Attachment E

HB 1117

Contractual Requirement of the Duty to Defend
and the Potential Impact on Architects and Engineers

Under common law, every individual is responsible for his or her own negligence. Whether an individual is considered to be negligent is based on the duty of care that individual owes to another person. Architects and engineers owe their clients a professional duty of care – a duty of reasonable care to perform their work in a manner consistent with that degree of care and skill ordinarily exercised by members of the same profession practicing under similar circumstances at the same time and in the same or similar locality. However, a duty of care does not mean duty to defend.

In an attempt to shift the risks associated with undertaking a construction project, written indemnifications are common in contracts for design and construction services. While the entity in the best position to control the risk should bear it, many owners have indemnification provisions that shift most, if not all, of the risk onto the A/E.

In the context of A/E services, "indemnify" means to compensate the indemnitee (the entity being indemnified) for loss or damage it incurred that was caused by the negligence of the indemnitor (the entity providing the indemnification). In other words, to make that entity "whole" or to put that entity in the position it would have been had the indemnitor's negligence not occurred. In addition to losses and damages, the duty to indemnify can also include costs associated with an entity's defense to the extent the A/E is found to be negligent. The obligation to indemnify is triggered after a finding of negligence. (Similar to the presumption that a person is innocent until proven guilty.)

In addition to the requirement to indemnify, many contracts also contain a requirement that the A/E defend the owner (and others). In some cases, the requirement to defend is triggered even if the owner is the only party sued and even if it is alleged that the owner's negligence was the sole cause. In other words, this "duty to defend" arises before a determination is made as to whether the A/E was negligent at all. (It is significant to note that contracts from both the federal government and the State of Colorado do not require the A/E to defend against claims. Indemnify, yes; defend, no.)

What may be contributing to the duty to defend language in owner contracts with A/Es is a misunderstanding of the nuances of difference between a commercial general liability insurance policy (CGL) and a professional liability insurance policy (PLI). A CGL policy obligates an insurer to defend an insured against any suit seeking damages because of bodily injury, property damage, or personal and advertising injury. This is the primary type of insurance a contractor typically carries because general liability insurance covers most damages caused by the negligence of the named insured.[1] Note that CGL policies typically exclude coverage for any liability arising from the rendering of "professional services," such as engineering or architecture.[2] In addition, CGL insurance provides for covering the owner as an "additional insured," which means the insurer is also obligated to defend the owner for damages caused by the named insured.[3] Further, the policy can be endorsed to cover contractually assumed liability in addition to ordinary negligence by the named insured.[4] So requiring defense in an indemnification provision for a contractor is both appropriate and insurable.

In stark contrast to CGL, it is the A/E's professional liability insurance (PLI) policy that provides the most important coverage for the A/E in any claim involving its services.[5] And, PLI does not offer "additional insured" status to the owner or anyone for that matter; it only covers the professional, and the insurer is only obligated to defend the professional. And most notably, a key difference between CGL and PLI

policies is that, under a PLI policy, a contractually assumed liability is excluded from coverage.[6] Therefore, when an A/E is required by contract to defend an owner, the duty to defend, unlike the duty to indemnify, arises before a liability determination has been made. And, because PLI coverage excludes liability assumed under contract, except to the extent that liability would have existed under common law, the A/E is left to foot the bill for the entire defense of the owner without the benefit of insurance – even if the A/E is ultimately found to not have been negligent, or only partially negligent. The cost of this defense obligation can easily far exceed the fee the A/E received for the project and, with the cost of attorneys' fees, could potentially sink most small- to medium-size A/E firms. Of note, roughly 90%to 95% of all engineering firms and architecture firms in Colorado are small businesses (federal size standard).

To justify their "duty to defend" requirement, municipalities have stated that they are "stewards of the public trust" and must protect and preserve the public funds entrusted to them. Many of these contracts also state that the A/E should obtain, at its own expense, any additional insurance it deems necessary for the municipality's protection. The problem is there is no such insurance for an A/E that will cover this up-front defense. Indemnify (make whole) after a judgment is rendered, yes; defend up front, no. So the "stewards of the public trust" argument is flawed because the public funds are still at risk if an A/E has to declare bankruptcy because it doesn't have the assets to cover defense costs (and most A/E firms don't) and because its insurance doesn't cover the defense the A/E assumed by contract. In this scenario, the municipality is left to cover the defense costs anyway, which, if the indemnification provision did not include the requirement to defend, would likely have been covered by the A/E's PLI as part of the settlement to the extent the A/E was found to be negligent.

Bottom line, it is unfair for an owner to require the A/E to provide up-front defense based on an allegation, particularly because the A/E cannot insure itself against this risk and because negligence has not been determined. Further, the duty to defend requirement could have a particularly detrimental effect on MBE, WBE and DBE firms, which may already find it more difficult to compete for work and likely have even fewer resources to cover defense costs. And, frankly, no A/E should have to put its livelihood on the line just to obtain work.

In order to address the duty to defend requirement found in many contracts, particularly contracts from municipalities which are largely unwilling to negotiate terms, we are encouraging the legislature to revise CRS 13-50.5-102 (8), ~~as well as C.R.S.13-21-111.5(6)(b) and (c)~~, to unequivocally state that, except to the extent covered by a party's insurance, any provisions in a construction contract requiring one party to defend another party from the outset of a claim is void as against public policy.

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1. Santa Clara Law Review, Vol. 50, No. 3 at 844
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id. at 845*
6. *Id.*