

Approved: Robert Tomlinson  
Date March 9, 1999

MINUTES OF THE HOUSE COMMITTEE ON INSURANCE.

The meeting was called to order by Chairperson Bob Tomlinson at 3:30 P.M. on February 18, 1999 in Room 527-S of the Capitol.

All members were present except: Rep. Showalter, Hummerickhouse, Jennings

Committee staff present: Bill Wolff, Research  
Ken Wilke, Revisor  
Mary Best, Secretary

Conferees appearing before the committee: Linda DeCoursey-Kansas Department of Insurance  
Michael Helbert-Trial Lawyers association  
Dee Meyer-Mother's Against Drunk Drivers-testimony only  
David Hanson-Kansas Association of Property  
& Casualty Insurance Co.  
Bob Totten-Kansas Contractors  
John Sherwood-Sherwood Construction-Wichita, Ks.  
Sue Ann Schultz-Insurance Management Agency  
Pat Morris-Kansas Association of Insurance Agents  
Trudy Aaron-American Institute of Architects  
Kathy Greenlee, General Counsel, Kansas Department of Insurance

Others attending: See attached Guest List

The Chair called the meeting to order. Committee was directed to turn their attention to **HB 2503.**

**HB 2503: Relating to insurance fraud**

The Chair recognized Ms. Linda DeCoursey, Kansas Department on Insurance, who gave Proponent Testimony. A copy of the written testimony is (Attachment #1) attached hereto and incorporated into the Minutes by reference. She also introduced Kathy Greenlee, General Counsel to the Kansas Department of Insurance. Ms. Greenlee also gave Proponent Testimony and a copy of her testimony is attached to Ms. DeCoursey's testimony, and will become (Attachment #2) attached hereto and incorporated into the Minutes by reference. Ms. Greenlee explained first-party and the bill to the committee. This bill will establish a definition for a "fraudulent insurance act". The definition would be "as an act committed by any person who, knowingly and with intent to defraud, presents, causes to be presented or prepared with knowledge or belief that it will be presented to or by an insurer ". As per the Insurance Department this "can be considered when a person knows that information they are giving contains materially false information concerning any fact thereto, to conceals for the purpose of misleading, on any written statement or on the application for a policy or the rating of an insurance policy for personal or commercial insurance. The bill sets out monetary penalties as well as classification of the wrong-doing. With this bill the violator pays restitution to the insurer or any person or entity who sustains a loss due to the violation. Section two states this applies to all insurance applications, ratings claims and other benefits pursuant to the policy. The committee was reminded that this bill was not just for automobile insurance but for all types of insurance. Ms. Greenlee requested the words "first party" be inserted into the sentence of line 36.

Questions were posed by Rep. Boston and Kirk

Michael Helbert, Kansas Trial Lawyers Association, gave Proponent Testimony, to the committee. A copy of the written testimony is (Attachment #3) attached hereto and incorporated into the Minutes by reference. Mr. Helbert stated the Trial Lawyers Association were supporters of the bill. He stated the present law allows insurance companies to void out obligation to provide coverage (even mandated), if they deem the insured has committed a fraudulent act. They feel this leaves many innocent victims paying for irresponsible people. They stated this eliminates protection to innocent parties who may have had nothing to do with the fraudulent act. They feel this bill will overturn this problem. They also requested in regard to subsection 1 (c) line 37, the word "on" be inserted between the words "coverage and or. This is in agreement with the Insurance Department. They felt this would help clean up the language.

Questions posed by Rep. Vining, Boston, and Burroughs.

Dee Meyer, Kansas Mothers Against Drunk Drivers, submitted written Proponent Testimony to the committee. A copy of the testimony is (Attachment #4) attached hereto and incorporated into the Minutes by reference.

Mr. David Hanson, Kansas Association of Property and Casualty Insurance Companies, gave Opponent Testimony to the committee. A copy of the written testimony is (Attachment #5) attached herein and incorporated into the Minutes by reference. Mr. Hanson felt the proposed amendment would result in insurance companies paying more claims involving fraudulent insurance acts, limiting non-payable claims to first party claims and requiring all others to be paid. He questioned whether "first party" is clearly defined. He feels at this time there is no significant problems with the existing provisions with the adoption of the 1994 proposed amendment.

Questions were from Chairperson Tomlinson, Rep. Toelkes, O'Brien, Burroughs, Kirk, and Boston.

This closed the public hearings on **HB 2503**.

Public hearings were then opened on **HB 2483: Construction contracts; indemnification agreements**.

