



***Indemnification – A Contractual Sword and Shield, Tips on how to enter into contracts which leave design professionals well armed and well protected***

*Indemnification* is a legal term with which design professionals are generally familiar, but it is also a term that causes confusion and sometimes results in bad contracts for the unwary. In plain terms, indemnification is an Agreement to be responsible for the liability, such as errors and omissions, of another party. Indemnification clauses appear in owner-design professional contracts and frequently in design professional-sub-consultant contracts. These clauses should be read and understood fully. If they are unclear in any way, a design professional should seek the advice of an attorney.

Since indemnification provisions in contracts can shift the liability for losses on a project, it is essential that a design professional is aware of the scope and obligations imposed by any such indemnification language. Design professionals should remember that they do not need to sign form contracts submitted to them. A better practice is to negotiate or modify terms. If an actual negotiation of terms is not possible, design professionals can always resort to crossing out unfavorable indemnification clauses in form contracts supplied to them. Often, if a party gets most of its preferred form's terms agreed to, it may choose to not fight to maintain one or two stricken terms. If the work goes forward and payment is made, the stricken terms are generally deemed to have been accepted. Design professionals should not be shy about modifying or crossing out terms in form contracts that they view as unfavorable to their business.

In a perfect world, your company's contracts would require those you contract with for project work and professional services to indemnify your company broadly; while at the same time, your company has limited or eliminated its own indemnification obligations as thoroughly as possible. While this approach may not seem "fair" from a certain perspective, it is important to remember that today's litigious world requires that each company work aggressively to manage its own risk. Entering into agreements with terms favorable to your company is good business practice. Companies cannot be reluctant in limiting liability and protecting their own interests. Similarly, design professionals should never sign another entity's form contract without having it reviewed by an attorney or a contract specialist. The expense associated with a few minutes of review is often miniscule compared with the costs associated with defending a claim or a lawsuit.

If there is no in-house counsel or contract specialist, design professionals should have a general business attorney on retainer in order to review contracts. The attorney selected should have working knowledge of construction, AIA documents, and litigation. Additionally, some professional liability insurance carriers offer contract review services for their Insureds at no charge beyond the policy premium. If your design firm is unaware of these no-cost services provided by certain carriers, you should indicate to your broker that you would like a policy that encompasses these additional services when you are evaluating premiums as part of your company's next annual renewal.

In addition to rejecting indemnification provisions in form contracts received by your company for signature, there are other options for limiting indemnification liability. For instance, if a party refuses to eliminate an indemnification provision completely, at least attempt to rework the language so that it reads: "Indemnification is limited to the insurance coverage in place by your company at the time the contract is entered into."

A more advantageous clause would be to state that the parties to the Agreement have negotiated an indemnification provision where there is a limit to the indemnification amount. For instance, the Agreement could state that the parties have evaluated the Project and its risks, and have mutually agreed to cap indemnification liability at a negotiated amount. Obviously, the lower amount your company can negotiate, the less risk your company has.

A less-desirable option is a mutual indemnification Agreement. Mutual indemnification provisions evolved as a remedy to indemnification negotiations, and essentially say that each party to the contract indemnifies the other. Typically, these mutual clauses cause more problems than they solve, as they wind up being the subject of dispute and litigation. While a mutual provision might be offered to satisfy the insurance requirements of a well-known, longstanding client, aside from such rare circumstances, mutual indemnification clauses are best avoided.

If you are entering into a sub-consultant Agreement, ideally you would like language in the Agreement which states that the sub-consultant agrees to defend and indemnify your company, and further requires that the sub-consultant carry a certain level of Professional Liability and Commercial General Liability Insurance. Certificates of Insurance which supply proof of coverage should also be required in the terms of the sub-consultant Agreement.

If possible, there should be a term in the sub-consultant Agreement which requires the sub-consultant to identify the other contracting party as a “named” or “additional insured” on the sub-consultants’ policies. This is often overlooked and is sometimes admittedly difficult to bring about. However, on particularly large or risky projects, the additional attention to the detail in the contracting phase is well worth any additional effort.

Indemnification provisions also often contain the word *defend*. This places the obligation of legal representation upon the party agreeing to undertake the defense duty. If your company is being asked to defend as well as indemnify, you should attempt to avoid both obligations. The burden of defending is expensive and will be triggered even if there is no meritorious claim. Anybody can make a claim or file suit. Even if such a claim or suit has no merit, the costs involved defending such matters can be significant. Design professionals should get in the habit of crossing out any defense obligations in contracts entered into.

It is also a good habit to use your own company’s standard documents as frequently as possible. You should have a comprehensive variety of attorney-authored, or at least attorney-reviewed, proposals and agreements. Proposals should contain a one-page list of terms at the end which will govern in circumstances where a proposal is accepted, perhaps by performance or by Letter Agreement, but where no full formal Agreement is executed. An attorney can help draft an appropriate proposal add-on form specific to the needs of your business and typical clients. Having an appropriate range of business documents and agreements comes with a cost, and is an investment, but it is one which protects your business and gives peace of mind when undertaking a project.

Proposals and Agreements have far-reaching implications beyond the typical concerns of pricing and completion dates. Indemnification clauses are one example of how an unnoticed or un-negotiated term may create substantial exposure for an unwary design professional. In today’s slow economy, owners’ claims against design professionals are common, and such claims are complicated if the design professional has undertaken a broader duty to the owner of the project beyond responsibility for its own work.

### **Risk Management Prevention Tip**

Design professionals need to be proactive in managing their risk, and this includes being careful and selective about the terms and conditions to which they agree. The old adage that “bad contracts make bad claims” remains true. Design professionals should make certain they avoid bad contracts by negotiating their agreements effectively using their own customized attorney-created forms as often as possible, and by crossing out terms which are plainly disadvantageous to their business. Since clauses providing for the defense and indemnification of other parties are rarely advantageous, design professionals should seek out and delete those provisions in the normal course of entering into a project agreement.

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