

Q&A on Contractual Indemnification Agreements

Virtually every contract an architect, engineer, or contractor signs includes some form of indemnification agreement. Recent years have seen increased demands by potential clients for indemnification against claims, losses, liabilities, and more that exceed the professional liability and breach of contract exposures firms have faced in the past. In this article we address some of the more common questions we hear on a regular basis.

Question & Answers

1. At what point in the client relationship or in contracting for a particular job are these Indemnification requests generally received?

Answer: *Generally, this issue is raised at the time of the contract award and frequently the indemnification provisions are included in the request for proposal (RFP) even if the entire agreement is not.*

2. What is the process the firm uses, and who in the firm has the responsibility/authority, to review, negotiate and approve these provisions? How can this process be managed better?

Answer: *The best practice is for these provisions to be reviewed by whoever in the firm is in charge of risk management or by someone who works directly for him or her. In the larger firms, this would be the general counsel or someone in that office. In smaller firms, it is typically the CEO or a senior partner who has the overall interest of the firm in mind and who is emotionally detached from the chase of the project.*

3. Are there any types of liability or other particular provisions that an architecture and engineering (A&E) firm has more success in being able to remove or amend in order to reduce liability?

Answer: *A&E firms are reasonably successful in negotiating from a starting point of liability for any damages that arise from their services to liability for damages caused by their negligence. In other words, they are fairly successful in negotiating a negligence trigger into the agreement. They have much more difficulty in negotiating proportional responsibility—in other words, responsibility only “to the extent” that they cause the damage.*

Instead, if the design professional caused any portion of the damage, the client wants it to accept responsibility for all of the damage except that which the client itself caused.

4. Are there types of potential liability you will accept under an indemnity provision because you believe the risk of exposure is insignificant?

Answer: *Not really types of liability, but the type of assignment definitely has a bearing as does the fee amount. For example, a design professional is much more likely to accept an onerous indemnity provision if it is only commissioned to do a feasibility study since that type of assignment is highly unlikely to generate a claim. Similarly, clients that do only interior architecture may accept more onerous provisions. We have also seen clients take on more liability where the fee is rich. The theory is that they are being paid to take on the risk.*

5. Are there types of clients or industries that are more flexible than others with respects to amending these provisions or removing them completely?

Answer: *We really haven’t come across an industry that will remove indemnity provisions, but there is definitely a difference between how types of clients react. Clients that typically buy products, not services, are far less likely to agree to a reasonable indemnity provision. The reason is that products liability is typically strict liability; so in their world, a negligence trigger is unusual.*

6. What sort of “pushback” or arguments against including an indemnity provision are most successful?

Answer: *Under U.S. law, there is a “common law” indemnity implied in every professional service arrangement. That indemnity is for damages to the extent caused by the professional’s negligence.*

As such, there really isn't a good argument for not having an indemnity provision at all. The fight is usually over the breadth of it.

7. Are there any specific provisions that would always make a firm walk away from a contract if they were not removed / amended?

Answer: *One of the most difficult provisions is the duty to defend that you frequently find in such provisions. This duty is not required under common law; so if accepted, the duty becomes purely a contractual one. Most professional liability policies exclude coverage for contractual duties except where the contract merely confirms the common law duty. As such, if a design professional agrees to defend, then the cost of doing so is an uninsured cost. Many firms will not accept this responsibility because the cost is immediate and frequently substantial. In addition, U.S. does not have a "loser pays attorneys' fees" system; so the prospects of recovering this cost if the design professional prevails are slim.*

8. Have firms walked away from contracts that contained unacceptable indemnity provisions? Have they been able to do business with the same client thereafter without the client insisting on such a provision? In other words, did the hard-line position modify the client's position?

Answer: *Yes, we have seen firms walk away. Most of the time, as long as the design professional is taking a reasonable (but unsatisfactory) position, the client ultimately accepts that position because the client has chosen the design professional because of its technical capabilities, not because it will sign the contract.*

9. Under what circumstances and through what approval process should a firm sign a contract containing an indemnity provision, knowing that its

insurance coverage would not respond and that signing was a purely commercial decision?

Answer: *Where the fee is sufficient to cover the risk, where the risk of the project is minimal, or where there is great comfort in the people running the project for the client. The latter circumstance is tricky, though, because project personnel frequently change.*

10. Are there any tips/tricks that you could recommend when dealing with these provisions?

Answer: *A firm should start out by affirming the design professional's willingness to be responsible for damage that results from its doing something "wrong," which we sometimes call "culpable conduct." The firm should also ask the client if it expects the design professional to be perfect. Almost always, the response to that question is "No." Once those two points are established, getting to what constitutes culpability and how "wrong" the design professional can be, the issues usually work themselves out. We also would point out that it is in everyone's interest to have the design professional's liability to be insured, which is best accomplished with a negligence trigger.*

11. Under what circumstances and with what types of clients are these provisions negotiated between lawyers for both sides as opposed to management or administrative types?

Answer: *Usually, it starts with project people. The lawyers get involved if the discussion becomes too technical. There really isn't a type of client that changes the dynamics. In our experience, however, the larger the client is, the more likely that it will have a procurement department, a risk manager, or a legal department that handles the negotiations.*