

# Risk Management Advisory

## ARCHITECTS AND ENGINEERS PROFESSIONAL LIABILITY INSURANCE

### Indemnification issues

*With increasing frequency design consultants are being asked, and sometimes required, by their clients, to sign professional services agreements in connection with the projects for which the design consultants are providing services. These agreements typically include an indemnification clause. In some cases, the indemnification clause is so broadly worded that it applies to any loss the client may suffer whether or not the loss is attributable to the design consultant's services. In other cases, the indemnification clause is based on any wrongful conduct by the design consultant regardless of the degree of responsibility for the loss. Other clauses make the design consultant liable for losses (caused in whole or in part) by their negligence regardless of the fact that much of the damage may have been caused by the party seeking indemnification. While there are some clauses that only require indemnification for the portion of the loss attributable to the design consultant's negligence, indemnification language can impose liabilities on design consultants that fall outside their proper professional responsibility or involve exposures in excess of what the law would otherwise normally require. Owners should be prepared to accept that there is some inherent level of risk tied to the participation in a project and not attempt to transfer such risks to design consultants through indemnification clauses.*

Indemnification clauses should be simple and specifically relate to damage resulting from the negligent acts, errors or omissions of the design consultant. Design consultants should avoid broad-form indemnification clauses that owners frequently attempt to include in professional services agreements. Many indemnification clauses could be construed to require indemnification for damages resulting from the non-negligent performance of the design consultant. While a

design consultant may agree to indemnify their clients for anything allowed under law, professional liability insurance only provides coverage for those damages and costs resulting from the design consultant's professional negligence in providing services on a project.

An indemnity agreement that goes beyond damage caused by the negligence of the design consultant in providing professional services may be covered by professional liability insurance, but only to the extent that



the design consultant was negligent in their performance of professional services (i.e., if it is alleged that the design consultant's act or error did not meet the standard of care and resulted in damage) or was negligent in not providing the professional services which should have been performed under the contract. Design consultants should be aware that in agreeing to an indemnification clause they may be accepting contractual responsibilities beyond this normal insurable legal liability.

## Example of an uninsurable indemnification obligation

*Design consultant agrees to indemnify and hold harmless the client from all claims, losses, damages and expenses (including lawyers' fees and other legal expenses) caused by, related to or in any way connected with the Project (or the design consultant's services).*

This indemnification clause extends beyond the coverage provided by professional liability insurance because it does not limit indemnification to the design consultant's negligence; however, such a claim would be covered if the design consultant performed negligently or failed to provide the professional services. While it is possible that a sophisticated client would only demand indemnification for loss resulting from the design consultant's negligent performance, this is not assured.

In this case, the design consultant may not have coverage for a claim. On the whole, indemnification clauses such as this provide little benefit to a client. It is unreasonable to hold the

design consultant responsible for any claim that is not associated with the project or with their performance. Since professional liability policies do not cover claims arising from broad indemnification clauses, the client is left to try and secure the indemnity payment from the assets of the design consultant.

This broad-form indemnification clause ignores the realities of professional practice, the legal standard to which design consultants are held, and the basic fact that without professional liability insurance coverage most professional services firms do not have assets that can effectively indemnify their client. Nor is the client well-served if the design consultant is uninsured. Note that a client can tender the defence to the design consultant in a situation where the claim alleges the sole negligence of the design consultant or where the damage is caused by the design consultant's negligence. The client can also ask for indemnification of reasonable legal fees resulting from a claim alleging damages caused by the negligent act, error or omission of the design consultant but only **after** negligence is established through the courts.

While the language of this clause represents a fairly common attempt by owners/clients to shift all of the risk and cost of any claim to design consultants, professional liability insurance will only respond to the allegation of professional negligence. The uninsured risk that this indemnity agreement may present is an assumption of a business risk on the part of the design consultant. The design consultant is in the best position to decide if that business risk is acceptable.

To increase the likelihood that a professional liability insurance policy would respond to a claim, the clause should be modified so that the language states "caused by or arising out of any negligent act, error or omission," clarifying the fact that the indemnification obligation is triggered by the legal liability of the design consultant not to commit a negligent act or to be responsible for a negligent omission.

## Indemnification clauses based on negligence

It is recommended that specific language in indemnification clauses be reviewed by independent legal counsel because indemnification clauses are, to a great extent, drafted in response to specific provincial statute law or provincial statutory regulation. The advice of local legal counsel is appropriate in evaluating the responsibilities established in indemnification clauses. The following sample language is clear in its intent:

*To the fullest extent permitted by law, Consultant shall indemnify Client, its officers, directors, partners, employees and representatives, from and against losses and damages arising from claims by third parties, including reasonable lawyers' fees and expenses recoverable under applicable law, but only to the extent they are found to be caused by a negligent act, error or omission of Consultant or Consultant's officers, directors, members, partners, agents, employees or subconsultants in the performance of services under this Agreement.*

It is specifically understood and agreed in such a clause that in no case shall the design consultant be required to pay an amount disproportionate to their culpability. Clients, of course, should also be required to give the design consultant prompt notice of any claims of injury or damage subject to the indemnity.

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