

**LETTER OPINION
2002-L-21**

April 4, 2002

Ms. Johanna Zschomler
Director, Risk Management Division
Office of Management and Budget
400 E Broadway Ave Ste 613
Bismarck, ND 58501

Dear Ms. Zschomler:

Thank you for your letter asking whether the North Dakota Mill and Elevator Association (State Mill) is authorized to indemnify or assume the liability of a contractor or a third party by contract under N.D.C.C. § 54-18-02.

Whether the State Mill is authorized to indemnify¹ a contractor or a third party is governed by two fundamental limitations on an agency's activity.² First, state agencies are creatures of the Legislature and therefore "have only such authority or power as is granted to them or necessarily implied from the grant." First Bank of Buffalo v. Conrad, 350 N.W.2d 580, 584-85 (N.D. 1984). Second, even if an agency has statutory authority to enter into a contract agreeing to indemnify a contractor or a third party, any such agreement involves the potential use of public funds and must be limited to the funds available to the agency. See N.D. Const. art. X, § 12 ("All public moneys, from whatever source derived, . . . shall be paid out and disbursed only pursuant to

¹ As used in this opinion, the term "indemnify" includes contractual commitments, however labeled, to hold harmless, save harmless, defend, or assume or limit the liability of a contractor or third party to a person other than the State itself.

² The North Dakota Supreme Court has noted on several occasions that an indemnity obligation may be express or implied. This opinion is limited to "express" indemnity provisions in a contract which attempt to expand the general legal liability of the State Mill. Whether the State Mill can be subject to an implied indemnity obligation in a particular case involves the statutory immunities provided to the State Mill under N.D.C.C. ch. 32-12.2, as well as the self-retention program created in that chapter, and is beyond the scope of this opinion.

appropriation first made by the legislature”); N.D. Const. art. X, §13 (state debt limitation).

The statutes governing the State Mill include a broad grant of authority:

The business of the [State Mill], in addition to other matters specified in this chapter, may include anything that any private individual, corporation, or limited liability company lawfully may do in conducting a similar business except as restricted by the provisions of this chapter.

N.D.C.C. § 54-18-02. Nothing in chapter 54-18 addresses the State Mill’s authority to indemnify a contractor or third party by contract.

This office has previously determined that a similar grant of authority to the Bank of North Dakota authorizes the bank to indemnify its officers, directors, and employees just as any privately-owned bank could do. Letter from Attorney General Nicholas Spaeth to Joe Lamb (May 16, 1988). See also N.D.C.C. § 6-03-02.1 (“Each banking association has the same power to indemnify as provided for business corporations”). In today’s business environment, risk transfer by contract is common and it cannot be questioned that a private corporation may enter into agreements to indemnify its contractors or third parties.³ It is my opinion that N.D.C.C. § 54-18-02 gives the State Mill similar authority to indemnify contractors and third parties, notwithstanding the general limitations on the State’s tort liability in N.D.C.C. ch. 32-12.2.

Before agreeing to indemnify a contractor or third party, the State Mill needs to identify the funds from which it would fulfill its contractual obligations if a claim arose under an indemnity provision. The authority of any state agency to commit public funds is subject to the limits of appropriations or other spending authority of the agency.⁴

³ See N.D.C.C. § 10-19.1-91(11) (corporate officer and director indemnity statute “does not limit the power of the corporation to indemnify persons other than a director, officer, employee, or member of a committee of the board by contract or otherwise”); N.D.C.C. § 10-19.1-26(22) (a “corporation may indemnify other persons”); N.D.C.C. § 10-19.1-26(7) (a “corporation may make contracts and incur liabilities”).

⁴ The State Mill has a standing constitutional appropriation “required for the financial operations of the state mill and elevator association.” N.D. Const. art. X, § 12. Nevertheless, the Legislature typically appropriates funds for the State Mill’s operations. See, e.g., 2001 N.D. Sess. Laws ch. 40, § 1. See also N.D.C.C. § 54-18-07 (“expenditures for the operation and maintenance of the [State Mill] must remain within the appropriation and earnings lawfully available in each year for such purposes”).

The tort liability of the State is covered by the risk management fund created under N.D.C.C. § 32-12.2-07. Chapter 32-12.2, N.D.C.C., does not authorize claims against the state or its employees for "liability assumed under contract," other than liability arising out of an employee's operation of a rental vehicle. N.D.C.C. § 32-12.2-02(3)(p). Some claims covered by a contractual indemnity obligation will also be covered by the Risk Management Fund, but the liability of the Risk Management Fund for claims from a contractor or third party may not be expanded by a contract. In addition, the authority of agencies to purchase insurance under N.D.C.C. § 32-12.2-06 requires the approval of the director of the Office of Management and Budget and is limited to the "liability of the entity and its employees for damages resulting from claims under" N.D.C.C. ch. 32-12.2. Thus, insurance purchased under N.D.C.C. § 32-12.2-06 would not include liability assumed under an indemnity provision in a state contract. As a result, the State Mill would need to look for other sources of funds to fulfill any potential indemnity obligation.

One complicating factor in budgeting for the payment of an indemnity obligation is that the protections of an indemnity provision in a state contract may not be invoked by a contractor or third party until months or even years after the end of the biennium during which the contract was entered. For this reason, a state contract that includes an indemnity provision must include a nonappropriation clause. 1997 N.D. Op. Att'y Gen. L-108. Any such clause must expressly provide that the indemnity provision is effective only to the extent the State Mill has an appropriation or liability coverage to cover the potential liability in the current biennium or in any future biennium in which an indemnification claim may arise.

Another complicating factor is that the State Mill may not know how much to have appropriated to cover the potential liability created by an indemnity provision running in favor of another party. State agencies, unlike insurance companies, generally lack the experience or expertise to attempt to quantify potential losses.

If a state agency has express or necessarily implied authority to indemnify a contractor or third party, "the manner and means of exercising [that authority] where not prescribed by the Legislature [is] left to the discretion of the agency." 1995 N.D. Op. Att'y Gen. L-243, L-245 (quotation omitted). C.f. Haugland v. City of Bismarck, 449 N.W.2d, 453-54 (N.D. 1988). Just as the broad powers given to the State Mill include the authority to indemnify contractors or third parties under a contract, it is my opinion that the State Mill has the implied authority to purchase insurance to cover those additional liabilities. See N.D.C.C. § 10-19.1-26(22), (25). Indeed, as observed by this office in a 1978 letter, it is "logical" for the State Mill to consider the purchase of insurance to cover those liabilities. Letter from Chief Deputy Attorney General Gerald VandeWalle to Edwin Zuern (May 4, 1978). Of course, the State Mill could decide to retain the risk of

incurring some of those additional liabilities rather than procure insurance, within the limits of the appropriations to the agency.⁵

Sincerely,

Wayne Stenehjem
Attorney General

jcf/vkk

⁵ The legislature, when it created the State Mill in 1919, gave it corporate powers, 1919 N.D. Sess. Laws ch. 152, which I conclude give it the authority to indemnify. The authority to indemnify is, in effect, the authority to waive by contract the sovereign immunity of the state. Letter from Chief Deputy Attorney General Gerald VandeWalle to Edwin Zuern (May 4, 1978). Generally, when the legislature has authorized an agency to indemnify another party, it has done so by express and specific language giving the agency the authority to indemnify. For example, N.D.C.C. § 24-02-02.1 authorizes the Director of Transportation to agree to hold the United States harmless and free from damages due to the construction or operation and maintenance of a bridge over Oahe Reservoir. See also N.D.C.C. § 40-05-01(59) (specifically authorizing cities to agree to hold harmless and free from damages the United States, the state, or any municipality with regard to the construction of certain public works projects.) Since under current law, the authority of the State Mill to indemnify is derived from its corporate powers rather than from specific language authorizing it to hold a third party harmless from damages as the legislature has done elsewhere, I recommend that the question be considered during the next legislative session.