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Risk Management Tools for the Design Professional

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Making the Grade: Testing Design Professional Indemnity Obligations

By David A. Ericksen, Severson & Werson, San Francisco, CA

In-dem-ni-fy Verb.

- Compensate (someone) for harm or loss.
- Secure (someone) against legal responsibility for their actions.

Imagine a case where an engineering firm was found to have had an expensive duty to defend claims asserted against a developer, even after the engineer's performance was judged not to have violated the professional standard of care. That was the decision three years ago, in the California Court of Appeals in *UDC – Universal Development L.P. v. CH2M Hill*. In fact, that case extended another one, decided two years earlier in the California State Supreme Court. (*Crawford v. Weather Shield Mfg., Inc.*). That decision held that the duty to defend was incurred the moment that the indemnitee (the party that the design firm was contractually bound to indemnify) tendered its defense to the design firm.

Candidly, the indemnity provision underlying the *UDC v. CH2M Hill* decision was long and rambling, repetitive, and ambiguous. That's what opened the door to the expansive (and expensive) legal interpretation. The clear message to design professionals was: if you do not want to take on the extensive defense and indemnity obligations implied or required by statute and case law, you must be clear. Further, the longer and more confusing an indemnity provision is, the more likely it is to receive an expansive reading.

The point of this article is to provide design professionals with a simple, three-step evaluation and corresponding "scoring" model to evaluate and improve the indemnity obligations it receives.



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The Warning Shot. After reviewing hundreds of client-drafted indemnity provisions provided to architects and engineers, it seemed that well over half open with the phrase “to the maximum extent permitted by law” or its equivalent. These words would only come into play if the proposed indemnity clause were actually beyond what the law would allow. This clause is used to scale it back to what is legal and enforceable, as opposed to risking voiding the clause as a whole. This is not particularly common and may not even be effective in some situations.

What is far more telling, and potentially troubling, is the client attitude it conveys. Essentially, this language tells the design professional that the client seeks to transfer as much of its financial and legal risk as possible to the design professional. Ideally, it should be removed on the basis that the agreement (not the Courts or others) should define the rights and obligations between the parties. When a client will not do so, its reasons can be very telling.

Ten Words You Need To Use. Many indemnity-related advisories and articles for design professionals focus on the negative. Too often, this fails to provide any guidance toward the positive solution. Just ten simple, aspirational words can move a clause from onerous to essentially fair, balanced, and largely insurable. Those “magic” words are:

“but solely to the extent actually caused by the negligent”

Those ten words result in five key accomplishments which dramatically balance and level the typical indemnity obligation. They make the obligation:

1. **Limited.** Open-ended or ambiguous obligations subject design professionals to open-ended exposure. It is critical to expressly limit exposure by employing overall limitations, express subject matter limitations (*i.e.*, property damage and bodily injury claims only) and by avoiding the catch all phrases referenced above.

2. **Proportionate.** In any contract negotiation, and particularly with respect to an indemnity clause, the key concept should be “the party with the ability to control a risk, should bear a risk.” Too often, clients seek to tie together architects and engineers, and then design professionals with others, for shared and equivalent indemnity obligations. This makes you potentially responsible for the acts or failures of others. You should not have to accept risk for issues that are outside of your control. It is not fair, and it is probably uninsurable.

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3. **Real.** In the *UDC v. CH2M Hill* decision, CH2M Hill successfully vindicated its performance, but was still saddled with a \$400,000+ liability for the developer's litigation costs. Sometimes the proposed indemnity clause is up front about this by including "actual or alleged" liability of the design professional. Sometimes the language is silent on the point and therefore subject to expansive interpretations, such as that presented in the *Crawford* decision. Design professionals can really only avoid this by being clear and limiting the application to "actual" negligence or wrongdoing.

4. **Relevant.** Many indemnity provisions use soft language, which conveys "close enough" application. Common phrases in this regard include "arising out of", "related to", or "pertaining to", and often include the kicker "in any way". Under this language, a genuine "cause and effect" is not actually required. This offends the linear sensibilities of many design professionals and is also inconsistent with the core elements of a claim for negligence. Such a claim **always** requires a causative relationship between the negligent conduct and the corresponding damages.

5. **Negligence based.** Finally, and perhaps most importantly, the obligation should be based on negligence. That is the standard of care under the law, and importantly, the coverage provided by design professional liability insurance. Simple references to "acts or omissions" without the "negligent" qualifier may greatly expand the liability beyond the prevailing standards and risks the application of insurance coverage to the claims.

Two Words to Avoid. Even with positive words to build toward, there are still some common indemnity clause obligations so significant that they should be avoided as red warning flags. They are:

1. **Defend.** As illustrated by the California Appellate decisions referenced above, the most troubling aspect of most indemnity provisions is the duty to "defend". It can be **very** expensive and is often not covered by insurance. As a result, the very simple objective should be to eliminate the obligation and limit the provision to the more benign "indemnify", "hold harmless", and "save".

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2. **Agents & Representatives.** Yes, it is actually two words (and there other synonyms, such as “consultant”), but the concept is the same. Design professional indemnity obligations should be limited to the client (and maybe *its* client), but should not extend to other third parties and especially so without a better defined identification. Such vague third-party obligations can greatly expand the indemnity obligation, often beyond that which is fair and reasonable. It may also create even more issues of insurability.

Scoring the Clause. Fans of Olympic sports and *Dancing with the Stars* are familiar with a ten point scoring system. It also makes sense here in assigning weight to the issues of most critical importance. Accordingly, design professionals may consider the following template for evaluation of proposed indemnity clauses:

Two Point Issues:

1. Limited to claims based on negligence.
2. Proportionate to actual responsibility.
3. No express affirmative duty to defend.

One Point Issues:

1. Requires **actual** negligence.
2. Requires causation between negligence and damages.
3. Expressly limited without open-ended caveats, such as “to the maximum extent” or “in any way”.
4. Limited to client, granting no third-party coverage and containing no ambiguous descriptions.

With this as a measuring tool, design professionals may both assess their risk and seek to improve their position. In reality, the risk evaluation may even translate well to traditional academic grading system in that a 7 would translate to a “C”. Anything lower would be reason for concern and anything higher can probably be managed.

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