



**League of Minnesota Cities  
Insurance Trust**

145 University Avenue West, St. Paul, MN 55103-2044  
(651) 281-1200 • (800) 925-1122  
Fax: (651) 281-1298 • TDD: (651) 281-1290  
www.lmnc.org

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RISK MANAGEMENT INFORMATION  
**LIABILITY COVERAGE FOR  
JOINT POWERS AGREEMENTS**

A common issue for LMCIT members concerns liability coverage for joint powers operations. This memo explains how LMCIT liability coverage applies to joint powers agreements and what cities need to do to make sure that the appropriate insurance coverage is in place.

Keep in mind that this memo discusses tort liability coverage. Cities also need to think about workers' compensation coverage and property coverage, but these issues are generally a little easier to deal with.

**Key provisions of LMCIT liability coverage document**

There are two key points to be aware of in the city's LMCIT liability coverage:

1. *First, unless special arrangements have been made, a joint powers entity is not a covered party under the city's coverage.* This means that if a joint powers entity of which the city is a member is sued, the city's LMCIT coverage would not respond to that suit.
2. *Second, liability arising out of the activities of a joint powers entity is specifically excluded from coverage.* This means that if the city or a city officer or employee is sued as a result of some activity of the joint powers entity, the city's LMCIT coverage would not respond to that suit.

The exclusion for joint powers entities is not unique to LMCIT. Almost all commercial liability insurance policies contain a similar exclusion for "joint ventures." Thus cities that are not members of LMCIT also need to be concerned about making sure there is coverage for the activities of joint powers entities in which they are involved. In fact, the "joint venture" exclusion in a commercial liability policy might have a broader effect. It is possible that an insurance company might take the position that even a mutual aid agreement is a "joint venture" for purposes of that exclusion.

**Which joint powers agreements are affected?**

Not every joint powers agreement creates a coverage issue. The "joint powers" exclusion in LMCIT's liability coverage applies only to joint powers agreements that actually create a separate "joint powers entity."

The LMCIT liability coverage document spells out which joint powers agreements are deemed to create a "joint powers entity." The coverage document states:

*Joint powers entity* means an operating entity created by two or more governmental units entering into an agreement as provided by statute for the joint exercise of governmental powers. An intergovernmental agreement will be deemed to create a joint powers entity if the agreement establishes a board with the effective power to do any of the following, regardless of whether the specific consent of the constituent governmental units may also be required:

- 1) To receive and expend funds;
- 2) To enter contracts;
- 3) To hire employees;
- 4) To purchase or otherwise acquire and hold real or personal property; or
- 5) To sue or be sued.

Unless the joint powers agreement creates a joint board with one or more of these powers, the "joint powers" exclusion in the LMCIT liability coverage does not apply.

### **Which joint powers agreements are not affected?**

The Joint Powers Act, Minnesota Statutes, Section 471.59, authorizes cities to cooperatively exercise their powers in a wide variety of ways. Some of these ways involve creating a new joint entity; others do not. A typical example of the latter is a "mutual aid" agreement. This type of agreement simply says that each city agrees to provide specified assistance to the other under specified circumstances.

Another example would be a contract under which one city agrees that its police department will provide patrolling and law enforcement for another city. The second city then pays the first for the services it receives.

Neither of these examples usually involves a joint managing board with the kinds of powers listed above, and thus would not be considered a joint powers entity for insurance purposes. The city does not need to take any special action in order to have coverage for liability claims arising out of activities under these kinds of agreements. However, there are some coverage-related considerations to be aware of regarding these types of agreements. The last section of this memo discusses these issues.

In evaluating whether a joint powers agreement poses a coverage issue, it is important to review what the agreement actually does, not just what it is called. LMCIT has reviewed joint powers agreements that were titled mutual aid agreements, but which actually did set up a joint powers entity.

If you are not sure about a joint powers agreement – whether it is an existing agreement or a draft that your city is considering – send us a copy. LMCIT will review it and let you know if it creates a “joint powers entity” and whether the city’s coverage would cover liability arising from that agreement.

### **How does LMCIT handle coverage for joint powers entities?**

There are two ways coverage can be provided for a joint powers entity and its members.

- The usual practice is for LMCIT to issue a separate liability coverage document to the joint powers entity. This coverage document includes as covered parties the entity itself; its officers and employees; the political subdivisions who are members of the joint powers entity; and the officers and employees of those political subdivisions. The idea is to get all of the liability coverage for the entity's activities in one place, so that everyone who might be sued as a result of the entity's activities is covered in the same place.
- It is less common but sometimes preferable to add the coverage for the joint entity to one of the individual city's coverages. This might make sense, for example, if the relationship between the member cities is such that one city is in a position to effectively control the joint entity's activities and decision-making. If the member cities prefer, LMCIT can provide the coverage this way, by naming the joint powers entity as a covered party on one of the constituent city's policies.

