November 21, 1996

OPINION NO. 96-060

The Honorable J. Kenneth Blackwell
Treasurer of State
30 East Broad St., 9th Floor
Columbus, Ohio 43266-0421

Dear Treasurer Blackwell:

You have requested an opinion regarding the inclusion of an indemnification or hold harmless clause in a state contract. Specifically, you wish to know whether your office, when entering into a contract with a private or public entity, may agree to indemnify or hold harmless that entity without violating any provision of the Revised Code or the Ohio Constitution.

You explain in your letter that your office often is requested to execute "form" agreements or contracts that contain clauses declaring that the Treasurer of State or the State of Ohio will indemnify or hold harmless the other party to the contract should a legal dispute ensue with respect to the contract or agreement. These form agreements ordinarily are prepared and submitted by the entities with whom your office contracts for particular services. They include contracts with financial institutions authorizing those institutions to receive tax and fee payments at a post office box pursuant to R.C. 113.07, contracts with financial institutions that have been designated public depositories of public moneys in accordance with the provisions of R.C. 113.05(B)(2) and R.C. 135.12, and agreements with vendors for maintenance and repair services performed upon equipment used by your office in effecting your responsibilities as Treasurer of State.

In resolving your inquiry, I must first review briefly the general nature and purpose of hold harmless and indemnification clauses. *Black's Law Dictionary* 731 (6th ed. 1990) defines a "[h]old harmless agreement" in the following manner:

> A contractual arrangement whereby one party assumes the liability inherent in a situation, thereby relieving the other party of responsibility. Such agreements are typically found in leases, and easements. Agreement or contract in which one party agrees to hold the other without responsibility for damage or other liability arising out of the transaction involved.

The verb "[i]ndemnify" is accompanied by the following entry:

> To restore the victim of a loss, in whole or in part, by payment, repair, or replacement. To save harmless; to secure against loss or damage; to give security for the reimbursement of a person in case of an anticipated loss falling upon him. To make good; to compensate; to make reimbursement to one of a loss already incurred by him. Several states by statute have provided special funds for compensating crime victims.

Id. at 769. The noun "[i]ndemnity" is further defined, in part, as "[r]eimbursement. An undertaking whereby one agrees to indemnify another upon the occurrence of an anticipated loss"; "[a] contractual or equitable right under which the entire loss is shifted from a tortfeasor who is only technically or passively at fault to another who is primarily or actively responsible"; "[t]he term is also used to denote the compensation given to make a person whole from a loss already sustained; as where the government gives indemnity for private property taken by it for public use." *Id.*

Comparison of these respective definitions indicates that the terms "hold harmless," "indemnify,""indemnity," and "indemnification" represent closely-related concepts. The term "hold harmless" (or "save harmless") ordinarily signifies an agreement by one party to a contract to relieve the second party of liability that would otherwise be incurred by the second party as a result of some failure in connection with the undertaking in question. It also may mean that the first party further agrees to assume whatever liability would otherwise be borne by the second party. Similarly, the terms "indemnify," "indemnification," and "indemnity" are used to convey the understanding that one party to a contract or agreement will compensate or reimburse a second party for actual damages, losses, or expenses that may be incurred by the second party for various occurrences or conduct related to the contract or agreement. *See generally, e.g., Travelers Indemnity Co. v. Trowbridge,* 41 Ohio St. 2d 11, 13-14, 321 N.E.2d 787, 789 (1975) (comparing the concepts of indemnity and contribution, and explaining that indemnity "arises from contract, express or implied, and is a right of a person who has been compelled to pay what another should pay in full to require complete reimbursement").[1]

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[1] Contract drafters typically use the terms "hold harmless" and "indemnify" interchangeably or in combination within a single clause. For example, the following indemnification/hold harmless provision was at issue in *Stychno v. Ohio Edison Co.*, 806 F. Supp. 663, 670 (N.D. Ohio 1992):

> Lessees agree to defend, indemnify and save Lessor harmless from and against any and all claims, demands, damages, actions or causes of action, together with any and all losses, costs or expenses in connection therewith or related thereto asserted by any person or persons for bodily injury, death or property damage arising or in any manner growing out of Lessees' use of said premises during the term of this Lease or any extension thereof.

