Approved: 4-1-08
Date

MINUTES OF THE HOUSE JUDICIARY COMMITTEE

The meeting was called to order by Chairman Mike O'Neal at 3:30 P.M. on March 12, 2008 in Room 313-S of the Capitol.

All members were present except:
Representative Dick Proehl - excused
Representative Joe Patton - excused
Representative Paul Davis - excused

Committee staff present:
Jerry Ann Donaldson, Kansas Legislative Research
Athena Andaya, Kansas Legislative Research
Jill Wolters, Office of Revisor of Statutes
Jason Thompson, Office of Revisor of Statutes
Cindy O'Neal, Committee Assistant

Conferees appearing before the committee:
Tom Whitaker, Kansas Motor Carriers Association
Will Larson, Kansas Association of Insurance Agents, Kansas Contractors Association & Associated General Contractors of Kansas
Gus Meyer, Associated General Contractors of Kansas City
Dan Haake, Haake Foundatins, Inc.
Bill Miller, American Subcontractors Association
Brent Moore, OXY USA & Kansas Petroleum Council
Pat Barns, General Counsel, Kansas Automobile Dealers Association
David Dayvault, Kansas Independent Oil & Gas Association

The hearing on **SB 379 - indemnification clauses**, was opened.

Tom Whitaker, Kansas Motor Carriers Association, spoke in support of **HB 2262**, with a suggested technical amendment. (Attachment #1) Currently, shippers are pressuring motor carriers to sign contracts which indemnify and hold harmless the shippers of any responsibility. The motor carriers have no choice than to sign the contracts if they want to provide service.

Will Larson, Kansas Association of Insurance Agents, Kansas Contractors Association & Associated General Contractors of Kansas, appeared before the committee as a proponent of **SB 379**. The bill simply requires that each company be responsible for their own negligence or fault. It's important to maintain the central concept of the subject, and that if a compromise is reached it must be consistent with the law in Kansas. (Attachment #2)

Gus Meyer, Associated General Contractors of Kansas City, expressed his concern with the unfair shift of liability that insurance companies exclude coverage for these clauses. Contractors are forced to put their companies on the line thus placing the employees and their families also at risk. (Attachment #3)

Dan Haake, Haake Foundations, appeared in support of any bill that would limit indemnification clauses. If these types of contracts continue, companies will have to start carrying additional insurance. He strongly endorsed all businesses be responsible for their own negligence and carry insurance for themselves. (Attachment #4)

Bill Miller, American Subcontractors Association, commented that bills, closely to **SB 379,** have passed in Oklahoma, Colorado, New Mexico and one legislative house in Missouri. (Attachment #5)

Written testimony in support of the bill was provided by Western Extralite Company (Attachment #6)

Brent Moore, OXY USA & Kansas Petroleum Council, appeared before the committee to oppose **SB 379.** There needs to be significant abuses brought to the committee before such legislation is adopted. The U.S. has adopted the "freedom of contracts" and if this bill is going to pass it should be narrowly drafted to apply only in limited circumstances.

However, he did propose two amendments that they would support with regard to the definition of "construction contracts". If either amendment was adopted, they would withdraw their opposition to the bill. (Attachment #7)

David Dayvault, Kansas Independent Oil & Gas Association, appeared before the committee in opposition of the bill. Indemnification clauses are used in just about every contract they sign. There are generally five types of agreements used in the oil & gas industry:

- Operating Agreement in which all parties share proportionately by the owners.
- Purchase Properties Agreement
- Servicing Contracts such as Master Service Agreement
- Payment of Interest Owners for Crude Oil Purchases Agreements
- Drilling Contract Agreements

They support using these types of agreements because of the risk involved in oil and gas operations. It reduces litigation and the associated costs with it. Both parties understand these types of agreements and are entering into it willingly. (Attachment #8)

Pat Barns, General Counsel, Kansas Automobile Dealers Association, appeared before the committee. They believe in the freedom of contract and how it applies to a large number of situations. In their industry they have owners who are selling out their ownership and wanting to retire. They do not want to be held responsible for negligence of the dealership after they have left. (Attachment #9)

Written testimony, in opposition to the bill, was provided by the Coalition to Preserve the Freedom of Contract and American Legislative Exchange Council. (Attachments #10 & 11)

The committee meeting adjourned at 5:00 p.m. The next meeting was scheduled for March 13, 2008.

KMC 71 YEARS

Kansas Motor Carriers Association

Trucking Solutions Since 1936

LEGISLATIVE TESTIMONY

Presented by the Kansas Motor Carriers Association
Before the House Judiciary Committee
Representative Mike O'Neal, Chairman
Wednesday, March 12, 2008

MR. CHAIRMAN AND MEMBERS OF THE HOUSE JUDICIARY COMMITTEE:

I am Tom Whitaker, executive director of the Kansas Motor Carriers Association. I appear here this afternoon along with Kevin Gregg, KMCA director of industry relations, representing our 1,200 member-firms in support of legislation which prohibits indemnification clauses in motor carrier transportation contracts that require one party to indemnify and hold harmless a second party's negligence or wrongful acts.

We have attached a copy of House Bill No. 2262 to our testimony. We respectfully request that the contents of HB 2262 be attached to the final legislative proposal adopted by this Committee. There is one technical amendment to HB 2262 that needs to be made. On Page 1, line 36 - 38, the bill should read: (d) a motor carrier transportation contract shall not include the **U**niform **I**nternational **I**nterchange and **F**acilities **A**ccess **A**greement administered by the **I**ntermodal **A**ssociation of North America or other agreements providing for the interchange, use or possession of intermodal chassis, containers or other intermodal equipment.

Shippers are pressuring motor carriers to provide transportation under contracts by which the motor carrier contractually agrees to indemnify and hold harmless the shipper for the shipper's failure to meet its duties or responsibilities. In other words, shippers are not taking responsibility for their own negligent acts. There is no negotiation. It is take it or leave it. The motor carrier in essence becomes an insurer for the shipper. The shipper has no financial investment by being indemnified and receives tremendous financial protection under these agreements. This shifting of liability through non-negotiable contracts completely contradicts sound public policy. Kansas is a "comparative fault" state.

One of the primary reasons for assigning liability is to persuade the offending party to change its behavior. In these instances, where the shipper is at fault but is indemnified by the motor carrier, there is nothing the motor carrier can do to change the shipper's behavior.

PO Box 1673 • Topeka, KS 66601-1673 • 2900 SW Topeka Blvd. • To
(785) 267-1641 • Fax: (785) 266-6551 • www.kmca.or

House Judiciary
Date 3-12-08
Attachment # 1

The purpose of HB 2262 is to promote safety in the movement of goods by motor carriers through the elimination of clauses that shield shippers and others from their own negligent or wrongful acts. The bill does not shield a motor carrier from their own liability or negligence. In fact, HB 2262 still allows the shipper to require the motor carrier to indemnify the shipper against legal actions created by the motor carrier's negligence.

Prohibition of indemnification clauses in transportation contracts is pro small business legislation. Of the 8,981 motor carriers in Kansas registered with the Federal Motor Carriers Safety Administration, 86% operate six or fewer trucks, 95% operate 19 or fewer trucks, and, only half of one percent operate more than 100 trucks. The small carrier is the most affected by the indemnification clauses in transportation contracts. If the small carrier wants the freight, they must sign these agreements. Large trucking companies have the legal staff to review these contracts and the clout to negotiate out harmful elements of the contracts.

