International Federation of Consulting Engineers
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Indemnities

A FIDIC Briefing Note prepared by Business Practice Leadership Committee Risk and Liability Task Group

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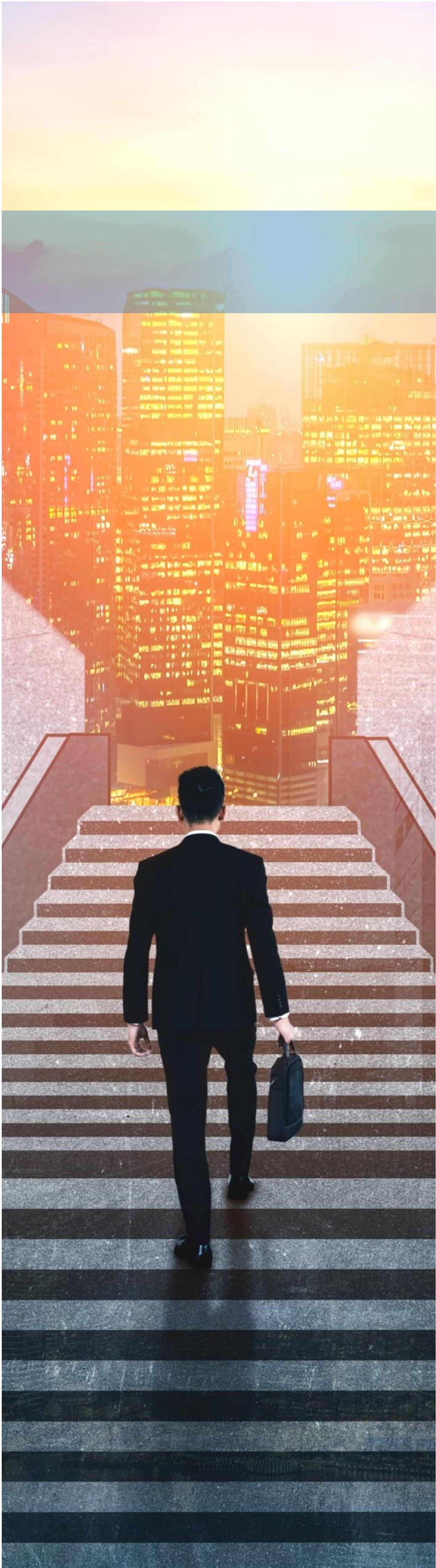
Contents



Aim and Introduction

The aim of this guidance note is to provide consultants with a high-level overview of the subject. It is not an exhaustive review of the subject matter and is not a substitute for obtaining legal advice. FIDIC recommends that consultants liaise with FIDIC Member Associations in the jurisdiction of the project to understand the local law and conditions of the market.

Indemnities are a hotly contested part of contract negotiations, but they are complex and commonly misunderstood. Navigating and understanding indemnities, has become key to managing risks for consultants. Indemnities are a common way for clients to transfer or apportion risk to the consultant in relation to eventualities it believes the consultant can prevent or can control.

There are, however, significant risks arising under indemnities, including potential inconsistencies with professional indemnity insurances. Consultants should therefore look to remove or restrict these as far as possible.

What is an indemnity?

When a consultant agrees to provide professional advice to a client, the basis of that arrangement should be set out in the contract between the consultant and the client. If the consultant breaches that contract and the client suffers a loss, the consultant would be liable for that loss. Contracts, however, sometimes include express provisions providing for the consultant to *indemnify* the client for different types of losses in certain situations. For the consultant, this means that should the indemnified situations occur, they could be liable for all the losses (both direct and indirect) that flow out of those indemnified situations, irrespective of, for instance, remoteness of damage or any duty to mitigate.

An indemnity is therefore, a promise from one party to compensate another party on a "pound for pound" basis for the loss they suffer as a consequence of a specified or triggering event. The specified or triggering event can be as broad as any claim arising under the contract or as narrow as covering a single risk (e.g., damage to third party property).

