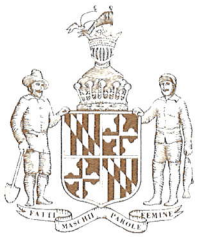
Jon S. Cardin
Legislative District 11
Baltimore County

Judiciary Committee

Chair
Civil Law and Procedure
Subcommittee



The Maryland House of Delegates
6 Bladen Street, Room 217
Annapolis, Maryland 21401
410-841-3054 · 301-858-3054
800-492-7122 *Ext.* 3054
Fax 410-841-3385 · 301-858-3385
Jon.Cardin@house.state.md.us

THE MARYLAND HOUSE OF DELEGATES
ANNAPOLIS, MARYLAND 21401

RE: House Bill 256

Courts – Prohibited Indemnity and Defense Liability Agreements

Position -- Support

Maryland is one of a handful of states that does not prohibit Duty to Defend Clauses for design professionals from state and private contracts. What that means in English is that state and municipal contracts for major construction almost always contain a clause that requires the "design professional" to PAY ALL DEFENSE COSTS FOR ALL PARITES arising from litigation based on tort or negligence -- **regardless of who is determined to be the wrongdoer**. Let us be clear, if and when the design professional is determined to be the party at fault it should and it does indemnify the other parties and it pays for all applicable costs. But if it is not the wrongdoer, why are we allowing the state to make them pay for others' mistakes?

To that end, it is against public policy and the philosophy of our government to require one party to pay all defense costs for everyone if that party HAS NOT been determined to be the party at fault. Furthermore, said liability is NOT NEGOTIABLRE Nor IS IT INSURABLE, so it means that the design professionals must assume these costs into their bid, **and it ends up disqualifying all the small and minority owned businesses from major state and municipal contract bids.** This is illogical, unjust, and counter to the public good.

There has been no opposition to this legislation for 5 years save one – the Office of the Attorney General. The inconsistent objections raised by the Attorney General's staff are predicated on a misunderstanding of the legislation, specifically the distinction between duties to defend and duties to indemnify, coupled with the misperception for the non-precedent setting, industry-specific purpose this legislation is predicated on.

The proposed legislation promotes and strengthens the State's financial interests and public policy objectives, while requiring that design professionals remain legally liable and responsible for the consequences of their own negligence.

With all the background noise the public policy issues behind the legislation are overlooked. The singular purpose of HB 256 is to provide the opportunity for Disadvantaged Business Enterprise (DBE) to compete with entities that have the financial resources to bid and win contracts simply because the DBE's do not. If the value of the contribution that DBE's offer is not recognized and protected, they have no chance to participate in the process. Instead of protecting and uplifting the DBE's, the government created a monopoly, and that is neither the intent of the government nor consistent with public policy.

That is to say that eliminating "duty to defend" clauses in this limited context, it is the best interest of the State. Enacting HB 256 nourishes, rather than diminishes the State's vital roles in development, good governance, the promotion of social justice, and importantly, serves the public good.

Please see the attached explanatory letter prepared by the law firm of Lee/Shoemaker that distills the complexities of the law, addressed past AG concerns, and offers guidance on the way ahead.

The Attorney General's staff has yet again demonstrated opposition but still fails to articulate specific reasons to avoid altering public policy positions. My intuition continues to suggest that it is both inertia and the fear of litigation time borne on the assistant attorney's general and not a definable liability to the state that musters their opposition. After long and arduous discussions, with Attorney General Brown, I am optimistic that his attorneys and ours will resolve this impasse

Attachments

ACEC/MD

AMERICAN COUNCIL OF ENGINEERING COMPANIES/MARYLAND

Chad Faison
cfaison@acecmd.org
850-768-0321

January 25, 2023

SB 56 / HB 256: Courts – Prohibited Indemnity and Defense Liability Agreements

Dear Senator West and Delegate Cardin,

ACEC/MD recently asked Lee/Shoemaker to provide us with their professional opinions regarding various concerns raised in years past related to the above-referenced legislation. The following letter is what Lee/Shoemaker provided.

If you have any questions or concerns, please feel free to contact me directly via email (cfaison@acecmd.org) or my cell (850-768-0321).

