

ALASKA STATE LEGISLATURE
SENATE JUDICIARY STANDING COMMITTEE

January 21, 2008

1:34 p.m.

MEMBERS PRESENT

Senator Hollis French, Chair
Senator Charlie Huggins, Vice Chair
Senator Bill Wielechowski
Senator Gene Therriault

MEMBERS ABSENT

Senator Lesil McGuire

COMMITTEE CALENDAR

CS FOR HOUSE BILL NO. 151(JUD)

"An Act requiring an indemnification, defense, and hold harmless provision in construction-related professional services contracts of state agencies, quasi-public agencies, municipalities, and political subdivisions."

HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 151

SHORT TITLE: INDEMNITY CLAUSE IN PUBLIC CONTRACTS

SPONSOR(S): REPRESENTATIVE(S) JOHNSON BY REQUEST

02/22/07	(H)	READ THE FIRST TIME - REFERRALS
02/22/07	(H)	STA, JUD
03/20/07	(H)	STA AT 8:00 AM CAPITOL 106
03/20/07	(H)	Heard & Held
03/20/07	(H)	MINUTE(STA)
03/24/07	(H)	STA AT 10:00 AM CAPITOL 106
03/24/07	(H)	Moved CSHB 151(STA) Out of Committee
03/24/07	(H)	MINUTE(STA)
03/26/07	(H)	STA RPT CS(STA) NT 6DP
03/26/07	(H)	DP: JOHANSEN, JOHNSON, COGHILL, DOLL, GRUENBERG, LYNN
04/02/07	(H)	JUD AT 1:00 PM CAPITOL 120
04/02/07	(H)	Heard & Held
04/02/07	(H)	MINUTE(JUD)
04/30/07	(H)	JUD AT 1:00 PM CAPITOL 120
04/30/07	(H)	Moved CSHB 151(JUD) Out of Committee

04/30/07 (H) MINUTE(JUD)
05/01/07 (H) JUD RPT CS(JUD) NT 3DP 4NR
05/01/07 (H) DP: GRUENBERG, LYNN, RAMRAS
05/01/07 (H) NR: COGHILL, DAHLSTROM, HOLMES, SAMUELS
05/09/07 (H) TRANSMITTED TO (S)
05/09/07 (H) VERSION: CSHB 151(JUD)
05/09/07 (S) READ THE FIRST TIME - REFERRALS
05/09/07 (S) STA, JUD
05/12/07 (S) STA RPT 2DP 2NR
05/12/07 (S) DP: MCGUIRE, GREEN
05/12/07 (S) NR: FRENCH, BUNDE
05/12/07 (S) STA AT 1:00 PM BELTZ 211
05/12/07 (S) Moved CSHB 151(JUD) Out of Committee
05/12/07 (S) MINUTE(STA)

WITNESS REGISTER

REPRESENTATIVE CRAIG JOHNSON
Alaska State Capitol
Juneau, AK
POSITION STATEMENT: Sponsor of HB 151.

BRAD THOMPSON, Director
Division of Risk Management
Department of Administration
Juneau, AK
POSITION STATEMENT: Supported HB 151.

BOYD MORGENTHALER, Chair
PE Contracts Committee
Alaska Professional Design Council
Anchorage, AK
POSITION STATEMENT: Supported HB 151.

ACTION NARRATIVE

CHAIR HOLLIS FRENCH called the Senate Judiciary Standing Committee meeting to order at [1:34:42 PM](#). Present at the call to order were Senators Huggins, Wielechowski, Therriault, and Chair French

HB 151-INDEMNITY CLAUSE IN PUBLIC CONTRACTS

CHAIR FRENCH announced the consideration of HB 151. Before the committee was CSHB 151(JUD).

[1:35:05 PM](#)

REPRESENTATIVE CRAIG JOHNSON, sponsor by request, explained that HB 151 will require that uniform indemnification and hold harmless provisions be included in professional services contracts for all public agencies within the state. He suggested that the proposed changes are sound public policy and will constitute fair business practices between the public and private sector. It will ensure accountability for all parties involved in professional services contracts and it will save money. Currently, in some contracts that are signed by the state - specifically construction and engineering - the design consultant is required to hold state agencies harmless regardless of who is responsible for a negligent act. The problem is that the design consultant is unable to buy insurance for that assumed responsibility. This places a company at risk each time it submits a bid. As a result very highly qualified companies are electing not to bid on projects or they are building in a contingency to cover the increased responsibility, which increases costs to the state.

REPRESENTATIVE JOHNSON explained that HB 151 requires that professional services contracts adopt the language currently used by the Department of Transportation and Public Facilities (DOTPF). The bill allows competitive bidding and places the burden for mistakes where it belongs. HB 151 does not keep design engineers from being responsible, it keeps them from being solely responsible for things that they may not control.

