PROFESSIONAL LIABILITY AGENTS NETWORK
NEWSLETTER
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Indemnities: The Bane of Design Firms

Indemnity clauses in design firm agreements can be deal breakers. Design firms are consistently advised to only agree to indemnities that are insurable. Their insurance agents, professional liability insurance carriers, lawyers, and risk management advisors all emphasize the same message: "don't agree to an uninsurable indemnity agreement". By doing so, they fulfill their obligation to their design firm clients, highlighting the uninsurable risks involved and often suggesting insurable alternative language. However, many clients of design firms may not be interested in this insurable language, as they have their own risk advisers who emphasize the importance of protecting that client's interests, even if that means insisting on an indemnity clause that is not insurable under design firms' insurance program. Client representatives must navigate their responsibilities to their bosses and owners, and they could potentially face repercussions if they agree to an indemnity that is not "tough enough".

Obtaining an insurable indemnity by the design firm in every contract is not easy; in fact, it is often impossible. Most design firms cannot avoid these situations; bills must be paid, projects must be secured, employees expect competitive compensation packages, and the firm needs to grow to survive. Let's briefly examine some common uninsurable issues seen in such indemnities and then consider possible negotiation approaches instead of just accepting the clause as is or walking away.

Common Reasons Indemnity Clauses Are Uninsurable Under A/E Professional Liability Policies

1. Duty to Defend: Most A/E professional liability policies will not support an indemnity clause that obligates the firm to defend the client against third-party claims. This means that if a design firm agrees to a "duty to defend" clause, they could be responsible for substantial out-of-pocket expenses that are not reimbursed by their insurance.

2. Indemnified Parties: While it's understandable for clients to insist on indemnification, it's not unusual for them to request indemnification for other parties, such as contractors or investors. Indemnifying multiple parties increases the design firm's risk exposure and can be problematic.

3. Indemnity Scope: Are we agreeing to an open-ended indemnity? Terms like "any and all" and "without limitation" are intentionally broad and can create significant exposure, potentially holding the design firm responsible for virtually any claim, regardless of its nature or origin.

4. Trigger: What event triggers the indemnity obligation? Ideally, the indemnity obligation should be tied specifically to the design professional's negligence. This ensures that the firm is only responsible for damages directly resulting from their own negligent actions.

Possible Negotiation Strategies

The goal of the design firm is to secure an insurable indemnity or come as close to it as possible. Often, firms must settle for less-than-perfect terms. That's reality. The threshold for acceptable indemnity terms will vary by firm. Many design firms might find themselves either needing to walk away from a project or agreeing to uninsurable indemnity language, and very few can afford to walk away every time this issue arises. Here are some possible responses that might persuade the prospective client to reconsider.

1. Insurance Funding: In the event of a significant claim, the Professional Liability (PL) policy is usually the only source of funding for any damages. Explain that the PL insurance your client requires does not cover the indemnity they are asking you to agree to and you want to ensure that in the unlikely event your services result in a claim, your PL insurance can fully support you and your client.

2. Limiting Responsibility: Stress that your firm is committed to taking responsibility for its actions and that you are not trying to avoid your responsibilities; but rather you aim to limit your liability to exposures for which you control and damages you are legally responsible for. Provide examples of your strong claims record to build trust.

3. Peer Practices: Other firms' agreements should not dictate your firm's risk management practices. Clarify that while some consultants may accept broader indemnity clauses, your firm prioritizes careful risk management. Explain that adhering to best practices in contractual agreements is essential for the long-term success and sustainability of your firm. This approach ensures that both parties are protected and that your firm can continue to deliver reliable services.

4. Client Education: Use this as an opportunity to educate your client about the limitations of your Professional Liability insurance. This transparency helps clients understand the rationale behind your request for insurable indemnity terms. It also positions your firm as a knowledgeable and trustworthy partner.

5. Appeal to Fairness: Point out that while their legal counsel may push for tough indemnity clauses, they should understand the insurance limitations. Explaining that overly stringent indemnity clauses can be counterproductive. Highlight that a balanced approach benefits both parties by ensuring that any claims can be adequately covered by insurance.

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Alternatives to Walking Away

If negotiations stall, consider proposing alternatives like:

- Limitation of liability
- Waiver of consequential damages
- Shorter statute of limitations
- Detailed and clear scope of services

These strategies can help design firms navigate the complexities of indemnity clauses while protecting their interests and maintaining client relationships.

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