Thank you,

Chad F-

Chad Faison
ACEC/MD Executive Director

LEE/SHOEMAKER

Jonathan C. Shoemaker
jcs@leeshoemaker.com
Admitted in DC, VA, and MD
Direct: (202) 971-9401

January 23, 2023

VIA EMAIL ONLY
Chad Faison
American Council of Engineering Companies of Maryland
2408 Peppermill Drive, Suite F
Glen Burnie, Maryland 21061
cfaison@acecmd.org

RE: Duty to Defend Legislation

Dear Chad,

On behalf of the American Council of Engineering Companies of Maryland, you asked us to provide our professional opinions regarding various concerns raised in years past related to the above-referenced legislation. It appears that all of the concerns are predicated on a misunderstanding of the legislation, the distinction between duties to defend and duties to indemnify, and a lack of appreciation for the industry-specific reasons for this legislation. Contrary to the positions asserted in previous opposition to the legislation, we believe that the proposed legislation promotes and strengthens the State's financial interests and public policy objectives, while requiring that Design Professionals remain legally liable and responsible for the consequences of their own negligence.

Summary of Legislation

Under current law, provisions in construction-related contracts, including contracts with design professionals, that purport to require one party to **indemnify** and/or to **defend** another person or entity (an "indemnitee") against liability for damages arising out of bodily injury or damage to property caused by the **sole**

negligence of the indemnitee are void, and unenforceable as against public policy. *See* Md. Code Cts. & Jud. Proc. Art. §5-401(a)[1].

The current duty to defend legislation proposed in the House and the Senate ("the Bills") seek to further refine these protections, as applied to contracts with Design Professionals specifically, in order to align contractual obligations with accepted legal and professional duties, by also making the following types of provisions void as against public policy:

- **indemnity** "against loss, damages, or expenses ... **unless the fault of the Design Professional ... is the proximate cause** of the loss, damage, or expense indemnified"

- **defense** "against liability or claims for damages or expenses, including attorneys' fees, **alleged to be caused ... by the professional negligence** of the Design Professional"

To be clear, if the Bills were enacted, Design Professionals would still be and will remain responsible for liability, damage, and loss proximately caused by their wrongful conduct (or their employees or sub-consultants); however, Design Professionals would not be expected to assume liability for damage, and loss proximately caused by others whom they are not responsible.

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[1] (a) (1) A covenant, promise, agreement, or understanding in, or in connection with or collateral to, a contract or agreement relating to architectural, engineering, inspecting, or surveying services, or the construction, alteration, repair, or maintenance of a building, structure, appurtenance or appliance, including moving, demolition, and excavating connected with those services or that work, purporting to indemnify the promisee against liability for damages arising out of bodily injury to any person or damage to property caused by or resulting from the sole negligence of the promisee or indemnitee, or the agents or employees of the promisee or indemnitee, is against public policy and is void and unenforceable.

(2) A covenant, a promise, an agreement, or an understanding in, or in connection with or collateral to, a contract or an agreement relating to architectural, engineering, inspecting, or surveying services, or the construction, alteration, repair, or maintenance of a building, a structure, an appurtenance, or an appliance, including moving, demolition, and excavating connected with those services or that work, purporting to require the promisor or indemnitor to defend or pay the costs of defending the promisee or indemnitee against liability for damages arising out of bodily injury to any person or damage to property caused by or resulting from the sole negligence of the promisee or indemnitee, or the agents or employees of the promisee or indemnitee, is against public policy and is void and unenforceable.

Apparent Misunderstanding of the Bills

In previous years, concerns have been raised that the legislation would render most indemnity provisions void and unenforceable. This is incorrect.

The Bills only prohibit indemnity clauses that purport to require a Design Professional to indemnify its client against damages (1) caused by the sole negligence of its client and (2) not proximately caused by the fault of the Design Professional. The Court of Appeals has long-held that, "[a]t common law, Maryland generally recognized indemnification only in cases where a wrongful act of a party imposed liability on a third party; in such instances the latter could seek indemnification from the party actually guilty of the wrongful act. *Parler & Wobber v. Miles & Stockbridge, P.C.*, 359 Md. 671, 683 (2000)(citing *Baltimore & O.R. Co. v. County Comm'rs of Howard County*, 113 Md. 404, 414 (1910)).

