CBIZ Insurance Services, Inc.
9755 Patuxent Woods Drive, Suite 200
Columbia, MD 21046

January 18, 2021

The Honorable William C. Smith, Jr.
Chair of the Judicial Proceedings Committee
Maryland Senate
Miller Senate Office Building, 2 East Wing
11 Bladen Street
Annapolis, MD 21401

Re: SB 189 / HB 213
Prohibited Indemnity and Defense Liability Agreements
Indemnity Clauses

Dear Senator Smith,

I am an insurance agent in Columbia, Maryland representing hundreds of architects and engineers throughout the state. I write to you to in support of the above referenced bills and to explain how the insurance policies of architects and engineers work with respect to indemnification clauses in contracts.

The above referenced bills would eliminate two onerous burdens for design firms with respect to indemnification clauses. These burdens relate to certain coverage gaps in the insurance programs of the design firms. The first gap is that the duty to defend is not covered by the general liability or professional liability policies carried by these firms. The second gap is that insurance will only cover an indemnification obligation to the extent that damages are caused by the negligence of the design firm.

It is very common for private developers and local municipalities in Maryland to require indemnification for these uninsured exposures in their contracts. In the absence of insurance coverage for these obligations, design firms are forced to either not bid on the projects, or to take the risk that they could have to pay these costs themselves. This increases the financial uncertainty for all design firms and in particular puts an undue burden on small and minority-owned businesses. These coverage gaps can result in hundreds of thousands of dollars of expenses, or more, for the design firms. While larger firms may be able to withstand these kinds of losses, smaller firms face an existential threat to their business.

These contracts very often are not between two parties with equal bargaining power, but rather between a large owner client and a relatively small design firm. Frequently the owners offer the contracts on a take it or leave it basis. This might be acceptable if there were a reliable way for the design firms to transfer the risk through insurance, but unfortunately the insurance market does not adequately support coverage for these risks.

It is widely understood in the insurance industry that professional liability policies for design firms do not cover a duty to defend an indemnitee when an insured party agrees to such a provision in a contract. It is common under commercial general liability (CGL) policies to cover this exposure for contractors and other types of vendors, and the way this happens is the addition of the indemnitee as an additional insured under the indemnitor's policy. The unique issue which design firms face is that the

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insurance companies universally exclude claims arising out of professional services when they issue a CGL policy for a design firm. The policy which covers the design firm's professional services is their professional liability insurance.

Professional liability insurance policies for design firms do not cover the duty to defend. Professional liability may cover the reimbursement of a claimant's defense costs, but that would only occur **after** negligence is established by a court or a settlement is agreed to among the parties involved in a claim. The vast majority of professional liability policies for design firms do not allow additional insureds, and they all have exclusions similar to the one shown below:

> A. THIS POLICY DOES NOT APPLY TO:
> 4. Contractual Liability
> That part of any CLAIM based upon or arising from liability of the INSURED assumed under any contract or agreement.
> This exclusion does not apply to liability for DAMAGES arising from a WRONGFUL ACT for which the INSURED would have been liable for in the absence of such contract or agreement.

In general, if a design firm agrees to a duty to defend in an indemnification clause, any claim by an indemnitee for an immediate defense would trigger the contractual liability exclusion. This is clearly an uninsurable exposure under the standard insurance policies carried by an overwhelming majority of design firms. There have been some efforts in recent years by a very small number of insurance companies to cover contractual defense obligations through the purchase of yet another insurance policy with limited coverage, or through dubious policy wording that appears to cover the exposure but in reality may not properly cover it. This has been an extremely limited offering that could quickly disappear if the carriers decide to stop offering the coverage.

If a design firm signs a client's indemnity that is not limited to the firm's negligence (holding the client harmless from "*any* act" or for "*all* claims arising from the project," for example), they are accepting more liability that the law would otherwise require—and this obligation would also trigger the contractual liability exclusion discussed above. It is clearly an uninsured exposure for a design firm to agree to an indemnification which is not limited to the AE firm's own negligence or that of their subconsultants. There is no coverage available under the CGL policy for this exposure, nor is there any other policy available in the insurance market for design firms to cover this risk.

I strongly feel that it is in the public's best interest for the obligations of design firms under their contracts to be fully covered by their insurance policies. I hope that this information is helpful and would invite any additional questions that you may have on this topic.

Respectfully,

Michael T. Hraber CPCU, RPLU
Vice President - CBIZ Insurance Services, Inc.
Phone: 443-259-3244 | Email: mhraber@cbizinsurance.com