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FISCAL IMPACT REPORT

ORIGINAL DATE 02/03/09
LAST UPDATED 03/06/09 **HB** _____

SPONSOR Leavell

SHORT TITLE Commercial Transaction Indemnity Agreements **SB** 276/aSCORC

ANALYST Woods

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
NFI	NFI		

(Parenthesis () Indicate Expenditure Decreases)

Duplicates, Relates to, Conflicts with, Companion to N/A

SOURCES OF INFORMATION

LFC Files

Responses to Amendment Received From

Office of the State Engineer (OSE)

Energy, Minerals and Natural Resources Department (EMNRD)

Attorney Generals Office (AGO)

SUMMARY

Synopsis of SCORC Amendment

Senate Corporations and Transportation Committee amendment to SB 276 amends an existing statute (NMSA 1978, Section 56-7-2) which prohibits indemnity agreements in private contracts pertaining to oil, gas or water wells or mines (such as well drilling contracts). The amendment changes the original bill substantively in two respects, and to some extent clarifies other provisions. The substantive changes are as follows:

The amendment limits the prohibition on indemnity agreements to indemnification against liability for personal injuries or wrongful death. This represents a change in existing law, which also prohibits indemnification against liability for negligent or accidental property damage.

The amendment excludes from the prohibition on indemnity agreements “transport, gathering, processing or treatment of a product.” This is not a change in existing law. NMSA 1978 Section 56-7-2 expressly applies only to contracts concerning wells, and thus would not apply to the activities that the amendment excepts. However, the bill

broadens the application of that section, and, without the amendment, would arguably have extended the prohibition on indemnity agreements to “transport, gathering, processing or treatment of a product.”

SB 276/aSCORC clarifies in certain respects the provisions limiting the ability of the parties to stipulate for application of the law of another state to their contracts in order to avoid the prohibition on indemnification. The amendment making clear that it limits choice of the law of a sister state, as well as choice of a foreign nation’s law. Like the original bill, however, the amendment may relax, rather than tighten the prohibition of indemnity agreements, compared to existing law, since the courts, in construing the existing statute, have indicated that such “choice of law” provisions are generally unenforceable.¹

FISCAL IMPLICATIONS

None suggested by respondents.

SIGNIFICANT ISSUES

EMNRD indicates the following:

Activities to which the Prohibition on Indemnity Agreements Applies - The amendment retains language in the original bill extending the prohibition on indemnity agreements to “all operations up to the point of measurement and transfer or ownership and determination of payment for oil, gas other minerals or water.” However, the amendment adds language excluding “transport, gathering, processing or treatment of a product.” It is unclear exactly what operations, in addition to drilling and operations of wells, are included in the expansionary language of the bill and not excluded by the amendment.

“Choice of Law” Provisions - The amendment changes the provisions restricting choice of non-New Mexico law by substituting “another state” in place of “a foreign government.” Lawyers frequently refer to “foreign law” to mean the law of another state or of another nation. However, that usage differs from the common understanding of the word “foreign” in other contexts. Hence the amendment in this respect is a welcome clarification.

SB 276 SCORCa’s provisions regarding what choice of law provisions would be enforceable remain vague. Under the amendment, as under the original bill, a provision for application of another state’s law will be enforced only if it “provide[s] for a choice of law analysis for a dispute arising from, connecting to or concerning the indemnity obligations.” However the amendment deletes the original bill’s problematic requirement that the choice of another state’s law be “mutually selected.”

OSE adds that, the second amendment is not very precise as an exception to the set of contracts to which this statute’s prohibition applies. Additionally, the replacement of the term “foreign government” with “another state,” probably based on the FIR’s observation that the original

¹ Excerpted to EMNRD comments dated 3-3-09.

bill's term, "foreign government," "presumably includes other states," fails to continue to include foreign government courts in the prohibition. OSE concludes, "Nevertheless, the above concerns about the effect of the amending language are outside of the special expertise of the Office of the State Engineer, and present no significant issues."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

EMNRD states, "Section 56-7-2, as now worded, will continue to govern indemnification agreements in contracts regarding drilling and operation of oil and gas wells, water wells and mines. The *Banta* decision [*Banta Oilfield Services, Inc. v. Bituminous Insurance Companies*, 2006-NMCA-063] will continue to govern, and generally prohibit, choice of law provisions that would apply another state's law to enforce an indemnification provision prohibited by Section 56-7-2."

