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Indemnities, Part 1: Getting to "No"

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Indemnity agreements between environmental firms and their clients can present a minefield of liability risks. By agreeing to a client's onerous indemnity agreement, your environmental consulting firm may be saddled with virtually all project risks – with many of them uninsured. That's why it is imperative for you to understand the issues surrounding indemnities and to work with your attorney to ensure that your client agreements do not put you in an untenable position. Your goal is to get to "No" and remove indemnities from your client contracts.

A Little History

The concept of indemnification originated in the construction industry as a method to hold project owners harmless from liabilities that arise during construction. This basic concept makes sense: since the contractor has control of the jobsite, it should indemnify -- or hold harmless -- the project owner for any site-related liabilities that arise. If a worker or visitor is injured falling into a ditch on a construction site, for example, the contractor is generally held responsible since it controls jobsite safety.

Over time, thanks largely to the efforts of clients and their lawyers, the concept of indemnification has been altered in ways that are inherently unfair to design and environmental consultants. Environmental consultants are often asked to sign indemnity agreements that make them assume a large portion of project risks. Indeed, it is not uncommon for environmental firms to find one or more clauses requiring them to indemnify the client from substantial liabilities for things over which they exercise no control -- such as jobsite safety or unknown pollution risks. Likewise, these clauses often make environmental consultants liable for their actions and services even when those actions and services are non-negligent and meet the prevailing standard of care.

Many environmental professionals concede that they have unwittingly encouraged the use of these onerous indemnifications by accepting them too readily. If they balk at an indemnity, the client may say, "Well, the last environmental firm I used didn't object to the language." Fearing it might lose the job, the environmental firm disregards better judgment and signs an indemnity-laden contract.

But before signing on that dotted line, consider:

- Client-drafted indemnities may ask you to assume liability for others' negligent actions. Ask yourself: without the indemnity agreement, whose risk would it be? Almost invariably it would be the client's or contractor's risk.
- Most client-drafted indemnities are uninsurable. If you sign an indemnity agreement that is not limited to indemnifying the client against your own negligence, you are accepting liability beyond that required by common law. Your professional liability policy likely specifies that your insurance does not cover any liability voluntarily assumed by you under contract unless you would have already been liable in the absence of the contract.
- Client-drafted indemnities frequently contain unclear language that can be broadly interpreted – and misinterpreted. For instance, a client may

ask for indemnity for your "intentional acts." A crafty attorney could interpret virtually any of your acts as "intentional."

- Client-drafted indemnities may require you to pay for your client's legal defense in the event of a claim or lawsuit. This "Duty to Defend" provision could be interpreted as an obligation on your part to pay for an attorney and other legal fees for your client even before any liability for negligence has been alleged or established. In fact, a court case in California upheld a Duty to Defend provision even though no allegation of negligence was made against a design firm (see sidebar).
- Client-drafted indemnities may include inappropriate parties to be indemnified. You should never agree to indemnify a client's agent, contractor, attorney, contract employee, lender, volunteer or anyone else who is not directly part of the client entity with which you have a contract. Doing so could create a contractual relationship with these parties (called "privity") and erode the so-called "economic loss doctrine" that protects you from being sued for losses by third parties.

Types of Client-Drafted Indemnities

Client-drafted indemnities used in the environmental industry can be separated into three general types: broad-form, intermediate-form and limited-form.

Broad-Form Indemnities create the greatest problems. Such an indemnity can make an environmental firm responsible for almost any problem that befalls its client during the project, whether or not the consulting firm was negligent. A typical broad-form indemnity requires the consultant to agree to hold harmless and indemnify the client from "any and all liability," including the cost of defense, arising out of the performance of environmental services.

It is important to note that broad-form indemnities do not limit the indemnification to liability that is the result of the environmental consultant's negligent acts, errors or omissions. Obviously, such an all-encompassing indemnification covering all of the consultant's actions creates enormous and largely uninsurable liabilities.

In some states, broad-form indemnification has been made illegal by virtue of court decisions or anti-indemnification statutes. But even in states where such indemnities are illegal, a judge might still rule that a given clause is enforceable when the parties to the contract have enjoyed relatively equal bargaining strength and the clause is written so clearly that its intent is unmistakable.