It is important to understand that if the joint powers entity formed by City A and City B is named as a covered party on City A's coverage, City B and City B's officers and employees also become covered parties under City A's coverage, assuming that the act or omission giving rise to the claim is related to the joint powers agreement. In addition, City A's insurance will provide coverage for the joint entity itself and its board members and employees. Thus, any claims will affect City A's experience, deductibles, and ultimately, its insurance premium.

It would not make sense to add the joint entity to *both* member cities' coverages. That would result in duplicate coverage and create the potential for exactly the kind of conflicts among defendants that members of a joint powers entity should try to avoid.

### **What happens if the city overlooks a joint powers entity it is involved in?**

LMCIT's approach to covering joint powers entities means that cities must be careful to make sure that any joint powers entity in which they participate does in fact have liability coverage. If not, the city can be left with a coverage gap if it is sued because of something the joint powers board did or if a personal injury or property damage arises from the activities of the joint powers entity. LMCIT has had a couple instances where cities inadvertently overlooked a joint powers entity of which they were members, and were left without coverage when the joint powers entity's activities led to claims against the joint powers entity and its member cities.

In response to these kinds of problems, the LMCIT Board in 1993 added a "safety net" to LMCIT coverage, to provide some protection for joint powers entity exposures the city inadvertently overlooks. This "safety net" gives the city a chance to correct these kinds of oversights after the fact.

Specifically, a member city has the right to have a limited amount of retroactive coverage issued to any joint powers entity of which the city is a member and which does not already have coverage in its own name. This coverage will carry the same retroactive date and the same inception date as the city's own coverage. It will then protect the joint powers entity, its member political subdivisions, and their respective officers and employees for claims arising from the joint entity's activities, including claims that have already been made at the time the coverage is actually issued. In effect, this provision lets cities put in place, after the fact, the kind of coverage that should have been in place originally for the joint powers entity's activities.

**Caution.** *The retroactive coverage option does **not** completely eliminate the need for joint powers entities to obtain liability coverage up front just as any city or other operating entity generally should. The retroactive coverage is more expensive and the protection is not as great.*

City officials need to be aware of two important limitations:

- First, retroactive coverage for joint powers entity liability will carry a \$200,000 annual aggregate limit, including defense costs. By contrast, standard LMCIT coverage provides a \$1,000,000 per occurrence limit for most claims, regardless of the number of claims per year. And for most claims, that \$1,000,000 per occurrence limit applies only to damages; defense costs are in addition to the limit.
- Second, the premium for the retroactive joint powers entity liability coverage will be substantially higher than LMCIT's standard rates for many joint powers exposures. The premium for the retroactive coverage will be the greater of LMCIT's standard rates or \$5,000.

### **Is LMCIT's basic \$1,000,000 coverage limit sufficient for a joint powers entity?**

There is always a risk that liability will exceed insurance coverage. This is true for both a joint powers entity and an individual city. One example is a federal civil rights claim, which is not subject to the statutory tort liability limits. There are a number of other ways liability can exceed coverage limits which is discussed in more detail in the LMCIT Risk Management Information Memo "LMCIT Liability Coverage Options - Liability Limits, Coverage Limits, and Waivers."

A 2005 federal court decision, *Reimer v. City of Crookston*, created a concern that liability arising from a joint powers entity's activities could exceed the current statutory tort limit of \$1,000,000. In that case, the Court said that a claimant could make a claim against each political subdivision that was a member of the joint powers entity, for damages caused by the joint powers entity's activities. The Court also ruled that a claimant could "stack" the statutory liability limits of each member, effectively multiplying the statutory tort limits by the number of members in the joint powers entity.

In response to *Reimer*, the League, in cooperation with other local government organizations, was successful in getting the state legislature to address the concerns caused by this decision. The state legislature amended the joint powers law, Minnesota Statutes, Section 471.59, by adding two provisions.

- First, the amendment provides that a governmental unit is liable for the acts or omissions of another governmental unit in a joint venture or joint enterprise only if has so agreed in writing.
- Second, the amendment provides that governmental units operating together under the Joint Powers Act, and any joint boards created thereunder, are a single governmental unit. The total liability for the governmental units and any joint board may not exceed the limits on liability for a single governmental unit.

The joint powers amendment became effective on May 25, 2006. The risk of liability for the activities of a joint powers entity is now no greater than the risk of liability for a single political subdivision acting alone. A city, however, will still be separately liable for its own independent acts or omissions that are not related to the actions of the joint powers entity.

It is important to keep in mind that there is still a risk of liability above the tort liability limits because some types of claims are not governed by the statutory liability limits, such as a federal civil rights claim. Thus, it is always worthwhile for any public entity, whether one city or a number of cities cooperating together as a joint powers entity, to consider carrying insurance in excess of the tort liability limits. Also, it is important to remember that your city's individual LMCIT liability coverage does not cover liability arising from a joint powers entity's activities. Instead, that protection is found under the joint powers entity's coverage.