Mr. Bob Totten, Kansas Contractors, gave the first Proponent Testimony to the committee. A copy of the testimony is (Attachment #6) attached hereto and incorporated into the Minutes by reference. This bill contains the language to state who bears liability when a problem arises on the owner's property where a contractor is working. It is their feeling the "indemnification clause" should be eliminated. There were changes made that should not have been when the bill was first introduced. They are offering a balloon requesting in line 22 to replace the word "agreement" with the word "provision: and in line 26 insert the words "in a construction contract" between the words "provision and is". This is to assure everyone the indemnification language pertains only to construction contracts. Mr. Totten then introduced Mr. John Sherwood.

Mr. John Sherwood, Sherwood construction, Wichita, gave Proponent Testimony, to the committee. A copy of the testimony is (Attachment #7) attached hereto and incorporated into the Minutes by reference. Mr. Sherwood confirmed Mr. Totten's testimony and further stated that this proposed piece of legislation arose out of a proposed agreement from Burlington Northern & Santa Fe Railroad. Mr. Sherwood feels this is only fair and equitable to pass the proposed bill" so that each party is responsible for its own negligent act and misdeeds".

Questions were asked by Rep. Vining, Empson and O'Brien

Ms. SueAnn Schultz, Insurance Management Associates, gave Proponent Testimony to the committee. A copy of the testimony is (Attachment #8) attached hereto and incorporated into the Minutes by reference. Ms. Schultz supported previous testimony and supports the bill.

Questions by Rep. Vining, Grant

Mr. Pat Morris, Kansas Association of Insurance Agents, gave Proponent Testimony to the committee. A copy of the testimony is (Attachment #9) attached hereto and incorporated into the Minutes by reference. Mr. Morris supports the proposed legislation. They feel the need has arisen for anti-indemnification language centered around the increasing insurance premiums for contractors based on insurance claims paid not as a result of fault of the contracted entity, but rather because of contractual agreements the contractor has had to agree to in order to get the contract.

Ms. Trudy Aaron, American Institute of Architects, gave Opponent Testimony to the committee. A copy of the testimony is (Attachment #10) attached hereto and incorporated into the Minutes by reference. Ms. Aaron stated to the committee the contracts between parties involved in design and construction develop consensual documents. They are drafted to assign risk to those best able to control the risk and this bill would bring uncertainty and undermine the principles established by these contracts.

Questions were posed by Rep. Kirk, O'Brien

Public hearing on the bill were closed.

The Chair then announced his intent to work the following bills in this order **HB 2266, HB 2092, HB 2503, HB 2483.**

**The first bill HB 2266: Mutual holding companies' reindemnification Rep Cox made the motion to pass the bill out favorably. The motion was seconded by Rep. Empson. No discussion. The bill was voted unanimously to pass out favorably.**

**HB 2090- Small employer health plans; mandatory requirements. Rep. Kirk made the motion to accept the balloon to amend HB 2090. Rep. Empson seconded. The vote was taken and vote was unanimous to accept the balloon. Rep. Kirk made the motion to move HB 2090 out favorably as amended. Rep. Toelkes seconded. Discussion called. No discussion. Vote 1 no, Rep Boston as recorded, remainder of the committee 16 ayes. Bill passed out favorably as amended.**

**The next bill called was HB 2503: Penalties for fraud. Rep. Boston requested bill be referred to summer interim committee for study. Rep. Vining seconded. Discussion. Substitute motion was made by Rep. Cox to insert the word "on" in line 37, between the words "coverage" and "or". Rep. O'Brien seconded the motion. Committee vote was taken on the amendment to line 37 of the bill, vote passed favorably to amend. Rep. Boston moved to table the bill. The motion was seconded by Rep. Dreher. Motion was to table with the Chair tabling the motion, no, leaving it open to discussion. Vote to table 6 votes, noes, 7 votes. Motion to table failed. Rep Grant made motion to have committee recommend this report for the bill be considered for interim study. Rep. Vining seconded. Call for discussion. No discussion. Vote taken on motion, motion passed with 2 nays, Rep. Myers and Rep. Cox. Chairperson Tomlinson reminded the committee that there was no guarantee the bill would be picked up on their recommendation before the vote was taken..**

**The last bill to be called was HB 2483: Construction contracts; indemnification agreements. Rep. Moved to amend the bills according to the balloon offered, in the two areas requested, line 22 striking "agreement" and putting in "provision", and line 26, inserting "in construction contract" between "provision" and "is". Motion seconded by Rep. Dreher. No discussion on the motion. Vote taken. Motion to amend, pass unanimously. Rep. Empson then made the motion to pass the bill favorably as amended. Rep. Dreher seconded. Call for discussion. Discussions by Rep. Kirk, Grant, Mr. Totten, Rep. O'Brien and Burroughs. Vote called on the motion. Vote to pass out favorably as amended was voted unanimously.**



House Insurance Minutes 2-18-99 Continued

Meeting adjourned 5:30p.m.