Mr. Chairman, opposition to this legislation under the guise of "freedom to contract" comes from large and powerful corporations. Their opposition to adoption of anti-indemnification legislation illustrates a refusal to take responsibility for their own negligence. These corporations have the ability through their vast resources to shift their risk exposure onto small motor carriers that possess limited or no resources to fight them. These large corporations do it because they can. They have nothing to lose and everything to gain by using these one-sided negotiation tactics.

Lastly, KMCA commends the oil and gas industry for coming together to develop uniform contracts that assess responsibility based on historical data. The motor carrier industry would be pleased to be able to do this however; we could be subject to antitrust violations and could provide the shipper the opportunity to recover treble damages.

The Kansas Motor Carriers Association respectfully requests that the House Judiciary Committee include the provisions of HB 2262, with the proposed amendment, in the final legislative proposal developed by this Committee. We thank you for the opportunity to appear before you today. I will be pleased to stand for questions.

TESTIMONY OF WILLIAM A. LARSON ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF KANSAS, THE KANSAS ASSOCIATION OF INSURANCE AGENTS, THE KANSAS CONTRACTORS ASSOCIATION AND THE BUILDERS ASSOCIATION-KANSAS CITY CHAPTER OF THE ASSOCIATED GENERAL CONTRACTORS, IN SUPPORT OF SENATE BILL 379

I am an attorney representing the four Associations referred to above which constitute the major associations in this State representing commercial building and highway contractors and independent insurance agents. All four Associations support passage of Senate Bill 379.

In the 2004 legislative session, the Legislature passed and the Governor signed into law what became K.S.A. 16-121 and which is attached to this testimony. This statute prohibits certain types of indemnification agreements in construction contracts. Specifically, the statute prohibits indemnity agreements which require one party to indemnify another party for the other parties own negligence. For example, the statute prohibits an owner from requiring in a construction contract, a general contractor to indemnify the owner for any liability incurred by the owner as a result of the owner's own negligence. The rationale behind K.S.A. 16-121 was simple. It was that each party should be responsible for its own negligence or fault and should not be allowed to transfer that responsibility to another party. This legislation was necessitated by the fact that it was becoming common in construction contracts to find these types of indemnity provisions.

It is important to understand that the anti-indemnity legislation did not affect standard indemnity clauses which required, for example, the contractor to indemnify the owner for any liability incurred by the owner as a result of the contractor's own negligence. This sort of indemnity provision is perfectly allowable and unaffected by K.S.A. 16-121.

After the enactment of K.S.A. 16-121it became apparent that some parties to construction agreements were, in essence, getting around the prohibition against certain indemnity provisions in K.S.A. 16-121by requiring, for example, general contractors to name the owner on the general contractor's general liability insurance policy as an additional insured so that the general contractor's liability policy would cover the owner for the owner's own negligence. This again, results in one party shifting the responsibility for its own negligence to another party. It is inconsistent with the concept that all parties should be responsible for their own negligence or fault. Senate Bill 379 is a response to this problem. It would prohibit one party to a construction contract from requiring a the other party to name the first party as an additional insured on the other parties general liability policy to provide coverage for the first parties own negligence. Again, Senate Bill 379, like K.S.A.

16-121, does not prohibit construction contract provisions that would require, for example, the general contractor to name the owner as an additional insured on the general contractor's general liability insurance policy to provide coverage for any liability incurred by the owner because of the negligence or fault of the general contractor. It only prohibits provisions that would require the general contractor to insure the owner for the owner's own negligence.

Again, the underlying rationale of Senate Bill 379 is simple and straight forward. Everyone should be responsible for their own negligence or fault. Basically, that is what Senate Bill 379 is all about.

The opponents of this bill argue that they should be allowed to shift the risk of their own negligence or fault because of their right to contract freely. The reality is, however, that in the construction industry, there are many times when parties simply have no choice but to enter into contracts which contain the additional insured provisions Senate Bill 379 prohibits.

In an attempt to work with the opponents of this act, the Associations I represent would agree to certain compromise language if the committee should deem it appropriate to incorporate that language into Senate Bill 379 which is reflected in the balloon which is attached to this testimony. The Associations I represent, however, can not and will not agree to language which would impair the central purpose of Senate Bill 379 and of the previously enacted K.S.A. 16-121, which is, once again, that everyone should be responsible for their own negligence. We would, therefore, urge the adoption of Senate Bill 379.

KANSAS STATUTES ANNOTATED
CHAPTER 16.--CONTRACTS AND PROMISES
ARTICLE 1.--GENERAL PROVISIONS

16-121. Construction contracts; certain indemnification provisions void, when.

(a) When used in this section:

(1) '**Construction contract**' means an agreement for the design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, road, bridge, water line, sewer line, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation, except that no deed, lease, easement, license or other instrument granting an interest in or the right to possess property shall be deemed to be a **construction contract** even if the instrument includes the right to design, construct, alter, renovate, repair or maintain improvements on such real property.

(2) 'Damages' means personal injury damages, property damages or economic loss.

(3) 'Indemnification provision' means a covenant, promise, agreement or understanding in connection with a **construction contract** that requires the promisor to hold harmless, indemnify or defend the promisee or others against liability for damages.

(b) An indemnification provision in a **construction contract** or other agreement, including, but not limited to, a right of entry, entered into in connection with a **construction contract**, which requires the indemnitor to indemnify the indemnitee for the indemnitee's negligence is against public policy and is void and unenforceable.

(c) This act shall not be construed to affect or impair the contractual obligation of a contractor or owner to provide railroad protective insurance or general liability insurance.

(d) This section applies only to indemnification provisions entered into after the act takes effect.

History: L. 2004, ch. 70, § 1; July 1.

<General Materials (GM) - References, Annotations, or Tables>

K. S. A. § 16-121, KS ST § 16-121

Current through the 2005 Reg. Sess.

END OF DOCUMENT

2-7-08
SILL/LARSON

As Further Amended by Senate Committee

As Amended by Senate Committee

Session of 2007

SENATE BILL No. 379

By Committee on Ways and Means

3-12

AN ACT concerning construction contracts; relating to indemnification provisions and additional insured parties; amending K.S.A. ~~2006 Supp.~~ 16-121 and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. ~~2006 Supp.~~ 16-121 is hereby amended to read as follows: 16-121. (a) When used in this section:

(1) "Construction contract" means an agreement for the design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, road, bridge, water line, sewer line, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation, except that no deed, lease, easement, license or other instrument granting an interest in or the right to possess property shall be deemed to be a construction contract even if the instrument includes the right to design, construct, alter, renovate, repair or maintain improvements on such real property.

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

(3) "Indemnification provision" means a covenant, promise, agreement, *clause* or understanding in connection with, *contained in, or collateral to* a construction contract that requires the promisor to hold harmless, indemnify or defend the promisee or others against liability for *loss or* damages.

(4) ~~"Indemnitee"~~ *shall include an agent, employee or independent contractor who is directly responsible to the indemnitee.*

(b) An indemnification provision in a construction contract or other agreement, including, but not limited to, a right of entry, entered into in connection with a construction contract, which requires the ~~indemnitor~~ to indemnify the ~~indemnitee~~ for the ~~indemnitee's~~ negligence *or intentional acts or omissions* is against public policy and is void and unenforceable.

(c) *A provision in a construction contract which requires a party to*

"Promisee"

Promisor promisee's

provide liability coverage to ~~another~~ party, as an additional insured, for ~~such other~~ party's own negligence or intentional acts or omissions is against public policy and is void and unenforceable~~, except that the provisions of this subsection shall not apply to a construction contract between the owner of the property and the general contractor~~.

