

September 21, 1999

OPINION NO. 99-049

The Honorable William R. Swigart
Fulton County Prosecuting Attorney
123 Courthouse Plaza
Wauseon, Ohio 43567

Dear Prosecutor Swigart:

We have received your request for an opinion on the following questions:

1. May a board of county commissioners on behalf of the county enter into a contract with a private entity which in part provides that the county will indemnify or hold harmless that entity without violating any provision of the Ohio Revised Code or the Ohio Constitution?
2. If so, are there any constitutional or statutory prerequisites or limitations that must be complied with by the board of county commissioners?

We are informed that these questions have arisen because the county commissioners are frequently asked to execute contracts consisting of "form" agreements that contain clauses declaring that the county will indemnify and hold harmless the other party to the contract if a legal dispute should ensue with respect to the subject matter of the contract. The significance of the clauses is that the county assumes potentially substantial financial obligations in the event that negligence claims are asserted by injured third parties.

An indemnification or hold harmless clause may appear in a variety of types of contracts. Such a provision imposes a financial obligation upon one party to the contract for the benefit of another party to the contract. *See Worth v. Aetna Cas. & Sur. Co.*, 32 Ohio St. 3d 238, 513 N.E.2d 253 (1987); 1996 Op. Att'y Gen. No. 96-060. You have provided as an example an agreement for the purchase of elevator service which states that the purchaser of the service (the county) unconditionally agrees to indemnify and hold harmless the seller (the elevator service company) from any demands, judgments, awards, liabilities, costs, attorney's fees, or other damages to persons or property which may result from riding on or being about the elevator or

the associated areas, regardless of the cause of the actions and regardless of any negligence on the part of the seller.

We begin our consideration of your questions by noting that a board of county commissioners is a creature of statute and, as such, it has only the powers it is granted by statute. *See State ex rel. Shriver v. Board of Comm'rs*, 148 Ohio St. 277, 74 N.E.2d 248 (1947). Various statutes grant boards of county commissioners, acting on behalf of their respective counties, authority to enter into contracts for different purposes. *See, e.g.*, R.C. 307.02; R.C. 307.04, R.C. 307.15; R.C. 307.69. Clearly, each contract is subject to such statutes as are applicable. In the exercise of its authority to enter into contracts, a board of county commissioners has discretion to agree upon any contractual terms, including an indemnification or hold harmless clause, provided that the terms come within its statutory authority and are not in conflict with constitutional provisions. *See, e.g.*, 1996 Op. Att'y Gen. No. 96-060, at 2-236; 1987 Op. Att'y Gen. No. 87-025; 1983 Op. Att'y Gen. No. 83-069.¹

The statutory provisions of most immediate concern in matters involving a county's authority to enter into a contract containing an indemnification or hold harmless clause are those governing the expenditure of county funds. Pursuant to R.C. 5705.41, a county cannot enter into a contract (with limited exceptions) unless there is a certificate of the county auditor that the amount required to meet the obligation, or for a continuing contract the amount required to meet the obligation in the fiscal year in which the contract is made, "has been lawfully appropriated for such purpose and is in the treasury or in process of collection to the credit of an appropriate fund free from any previous encumbrances." R.C. 5705.41(D)(1); *see also* R.C. 5705.01(D). A contract made without such a certificate is void. *Id.*; *see also State v. Kuhner & King*, 107 Ohio St. 406, 413, 140 N.E. 344, 346 (1923) (the purpose of requiring such a certificate is "particularly to preclude the creation of any valid obligation against the county above or beyond the fund previously provided and at hand for such purpose").

If the contract is to be performed in a single fiscal year, then the amount required to complete the contract must be appropriated and certified for that fiscal year. If the contract is a continuing contract to be performed in whole or in part in an ensuing fiscal year, then the amount required to meet the obligation for the fiscal year in which the contract is made must be appropriated and certified. R.C. 5705.41(D)(1). If the contract runs beyond the termination of the fiscal year in which it is made, the amount "remaining unfulfilled at the end of a fiscal year,

¹ Certain types of indemnity agreements are prohibited by Ohio law. *See, e.g.*, R.C. 2305.31; R.C. 4123.82. Where no such prohibition applies, indemnification agreements are generally enforceable. *See Worth v. Aetna Cas. & Sur. Co.*, 32 Ohio St. 3d 238, 513 N.E.2d 253 (1987); 1996 Op. Att'y Gen. No. 96-060, at 2-237 n.2. The wisdom and efficacy of including an indemnification or hold harmless clause in a public contract, however, are subject to question. *See, e.g.*, 1996 Op. Att'y Gen. No. 96-060.

and which will become payable during the next fiscal year, shall be included in the annual appropriation measure for the next year as a fixed charge.” R.C. 5705.44.

