



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Ed Shikada
Mark Danaj

SUBJECT: PUBLIC/PRIVATE PARTNERSHIPS
MUTUAL INDEMNIFICATION

DATE: September 17, 2007

Approved

Date

9/21/07

RECOMMENDATION

1. Approval of the approach to be used by staff when a request is made that the City provide indemnity to the other contracting party, including requests for mutual indemnification requirements for contracts, where the contract involves services donated at no cost, or services provided with a substantial donation (donated services agreement);
2. Adoption of a resolution authorizing the City Manager to negotiate and execute indemnity provisions in donated service agreements, including mutual indemnification provisions, where the City Manager concludes that the benefit received by the City outweighs the risk by the City under the negotiated indemnity provision, and where the contracts are otherwise within the City Manager's authority to execute; and,
3. Where donated services agreements involve City Council approval, direct staff to present a risk analysis in conjunction with any recommended indemnity provision.

OUTCOME

Acceptance of this recommendation will provide direction to staff when a request is received to include a mutual indemnification provision in a donated services agreement as part of a public/private partnership. This will improve certainty in the approval process for private partners and City officials, and may expedite future partnerships.

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BACKGROUND

On June 12, 2007, the City Council directed staff to proceed with implementation of a proposed framework for advancing and encouraging public/private partnerships, including monthly status reports to the Rules and Open Government Committee (Rules Committee) beginning in August through December 2007 and presentation of policy recommendations to the City Council by January 2008. Staff was further directed to return to Council as needed for input on specific policy issues or “deal points” as encountered throughout the review period.

On September 15, 2007, staff presented to the Rule Committee its second monthly public/private partnership status report. The report provided an update on the eleven case studies and discussed mutual indemnification as an issue key to advancing two pending partnership proposals. Specifically, requests have been received from the Police Activities League (PAL) Board and Steinberg Architects that the City provides mutual indemnity to the PAL Board and Steinberg as a component of proposed donated services agreements.

Staff recommended that the Rules Committee agendaize the issue for Council consideration. The Rules Committee discussed the issue and requested clarification on several points, and approved placing this issue on the October 2, 2007 City Council agenda.

ANALYSIS

Two public/private partnerships involving the Police Activities League (PAL) have triggered the need to clarify the City’s willingness to provide indemnification in contracts involving donated services. These include a restroom design project involving Steinberg Architects, a private architectural firm donating architectural services for restroom modifications, and a PAL operation, promotion, and support agreement involving use of the PAL Stadium and fundraising for the City’s PAL program and facilities.

An indemnity provision in a contract is a contractual promise by the person giving the indemnity to protect the other party to the contract against loss or damage. For example, assume a consultant negligently designed a building for the City resulting in a member of the public being injured. The injured person probably would sue the City as the owner of the building and may or may not sue the consultant who designed the building. In the absence of an express indemnity provision in the contract with the consultant, the City might be able to bring the consultant into the lawsuit, if the consultant was not sued by the injured party; and the City could shift liability to the consultant to the extent the injury was caused by the consultant’s negligence or breach of contractual obligation. However, an express indemnity provision makes more definite the right of the City to bring the consultant into the lawsuit and to shift the liability to the consultant. In addition, some contractual indemnity provision can allow the City to shift liability to the other contracting party beyond their fault or negligence. Express indemnity also allows the City to shift the burden of its legal defense to the other contracting party.

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When the City enters into a contract with a private party, the City typically requires that party to indemnify the City for third party claims arising out of the performance of the contract. The City typically does not agree to provide indemnity in agreements for the benefit of private parties where the City's primary obligation under the contract is the payment of money or providing the use of the City's facilities. The City's contracts with *public entities* more commonly include a mutual indemnification clause. The City also is typically named as an additional insured under the private party's commercial insurance policies for claims arising out of performance of the contract (some larger private parties are self-insured, like the City).

