mtg.

September 11, 1962

MEMORANDUM NO. 50(1962)

Subject: Study No. 52(L) - Sovereign Immunity (Indemnification or Save Harmless Agreements)

The Commission's tentatively recommended legislation upon this subject appears as Chapter 22 on pages 86 and 87 of the General Liability Statute that was previously distributed. The tentative recommendation appears on pages 44 and 45. A copy of the tentative recommendation on this subject, dated July 1, 1962, is attached.

Also attached to this memorandum are copies of three communications we received containing comments on this recommendation. These are:

Exhibit I (pink) - Extract--First Report of State Bar Committee to the President and Board of Governors of the State Bar

Exhibit II (yellow) - Letter from Trent G. Anderson, Jr., of Eilers, Wehrle & Anderson of Los Angeles

Exhibit III (white) - Copy of letter from Charles MacCloskey Company of Gardena to Southern California Chapter of Associated General Contractors.

You will note that the State Bar approves the recommendation but recommends the addition of "or injury" in Section 992.2 as proposed in the distributed tentative recommendation. In Section 898 of the general liability statute, the defined word "injury" was substituted for "damage."

The letters in Exhibits II and III object to the sweeping language of the authorization. They suggest, in effect, that such clauses should require indemnification only for injuries caused by the contractor's own negligence and not for injuries caused in whole or part by the negligence of the public entity or its employees. Or at least the authorization should be to require

indemnification for losses of a kind that are normally insurable.

The Commission's recommendation purports to state what is probably existing law. The recommendation states that it is intended to clarify the existence of this authority. If this is so, it would be necessary to frame language prohibiting such broad indemnification and save harmless agreements in order to meet the objections contained in these letters. The statute proposed does not, of course, require indemnification clauses in public contracts, it merely authorizes them. The public entities may find it unwise to require the broadest form of agreement possible in construction contracts because of the resulting increase in construction costs. On the other hand, they may find it desirable in particular cases to require the contractor to assume all risks.

The question the Commission must resolve is whether to forbid broad indemnity agreements by statute or whether to leave this matter to the negotiations of the contracting parties.

Respectfully submitted,

Joseph B. Harvey
Assistant Executive Secretary

EXHIBIT I

EXTRACT

from

STATE BAR COMMITTEE ON SOVEREIGN IMMUNITY

First Report of Committee to the President
And Board of Governors of the State
Bar of California

INDEMNIFICATION OR SAVE HARMLESS AGREEMENTS

The Committee recommends the adoption of this draft statute as written, with the addition of the words "or injury" after the word "damage" in the seventh line of Section 992.2.

Memo 50(1962)

EXHIBIT II

EILERS, WEHRLE & ANDERSON
Lawyers
606 South Hill Street
Los Angeles 14, California

August 30th, 1962

California Law Revision Commission
School of Law
Stanford University
Palo Alto, California

Gentlemen:

In the Los Angeles "Metropolitan News" for July 24th, 1962, there appeared an article indicating the tentative recommendation by your Commission for the inclusion of the indemnification or save harmless agreement in all public agency contracts. This was also the subject of comment in the "Weekly Law Digest" for August 6th, 1962.

In this field of law, policy decisions should be considered from the position of both parties. In an ideal world where no public official would be tempted to take advantage of the hold harmless agreement, there would be a benefit to the public agency. However, public agencies, like other organizations, must operate through individuals, and individuals may be tempted at the administrative level, or at the engineering level, or at the construction level, either to neglect their own duties or to impose upon the contractor. This may be done unintentionally by failure to indicate points of danger in the course of construction, or by a failure to go ahead with the affirmative duties of the agency in furtherance of the project.

Obviously, third party rights and safety are frequently affected by the manner of construction and the effective cooperation between the public agency and the contractor. If, in every instance, the public agency is able to state that the contractor must assume all liability, an unfair burden will be placed upon the contractor. The contractor should be entitled to rely on the plans of the agency and should be protected in undertaking work according to those plans. If the plans are wrong and someone is damaged, the burden of liability should not fall on the contractor.

You may say that this burden can be assumed by insurance. To a very limited extent, your answer may be correct. There are, however, many instances where third party claims will not be insurable under policies in general use. If the contractor then must assume the burden of liability from actions which, in part, stem from the actions or plans of the public agency, it will impose an element of uncertainty in the bid which, in the long run of things, will probably increase the cost of public works contracts. It is contrary to the spirit of public agency contract law to fail to provide for foreseeable contingencies in the specifications, and I believe your tentative recommendation would allow an uncertainty in each and every contract insofar as the negligence of District personnel must be assumed by the contractor.