If it is not known when liability may be incurred under a contract, the funds necessary to cover the liability must be presumed due and payable in the first fiscal year and appropriated and certified accordingly. *See* 1987 Op. Att’y Gen. No. 87-069, at 2-433 (if a contract is not a continuing contract, “the entire amount due under such a contract must be certified as available when the contract is entered into, even though such amount may not be due until the following fiscal year”). Amounts that are certified in accordance with R.C. 5705.41(D)(1) are considered to be encumbered and remain available in subsequent years for the expenditures for which they have been certified. *See* 1987 Op. Att’y Gen. No. 87-069, at 2-433 to 2-434; 1985 Op. Att’y Gen. No. 85-043; *see also* R.C. 5705.40 (“no appropriation for any purpose shall be reduced below an amount sufficient to cover all unliquidated and outstanding contracts or obligations certified from or against the appropriation”); 1933 Op. Att’y Gen. No. 1041, vol. II, p. 1063, at 1064-65 (“the amount so certified becomes at once encumbered for the purpose of meeting the contract and cannot be spent or certified against for any other purpose”); 1928 Op. Att’y Gen. No. 2465, vol. III, p. 1964, at 1966-67 (“[s]o long as a certification is outstanding against such funds, they remain encumbered and available for the purpose of the contract or obligation, irrespective of the termination of the fiscal year”).

An indemnification or hold harmless clause commits the contracting party to financial obligations that are generally unknown at the time the contract is made. A county has no statutory authority to promise that, at some time in the future, it will secure funds to pay whatever liability may occur under a contract. Rather, pursuant to R.C. 5705.41(D)(1), the county must certify at the time it makes a contract that it has sufficient money to pay its obligations under that contract. In order to make such a certification, the county must identify a specific dollar amount that is at risk under the contract.

Exceptions to the requirement that the total amount due under a contract must be appropriated and certified apply to continuing contracts and contracts entered into upon a per unit basis, for which it is sufficient to certify the amount due during the fiscal year. R.C. 5705.41; R.C. 5705.44; 1987 Op. Att’y Gen. No. 87-069. Continuing contracts are divisible contracts that provide for periodic performances over a space of time—such as contracts for salaries, rents, insurance payments, or utilities—and other contracts designated by statute as continuing contracts. Per unit contracts are contracts under which amounts due are determined according to the number of units provided. *See* 1987 Op. Att’y Gen. No. 87-069; 1958 Op. Att’y Gen. No. 1604, p. 22.

Although an indemnification or hold harmless clause might be included in a continuing or per unit contract, that clause itself would not constitute a continuing or per unit contract because it is not so designated by statute and because it is a present obligation to pay such liability as might accrue in the future, whenever it might accrue, rather than an obligation to pay for portions of a product or service on a periodic basis. *See* 1987 Op. Att’y Gen. No. 87-069.

Hence, an indemnification or hold harmless clause is not subject to the exceptions that apply to continuing or per unit contracts.

The continuing contract provisions operate to assure compliance with Ohio Const. art. XII, § 11. *See* 1963 Op. Att’y Gen. No. 167, p. 273, at 275. That constitutional provision says that if the state or a political subdivision incurs bonded indebtedness, provision must be made for levying and collecting annually by taxation an amount sufficient to pay the interest on the bonds and to provide a sinking fund for their final redemption at maturity. The continuing contract statutes indicate that continuing contracts of a subdivision can be financed on the basis of amounts due in each fiscal year without constituting bonded indebtedness. *See Dix v. Shoemaker*, 24 Ohio N.P. (n.s.) 321, 325 (C.P. Delaware County 1922), *error dismissed*, 109 Ohio St. 629 (1923) (the sole purpose of Ohio Const. art. XII, § 11 “is to prevent the state and other subdivisions from contracting a debt without providing a revenue to meet such indebtedness when it becomes due”); 1939 Op. Att’y Gen. No. 1087, vol. II, p. 1565, at 1569-70. *See generally State v. Medbery*, 7 Ohio St. 522 (1857), *writ of error dismissed*, 65 Ohio St. 413 (1860).

