CE News "Risky Business" No. 4

Of all contractual hot potatoes, none is hotter than indemnities. An indemnity is a contract provision through which Party A agrees to reimburse Party B for Party B's losses.

Common law requires that clients and third-parties by indemnified by engineers for damages caused by the engineers' negligence. As such, were an engineer 100% responsible for a $100,000 loss, the engineer would have to fully indemnify the party that experienced the loss; i.e., would have to pay the party $100,000. Were the engineer 40% responsible for the loss, $40,000 would be owed, and so on.

Sometimes clients put the common law indemnification requirement into their contracts. Known as a "limited-form indemnity," it would look something like this sample:

> ***INDEMNITY***
>
> **CONSULTANT agrees to hold harmless and indemnify CLIENT from and against liability to the extent caused by CONSULTANT's negligent performance of the services.**

What turns indemnities into hot potatoes are variants that make engineers liable for their own negligence *and for the negligence of others, including clients*. Clients' attorneys like such indemnities, of course, believing – incorrectly – that they provide extra protection. But the exact opposite could be true. Consider this "intermediate-form indemnity":

> ***INDEMNITY***
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> **CONSULTANT agrees to hold CLIENT harmless from damages arising from CONSULTANT's negligence, whether it be sole or in concert with others, arising from provision of the services enumerated herein. Damages shall include [*everything we can think of*].**

By accepting that provision, you could become responsible for any damages experienced by the client, provided you were at least 1% at fault and, therefore, "in concert with others." As such, were the client to be 99% at fault for a $1 million loss, you would be liable for the full $1 million as long as a judge or jury believed your negligence caused at least 1% of the damage. Your professional liability insurance might pay 1% of the total ($10,000, the portion attributable to your negligence), but you would be corporately and personally responsible for the remaining $990,000. (Chances are it would be for the full $1 million, because your deductible is probably more than $10,000).Your commercial general liability policy would pay nothing.

Your client needs to understand that the problems such indemnities are trying to compensate for are or certainly should be covered by the insurance of the negligent party

and/or by the client's insurance. Unfortunately, having the indemnity in a contract can give the client's or other party's insurer the excuse it needs to pay nothing at all: "The engineer agreed to indemnify you. Why should we? Get the money from the engineer, and if the engineer can't pay in full, maybe we'll help out," an insurer might say. As such, the indemnity could create the high-risk potential that the client might have to sue its own or some other party's insurer to obtain the protection that would have been forthcoming were the indemnity not included in the agreement.

Intermediate-form indemnities can also undermine relationships. The client/consultant bond that should exist probably won't, because the engineering firm has to watch the client and everyone else on the project with hawk-like vigilance, given that the engineering firm could wind up being responsible for the negligence of any or all. And as for the provision's impact on design, the client has every right to expect a costly-to-build, fortified off-the-shelf approach that's just about failure-proof.

Because the client may simply be doing what its counsel said to do, without understanding what the provision really means, you might find it worthwhile to check with your own counsel and then offer an alternative provision that affords the same protection, but puts into somewhat humorous English what the client is really asking for. The alternative might read like this sample:

> *INDEMNITY*
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> **CLIENT insists that CONSULTANT indemnify CLIENT for damages resulting from CONSULTANT's negligence. CLIENT also insists that CONSULTANT indemnify CLIENT for damages resulting from CLIENT's own negligence, and from the negligence of third-parties such as CLIENT-selected contractors and CLIENT-selected consultants, even if CLIENT and/or such third-parties were 99% at fault, and CONSULTANT were only 1% at fault. CLIENT insists that CONSULTANT accept this risk, even though it is patently unfair, even though CONSULTANT's insurance will not provide any coverage of it, and even though paying the uninsurable damages could result in the financial ruin of CONSULTANT's firm, and the loss of CONSULTANT's personal assets, including CONSULTANT's retirement funds, home, autos, etc. CLIENT and CONSULTANT recognize that CONSULTANT may be able to file a lawsuit against other negligent parties, except CLIENT, but the financial realities of doing so, and the vagaries of litigation, would probably make such action unwise. CLIENT understands that CONSULTANT would have to be really dumb or really desperate to accept the huge uninsurable risk posed by this provision, or CONSULTANT would have to be virtually penniless or otherwise "judgment-proof." Because CLIENT recognizes that retaining a "judgment-proof" consultant would make this entire provision meaningless, given it would afford no protection to CLIENT, CLIENT hopes that CONSULTANT is dumb or desperate, and CLIENT looks forward to entrusting the success of this project to CONSULTANT.**

Some public entities may laugh at the alternative language, but still refuse to modify their one-sided provision on the ground that "it's the taxpayers' money." But that being the case, why use a provision that casts uncertainty on the availability of the insurance that the public needs to protect its investment?

Of course, some firms have assets that are so substantial, clients don't have to worry about whether or not they have insurance to pay for damages. But firms don't get to be that size by being stupid. Unless they're willing to gamble, the only indemnities they'll accept are those that the law requires in any event.