Next meeting March 4, 1999, in Room 519S.

# HOUSE INSURANCE COMMITTEE GUEST LIST

DATE: 2/18/99

NAME	REPRESENTING
Don Pulliam	USD 501
Tish Heim	Security Benefit
Tom Slattery	AGC of KS
Bill Sneed	Ar Vest
Danielle Noe	Governor's Office
Theresa Dulin	IMA
Kevin Davis	Am Family Ins.
Pat Morris	ICAIA
Steve Montgomery	UnitedHealthcare
Trudy Arow	Amer Inst of Architects
Bob Wilborn	Farmers Alliance
Harris Ann Brown	KS Assoc. of Health Plans
<del>Frank Hunsicker</del>	<del>KS Trial Lawyers Assn.</del>
<del>William Fisher</del>	<del>KS Trial Lawyers Assn.</del>
JAKE FISHER	WHITNEY DAMRON
Dick Bauman	KDOT
Sue Ann Stuebel	IMA
Lee Wright	Farmers Ins. Group
John Magler	American Investors





**Kathleen Sebelius**  
Commissioner of Insurance  
**Kansas Insurance Department**

TO: House Committee on Insurance

FROM: Linda De Coursey

RE: HB 2503 – Act relating to fraud insurance; and penalties

DATE: February 18, 1999

Mr. Chairman and members of the Committee:

Thank you for this opportunity to discuss HB 2503. The Kansas Insurance Department requested the bill. The bill establishes the definition in K.S.A. 40-2,118 for “fraudulent insurance act” as an act committed by any person who, knowingly and with intent to defraud, presents, causes to be presented or prepared with knowledge or belief that it will be presented to or by an insurer. This can be considered when a person knows that information they are giving contains materially false information concerning any fact thereto, or conceals for the purpose of misleading, on any written statement or on the application for a policy or the rating of an insurance policy for personal or commercial insurance.

The bill also sets out the penalties. If the amount involved is \$25,000 or more, the penalty is a severity level 6, nonperson felony. And the amounts and severity levels decline from there to if the amount is less than \$500, the penalty is a class C nonperson misdemeanor.

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*House Comm on Insurance*  
**Consumer Assistance Hotline**  
1 800 432-2484 (Toll Free)

*Attachment #1  
February 18, 1999  
1-2*

HB 2503 stipulates that a person who violates this statute is ordered to make restitution to the insurer or ~~any person~~ or entity for any financial loss sustained as a result of the violation.

The insurer does not have to pay claims or provide coverage to the first party.

Section two of the bill states that it applies to all insurance applications, rating, claims, and other benefits made pursuant to the insurance policy.

Mr. Chairman and members of the Committee, I would like to ask the General Counsel of the Kansas Insurance Department, Kathy Greenlee, to discuss with you further HB 2503. As the former Director of Consumer Assistance Division of the Kansas Insurance Department, Kathy dealt with claims of consumers regarding the issue HB 2503 hopes to help eliminate.



My name is Kathy Greenlee and I am the General Counsel of the Kansas Insurance Department. I am here today asking you to protect people who are innocent victims of insurance fraud. In 1994, the Kansas legislature made several revisions to K.S.A. 40-2,118. At the end of line 36 you will see a sentence which says "An insurer shall not be required to provide coverage or pay any claim involving a fraudulent insurance act." We wish to insert the words "first party" into this sentence.

This simple sentence is creating significant hardships for people who are innocent bystanders of the fraudulent conduct. In order to explain the significance of the 1994 amendment, I would like to briefly discuss Kansas no-fault laws and three Kansas appellate court decisions.

- At common law the right of rescission *ab initio* for fraud and misrepresentation was available to an insurance company. This means that companies could cancel a policy back to its inception.

See *Slaby v. Cox*, 250 Kan. 429, 431 (1992), *Continental Western v. Clay*, 248 Kan. 889 (1991), *Dunn v. Safeco Inc. Co.*, 14 Kan.App.2d 732 (1990).

- In 1974, Kansas passed the Kansas Automobile Injury Reparations Act, K.S.A. 40-3101 *et seq.* A part of that act, K.S.A. 40-3118(b), states that no motor vehicle liability insurance policy shall be terminated by cancellation by the insurer until at least 30 days after mailing a notice of termination.
- In 1990, in the *Dunn* case, the Kansas Court of Appeals was asked to consider for the first time how common law right of rescission was affected by the no-fault insurance law. The Court held that the mandatory liability coverages could only be cancelled by complying with the cancellation law, K.S.A. 40-3118(b). The optional coverages could be cancelled *ab initio*. *Dunn* at 738.

*House Comm on Insurance  
Attachment #2  
February 18, 1999*      *2-1  
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- In 1991, in the *Continental Western* case, the Kansas Supreme Court ruled that the insurance company could not cancel the policy *ab initio* and cut off the liability claims of the third party. The Court quoted extensively from a Michigan case,

"In those cases where an innocent third party is involved, there is a public policy which requires a holding that the insurance company cannot avoid liability by rescission." *United Security v. Ins. Comm'r*, 133 Mich. App. 38, 43 (1984).

- In 1992, in the *Slaby* case, the Kansas Supreme Court again ruled that rescission or reformation of a policy is generally not allowed to exclude the claim of an injured innocent third party.

Because of the 1994 amendments to K.S.A. 40-2,118, some insurance companies are denying ALL claims which are connected to an underlying fraudulent act. We at the Kansas Insurance Department frequently hear from innocent third party claimants, such as this man.

On July 21, 1997 a man in Humboldt, Kansas was riding his motorcycle when he was struck by a car driven by a 17 year old man from Iola. The Iola driver was 100% at fault yet his insurance company refused to pay the claim.

After receiving the claim, the insurance company discovered that the young man's mother had failed to tell the company that her son was a member of the household, that he frequently operated the vehicle and that he had his own set of keys. The mother also failed to tell the insurance company that her son had a suspended driver's license as a result of a DUI.

In this situation the insurance company rescinded the mother's policy. The motorcycle driver's claims were denied although he had nothing to do with the underlying fraud.

Not all insurance companies interpret the fraud statute in the same way. Some companies pay third party claims, others do not. We want to ensure that all insurance companies are taking adequate steps to protect the innocent victims of insurance fraud. We ask for your support of this bill.

*Law Offices of  
Michael E. Helbert*

*Phone: (316) 343-6500*

*519 Commercial  
P.O. Box 921  
Emporia, KS 66801*

*Fax: (316) 343-1734*

**House Bill 2503  
Testimony Before the House Committee on Insurance**

My name is Michael Helbert and I am an attorney practicing in Emporia, Kansas. I am also the Vice-president for legislation for the Kansas Trial Lawyers Association. I am here today to testify in support of House Bill 2503.

We believe that House Bill 2503 addresses a real need in the State of Kansas. Prior to the passage in 1994, of the predecessor to House Bill 2503, an insurer could not avoid liability to an innocent third party if the insured had committed a fraudulent insurance act. However, since 1994, innocent third parties have become at risk in the State of Kansas. The present law allows insurance companies to void any obligation that they might have to provide coverage, even mandated coverage, if an insured has committed an act that the insurance company deems to be fraudulent. The practical side of this is that innocent victims of negligent actions are forced to pay for the acts of irresponsible people.

On January 1, 1974 the Automobile Injury Reparations Act, also known as the Kansas No-Fault Law, went into effect. At that time, this state as a matter of public policy determined that anyone owning an automobile and operating it on the streets and highways of our state would be required to have current and continuous liability insurance coverage. It was felt by the Kansas Legislature that the safety of the public required mandatory insurance coverage. The public in return for that type of protection surrendered its rights to the unlimited common law

*House Comm on Ins.  
Attachment # 3  
February 18, 1999*

*3-1  
T-3*

ability to file a law suit to remedy injuries received from an automobile collision. The No-Fault Law significantly altered the rights of the consumers of the state. It was felt that those rights were being relinquished in exchange for a mandatory liability insurance public policy that would provide protection to everyone in our state. That protection is in jeopardy under the existing law. The reason for that is very simple. It eliminates protection to innocent third parties who have nothing to do with the fraudulent or alleged fraudulent insurance acts of the driver who caused the collision.

Prior to 1994 this was not a problem. The Kansas Supreme Court had ruled, along with virtually every other state, that an insurer cannot, on the grounds of fraud or misrepresentation related to the inception of the policy, retroactively avoid coverage under a compulsory or financial responsibility insurance law so as to escape liability to a third party. The Legislature, we believe, unknowingly changed that rule and thereby put itself at odds with prior Kansas court decisions and the public policy of this state. A review of the testimony on the 1994 bill reveals that the primary concern of the legislature was to provide criminal penalties for insurance fraud. The only mention of section c was the positive statement of one proponent that the law would allow insurers to void coverage as to the insured. The subject of liability to innocent third parties was not addressed. We believe that the use of this language since 1994 to deny innocent third parties coverage is an unfortunate, and unintended consequence of a legislative attempt to establish criminal penalties for fraudulent insurance acts.