If the City receives a claim arising out of the work performed under contract that has typical City indemnity and insurance provisions, the City would ordinarily tender the claim to the private party's insurance company. If, in addition to receiving indemnity from the private party, the City agrees to provide indemnity to the private party, the City may, depending on the language of the indemnity provision and the circumstances of the claim, have the obligation to provide for the defense of the private party and pay for claims against the private party under circumstances where it otherwise would not have those obligations. In addition, the City's right to tender the claim and to recover from the private party or its insurance carrier may be limited. City Council approval is needed to authorize the City Manager to approve contracts which impose these additional obligations on the City.

Police Activities League Restroom Design Project

Steinberg Architects have offered to donate architectural services to remodel the restrooms at PAL stadium. In this case, the City requested that Steinberg manage needed civil and mechanical engineering work to be performed by subconsultants, with payment to Steinberg limited to reimbursement of these subconsultant costs. During these negotiations, Steinberg requested that the City indemnify Steinberg against certain third party claims, in recognition of its donation of services. The provision requested by Steinberg would require the City to indemnify and hold Steinberg harmless from claims arising out of Steinberg's provision of donated services, unless the claim arose directly from the negligence or willful misconduct of Steinberg.

One illustration of the effect of this indemnity provision is that it would require the City to pay a claim made by a party injured because of negligent design of the building, if the design error was not directly attributable to Steinberg, e.g. was an error by a design subconsultant, even though the City would have no contractual indemnity remedy against the subconsultant. This indemnity provision might also preclude the City from presenting a claim to Steinberg's insurance carrier where the claim was based on subconsultant negligence, even if Steinberg were also negligent in failing to note and correct the subconsultant error. If the injured party happened to be a City employee who was injured by the same subconsultant negligence, the City's potential liability to its employee would no longer be limited to workers' compensation.

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The Administration believes that in an agreement such as this, where the total value of the agreement is under \$100,000, and where the consultant is agreeing to perform the services for the City at no cost or a significantly reduced cost, it is reasonable to negotiate an indemnity provision that addresses Steinberg's concerns. In such situations, the Administration believes it is appropriate for the City to accept some additional potential liability in recognition of the benefit to be gained by the City from the contract.

If the City Council accepts the recommended approach to mutual indemnification, staff anticipates that the proposed donated services agreement will be executed under the City Manager's authority.

PAL Operation, Promotion and Support Agreement

A parallel effort has been underway to renew the Agreement with PAL to increase recreational programming at the facility and to support PAL's efforts to solicit contributions (private and other donors) to invest in youth sport programs and capital improvements.

This Operation, Promotion and Support Agreement, which will clarify the relationship between the City and PAL, provides that the City will be booking and operating the facility and encourages a broad range of activities that will enhance the programming at the complex. The agreement also allows PAL to operate the concessions, to sell advertising space, and to hold a limited number of special events for fundraising purposes. The PAL Board has asked for mutual indemnification language in the Operations, Promotion and Support Agreement.

If the City Council accepts the recommended approach to mutual indemnification, staff will incorporate a risk analysis into the City Council report on the proposed agreement.

Recent Council Action on an Indemnification Issue

On August 21, 2007, the City Council considered a modification of the City's standard contractual requirements for indemnification and to move forward with a community-based reconstruction of the youth playground at Welch Park and enter a contractual relationship with KABOOM.

When the City enters into a contract to construct a capital improvement project, the contractor, designer and the construction manager, if there is one, are all typically required to indemnify the City for third party claims (usually injuries to people using the facility) arising out of the work performed by the contractor or consultant. KABOOM would not agree to the City's standard indemnification provision and instead asked the City to indemnify them for all claims except those caused by the willful misconduct of KABOOM. KABOOM also agreed to indemnify the City, but only to the extent that: 1) the claim or action arises directly from the playground build on the build day; and 2) the claim or action is the result of KABOOM's willful misconduct. The Council evaluated the capital project savings and the positive effects of a community-built playground and determined that the cost savings, and the minimal exposure to risk of the project due to the track record of KABOOM, history of related litigation, and the fact that the

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playground equipment was manufactured by a reputable company and that the City would receive the manufacturer's warranty, the benefits the City would receive from the project and the agreement with KABOOM outweighed the potential unknown costs of the added liability under the modified indemnification provision. The Council then directed staff to negotiate and execute an agreement with KABOOM without the City's standard contractual requirements for indemnification.

