Recommendation 88-2

Federal Government Indemnification of Government Contractors

(Adopted June 9, 1988)

Indemnification of government contractors for third-party liability involves this issue: Who should bear the risk of liability for injury or damage to a third party caused by products and services supplied by government contractors? This issue is especially significant when the products and services involve high-risk or hazardous governmental activities.

The liability of the government is limited by the doctrine of sovereign immunity, which has been waived only in certain situations, such as the Federal Tort Claims Act. Some courts have recognized a common law immunity for government contractors who have complied with pertinent government specifications and have disclosed all known defects or hazards to the government.[*] In the absence of insurance or indemnity, government contracts may be exposed to claims based, for example, on alleged failure to follow specifications or adequately warn the government or others about product design defects.

No government-wide legislation provides generally for indemnification of government contractors for third-party liability, although a number of individual departments and agencies are authorized to indemnify contractors[1]. All of the laws authorizing government indemnification of contractors state conditions that must be met before contractual indemnity been met. Thus some statutes restrict indemnification to unusually hazardous governmental activities or activities that may result in catastrophic losses and further require the contractor to obtain such insurance as is available. Indemnification clauses included in contracts usually

[*] Subsequent to adoption of the recommendation, in a case involving military equipment, the Supreme Court accepted this view. See *Boyle v. United Technologies*, 108 S. Ct. 2510 (1988).

[1] Examples are the National Defense Contracts Act, 50 U.S.C. 1431, as implemented by Executive Order 10789 (providing for indemnification under national defense contracts for unusually hazardous or nuclear risks); section 2354 of title 10 of the United States Code (providing for indemnification for unusually hazardous defense research and development activities); section 170 of the Atomic Energy Act, as amended by the Price-Anderson Act of 1957, 42 U.S.C. 2210(d) (providing indemnification for activities involving the risk of a substantial nuclear incident); the Federal Aviation Act, as amended, 49 U.S.C. 1531 *et seq.* (providing for indemnification for risks where aircraft operations are necessary to carry out U.S. foreign policy); and the National Aeronautics and Space Act, as amended, 42 U.S.C. 2458b (providing for indemnification for damages related to the launch, operation or recovery of space vehicles).

contain further conditions, some of which are required by agency rule. A common restriction is that the indemnity does not cover claims resulting from the contractor's willful misconduct.

Indemnification clauses are reserved for unusual circumstances, and few contractors are actually provided with indemnity. The Department of Defense, for example, included indemnification clauses in an average of about 70 contracts per year in the five-year period 1980-1984; by way of comparison, during fiscal year 1984 alone, the Department entered into over 14.8 million contract actions.

The Conference's study of contractual indemnification found virtually no evidence of claims made on the basis of indemnification clauses or litigation over such claims. Although there is no indication that the government has incurred significant costs under contractual indemnity provisions in the 30 years that have passed since enactment of the National Defense Contracts Act in 1958 and the Price-Anderson Act in 1957, the space shuttle disaster and the Three Mile Island nuclear incident suggest that contingent liabilities under indemnity agreements are potentially costly.[2]

The Conference's study found that agencies generally do not believe that current practices and limits on indemnities discourage potential contractors from bidding. Federal agencies, with few exceptions, see little need for greater indemnification authority or for broad legislation that would extend indemnities to government contractors generally. However, this view is not shared by many federal contractors. They take the position that the decreasing availability of private insurance for a broad range of hazardous activities is greatly reducing the pool of bidders for contracts involving those activities in the absence of government indemnification. This legislative debate is beyond the scope of the present recommendation.

While the Conference takes no position on the current debate over proposals to expand agency authority to indemnify contractors for hazardous activities, mass injuries, or other special circumstances, the Conference does recommend the compilation of certain information that would provide a better basis in the future for ascertaining the need for and risks associated with broader indemnification.

[2] In 1982, the Comptroller General issued an opinion (B-201072, May 2, 1982; reconsid. 62 Comp. Gen. 361 (1983)) stating that to comply with the Federal Anti-Deficiency Act, 31 U.S.C. 1341, indemnity clauses in government contracts must specify that the indemnity is available only to the extent of available authorized appropriations. This limitation, however, has limited impact where Congress has set maximum indemnity limits by statute, as in the Price-Anderson Act, or where no ceiling is set, as in the National Defense Contracts Act. The Price-Anderson Act reauthorization is pending as of the date of this recommendation.