How does this affect our daily lives. Some good examples of what the present law can and has done are:

- A. A drunk driver obtains an insurance policy through fraud and strikes an innocent

pedestrian. In that situation, even though the pedestrian did nothing wrong, under our present statute, the insurance company would be protected and the risk of loss would be cast on the injured and the innocent.

B. A person is lawfully driving her vehicle and is struck by a motorist who has obtained his insurance policy through fraud. In the car with the fraudulent motorist is his five year old daughter. The daughter and the innocent driver are both injured. In that case, there would be no coverage to either the innocent driver or the child of the insured.

C. A group of college students leave for a weekend trip. The driver of that vehicle is driving under a family policy that was obtained by his parents through fraud. The group of college students becomes involved in an automobile collision and all of them are injured. Under the present law the insurance company could void its obligation to everyone in that vehicle.

These are real life situations that affect real people in our state. When we mandated automobile insurance coverage in this state that insurance policy became not only a contract between the insurer and the insured, but also a matter of public interest because it provides protection to the innocent people of this state. Innocent persons should not pay for the mistakes or criminal acts of others.

We strongly urge you to pass House Bill 2503. Thank you for your time and attention.





## Mothers Against Drunk Driving

3601 SW 29th Street • Topeka, KS 66614 • (785) 271-7525 • 1 (800) 228-6233

KANSAS STATE OFFICE

February 17, 1999

Representative Robert Tomlinson, Chairman  
House Insurance Committee  
Room 112 S, State Capital  
Topeka, Kansas 66612

Dear Representative Tomlinson and Committee Members:

Kansas MADD would like to take the opportunity to submit written testimony in support of House Bill 2503.

During 1997, (1998 statistics unavailable) 3,266 drinking drivers were involved in 3,205 alcohol-related crashes involving 6,768 persons. Eighty-six persons were killed and 2,508 were injured. Approximately one of every three persons killed in an alcohol-related crash is not the drinking driver.

It is MADD's policy to protect and support victims of drunk driving crashes and oppose laws which diminish or restrict the rights of victims of drunk drivers to be compensated. Present Kansas law does not require the insurer to provide coverage or pay third party claims if the individual obtained insurance fraudulently. House Bill 2503 would provide third party compensation in those instances involving a fraudulent insurance act on the part of the drinking driver.

Kansas MADD asks your support for House Bill 2503.

Sincerely,

*Dee Meyer*

Dee Meyer, State Chairperson  
Kansas MADD

*House Comm on Ins  
Attachment # 4  
February 18, 1999*

# Kansas Association of Property and Casualty Insurance Companies

David A. Hanson, Legislative Counsel  
900 Mercantile Bank Tower  
800 S.W. Jackson  
Topeka, KS 66612-1259

Phone 785-232-0545  
Fax 785-232-0005

## House Insurance Committee Testimony on HB 2503 Presented by David A. Hanson February 18, 1999

### Mr. Chairman and Members of the Committee:

Thank you for giving me the opportunity to present concerns for the Kansas Association of Property and Casualty Insurance Companies, whose members are domestic insurance companies in Kansas.

Our member companies are very concerned about the provisions of House Bill 2503 and are opposed to passage of the bill in its present format. Essentially, the bill attempts to amend the current statutory provisions prohibiting insurance fraud. In 1994, our statutory provisions relating to insurance fraud were amended to impose specific criminal penalties, as now set forth in subsection (b), and to deny benefits or require reimbursement of benefits paid or damages sustained as a result of a fraudulent insurance act. At that time, insurance fraud was estimated to total about \$80 billion nationally. Studies have shown increases since then with auto insurance fraud being about \$14 billion and homeowners insurance fraud being about \$3 billion. It has been estimated that insurance fraud costs every American family over \$1,000 per year in higher insurance premiums, taxes and increased costs of goods and services.

It would appear that the proposed amendment would require insurance to pay more claims involving fraudulent insurance acts by limiting the non-payable claims to only first party claims, thereby requiring payment of all others.

The issue is further complicated by the reference to first party claims. Do we have a clear definition of "first party" to determine whether payment should be made? Is the first party just the named insured or an additional insured or maybe a beneficiary under the policy?

The current law does not prevent payment to innocent victims. It is necessarily broad to deny benefits to anyone involved in a fraudulent insurance act, regardless of whether the person may be the insured, a provider, a claimant or anyone else regardless of being first, second or third party. No one engaged in insurance fraud should be allowed to benefit from that fraud. We have not seen any significant problems with the existing provisions since their adoption in 1994 that would justify the proposed amendment.