In *City of Columbus v. Alden E. Stilson & Assoc*., 90 Ohio App. 3d 608, 613-14, 630 N.E.2d 59, 63

The essential characteristic that is thus common to hold harmless and indemnification clauses is the financial obligation, either absolute or contingent, that they impose upon one party to a contract for the benefit of another party to the contract. For the purpose of this opinion, it is this element of financial obligation that is significant about hold harmless and indemnification clauses. You have informed me that an examination of the form agreements that have been submitted to your office indicates that, in each instance, the hold harmless and indemnification clauses in those agreements have been drafted in a way that imposes such a financial obligation either upon the Treasurer of State or the State of Ohio, although variations among the clauses are presented with respect to the types of expenses that are covered by that obligation.

You have supplied me with several sample agreements from which I have selected two such clauses that are fairly representative of the types of hold harmless and indemnification clauses that ordinarily appear in those form agreements. The first clause appears in a third party securities lending agreement and reads, in part, as follows:

> [Treasurer of State] hereby agrees to indemnify and hold [Bank] and Custodian harmless from and against any and all damages, liabilities, losses, costs, claims and expenses (including legal fees) of whatever kind which directly or indirectly arise from or relate to securities lending activities for [Treasurer of State's] account undertaken pursuant to this Agreement and any Lending Agreement, except that this indemnity shall not apply where such damages, liabilities, losses, costs, claims and expenses were caused by the gross negligence or willful misconduct of [Bank] or Custodian.

The second clause appears in an automated clearing house and electronic data interchange service agreement and states, in part, the following:

> [Client Treasurer of State] shall indemnify Bank and hold it harmless from and against any and all claims, demands, losses, liabilities or expenses (including attorney's fees and costs) resulting directly or indirectly from: (i) a breach of any Client warranty; (ii) the transmittal by Bank of Entries and Entry Data in accordance with Client

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(Franklin County 1993), the court of appeals determined that the following indemnification/hold harmless clause in an engineering services contract was clear, unambiguous, and "enforceable, despite its very broad scope":

> "The Engineers [Stilson] shall assume the defense of and indemnify and save harmless the City from any claims or liabilities of any type or nature to any person, firm or corporation, arising in any manner from the Engineers' [Stilson's] performance of the work covered by the engineering contract, and [they] shall pay any judgement obtained or growing out of said claims or liabilities or any of them." (Bracketed material in original.)

> instructions, including cancellations, reversals, error corrections or adjustments; or (iii) the delay or failure of [a receiving depository financial institution] in debiting or crediting a Receiver's account.

A review of the Ohio Constitution and the Revised Code discloses the absence of any provision that expressly addresses, in plain terms, the use of indemnification or hold harmless clauses in contracts that your office has with private or public entities. In particular, there is no constitutional or statutory provision that specifically authorizes the inclusion of those kinds of clauses in state contracts to which the Treasurer of State is a party. *Cf., e.g.*, R.C. 9.87 (indemnification of state officers or employees). As a general matter, however, the lack of express authorization does not lead to the conclusion that hold harmless and indemnification clauses may not appear in those contracts.

The Treasurer of State is one of six constitutional offices that comprise the executive department of state government. Ohio Const. art. III, '1. As a constitutional officeholder of the first rank, the Treasurer of State exercises a portion of the state's sovereign authority in effecting his constitutional and statutory responsibilities, and "the capacity to contract is one of the essential attributes of sovereignty." *Matheny v. Golden*, 5 Ohio St. 361, 366 (1856). Implicit in the power to contract is the authority to select and decide upon those matters that will be included and addressed within a particular contract. *See, e.g.*, 1983 Op. Att'y Gen. No. 83-069 at 2-287 (no statutory limitations are imposed upon a board of township trustees with respect to the terms that the board may include in a contract the board executes with a private fire company under R.C. 9.60 for fire protection services; accordingly, subject to the standard of abuse of discretion, the board of township trustees may agree to such contract terms and conditions as it deems appropriate); 1977 Op. Att'y Gen. No. 77-048 at 2-170 ("[n]ecessarily implied from [a community mental health and retardation board's] power to contract is the authority to set specific contractual terms"). Accordingly, the ability of the Treasurer of State to agree to the inclusion of hold harmless and indemnification clauses in a contract to which he is a party reasonably may be implied by the authority granted him to negotiate and enter into the contracts in which those clauses are to appear.

