INDEMNITY CLAUSES IN LOCAL GOVERNMENT CONTRACTS

I. INTRODUCTION:

It is a rare week in municipal law practice that counsel for a city or town is not presented with a contract that includes an indemnification clause. These provisions generally require the local government to indemnify or “hold harmless” the other party to the contract from any liability or costs arising from that party’s performance under the contract.\(^1\)

There are many good, **practical** reasons for the local government practitioner to counsel his client to reject indemnification language. These include:

- The likelihood that this contractual obligation is not covered by the local government’s insurance policy or self-insurance pool coverage.
- The fact that such clauses do not typically expire upon termination of the contract with the result that they are virtually perpetual.
- The inherent inequity of such provisions since they are typically unilateral rather than reciprocal.
- The unpredictability of indemnity obligations since they are open-ended and unlimited in scope and amount.

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\(^1\) An indemnity clause is distinguishable from a “release” or “waiver” which limits a contracting parties ability to sue the other contracting party but does not require a defense or indemnification against claims brought by third parties.
Since indemnity clauses are contractual obligations and not tort claims per se they are probably NOT subject to the liability limits, notice requirements or substantive immunities of the Colorado Governmental Immunity Act. C.R.S. § 24-10-101 et seq.

Even putting aside the fact that ANY client is ill-advised to enter into a contractual indemnity clause, however, the almost universal consensus among lawyers who have carefully considered the issues is that local governments in Colorado are legally prohibited from entering into these types of arrangements and that, when and if they do, the contractual indemnification obligation is void and unenforceable ab initio.

This is so for several reasons.

II. C.R.S. § 29-1-110.

A. C.R.S. §29-1-110 is part of the Local Government Budget Law of Colorado. It states as follow:

29-1-110. Expenditure not to exceed appropriation. (1) During the fiscal year, no officer, employee, or other spending agency shall expend or contract to expend any money, or incur any liability, or enter into any contract which, by its terms, involves the expenditures of money in excess of the amounts appropriated. Any contract, verbal or written, made in violation of this section shall be void, and no moneys belonging to any local government shall be paid on such contract.

(2) Multiple-year contract may be entered into where allowed by law or if subject to annual appropriation.

B. Knowing violation of this prohibition, as well as the other requirements of the Local Government Budget Law, by any member of the governing body or any local government or any officer, employee, or agent of any spending agency, is malfeasance in office which, upon conviction, shall result in removal from office. C.R.S. §29-1-115.

“Any elector [read political opponent or dissident] of the local government may file an affidavit regarding suspected malfeasance with the district attorney, who shall investigate the allegations and prosecute the violation if sufficient cause is found. Id. (emphasis added). See e.g. People v. Losavio, 199 Colo. 212, 606 P.2d 856 (1980).
C. It is, as a practical matter, impossible to appropriate funds in support of a contractual indemnity obligation since the term and amount of the obligation are undetermined.


E. C.R.S. §29-1-110 was applied in the recent case of Thyssenkrupp Safway, Inc. v. Hyland Hills Parks and Recreation Dist., 271 P.3d 587 (Colo. 2011) (copy attached) to bar a contractual claim for indemnification.

III. COLORADO CONSTITUTION ARTICLE XI, SECTION 1 AND 2:

A. Section 1 of Article XI of the Colorado Constitution states as follows:

Section 1. Pledging credit of state, county, city, town or school district forbidden. Neither the state, nor any county, city, town, township or school district shall lend or pledge the credit or faith thereof, directly or indirectly, or in any manner to, or in aid of, any person, company or corporation, public or private, for any amount, or for any purpose whatsoever; or become responsible for any debt, contract or liability of any person, company or corporation, public or private, in or out of the state.

B. An agreement to indemnify another is, by definition, becoming responsible for the liability of a person, company or corporation, public or private, and would seem to be explicitly barred by Art. XI, Sec. 1.

C. While no Colorado case has specifically addressed this issue an article in a recent edition of the Special District Association Newsletter discusses an opinion by the Florida Attorney General concluding that local governments in that state are precluded from entering into indemnity clauses by state constitutional language almost identical to Art. XI, Sec. 1. Erb, “To the Extent Permitted By Law,” SDA Newsletter, July 2010 (copy attached by permission of the author).

D. May not bar indemnity provisions as between governmental entities.
D. The policies supporting the judicially-created “public purpose” exception to Art. XI, Sec. 1 would not seem to apply to contractual indemnity clauses. CITE.

E. Section 1 of Article XI of the Colorado Constitution states, in pertinent part, as follows:

   Section 2. No aid to corporations – no joint ownership by state, county, city, town, or school district. Neither the state, nor any county, city, town, township, or school district shall make any donation or grant to, or in aid of, . . . any person, company, or corporation, public or private . . . .

F. Indemnification of another entity is arguably a “grant to, or in aid of” such entity.

IV. TABOR:

   A. The so-called Taxpayer Bill of Rights or TABOR requires an election for the “creation of any multiple-fiscal year direct or indirect district debt or other financial obligation whatsoever, without adequate present cash reserves pledged irrevocably and held for payments in all future years.” Colo. Const. Art. X, Sec. 20(4).

   B. Multi-year fiscal obligations entered into in violation of this election requirement are void and unenforceable.

   C. Since indemnity obligations are usually unlimited as to duration and are certainly financial obligations (albeit in an undetermined amount) they most certainly violate TABOR with the result that they are void and unenforceable.

   D. The application of TABOR’s prohibition against multiple-year fiscal obligations to an indemnity clause was touched on, but not decided, in Board of County Comm’rs v. Fixed Base Operators, Inc., 939 P.2d 464 (Colo. App. 1997).

V. C.R.S. § 24-91-103.6(1):

   A. C.R.S. § 24-91-103.6(1), applicable to construction contracts with public entities, states as follows:
24-91-103.6. Public entity – contracts – change orders – severability. (1) No public entity shall contract with a designer, a contractor, or a designer and contractor for the construction, the design, or both the construction and the design of a public works project unless a full and lawful appropriation when required by statute, charter, ordinance, resolution, or rule or regulation has been made for such project.”

B. Since it is practically impossible to appropriate funds for payment of for the undefined obligation created by an indemnification clause, this statutory language will generally prohibit local governments from including such clauses in construction and/or design contracts.

VI. “TO THE EXTENT ALLOWED BY LAW”:

It is difficult, if not impossible, to craft a principled legal argument in support of the validity and enforceability of indemnity clauses when entered into by local government. Perhaps for this reason, the usual response to any objection to such a clause by the local government practitioner is something along the lines of “well, we get these from every other local government and there lawyers don’t object.”

That’s baloney.

In my experience most local governments DO understand the legal and practical impediments to indemnity obligations and refuse to sign them. Where such provisions are agreed to it is often because the local government’s lawyer never saw the contract.

We practitioners are, however, under considerable pressure from our clients, who generally don’t appreciate or care about the nuances of this issue. They simply know they need the goods or services to be contracted for and want the contract approved.

Thus, the conventional compromise has developed where the indemnification clause is preceded by the qualifying phrase “to the extent allowed by law.” Since the indemnification clause is prohibited under Colorado law, as discussed above, the added phrase nullifies it and renders it meaningless—at least in theory.

While I still employs this device when all else fails, I have become increasingly uncomfortable with it over the years. The prospect of explaining to a judge that my client and I knew that the indemnity obligation was illegal and void, but that we left it in the text anyway but rendered it ineffective by the use of some legal “weasel words” is pretty unappealing.
VII. CONCLUSION:

Local governments are legally prohibited from entering into open-ended indemnification clauses. The local government lawyer should reject these clauses, reciting the authorities set forth in this outline.

Remember—you are not alone!