Synopsis of Original Bill

The Attorney General's Office (AGO) indicates that this legislation amends NMSA Section 56-7-2, which currently prohibits certain indemnification provisions in agreements pertaining to a well for oil, gas, or water or mine for a mineral. It would expand the prohibition to prohibit an obligation of defense, and would include third-party beneficiaries within the prohibition.

The bill would also amend that section to list the claims, costs and damages which are prohibited from being included in an indemnification agreement.

The bill also expands the definition of an "agreement pertaining to a well for oil, gas, or water or mine for a mineral" to include "all operations up to the point of measurement and transfer of ownership and determination of payment for the oil, gas, other minerals or water."

The bill would also prohibit agreements to purchase insurance which require the indemnitor to include in any invoice for services a line item for the insurance premiums, or to arrange for the indemnitee to pay such obligation directly.

The bill would also prohibit an agreement that requires the application of the laws of another state, if the provision is not "mutually selected" and does not provide for a choice of law analysis for a dispute arising from, connecting to, or concerning the indemnity obligations for work performed in the State of New Mexico.

The bill would also prohibit a provision in an agreement that allows exclusive jurisdiction of a "foreign government" that deprives the courts of this state of jurisdiction or that recognizes venue of a foreign government for any dispute arising from indemnity obligations for work performed in New Mexico.

Provisions in agreements which are prohibited by this bill are declared to be "against public policy" and "void".²

There is no appropriation attached to this legislation.

² The AGO response carries the caveat, *This analysis is neither a formal Attorney General's Opinion nor an Attorney General's Advisory Opinion letter. This is a staff analysis in response to the agency's, committee's or legislator's request.*

SIGNIFICANT ISSUES

AGO indicates that, currently, NMSA Section 56-7-2 prohibits indemnification agreements agreeing to indemnify the indemnitee for claims, costs, damages etc. arising from the indemnitee's negligence, the negligence of an independent contractor directly responsible to the indemnitee, or an accident that occurs in operations supervised by the indemnitee or in accordance with methods specified by the indemnitee. In other words, current law prevents one party from assuming all risk relating to oil, gas, and water wells, and mining, even when the injury is caused by the other party. This bill expands upon those concepts by defining the types of claims, damages etc. which cannot be included in such an indemnification agreement and by including an agreement to indemnify a "third-party beneficiary", presumably of the indemnitee, within its prohibitions. AGO further notes:

- The bill appears to require the application of New Mexico law regarding indemnification agreements as they pertain to work performed in this state pertaining to oil, gas, or water wells, or mining operations.
- The bill also appears to prohibit provisions in an agreement shifting the obligation to purchase insurance, presumably covering the negligent acts of an indemnitor, to a prospective indemnitor and then submitting invoices to the prospective indemnitee for that purchase.
- The bill also appears to prohibit the application of the laws of another state for work performed in the State of New Mexico if the "indemnity obligations" are not subject to a "choice of law" analysis, effectively requiring the application of New Mexico law regulating indemnification agreements for oil, gas, and water well, or mining operations conducted within this state.
- The bill also appears to effectively establish venue in New Mexico for disputes arising from indemnity obligations for work performed in New Mexico. It also prohibits provisions granting exclusive jurisdiction over those disputes to a "foreign government". Although the bill does not define "foreign government", that term presumably includes other states.