(d) This act shall not be construed to affect or impair the contractual obligation of a contractor or owner to provide railroad protective insurance or general liability insurance.

~~(d)~~ *(e)* This section applies only to indemnification provisions entered into after the act takes effect.

Sec. 2. K.S.A. ~~2006 Supp.~~ 16-121 is hereby repealed.

Sec. 3. This act shall take effect and be in force on and after January 1, ~~2008~~ *2009*, and its publication in the statute book.

a second
the second

This subsection does not
(1) impair additional insured
coverage for liability of the
second party to the extent
of the first party's negligence

(2) an agreement under which an owner, a responsible party, or a governmental entity agrees to indemnify a contractor directly or through another contractor with respect to strict liability under environmental laws;

(3)(A) an indemnification agreement that is an integral part of an offer to compromise or settlement of a disputed claim, if (a) the settlement is based on consideration; (b) the dispute relates to an alleged event that is related to a construction contract and that occurred before the settlement is made; and (c) the indemnification relates only to claims that have arisen or may arise from the past event; and

insurance contract

(4)(B) validity of any insurance contract, workers' compensation ~~agreement~~, construction bond, or other agreement lawfully issued by an insurer or bonding company.

TESTIMONY BEFORE THE HOUSE
JUDICIARY COMMITTEE

TESTIMONY ON SB 379
RESTRICTIONS TO INDEMNIFICATION CLAUSES
BY GUS RAU MEYER
MARCH 12, 2008

My name is Gus Meyer, President of Rau Construction Company in Overland Park. Rau was founded in 1870, and is a mid-size General Contractor working on commercial, retail, office and historic rehabilitation projects. I am also here today as a Past Chairman of the Builders Association, representing over 1,000 General Contractors, Subcontractors, Suppliers and Associates in the Kansas City area and surrounding counties; and as a member of the Kansas City Chapter of the Associated General Contractors (AGC). I urge your support of SB 379 which would restrict indemnification clauses requiring a first party to indemnify a second party for the negligent acts of the second party. This legislation would render unenforceable indemnification provisions in construction contracts that require the promisor (contractor or first party) to hold harmless, indemnify, or defend the promisee (owner or second party) against liability for damages caused by the promisee's own negligence or intentional acts; and to be required to provide insurance as an "additional insured" for the second party's own negligence or intentional acts.

Ordinarily I would not ask the legislature to get involved in matters that involve private contracts, but this legislation addresses an issue that is starting to have a negative effect on all reaches of the construction industry, as well as many other industries.

For many years, the majority of contracts have been fair to all parties involved. Typically using standardized contracts written together by all parties involved does this. Language from some of these contracts we have utilized include the following indemnification clause:

> To the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner, Architect, Architects consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, rising out of or resulting from performance of the Work, providing that such claim, damages, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself) including loss of use resulting therefrom, but only to the extent caused in whole or in part by negligent acts or omissions of the Contractor, a Subcontractor, or anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused by a party indemnified hereunder.

In addition, this contract also stipulates:

> This obligation of the Contractor shall not extend to the liability of the Architect, the Architect's consultants, and agents and employees of any of them arising out of (1) the preparation or approval of maps, drawings, opinions, reports, surveys, Change Orders, design or specifications, or (2) the giving of or the failure to give directions or instructions by the Architect, the Architect's consultants, and the agents and employees of any of them provided such giving or failure to give is the primary cause of the injury or damage

House Judiciary
Date 3-12-08
Attachment # 3

TESTIMONY BEFORE THE HOUSE
JUDICIARY COMMITTEE

TESTIMONY ON SB 379 – RESTRICTIONS
TO INDEMNIFICATION CLAUSES
BY GUS RAU MEYER
MARCH 12, 2008

This has allowed the additional insured provisions to work well in the construction industry as parties up the construction chain have requested to be named as additional insured not to gain them coverage for their own acts and omissions, but to facilitate coverage for the acts and omissions of those providing the insurance certificates. This in fact facilitates claim resolution as the first party's insurance company acknowledges the presence of the second party, via the naming them as an additional insured on the insurance certificate for the coverage of the first party for that contractors acts and omissions.

In recent years, some indemnification clauses we have seen in Contracts has changed, and Owner have started using their own custom contracts. As time progresses, more and more Owners are taking up this practice. One of these modifications we encountered several years ago was written like this:

> To the fullest extent permitted by law, Contractor agrees to indemnify, protect, defend and hold harmless the Owner, Architect, Owner's lenders, if any, and each of the aforementioned parties' respective affiliated companies, partners, successors, assigns, heirs, legal representatives, devises, officers, directors, shareholders, employees and agents (herein collectively "Indemnitees") for, from and against all liabilities, claims, damages, losses, liens, fines, penalties, costs, causes of action, suits, judgments and expenses (including court costs, attorneys' fees, and costs of investigation), of any nature, kind or description of any person or entity directly or indirectly arising out of, caused by, or resulting from (in whole or in part) (1) the work performed hereunder or any part thereof, (2) this Contract, or (3) any act or omission of Contractor, and Subcontractor, anyone directly or indirectly employed by them, or anyone that they control or exercise control over (herein collectively "Liabilities"). <u>The obligations of Contractor under this indemnification shall apply to Liabilities even if such Liabilities arise from or are attributed to the negligence of any Indemnitees.</u>

Again, this is just one sample of an indemnification an Owner is using. There are numerous other samples, some of which are even more outrageous. Such indemnification provisions are so unfair and onerous that they ought to be declared to be against the public policy of the state.

Most troubling is that following this unfair shift of liability, more and more insurance companies exclude coverage for these clauses. This in turn has caused Owners to write into their Contracts language requiring specific insurance covering these indemnification clauses. As insurance companies balk at providing coverage, Contractors are then forced to put their companies on the line and take their chances. This puts employees and their employees' families at risk as well.

TESTIMONY BEFORE THE SPECIAL COMMITTEE ON JUDICIARY

DISUCSSION CONCERNING RESTRICTIONS TO INDEMNIFICATION CLAUSES BY GUS RAU MEYER MARCH 12, 2008

As an example of what could happen if an indemnification like this was in a contract, I look at what possibly is the first lawsuit filed against Rau Construction on a construction issue in our 133 year history. It was litigation involving two buildings by a national hotel chain. That organization built several hundred hotels across the country in the late 1990's using the same basic design, all drawn by one the same architectural firm. They felt there is a problem with the EIFS exterior system they called for in their plans and specifications, and are suing all the Contractors who built these hotels, as well the EIFS installer and manufacturer. As part of the suit against the General Contractor, the plaintiff is claiming we are responsible since we allowed the building to be built per their plans and specification knowing what they called for was a defective product.

What would have happened if there was an indemnification clause similar to the one above in our contract? My supposition is that this Owner would only need to make a claim to us saying he and/or his architect made a mistake in specifying the exterior system and since we have indemnified them against their own mistake which has caused damage and loss we need to replace the whole exterior system on all these projects.

The above example is only one of a multitude of scenarios that could unfold in a construction contract. The possible items that an Owner could want covered are limitless. From errors in judgment that the Owner makes, to willful misconduct by an agent of an owner on a construction jobsite. That is why these indemnification clauses are so outrageous.