Based on these recent examples, staff is recommending that the City Council establish a framework for the consideration of indemnification provisions related to donated services agreements. There are costs, benefits and risks to proceeding with projects when the City provides indemnity to a third party. Staff believes, structured properly, there may be instances in which the City should be able to approve an indemnity to third party, including situations within the City Manager's contracting authority. The ultimate goal is to reduce administrative barriers and to facilitate the timely resolution of similar indemnification issues in order to expedite future partnerships while still staying within the boundaries of prudent contracting practices by the City.

Recommended Process for Determining Whether Mutual or Limited Indemnification May be Granted

Staff recommends that the following process and criteria be established for handling a request that the City provide indemnity, including requests for mutual or limited indemnification for contracts involving donated services:

- A risk analysis will be conducted to evaluate the benefits and the potential liability to the City. The analysis will be performed by the lead Department, in coordination with the City Attorney's Office and Risk Management, and for capital projects, Public Works.
- The lead Department will be responsible for forwarding the joint recommendation to the City Manager on whether to provide or limit indemnity.
- The City Manager will consider factors such as the following in a risk analysis:
 1. Track record of the service provider (including history of performance not limited to the City), and ability to complete service
 2. Scope of the project, dollar amount
 3. The availability of insurance and its cost for the project
 4. Warranty of manufacturer (if applicable)
 5. Need to meet engineering specifications and city involvement in review and preparation of specifications
 6. Need to inspect project to ensure compliance with specifications
 7. History of liability on similar projects

8. Community benefit

If the City Manager determines that the benefit to the City outweighs the risk undertaken by the City, and the contract is within the City Manager's authority to sign, the Manager will execute the contract. For agreements that exceed the City Manager's authority to execute, the City Council will be presented with the risk analysis and staff's recommendation.

EVALUATION AND FOLLOW-UP

If Council approves the recommended approach to mutual indemnification for donated service agreements, staff will work with the PAL Board and Steinberg Architects to finalize the proposed agreements. The Steinberg agreement is anticipated to be executed under the City Manager's authority, and the PAL Board agreement will be brought forward to the City Council for approval. City Manager's Office, Human Resources, and City Attorney's Office staff will also provide guidance to departments for the handling of indemnity requests and conducting risk assessments.

PUBLIC OUTREACH/INTEREST

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**
- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

As part of an on-going process to solicit community input staff facilitated two stakeholder input sessions. The first meeting was held with prospective private company partners on July 11, 2007. A second meeting was held with non-profit organization partners on July 12, 2007, followed by a general "town hall" meeting at the Northside Community Center on August 16, 2007. Staff has also met with bargaining units representing City employees regularly since inception of the public/private partnership initiative, and with several labor organizations on September 5, 2007.

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COORDINATION

This staff report has been coordinated with the following Departments and Offices: Employee Relations, Finance, General Services, Human Resources, Parks, Recreation and Neighborhood Services, Public Works, and the City Attorney's Office.

FISCAL/POLICY ALIGNMENT

Not applicable.

COST SUMMARY/IMPLICATIONS

The City will likely realize savings by engaging more public/private partners to donate services by streamlining the process, and creating more certainty, yet will be taking on an unknown liability in relation to potential future claims and lawsuits. Based on the expected benefit to public/private partners, when it is determined that the risk is minimal, staff recommends approval of an approach to accepting mutual indemnification for agreements involving donations to the City.

BUDGET REFERENCE

Not applicable.

CEQA

Not a project.



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