No. B296968

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT, DIVISION SIX

CITY OF PISMO BEACH, et al.

Plaintiffs and Respondents

v.

SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY, et al.

Defendants and Appellants.

On Appeal from the Superior Court of California,
County of San Luis Obispo, Case No. CV 130383
Before the Honorable Barry T. La Barbera (retired)

CALIFORNIA STATE ASSOCIATION OF COUNTIES' APPLICATION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF AND PROPOSED *AMICUS CURIAE* BRIEF IN SUPPORT OF APPELLANTS SAN LUIS OBISPO LOCAL AGENCY FORMATION COMMISSION AND SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY

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CERTIFICATE OF INTERESTED ENTITIES OR PARTIES

There are no interested entities or persons to list in this certificate. (Cal. Rules of Ct., Rule 8.208(e)(3).)

Respectfully submitted.

Dated: August 26, 2020

COUNTY OF SANTA CLARA
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APPLICATION FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF

Pursuant to California Rules of Court, rule 8.200, subdivision (c), the California State Association of Counties ("CSAC") applies to the Court for leave to file an *amicus curiae* brief. A copy of the proposed brief is included with this application.

CSAC is a non-profit mutual benefit corporation, which does not offer stock and which is not a subsidiary or affiliate of any publicly owned corporation.

CSAC's membership comprises all fifty-eight California counties. All of CSAC's member counties bear responsibility for preserving the public health, safety, and welfare within their borders. Each of these counties has a unique geography, and a diverse set of industries. Regardless of each member county's differing set of circumstances, every member county of CSAC maintains the same interest in the orderly development of their communities.

CSAC sponsors a Litigation Coordination Program, which is administered by the County Counsels' Association of California and is overseen by the Association's Litigation Overview Committee, comprised of county counsels throughout the state. The Litigation Overview Committee monitors litigation of concern to counties statewide and has determined that this case is a matter affecting all counties.

The Court's decision in this matter will significantly impact CSAC's interests, and the interests of counties generally. Under the

Cortese-Knox-Hertzberg Local Reorganization Act of 2000 ("CKHA"),[1] every California county is required to establish a local agency formation commission ("LAFCO"). This appeal concerns the ability of LAFCOs, which are funded in part by counties, to require indemnity from their applicants.

Given the foregoing, *Amicus* is uniquely situated to offer context for the Court and provide insight into the practical ramifications of the trial court's ruling.

Appellants in this case are the San Luis Obispo Local Agency Formation Commission ("SLO LAFCO"), and the Special District Risk Management Authority ("SDRMA"). SLO LAFCO's duties include "discouraging urban sprawl, preserving open-space and prime agricultural lands, encouraging the efficient provision of government services, and encouraging the orderly formation and development of local agencies based upon local conditions and circumstances … ."[2] The SDRMA is a self-insurance pool for public agencies that provides its members with comprehensive liability coverage protection. The SDRMA is the subrogee of SLO LAFCO's claim for indemnity, as the SDRMA funded SLO LAFCO's defense of the underlying lawsuits.

Because *Amicus* will be affected by this Court's decision, and may assist the Court through its unique perspective, it respectfully requests permission of the Honorable Presiding Justice to file its proposed brief.

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[1] Gov. Code, § 56000, *et seq*.

[2] Gov. Code, § 56301.

Pursuant to Rule 8.200, subdivision (c)(4), the proposed brief is combined with this application, and commences immediately below.

Respectfully submitted.