Contractors are at a serious economic disadvantage in negotiating such clauses out of owners' contracts, particularly in periods of soft markets. Compounding upon the effects of soft construction market is the tumultuous insurance market we recently experienced. Insurance has either increased significantly in cost, or in some cases, no longer possible to obtain. In order to maintain our insurance, Rau Construction has submitted to our insurance carrier any indemnification clause that is not the standard AIA clause for their review and approval. Clauses with onerous language are contested and a contract is not signed unless the clause is modified. Speaking from practical experience. Not all contractors are as diligent as Rau Construction is in fighting these clauses. Many contractors do not have the expertise to be able to review and understand the impact of the "legalese" written in these contracts.

All parties should be responsible for their own negligence. These new indemnification provisions defy common sense as well as ethical business practices. Requiring them to be backed up by insurance, which sometimes is impossible to obtain makes this situation even worse. We will appreciate your support on this important issue. Thank you for your thoughtful consideration of SB 379.

DAN HAAKE

Haake FOUNDATIONS, INC.

March 10, 2008

Re: House Bill No. 2228
Testimony From Dan M. Haake
President Of Haake Foundations, Inc.

Chairman Mike O'Neal, Vice Chairman Lance Kinzer and Committee Members,

Every day and every job, it becomes more difficult to please Owners, Architects, Engineers and our customer the General Contractors who own, design and build projects in Kansas using Subcontractors specialized in their specific trade of work, demanding those subcontractors to carry insurance to cover the risk of their work as well as the risk from the Owners Design and Build Team.

When the Owners and Design Build Team becomes a part of my insurance policy thru broad form indemnification clauses and additional insured endorsements, they have successfully transferred their risks to me which further releases them from damages arising from occurrences caused by them. This Bill will help ensure that the Owner and Design Build Team retain their own risk thus ensure the Owner and his team keep their mind focused on their job and manage the risk of their Construction Team.

I can tell you that I do not have the work to afford the insurance limits to cover my risk as well as the risk of the Owners and their Design Build Team especially when they dictate to me limits of coverage as well as indemnification clauses extending coverage outside policy endorsements.

It is time to stop this practice of shifting risk to others and start demanding that all parties to a contract be responsible for the acts.

Sincerely,

Dan M. Haake

10029 E. 63RD TERRACE

RAYTOWN, MISSOURI 64133

816•737•2954

House Judiciary
Date 3-12-08
Attachment # 4

MIDWEST CRANE AND RIGGING, INC.

15585 S. KEELER • P.O. BOX 970 • OLATHE, KANSAS 66051-0970
(913) 747-5100 • FAX (913) 764-0102

March 12, 2008

House Judiciary Committee

Chairman O'Neal; Vice-Chairman Kinser, and Committee Members:

My name is Bill Miller. I am here representing the American Subcontractors Association and myself as a subcontractor. The American Subcontractors Assoc. represents subcontractors in Eastern Kansas and Western Missouri that do work and supply materials throughout Kansas. I am here to testify in favor of SB-379

The primary issue is the contractual requirement to list multiple individuals and entities as additional insureds on the auto and general liability policies of all parties in the contract chain due to the flow down provisions that are in virtually every contract. This forces the lowest party in the chain to be liable for all of the claims against the parties above, regardless of who is responsible.

This additional insured requirement circumvents the anti-indemnity law that was passed in Kansas in 2004. The net result is higher premiums for the lower tier contractors and clean loss runs for those that should be liable for losses that they or their agents cause. There is no incentive to maintain a safe jobsite if someone else is paying all of the claims that result from unsafe conditions. The subcontractor is not the controlling contractor and in the case of expansion or renovation of existing facilities, the general contractor has no control over the plant operations.

The typical additional insured language requires defense should a claim be made or a suit be filed against the upper tier contractor. This cost reduces the available coverage by the amount of the cost of litigation and even if the defense is successful, it counts as a loss and the deductible applies. These costs need to be allocated according to the degree of fault.

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A major pitfall for many who do not understand the language that is peculiar to the insurance industry is that they unwittingly sign contracts that have insurance limits or extended coverage's that are either not available or cost prohibitive. In some instances, the policy renewal date is in the midst of a project term and coverage that was in effect in one policy period is no longer available in the next. The worst case is when an unwitting subcontractor signs a contract agreeing to additionally insure someone only to find out, too late, that his insurance company denies coverage required by the terms of the contract and the subcontractor has self insured the loss.

Topeka Branch
711 1/2 24 Hwy
785-233-0400

SUBCONTRACTORS
THE HEARTBEAT OF CONSTRUCTION
AMERICAN SUBCONTRACTORS ASSOCIATION

House Judiciary
Date 3-12-08
Attachment # 5

We believe that every one should be responsible for their own actions and the acts of their agents and employees. The only legitimate additional insured requirements should be for vicarious liability and for the actual employers of employees that fall under statutory employee or borrowed servant doctrine where the employees are under the direction and control of someone other than the employer.

It is fair and necessary to require additional insured status in those instances where the additional insured has no responsibility for a claim. This will protect public entities and private owners who allow the use of their property for public use, and owners of construction projects who have no control of the construction process. This will also protect employment agencies and others who provide labor or services to others where the direction and control is by the statutory employer.

If we can enact legislation that makes everyone responsible for their own claims and the claims caused by those for whom they are responsible, we could reduce liability insurance costs and likely have safer construction sites which would in turn reduce the cost of work comp insurance as well.

The latest development is the requirement by the insurance companies that upper tiers force lower tiers to additional insure them for losses that they themselves cause. This is a condition of the cost of their premiums. We believe that the Legislature should establish the rules that govern the terms and conditions of the insurers that do business in this state. This latest requirement also increases the limits that each subcontractor must purchase to satisfy the upper tiers requirements that are also dictated by the insurance companies. It is no surprise that the insurance companies are enjoying record profits from last year.

Other states have passed this same law to stop this abusive risk transfer including the State of Oklahoma, the State of Colorado, and the State of New Mexico. A similar bill has passed the Missouri Senate this month.

We believe that every business, regardless of size, should purchase the limits of insurance required by law to protect the public. Any other coverage should be for their own protection with limits that they feel necessary to protect their assets. We **do not** believe that the bottom line of the corporations that oppose this Bill will be adversely affected if they are forced to purchase their own insurance.

There is no fiscal downside for the State of Kansas that will result from the passage of this Bill.

William R. Miller
President
Midwest Crane & Rigging
Building Erection Services Co.
Greater Kansas City American Subcontractors Assoc.

March 12, 2007

To: House Judiciary Committee
Re: SB 379

Mr. Chairman,

I want to thank you and your committee for the opportunity to speak to you in support of Senate Bill 379. I am Ken Keller, retired controller of Western Extralite Company. Western Extralite Company supplies electrical materials to the construction industry and has 6 locations in Kansas and others in Missouri. I also represent the Electric League of Greater Kansas City, the National Association of Credit Managers, American Subcontractors Association of Greater Kansas City and many other interested parties.

In 2004 the Kansas Legislature passed a bill eliminating hold harmless and indemnification agreements from construction contracts. The industry has sidestepped this law by requiring subcontractors and sometime suppliers to name owners, general contractors and possibly others as additional insured on their auto and liability policies. This transfers the risk of loss to the subcontractor and his insurance company to be responsible for claims outside of their control and for which they are not responsible. It raises the question: is it fair, or right, to continue to allow risk to be shoved down the food chain so the little guy has all the risk?

