

MUNICIPAL LEGAL BRIEFS

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Guest Articles

I. MUNICIPAL INDEMNIFICATION: THE EVOLVING CASE LAW

Thanks to John C. Schrier, city attorney, Muskegon and also to Colleen Healy, student, Duke Law School and summer clerk, Parmenter O'Toole, for assisting with this article.

There is no question that municipal attorneys, as well as the courts, have disagreed as to a municipality's legal authority to provide indemnification. Instead of an article articulating a position, the following is a chronology of significant cases which suggest a shift in philosophy. One cautionary note: The more recent cases tend to be unpublished or federal district court decisions. Whether a state appellate court will find a more recent non-binding case persuasive and ignore older published cases is problematic.

Wheeler v City of Sault Ste. Marie, 164 Mich 338 (1911) – Sault Ste. Marie entered into an agreement to acquire property from Wheeler, which included a number of provisions including an indemnity provision. When Sault Ste. Marie refused to undertake its obligations pursuant to the agreement, Wheeler sued. The Supreme Court upheld dismissal of the suit opining that *the City had only those powers specifically conferred upon it by the legislature* and the obligations the City would have had were beyond the City's authority.

Detroit Edison Co. v Public Service Commission, 359 Mich 137 (1960) – Detroit Edison Company challenged the Public Service Commission's classification of the Company's guaranty agreement as a certificate of indebtedness. The Court held that 'indebtedness,' including municipal indebtedness, should be broadly interpreted to include contingent liability and contracts of guaranty.

City of Gaylord v Gaylord City Clerk, 378 Mich 273 (1966) – The City of Gaylord agreed to lend its tax-free status to United States Plywood Corporation (USPC) by selling industrial building revenue bonds in order to finance USPC's purchase of land and construction of an industrial plant in the city.

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USPC was to lease the building for 25 years at a rate sufficient to repay the cost of the building and have the option of purchasing the building for \$1 after 25 years. The bonds and interest did not obligate the general taxing power (they were to be paid solely from the revenues

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of the facility). The Court held that “self-liquidating projects do not involve a granting of state credit” since they do not invoke the general taxing power of the municipality.

***City of Gaylord v Gaylord City Clerk*, 378 Mich 273**

(1966) – The City of Gaylord agreed to lend its tax-free status to United States Plywood Corporation (USPC) by selling industrial building revenue bonds in order to finance USPC’s purchase of land and construction of an industrial plant in the city. USPC was to lease the building for 25 years at a rate sufficient to repay the cost of the building and have the option of purchasing the building for \$1 after 25 years. The bonds and interest did not obligate the general taxing power (they were to be paid solely from the revenues of the facility). The Court held that “self-liquidating projects do not involve a granting of state credit” since they do not invoke the general taxing power of the municipality.

***Alan v Wayne County*, 388 Mich 210 (1972)**

– Wayne County established and contracted with the Stadium Authority to build and lease a baseball stadium. The Stadium Authority was given the duty to sublease the stadium on behalf of the county. Pursuant to this agreement, the Authority arranged a sublease with the Tigers. The county covenanted its full faith and credit to: (1) support bonds issued by the Stadium Authority to finance the building of the stadium, and (2) pay a fixed rental to the Stadium Authority regardless of “whether the stadium was completed, destroyed, or whatever.” The Court rejected the county’s efforts to characterize the bonds as revenue bonds because the bonds were based on the fixed rental price of the stadium (not the revenues) and backed by the full faith and credit of the municipality (obligating the general taxing power rather than only the revenues). The court characterized the bonds as general tax bonds instead and held that they were illegal and invalid because the Stadium Authority did not have the constitutional or statutory authority to issue general obligation tax bonds.

***Advisory Opinion No. 5683*, 1979-80 Op. Atty Gen. Mich.**

693 (1980) – The Job Development Authority (JDA) is “a public corporation and government instrumentality.” As such, it may enter into contracts and “specify financing for indemnification on a self-liquidating basis.” The JDA may only commit funds to indemnification if they are “demonstrably available and authorized for the purpose.” Thus, the JDA may not agree to a limitless hold harmless clause because this would commit an indefinite sum of money to indemnification.

***Cordova Chemical Company and Aerojet-General Corporation v Department of Natural Resources*, 212**

Mich 144 (1995) – Property was owned by Ott Chemical and then Story Chemical. In 1976, Story filed bankruptcy. Apart from any contractual obligation, the DNR had potential liability for clean-up. The property was sold to Cordova with the agreement that the DNR would remove 8,700 contaminated drums and 8,000 cubic yards of contaminated soils and sludge.