We would therefore respectfully urge you not to pass the bill in its present form.

Respectfully,



DAVID A. HANSON

*House Committee on Ins.  
Attachment # 5  
February 18, 1999*

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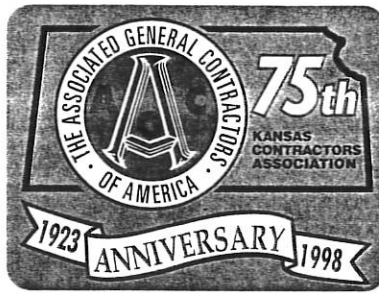
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### MEMBER COMPANIES

Armed Forces Insurance Exchange, Ft. Leavenworth  
Bremen Farmers Mutual Insurance Co., Bremen  
Columbia Mutual Insurance Group, Salina  
Farm Bureau Mutual Insurance Company, Manhattan  
Farmers Alliance Mutual Insurance Company, McPherson

Farmers Mutual Insurance Company, Ellinwood  
Kansas Mutual Insurance Company, Topeka  
Marysville Mutual Insurance Company, Marysville  
Mutual Aid Assn. of the Church of the Brethren, Abilene  
Upland Mutual Insurance, Inc., Chapman

# THE KANSAS CONTRACTORS ASSOCIATION, INC.



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Towanda, Kansas

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Wichita, Kansas

## Testimony

By Bob Totten, Public Affairs Director for the Kansas Contractors  
Association

before the House Insurance Committee

regarding HB 2483

February 18, 1999

Mr. Chairman and members of the House Insurance committee, I am Bob Totten, Public Affairs Director for the Kansas Contractors Association. Our organization represents over 400 contractor and associate members who are involved in the heavy, highway and utility construction industry.

I am here today to support HB 2483. This measure came to our attention some time last year when many of our members indicated to us a concern with contracts with some owners in Kansas. The language spelled out in these new contracts would change who is liable for problems that occur on the owner's property when the contractor was involved in construction.

*House Comm on Ins.  
Attachment # 6  
February 18, 1999  
6-1  
13*

In our opinion, the language gave undo responsibility to the contractor. It is our feeling that these "indemnification clauses" should be eliminated.

We have discovered that over 20 states have similar indemnification clauses and the bill before you is patterned after a law in Utah.

We were instrumental in getting this bill introduced however between Representative Doug Mays who introduced in Federal and State Affairs committee and the Revisor's Office there were some minor changes that should not have occurred.

I visited with the chair and Representative Mays about these concerns and I was told to bring them to you as friendly technical amendments.

The changes we are seeking is part of a balloon which is attached to this testimony. In line 22 instead of " agreement ", we want that to read "provision"... and then in line 26 between the words "provision and is", we want to insert the words "in a construction contract". The reasons for these changes is to make sure that the indemnification language only pertains to construction contracts. If these words were not there, it would allow the issue of indemnification to be used in other situations.

As you all know, I don't know too much about indemnification and contracts But I have brought some people with me today who know a lot more about it than I do and I would like to introduce you to our first conferees at this time.

At this time, I would like to introduce you all to John Sherwood of Sherwood Construction in Wichita. Mr. Sherwood, along with his brother is a contractor But he is also a lawyer...and he seems to know a whole lot more about this than I do.

HOUSE BILL No. 2483

By Committee on Federal and State Affairs

2-11

9 AN ACT concerning construction contracts; relating to indemnification  
10 agreements.

11  
12 *Be it enacted by the Legislature of the State of Kansas:*

13 Section 1. (a) When used in this section:

14 (1) "Construction contract" means a contract or agreement relative  
15 to or collateral to the design, construction, alteration, repair or mainte-  
16 nance of a building, structure, highway, road, bridge, water line, sewer  
17 line, oil line, gas line, appurtenance, appliance or other improvement to  
18 real property, including any moving, demolition or excavation under a  
19 construction contract.

20 (2) "Damages" means personal injury damages, property damages or  
21 economic loss.

22 (3) "Indemnification ~~agreement~~ **provision**" means a covenant, promise, agree-  
23 ment or understanding in connection with or collateral to a construction  
24 contract that requires the promisor to insure, hold harmless, indemnify  
25 or defend the promisee or others against liability for damages.

in a  
construction  
contract

26 (b) An indemnification provision ~~is against~~ public policy and is void  
27 and unenforceable.