It raises a second question, what incentive does the owner, or the general contractor, have to maintain a safe work environment if he can't be held responsible for injury or accidents. Why not cut cost, turn the other way if you have no risk. SB 379 solves these issues by making those responsible for the loss liable for that loss. We have no problem being held responsible for our negligence, that is the way it should be, but we shouldn't be responsible for the negligence of others.

Opponents to the bill will claim this legislation isn't necessary, that the terms of the contract should be negotiated between the parties. They want to play by the golden rule-those who have the gold make the rules. The problem here is the negotiation table is not level and both parties don't have equal say. All to often the contract is take it or leave it or I'll get someone else to do the work. SB 379 will correct this and is necessary. I urge your support of SB 379 including a pro-ration of deductible and legal cost based on degree of fault.

Thank You,
Ken Keller
Western Extralite Company

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OXY USA Inc.
A subsidiary of Occidental Petroleum Corporation

Brenton B. Moore
Managing Counsel

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Testimony re: SB 379
House Judiciary Committee
Presented by Brenton B. Moore
on behalf of
OXY USA Inc. and the Kansas Petroleum Council

March 12, 2008

Mr. Chairman, Members of the Committee:

My name is Brent Moore, and I am Managing Counsel for OXY USA Inc. OXY USA Inc. ("OXY") is one of the largest producers of oil and gas in the State of Kansas, and is a wholly owned subsidiary of Occidental Petroleum Corporation. OXY is a member of the Kansas Petroleum Council and represents that association's concerns here as well.

OXY opposes SB 379 for the following reasons:

1. As a general premise, OXY is of the opinion that there needs to be significant abuses documented before this Committee in order to justify statutorily limiting the right to freedom of contract of the people and entities doing business in Kansas. Indemnity clauses within contracts serve legitimate goals in allocating risk between the parties that another party may not be willing or be able to accept.

2. It is believed that the drafters of this proposed legislation intended it to apply to the construction industry. However, because of broad and vague terminology used within the definition of "construction contract" (Section 1, Paragraph 1), it causes concern that the proposed legislation will be applied in certain service oriented aspects of the oil patch.

3. OXY and many other large producers employ a common practice in the industry in Kansas and many other states with respect to their contractor service agreements. These contracts have incorporated what are known as "knock-for-knock" risk allocation provisions. Generally, the knock-for-knock arrangement provides that each contracting party (the producer and the contractor) will be liable for the injuries to and claims from its own employees and contractors, regardless as to the negligence of the other party and its contractors. It is similar to the no-fault insurance provided for with respect to vehicles. These mutual obligations are backed by insurance and require the other party to be named as an additional insured. OXY has not, to my knowledge, had any complaints regarding an inability of contractors to obtain insurance for this type of coverage, and certificates of insurance evidencing compliance are required and received.

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4. The following is a definition taken from "A Glossary of Insurance Terms" at the Trafalgar International Ltd. (Insurance Brokers and Consultants) website:

> **Knock for Knock Agreement**
> **An agreement between two insurance companies whereby each insurer pays the vehicle's repair costs of its own policy-holder regardless of who was responsible for an accident. While an insurer may be able to pursue a recovery from the party responsible for an accident from his insurer, this is a costly administrative procedure. The Knock for Knock Agreement simplifies recovery claims among insurers and the cost is seen to balance out over a long period of time.**

5. In a 1999 article entitled "Contractual Insurance and Risk Allocation in the Offshore Drilling Industry" Cary A. Moomjian, V.P. and General Counsel for Santa Fe International speaking about offshore drilling contracts states:

> "The interests of both contracting parties are furthered by establishing a firm risk allocation scheme which allocates responsibility for specific risks and enables each party to measure the risk exposures it will absorb or insure. This only can be accomplished by a straightforward and unconditional risk allocation structure. *Provisions which provide that one party will assume a specific risk of loss or liability unless the other party is negligent or otherwise culpable do not accomplish this objective.* To the contrary, they create a situation where a determination of culpability is a prerequisite to identifying which party must absorb the risk. The undesirability of this situation becomes evident when it is recognized that such conditional risk allocation provisions often effectively require both parties to place insurance covering the same risks since a determination of negligence or culpability (and resulting contractual liability) only can be made after the loss occurs. Accordingly, risks generally are allocated to the contracting parties without regard to cause. While it may initially seem inappropriate to protect a party guilty of negligence or misconduct, a fundamental purpose of risk allocation is to create a clear line of demarcation so each party will be able to evaluate its risk exposure and obtain appropriate insurance (or elect to self-insure)."

6. This "knock-for-knock" risk allocation eliminates the inevitable finger-pointing and maneuvering that takes place to establish the existence and degree of liability as well as the costly litigation that results from trying to determine which party was at fault and the extent of that fault. However, in order for this risk allocation arrangement to be fair to all parties, all of a

producer's contractors need to participate in the same risk provisions. As a result of the proposed legislation, a service contractor's agreement with a producer containing "knock-for-knock" indemnities may be legally binding for some services provided but declared void for other services – even though the services are rendered for the same well site.

7. The definition of "construction contract" arguably removes certain oil and gas field activities from the ability of the contracting parties to use a "knock-for-knock" risk allocation. Although it is assumed that the authors of this statute intended to cover the building of highways and automobile roads when they refer to "highways" and "roads" in the definition of "construction contract", it can also be read to also include the construction of small lease roads located on private property that are used to access an oil and gas well site. These lease roads are usually "constructed" by arranging for a local dirt contractor to take a bulldozer and blade a dirt access into the well site. This same dirt contractor is generally used to blade off the well site to prepare it for drilling. Thus, it is possible that the same dirt contractor, who is under one contract with the producer, would be covered by one set of indemnity rules while constructing the dirt road and a different set of indemnity rules while constructing the dirt well site.

8. Likewise, the definition of "construction contract" includes the construction of a "water line", "sewer line", "oil line" or "gas line". Here again, the bill before this Committee does not lend factual support that it was intended that small gas gathering lines or small oil flow lines running from a producing well located on the leased premises were the target, just like it was probably not meant to cover the laying of a water line to someone's house or cattle trough or a sewer line running to a septic tank. These gas gathering lines and oil flow lines are pipelines that are usually laid on top of the ground or trenched into the ground by use of a ditching machine. It is believed that intent behind the statute is that large construction projects, such as mainline oil and gas transmission lines were the oil and gas pipelines were to be included within the definition of "construction contract", not the laying of thousands of small pipelines that run from individual wells to these main lines.

9. Ideally, the scope of the bill needs to be narrowed and limited to those specific abusive situations which are documented to be prevalent. In order to avoid unintended consequences for the oil and gas industry, OXY and the Kansas Petroleum Council recommend that this Committee consider either of the two amendments that I have appended to my written testimony. These amendments offer a clarification to the definition of "construction contract" found in paragraph (1) of Section 1 of the proposed legislation.

In conclusion, OXY believes that any prohibition imposed by the State of Kansas against freedom of contract should be applied very narrowly. It is not believed that the intent of the statute was to cover the construction of dirt or graveled lease roads nor the construction of small gas gathering lines or oil flow lines that are required by every producing oil and gas well in the state. Therefore, you are asked to consider the enclosed proposed amendments to the definition

of "construction contract" which clarifies that these types of minimal construction are not intended to come within the purview of this statute.

OXY and the Kansas Petroleum Council will withdraw their opposition to SB 379 if it is amended as per either of the attached proposed amendments.

Thank you for permitting me to testify, and I would be happy to answer any questions.

