Talk to Me About A&E: Episode 4 — Indemnity clauses

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SPEAKER: Welcome to Talk to Me About A&E, a podcast series focused on risk management for architects and engineers. Host Dan Buelow, managing director of Willis A&E, will engage experts across the A&E spectrum on topics ranging from contract details, to the broadest trends impacting design professionals in North America.
DAN BUELOW: Hello and welcome to another episode of Talk to Me About A&E, a Willis A&E podcast series where we invite experts to address a specific topic managing risk for architects and engineers. I'm Dan Buelow, managing director of Willis A&E. And our topic today is negotiating the dreaded indemnity clause. My guest is Colleen Palmer, risk manager for Beazley's Architects and Engineers Group. Hello, Colleen, how are you doing?
COLLEEN PALMER: I'm well. Thanks for having me, Dan. I'm excited to be here today.
DAN BUELOW: It's great to have you, Colleen. Let me give you a little background, Colleen joined Beasley A&E risk managers quite a while ago back, in 2007 I believe. And before joining Beazley, Colleen was a practicing attorney in Boston where she focused on assisting architects and engineers. And has specialized in providing risk management services to design professionals on a nationwide basis. Including conducting risk management seminars and advising on contractual issues.
In fact, a lot of our Wills A&E clients that are with Beazley certainly benefit from Colleen's expertise when it comes to contracts. And we've had her on as a regular guest over the years on our Willis A&E webinars. So it's great to have her.
We touched on indemnities on our last podcast which we were going into deal breakers. And if you recall, deal breakers are those client drafted clauses that are so onerous unless the design firm can delete this clause or significantly modify the clause. They should seriously consider if they want to take or accept the project at all. That's how bad these clauses can be.
And of all the deal breakers, frankly, indemnities are probably at the top of the list for all firms when it comes to the level of risk you're being asked to take on. And firms need to approach these clauses with caution, and fully understand what they are being asked to accept. And this is even in your personal life if you ever get an indemnity, it's something that if you're not familiar exactly with what that wording is trying to do to you.
You probably should seek legal advice when it comes to these clauses. And so let's talk about this with Colleen here. And Colleen, what is the purpose of an indemnity clause, and why are they so common in owner drafted agreements with design professionals?
COLLEEN PALMER: Sure. So, the purpose of indemnity provisions as a general matter is to shift liability and risk to another party. And you're absolutely right. I completely agree with you that these can be one of, if not the hardest provision to negotiate with the client. Because the client wants to try to shift as much

risk as possible to the design professional. And of course, the professional should really only be responsible for its negligent performance of services.
And these types of provisions that are client drafted often are significantly broader than that, which not only makes a professional responsible for risk that it ordinarily would not have. But it also can run afoul of what would be covered by the professional liability insurance policy. And just as a quick aside, you mentioned, be careful in your personal life.
Years and years ago, I think I had just graduated from law school. My family and I went rock climbing in the Adirondacks. And we were presented with this very broad waiver and release that had an indemnity. And I remember being just out of law school, I scratched this thing up it only had three words left.
And I turned it in and the guy said, well, if you want to participate you have to sign it as we have written it. And I read faced him. Well, I do want to participate, and I made the risk and the decision that well the risk reward analysis here is I want to participate. So I'll sign it as you have written it. But just a funny story that these things can creep into your life, whether it's professionally or personally.
DAN BUELOW: That's a great-- Yeah, and again we from a design professionals perspective, we have to remember with these contracts that they're so binding here. And that as long as you're of legal age and you're sober, you can pretty much agree to anything, right?
COLLEEN PALMER: That's right.
DAN BUELOW: So you really got to be careful and this is one sneaky clause. And in our podcast on deal breakers when we were talking about indemnities, we identified three areas of an indemnity clause that design professionals really need to pay particular attention to. And here are the three areas which we're going to really talk about today is there a duty to defend. The other question is who are the indemnities. And lastly, is the obligation negligence based.
And so let's dissect the bad indemnity clause. And I would say on the front end here and Colleen you see a lot of contracts. The ones that I've seen-- things are just getting more and more convoluted it seems with these contracts. And we're seeing these indemnities that I think you probably at the end of the day could come up with a fair balanced and pretty broad indemnity in a paragraph.
And we're seeing these things run multiple pages, and even being embedded throughout a contract, right? So we have to be careful about that. But let's talk about and dissect a simple, but bad indemnity agreement. So it starts off like this, the consultant shall be responsible for and shall indemnify and defend the owner against any and all demands, alleged losses, claims, delay costs, et cetera, et cetera. So, Colleen, what is wrong with this language and why must the design professionals strike the word defend an indemnity clause that seems to be in almost every owner drafted agreement?
COLLEEN PALMER: Right. So, I agree with you. The provisions are getting longer and more convoluted as the years tick by. When you see the word defend, the express word defend automatically OK, well, this might be a problematic provision as a whole. Maybe there's just the duty to defend and the rest is going to be okay. The other two prongs that you mentioned that we'll get to.
But the duty to defend is problematic, because it's broader than the duty to indemnify. And it's triggered by allegations of your fault as opposed to proof of your fault. And it's an upfront duty, so in the event that this obligation is triggered, and the client says, hey, design professional pursuant to this indemnity provision I'm going to tender the defense over to you. Meaning I'm going to turn this defense obligation over to you.