The inclusion of hold harmless and indemnification clauses in those contracts, however, is neither unrestricted nor wholly unqualified. No provision of either the Ohio Constitution or the Revised Code imposes an express prohibition[2] against the inclusion of these kinds of clauses in state contracts, yet it is apparent that their use implicates several concepts of a constitutional magnitude. These concepts are the creation of debt on the part of the state and extension of the state's credit in aid of private enterprise, which are addressed, respectively, in article VIII, ''1-3 and article VIII,

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[2] "Certain kinds of indemnity agreements are forbidden under Ohio law. See, *e.g.*, R.C. 2305.31 and *Kendall* v. *U.S. Dismantling Co.* (1985), 20 Ohio St. 3d 61, 20 OBR 360, 485 N.E.2d 1047 (construction contracts); R.C. 4123.82 and *Ledex, Inc.* v. *Heatbath Corp.* (1984), 10 Ohio St. 3d 126, 10 OBR 449, 461 N.E.2d 1299 (workers' compensation benefits); *Cumpston* v. *Lambert* (1849), 18 Ohio 81 (illegal agreements)." *Worth v. Aetna Casualty & Surety Co.*, 32 Ohio St. 3d 238, 241, 513 N.E.2d 253, 257 (1987). Absent a statutory exception, however, "an agreement to indemnify another is generally enforceable." *Id.*

'4 of the Ohio Constitution. Associated with the state debt question is the biennial appropriation limitation set forth in article II, '22 of the Ohio Constitution. Let me review for you these concepts and the jurisprudence that has developed regarding their interpretation and practical application, and then discuss the limitations that these concepts impose upon the use of hold harmless and indemnification clauses in state contracts.

First, with regard to the state debt question, section 3 of article VIII of the Ohio Constitution declares that, except for the debts specified in ''1 and 2 of that article, "no debt whatever shall hereafter be created by or on behalf of the state." Section 1 of article VIII provides that the state "may contract debts to supply casual deficits or failures in revenues, or to meet expenses not otherwise provided for," and further imposes a limit of $750,000 upon the aggregate amount of such debts. Section 2 of article VIII also provides that the state "may contract debts to repel invasion, suppress insurrection, defend the state in war, or to redeem the present outstanding indebtedness of the state," and ''2b through 2m of article VIII authorize the creation of state debt for the specific purposes described in those sections, in amounts that exceed the aggregate limit otherwise imposed by '1 of article VIII. Section 22 of article II imposes the following limitations with respect to money drawn from the state treasury and the General Assembly's appropriation authority: "No money shall be drawn from the treasury, except in pursuance of a specific appropriation, made by law; and no appropriation shall be made for a longer period than two years." *See also* Ohio Const. art. XII, '4 ("[t]he General Assembly shall provide for raising revenue, sufficient to defray the expenses of the state, for each year, and also a sufficient sum to pay principal and interest as they become due on the state debt").

Nearly 140 years after it was issued, the opinion of the Ohio Supreme Court in *State v. Medbery*, 7 Ohio St. 522 (1857), *writ of error dismissed*, 65 U.S. 413 (1860), remains the court's most definitive and eloquent statement upon the scope and application of the debt and appropriation provisions of the Ohio Constitution. Because that decision occupies such a central and significant position in this area of the law, I believe it important to review in detail the factual circumstances that were before the court in that case and the analysis the court employed in support of its specific holdings. That review also will facilitate a clear and full understanding of the conclusions I have reached in this opinion.

In 1845 the General Assembly enacted legislation that reestablished a Board of Public Works for the State of Ohio and granted the Board the authority to award contracts for the repair of various public works throughout the state, for any term of years not exceeding five. In 1855 the Board of Public Works exercised that authority when it awarded contracts to Arnold Medbery & Co. and various other contractors for repairs to be undertaken on the Ohio canal system. The contracts were for a term of five years and an aggregate price of $1,375,000 and were executed by the Board of Public Works on behalf of the State of Ohio. Thereafter, in 1857, the General Assembly refused to execute the contracts thus made by the Board, but appropriated money for public works in 1857. The General Assembly also directed the Board to expend those moneys without regard to the contracts.[3] That legislation also gave the contractors a right of action against the State of Ohio for

[3] In 1854 the General Assembly had appropriated moneys for canal repairs to be performed

such damages as they might be entitled to. Pursuant to that legislation the contractors brought a breach of contract action against the State of Ohio and received a judgment in their favor.

The Attorney General appealed that judgment to the Ohio Supreme Court. The gravamen of the appeal was that the act of the General Assembly authorizing the foregoing contracts, and such contracts as were made pursuant to that authorization, contravened Ohio Const. art. II, '22, art. VIII, ''1-3, and art. XII, '4. The question specifically posed by the Attorney General was whether an indebtedness or liability as was disclosed in those contracts might be created against the State of Ohio without violating the Ohio Constitution. The court restated the question in the following manner: "The question before us is, whether a contract binding the State to pay specific sums of money at a future period, without revenue provided or appropriations made to meet it, is such a contingent liability as may be entered into under this financial system, and the provisions of the constitution relating to debts ?" *State v. Medbery*, 7 Ohio St. at 531.

Before proceeding to its resolution of the foregoing question, the court suggested that "it may be proper to allude to the general working of the financial system of the State, in respect of the payment of current expenses, and the creation of a debt." *State v. Medbery*, 7 Ohio St. at 528. The court's opinion thus offered the following synopsis of that system:

> The sole power of making appropriations of the public revenue is vested in the General Assembly. It is the setting apart and appropriating by law a specific amount of the revenue for the payment of liabilities which may accrue or have accrued. No claim against the State can be paid, no matter how just or how long it may have remained over due, unless there has been a specific appropriation made by law to meet it. Article 2, section 22.
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> By virtue of this power of appropriation, the General Assembly exercise their discretion in determining, not only what claims against or debts of the State shall be paid, but the amount of expenses which may be incurred. *If they authorize expenses or debts to be incurred, without an appropriation to pay them, and the expenses are incurred, those expenses create a debt against the State, and it must remain such, until payment under an appropriation afterward made.*
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> The General Assembly usually, however, provide for the current expenses for a period not exceeding two years, out of the incoming revenues, by making appropriations of a sufficient amount of money to pay the expenses during that period, and provide by law for the raising of revenue sufficient to meet the appropriations.
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> The discretion of each General Assembly for the period of two years in respect to the amount of expenditures, except in some special cases relating to salaries, is without limit and without control; but each must provide revenue and set apart a sufficient amount by a law operative within the same two years, to pay all expenses and claims. This is the general system provided by the constitution. Art. 2, sec. 22; art. 12, sec. 4. Under it, all the claims which are authorized, or which can accrue within each of

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and completed in that year and 1855 only. *State v. Medbery*, 7 Ohio St. 522, 524 (1857).

> the two years, and their payment, form one governmental and financial transaction; so that, at the end of each of the two fiscal years, the expenditures authorized and liabilities incurred have been provided for by revenue, adjusted by the executive officers, and, out of the revenue previously set apart and appropriated, are paid.
> So long as this financial system is carried out in accordance with the requirements of the constitution, unless there is a failure or deficit of revenue, or the General Assembly have failed for some cause to provide revenue sufficient to meet the claims against the State, they do not and cannot accumulate into a debt....
> *But if the General Assembly should authorize liabilities to be incurred and make no appropriations to meet them*, but let each citizen who performed services or furnished materials to carry on the government, hold his claim against the State unpaid, *debts to the amount of these claims against the State would at once be created, and remain debts at the end of the two years and until an appropriation was made to meet them*, whatever public revenue might be on hand, inasmuch as every executive officer is forbidden by the constitution to pay any claim unless there has been a specific appropriation for that purpose made by law.
> And for the same reason, if, without app[r]opriations or revenue provided, the General Assembly should authorize contracts binding the State to pay specific sums of money to citizens within two years contingent upon their furnishing certain materials or labor, these contracts would at once create a contingent debt, and on performance would become an absolute debt. (Emphasis added.)

State v. Medbery, 7 Ohio St. at 528-30.

The court then reached several preliminary conclusions about the practical application of this constitutional scheme. First, '3 of article VIII prohibits the state from incurring any debt whatever, except those debts specifically provided for in the first and second sections of that article. Second, this absolute prohibition includes debt, whether actual or contingent, that is incurred by contract, such as through the purchase of goods or services, or by contracting for the construction of public works; the prohibition is not limited to debts for borrowed money only. Third, a debt is created for purposes of this prohibition whenever the state incurs a financial obligation for which the General Assembly has not already provided an appropriation within the current biennium pursuant to '22 of article II. Fourth, a debt is created for purposes of this prohibition whenever the state incurs a financial obligation that continues beyond the current biennium and thus attempts to bind successive General Assemblies to that obligation. *State v. Medbery*, 7 Ohio St. at 534-38.

