not damages, and the mere fact that they occur may or may not have anything to do with your negligence.

This is not a make or break proposition, either, but clarity of intent finds offense in these words and the absolutes which precede them. Best they be deleted.

## 5. "...directly or indirectly..."

This phrase is clearly at odds with one of the four characteristics of indemnity which counts no coup. Your responsibility under the common law ends with proximate cause (a direct consequence of your negligence), and your indemnification should end there too. This is chaff. It should not pass through your principled thresher.

## 6. "...connected with, attributable to, or alleged to be caused by, connected with, or attributable to..."

Hold it! You are not in a position to assume responsibility for 100% of any loss to which you may have contributed in some way. Nor, absent negligence, are you willing to spring forward and start throwing money around in response to each and every allegation of wrongdoing that may come along.

You are not negligent until you are found by a court or forum of competent jurisdiction to have been negligent. It follows that you cannot insure against costs incurred by someone else as a result of mere allegations of negligence on your part. Even if you are found to have contributed to a loss through your negligence, your insurance will respond only to the extent of that contribution. The contribution of others is their problem, and the language of your agreement to indemnify should be as clear on this point as you are. Delete these words.

## 7. "...the performance of services..."

There is a serious omission here, and by now you know what it is. The word "negligent" is missing. Without it you will find yourself responsible, not just for losses for which you are legally liable, but for losses arising out of anything that might be related to the services you perform.

You can safely agree to accept responsibility for the consequences of your negligent performance, but only at great peril can you agree to accept responsibility for losses of any kind which may somehow be associated with your existence on earth. The distinction: Liability for losses which would not otherwise be yours. It is here that you will want to limit the scope of your indemnification agreement to the consequences of your negligence, and you can easily do so by inserting "negligent" in front of the word, "performance."

What about your agents and consultants? By virtue of your position in the line of fire, you may well be legally liable for their negligent acts, errors, and omissions under a theory of vicarious liability--just as the owner may be liable for yours by virtue of having contracted with you in the first place. This explains the owner's interest in your indemnity agreement. It also explains your insurer's interest in the Certificates of Insurance you obtain from your consultants, and it argues for passing the obligations you assume under your contract through to them. If you keep those obligations within the maximum limits of fairness, there should be no problem with this.

## 8. "...willful misconduct by any of them..."

If you are willing to extend indemnification for your negligence (harm inadvertently caused), why is it unfair to extend indemnification for harm intentionally done? This is presumably something you can



control, and the case from your client's point of view would seem more compelling for intentional harm than for negligence.

Your reluctance is due to the absence of insurance for either damages or defense costs arising out of harm intentionally caused, but that will not be persuasive to your client. Any argument you might have against indemnification for willful misconduct probably must spring from the general unfairness of wild western courtrooms, where anyone can sue for anything and say the most outrageous things in the process of doing so. You might frame your argument like this:

"I cannot pay all the bills to support the vagaries of the legal system we have in place. I buy insurance for the bulk of my risk, but if some cockeyed plaintiff alleges that I practice my sacred trust in a way to intentionally hurt another as a tactic to embarrass me or pressure me into an unjustified settlement, I decline to compound my problem by taking on the cost of defense of clients, their officers, directors, employees, agents, designees, friends, acquaintances, and playmates of their children. That plays into the hands of the unscrupulous who would claim intentional harm to gain a choke hold on me. If you think I would intentionally harm another soul, then we have a great deal more talking to do. Sorry, but there are limits. This is one of them. "

## **9. "...infringement of any copyright, trade secret, or patent..."**

Copyright infringement is one of those wrongs needing no proof of intent, negligence, or any evil behavior save the infringement itself. So are trade secrets and patents. This is truly a problem. There is no place where the borders of anyone's copyright or trade secrets are recorded. One can register a copyright, but it is not necessary to do so in order to claim one. Patents are registered, but you are neither qualified, nor compensated to conduct the legal research which would be necessary for the peace of mind your client would have you guarantee.

Owners can easily argue that, if there is infringement, the loss should not fall on them. They did not infringe--you did. Your argument is this: Where rights are vague and their limits nearly undiscoverable until the court decides who is on the wrong side of them, defending against an allegation of infringement is an everyday risk for everyone. It is not a risk you can reasonably control, and it is not one you can reasonably be expected to assume. Moreover, it may be excluded from coverage under your professional liability insurance policy. Whether it is or not, you will want to delete this obligation. Indemnification for your legal liability arising out of your negligence is the most you can reasonably concede.

## **10. "...breach of any term or condition of this Agreement..."**

Negligence may be difficult to prove, but breach of contract is not. To establish a breach, all an owner need do is prove that 1) you owed a duty to perform under your agreement, 2) you breached that duty, and 3) damages were sustained as a result. This is your client's fall back position in the event negligence turns out to be impossible to establish. It is also your invitation to the owner to sue you at your expense.