Intermediate-Form Indemnities are not much better than broad-form ones, but they are legal in more jurisdictions. Intermediate-form indemnities provide that an environmental firm will cover the client's risk whenever the environmental professional shares some of the liability due to negligence. A typical intermediate-form indemnity requires the environmental firm to agree to hold harmless and indemnify the client from any and all liability, including cost of defense, arising out of the consultant's negligence, whether it be sole or in concert with others, in connection with performance of contracted services. Given a clause such as this, the client or contractor could be 99% at fault and, as long as the environmental consultant is at least 1% at fault, the consultant could pick up 100% of the tab. And in the event of a project upset, there is a very good likelihood that an environmental consultant would be held at least partly at fault. Virtually any attorney worth his or her salt could convince a pubic jury that an environmental professional had at least a minor role in a project upset.

Limited-Form Indemnities assign liability to the parties involved in proportion to the degree of fault. For example, if you are found to be 20% at fault, you will pay 20% of the damages. With a typical limited-form indemnification the consultant agrees to hold harmless and indemnify the client from and against liability arising out of consultant's negligent performance of services.

While this limited-form indemnity is certainly more acceptable than the other two, it is best not to have any indemnity in a contract. First, a limited form indemnity is unnecessary since you are already liable for your negligence. Second, such an indemnity could muddy the waters regarding the insurability of any errors and omissions.

Just Say No

Regardless of how attractive a potential project may be, your guiding principle should be that you will not accept unlimited or uninsurable liability imposed by a client-written indemnity agreement. You must insist that liabilities remain with those parties who are in the best position to control them. You should do your best to persuade the client to remove any indemnity language that increases your liability beyond the

liability you already have for your negligence, errors and omissions. Specifically, be sure you:

Know the law. Working with your attorney, find out whether your state has anti-indemnification statutes on the books. If so, what do they say and how have the courts interpreted them? Familiarize yourself with any recent state court decisions regarding indemnity agreements. Be aware, however, that the law in your state may not apply to your project dispute. Client-drafted contracts frequently require that disputes be settled in the jurisdiction where the client is located and/or where the work is performed. So become familiar with statutes and rulings in these jurisdictions as well.

Educate your client. Perhaps the best tactic for getting rid of an unfair indemnity is to demonstrate to the owner the ineffectiveness of such a contractual stipulation. Point out any anti-indemnification statutes on the books in your state or the jurisdiction where any dispute would be tried. Explain that any indemnification that expands your liabilities will be uninsurable and could even jeopardize coverages that would apply without the indemnification. As your insurance agent, we can help explain to your client that you are already liable for your errors and omissions and any resulting damages are covered within the available limits of your professional liability insurance policy. We'll explain that an indemnity is unnecessary and may cloud the issue of your insurance coverage and legal responsibilities.

Plead for fairness. Explain that to hold you legally responsible for another's liability is simply unfair. Reaffirm your willingness to accept responsibility for your own errors and omissions but state your unwillingness to be liable for the mistakes and oversights of others. Explain that the theory of indemnities applies to contractors on the construction site since they assume control over the work site. Explain how it is unfair to hold a consulting firm responsible for liabilities that are completely out of its control.

Convincing an owner that an indemnification would be unenforceable and/or unfair can be difficult when the client has paid an attorney to draft the contract and the client has been told that another environmental firm will agree to the provision. What do you do when a plea for basic fairness does not work? There are still some options that while not ideal, are far better than accepting a client-drafted indemnity.

Next issue, Part 2 of this two-part report will address those alternatives. Plus we will examine certain cases where you might want to request indemnities from a client, third party or subconsultant.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.

Sidebar

California Cases Demonstrates Danger of Duty to Defend Clause

A 2010 California court decision clearly demonstrates that Duty to Defend provisions in an Indemnity clause can be upheld in favor of a client even when the consulting firm is not shown to be negligent and meets the prevailing standard of care.

In *UDC-Universal Development L.P.* v. *CH2M Hill*, a developer included an Indemnity and Duty to Defend clause in its agreement with its design consultants. The contract stated that the consultants would indemnify the developer from and against any and all claims to the extend they arise out of or are in any way connected with any negligent act or omission by the design firm. The clause went on to state that the design firm agrees to defend the client in any suit, action or demand brought against the client.

A claim was brought against Universal Development by a homeowners association The developer, in turn, filed a cross complaint against various parties to the project including CH2M Hill alleging the client was damaged due to deficient work. During the court proceeding CH2M Hill argued that it had no duty to indemnify or defend the client unless negligence could be shown. However, the court ruled that the language of the clause indeed created a duty to defend as soon as defense was tendered, even in the absence of a finding or allegation of negligence. Citing a previous California case (*Crawford* v. *Weather Shield Mfg., Inc.*) the court reasoned that the duty to defend was triggered as soon

as the claim was made, even if that claim did not allege negligence. Based on these two court decisions, it seems that in California, defense obligations can be deemed included in any indemnity agreement unless the parties indicate otherwise.