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UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

JUL 17 1981

OFFICE OF GENERAL COUNSEL

MEMORANDUM

SUBJECT: Liability Agreements Between EPA Contractors and Stationary Air Pollution Sources

FROM: Gerald H. Yamada, Acting Associate General Counsel
Grants, Contracts and General Administration Division (A-134)

TO: Edward Reich, Director
Division of Stationary Source Enforcement (EN-341)

Your memorandum of September 23, 1980, raises several issues for our consideration concerning liability agreements between EPA contractors and stationary air pollution sources (hereinafter sources). You ask what the legal and practical effects are on EPA of a "hold harmless" agreement between a contractor engaged in compliance inspections as an EPA representative under section 114 of the Clean Air Act and a source. Such an agreement would indemnify the source for payments it makes for injuries to employees of the contractor. Additionally, you inquire whether amounts paid under such agreements could exhaust contract funds allocated to the inspection task itself. EPA has determined previously that EPA officers and employees conducting inspections may not enter into such agreements since they are not equivalent to private visitors. (See the November 8, 1972 memorandum captioned "Visitors' Releases and Hold Harmless Agreements as a Condition to Entry of EPA Employees on Industrial Facilities.")

Discussion

A "hold harmless" agreement is a contract of indemnification. As used in the context you describe, it obligates a contractor to reimburse a source for the source's payments of contractor employee injury claims where the employee's injury is caused by the negligence or breach of a duty of care by the source. The practical effect of such an agreement is to shift financial liability to the contractor for a source's negligence or breach of duty. The costs associated with such an assumption of liability, if allowed as costs under the contract, raise both legal and policy concerns.

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A. Costs Generated From "Hold Harmless" Agreements Could Expand Governmental Financial Liability

Costs that are or may be incurred by a contractor when it enters into a "hold harmless" agreement can take the form of either increased contractor insurance costs, or the additional costs of the contractor's indemnification of the source's expenditures where there is an absence of insurance coverage. If a contractor entering into such agreements does so with EPA approval (by determining these costs to be allowable under the contract), EPA will ultimately bear the financial burden of the shift of liability since EPA will pay the costs of the increased premium or will reimburse the contractor under the contract for its indemnification payment. EPA will also have to bear legal costs associated with any litigation. In this context there is no reason for EPA to treat its contractor representatives any differently than EPA officers and employees regarding their entering into "hold harmless" agreements. (See November 8, 1972, memorandum referenced above.)

1. "Hold Harmless" Agreements Could Increase Contractor Operational Costs

The assumption by a contractor of financial liability under a "hold harmless" agreement is contrary to EPA's interest in minimizing operational costs. The typical government contract requires the contractor to secure workmen's compensation and occupational disease insurance for the protection of its employees from job related injuries. This insurance requirment effectively limits the amount of the Government's contractual liability for such injuries. Where the contractor is enrolled in a workmen's compensation plan the employee is generally precluded from seeking recovery from the contractor outside the workmen's compensation plan. The amounts received by the injured employee from the contractor is limited to rates of awards established by the workmen's compensation plan. The amount of the workmen's compensation award is not recoverable under the contract. The EPA is obligated by its contract only to pay for the contractor's costs in maintaining the workmen's compensation plan. Thus, by requiring a contractor to maintain a workmen's compensation plan the Government has accomplished two things. First, it has ensured that adequate financial protection is provided to cover injuries to contractor employees. Second, it has limited contractor operational costs, as regards payments for injuries to its employees, to levels either conforming to maximum workmen's compensation payments or applicable insurance or enrollment costs for the workmen's compensation plan. This second factor is of significance to EPA contract consideratins. To the extent that a contractors' operational costs are kept to a minimum, government costs are also reduced. A "hold harmless" agreement has the dual effect of expanding the potential operational costs of the contractor to include these additional costs and increasing the total costs chargeable under the contract.

