

Design Professional Newsletter



THE GRAND FINALE: THE INDEMNIFICATION CLAUSE: WHAT IS IT AND WHAT CAN YOU DO ABOUT IT?

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Great American's Professional Liability's "Year of the Contract" is coming to an end. Over the last 12 months, we have dissected various contract provisions that should be carefully reviewed and analyzed to best protect design professionals when entering into project contracts. We saved the best for last: Indemnification. The indemnification provision of your contract can come in many shapes and sizes. Clients usually aim for the broadest of provisions, which in most cases, can mean an increase of exposure to design professionals.

What is "indemnification"? In the simplest terms, to indemnify another party is to compensate them for their losses. However, it does not end there. Most times, an indemnification provision includes a *defense obligation* as well, making the design professional responsible to defend their clients in the instance of a claim or a lawsuit *and* indemnify them against all losses. This can present a big exposure to design professionals and, most importantly, a typical professional liability policy does not provide coverage for defense costs of another party.

In addition, many times, the client/owner will increase the scope of indemnification to include an obligation to defend and indemnify other parties, such as the client/owner's agents, subsidiaries and affiliates. In some cases, the obligation will go as far as defending and indemnifying the contractor. It should be noted that a typical professional liability policy will only provide indemnification coverage for the party with whom the design professional is contracting.

To better understand some of the most common issues that arise from the contractual indemnification provisions often seen in insureds' contracts, please consider the following:

John Doe Architect enters into a contract with a developer, and the contract contains the following indemnification provision:

To the fullest extent permitted by applicable law, consultant [Insured] will indemnify, defend and hold harmless the company [Developer] from and against any and all loss, damage, costs (including, but not limited to, attorneys' fees, expert fees and expenses, and court costs, and any notification related costs arising out of a data breach, loss, or unauthorized access to data), or liability resulting from any and all demands, claims, suits, costs, fines, penalties, proceedings, or actions of any kind or character ("Claim") presented or brought against the company caused by, arising out of, or related to any act or omission of consultant or any representatives, anyone directly or indirectly employed by any of them (including any approved subconsultants and any persons directly or

indirectly employed by an approved subconsultant), or anyone for whose acts any one of them may be liable that is in any way associated with or connected with any obligation of consultant, right of company, or the work in whatever manner the same may be caused and regardless of whether the same may be caused by or arise out of the joint, concurrent, or contributory negligence of the company or any other persons or entities not a party to the contract; provided, however, if any claim is determined to have been caused by the sole negligence of the company, then consultant will not be liable under this General Indemnification section. A consultant's indemnity obligation will include, without limitation, court costs, attorneys' fees, costs of investigation, costs of defense, expert fees and expenses, settlements, and judgments associated with any Claims. Consultant will further be liable for the costs of repair or replacement of any property of the Company that is damaged by any act or omission (whether negligent or otherwise) of consultant or representatives under the contract.

The above contract provision presents multiple "red flags" of which John Doe Architect should be aware when reviewing the contract. First and foremost, John Doe Architect should be concerned that, according to the contract, its obligations are not limited to instances of negligence. Rather, the provision purports to obligate John Doe Architect to indemnify the company for "any act or omission...that is in any way associated with...any obligation of consultant," regardless of whether there is a finding of negligence. Equally concerning is the fact that the provision also states that John Doe Architect will be "liable for the costs of repair or replacement of any property of the company that is damaged by any act or omission (whether negligent or otherwise) of consultant or representatives under the contract."

Secondly, the provision is overly broad, in that it imposes liability upon John Doe Architect for the acts of persons / entities unrelated to John Doe Architect. According to the contract, John Doe Architect can be liable for the acts or omissions of "anyone for whose acts any one of them may be liability that is in any way associated with any obligation of consultant, right of company or the work..." Such language significantly broadens John Doe Architect's potential exposure.

Third, the contract provision, as written, calls upon John Doe Architect to defend and indemnify the company for the company's own negligence, as long as the company's negligence was not the *sole* cause for the claim. This is problematic, as it potentially exposes John Doe Architect to liability for the contributory negligence of the Company.

Lastly, the indemnification provision could be interpreted to impose unlimited liability upon John Doe Architect for "any and all" attorneys' fees, expert fees and expenses, etc., without any requirement on the part of the Company to establish the reasonableness of such losses. For this reason, it is prudent for John Doe Architect to propose amending the contract provision to provide for indemnification only for "reasonable" fees / costs.

Below is a revised version of the indemnification provision, which illustrates how the provision could have been revised to address concerns raised in this claim study and to better protect the interests of John Doe Architect:

To the fullest extent permitted by applicable law, Consultant [Insured] will indemnify, ~~defend~~ and hold harmless the Company [Developer] from and against ~~any and all~~ loss, damage, costs (including, but not limited to, reasonable attorneys' fees, expert fees and expenses, and court costs, and any notification related costs arising out of a data breach, loss, or unauthorized access to data), or liability resulting from any and all demands, claims, suits, costs, fines, penalties, proceedings, or actions of any kind or character ("Claim") presented or brought against the Company caused by, arising out of, or related to any negligent act or omission of

consultant or any representatives, anyone directly or indirectly employed by any of them (including any approved Subconsultants and any persons directly or indirectly employed by an approved subconsultant), ~~or anyone for whose acts any one of them may be liable that is in any way associated with or connected with any obligation of Consultant, right of Company, or the Work in whatever manner the same may be caused and regardless of whether the same may be caused by or arise out of the joint, concurrent, or contributory negligence of the Company or any other persons or entities not a party to the Contract;~~ provided, however, if any claim is determined to have been caused by the sole or contributory negligence of the company, then consultant will not be liable under this General Indemnification section. Consultant's indemnity obligation will include, ~~without limitation,~~ to extent such amounts are determined to be reasonable, court costs, attorneys' fees, costs of investigation, costs of defense, expert fees and expenses, settlements, and judgments associated with any claims. ~~Consultant will further be liable for the costs of repair or replacement of any property of the Company that is damaged by any act or omission (whether negligent or otherwise) of Consultant or Representatives under the Contract.~~

Finally, the indemnification obligation should be based in negligence-only, meaning that a design professional should only be responsible to compensate their client for damages arising out of the design professional's negligence. A standard professional liability policy does not provide coverage for business disputes (breach of contract) or any type of fraud or willful misconduct.

Upon review of your next contract, look for uninsurable 'buzz words' such as "defend", "contractor" and "subsidiaries, agents and affiliates". Furthermore, terms such as "suits", "actions", "demands" and "proceedings" can indicate a defense obligation, so it is recommended that these terms be removed from the provision as well. Lastly, be on the lookout for terms such as "breach of this agreement" and "willful misconduct, or fraud", which also present insurability issues under a professional liability policy.

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