Analyzing the specific provisions of the challenged contracts in the light of the foregoing observations, the court held that the contracts created debt on the part of the state in violation of the debt prohibition in article VIII, '3 and the biennial appropriation limitation in article II, '22:

> These contracts, then, so far as the inhibition of the constitution relating to debts is involved, stand precisely upon the same ground as any other contracts for expenditure, which the General Assembly have authorized, but provided no revenue and made no appropriations to meet the amount specified to be paid by the State

> when it becomes due. It is a contingent debt ripening into an absolute one, without money being set apart to meet and pay it. The contracts, indeed, can stand nowhere else than among inhibited debts, inasmuch as they are, in our opinion, and for the reasons which we shall now state, in addition to those already given, inconsistent with the provisions of the constitution relating to expenditures and appropriations.

State v. Medbery, 7 Ohio St. at 539. The court found particular fault with the fact that the contracts, having been made for five years, would divest future General Assemblies of their appropriation and revenue raising responsibilities under article II, '22 and article XII, '4, and employed rather forceful language to express its concern in that regard:

> If the State can be thus bound, and the General Assembly be thus divested of the power and discretion to control the amount of appropriations for five years, it may be done for fifty years; and if it can be done in respect of the canals, all the other branches of the government can be farmed out for a like period and with like effect, upon the discretion, power and responsibility of the General Assembly, in respect of making provision for revenue to meet expenses and determining the amount of appropriations. If all this can be done, the provision of the constitution which prohibits appropriations being made for a period beyond two years, is practically and for all the purposes intended by the constitution annulled; for if the State is bound to expend and to pay the amounts of money specified in such contracts, the General Assembly afterward becomes a mere Bed of Justice, convened by contractors to record laws assessing taxes and making appropriations already fixed and determined in amount, and obligatory upon the State.

Id. at 541 and 542. Accordingly, the court found the contracts invalid and unenforceable.

Several subsequent decisions of the court have refined the application of the *Medbery* holdings with respect to particular types of contractual arrangements. *State ex rel. Preston v. Ferguson*, 170 Ohio St. 450, 166 N.E.2d 365 (1960) (no impermissible debt created in the case of a two year agreement between two state agencies for the purchase of land that contained an option to renew the contract beyond the initial term where a new appropriation was made an express prerequisite to that renewal and the lease in no way bound subsequent General Assemblies to the agreement or any renewal thereof); *State ex rel. Ross v. Donahey*, 93 Ohio St. 414, 113 N.E. 263 (1916) (no impermissible debt created in the case of a lease of property for a term of two years, when an advance quarterly rental payment became due with respect to a quarter beyond the two year period, so long as the lease expressly provided that it created no binding obligation on the part of the state unless and until the General Assembly appropriated funds sufficient for the payment of rent under the lease). *See* 1979 Op. Att'y Gen. No. 79-103; 1965 Op. Att'y Gen. No. 65-80; 1938 Op. Att'y Gen. No. 3098, vol. III, p. 1900.

Those decisions, however, have not altered the fundamental principles announced in *State v. Medbery* regarding the creation of state debt and the General Assembly's appropriation responsibilities under the Ohio Constitution. *See, e.g., State ex rel. Ohio Funds Mgt. Bd. v. Walker*,

55 Ohio St. 3d 1, 561 N.E.2d 927 (1990); *cf. also State ex rel. Kitchen v. Christman*, 31 Ohio St. 2d 64, 285 N.E.2d 362 (1972) (syllabus, paragraph two) (for purposes of Ohio Const. art. XII, '11 regarding the creation of bonded indebtedness of the state or any of the state's political subdivisions, a contract between a municipality and a construction company whereby the municipality presently and unconditionally obligates itself to make future quarterly payments until the full amount of the contract price is paid, and under which contract the company has a present right to compel each succeeding municipal council to make those payments, is an installment purchase contract and creates a present indebtedness in the amount of the total payments required to be made at future dates). Those same principles are further reflected in current provisions of the Revised Code that are intended to ensure that all state contracts involving the expenditure of appropriated moneys comply with the constitutional mandates in this area. R.C. 126.07 thus imposes the following fund certification requirement:

> No contract, agreement, or obligation involving the expenditure of money chargeable to an appropriation, nor any resolution or order for the expenditure of money chargeable to an appropriation, shall be valid and enforceable unless the director of budget and management first certifies that there is a balance in the appropriation not already obligated to pay existing obligations. Any written contract or agreement entered into by the state shall contain a clause stating that the obligations of the state are subject to this section.

