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February 7 **2014**

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Indiana Supreme Court: Private Water Company Cannot Invoke Sovereign Immunity

For those of you tuning in this week in the hopes of reading yet another installment on AIA standard construction contract interpretation, I am sorry to disappoint. While the Indiana Court of Appeals did issue another opinion interpreting the AIA contract, your author is suffering a tad bit of AIA contract fatigue. However, if there is not a better topic next week, then you may well see a discussion of *Board of Commissioners of the County of Jefferson v. Teton Corp*. But this week we have an Indiana Supreme Court decision to discuss that I have been looking forward to since August 2012 when the court of appeals issued a decision that I very much disagreed with. The Indiana Supreme Court, Justice Stephen H. David writing for the unanimous court, issued the opinion that I had hoped to see.

Our regular readers may recognize that I do not usually go out of my way to identify the author of court opinions – with the obvious exception of opinions by Judge Richard Posner and by Indiana Justice Mark Massa. I add a tip of the hat to Justice David for two reasons. The first is that having recently had the privilege of meeting with Justice David as part of the state bar association's dinner with the judiciary, I was immensely impressed by the character of the man. The second is as a follow up to a post from October 2012 discussing the danger in the politicization of judicial retention votes that was inspired by the ongoing efforts of some to seek the

removal of Justice David for a controversial decision in which he authored the majority decision. In that lengthy post, I concluded by stating:

> I do not advocate for the retention of Justice David. It is for each individual voter to decide whether, on balance, his judgment is so deficient as to make him unworthy of the office of Associate Justice for the Indiana Supreme Court. There may well be merit to opinions seeking his withdrawal. However, do not confuse an adverse decision for a deficiency in judgment.

It is in light of the fact that Justice David has been so harshly criticized for a single decision that I ensure his recognition for authoring an opinion that I will subsequently praise.

Without further ado, let us embark upon our discussion of *Veolia Water Indianapolis LLC v. National Trust Insurance Company*.

The case stems from a fire in January 2010 in a restaurant in Indianapolis. Despite firefighters promptly arriving on the scene, the firefighters were hampered by frozen fire hydrants. The delay resulted in the total loss of the restaurant. Because the restaurant was insured and its insurance company was exercising its subrogation rights, the plaintiff in the case was the restaurant's insurance company. The insurance company filed suit against the City of Indianapolis and its related department as well as Veolia Water Indianapolis LLC – the company "responsible for operating the City's water utility pursuant to a Management Agreement" with the city. Part of Veolia's responsibilities to the city was to maintain the fire hydrants that were frozen when the firefighters arrived that cold January day. Veolia was also responsible for licensing "access to the hydrants' water supply to private companies for commercial use."

The insurance company alleged that the hydrants had frozen "because the private companies to whom Veolia licensed access failed to properly close the hydrants[.]" The city filed a motion to dismiss the case against it invoking sovereign immunity under Indiana common law and under the Indiana Tort Claims Act (ITCA). We have previously discussed the ITCA in depth. In short, the classic common law rule was that a governmental entity could not be sued. As that rule broke down, states, such as Indiana, enacted tort claims statutes defining precisely when and how a governmental entity could be sued. The ITCA provides the specific procedures to sue an Indiana governmental entity as well as specific exceptions to liability – that is, instances of sovereign immunity. Veolia filed a judgment on the pleadings, invoking the same common law sovereign immunity as the city. It did not, however, argue immunity under the ITCA.

The trial court denied both the city's and Veolia's motions and granted interlocutory appeal of the decision. On appeal, the Indiana Court of Appeals reversed the trial court, finding that both the City and Veolia were entitled to common law sovereign immunity. The insurance company sought transfer to the Indiana Supreme Court, which brings us to today's case.