As the Bills merely seek to limit the enforceability of indemnity provisions to common law indemnity principles, it appears that the previously voiced concerns with the legislation may stem from a misrecognition of the important difference between a "duty to indemnify" and a "duty to defend." The Bills would prohibit a "duty to defend" from being imposed on a Design Professional by contract, but do not prohibit a "duty to indemnify" that conforms to the two limitations discussed above.

The distinction between a duty to defend and a duty to indemnify is well-recognized in Maryland jurisprudence:

> A **duty to defend** obligates a party to pay the litigation expenses of another party *regardless of the outcome* of the case[.]

URS Corp. v. Maryland-National Capital Park & Planning Comm'n, 2018 Md. App. LEXIS 663 at *19, 2018 WL 3323194 (Md. App. 2018) (*citing Litz v. State Farm Fire & Cas. Co.*, 346 Md. 217, 225 (1997), *cert. denied*, 452 Md. 48 (2017). "Duties to defend are triggered by claims, not viable claims." *Id.* at *24 (*citing Litz*, 346 Md. at 225 ("[T]he duty to defend exists even though the claim asserted ... cannot possibly succeed [due to a lack of factual or legal merit]").

> [T]he **duty to indemnify** is a narrower 'obligation to pay a judgment.'

Id. at *19 (*citing Walk v. Hartford Cas. Ins. Co.*, 382 Md. 1, 15 (2004)). A contractual duty on the part of a Design Professional to indemnify the State against damages caused by the Design Professional's "fault"—namely, breach of contract; negligent, reckless, or intentional act or omission constituting a tort; or violation of applicable statutes or regulations" (§ 5-401(a)(1)(VI) (1)–(3)—would remain valid and enforceable upon enactment of the Bills.

Industry-Specific Application

The existing statutory limitation on the duties to indemnity and defend, as set forth in §5-401(a), pertains exclusively to contracts with design professionals or construction-related agreements, and since the Bills retain this limitation while simply revising and refining the statute as it relates to design professionals, there should be little concern that the Bills would affect other industries or create an influx of similar legislation for other special interests.

The Supreme Court of Maryland has recognized the importance of contracts in the construction industry:

> Perhaps more than any other industry, the construction industry is vitally enmeshed in our economy and dependent on settled expectations. The parties involved in a construction project rely on intricate, highly sophisticated contracts to define the relative rights and responsibilities of the many persons whose efforts are required—owner, architect, engineer, general contractor, subcontractor, materials supplier—and to allocate among them the risk of problems, delays, extra costs, unforeseen site conditions, and defects. Imposition of tort duties that cut across those contractual lines disrupts and frustrates the parties' contractual allocation of risk and permits the circumvention of a carefully negotiated contractual balance among owner, builder, and design professional.

Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP, 451 Md. 600, 626 (Md. 2017)(citations omitted). A critical part of the web of contracts allocating risk within the construction industry the contracts contractors and design professionals have with insurance carriers related to the allocation of risk.

The professional liability insurance commercially available to Design Professionals do not extend coverage to contractually-assumed duty to defend obligations. As

Design Professionals are not in the business of providing insurance to their clients, and underwriting that risk, insurance carriers exclude from coverage "any actual or alleged liability of others that the Insured assumes under any oral or written contract or agreement" separate and apart from liability arising out of the professional services. The "Contractual Undertaking Exclusion" excludes from coverage available to the Design Professional both (i) duties to defend and (ii) duties to indemnify for losses caused by parties other than the Design Professional. Accordingly, the ability to resolve disputes is impaired in circumstances where there is an insurance coverage dispute (in addition to the underlying dispute).

Design Professionals are unique in the construction industry, in that the general liability insurance available to construction contractors does allow a construction contractor to name its client as an additional insured under its policies so that the client is able to receive the benefit of the duty to defend afforded by those policies. Unfortunately, general liability policies specifically exclude from coverage claims related to the performance of professional services, such as those performed by Design Professionals. As such, the issue raised in the Bills is unique to Design Professionals within the construction industry.