You now have to defend me. I'm going to be sending you my attorney bills for this defense, and you're going to pay them. So it's an upfront duty that is something that would ordinarily not be an obligation that the professional would have absent this contractual language. And so that then creates a coverage issue under professional liability insurance, and that it's likely to fall under the risk assumed by contract exclusion.

So, some firms when they see the duty to defend they absolutely consider it to be a deal breaker. Do not pass go, we will not take this project because it can be this bet the firm type of a concept where you don't know. The duty to defend costs may be hundreds of thousands of dollars that could legitimately put some firms right out of business.

So other firms do their risk reward analysis. And they come to the conclusion that for this project, with this fee and this scope and this client and they look at all the factors. They are willing to take that risk on, but they do so knowing that in the event that obligation is triggered it's going to be an out of pocket cost for them. And something that they have to write the checks for that's not going to be covered by their insurance policy.

I would also point out that in addition to the word defend there are some other words that can create the duty to defend. And a sneaky one is the word protect, and I talk about this all the time because it doesn't seem like it is that problematic. But if you actually look up the word protect in the dictionary one of the synonyms is defend. So we always recommend that you take out defend and protect as express obligations. But we also recommend that the professionals take out language that is an implied duty to defend.

So, words such as you'll indemnify for claims, for demands, allegations, litigation, proceedings, arbitration, causes of action. Those types of words and the list kind of goes on and on suggest this upfront duty. And so even if you don't see the word defend or protect I do always recommend taking out those implied duty to defend words as well.

DAN BUELOW: Those are some great points. And if you think about it what the owner is asking for should be particular galling for the design firm. Because essentially, they're saying we want you to pay for our attorneys on all the fees that they'll incur for suing you on even a baseless allegation as you read on. So these things are really blatantly ridiculous, but they're prevalent on these agreements.

The other thing I question too is I always come back to where wondering does the attorney that's behind this that's drafting this language -- do they know what they're doing or do they know exactly what they're doing? Okay, and so I think there's some there that honestly don't know what they're doing because they come from a construction background or so forth where they are more used to general liability, right? And so, in a general liability policy, you can add an additional insured and you can reasonably provide a defense.

And so, where is you can't do that in professional. So, to your point, it's a liability assumed under contract for which in the absence of that contract you wouldn't be liable for. So, you don't have insurance for it. Is there an opportunity and we've talked about this with some folks in the past and we've had some success with this. But I know it's not as simple as just bifurcated. But that's what I'm talking about here.

Could you possibly bifurcate, saying, yeah, we'll provide a defense for the GL but not the PL? Where I'm coming from here is what if the owner is saying, hey, this is a deal breaker for us. If you don't accept defend what can the design professional do to possibly negotiate that?

COLLEEN PALMER: There are some options here. I think you have to remember that the ultimate goal with all contract provisions, but especially indemnity, because it is such a far reaching type of provision, is that it should be as clear as possible. And that's a fundamental issue I have when you see these indemnity provisions that are three pages long that it's not clear.

And the last thing you want is for somebody else to tell you what you meant when you contracted. So as far as bifurcation goes you absolutely can do this to separate out the obligation with regard to professional services and non-professional. And the way that looks is for GL things that would be covered under commercial general liability you can say something along the lines of. For non-professional services that are performed, and to the extent covered by the professionals commercial general liability insurance policy comma blah, blah, blah.

And then, alternatively for the professional, you would say, for professional services performed by the professional and to the extent covered by the professional liability insurance policy blah, blah, blah. And those two phrases hopefully make it crystal clear that the first one is talking about non-professional, and it's got to be covered by the general liability. And then the second portion is talking solely about professional services that are provided, and to the extent covered by the professional liability insurance. And taken in combination the goal is that it stays within the insurance coverage for both policies. And that, there, is this clear division between professional and non-professional.

DAN BUELOW: Excellent. Well let's go on. Okay, so that's the defend. And some great points on there we don't want to accept the defend obligation. Well, let's dissect another problematic sentence in our sample of our bad client drafted indemnity clause here. And this is in regards to who you should agree to indemnify.

And so, in this clause that I was reading earlier, it says the consultant should be responsible for and shall indemnify and defend. And then it goes on the owners, development manager, agents, attorneys, subsidiaries, related affiliated companies, assigns, lenders, contractors, subcontractors, consultants, mother in-laws. Where do you draw the line?

COLLEEN PALMER: That's another huge issue as far as I'm concerned. And I, always in my mind, I consider that the second pillar of indemnity that you have to address. And that is, who are these entities or people that you are going to agree to take on the liability. And it should be limited to your client and your client's officers, directors, and employees.

This crazy long list of third parties that you don't have-- with whom you have no contract, and unidentified parties like agents or representatives are unacceptable from a risk management standpoint. And as you point out, this list is laughable when you see it because it is almost like you expect to see mother-in-law added in. But attorneys, contractors, other subs, successors, assigns on and on it goes. And the main issue here is-- well, it's twofold.

One is that these third parties you don't have a relationship with in the same sense that you do with your client. And since you are not under contract with them they should not be afforded the same rights and obligations that you give to your client. The second consideration is that if you include these other parties as named indemnities they arguably become third party beneficiaries to the indemnity.

And therefore can act as a party that can enforce rights that client has under the contract. And I'm sure you're going to talk about third party beneficiaries in another podcast with another speaker. But I tease it now because I don't think it's necessarily understood that it can have far reaching implications if you're naming these other third parties as somebody who has rights as an indemnity.

DAN BUELOW: Bottom line who are you having a contract with, right? Who's a party to this agreement, I think, is your pushback on that. So great points on that.
So the third point that we want to and then again using this bad clause, which by the way is a real clause from a real owner drafted agreement. It gets into is this negligence based, right? So this is where we're back to on this. And so after the defend obligation in this clause and after the long list and indemnities that we just read off.
This bad contract states the following, against any and all alleged losses, claims, delays arising out of related to based on derived from or in any way connected with any willful misconduct or any acts, errors, or omissions of consultant or those of. And then it goes on agents, assigns, employees, attorneys, members, affiliates and so on. Talk to us about the significance of this word arising out of versus the language to the extent caused by.
COLLEEN PALMER: There's a big distinction. And arising out of or resulting from or arising out of in whole or in part. That type of language is significantly broader than what I always call my magic phrase, my magic words of to the extent caused by the professional's negligence. And when you think about it sometimes you have to go back to your 11th grade English course where you had to dissect sentences. This may be aging me now because I don't know that kids do dissect sentences anymore.
But if something arises out of or is caused in whole or in part. Arguably you would only have to have 1% of damages come from the negligence for the professional to be responsible. And so we really in order to be consistent with coverage that's afforded under the professional liability insurance policy. We really want to have that limited to the extent damages are caused by the professional negligence.
If you remember nothing else that's the magic phrase to the extent caused by your negligence. And that's what is appropriate, that's what you should be responsible for under contract. And that's what's going to be consistent with the coverage you have under insurance.
DAN BUELOW: Adding that word negligence is very important. So if taking that what seemed pretty unreasonable, but if we could change arising out of narrow it to the extent caused by an added negligence in front of that. We'd be in a lot better place wouldn't we?
COLLEEN PALMER: Yes, yes. For sure.
DAN BUELOW: What about the term gross negligence? What does this exactly mean, and does this belong in any clause or an indemnity clause in particular?
COLLEEN PALMER: Yeah, the short answer is no, it doesn't belong in. As any good risk manager, my first instinct is I would just say no. But in this case, it really shouldn't be in there. Gross negligence maybe from a layperson standpoint you think oh gee well it must be really bad negligence, it must be extra bad negligence.
But the reality is gross negligence is a tort. It's a legal theory that's defined by law, and it's an intentional tort. As opposed to negligence, which is not an intentional tort. So intentional torts like gross negligence or willful misconduct arguably those are not going to be covered by your negligence based professional liability insurance policy.
So I would encourage you when you see that gross negligence don't be lulled into thinking, oh that's actually better for us because it means extra bad negligence. It doesn't mean that at all. It means it's an intentional act, and it should be deleted from your contract provision.
DAN BUELOW: And sometimes we'll see that a client will negotiate saying, all right, we're going to stick you with this bad indemnity wording. However we're going to make it mutual.