R.C. 131.33 also provides that "[n]o state agency shall incur an obligation which exceeds the agency's current appropriation authority." *See, e.g., Sorrentino v. Ohio National Guard*, 53 Ohio St. 3d 214, 560 N.E.2d 186 (1990) (in accordance with Ohio Const. art. II, '22 and R.C. 131.33, the Ohio National Guard could not pay the full amount of tuition grants for its enlistees insofar as such payments would have exceeded the agency's current appropriation authority).

As I already have noted, it is the nature of hold harmless and indemnification clauses to impose an additional financial obligation upon one party to a contract. When that party is a state agency or state office, those clauses pose the potential of creating debt on the part of the state in contravention of the Ohio Constitution. *State v. Medbery*. To ensure that this constitutional infirmity is avoided, the use of a hold harmless or indemnification clause in a state contract must satisfy certain requirements. First, the clause may obligate the state only for the duration of the biennium in which the contract is executed; it may not bind the state for any length of time beyond that biennium. Second, the clause must specify a maximum dollar amount for which the state is obligated. Third, in accordance with the provisions of R.C. 126.07 and R.C. 131.33, the amount thus specified must be appropriated and certified as available for payment prior to the contract's execution.

Accordingly, your office may include in its contracts hold harmless or indemnification clauses so long as those clauses and the contracts in which they appear strictly conform to each of these requirements. It appears that the clauses selected from the sample agreements you have provided me, which I have set forth above, do not comply with these requirements.

The second question to be addressed is whether hold harmless or indemnification clauses in general present any problem under the lending aid and credit provisions of the Ohio Constitution. Section 4 of article VIII imposes the following prohibition in that regard:

> The credit of the state shall not, in any manner, be given or loaned to, or in aid of, any individual association or corporation whatever; nor shall the state ever hereafter become a joint owner, or stockholder, in any company or association in this state, or elsewhere, formed for any purpose whatever.

A similar restriction is imposed in Ohio Const. art. VIII, '6 upon the lending of credit by political subdivisions of the state. Cases interpreting either '4 or '6 may be consulted in construing the other provision. *See State ex rel. Eichenberger v. Neff*, 42 Ohio App. 2d 69, 330 N.E.2d 454 (Franklin County 1974); 1992 Op. Att'y Gen. No. 92-016; 1978 Op. Att'y Gen. No. 78-040; 1977 Op. Att'y Gen. No. 77-047; 1971 Op. Att'y Gen. No. 71-044.

From a review of the decisions and opinions on this subject, several propositions are evident. First, the prohibitions of Ohio Const. art. VIII, ''4 and 6 often have been given an expansive interpretation, and have been construed to apply to a wide array of situations, including arrangements wherein the fiscal resources or property interests of the public and private sectors are combined in a mutual business partnership or joint venture. *Village of Brewster v. Hill*, 128 Ohio St. 343, 190 N.E. 766 (1934); *Alter v. City of Cincinnati*, 56 Ohio St. 47, 46 N.E. 69 (1897). The constitutional prohibitions also apply to direct, unconditioned grants, transfers, or expenditures of public funds as well as to formal extensions of credit by the state and its political subdivisions. *State ex rel. Dickman v. Defenbacher*, 164 Ohio St. 142, 128 N.E.2d 59 (1955); *New York Century R.R. v. City of Bucyrus*, 126 Ohio St. 558, 186 N.E. 450 (1933); *Markley v. Village of Mineral City*, 58 Ohio St. 430, 51 N.E. 28 (1898); Op. No. 71-044. Finally, there can be a lending of credit within the meaning of the constitutional provisions even where no actual debts of the state or its political subdivisions are incurred. *State ex rel. Saxbe v. Brand*, 176 Ohio St. 44, 197 N.E.2d 328 (1964).

Whether a particular governmental undertaking is prohibited by Ohio Const. art. VIII, ''4 and 6 presupposes a two-step inquiry. *See* 1985 Op. Att'y Gen. No. 85-047. One must first determine whether the contemplated action produces a lending of the state's aid or credit to an individual, association, or a corporation, or a union of the resources of the state with private enterprise. If not, then the proposed action will be deemed permissible under the constitutional provision, and allowed to proceed. If, however, that action does effect a lending of the state's credit, then one must determine further whether an exception to the constitutional barrier might nonetheless apply to permit government the lending of its aid or credit.