There is great leverage in this, and it flows in a single direction--from you to your client. Your client sues you for breach of contract, and you pay the associated attorneys' fees and costs. Arguably, this is inconsistent with public policy. Public policy generally demands mutuality as a matter of equity where

there is an agreement by one party to pay the attorney's fees of another regardless of the outcome of a dispute between the two.

Attorney's fees are the only issue here, for if you are found to have breached your contract, there is a remedy for that in the law. As far as you are concerned, it is neither necessary, nor is it appropriate for you to add your indemnity to that remedy. Absent negligence, your indemnification for breach of contract may be uninsurable; absent mutuality, it is unfair. Delete this language if you can.

If you encounter sustained resistance, you might invoke the public policy argument and propose, as an alternative, to substitute language elsewhere in your agreement calling for the non-prevailing party to any dispute to compensate the prevailing party for costs of defense. There is leverage in this for you, but there is also some risk. Seek the advice of counsel before you pursue this strategy.

## **11. "...violation of any...law, code, ordinance, or regulation... "**

You cannot possibly know or even come to know all of the laws, codes, ordinances, and regulations which may somehow have a bearing on your project. Nor, within a standard of usual and customary professional care, is it necessary that you do. Even those you must know about contain inherent conflicts, and they require the exercise of professional judgment in their application to the unique circumstances surrounding each and every project you undertake. Code officials change, and interpretation changes with them. Judgments are made, but certainty is unavailable.

This obligation has no place in an indemnity provision. Delete it here. If you must address it elsewhere in your agreement, well and good, but keep this in mind: The most you can reasonably concede is to agree to exercise usual and customary professional care in your efforts to comply with the law.

This applies to all laws, codes, ordinances, and regulations, but it is particularly applicable to the Americans with Disabilities Act and the regulations which have been drafted to implement it. Whether your interpretation of the requirements of this far reaching legislation are accurate or not will depend on legal battles not yet fought. They will be civil rights battles, and coup will be counted on the fields of others. You will have no safe place there unless your responsibility begins and ends with the consequences of your negligence.

## **12. "...excepting only...the sole, active negligence of the Owner."**

Never mind that it may be permissible under the law in most states. You know by now that it is neither reasonable, nor insurable for you to assume 100% of the liability for losses for which you may be only partially responsible. Nor does the distinction between active and passive negligence fall within the boundaries of reason (for more on this, see "The Innocent Bystander" in Chapter III). You cannot insure against the risk that your client may contribute to a loss, regardless whether actively or passively, but your client can. Best you delete these words and leave this risk where it belongs.

## ***A Relatively Safe Haven***

In the final analysis, how far can you reasonably go in your agreement to indemnify? Not very far, and certainly not beyond the protection afforded under your professional liability policy. Here is the product of an acceptable mark-up of the unacceptable provision with which we started:

*The Architect/Engineer shall hold harmless and indemnify the Owner, its officers, directors, and employees from and against losses, liabilities, expenses, and costs, including, without limitation, attorney's fees and costs, caused by the negligent performance of services under this Agreement.*

This truly brings us full-circle, for what we have left amounts to little, if anything, more than what is already required of you under the common law. But, with the exception of some manageable legal and insurance-related refinements, it is the most you can reasonably concede.

It may seem as if a great deal of effort is wasted to produce a result that would have been achieved had the issue never been raised in the first place. Negotiations are sometimes like that. This is a strong argument in support of legislative remedies against the predations of the powerful. Absent those remedies, however, you have little choice but to respond. Once raised, indemnification is an issue you can ill-afford to ignore.

## ***Practice, Practice, Practice***

This isn't a "practice " note for nothing. This section is your opportunity to test your skill at spotting coup, uninsured risks, and other offensive features. All of the following provisions are foul, and you will know the reasons why. Study how the words in italics broaden your obligation from legal liability for negligence to an assumption of liability for all manner of harm:

1. The Architect shall ***defend***, save and hold harmless, and indemnify the State and the Department, its officers, ***agents***, and employees, from ***all claims, suits, or actions of whatsoever nature*** resulting from or arising out of the ***activities*** of the Architect or the Architect's consultants under this Agreement.
2. Consultant acknowledges responsibility for liability arising out of the performance of this agreement and shall hold County harmless from and indemnify County for ***any and all*** liability, settlements, loss, costs, and expenses in connection with any action, suit, or claim resulting ***or allegedly resulting*** from ***activities under or services provided*** pursuant to this Agreement.
3. Engineer agrees to ***defend***, indemnify, ***protect***, and hold City and its ***agents***, officers, and employees harmless from and against ***any and all claims asserted*** or liability established for damages or injuries to any person or property, including injury to employees, agents, or officers of Engineer, ***which arise from or are connected with*** or are caused ***or claimed to be caused*** by the ***acts or omissions*** of Engineer and its agents, officers, or employees, in performing the work or services herein, and all expenses of investigating and defending against same; provided, however, that the duty of Engineer to indemnify and hold harmless shall not include any claims or liability arising from the ***established sole negligence*** or willful misconduct of City, its agents, officers, or employees.

4. **To the fullest extent permitted by law**, Consultant shall indemnify and save harmless State and all of its officers, agents, and employees from all **suits, actions, or claims of any character** brought for or on account of any injuries arising from the negligent acts, errors, or omissions of Consultant in prosecuting the work under this Agreement, **whether or not State is negligent or otherwise culpable**.
5. Contractor shall indemnify and hold City, its officers, **agents**, and employees, harmless from and against **any and all claims, actions**, liabilities, and costs, including costs of defense, **arising out of the work or other actions or failure to act by Contractor** and Contractor's employees, agents, officers, and Subcontractors. In the event any such action or claim is brought against City, Contractor shall, if City so elects upon tender by City, **defend the same at Contractor's sole cost and expense**, promptly **satisfy any judgment adverse to City or to City and Contractor, jointly**, and reimburse City for **any loss, cost, damage, or expense** (including legal fees) suffered or incurred by City.

### III. HOLDING THE LINE AT THE MAXIMUM LIMITS OF FAIRNESS

"It is uninsurable, " you point out patiently. "So what? " is the response. Stay calm. There are compelling reasons you can give for refusing to assume liability which properly belongs to someone else. Consider these: 1) There is no historic rationale for indemnification by architects and engineers; 2) it has no economic justification; and 3) it has no basis in law or in equity.

To understand how you might use these arguments successfully, it may be helpful to take a close look at the frames of reference within which demands for indemnification are typically advanced by your clients and their attorneys. There are three. Each is grounded in faulty reasoning. Your knowledge of the flaws can help you formulate an effective response.

#### *The Construction Paradigm*

The model is the construction contract. The mindset is based on the ill-considered notion that protections for the owner which are readily available from general contractors can somehow appropriately be imposed on the design team. Architects and engineers are, after all, part of the same process. Why should they be treated differently?

The answer is simple. The law treats them differently. Contractors build improvements on real estate, and there is long standing law on that. Their work is subject to a guarantee. They are obligated under the law to stand behind that work, and they are generally held responsible for damages caused by their faulty workmanship.

Architects and engineers do not build. They perform professional services, and there is long standing law on that, too. They are not obligated under the law to guarantee their performance, not even its result. They are generally held responsible only for those damages caused by their failure to exercise reasonable professional care.



## ProNet Practice Notes

The historic and economic rationales which support indemnification by contractors simply cannot be applied to the design team. The historic rationale is based on the principle that, when one party, for its own economic benefit, takes possession and control of the property of another, the associated risks ought reasonably to follow. The economic rationale is equally straightforward: Because general contractors are better positioned than owners to control the risks of construction, they can more efficiently either manage those risks, or transfer them to subcontractors or insurers. In either case, the costs are measurable, and they are easily passed through to the owner.

Architects and engineers do not assume control of the property of the owner in a construction project, nor that of anyone else. Beyond responsibility for the consequences of their own negligence, they are not in a position to control, nor can they insure against the owner's risks. The costs are not measurable; passing them through to the owner is out of the question.

The Construction Paradigm does not apply to architects and engineers any more than it does to attorneys who practice law in the construction arena. This is a point you may want to stress. The attorneys with whom you negotiate and with whom you share a client will understand exactly what you mean, and they will know you are right.

### ***A Fall Back Position***

There is an insurance-related refinement worth mentioning in the context of the mind set of counsel who are fixed on The Construction Paradigm. It has to do with the coverage afforded the general contractor under a typical general liability insurance policy (and to you under yours).

If you must, you can agree to defend the owner and to assume liability for the owner's contribution to a general liability loss in which you share responsibility. You can do this because the contractual liability coverage afforded under most general liability policies will provide coverage for this risk. If you need room to maneuver, and if this issue is clogging progress in your negotiations, you might suggest separating your indemnification into two parts.