COLLEEN PALMER: As I run out of the room.
DAN BUELOW: Should that give us a little more comfort as the design professional?
COLLEEN PALMER: No, it doesn't. Again, I hate to always be the person who says no. And I do see this argument a lot Dan, where they say, hey don't worry because we're going to take on the same tough provision and obligation as you are designed professionals. So you're good because we're taking the same risk. The reality is they are not taking the same risk because more often than not, it's going to be the professional that's asked to indemnify the client. As opposed to the client being asked to indemnify the professional.
So you also see sometimes a tangent argument says, actually it's better for you to have this bad mutual indemnity where the client takes on the same risk. Than to have a narrow negligence based indemnity that's only you taking it on professional. And that's also not true. I'd rather see you have just a one sided indemnity where you as a professional are assuming the indemnity obligation if it doesn't have the duty to defend.
Its narrow with its definition of indemnities, and it's limited to the extent damages are caused by your negligence. Then have some crazy, broad mutual indemnity. You still have to make sure that those three pillars are satisfied.
DAN BUELOW: All right, and then one other question or a couple more here I have is. We know that some states will have an anti indemnity statute. What does that mean and what comfort does that give the design professional when it comes to like, hey, can I sign this crazy indemnity knowing that we're protected by this statute?
COLLEEN PALMER: I see that question with some frequency. And anti indemnity statutes are designed to be beneficial and protective to the professional because essentially what they do is say. By statute, by law that if an indemnity does X, Y, Z, or if it requires you to do these various things. It's going to be unenforceable. It's void as a matter of law.
So in theory that's good for the professional. But I do not recommend that a professional rely on a current statute, a current anti indemnity statute. And thinking oh it's no problem if we sign this contract with the bad indemnity because the statute will protect us.
And the reason I don't think it's wise to do that is because statutes can change. So maybe right now that anti indemnity statute is pretty tight and pretty favorable to the design professional. But we all know that claims in the A&E world have this long tail in that sometimes it's years after a project is finished that a claim is made in a professional is brought into a claim. So you don't know what that statute will say at the time that you may be looking to rely upon it.
So regardless of what a statute says, certainly you can use that in your negotiation techniques with the client to say, hey, look, there's this statute out there that your language is running afoul of, so we need to revise this. But I would still recommend that you negotiate and only agree to sign an agreement with an indemnity that's meeting these requirements that we've talked about today.
DAN BUELOW: I would agree that you don't want to play that game of altering your negotiating strategy from state to state, and rely on an anti indemnity statute to protect you in the future against accepting bad indemnity language from your client. Better to be consistent in your approach of not accepting any uninsurable or overly broad contract language. We've discussed contractual liability in the past and the fact that every A&E PL policy contains an exclusion for liability assumed under contract, unless you would have been liable in the absence of that contract.

Agreeing to providing a defense to your client prior to a finding of negligence. For example, is over and above the standard of care for a design professional, and therefore would be a liability assumed under contract that would not be covered by your firm's PL policy. And it's important to note that while we see owner drafted contracts requiring that your PL policy provide contractual liability coverage. The design firm needs to push back on this because this is simply not available under any A&E PL policy. And any such requirement to have contractual liability should be struck from your agreements.

And so the bottom line, I think for all of this is what we're talking about here is important to amend and owner drafted agreement to ensure that they are insurable. By addressing as we went over today the defend obligation is there one. Indemnities, who are you responsible for. And having this based on your negligence I think is very important.

Well, I want to thank Colleen Palmer for joining us today and providing some excellent insights into this inherent risks of indemnities in A&E contracts. Thank you, Colleen.

COLLEEN PALMER: Thank you so much, Dan, for having me. I really appreciate the opportunity to have the chat with you on this important topic. I hope it was helpful to people.

DAN BUELOW: It's great. Really appreciate it. And I want to thank you, everybody, for joining us for another episode of our Willis A&E Talk to Me About A&E podcast series. I'm Dan Buelow. I wish everybody well and talk to you soon.

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