[1:38:41 PM](#)

SENATOR THERRIAULT asked if the unintended consequence of bringing in financial consultants from the Permanent Fund Dividend group and the Alaska Retirement Management Board had been corrected.

REPRESENTATIVE JOHNSON said that was corrected. Furthermore, he isn't aware of anyone who opposes the bill as it is currently drafted.

SENATOR HUGGINS asked if financial savings are anticipated.

REPRESENTATIVE JOHNSON outlined savings in two areas. First, when designers are responsible for just their own mistakes, contingencies won't be figured into the bid. Second, this will attract more qualified designers and the competition will drive costs down.

SENATOR HUGGINS questioned how prevalent the suggested language is across the state.

REPRESENTATIVE JOHNSON relayed that the mere introduction of the bill has caused a lot of people to adopt the DOTPF language. For example, the University of Alaska Board of Regents has adjusted its policy.

[1:42:14 PM](#)

SENATOR HUGGINS said the MatSu Borough may have this provision and he'd like to hear the counter arguments.

REPRESENTATIVE JOHNSON said he believes that MatSu still has the language, but that doesn't make it right.

CHAIR FRENCH stated his intention is to hear and hold the bill today.

SENATOR WIELECHOWSKI opined that it's good for the state if it can get a design firm to contract to assume liability. He asked if the bill doesn't take away a right of the state to enter into a free contract, and if it doesn't potentially increase future costs when the state assumes liability it didn't have before.

REPRESENTATIVE JOHNSON agreed with the assessment, but he doesn't think it's a bad thing to hold the responsible party accountable for their own errors. This won't necessarily drive costs up because the state will get a better product.

[1:45:26 PM](#)

BRAD THOMPSON, Director, Division of Risk Management, Department of Administration, explained that the division administers the state's self-insurance program. The division provides guidance in the creation of policy related to contractual transfers of risk. The terms of HB 151 is addressing and trying to apply for construction-related contracts. Referring to Senator Therriault's question, he explained that the bill was narrowed to apply only to construction-related professional service contracts.

MR. THOMPSON explained that the Division of Risk Management guides DOTPF and other state agencies that contract for construction projects to use what is characterized as "Appendix D." It is a standard comparative fault allocation form. He clarified that the division provides guidance to DOTPF and other state agencies that might have a construction-related contract. It does not give guidance to the Alaska Railroad, the University of Alaska, or other local municipal agencies. However, many do

follow that standard language format. HB 151 makes that language a uniform application throughout all public entities.

CHAIR FRENCH said his understanding of the bill is that if a consultant makes mistake, the consultant is responsible and if the state makes a mistake, the state is responsible, but you can't sue the state if a consultant makes a mistake.

MR. THOMPSON said it's a comparative allocation. Typically, if there is a third-party claim, the state and perhaps the independent party that may have a comparative responsibility will be named. "We may bring them in. We would tender to that responsible party per the terms of this contractual statement to also pay their share if there is comparative allocation by that independent design agency," he said.

CHAIR FRENCH said if the independent party didn't make a mistake, then they wouldn't be brought in.

MR. THOMPSON agreed.

CHAIR FRENCH added that the same would hold if the state didn't make a mistake and the consultant had agreed to indemnify, defend, and hold harmless the state from claims of liability for the negligent acts, errors, or omissions of the consultant.

MR. THOMPSON said yes; the consultant is able to obtain a professional malpractice policy that provides protection so it's an insurable risk. One of the division's criteria for selecting outside professionals is that they have to carry insurance to be able to meet the obligation of the indemnity.

CHAIR FRENCH summarized that it's a fairly standard comparative fault statute.

MR. THOMPSON agreed; the statute portrays application of the state standard form for all public agencies within the state.

SENATOR WIELECHOWSKI read, "This language insulates public agencies from liability for their own negligence by unfairly transferring it to design consultant companies." He asked if the state is unfairly transferring liability to design consultant companies.

[1:50:16 PM](#)

MR. THOMPSON restated that state agencies generally adopt the language currently used by DOTPF, but the university, for example, has had consultant agreements that used language much stronger than a comparative allocation. It transferred any and all risk associated with the work. Because of that contractual language, the university was able to tender the defense of any claim.

SENATOR WIELECHOWSKI asked if in the past the university held design consultants completely responsible if anything went wrong, even if it was the university's fault.

MR. THOMPSON said under the language that was previously applied, he believes there were situations where the university was able to transfer responsibility to the design consultant.

SENATOR WIELECHOWSKI asked if he has knowledge of any lawsuit where the liability was transferred to the design company.

MR. THOMPSON said he can't respond to the university's situation.