2. Indemnification Payments Under a "Hold Harmless" Agreement Would Subject EPA to Reimbursements In Excess of the Amounts of Its Normal Liabilities

An injured employee may elect to proceed directly against a nonemployer for damages under various state law theories of negligence or breach of duty. Such actions are not resricted by workmen's compensation's monetary limits on the amounts of possible awards. In fact, such awards are usually substantially higher because of the escalation in awards caused when such factors as pain and suffering, emotional distress, loss of consortium, etc. are considered. Since a source is liable and will make payment for injuries to a contractor's employee only where the employee can show negligence or wrongful breach of duty by the source, a contractor's reimbursement of a source under the "hold harmless" ageement would, in most instances, be for sums well in excess of workmen's compensation limits. To the extent these contractor costs are determined to be allowable costs under the contract, EPA's contract costs could substantially exceed cost projections based only on the contractor's potential liability under its workmen's compensation plan. (Note also that, to the extent the contractor is found to be an agent or employee of the EPA in carrying out the inspection function, EPA's reimbursement of a contractor's indemnification for employee personal injuries could be argued to be an improper attempt to circumvent the Federal Tort Claims Act's limitation on tort suits against the United States.)

3. "Hold Harmless" Agreements Adversely Affect Subrogation Actions

A contractor employee injured because of the negligence of a source could elect to receive compensation for his injuries under the employee's workmen's compensation plan. Payment by the plan would create a right of subrogation in the payor. Thus, to the extent the contractor or the insurer makes payments to the employee it can proceed against a negligent third-party for recovery of the amounts of is payments. However, an indemnification agreement would severly hamper, if not preclude, recovery of the contractor's or the insurer's costs through a subrogation action. A contractor seeking to recover, from a negligent source, its expenditures for an employee's injuries is likely to find that the "hold harmless" agreement effecively bars such recovery. This result is possible since recovery by the contractor from the source leads to recovery by the source from the contractor (using the "hold harmless" agreement), thereby nullifying the subrogation action. Additionally, even where payment is made by the contractor's workmen's compensation insurance carrier, the exercise by the insurer of its subrogation right also leads to the contractor liability under the "hold harmless" agreement. Thus the net effect of a "hold harmless" agreement is to create higher contractor and higher EPA contract costs by hampering recovery action against potentially liable sources.

B. Public Policy Does Not Appear to Favor These Types of "Hold Harmless" Agreements

Two principles allow an injured party to recover damages from one whose actions caused the injury. First, it is in the public interest that a party is held responsible for the consequences of its actions. Second, in the allocation of risks between parties the individual whose negligence causes an injury is in a better position to be aware of the potential for harm and is better able to protect a third party from the risk of the harm. The "hold harmless" agreement tends to reduce the duty of care usually associated with a source as an ongoing business concern. The agreement protects the source from the financial consequences of its negligence which causes injury to contractor employees.

However, the source clearly possesses the best knowledge of the potential hazards of its operations. Additionally, it is in the best position to mitigate, to the extent possible, the risks of harm to individuals such as contractor employees. Yet, since the agreement holds the source harmless, the incentives (i.e., potential financial liability) for its active participation in an effort to protect these types of individuals is substantially reduced. To the extent EPA concurs in its contractor's execution of "hold harmless" agreements, it appears to sanction the implementation of a standard of care for a source which is less stringent for contractor employees than that imposed for EPA officers or employees. Since the contractor is acting as a representative or agent of the EPA, such a distinction appears to be unwarranted.

C. "Hold Harmless" Agreements Could Exhaust Contract Funds Allocated To The Inspection Task

If costs created by the "hold harmless" agreement are allowable costs under the contract, they can be satisfied from all available contract funds. The "Limitation of Costs" clause genearlly inserted into these types of EPA contracts would most likely limit EPA's liability for such costs to sums specifically set out in the contracts schedule. The scheduled amount would establish a dollar ceiling for costs claimed under a particular contract. Thus, the point in time at which the contractor incurs the particular cost (early in the contract period or late in the period) will be determinative of whether contract monies will be exhausted in order to satisfy these costs.

Conclusion

A contractor's execution of a "hold harmless" agreement could have a direct effect on EPA operations and could create an unwarranted distinction between EPA employees and contractor employees acting as EPA representatives in inspections under section 114 of the Clean Air Act. However, execution of a "hold harmless" agreement by an EPA contractor would not, in our opinion, be a violation of any law or regulation.