Exceptions have been recognized where the entity receiving the state assistance is either a public organization created for public purposes, or a private, nonprofit entity engaged in an activity that advances a public purpose. *Bazell v. City of Cincinnati*, 13 Ohio St. 2d 63, 233 N.E.2d 864 (1968), *appeal dismissed*, 391 U.S. 601 (1968); *State ex rel. Dickman v. Defenbacher*; *State ex rel. Kauer v. Defenbacher*, 153 Ohio St. 268, 91 N.E.2d 512 (1950); *State ex rel. Leaverton v. Kerns*, 104 Ohio St. 550, 136 N.E. 217 (1922). The courts have generally accorded legislative authorities

"broad discretion in determining what constitutes a public purpose, and such determination will be judicially overturned only in cases where the determination is manifestly arbitrary or unreasonable." Op. No. 85-047 at 2-173.

Other exceptions are set forth in Ohio Const. art. VIII, ''13-16 for the specific activities and purposes therein enumerated. *See also* Ohio Const. art. VI, '5 (the state may guarantee the repayment of loans made to Ohio residents attending colleges or universities). Finally, the provisions of ''4 and 6 do not apply to transactions in which one governmental entity furnishes credit or assistance to another governmental entity. *See, e.g., State ex rel. Speeth v. Carney*, 163 Ohio St. 159, 126 N.E.2d 449 (1955) (statute authorizing a county to issue bonds for construction of subways for transportation systems not owned by the county is not unconstitutional since those transportation systems are municipally and not privately owned); *Purcell v. Village of Riverside*, 1 Ohio C.C. 12, 1 Ohio Cir. Dec. 7 (Hamilton County 1885) (contribution of funds by a municipality to a county for the purpose of reimbursing the county the costs it incurred in purchasing a right-of-way and locating and establishing a road to be controlled by the municipality not prohibited by Ohio Const. art. VIII, '6); 1979 Op. Att'y Gen. No. 79-032 (gratuitous assignment of a state university's interest in defaulted student loans to an agency of the federal government not violative of Ohio Const. art. VIII, '4).

The question presented in this instance, therefore, is whether payments as might be made by your office in satisfaction of the financial obligations imposed by these hold harmless or indemnification clauses would constitute a lending of credit under Ohio Const. art. VIII, '4. For the following reasons, I am of the opinion that, in the ordinary situation, such payments do not.

The hold harmless and indemnification clauses appear within contracts and agreements that your office executes with other parties for services they provide your office, which are necessary to fulfilling your constitutional and statutory responsibilities as Treasurer of State. I must presume that your office and those parties accomplish the negotiation of those contracts and agreements from bargaining positions of relatively equal strength. If this is the case, then it should also mean that in the bargaining process your office receives from those parties consideration sufficient to support the obligations you assume under those contracts, including such obligations as may be set forth in the hold harmless and indemnification clauses. So long as the value of that consideration is equal to the value of those obligations, any payments that might be made by your office in their eventual fulfillment would not constitute a gratuitous transfer of state moneys for purposes of the lending credit prohibition. *Cf. generally, e.g., Taylor v. Comm'rs of Ross County*, 23 Ohio St. 22, 78 (1872) ("[t]he constitution does not forbid the employment of corporations, or individuals, associate or otherwise, as agents to perform public services; nor does it prescribe the mode of their compensation"); 1984 Op. Att'y Gen. No. 84-080 at 2-272 ("where the [public] money to be paid constitutes compensation for services, the lending credit provisions do not operate to specify how the money is to be paid"). *See also State ex rel. Speeth v. Carney.*

On the other hand, should the value of the consideration received by your office under such contracts be insufficient to support the obligations you assume under the hold harmless and indemnification clauses in those contracts, then one might conclude that payments made by your

office in satisfaction of those obligations constitute a lending of the state's credit. *See, e.g.*, 1986 Op. Att'y Gen. No. 86-046 at 2-247 and 2-248; 1952 Op. Att'y Gen. No. 1713, p. 559, 565 ("[t]he mere giving away of public funds to private persons without such persons rendering any service or providing any sort of consideration in return is clearly not the expenditure of public funds for a public purpose, but rather is the expenditure of public funds for a private purpose [that] has been judicially recognized as illegal in Ohio"). Care should be taken, therefore, to ensure that such obligations as you agree to assume are supported by adequate consideration provided by the parties with whom you are contracting.