The first would relate to the performance of professional services, and you can make your intent clear on this simply by inserting "professional" before "services" in the marked-up provision above. Then you might propose an additional provision, one drafted using words which track those proposed by your client as closely as the coverage under your general liability policy will allow. In this particular case, that language might read as follows:

*As respects its operations under this Agreement other than the performance of professional services, the Architect/Engineer shall, to the fullest extent permitted by law, hold harmless, indemnify, and defend the Owner, its officers, directors, and employees from and against any and all claims, demands, actions, suits, losses, liabilities, expenses, and costs, including, without limitation, attorney's fees and costs, arising out of injury to any persons, including death, or damage to any property caused by, connected with, attributable to, or alleged to be caused by, connected with, or attributable to the negligent acts, errors, or omissions of the Architect/Engineer or its officers, employees, agents, and consultants under this Agreement, excepting only those claims, demands, actions, suits, losses, liabilities,*

*expenses, and costs caused by the sole negligence of the Owner.*

Note some important changes here. The owner's agents, representatives, and designees have been eliminated. The scope of the indemnity is limited to bodily injury and property damage because the coverage of the general liability policy is generally so limited. This excludes economic loss, a risk which is covered under your professional, but not your general liability insurance policy. For the same reason, the indemnity is limited to the consequences of your negligence, and, "to the fullest extent permitted by law " notwithstanding, the word "active " has been deleted from the exception applicable to the owner.

### ***The Innocent Bystander***

Those who cloak themselves in the robes of The Innocent Bystander are usually public entities. They characterize their role in construction as passive, and from this they draw the conclusion that, if there is risk involved, it must belong to someone else.

The conclusion is false, at least in part because the assumption is wrong. No design could go forward without active participation on the part of the owner. That participation has a direct bearing on the degree of risk involved. Cost/benefit tradeoffs and the difficult decisions they require of the owner are examples; so, too, is selection of a contractor whose low bid is unrealistically out of line.

You might ask The Innocent Bystander: "Who is going to make these vitally important decisions? Who reasonably ought to take the associated risks?" The owner, of course--even if the owner is a public entity.

It cannot be reasonably argued that you should assume the greater risk because you happen to operate "for profit " in the private sector. Every owner faces enormous risk in construction. Every owner anticipates a profit commensurate with that risk. Otherwise, the project would have no economic justification in the first place. For public entities, "profit" takes the form of beneficial use of the facility by the public, enhanced political careers, and the reaping of bureaucratic bounty.

Architects and engineers are retained to help to reduce the risks of construction and enhance the gain, but they can neither eliminate the former, nor guarantee the latter. Their profit pales in light of the value of beneficial use, and it is ingenuous to assume that the risks somehow ought to be transferred from the public to the design team because the latter is actively involved, whereas the former wrongly presume themselves passive.

### ***"Take It or Leave It!"***

This is a strong-arm tactic. It is usually adopted by clients prepared to press the advantage of a superior bargaining position. Their point of view is this: "Those who are privileged to work for us can accept our terms, no matter how onerous. If you choose otherwise, so be it. Thousands are standing in line to take your place. " It is called winning by intimidation.

Do not be intimidated. "You will simply have to accept it as a cost of doing business " is a ridiculous posture for any client to assume. You are not an insurance company, and you are not in a position to collect a premium for assuming someone else's risk. Nor can you insure against that risk. What your client stands to gain by imposing a requirement which deprives you of your financial capacity to respond in the



event of a loss is difficult to understand. From both your points of view, it makes far more sense to reach a fair, equitable, and enforceable agreement and move on.

Persistence, measured calm, right reason, and the knowledge that you were not selected out of the Yellow Pages should get you past this barrier. If not, you may be better off in the end if your "Take It or Leave It" client were to turn to that throng of thousands out there. Keep in mind, as you consider this option, that it will not be easy, nor will it be inexpensive for your client to effect a change once you have been selected. Keep in mind, as well, that time is usually on your side. The more protracted your negotiations, the more negotiating strength you gain.

#### IV. A FINAL WORD

As more and more owners, public and private alike, find themselves facing risks they do not care for, you can expect the pressures on you to assume those risks to increase. The stakes are high, and they are rising. But, if there is coup to be counted, it need not be on you.

Sharpen your skills on this issue of ***ProNet Practice Notes***, but do not hesitate to seek the advice and assistance of a knowledgeable attorney and a competent insurance professional. Indemnity provisions involve legal and insurance complexities which can only be addressed by skilled advisors, and they pose negotiating challenges your attorney and your insurance broker can be of great help to you in meeting.

---

\* Since 1996, F. David Shipley has been President of Shipley & Associates, Inc., located in Portland, Oregon. At the time this article was written in 1991, Mr. Shipley was a Vice President of Willis Corroon in Portland. His Firm specializes in the Risk Management and Insurance needs of the design and design/build Communities in the Northwest. Mr. Shipley is a founding member of a/e ProNet and serves as its national Treasurer.

\*\* David W. Lakamp is President of Professional Practice Insurance Brokers, Inc. and a founding member and former President of a/e ProNet. He has specialized in professional liability insurance and risk management for the design professions for the past fourteen years. He writes from his office in Redwood City, California.