The issues addressed in the Bills are also unique to Design Professionals, and not a significant concern for professionals in other industries (such as lawyers, doctors, and accountants) in that those other professionals are not typically asked to assume a contractual obligation to defend or indemnify their client from/against loss. Rather, tort law governs the duties owed by such professionals. As outlined above, the Bills would align the limits of indemnity and duty to defend coverage with common law indemnity concepts.

Fiscal Impact of the Bills

It is our understanding that, after several years of determining that the Bills had no fiscal impact, the Fiscal and Policy Analysis Unit determined that "*may* result in increased litigation expenditures for affected State [and local] agencies" and, impliedly, Maryland taxpayers. The Supreme Court of Maryland has recognized that Design Professionals respond to potential liability by increasing the cost of services:

> We are also mindful that government contracts have a special consideration—the public purse. Imposing a tort duty on design

professionals will likely correlate with an increase in project costs and with a corresponding rise in price for government entities.

Balfour Beatty v. Rummel Klepper & Kahl, LLP, 451 Md. 600, 626–27 (2017); *see also Columbia Venture, LLC v. Dewberry & Davis, LLC*, 604 F.3d 824, 831 (4th Cir. 2010) ("[t]he cost of defending such claims against independent contractors in Dewberry's position will be transferred to FEMA through increased contract fees"). The cost of permitting onerous contract provisions like a duty to defend may be reflected in flat fee Prime Agreements and/or Design Professionals serving as a subconsultant who are compelled to accept these provisions when "flowed through" from the Prime Agreement. The impact of these onerous provisions may also be felt by the Maryland taxpayer when public funding is made available to private developers who include duties to defend in their contracts with Design Professionals.

Conversely, the theoretical impact identified by the Fiscal and Policy Analysis Unit – a potential increase in litigation expenditures – suggests a limited understanding of the Bills and the impact of duties to defend in the claims environment. As it relates to the Bills, any potential increase in litigation expenditure would necessarily correlate to the underlying merits of the claims brought against Design Professionals, as the Bills would not limit or preclude the State from being reimbursed legal expenses incurred as a result of the negligence of a Design Professional.

As it relates to the impact of duties to defend in the claims environment, it is our experience that these provisions are an impediment to resolution. When a claim is asserted against a Design Professional, the Design Professional's professional liability insurer must make a decision as to whether the policy extends coverage to the claims asserted. Where there is a claim asserted related to a duty to defend, the professional liability insurer will typically issue a reservation of rights letter to the Design Professional. When a reservation of rights letter has been issued, the professional liability insurer may then try to use the potential coverage issue as a basis for seeking a discounted resolution of the claim. In other words, the mere existence of the uninsurable duty to defend impedes resolution, and increases costs.

Apparent Inconsistency with Public Policy Objectives

The Bills provide significant protection to Disadvantaged Business Enterprise (DBE) firms above all. The State's DBE requirements typically generate a design team with one or more DBE-qualified firms engaged as subconsultant(s) to the prime Design Professional. While the terms of the Prime Agreement may be subject to negotiation with the State, the subcontracts typically "flow through" the Prime Agreement terms down to the subconsultants. As a result, the Prime Agreement terms are effectively an adhesion contract from the standpoint of DBE subconsultants as a condition to obtaining the work. Indeed, the DBE qualification is of far greater value on public projects than on private projects. Duties to defend put these DBE's in a position of having to "bet the company" in exchange for a disproportionately small slice of the design scope and fee—which in turn destabilizes the long-term viability of DBE design firms and perpetuates the systemic oppression of minority and historically marginalized peoples and communities.

Conclusions

For all of these reasons, we believe that eliminating a single cause of action – breach of a "duty to defend" – in this special and limited context, and narrowing the scope of permissible indemnity provisions, is in the State's best interests. Enactment of the Bills will nourish—rather than diminish—the State's vital roles in development and governance, promotion of social justice and service of the public good.

Please let us know if you have any questions.

Sincerely,

Jonathan C. Shoemaker

ACEC

American Council of Engineering Companies
Maryland

Response to the Letter from Office of Attorney General

Dated: January 20, 2021

In opposition to

HB 213 & SB 189

Courts – Prohibited Indemnity and Defense Liability Agreements

A delegation from ACEC/MD met with Mr. Hannibal Kemerer, Chief Council, Legislative Affairs, Office of the Maryland Attorney General (AG) during the 2020 legislative session to discuss a letter dated February 12, 2020 opposing HB 681 & SB 368. The letter submitted by the AG opposing HB 213 & SB 189 is identical to the one issued in 2020, notwithstanding efforts to achieve a resolution.