The court, recognizing that the city and Veolia, a private company, are very different entities in nature, addressed each individually. The first issue was whether the city was entitled to sovereign immunity under the ITCA. Under the ITCA, a "governmental entit[y] can be subject to liability for tortious conduct unless the conduct is within an immunity granted by Section 3 of [the] ITCA." The city specifically argued protection under Subsection 7 that provides immunity for the "performance of a discretionary function." Previously, the Indiana Supreme Court devised the "planning/operational test" to determine whether something is discretionary as required to invoke Subsection 7 immunity. The court previously stated:

> Under the planning/operational dichotomy, the type of discretion which may be immunized from tort liability is generally that attributable to the essence of governing. Planning activities include acts or omissions in the exercise of a legislative, judicial, executive or planning function which involves formulation of basic policy decisions characterized by official judgment or discretion in weighing alternatives and choosing public policy. Government decisions about policy formation which involve assessment of competing priorities and a weighing of budgetary considerations or the allocation of scarce resources are also planning activities.

An example of Subsection 7 discretionary function immunity that has been found by the Indiana Court of Appeals – though in your author's opinion is open to challenge – is sidewalk maintenance in Indianapolis. The Court of Appeals held, in *City of Indianapolis v. Duffit*, that, due to the limited budget for sidewalk repair in Indianapolis, the decision to let some sections fall into a dangerous state of disrepair is a discretionary function under Subsection 7.

In discussing the application of discretionary function immunity to the *Veolia Water* case, the court recognized that the test "distinguish[es] between decisions involving formulation of basic policy, entitled to immunity, and decisions regarding only the execution or implementation of that policy, not entitled to immunity." The court further noted, "The critical inquiry is not merely whether judgment was exercised but whether the nature of the judgment called for policy considerations." The city relied upon the 2001 Court of Appeals case *Lamb v. City of Bloomington*

that found claims for "(1) obstruction of firefighters' ability to act; (2) negligent instruction and/or training of firefighters; (3) negligent maintenance of fire protection equipment; (4) intentional failure to maintain fire protection equipment; and (5) negligent performance of duties as fire chief" to be discretionary functions for which the City of Bloomington – home to Indiana University – was immune under Subsection 7. The city relied upon *Lamb* "for the proposition that a city's decision not to maintain fire protection equipment involves the formation of policy and is thus necessarily immune from liability[.]"

The court agreed with the insurance company that *Lamb* is distinguishable because, unlike in *Lamb* where the decision of firefighting budgeting turned upon the weighing of budgetary considerations, here "the City simply failed to require Veolia to follow the terms of the Management Agreement or pre-determined policy." Thus, because the injury was not the result of deliberated policy, but rather would have been prevented by Veolia following the already established policy, discretionary function immunity did not apply to protect the city.

Fortunately for the city, its other argument – common law sovereign immunity – was successful. Prior to the enactment of the ITCA, the common law rule was that "governmental units are liable for their torts except:

> (1) where a city or state fails to provide adequate police protection to prevent crime . . . (2) where a state official makes an appointment of an individual whose incompetent performance gives rise to a suit alleging negligence on the part of the state official for making such an appointment; and (3) where judicial decision-making is challenged.

Previously, in *Gates v. Town of Chandler, Water Department*, the Court of Appeals found that "adequate fire protection is so closely akin to adequate police protection that fire protection should be treated as an exception to governmental tort liability . . . because both services are essential for public safety. Consequently, the *Gates* court held that governmental units are immune under the common law from liability for damages caused by the "failure to provide suitable equipment or an adequate supply of water with which to fight the fire, i.e., insufficient water pressure . . . or improperly functioning hydrants."

The Supreme Court agreed with the reasoning of *Gates* and thereby applied it to the city in this case. As a result, though the ITCA's discretionary function immunity was not a sufficient mechanism for the city to avoid liability, it was able to invoke common law sovereign immunity with success. A note that is not discussed by the court but at play is the interplay of the ITCA and common law sovereign immunity. As the court recognized, the creation of the ITCA was in

response to the 1972 case *Campbell v. State*. The *Campbell* case destroyed the classic rule of sovereign immunity and left the three exceptions discussed above. Because the ITCA is a statute that contravenes the common law, it is strictly construed – meaning read literally and interpreted in a narrow fashion so that when in doubt, the common law rule applies. Because the purpose of the ITCA is to limit governmental liability, even though it does not include the three sovereign liability exceptions from *Campbell*, those exceptions are presumed to still exist, as their continued existence does not contradict any portion of the ITCA.