[1:51:14 PM](#)

SENATOR WIELECHOWSKI highlighted a potential con to the state is that it may have to pay increased liability and lawsuit costs.

MR. THOMPSON clarified that the language in this stipulation is a comparative allocation. Without any contract term addressing that allocation, under the law today it is pure comparative. If an owner of a project is brought in for a third-party claim, even without this contractual term, that owner would be able to third-party in any other responsible party for their comparative fault. This contract term is more expeditious. The owner could present the claim and ask to be held harmless if it is only the other party's responsibility. If it is a comparative, the owner will share in the defense and each party will pay its share.

[1:52:15 PM](#)

CHAIR FRENCH asked if it's fair to say that this is a codification of existing common law into statute with regard to comparative fault.

MR. THOMPSON said yes, as it applies to professional services within construction-related contracts.

SENATOR WIELECHOWSKI questioned the necessity of placing it in statute.

MR. THOMPSON referenced the sponsor's statement that some public entities are seeking protection beyond what the law would provide without such a clause. That contractual term is onerous to some independent professionals because it is not insurable.

CHAIR FRENCH said a professional design consultant couldn't get insurance to cover something the state might be liable for.

MR. THOMPSON explained that a malpractice policy typically excludes contractual liability so an independent professional could not extend coverage for contractual liability except that which would be applied anyway under their own comparative responsibility. Someone can't obtain insurance if they sign a document obligating him/her self to protect the owner.

[1:54:31 PM](#)

SENATOR WIELECHOWSKI questioned how the bill benefits the state because if the state can get a design professional to agree to assume the state's liability, then that's what the market will bear and that's good for the state.

MR. THOMPSON restated that the Division of Risk Management has used this language for a number of years. The argument is that some design contractors won't respond to RFPs (request for proposal) that have a complete indemnity obligation.

[1:55:37 PM](#)

BOYD MORGENTHALER, Chair, PE Contracts Committee, Alaska Professional Design Council (APDC), described the council as a consortium of professional societies that represents about 5,000 registered professional architects, engineers, and land surveyors in Alaska. He explained that the bill addresses the fact that some quasi-governmental agencies within the state depart considerably from the common law with regard to professional services contracts. He clarified that he's referring to contracting officers who have the power to coerce consultants to enter into a take it or leave it contract. Several of those agencies have gone so far as to ask the consultant to take on all the responsibility for liability except for the agencies sole negligence.

[1:58:57 PM](#)

MR. MORGENTHALER explained that in a circumstance where the agency is 99 percent at fault and the consultant has 1 percent involvement, the consultant would still be required to pay 100 percent of the cost because there is no apportionment of cost on

a comparative fault basis in these contracts. There has been some progress in the last several years. For example, about two years ago an Alaska Railroad contract required the consultant to indemnify and hold harmless the railroad from and against all claims and actions asserted by a third-party or parties resulting from the services performed. After considerable discussion, the railroad realized the unfairness of the position and they adopted the DOTPF language. The University of Alaska had similar one-sided contract language but the Board of Regents has since changed all contracts in the university system to language that's essentially the same as DOTPF language.

[2:01:14 PM](#)

MR. MORGENTHALER relayed that the MatSu Borough began to use the DOTPF language in about 2000, but about five years later a new contracting officer opted to again use the one-sided language. He described a circumstance where two consultants are brought into the same lawsuit and said it can be a very unfair situation. Most small professional services companies rely on contracts from state and governmental agencies. and even when the contract language one-sided, somebody will ultimately bid. Usually it's the young engineer or architect who doesn't have much to lose by assuming all the responsibility.

CHAIR FRENCH said his professors described such individuals as "judgment proof."

[2:03:43 PM](#)

MR. MORGENTHALER agreed with the characterization. Companies that are well established won't bid on projects that have bad indemnification language, which is why HB 151 is so important to architects and engineers. It will level the playing field on contracts we sign with government agencies.

[2:05:45 PM](#)

SENATOR WIELECHOWSKI asked if there's a requirement to provide proof in insurance before signing a contract to indemnify the state.

MR. MORGANTHALER said yes, but professional liability policies only cover a consultant's negligence, not contractual requirements. Beyond comparative fault a company is on its own.

SENATOR WIELECHOWSKI asked if he's aware of lawsuits where design contractors have been sued and had to pay what would otherwise have been the state's responsibility.

MR. MORGANTHALER said no.

2:08:07 PM

CHAIR FRENCH relayed that he made contact with a former colleague who makes a living suing the state and he thinks HB 151 is fair all the way around.

CHAIR FRENCH held HB 151 in committee.

There being no further business to come before the committee, Chair French adjourned the meeting at 2:08:37 PM.