This recommendation identifies several factors that agencies should consider when they determine whether to grant an indemnity clause to a particular contractor. It is appropriate for agencies to consider the scope of the indemnity proposed to be granted, including the proper mix of self-insurance, private insurance, and government indemnity. The factors listed should also be considered by Congress in deciding whether to grant new authority to an agency to indemnify its contractors.

Decisions to indemnify ordinarily require an assessment of whether the activity in question involves an unacceptable hazard or degree of risk. Sometimes the degree of risk is defined in terms of availability of insurance. Agencies regularly engaged in high-risk activities and able to grant indemnity clauses, such as the Department of Energy, Nuclear Regulatory Commission, or National Aeronautics and Space Administration, would normally have the resources to perform risk assessments. However, other agencies that confront these issues less frequently may not have adequate technical expertise to decide. It has been asserted there is often great uncertainty, and such decisions may be made inconsistently. The recommendation suggests referral and interagency cooperation as a way of meeting this problem.

Recommendation

1. *Identification of Agency Authority to Indemnify*. Each agency that has, and intends to exercise, the authority to indemnify any of its contractors against liability to third parties should set forth, in a policy statement or regulation, the agency's understanding of the extent and source of its authority to indemnify contractors. The agency should consult with the Department of Justice and the Office of Federal Procurement Policy in drafting the statement or regulation.

2. *Agency Decision Whether to Grant an Indemnity Clause*. Before deciding to grant an indemnity clause to a contractor, an agency should identify the public benefits expected to be gained by such a grant and should take into account:

(a) The nature and magnitude of the risks involved in the covered activities, including the danger inherent in the work to be performed, the adequacy of the state of the art to assess the inherent danger, the aggregate liability that could be incurred, when the liabilities might be incurred, and how current insurance policies would apply to such liabilities;

(b) The scope of the indemnity proposed to be granted;

(c) The source of funds that would be used to pay an award under the indemnity clause, including the possible application of the Federal Anti-Deficiency Act, and the impact, if any, that such an award will have on the programs of the agency or other units of the government;

(d) The incentives that either providing or denying an indemnification clause would give the agency for supervising contractual performance, so as to provide for maximum protection of the public from injury and to protect the government from unwarranted liability in light of the identifiable risks;

(e) The incentives that the contractor would have, assuming indemnification was granted, for performing under the contract in a safe and prudent manner;

(f) The incentives that the contractor would have, assuming indemnification were granted, to defend itself or to help defend the government in any subsequent litigation; and

(g) Any effects, assuming indemnification were granted, on the ability or the willingness of the insurance industry to make available private insurance for the kinds of activities to which the indemnification would apply.

3. *The Need for More Information*. Each agency that has paid out any sum of money or received any claims for payment under a contractual obligation to indemnify a contractor, or on whose behalf such sums have been paid by the federal government, should report all such payments and claims to the Office of Federal Procurement Policy (OFPP) on an annual basis. The OFPP should periodically issue a report summarizing the information received. All such reports should be made available to the public except to the extent that release of any information included is prohibited by law. The OFPP should also obtain from each affected agency a list, updated periodically, of all existing contracts containing indemnity clauses.

4. *Contracting Office Expertise*. Where an agency is considering whether to grant an indemnity clause, but the contracting office does not have sufficient technical expertise to assess the degree of risk, the extent of the hazard, or the availability of insurance, these questions should be referred to an office of the agency that does have the requisite expertise to assist the contracting office in making such decisions. If the contracting agency as a whole lacks the expertise required to assess these matters adequately (for example, where unusual or newly emerging technological risks are involved), the agency should seek the assistance and cooperation of other agencies. Agencies with pertinent experience or knowledge should cooperate to make available to requesting agencies staff members whose experience in risk

assessment may be helpful. It may be appropriate to create a small, highly-qualified risk assessment office to furnish or coordinate such assistance.

Citations:

53 FR 26027 (July 11, 1988); corrected at 53 FR 39588 (October 11, 1988)

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