The last issue before the court, and the most important to your author, was whether Veolia could avail itself of common law sovereign immunity. The thought of a for-profit company contracted to handle water services for a city receiving the protections of sovereign immunity was flabbergasting to me. It was this portion of the Court of Appeals decision that I disagreed with. Fortunately, the Supreme Court joined me in disagreeing with the Court of Appeals on this point.

Veolia relied upon a line of cases beginning with the 1986 Indiana Supreme Court decision *Ayres v. Indiana Heights Volunteer Fire Department, Inc*. In that case, the court found that a private individuals or groups that "are endowed by the state with powers or functions governmental in nature, [ ] become agencies or instrumentalities of the state and are subject to the laws and statutes affecting governmental agencies and corporations," including sovereign immunity. The court also found that firefighting is a "uniquely governmental" service, and thus, a volunteer fire department was protected by sovereign immunity. The *Ayres*' reasoning was later used in *Metal Working Lubricants Co. v. Indianapolis Water Company* to find a private water company immune from liability due to its role in "fire protection services" reasoning that "if a private company did not provide the water services, then the government would . . . and the government would unquestionably be immune under the same circumstances."

So what makes Veolia Water different from the Indianapolis Water Company (IWC) ? Both are/were private companies handling water services in Indianapolis. Both did/do so under a contract. When you see the cases the Court of Appeals had to work with, it is easy to see why the conclusion was that Veolia was entitled to sovereign immunity. Indeed, the Court of Appeals invited the Supreme Court to weigh-in on this matter due to the "increasing prevalence and complexity of public-private contracts." The primary difference between Veolia and the IWC is the nature of the companies. The IWC, though technically a private company, was not the typical "private company." "It operates by the authority and at the will of the city." Veolia, to the contrary, "is a wholly private entity bound to the City only by contract." In fact, Veolia, though operating as an LLC concerned exclusively with Indianapolis, is a smaller entity within a grander Veolia "global organization that

manages water services for municipal and industrial clients on five continents and serves approximately six hundred communities in North America alone."

The court also latched on to some "compelling" arguments of the insurance company in urging that for-profit companies be treated differently from governmental units. The "most influential" argument was "that granting common law sovereign immunity to a private company – with a fundamental goal of maximizing profits – invites negligence. As the Court of Appeals observe[d], '[i]nsulating Veolia from liability for its alleged failure to monitor or maintain in this case may actually create a disincentive to maintain hydrants." The court further recognized:

> Insulating private companies from liability for negligence was neither the intent behind nor the purpose of establishing common law sovereign immunity for governmental units; rather, one key purpose for granting governmental units sovereign immunity was to protect the public treasury. This purpose is substantially diminished when a private company performs the government service.

The court made sure to clarify that *Metal Working Lubricants* is still good law, but that the distinguishing factor is that Veolia is a wholly private company. The court also recognized that this decision "is in line with a trend of federal circuits and at least one state" – Arizona – "to deny sovereign immunity to private entities who are for-profit companies with the ability to make economic decisions and insure themselves against claims for negligence." The court further cited to a Seventh Circuit decision authored by Judge Richard A. Posner – which as noted above is something that brought a smile to my face – for the proposition that "privatization of a governmental service is not 'a farce in which the privatized entity enjoys the benefits both of not being the state and so being freed from the regulations that constrain state agencies, and of being the state and so being immune from suit.'"

As a side note, I think it merits recognition that Justice David relied upon a description of Veolia's global organization that falls outside of the record. I have not read the briefs in the case, but doing a search for the word continents returns no results in the six briefs in the case. This means that a meaningful fact in the decision was the result of Justice David going to Veolia's website as recognized by the citation in footnote 7. While I am actually a fan of judges/justices using the internet in drafting decisions, this is certainly a contentious issue. This is a resource that Judge Posner strongly advocates for in his book *Reflections on Judging*. I am in league with Judge Posner and Justice David on this point, but think it merits note due to the fact that it is a heated point of contention in the legal community.

Join us again next time for further discussion of developments in the law.

Sources

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