Respectfully submitted,

Brenton B. Moore

Attachment

(Alternative 1) Proposed amendment to Section 1 of SB 379

(1) "Construction contract" means an agreement for the design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, road, bridge, water line, sewer line, oil line, gas line, appurtenance or other improvement to real property, including any moving, demolition or excavation, except that no deed, lease, easement, license or other instrument granting an interest in or the right to possess property shall be deemed to be a construction contract even if the instrument includes the right to design, construct, alter, renovate, repair or maintain improvements on such real property*; provided, however, that "construction contract" shall not include any design, construction, alteration, renovation, repair or maintenance of (a) dirt or gravel roads used to access oil and gas wells and associated facilities, or (b) oil flow lines or gas gathering lines used in association with the transportation of production from oil and gas wells from the wellhead to oil storage facilities or gas transmission lines.*

(Alternative 2) Proposed amendment to Section 1 of SB 379

(1) "Construction contract" means an agreement for the design, construction, alteration, renovation, repair or maintenance of a building, structure, highway, road, ***except a dirt or gravel road,*** bridge, water line, sewer line, ~~oil line, gas line,~~ appurtenance or other improvement to real property, including any moving, demolition or excavation, except that no deed, lease, easement, license or other instrument granting an interest in or the right to possess property shall be deemed to be a construction contract even if the instrument includes the right to design, construct, alter, renovate, repair or maintain improvements on such real property.

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Testimony to the House Judiciary Committee
Senate Bill 379
An Act concerning construction contracts; relating to indemnification provisions

David M. Dayvault
Kansas Independent Oil & Gas Association

March 12, 2008

My name is David M. Dayvault. I am the President of the Kansas Independent Oil & Gas Association (KIOGA) and the Chief Financial Officer of Abercrombie Energy, LLC. KIOGA is a trade association representing over 1,400 oil and gas producers and related service companies in the state of Kansas. Abercrombie Energy, LLC produces oil and gas in 35 Kansas counties and until recently operated five rotary drilling rigs in Kansas, Oklahoma and Texas. KIOGA opposes HB 2007 as explained below.

There are five primary uses of indemnity agreements in the Kansas oil and gas industry. The first of these is in the joint operating agreement. In a typical joint operating agreement the parties agree that all losses will be shared proportionately by the owners. This provision acts as indemnity agreement whereby the non-operators are indemnifying the operator for acts of simple negligence. As the non-operators are not in a position to have committed negligence, any negligence would have to be attributable to the operator. The parties recognize that there is a fine line between negligence and "stuff that happens" and are willing to assume those risks in advance of any event. For his efforts in handling the operations, paying the bills, calling service contractors and other services, the operator receives a modest monthly fee. This fee does not contemplate that the operator would fully absorb any losses which might later be determined to be caused by negligence. Were the indemnity provisions not available few operators would be willing to assume responsibility under their present fee arrangements.

The second area where indemnity contracts are frequently used relates to the purchase of properties. Oil and gas leases are frequently sold by one party to another. Environmental problems occur from time to time and the cause of the problem and the time that the problem occurred is often unknown. The point of negligence is frequently not the point of discovery. Parties selling properties require a certainty on sale that their liability has ended. Without this certainty many transactions would not occur. Accordingly most purchase and sale agreements provide that any environmental problems discovered after the date of closing are the responsibility of the buyer irrespective of when the event may have occurred. Knowing that he is assuming that responsibility, the buyer typically performs due diligence to assess the risk he is assuming. The parties factor this risk in their pricing. Most property transfers in Kansas involve

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a larger company selling to a smaller company. Without these indemnity agreements many significant transfers of properties from out of state major oil companies to Kansas independents would not have occurred. The need for absolution by the major companies is such that they typically only deal with larger independents whose indemnity agreement is backed by significant financial strength and a significant amount of insurance.

The third area where indemnity contracts are frequently used relates to payment of interest owners for crude oil purchases. A crude oil purchasing company prefers to distribute revenues after receiving a division order whereby the interest owner agrees as to his correct percentage of ownership. The purchaser does not issue the division orders until he has received a division order title opinion from a title attorney. Any distributions prior to the completion of this process could leave the purchaser liable for any errors. Often the process of receiving the title opinion and issuing the division order takes several months. To facilitate the early distribution of revenue, the operator will frequently indemnify the crude oil purchaser for any errors or omissions which occur as a result of paying interest owners in accordance with the operator's instruction. Most operators are willing to provide this indemnity to facilitate the early distribution of revenue.

The fourth instance where indemnity agreements are frequently used are in well servicing contracts. Frequently the parties will enter into a contract on a form promulgated by the Association Energy Service Contractors (AESC) prior to commencing operations. Alternatively an operator and a service contractor may have entered into a master service agreement (MSA). As in the case with drilling contracts, if the problem is caused by the function of the contractor's equipment or employees, responsibility should be that of the contractor. However if a problem is caused by unsafe lease and well conditions the responsibility would be that of the operator. The actual cause of a problem is often difficult to determine. Most leases and wells are unsafe to some degree. Frequently when a service is being performed an operator would not have his own personnel present. Because of the lack of a witness for the operator and uncertainty as to what may have caused the problem, many operators wish to contractually assign responsibility through an AESC contract or an MSA prior to allowing the contractor to enter his well site.

We are seeing the increased use of master service agreements (MSA's). These are agreements which outline the services between an operator and a contractor and assign responsibility in advance of any work being performed. To a large extent MSA's are a product driven by the insurance industry. MSA's frequently contain indemnity provisions. One type of indemnity provision generally holds each party responsible for claims made by that party's employees, irrespective of the cause of any damage. Other MSA's adopt the approach where each party accepts the responsibility for its own negligence and indemnifies the other party for any claims remaining relating to its own negligence. Still other MSA's try to place all liability and responsibility for damages to one party. As MSA's can be quite lengthy and complicated many operators and contractors have resisted using them notwithstanding the benefits and the urging of their insurers. KIOGA has developed a model form MSA which is beginning to be used in the industry. In the KIOGA MSA each party accepts responsibility for its own acts of negligence and indemnifies the other party for those acts. While some MSA's used by major oil companies attempt to place all liability to contractors, some contractors have used their negotiating position to reach an agreement which is more balanced. Others have chosen to use

the major's contracts and have assumed that risk as the necessary consequence of the benefits of dealing with a major oil company. Those benefits include knowing that you are dealing with a solvent party who is willing to pay top dollar for quality work.

The fifth significant use of indemnity agreements is in drilling contracts. Prior to the time that a well is drilled a drilling contractor and an operator typically enter into a drilling contract under the model form promulgated by the International Association of Drilling Contractors (IADC). In Kansas this contract is usually done on a footage and daywork contract. In this contract the contractor receives a set amount per foot drilled and a set amount for each hour in which additional hole is not being created because the operator wishes to evaluate sub-surface geological data. The IADC contract anticipates fault and assigns responsibility based upon those assumptions. If a problem occurs while a well is on a footage basis it's generally because there is a mechanical problem in the drilling operation. Under those circumstances the IADC contract assigns the responsibility to the contractor. Conversely, if the problem occurs while a well is on
daywork it is generally because of sub-surface conditions. The operator assumes responsibility for problems which occur when a well is on daywork. Certainly circumstances occur when a contractor's problem occurs on daywork or an operator's problem occurs while on footage. However these are less likely to occur and because of the uncertainty as to the cause of many problems, the parties have agreed to assign responsibility contractually.

The oil and gas industry has several unique features which have contributed to the use of indemnity agreements. In exploration and production much of what occurs is beneath the surface of the earth. Because of this, when things go wrong there is frequently uncertainty as to the cause of the problem. Exploration and production occurs at all hours of the day and night. Frequently when a problem arises no one is present at the location. These items combine for a significant amount of uncertainty as to the causes of any problems and who might be the responsible party.

Oil and gas operations involve a sharing of risk. Typically multiple parties own an equity interest (working interest) in any given oil and gas lease or other project. One party is delegated the responsibilities for conducting those operations and is designated the operator. Frequently the operator is chosen based upon his ability and technical expertise. Alternatively, the party that has developed the idea and has shown leadership in accumulating the necessary capital may be chosen as operator. Operators also share risk with the contractors who drill or service their wells. If a problem arises due to sub-surface conditions the responsibility generally rests with the operator. However, if the problem arises due to the operation of a contractor's equipment or personnel, that responsibility generally rests with the contractor. When a problem occurs it is often difficult to establish responsibility because of the uncertainty inherent in the industry. There is frequently a fine line between a problem that arises due to assumption of risks in an inherently risky business and negligence. When a problem occurs the monetary consequences can be significant. A well in Kansas frequently costs over $500,000 to drill, complete and equip. Any problem which causes the loss of use of that well would require the drilling of a replacement well or the loss of the reserves remaining in the ground. In other cases, escaping hydrocarbons in an "out of control" well can cause damage or injury to persons and property above ground.

We are seeing several trends in Kansas which are causing the increased use of indemnity agreements. Many major oil companies which have developed oil and gas reserves in Kansas are lowering their presence in the state. This creates opportunities for Kansas independent oil and gas companies if they are able to come to terms with the major oil companies. The major companies are highly reluctant to dispose of any assets unless they believe that their liabilities are relieved at the time of sale. Most major oil companies have very high market capitalization and don't want unneeded exposure to lawsuits. They can easily be named as additional defendants in circumstances where they are unlikely to have caused the problem but are a tempting "deep pocket" target. An independent company wishing to deal with a major company has many opportunities from that relationship and many independents are willing to play by the major's rules.

Indemnity agreements are occasionally used to provide a contractual solution to a perceived tort problem. As there is often a fine line between negligence and "stuff that happens" many companies fear being drawn into a lawsuit to their disadvantage. Our public expects compensation for a victim in most circumstances, even following acts of God. Notwithstanding its legal definition, negligence can better be described as the result of telling a compelling story to a receptive jury. Frequently indemnity agreements come from a deep pocketed entity not wishing to be drawn into a lawsuit under our current tort system.

Indemnity contracts have been in place for decades in our industry and have worked well for us. Changing the law would alter the fundamental relationships between the parties which have provided economic benefits to all. There are benefits from assigning fault in advance of an event. If this is assigned based upon the most likely source of the problem this can reduce uncertainty and reduce the costs of fact finding involved early in the litigation process. The parties in the indemnity agreement are likely to spend less on legal services.

It has been proposed that indemnity provisions be generally declared as contrary to public policy but exceptions would be provided in those instances where a strong case could be made as to their benefits. Texas has such a law. Should Kansas adopt such an approach we would suggest that the five types of indemnity agreements described above be allowed as good public policy. We believe the Texas law has been amended multiple times and the exceptions are numerous enough as to provide an ineffective and ambiguous statute. Should Kansas adopt a similar law it should be prepared for numerous petitions for relief in subsequent years.

KANSAS AUTOMOBILE DEALERS ASSOCIATION

March 12, 2008

To: Chairman Mike O'Neal and Members of the House Judiciary Committee

From: Pat Barnes, KADA General Counsel

Re: SB 379 and Indemnification Issues

Good afternoon, Chairman O'Neal and members of the committee, I am Pat Barnes, general counsel for the Kansas Automobile Dealers Association. We appear before you today in opposition changing the current law in this state with respect to indemnification as it may apply to matters under consideration directly affecting the automobile industry and, in particular, continue our opposition to concepts such as those expressed as existing law in SB 379, which also deals with indemnification agreements. It is our understanding that all of those issues are under consideration today, and as a result some of those, such as HB 2007, directly encompass contractual matters we regularly encounter.

Concepts such as those with which we are dealing would make indemnification agreements as set forth in various bills before you void as against public policy. We believe this is too stark of a departure from the norm in terms of the ability of individuals and businesses to contract with one another and sets an extremely bad precedent. Freedom of contract has been the emphasis of the common law for thousands of years. It is a concept that carries forward into the very nature of our jurisprudence. This is not to say there have not been exceptions, but those exceptions have been initiated in circumstances where no person would find the bargain to be one that was fairly entered where the other party virtually dictated all of the terms with no choice but to accept them. There are limited circumstances where that is always the case.

Indemnification agreements serve to give certainty to risky ventures where comfort on the part of one or both parties with the transaction is needed. There are many instances where something should be done, but would not be done if the party being asked to enter the contract was not protected from the consequences that could occur with it, whether real or imagined. There are many instances where one party very badly needs the other party's participation in a perfectly legal endeavor, and one which would benefit the public in some fashion as a whole, yet cannot get the assent necessary to enter the contract without providing protection to the other party.

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This works the other way, too. Many times, we would not enter contracts that we would like to enter without the assurance that we are not going to be financially ruined by them. An example of this will actually promote business enterprises where a small company or a sole proprietor would like to do the job, could do the job, and would be good at it, but cannot assume the risk of financial ruin, or turning a profitable deal into one which is not profitable, if someone else's performance draws them into a lawsuit or a situation causing a loss. Sometimes, it is simply providence that draws a party performing a contract into a situation where they cannot afford to be in it without the backing of someone else, which must be contractually assured.

Indemnification contracts are very common across a wide variation of arrangements. For example, KADA uses accountants in situations where their expertise is quite unique, and would be otherwise unavailable if we could not assure them that they would not be held responsible for something else that may go wrong in a particular situation. We also encounter this with dealership sales where the departing owner wants to retire or otherwise be free of the business once he is gone and that becomes part of the consideration paid for it. It occurs vice versa, too, when an acquiring party wants to use something that the departing owner has set up, but does not want to be responsible for the prior owner's obligations because they were simply those of the prior owner and may be unascertainable or unpredictable. There are instances where someone else's willingness to take a needed task, such as retrieving an automobile or some other routine task, will not occur where the charges cannot justify the potential risk absent indemnity.

While there are circumstances where indemnification agreements are forced upon us unwillingly, we nonetheless believe that overall it is the willing buyer and willing seller which must protect themselves in the situation at hand, in other words freedom of contract and the marketplace. While SB379 indeed represents existing changes to indemnification law, we think the proposals represented by the various bills under consideration for indemnification agreements, whether current law or otherwise, are not be good measures for business transactions in general. We therefore ask that you decline to recommend indemnification changes be made a part of our law. I would be happy to answer any questions you may have of me and I thank you for the opportunity to make our thoughts known to you.

Paid for by the Coalition to Preserve the Freedom of Contract

SB 379 is Anti-Freedom, Anti-Homeowner, and Out of the Mainstream

Contractors Cannot Justify the Need for Anti-Additional Insured Legislation

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Protecting an individual's or company's right to contract freely with others is a central principle of free markets, limited government, federalism, and individual liberty. Anti-additional insured legislation like SB 379 squarely contradicts the freedom of contract, because it completely prohibits two parties from contracting with each other over how to allocate liability between themselves in the event that they are sued. As written, SB 379 would prohibit a property owner from asking a contractor doing construction work on the property to list the owner as an additional insured on the contractor's insurance policy against acts of concurrent negligence that cause damage to the owner's property or an injury to persons performing work on the property.

Suppose, for instance, that a Homeowner has hired a Contractor to fix his roof. During work on the project, Contractor's employee falls through the roof, sustaining serious injuries. Contractor is immune from a suit brought by the employee because of workers' compensation. So, the Contractor's employee has every incentive to sue the Homeowner, claiming Homeowner failed to provide safe premises for the employee to work. Ordinarily, a Homeowner could insist that a Contractor indemnify the Homeowner against such a lawsuit. But if SB 379 passes, a Homeowner would not be able to negotiate with a Contractor to provide an additional insured endorsement to protect Homeowner from Contractor's employee's lawsuit. *In that case, a Homeowner's insurance policy must absorb the lawsuit, adversely affecting Homeowner's ability to obtain affordable insurance in the future*. This outcome would not only be true for Homeowners, but also for all other property owners, including farmers, ranchers, cities, counties, school districts, and small businesses.

Some contractors claim that SB 379 merely "closes a loophole" in legislation passed a few years ago that prohibited indemnity provisions in construction contracts that indemnify a premises owner against concurrent negligence. That claim is grossly misleading. Among those states that have prohibited indemnity provisions in construction contracts, the vast majority of them STILL PERMIT additional insurance agreements. There is a very good reason for making the distinction. Although both prohibitions interfere with freedom of contract, additional insurance provisions are even harder to attack than indemnity provisions. Additional insurance agreements are paid for by the person who hires the contractor as part of the implicit contract price of the job—just like many other kinds of insurance. There is simply nothing unfair about a contractor providing the defense of a claim already paid for by the premises owner as a part of the contract price. In fact, such agreements facilitate the settlement of claims and tend to avoid costly litigation that delays compensation for injured workers. The alternative, which these laws produce, is a situation where a Homeowner or other property owner is effectively prevented from forcing the Contractor to take responsibility for any mishaps without filing another lawsuit—even if the Contractor was really at fault for the accident or for harm to his employee.

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- Additional insurance agreements between two entities that work together are better than ordinary insurance. Insurers base premiums (and willingness to insure) on historical facts about a business's operations, but they cannot monitor ongoing behavior or precautions very frequently. In contrast, businesses that work in the same space can observe one another's actions on a closer, real-time basis—and react accordingly. For example, a trucking operator who finds a delivery terminal to be below par, and who has additionally insured the terminal owner for delivery liability, has every incentive to address the issue, either by requesting change, adjusting its own behavior, or instigating a joint fix.

- Property owners do not control the work of independent contractors on their property, yet they can be subject to liability for that work. If companies are no longer allowed to obtain additional insured status under insurance policies connected with a bid, then they will have to pay for insurance (through contract rates) they do not receive the benefit of.

- Enactment of SB 379 subjects both private and public property owners to a substantial new risk of liability and to dramatic increases in litigation costs. Such costs in turn will raise liability insurance rates and the already high premiums property owners face.

- Small businesses will suffer if SB 379 passes, because this legislation will discourage property owners from contracting with smaller contractors for fear that their relatively small capitalization will make the property owner a deep pocket litigation target.

- The inability to place the liability risk with the party who is most able to manage that risk (the Contractor) offends sound public policy that fosters safe work environments, because it reduces the incentive of the Contractor to minimize the potential for future claims.

- SB 379 does not promote workplace safety and could actually undermine safety by providing a disincentive for safety precautions in the form of immunity to contractors from liability for their conduct. Rather than assure that everyone pays their "fair share," this legislation shifts responsibility to property owners. It effectively protects contractors from their full liability in third-party lawsuits even if they substantially caused the harm.

- If property owners cannot obtain additional insured provisions, they end up defending lawsuits (at a minimum) and/or paying some portion of a settlement to minimize losses, or a judgment. The speedy and efficient settlement of claims would be discouraged, to the detriment of the owner, contractor, and injured workers. Increased costs divert resources which would have previously been used to compensate injured workers, make a state's manufacturers less competitive, and jeopardize economic growth.

- Litigation will be generated where none now exists. The inability to have an additional insured provision in a contract will encourage more lawsuits against third parties by injured workers making an end run around state sanctioned workers compensation programs and spark litigation among the parties to determine liability. Again, the legal costs that arise from duplicative new lawsuits may threaten the pricing and availability of property insurance.

AMERICAN LEGISLATIVE EXCHANGE COUNCIL

RESOLUTION OPPOSING ANTI-INDEMNITY AND ANTI-ADDITIONAL INSURED LEGISLATION

PURPOSE: Urging state legislatures not to adopt legislation that would prohibit or require the inclusion of indemnity and additional insured provisions in commercial contracts

WHEREAS, a number of state legislatures have passed laws prohibiting standard indemnity and additional insured contract provisions that have been in use for decades

WHEREAS, the freedom of contract is among the fundamental liberties guaranteed by the United States Constitution and is an essential element of a free-market economy

WHEREAS, the ability for businesses to contract freely and to consent voluntarily to commercial terms promotes prosperity and commerce by giving businesses tremendous flexibility in ordering their commercial relations with one another, including the ability to allocate risk appropriately to fit a particular transaction

WHEREAS, businesses are always free to decline contracts that contain commercial terms (including risk allocation and insurance requirements) they do not want to accept, and to negotiate alternative terms.

WHEREAS, government should be cognizant of leverage that may be exerted by larger entities against smaller entities with respect to risk allocation and insurance requirement

WHEREAS, contract terms should be bargained for during contract negotiations

WHEREAS, indemnity clauses and additional insured provisions are a legitimate means to allocate risk between contracting parties and customers have good reasons to seek risk allocation as part of the package of services they contract to obtain

WHEREAS, numerous contract terms involve contracting around the background tort rules and setting alternative arrangements for the assignment of liability, including contract provisions limiting punitive damages or excluding consequential damages

WHEREAS, blanket prohibition against indemnity and additional insured provisions penalizes companies who have a strong safety record, because safe

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contractors/operators/indemnitees will no longer be able to enjoy the benefits of being named as an additional insured at relatively little cost

WHEREAS, indemnity clauses and additional insured provisions allow parties to allocate liability between them in advance, thereby avoiding needless litigation over fault and who will defend liability claims when they arise

WHEREAS, the insurance market developed "additional insured" coverage (extending coverage to someone other than the named policyholder) in response to an identified need in the marketplace, and the cost (premium) of the coverage is generally known and can be included in the cost of a legitimately negotiated contract

WHEREAS, the common law has always permitted these provisions and courts have traditionally upheld them so long as there is no breach of duty to the public,

WHEREAS, there are other sound public policy reasons to permit both indemnity provisions and additional insured provisions in commercial contracts, including provisions that allow one party to indemnify or insure against another party's negligence. Inappropriate clauses, where a responsible party's sole fault and liability are shifted to a non-negligent party, should be discouraged as against public policy

THEREFORE, BE IT RESOLVED, that the American Legislative Exchange Council opposes legislation that would prohibit or require the inclusion of indemnity provisions in commercial contracts

BE IT FURTHER RESOLVED, that the American Legislative Exchange Council opposes legislation that would prohibit or require the inclusion of additional insured provisions in commercial contracts