No similar statute permits liability assumed under an indemnification or hold harmless clause to be financed on the basis of amounts due each fiscal year. *See generally* 1986 Op. Att’y Gen. No. 86-031; 1984 Op. Att’y Gen. No. 84-050; 1980 Op. Att’y Gen. No. 80-042; 1958 Op. Att’y Gen. No. 1604, p. 22. Therefore, amounts obligated under such a clause must be appropriated and certified when the contract is made as required by R.C. 5705.41(D)(1) in order to avoid the creation of debt in violation of Ohio Const. art. XII, § 11. *See State ex rel. Kitchen v. Christman*, 31 Ohio St. 2d 64, 285 N.E.2d 362 (1972); 1985 Op. Att’y Gen. No. 85-008, at 2-31 n.6; 1984 Op. Att’y Gen. No. 84-050.

Hence, a county cannot enter into a contract unless there is assurance that there will be adequate funds to meet the county’s obligations. A county cannot satisfy this requirement if an indemnification or hold harmless clause included in the contract would permit a liability of an undefined and unlimited amount. In order to comply with R.C. 5705.41(D)(1), a contract containing an indemnification or hold harmless clause must specify a maximum dollar amount for which the county is obligated, and that amount must be appropriated and certified as available for payment prior to the contract’s execution. We conclude, therefore, that a board of county commissioners, acting on behalf of the county, may include in a contract with a private entity a clause under which the county agrees to indemnify or hold harmless that private entity, but such a clause may be included only if the contract specifies a maximum dollar amount for which the county is obligated under the indemnification or hold harmless clause and that amount is appropriated and certified as available in accordance with R.C. 5705.41(D)(1).²

² We are aware that one reason a party might seek to have an indemnification or hold harmless clause in a contract is that the amount of potential liability is unknown and may be substantial. *See, e.g.*, 1996 Op. Att’y Gen. No. 96-060. Hence, a clause that is restricted to a

We turn now to the question whether an indemnification or hold harmless clause that complies with R.C. 5705.41(D)(1) will violate any provision of the Ohio Constitution. Questions similar to those you have raised were considered in 1996 Op. Att’y Gen. No. 96-060 in the context of the authority of the Treasurer of State to enter into a contract containing an indemnification or hold harmless clause. That opinion found that the authority to include such a clause in a state contract was affected by the provisions of Ohio Const. art. VIII, § 1-3, which restrict the authority of the state to create debt, and by the provisions of Ohio Const. art. II, § 22, which provide that money may be drawn from the state treasury only pursuant to specific appropriation and appropriations may be for no longer than two years. Those provisions are not applicable to counties and are not discussed in this opinion. *See, e.g., Walker v. City of Cincinnati*, 21 Ohio St. 14, 52 (1871) (“the limitations imposed upon the State by the first three sections of art. 8, were not intended as limitations upon her political subdivisions—her counties and townships”); *Tereck v. Ohio Dep’t of Taxation*, 84 Ohio Law Abs. 129, 168 N.E.2d 332 (Ct. App. Cuyahoga County 1960).

The debt limitation of Ohio Const. art. XII, § 11, discussed above, is applicable to political subdivisions as well as to the state. As noted, that limitation requires that, for bonded indebtedness to be lawfully incurred, there must be provision for levying and collecting taxes sufficient to pay the interest on the bonds and provide a sinking fund for their redemption at maturity. If the county should pledge to make future appropriations of tax revenues and create debt for purposes of Ohio Const. art. XII, § 11, the county would be required to make provision for levying and collecting annually by taxation an amount sufficient to pay the debt. *Id.* It does not appear that an indemnification or hold harmless clause imposing a single maximum liability would violate this provision, but such a clause would remain subject to the appropriation and certification provisions of R.C. 5705.41(D)(1) requiring that adequate funds be available.³

The remaining provision that is relevant to your question is Ohio Const. art. VIII, § 6, which prohibits a county from becoming a stockholder in a private enterprise, raising money for a private enterprise, or lending its credit to, or in aid of, a private enterprise.⁴ Under Ohio Const.