As background, EMNRD advises that many oil and gas producing states have statutes prohibiting agreements in drilling contracts whereby either the operator of the drilling contractor promises to indemnify the other against liability for personal injuries or property damages. The details of these statutes vary significantly, including what types of contracts are covered, whether the prohibition applies to any indemnification, or just to indemnification for the indemnified party's own negligence, and whether the prohibition applies to provisions that require one party to furnish liability insurance coverage for the other. New Mexico's Section 56-7-2 is among the strictest anti-indemnity statutes. It specifically prohibits agreements requiring one party to cover the other as an additional insured under its liability insurance policy and "waiver of subrogation" provisions that limit the right on one party's insurer to seek recovery of losses paid from another party or its insurer. Furthermore, Section 56-7-2 has been amended several times, and each time it has been extended to ban additional types of indemnification agreements. The legislative and judicial history of Section 56-7-2 are discussed in detail in the New Mexico Court of Appeals' opinion in *Banta Oilfield Services, Inc. v. Bituminous Insurance Companies*, 2006-NMCA-063.

EMNRD further notes that New Mexico courts have explained Section 56-7-2 as a statute designed to protect public safety, noting that requiring each party to service agreements to remain financially responsible for its own actions promotes safety consciousness. Some commentators have suggested that such statutes also serve an economic purpose, protecting drillers and service companies from being compelled by market power of operators to provide indemnification, including indemnification for injuries to their own employees, from which they would otherwise be protected by the workers' compensation laws. EMNRD adds:

- *Provisions of the Bill that Strengthen the Prohibition on Indemnity Agreements* - SB 276 further strengthens the prohibition on indemnification agreements. Several of the amendments are likely clarifications, expressly extending the indemnity prohibition to situations to which it probably already applies. This is probably the case with the bill's provision prohibiting indemnification of third party beneficiaries, and to provisions requiring one party to pay another's litigation costs. The provision prohibiting one party's paying for another party's liability insurance could be either a clarification or an extension of the existing law. Present law prohibits one party providing coverage for another under its liability policy, but does not specifically prohibit paying for another party's insurance. The provision extending the statute's application to certain other field operations not directly related to the drilling or operation of wells probably extends the reach of the statute somewhat.
- *"Choice of Law" Provisions* - Because state laws differ regarding the enforceability of indemnification agreements, and New Mexico's law is among the strictest in prohibiting such agreements, it is to the interest of parties wanting contractual indemnification to provide in their contracts for application of another state's law. Such "choice of law" provisions are generally enforced in other contexts. However, the New Mexico Court of Appeals, in the *Banta* decision, cited above, held that Section 56-7-2 evidences a legislative intent to prohibit application of laws of other states allowing indemnification agreements from applying to contracts for work performed in New Mexico. Under the bill, some such choice of law provisions would apparently be valid. The bill's provisions regarding what choice of law provisions would be enforceable are vague. A provision for application of another state's law will be enforced only if it is "mutually selected" and "provide[s] for a choice of law analysis for a dispute arising from, connecting to or concerning the indemnity obligations." It is unclear what this language means, and the bill does not further explain it. It may be significant that a court applying traditional "choice of law analysis" would likely have upheld the selection of Texas law on the facts of the *Banta* case. Instead, the New Mexico Court of Appeals held that Section 56-7-2 evidenced an overriding public policy that precluded application of another state's law.

EMNRD concludes that it is probably reasonable to assume that, if the SB 276 is enacted, attorneys writing contracts for clients who want indemnification provisions will be creative in writing provisions designed to be enforceable under the bill's terms.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

AGO states, "Current law regulating indemnity agreements as they pertain to oil, gas, and water wells, and mining operations will remain effective."

EMNRD suggests that, “Section 56-7-2, as now worded, will continue to govern indemnification agreements in contracts regarding drilling and operation of oil and gas wells, water wells and mines. It will remain unclear, until the courts resolve these issues, whether or not agreements to pay for another party’s liability insurance, or to indemnify a third party (not a party to the contract) are enforceable. The *Banta* decision will continue to govern, and generally prohibit, choice of law provisions that would apply another state’s law to enforce an indemnification provision prohibited by Section 56-7-2.”

AMENDMENTS

None suggested by respondents.

BW/mc:svb