The following is our response to the three general concerns that have been raised by the AG:

1. The first paragraph of the AG's letter indicates that HB 213 & SB 189 would limit the state's cause of action against a design professional to "negligent performance or breach of contract."

The contractual undertakings and obligations that design professionals have with the state or any other entity with whom they contract should align with their professional duties and legal liability. Inserting uninsurable clauses into contracts, merely to expand the potential causes of action or alternative theories of liability that might be asserted against a design professional, is misguided. After all, the design professional's legal and ethical obligations are to adhere to the professional standard of care. In the event of errors or omissions in the design professional's services, the designer's professional liability insurance policy would protect the client (state) from losses that result from the design professional's breach of the standard of care (negligent performance, breach of contract). Insurance coverage does not extend to losses the design professional did not cause, and a design professional should not be contractually obligated to assume the risk of losses caused by others for whom it is not legally liable.

2. The second paragraph mentions two lawsuits where two different architects were determined by the court to be responsible (the proximate cause) for negligent performance and their liability insurance was required to compensate the state for the damages.

These examples <u>do not</u> constitute reasons to oppose HB 213 & SB 189. This legislation would not relieve design professionals of any liability for which they are legally responsible. In fact, these examples demonstrate the appropriate process for resolving claims with design professionals. If either or both HB 213 & SB 189 are enacted, design professionals will still be held responsible for damages they cause, and indemnification obligations will remain enforceable to the extent the fault of the design professional is determined to be the proximate cause of the loss or damages. In such instances, their liability insurance will compensate the state for indemnity and defense costs.

3. In the third paragraph, on page 2, the AG asserts that excluding design professionals from access to state contracts if they refuse to accept uninsurable liability is: (A) appropriate given the "lucrative" fees paid to design professionals; (B) not a "contract of adhesion"; and (C) in the "best interests" of the state.

These final three objections are the underlying reasoning for the state's opposition to HB 213 & SB 189, which when considered together seem to describe inequitable treatment of vendors that may be contrary to public policy. Insistence that design professionals agree to assume uninsurable liability or forego project opportunities altogether may affect the cost and quality of design professional services in the state. In addition, it adversely impacts small, minority and women owned businesses.

Many small, minority and women owned design professionals submit proposals for design contracts and many are included as team members (subcontractors) on larger design contracts. Keep in mind, subcontractors are typically subject to the same liability provisions as the prime contractor. If there is a situation where the owner requires the prime to assume onerous and uninsurable indemnity obligations, that risk would be flowed down to the subcontractors on the team.

The AG indicates that no design professional is "forced to bid on Maryland RFPs." While this is a true statement it may also be somewhat misleading. To the design firms who must decide between accepting the contract and potential risk of uninsurable losses or forgoing the opportunity altogether and, therefore risk business failure, such a statement may sound unreasonable and cavalier.

Although the AG's letter asserts that these are not "contracts of adhesion," the practical effect remains that in order to submit a proposal, many public procurements typically require acceptance of standard contract terms and conditions, without a fair opportunity to negotiate the indemnity and liability provisions.

We also question the AG's premise that these contracts serve the "best interests" of Maryland. That might be a plausible statement if the state could demonstrate that it saves a significant amount of money by shifting its indemnity and defense costs onto design professionals regardless of fault and regardless of the disadvantage that this might cause small, minority and women owned firms. Fortunately, that is not the case if you believe the Fiscal Note attached to HB 213 & SB 189:

State Effect:	The bill is **not** anticipated to materially affect State finances or operations.
Local Effect:	The bill is **not** anticipated to materially affect local finances or operations.
Small Business:	Potentially meaningful [beneficial effect]

Final note: The concerns of design professionals have been dismissed as a business contract dispute or something that should be resolved between business entities in the courts. That might seem to be a reasonable view if both parties were on more of less equal ground but, that is not the situation. The other entity involved is often a public procurement agency. It controls the procurement system for all the contracts in question, which for many design professionals, and for many of our member firms, is the primary source of revenue.