The measurement or division of liability between the public agency and the contractor does not appear to be possible in a case where there is partial negligence by each party. The decisions indicate liability may fall upon the contractor under such a hold harmless clause. For instance, even though the public agency fails to accurately indicate the location of a utility or fails to take steps to remove an existing utility, the contractor is under a burden to proceed with the job. He has no effective power to compel any utility or the public agency to act, and the net result will be that in every instance he must go forward at his peril. We have had several cases recently in Los Angeles where gas lines have been broken, with consequent danger to the public as a result of this sort of problem. See, for instance, So. Calif. Gas v. A.B.C., 204 A.C.A. 811.

A recent case in our Superior Court arose because a land owner sued the District for failure to extend a drainage line orally promised. The District took the position that the hold harmless clause compelled the contractor to defend the District, even though the actions involved appeared to be entirely those of District personnel. In the same case, District drawings showed an existing retaining wall. District personnel on the job orally required that the wall be removed in order to place the line in the center of the right-of-way. The contractor objected that removing the wall would create a probability that the house immediately above the wall might suffer from subsidence. The initial answer of the District was that this was a risk assumed by the contractor and the liability, if any, would be his under the hold harmless clause.

In another case, the District drawings required excavation under a main thoroughfare. The District had not conferred with the Division of Industrial Safety. The Division inspector ruled that no workmen could enter the area beneath the street at the point where it was crossed by certain utility mains. It was the position of the inspector that the depth of trench and existence of utilities created an extreme hazard to life. The District ordered the contractor to proceed at his own peril. If the contractor had ordered personnel into the trench in violation of the inspector's order, he would have exposed the lives of the men and he would have created the possibility of unlimited liability in the event of injury. In that case, the contractor resolved the

problem in the old-fashioned way by he, himself, getting out a wheelbarrow and a shovel and removing several hundred yards of excavation from the trench in order that the job might progress.

There are many more examples, both in recent decision and from the newspapers and local experience.

The hold harmless clause is a means of allowing public agency personnel to impose their will upon the contractor. This type of clause has been used, moreover, to retain payments from the contractor on the premise that a third party claim had been filed and indemnity was required by the District. Improperly used, such a clause could result in insolvency to the contractor.

The recent decision of Doyle v. Pac. Tel. & Tel., 202 A.C.A. 783, states a limitation as between active as distinguished from passive negligence. This does not resolve the fundamental problem which confronts the contractor. If we assume that the District is only passively negligent in failing to report the existence of underground water or utility lines or other hazards, the contractor is still faced with the problem of constructing the job in a given period of time. He must hurry. He must use modern equipment and methods. If we impose upon him the burden of liability because he is actively negligent in digging, we will make the cautious contractor a slower builder and place upon him the burden of penalties for slow construction, whereas if he hastens and does not dig by hand to locate the utility, he will be faced with the risk of paying all third party claims under the hold harmless clause.

We respectfully urge that the hold harmless agreements in public agency contracts are a dangerous device for protecting the public agency against its own negligent personnel.

Yours very truly ,

S/ Trent G. Anderson, Jr.

TRENT G. ANDERSON, JR.,
of
EILERS, WEHRLE & ANDERSON

TGA, Jr./DM

EXHIBIT III

CHARLES MACCLOSKY COMPANY
Contractors--Engineers
15900 South Broadway
Gardena, California

September 4, 1962

Southern California Chapter
The Associated General Contractors
of America, Inc.
2551 Beverly Blvd.
Los Angeles 57, California

Attention: W. D. Shaw, Manager

Dear Mr. Shaw:

Inclosed is the July 24, 1962 issue of Metropolitan News of Los Angeles containing a recommendation of the California Law Commission to increase the scope of indemnification of public agencies in "Save Harmless" agreements which will have an adverse effect upon contractors. One paragraph of the recommendation states:

> "An indemnification provision may serve two useful purposes. First, it tends to minimize the financial impact of tort liability on the public entity by shifting the economic burden of that liability to another person. Second, ... (it) imposes upon the contractor the cost of protecting against tort liability ... "

From our own contract experience we have learned that when a public agency is sued by a third party, and the public agency then sues the contractor under the contract hold harmless provision, the contractor's insurance for that purpose will be of no protection to him unless the contractor has been negligent.

Thus, if the public agency has been in a controversy with third parties without the contractor's knowledge or negligence, the contractor is forced to defend the litigation and save harmless and pay damages at his own

expense to protect the public agency even though he had no prior knowledge of the dispute; and for this he cannot buy insurance.

Current State highway contracts provide that the contractor save harmless the State for any act or omission of the contractor which normally is insurable. However, the recommendation as proposed and shown below goes beyond the acts or omissions of the contractor thereby creating an immeasurable liability for which insurance is not available; the recommendation provides that the contractor

> "... shall wholly or partially indemnify and hold harmless the public entity and its employees and third persons from liability for damages proximately resulting from or in connection with the performance of or failure to perform the contract, whether caused by the act or omission of
> (a) the other party (contractor) ...
> (b) the public entity or its employees
> (c) any other person."