28 (c) This section shall not be construed to affect or impair the obli-  
29 gations of contracts for insurance, workers compensation, bonding, ex-  
30 pressed warranties, implied warranties, guarantees or settlement  
31 agreements.

32 (d) This section shall not be construed to affect or impair a promisor's  
33 liability for damages caused by a promisor's own negligence or breach of  
34 contract.

35 Sec. 2. This act shall take effect and be in force from and after its  
36 publication in the statute book.



Ladies and Gentlemen:

I have been requested to speak in favor of passage of HB2483 as amended on behalf of the construction industry.

First, indemnity clauses have been a long time problem in the insurance, construction and legal communities. The following states have similar statutes outlawing indemnification clauses: Alaska, Connecticut, Idaho, Massachusetts, Michigan, Minnesota, Nebraska, New Jersey, North Carolina, Rhode Island, Tennessee, Utah, Virginia, West Virginia, and there may be more. Therefore, you can tell this is not revolutionary new legislation.

Second, as an example of a real day-to-day problem with indemnification clauses, I will tell you of the case of Phillip Smiley.

Phillip Smiley was a heavy equipment operator for Sherwood Construction Co., Inc. on a project called "Lone Mountain" in Oklahoma. Lone Mountain was a hazardous waste dump site and Sherwood Construction had a contract to build more cells to be used to dump additional hazardous waste.

Phillip Smiley got something in this eye and after seeing a doctor filed a worker's compensation case against Sherwood Construction. This case was eventually settled with Mr. Smiley receiving a cash settlement. Mr. Smiley then filed suit against the operator of the hazardous waste site claiming that what he had gotten in his eye came from the hazardous waste site. The operator of the hazardous waste site then made demand upon Sherwood Construction to defend in the law suit and joined them as third party defendants based on an indemnification clause in the contract.

As you can tell, this put Sherwood Construction in the position of paying a worker's compensation case and then having to defend in a civil suit arising out of the same circumstances, all without any fault or negligence on their part.

Third, this proposed legislation arose out of a proposed agreement from the Burlington Northern & Santa Fe Railroad. In this agreement, they wanted highway contractors to indemnify them from all loss that occurred in the construction zone, no matter who was at fault. As you can tell, this would mean the contractor (or his insurance company) would pay even if the accident was caused by a transport truck driving through the work zone during the night time when the contractors work force was not present or an accident caused solely by the railroad's own negligence.

Therefore, we believe that it is only fair and equitable to pass this proposed legislation so that each party takes responsibility for its own negligent acts and misdeeds.

Respectfully submitted,

John D. Sherwood  
Corporate Counsel  
for Sherwood Construction Co., Inc.

*Attachment #9  
Hawaii Insurance Company  
February 18, 1999*

**TESTIMONY REGARDING HOUSE BILL No. 2483**  
Insurance Committee - Kansas House of Representatives  
February 18, 1999

Mr. Chairman and members of the committee, thank you for this opportunity to testify regarding House Bill 2483.

I currently serve as General Counsel to Insurance Management Associates, a Kansas company that is the 19th largest independent insurance agency in the United States. Our client base consists of numerous companies and businesses throughout the U.S. with in excess of three quarters of our revenues derived from commercial property and casualty coverages. As a large provider of commercial property and casualty insurance, we have many clients that are supporters of House Bill 2483 and we appear on behalf of those clients, which include Neosho Companies (Topeka/Parsons), Eby Companies (Wichita), N.R. Hamm Companies (Perry), Jomax Construction Company (Great Bend) and Meier's Ready Mix (Topeka/Osage City/Junction City/Atchison/Burlington) as well as appearing as a representative of the insurance industry.

A hold harmless or indemnification clause is basically the assumption, by contract, by one party (the "Indemnitor") of the liability of another party (the "Indemnitee"), arising out of the contract. Proposed House Bill 2483 provides that all hold harmless or indemnification provisions in construction contracts would be void and unenforceable as against public policy.

The insurance industry is familiar with hold harmless/indemnification statutes - currently 37 other states have enacted similar legislation that restricts the use of hold harmless/indemnification provisions in construction contracts. These states have passed statutes that recognize it is against public policy for construction contracts to contain provisions that purport to indemnify an indemnitee for its own negligence. These states have recognized that determination of liability is the responsibility of the courts, and upon such a determination of negligence by a party for any act, the responsible party should not be allowed to shift that liability to another party simply by operation of an indemnification provision in a construction contract.

In addition, many insurance carriers specifically exclude coverage for liability assumed under contract, thus many individuals and companies that have signed construction contracts that contain indemnification provisions are under the mistaken belief that if a claim is brought against them by virtue of an indemnification provision in their master construction contract that such claim will be considered a covered claim under their liability insurance. In actuality, there is a very good possibility that the carrier will deny coverage for these types of claims.

*House Comm on Ins.  
Attachment # 8  
February 18, 1999 8-7  
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The existence of these indemnification provisions in construction contracts reflect a long past era where the party providing the service under the construction contract would sign anything in order to get the job, and the party benefiting from the contract took full advantage of that unfair situation and included these broad form indemnification provisions. Today this type of liability shifting just because of the relatively unequal bargaining positions of the parties has been recognized as against public policy by numerous states - each party should be responsible for their own acts of negligence.

House Bill No. 2483 represents fair and reasonable legislation that ensures that each party bear responsibility for their own acts of negligence. IMA respectfully requests that you pass House Bill No. 2483. I am open for questions.

Respectfully submitted,

SueAnn V. Schultz  
General Counsel,  
IMA, Inc.



## Testimony on House Bill 2483

Presented by Patrick J. Morris

Kansas Association of Insurance Agents

February 18, 1999 - House Insurance Committee

Thank you Mr. Chairman and members of the committee for the opportunity to appear at today's hearing concerning House Bill 2483. I am Pat Morris, the Executive Vice President of the Kansas Association of Insurance Agents. Our association represents over 600 independent agency members across Kansas whose agencies employ nearly 3,500 people, most of whom are licensed agents.

It was the decision of our Government Affairs Committee and our Board of Directors to add our written testimony to the legislative record on this issue. We support the bill and the concepts outlined by the proponents at today's hearing, and have had an ongoing discussion within our committee structure over the last two years about this issue. Some of our discussion about the need for anti-indemnification language in the law has centered about the increasing insurance premiums for contractors that are based on insurance claims paid not as a result of the fault of the contracted entity, but instead because of the contractual agreements by the contractor in order to perform work.

Our legal counsel has also reviewed this language, and we would be happy to provide any additional information that the committee might require. Thank you for your time, and for allowing us to testify in support of House Bill 2483.

*House Comm on Ins.  
Attachment # 9  
February 18, 1999*

# AIA Kansas

A Chapter of The American Institute of Architects

February 18, 1999



TO: Representative Tomlinson and Members of the House Insurance Committee  
FROM: Trudy Aron, Executive Director  
RE: Opposition to HB 2483

Good afternoon, Mr. Chairman, and members of the Committee, I am Trudy Aron, Executive Director of the American Institute of Architects in Kansas (AIA Kansas.) I appreciate the opportunity to testify before you today in opposition to HB 2483.

AIA Kansas is a statewide association of architects and intern architects. Most of our 700 members work in over 100 private practice architectural firms designing a variety of project types for both public and private clients including justice facilities, schools, hospitals and other health facilities, industrial buildings, offices, recreational facilities, housing, and much more. The rest of our members work in industry, government and education where many manage the facilities of their employers and hire private practice firms to design new buildings and to renovate or remodel existing buildings.

Indemnification clauses are used by a variety of individuals within the design and construction industry. Some indemnification clauses cause our members heartburn and worse. Others provide comfort and protection.

Used correctly, indemnification clauses allow contracting parties to assign risk to those in control of those risks. When an owner wants a building, they contract with an architect for its design. The architect then contracts with consultants, engineers and other specialists, to provide for certain portions of the work. The contract between the architect and the consultant normally contains an indemnification clause that protects the architect from the negligent acts of the consultant. This clause protects the architect from the mistakes, errors and omissions of the consultant and are covered by the consultants professional liability insurance.

Indemnification clauses cause problems when they extend beyond the risks normally controlled by the architect and, therefore, not covered by professional liability insurance. Sometimes clients want the architect to indemnify them against any and all claims associated with a building. This type of indemnification clause seeks to indemnify the client against any type of claim regardless of who was responsible for the action that led to the claim or who was in a position to control the risk. This type of indemnification clause would not be covered by professional liability insurance unless the claim involved the architect's negligence.

Indemnification clauses are the basis of many standard contracts between parties involved in design and construction. All parties of the design and construction industry, including client groups, develop these standard consensual documents. They are carefully drafted to assign risk to those best able to control the risk. The passage of this bill would undermine the provisions of these contracts, bring uncertainty, and undermine the principles established by them.

While we would support the prohibition against indemnification clauses that assign risk to those not in control of the risk, we cannot support HB 2483 that would prohibit the correct usage of these types of agreements as well.

Thank you for allowing us to testify in opposition to HB 2483.

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*Case Comm on Ins.  
Attachment # 10  
February 18, 1999*