specified amount to comply with R.C. 5705.41(D)(1) may not serve the intended purpose and may be lacking in practical value. *Id.*

³ A debt limitation is imposed upon counties under the Uniform Public Securities Law, *see* R.C. Chapter 133, but that limitation pertains only to the amount of securities issued by the county and is not affected by liability under the indemnity or hold harmless clause of a contract. *See* R.C. 133.04; R.C. 133.07; 1942 Op. Att’y Gen. No. 5184, p. 383. Hence, that limitation is not relevant to the issues addressed in this opinion.

⁴ Ohio Const. art. VIII, § 4 contains similar provisions relating to the State of Ohio. Ohio Const. art. VIII, §§ 4 and 6 have been construed in the same manner and decisions relating to one of those sections are considered authoritative with respect to the other. *See State ex rel.*

art. VIII, § 6, a county may contract with a private person or enterprise to buy or sell goods or services on whatever terms it deems appropriate, in the reasonable exercise of the authority granted by statute, provided that the contract does not create a joint enterprise between the county and a private entity or obligate the county to raise money for, or lend its credit to, the private entity. Exceptions to the prohibition of Ohio Const. art. VIII, § 6 have been created by constitutional provision, *see* Ohio Const. art. VIII, §§ 13-16, and other exceptions have been recognized for transactions with public entities or with private nonprofit entities engaged in activities that serve a public purpose, *see* 1996 Op. Att'y Gen. No. 96-060.

A contract that defines the county's obligation in terms of a maximum dollar figure, as required by R.C. 5705.41(D)(1), will not violate the constitutional lending credit prohibition, provided that the consideration received is equal in value to the obligations undertaken, so that there is no gratuitous transfer of public moneys. *See* 1996 Op. Att'y Gen. No. 96-060; 1989 Op. Att'y Gen. No. 89-010. Questions concerning a violation of the lending credit provisions will not arise unless the county undertakes obligations that are disproportionate to the benefits received. *Id.* We conclude, therefore, that a board of county commissioners, acting on behalf of the county, may include in a contract with a private entity a clause under which the county agrees to indemnify or hold harmless that private entity, but such a clause may be included only if the contract complies with the provisions of Ohio Const. art. VIII, § 6 that prohibit a county from lending its credit to a private entity. Such compliance is achieved if the contract provides the county consideration sufficient to support the financial obligation that the county assumes under the agreement to indemnify or hold harmless the private entity.

Therefore, it is my opinion, and you are advised:

1. A board of county commissioners, acting on behalf of the county, may include in a contract with a private entity a clause under which the county agrees to indemnify or hold harmless that private entity, but such a clause may be included only if the contract specifies a maximum dollar amount for which the county is obligated under the indemnification or hold harmless clause and that amount is appropriated and certified as available in accordance with R.C. 5705.41(D)(1).
2. A board of county commissioners, acting on behalf of the county, may include in a contract with a private entity a clause under which the county agrees to indemnify or hold harmless that private entity, but such a clause may be included only if the contract complies with the provisions of Ohio Const. art. VIII, § 6 that prohibit a county from lending its credit to a private entity. Such compliance is achieved if the contract provides the

Eichenberger v. Neff, 42 Ohio App. 2d 69, 330 N.E.2d 454 (Franklin County 1974); 1996 Op. Att'y Gen. No. 96-060, at 2-242.

county consideration sufficient to support the financial obligation that the county assumes under the agreement to indemnify or hold harmless the private entity.

Respectfully,

BETTY D. MONTGOMERY
Attorney General

September 21, 1999

The Honorable William R. Swigart
Fulton County Prosecuting Attorney
123 Courthouse Plaza
Wauseon, Ohio 43567

SYLLABUS:

99-049

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2. A board of county commissioners, acting on behalf of the county, may include in a contract with a private entity a clause under which the county agrees to indemnify or hold harmless that private entity, but such a clause may be included only if the contract complies with the provisions of Ohio Const. art. VIII, § 6 that prohibit a county from lending its credit to a private entity. Such compliance is achieved if the contract provides the county consideration sufficient to support the financial obligation that the county assumes under the agreement to indemnify or hold harmless the private entity.