Because we have experienced litigation on a contract containing a hold harmless provision similar to this recommendation, we know how implacably it can be applied and its great danger to a contractor beyond his insurance coverage.

It is suggested that the appropriate AGC legislative committees look into this matter to oppose the proposed revision in the Government Code of the State of California, because of the unfair "shifting of the economic burden of liability to another person" as plainly stated in the recommendation.

Inclosed is copy of letter from our Attorney Trent G. Anderson, Jr.. to the Law Revision Committee, expressing his objections to this proposal.

Very truly yours,

CHARLES MacCLOSKY COMPANY

Charles C. MacClosky

Incl. - Metropolitan News July 24, 1962
Ltr. Trent G. Anderson Aug. 30, 1962

cc: - AGC. SF
Miller & Ames
Trent G. Anderson, Jr.
Calif. Law Revision Committee, School of Law,
Stanford University

(52)

July 1, 1962

CALIFORNIA LAW REVISION COMMISSION
School of Law
Stanford, California

TENTATIVE RECOMMENDATION

of the

CALIFORNIA LAW REVISION COMMISSION

relating to

Indemnification or Save Harmless Agreements

NOTE: This is a tentative recommendation prepared by the California Law Revision Commission. It is not a final recommendation and the Commission should not be considered as having made a recommendation on a particular subject until the final recommendation of the Commission on that subject has been submitted to the Legislature. This material is being distributed at this time for the purpose of obtaining suggestions and comments from the recipients and is not to be used for any other purpose.

52(L) July 1, 1962

TENTATIVE RECOMMENDATION

of the

CALIFORNIA LAW REVISION COMMISSION

relating to

Indemnification or Save Harmless Agreements

Experts on the problem of governmental tort liability have frequently urged that public entities utilize indemnification or save harmless agreements as a means of protecting themselves against tort liability arising from operations under franchises, permits, licenses, concession agreements, leases and other public contracts. Such indemnification provisions are commonplace in franchises and in State contracts[1] and are also found in contracts made by local public entities.

An indemnification provision may serve two useful purposes. First, it tends to minimize the financial impact of tort liability on the public entity by shifting the economic burden of that liability to another person. Second, an indemnification provision in a contract

1. State of California, Standard Agreement, Form 2, contains the following provision: "The Contractor agrees to indemnify and save harmless the State, its officers, agents and employees from . . . any and all claims and losses accruing or resulting to any person, firm or corporation who may be injured or damaged by the Contractor in the performance of this contract."

for work on a public improvement imposes upon the contractor the cost of protecting against tort liability and has the effect of making this cost a part of the cost of the improvement that often will be borne by the persons benefited by the improvement.

The Law Revision Commission recommends that all public entities be authorized, in their discretion, to include indemnification provisions in contracts and agreements and in franchises, permits, licenses and other similar authorizations. Public entities probably have this authority now but an express statutory authorization will remove any doubt as to the validity and effectiveness of this method of mitigating the financial impact of governmental tort liability.

The Commission's recommendation would be effectuated by the enactment of the following measure:

An act to add Chapter 7 (commencing with Section 992.1) to Division 3.5 of Title 1 of the Government Code, relating to indemnification or save harmless agreements.

The people of the State of California do enact as follows:

SECTION 1. Chapter 7 (commencing with Section 992.1) is added to Division 3.5 of Title 1 of the Government Code, to read:

CHAPTER 7. INDEMNITY OR SAVE HARMLESS AGREEMENTS

992.1. As used in this chapter:

(a) "Employee" includes an officer, agent or employee.

(b) "Public entity" includes the State, a county, city, district or other public agency or public corporation.

992.2. Except as otherwise specifically provided by law, any public entity that has authority to enter into a contract may in its discretion provide in such contract that the other party or parties to the contract shall wholly or partially indemnify and hold harmless the public entity and its employees and third persons, or any of them, from liability for damage proximately resulting from or in connection with the performance of or failure to perform the contract, whether caused by the act or omission of (a) the other party or parties to the contract or their employees or (b) the public entity or its employees or (c) any other party.

992.3. Except as otherwise specifically provided by law, any public entity that is authorized to exercise its discretion in determining whether to grant a permit, or in determining the conditions on which a permit will be granted, may in its discretion require that the person granted the permit shall wholly or partially indemnify and hold harmless the public entity and its employees and third persons, or any of them, from liability for death or injury to persons or property proximately resulting from a negligent or wrongful

act or omission of the permittee or his employees in connection with his operations or activities under the permit. As used in this section, "permit includes a franchise, permit, license or other similar authorization.