In closing, I believe it important to offer a final word of caution. This opinion advises that a hold harmless or indemnification clause may be included in a state contract, so long as the clause and the contract in which it appears comply with those provisions of the Ohio Constitution and the Revised Code that address the creation of state debt, the appropriation responsibilities of the General Assembly, and limitations upon the state lending its credit in a manner that benefits private enterprise. In addition to observing the foregoing legal requirements, however, a state agency also should consider whether agreeing to include such clauses in its contracts is prudent or advisable as a matter of public fiscal policy.

As this opinion explains, a hold harmless or indemnification clause imposes an additional financial obligation upon one party to a contract for the benefit of another party to that contract. That obligation generally operates with respect to various categories of expenses the second party may incur in connection with a legal dispute under the contract that ensues between the two parties. An obligation of that character may have unforeseeable and undesirable consequences for the state agency at some time in the future. *See, e.g., Maryland Casualty Co. v. Frederick Co.*, 142 Ohio St. 605, 53 N.E.2d 795 (1944) (syllabus, paragraph four) (before a tortfeasor secondarily liable may be entitled to indemnity from the one primarily liable, the latter must be fully and fairly informed of the claim and the pendency of the action and given full opportunity to defend or participate in the defense); *First Nat. Bank v. First Nat. Bank*, 68 Ohio St. 43, 67 N.E. 91 (1903) (if an indemnitor has had fair notice of the prior action and an opportunity to defend, the indemnitor is precluded from asserting in the subsequent action any defense that could have been interposed in the prior action); *Miller v. Rhoades*, 20 Ohio St. 494 (1870) (in an action to enforce an indemnity agreement, a prior judgment against the indemnitee is conclusive proof as to the amount of damages owed); *City of Columbus v. Alden E. Stilson & Assoc.*, 90 Ohio App. 3d at 614, 630 N.E.2d at 63 ("[w]hen judgment is obtained against an indemnitee, an indemnitor who has received proper notice and opportunity to defend the action falls in that class of nonparties who are bound by the outcome"). Therefore, before agreeing to include a hold harmless or indemnification clause in a particular contract, a state agency should make a close and careful examination of the nature and probability of that risk, and then determine whether that risk is worth whatever benefit, if any, the agency receives by having the clause in the contract.

Based upon the foregoing, therefore, it is my opinion, and you are advised that:

1. The inclusion of a hold harmless or indemnification clause in a contract to

which the Treasurer of State is a party and that imposes a financial obligation upon the Treasurer of State or the State of Ohio for the benefit of another party to the contract must comply with the state debt and appropriation provisions of Ohio Const. art. II, '22, art. VIII, ''1-3, R.C. 126.07, and R.C. 131.33. In order to comply with those provisions, the hold harmless or indemnification clause may obligate the Treasurer of State or the State of Ohio only for the duration of the biennium in which the contract is executed, and may not impose a financial obligation for any period beyond that biennium. The clause also must specify a maximum dollar amount for which the Treasurer of State or the State of Ohio is thus obligated, and the amount specified must be appropriated to the Treasurer of State and certified by the Director of Budget and Management as available for payment prior to the contract's execution.

2. The inclusion of a hold harmless or indemnification clause in a contract to which the Treasurer of State is a party and that imposes a financial obligation upon the Treasurer of State or the State of Ohio for the benefit of another party to the contract must comply with the prohibition in Ohio Const. art. VIII, '4 against the state lending its credit. In order to comply with that prohibition, under the terms of the contract the other party to the contract must furnish the Treasurer of State consideration sufficient to support the financial obligation the Treasurer assumes under the hold harmless or indemnification clause.

Respectfully,

BETTY D. MONTGOMERY
Attorney General

November 21, 1996

The Honorable J. Kenneth Blackwell
Treasurer of State
30 East Broad St., 9th Floor
Columbus, Ohio 43266-0421

SYLLABUS: 96-060

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2. The inclusion of a hold harmless or indemnification clause in a contract to which the Treasurer of State is a party and that imposes a financial obligation upon the Treasurer of State or the State of Ohio for the benefit of another party to the contract must comply with the prohibition in Ohio Const. art. VIII, '4 against the state lending its credit. In order to comply with that prohibition, under the terms of the contract the other party to the contract must provide the Treasurer of State consideration sufficient to support the financial obligation the Treasurer assumes under the hold harmless or indemnification clause.