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New Construction, Dealership, Franchise, & Transportation Contracts in Kansas Can No Longer Contain Commonly-Used Liability Indemnity Provisions

by Wyatt Hoch and Bill Wood

whoch@foulston.com bwood@foulston.com

The 2008 Kansas Legislature passed a statute that declares void as against Kansas public policy long-standing contract risk-allocation provisions in many commercial contracts. In 2004 the legislature enacted a prohibition against liability indemnity provisions in construction contracts. Over the past three sessions legislators considered both expanding that prohibition to other industries and voiding contract requirements for additional-insured liability insurance coverage. **The new statute, which amends K.S.A. § 16-121, prohibits indemnity, additional-insured, and choice of law and forum selection provisions in a broad array of Kansas construction, manufacturing, transportation, dealership, and franchise contracts (collectively defined by the statute as "Contracts") entered into after January 1, 2009.**

Indemnity and insurance provisions are common and accepted terms in many commercial contracts. Indemnification agreements transfer risk and assign future liability litigation arising from the contract performance. They remove doubt about future legal liability and avoid application of the comparative fault rule to marginally-involved defendants. The Kansas courts have historically enforced these risk-allocation provisions.

As an alternative or in addition to indemnity, contracting parties can also agree to allocate risk among their respective insurance carriers. In response to an identified need in the marketplace, the insurance market developed "additional insured" coverage, under which liability coverage is extended to someone other than the policyholder. For example, a franchisee may for a price name a franchisor as an additional-insured on the subcontractor's commercial general liability policy. But no more.

Prohibited Contract Terms. The 2008 statute severely hamstrings the ability of private parties to contract around the Kansas comparative-fault rule, under which parties generally bear responsibility for accidents in proportion to their fault for that accident. The new statute generally renders void and unenforceable:

Contract terms that require indemnification for negligence or intentional acts or omissions of the indemnified party. The definition of "indemnification provision" includes a promise, agreement, clause or understanding "in connection with, contained in, or collateral to a [C]ontract;"

Contract terms that require the extension of liability coverage to another party by naming them as an additional-insured for liability arising from their own actions; and

Choice of law and forum selection clauses in covered Contracts. Kansas law will apply to and govern every Contract that is performed in Kansas, and all disputes will be resolved in a Kansas arbitration or court forum.

Contracts Subject to Regulation. The 2004 statute covered only agreements for the design, construction, alteration, renovation, repair or maintenance of a structure, road (except oil-field road), bridge, waste, sewer, or oil or gas line. The 2008 statute exponentially expands its breadth to include:

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dealership agreements between an equipment manufacturer or service provider and an equipment or service dealer, which provides for the purchase or sale of equipment or services;

franchise agreements between manufacturers, distributors and dealers, by which one party is granted the right to offer, sell or distribute goods or services under the other's marketing system and trademark, service mark, trade name, or advertising; and

motor carrier transportation contracts covering the storage and transportation of property by a motor carrier and the entrance onto property by the motor carrier for the purpose of loading, unloading or transporting property. A motor carrier transportation contract does not include an uniform intermodal interchange and facilities access agreement.

Limited Safe Harbors. The 2008 statute specifically preserves the most-obvious form of indemnity obligation -- the validity of an insurance contract or construction bond issued by an insurer or bonding company. It also preserves the vitality of contract provisions (i) obligating a contractor or owner to provide general liability insurance or railroad protective insurance; (ii) obligating an owner to indemnify a contractor for strict liability under environmental laws; (iii) incorporating an indemnity obligation integral to settlement of a construction contract dispute.

The legislature, in a nod to the freedom of contract, did create two safe harbors for use by sophisticated contracting parties and their counsel in allocating liability risk in their transactions. First, the statute preserves the enforceability of a separately-negotiated provision in which the parties agree to a "reasonable allocation of risk," if it is based on industry loss experience and supported by adequate consideration. The legislature did not attempt to define the bounds of reasonableness, leaving abundant opportunity for legal challenges to the enforceability of the provision which -- by definition -- will arise only after the risk has manifested itself.

Second, the statute **enables parties to allocate risk through indemnity underwritten by liability insurance**. The indemnity obligation must be limited to the extent of coverage and dollar limits of the insurance. In the case of a unilateral indemnity obligation (under which only one party agrees to indemnify the other without a reciprocal obligation), the coverage must be obtained through a separate liability insurance policy procured at the indemnified party's expense. This final alternative will undoubtedly increase the cost of the transaction but provide the most secure allocation of risk for all but the most-catastrophic of accidents.

For Further Information

Foulston Siefkin regularly counsels clients on issues relating to business and construction law. If you are interested in additional information regarding this Issue Alert, or if you have questions about how this new legislation may impact you, call Wyatt Hoch at (316) 291-9769 or Bill Wood at (316) 291-9772 or email them at whoch@foulston.com or bwood@foulston.com. For additional information on the Firm, please visit our website at **www.foulston.com**. Information contained in this bulletin has been prepared for general information purposes only and is not legal advice.

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