Why do clients include indemnities?

Clients will typically look to include indemnities for two reasons:

1. Fuller method of recovery: depending on the wording of the indemnity and the applicable law, the amount a client can recover under an indemnity is higher and wider than the damages a court would award them for the same claims.
2. Easier and quicker: indemnities are an easier and quicker method of recovery than any other type of claim. This is because the indemnified party need only prove they incurred a loss due to the triggering event – they are generally not subject to the usual breach of contract thresholds (e.g. under English law, mitigation and remoteness).

It is therefore important that where an indemnity cannot be removed, consultants carefully consider the scope of indemnities within their contracts.

Indemnities and liability

Another important point to note is that the consultant's liability under an indemnity will be unlimited unless an express financial cap in relation to the indemnity is included. Indeed, it is not uncommon for indemnities to be expressly excluded from a cap on liability, which significantly undermines the cap and should be avoided.

It is vital therefore to include a financial cap on liability in respect of indemnities. A simple way to do this is by drafting the overall cap on liability which expressly states that it covers claims for any indemnities under the contract.

Indemnities and limitation periods

Indemnities also have an effect on the limitation period in a consultant's contract. For example, under English law indemnities can extend the limitation period for the purposes of bringing a claim under a contract. This is because the time period only commences when the indemnified loss is established (e.g., when a court has decided the amount of loss).

Indemnities and professional indemnity insurance

There is also a risk that indemnities may not be covered by professional indemnity insurance on the basis that they give rise to losses beyond those recoverable outside the contract and/or which are not due to negligence or breach of contract. This is a particular risk given the hardening insurance market.

How to deal with indemnities in a consultant’s contract

Ideally, a consultant’s contract should not include any indemnities. Indemnities only make it easier for the client to collect money from consultants and at law a consultant is not even liable to a client on an indemnity basis.

Indemnities are, however, increasingly difficult to remove. As such, it is important for Consultants to carefully manage and reduce the risks they present. Common ways of doing this include:

1. Drafting the financial cap on liability to include claims arising under any indemnities.
2. Avoiding broad and all-encompassing indemnities – try and limit an indemnity to one specified circumstance or a limited number of circumstances within your control (e.g. negligence).
3. Narrowing the losses recoverable under the indemnity to those that are reasonably foreseeable and mitigated.

Indemnities and FIDIC White Book

The indemnities included in the FIDIC White Book (2006 and 2017 editions) are in favour of the consultant rather than the client. Although, in practice, they are often amended, wherever possible the standard indemnities should be retained because they reduce the consultant’s liability.

For example, in the 2017 White Book, the client must indemnify the consultant for claims made by the contractor against it arising out of the works contract. Similarly, in the 2006 White Book the indemnity covers any claims beyond the agreed limit of liability.

Indemnities and other jurisdictions

This guidance has been focused on how English law treats indemnities, but it is important for consultants to acknowledge that different jurisdictions will treat indemnities differently. For example, in the UAE, indemnities are treated the same as a breach of contract and therefore the approach to managing the risk is similar to managing risks of a breach of contract claim.

Summary

Indemnities are increasingly common in the construction industry and consultant's need to understand the risks they pose to their potential liability. Wherever possible, indemnities should be resisted, or the risks managed by one of the mitigation measures set out above.

About FIDIC

FIDIC, the International Federation of Consulting Engineers, is the global representative body for national associations of consulting engineers and represents over one million engineering professionals and 40,000 firms in more than 100 countries worldwide.

Founded in 1913, FIDIC is charged with promoting and implementing the consulting engineering industry's strategic goals on behalf of its Member Associations and to disseminate information and resources of interest to its members. Today, FIDIC membership covers over 100 countries of the world.

FIDIC Member Associations operate in over 100 countries with a combined population in excess of 6.5bn people and a combined GDP in excess of $30tn. The global industry, including construction, is estimated to be worth over $22tn. This means that FIDIC member associations across the various countries are worth over $8.5tn.

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