Cordova agreed to remove the phosgene and pay the DNR \$600,000. Cordova, contractually, was relieved of any other liability in connection with the contamination. While the “indemnity” was upheld, the rationale was based upon an exchange of value and that the DNR was responsible for the cost of clean-up. The Court held that Cordova and the DNR simply contractually allocated the financial liability.

Michigan Municipal Liability and Property Pool v Muskegon County Road Commission, 235 Mich App 183 (1999) – Norton Shores and Fruitport Township designed the Harvey Street improvement. Muskegon County Road Commission (Road Commission) took over the project due to access to funding sources. Road Commission designated a Norton Shores employee as its engineer on the project and agreed to indemnify Norton Shores. Post construction, Road Commission and Norton Shores were sued and an award of \$40,000 from the Road Commission and \$20,000 from Norton Shores was entered and paid. Norton Shores sought reimbursement from the Road Commission and ultimately this suit was filed to enforce the indemnity provision. The Court found the indemnity provision unenforceable because the Road Commission lacked the legal authority to enter into such an agreement before any liability triggering event had occurred. The Court noted that after a liability triggering event there is a statute that permits a road commission or local government to indemnify its employee. Likewise, there is statutory authority to purchase insurance prior to a liability triggering event. The Court noted that local governments have no inherent power and possess only that power specifically conferred by the Constitution or statute.

Huntington Leasing Company v Manistee Intermediate School District, Robert C. Tillmann, Local Internet Services, and Larry E. Kivela and Mark Pehrson, 2005 Mich. App. LEXIS 1057 (2005) – Manistee Intermediate School District (MISD) entered into a contract for computer equipment from Local Internet Services (LIS). LIS was unable to obtain financial backing to purchase the equipment. Tillmann, on behalf of MISD, secured financing from Huntington without notifying the Board. Huntington wanted a legal opinion. LIS hired Kivela to prepare the opinion for MISD and paid Kivela \$100 for the opinion letter. Kivela did not have time to do any research and had to rely on the statements of Tillmann. Kivela requested and obtained an indemnification agreement signed by Tillmann on behalf of MISD. The Court opined that MISD lacked the authority to indemnify Kivela because local governments only have those limited powers conferred by the Constitution or statute or necessarily implied. Indemnification is not a power necessarily implied.

Hoover Investments v City of Charlotte, W.D. Mich Case No. 1:04-CV-689, Judge Enslin, decided 2005 – Charlotte bought contaminated property from Hoover. Prior to the signing of an agreement, an environmental evaluation was completed and remediation costs were estimated at \$200,000. The Agreement called for Charlotte to pay \$100, “secure the Equalization Cell”, and “be responsible for any environmental compliance of any other parcel”. Charlotte then asked MDEQ to remediate, which it did at a cost of \$1.2 million. MDEQ requested Hoover to reimburse the State and Hoover sued Charlotte. Judge Enslin opined that the City was not lending its credit because it received something of value in return for what it gave away. That the cost of remediation was \$1.2 million and not \$200,000 was irrelevant. Further, Judge Enslin opined that if it was a lending of credit, it was permissible because the Agreement was authorized by the city’s Charter and acquisition and remediation of property for a park is a public purpose.

G. E. Property & Casualty Insurance as Subrogee of Sandra Veal v The Detroit Edison Company, DTE Energy, and the City of Detroit, 2006 Mich. App. LEXIS 2644 (2006) – A fire at Sandra Veal’s residence was caused by either Detroit Edison’s power line or the City of Detroit’s distribution line. As part of a Power Supply Agreement, Detroit agreed to indemnify Detroit Edison. The Opinion cites *Wheeler v Sault Ste. Marie*, but finds any reliance on it misplaced because Detroit’s Charter provides the legal authorization required under Michigan Constitution Art. 7, § 26. Under the Home Rule Cities Act, a city may include within its charter any municipal powers not expressly denied by the constitution and general laws of the state. The Detroit Charter “provides for the [Public Lighting Department] to have general authority to exercise the powers necessary to perform any duties required to carry out its function and purpose of furnishing and selling light and power.” Since the indemnification was authorized by law for a public purpose, it falls within the exception provided by Michigan Constitution Art. 7, § 26.

Conclusion: Trying to reconcile the above conflicting cases leads to the following:

- 1) Whether an indemnity provision will be enforced or struck down depends upon whether the Court applies the Dillon Rule (see below) or applies a more recent private corporation analysis that a corporation has all powers it deems appropriate to achieve its corporate objectives, subject only to limitations established by law; and
- 2) If the indemnification was the “consideration” for the transaction, then it will be enforced if the local unit had the authority to enter into the transaction.

Note re: Dillon’s Rule: A municipal corporation possesses and can exercise the following powers, and no others: First, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation.