



On the Subject of Indemnification

Part 1: An Overview of the Indemnification Obligation

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Indemnification obligations are an important part of almost every design agreement. Stated simply, to indemnify someone means to financially protect them against specified claims. The party providing the financial protection (the “Indemnitor”) can be required to pay the amount of a judgment or settlement that is owed by the other party (the “Indemnitee”), or more commonly, can be required to reimburse the Indemnitee for costs the Indemnitee has incurred because of the specified claims.

As noted in previous articles in the January, February, and March 2017 editions of STRUCTURE, indemnification provisions in design agreements that have been drafted by owners are often worded in such a way that the indemnification obligations are not covered by professional liability insurance. These three articles suggested changes to the wording of commonly encountered indemnification provisions; this article will take a step back and look at the concept of indemnification in general.

Common Law Indemnification

Under the common law – the law that courts apply when there is no contract between the parties or there is no contract provision that is relevant to the dispute – there is an implied right of indemnification. Common law indemnification is sometimes referred to as equitable indemnification, meaning that it is required by the courts under basic concepts of fairness. Under the common law right to indemnification, someone who has been held vicariously liable (responsible) for damages caused by someone else can seek indemnification from the party who actually caused the damages. Typical situations where vicarious liability arises are when an employer is held vicariously liable for damages caused by an employee or a principal is held responsible for the actions of its agent (someone acting on its behalf). Judges who allow equitable indemnification will often justify it with wording such as: *Where one who has committed no actual wrong is held vicariously liable for the wrongdoing of another, he has a right to indemnification from the actual wrongdoer.*

Common law indemnification claims do arise in the design and construction context,

but generally because there is no contract between the parties. For example, in the case *Diplomat Resorts Limited Partnership v. Tecnoglass, LLC*, (Fla. 4th DCA 2013), a hotel owner hired a contractor to furnish and install glass shower doors. Due to an apparent defect in the manufacturing process, many of the shower doors spontaneously fractured. The hotel owner sued the contractor and obtained a judgment for the costs it incurred in replacing the doors. However, because it was unlikely that the contractor would be able to satisfy the judgment, the hotel owner took an assignment of the contractor’s claims against the company that manufactured the shower doors. The hotel owner, standing in the shoes of its contractor through the assignment, then asserted a common law indemnification claim against the manufacturer.

Contractual Indemnification

The owner of a building will almost always be sued when there is an injury or property damage even tangentially related to the building. Realistically, the injured party usually has no way to determine who (or what) caused the injury; they may only be able to establish that the injury was caused by the Owner’s property. Even though most design agreements say that the Engineer is an independent contractor and not acting as the Owner’s agent, the Owner will likely be held vicariously liable for any claims arising from the Engineer’s services.

While the Owner could file a claim against the Engineer for common law indemnification, very few owners are willing to take their chances with common law indemnification, particularly on large projects. A party seeking common law indemnification must prove they are entitled to indemnification; many states require the party seeking indemnification to be completely blameless or at the most “passively” negligent. Thus, most design agreements explicitly require the Engineer to indemnify the Owner for claims arising from the Engineer’s negligence.



Who Should Be Indemnified

While it is not unreasonable for Owners to require indemnification from the Engineer if the Engineer is negligent, Owners sometimes use language that is completely inappropriate, both with respect to what claims must be indemnified against and who must be indemnified.

It should be noted that, in terms of an indemnification obligation, the word “Owner” needs to be interpreted rather expansively to include anyone who holds “an insurable interest” in the project. This generally means the Lender and any investors as well as the Owner in the usual sense of the word. One of the main reasons that the claim is brought against the Owner (in addition to the fact that the injured party may not know who actually caused the injury) is that the building represents an asset that can be attached to satisfy a judgment in the injured party’s favor. The injured party’s chances of being able to collect on the judgment are much less certain if it brings the claim against a subcontractor whose insurance has already been exhausted from paying other claims.

It is reasonable that anyone with an ownership stake in the building will want to be financially protected against claims due to the Engineer’s negligence. Thus the indemnification clause will often include the Owner’s assigns, successors, affiliates, parent companies, and subsidiaries as indemnified parties, along with their respective employees, officers, directors, members, and managers. Although it is unlikely that an individual employee or officer would be held liable for the Engineer’s negligence, this indemnification request is not unreasonable; likewise, it is not unreasonable for the Owner to require

indemnification of its other (current and future) business entities.

When the Engineer is a subconsultant to another design professional, the Engineer will typically be required to indemnify the Prime Consultant as well as the Owner. This is reasonable since under most design agreements, the Prime Consultant is responsible for the work of its subconsultants and thus can be held liable for the Engineer's negligence.

What is not reasonable, however, is for the Engineer to be required to indemnify the other consultants, contractors, insurance carriers, sureties, and attorneys for the Owner and the Prime Consultant. It is possible that the Engineer could be partly responsible for a claim, along with another consultant. However, if it is alleged that the Engineer is partly responsible, the Engineer needs to be named in the claim, along with the other consultant. While claims involving multiple parties can, and usually do, get complicated, if the Engineer is involved in the defense of the claim, it has an opportunity to ensure that it is only held liable to the extent of its own negligence.

If the other consultant is the only party named in the claim, and the Engineer has agreed to indemnify the consultant, the consultant could settle the original claim and then bring a claim for indemnification against the Engineer

alleging that the damage was partly (or entirely) due to the Engineer's negligence. The consultant may also try to recover its legal fees for the original claim from the Engineer. While the Engineer can defend against the claim on the grounds that it had no liability for the injured party's damages, judges and juries tend to find that all parties involved bear some liability unless the allegations against a particular party are completely ludicrous. Assuming that the court finds that the Engineer's negligence partially caused the damages, the Engineer will be held liable for part of the settlement or judgment without having been able to participate in the original lawsuit.

Indemnification of the consultant will likely not be covered by professional liability insurance – professional liability insurance is designed to cover the Engineer's common law indemnification obligations for its negligence. Under the common law, the Engineer's indemnification obligation is limited to those that could be held vicariously liable for its negligence, which is essentially the entities that hold an insurable interest in the Project. In addition, few (if any) professional liability policies cover defense of an indemnified party, so the attorneys' fees that the consultant incurred in defending against the original lawsuit will almost certainly not be covered. In contrast,

if the Engineer is named in the original claim, both its defense and indemnification of the claim will be covered, provided the policy limits have not been exhausted by other claims.

This same reasoning applies if it alleged that the Engineer and the Contractor are jointly responsible for a claim. The Engineer should be named in the claim; it should not agree to indemnify the Contractor. The Engineer should also not agree to indemnify the Owner's (or the Prime Contractor's) insurance carriers, sureties, or attorneys. None of these entities can be held vicariously liable for the Engineer's negligence, so there is no reason the Engineer should be required to financially protect them. Including these entities as Indemnitees does nothing other than complicate the handling of any claim (and increase the costs).

Conclusion

This article has discussed the concept of indemnification, particularly with respect to who should be indemnified and what is covered under professional liability insurance. It is not unusual for design agreements to have a separate exhibit with a list of entities that must be indemnified; sometimes the indemnification clause itself may include a long list of required Indemnitees. Often, it can be difficult to determine

the relationship between the entities and the Owner or the property; in such cases, it is prudent to add the clause "provided any such entity holds an insurable interest in the property" to the end of the list. This will limit the Indemnitees to those who could actually be held liable for the Engineer's negligence. The second article in this series will look at the defense obligation that is often found in the indemnification clause.■

Disclaimer: The information in this article is for educational purposes only and is not legal advice. Readers should not act or refrain from acting based on this article without seeking appropriate legal or other professional advice as to their particular circumstances.

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