### **Why does LMCIT approach coverage for joint powers entities in this way?**

This is a good question given that the exclusion for joint powers entities requires the city to take special steps to put coverage into place for joint powers entities. The reason for this approach is to avoid some of the problems that can be created if several different parties' individual coverages became involved in defending suits that arise out of a single incident. If an incident were to occur, of course, the chances are that the plaintiff would sue everyone in sight: the joint entity, all of the individuals involved, all of the constituent cities, and so on. An example might help illustrate these problems.

Suppose that five cities combine to form a joint powers entity. The entity is controlled by a five-member board, with one representative from each city. The board has hired staff and directs the manager to take a particular action. As a result of that action, someone is injured and lawsuits are filed. The joint entity, its manager and its employees, and each of the individual board members are named individually, and are accused of being negligent in ordering and performing that action. The constituent cities and the individual council members of each of those cities are also sued, and are accused of being negligent in failing to adequately oversee the joint powers entity's activities.

Under LMCIT's approach, the joint entity's coverage document would respond to all of those suits and would defend all of the parties being sued. A single defense attorney would be named to defend all of the parties, and LMCIT would be on the hook for any damages that were awarded, regardless of which defendants were actually found liable. This assumes, of course, that the suit does not fall within any of the other exclusions such as dram shop liability (liability related to the sale of alcohol).

To defend that same action by relying on the various cities' individual coverages would be immensely more complicated, particularly if different insurers were involved. Each city would report the action to its own respective liability carrier, who would then assign a defense attorney to defend the case. Each of those defense attorneys would in turn do two things. First, they would try to defend the case against the plaintiff. Second, they would try to show that if there was any negligence and liability, it belongs to one of the other defendants.

This increases the cost of defending the case in at least three different ways. First, there are now five attorneys rather than one being paid to defend the case. Second, those attorneys are not only fighting with the plaintiff but are also fighting with each other, thus creating more work for each other. And third, they are each trying to dig up dirt on the other defendants so as to shift whatever liability there is to the other defendants, which in turn is very helpful to the plaintiff. All that information which the defendants are producing on each other's negligence gives the plaintiff a better chance of winning the case.

Note that in this scenario the same potential for conflicts among the defendants arises even if all of the cities were LMCIT members. Each of those cities still has an interest in making sure that any liability is charged against the other cities' policies and not its own. Many LMCIT cities now carry deductibles on their liability coverage. The city's losses are one of the factors taken into account in rating; and the city's losses are also a factor in the formula LMCIT uses to distribute dividends among the member cities.

Putting all of the liability coverage for all of the defendants in one coverage document eliminates that kind of fighting and finger-pointing among the defendants. The retroactive "safety net" coverage which the city can now obtain is designed to maintain the same kind of liability coverage structure for all of the participants. Using this approach (rather than simply deleting the "joint powers" exclusion from the coverage) limits the risk that LMCIT will incur catastrophically large defense costs by having to provide a separate defense to each of several cities.

### **What about coverage for agreements that do not create a joint powers entity?**

Again, a key question is whether the agreement creates a "joint powers entity." If it does not, the city's LMCIT liability coverage will cover claims arising from activities pursuant to that agreement.

Here are a couple of other issues to be aware of with regard to LMCIT liability coverage for claims arising from activities under agreements that do not create a joint powers entity.

- ***Defense and indemnification provisions.*** Agreements often require one party to defend and indemnify the other party for certain claims arising under the agreement. LMCIT strongly recommends doing this in mutual aid agreements and service contracts, since it can help make defending claims less expensive and more effective.

The city's LMCIT liability coverage covers this type of contractually-assumed liability. In other words, when a city agrees in a contract to defend and indemnify another party for tort claims, LMCIT covers the defense and indemnification of that party, assuming the underlying claim is not excluded from coverage.

Remember though that a coverage limit applies *per occurrence*. When the city agrees to defend and indemnify someone else, it creates a risk that the total liability could be greater than the city's coverage limit. For example, the city's own liability could use up the entire coverage limit. If the city must also indemnify another party for that party's liability, the city would have to do that out of its own funds because the city would have already used up all of its coverage. This problem can be avoided by using a "limited indemnification" approach in the agreement. That is, the city agrees to defend and indemnify the other party, but only up to the limit of coverage the city has available. LMCIT's model mutual aid agreement includes recommended language to do this.

- ***"Additional insured" provisions.*** Agreements sometimes require the city to add another party as an "additional insured" or "additional covered party" on the city's liability coverage. If an agreement requires your city to do so, contact your LMCIT Underwriter and it will be taken care of.

Keep in mind though that when you add another party to your city's coverage as an "additional covered party," you are now sharing your coverage limit with that party. That in turn creates a risk that you could run out of insurance coverage.

For agreements between LMCIT members, there is really little point in using "additional insured" type provisions. Since LMCIT automatically covers contractually-assumed tort liability, the same purpose is accomplished by a defense and indemnification provision. Using the "limited indemnification" approach described above prevents the coverage limits problem.