Dated: August 26, 2020

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PROPOSED *AMICUS CURIAE* BRIEF

I. INTRODUCTION

The Cortese-Knox-Hertzberg Local Government Reorganization Act ("CKHA" or "Act") delegates the Legislature's power to control the boundaries of cities and special districts to Local Agency Formation Commissions, or LAFCOs. The Legislature established LAFCOs "to encourage orderly growth and development which are essential to the social, fiscal, and economic well-being of the state."[3] LAFCOs are the Legislature's watchdog over local boundary changes.[4] "LAFCOs are responsible for coordinating logical and timely changes in local governmental boundaries, conducting special studies that review ways to reorganize, simplify, and streamline governmental structures, and preparing a sphere of influence for each city and special district within each county … . LAFCOs regulate boundary changes through the approval or denial of proposals by other public agencies or individuals … [.]"[5] "By exercising their powers … LAFCO actions are a key step in the

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[3] Gov. Code, § 56001. All further references to statutes in this brief shall be to the Government Code, unless expressly stated otherwise.

[4] Sen. Rules Com., Off. of Sen. Floor Analyses, 3d reading analysis of Assem. Bill No. 1725 (2017-2018 Reg. Sess.) as amended July 20, 2017, "Background," ¶ 1.

[5] Assem. Floor, Concurrence in Sen. Amends., Assem. Bill No. 1725 (2017-2018 Reg. Sess.) as amended July 20, 2017, "Comments," No. 1.

process which results in major land-use change … [.]"[6]

In this appeal, the Court is asked to decide whether indemnification protections required by SLO LAFCO from all of its applicants that shift costs of potential litigation onto applicants seeking the benefit of approvals should be struck down as unconscionable and unenforceable. Similar indemnification protections are routinely used by public agencies, including LAFCOs statewide, to protect taxpayers from substantial litigation costs that are more appropriately borne by applicants in front of LAFCOs.

Here, the parties disagree as to whether the indemnity agreements are enforceable.[7] Respondents contend, and the Superior

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[6] Comm'n on Local Governance for the 21st Century, *Growth Within Bounds: Planning California Governance for the 21st Century* (Jan. 2000), p. 49.

[7] The indemnity agreements at issue in this appeal contain the same language and state: "As part of this application, Applicant agrees to defend, indemnify, hold harmless and release the San Luis Obispo Local Agency Formation Commission ("LAFCO"), its officers, employees, attorneys, or agents from any claim, action or proceeding brought against any of them, the purpose of which is to attack, set aside, void, or annul, in whole or in part, LAFCO's action on the proposal or on the environmental documents submitted to or prepared by LAFCO in connection with the proposal. This indemnification obligation shall include, but not be limited to, damages, costs, expenses, attorneys' fees, and expert witness fees that may be asserted by any person or entity, including the Applicant, arising out of or in connection with the application. In the event of such indemnification, LAFCO expressly reserves the right to provide its own defense at the reasonable expense of the Applicant." *See* Superior Court Ruling on (1) San Luis Obispo

Court held, that the indemnity agreements required by Appellant San Luis Obispo Local Agency Formation Commission ("SLO LAFCO") are unenforceable because the agreements lack consideration and are unconscionable.[8]

Appellants contend that SLO LAFCO is allowed to require the indemnity agreements because the CKHA allows LAFCOs to recover service fees and charges that include the costs of defending LAFCOs' decisions against legal challenges. Appellants also contend that a reasonable construction of SLO LAFCO's powers as delineated in state law includes the implied power to require indemnification. They also assert that the indemnity agreements at issue in this case do not lack consideration and cannot be unconscionable because they are authorized by the Legislature.

Appellants are right. As discussed below, the CKHA expressly

Local Agency Formation Commission & Special District Risk Management Agency's Motion for Summary Judgment / Adjudication; (2) The City of Pismo Beach's Motion for Judgment on the Pleadings; and (3) Central Coast Development Company's Motion for Judgment on the Pleadings, dated Jan. 4, 2019, p. 4:9-19 ("Superior Court Ruling").

[8] During the proceedings below, Respondents also alleged that the indemnity agreements amounted to economic duress. However, the issue of economic duress was not raised in Respondents' briefs, and is therefore not discussed herein. *Amicus* also will not address the lack of consideration issue, other than to note that it agrees with Appellants' position that the indemnity agreements do not lack consideration because LAFCOs have the implied power to require indemnity from their applicants, as discussed herein.

requires LAFCOs to exercise quasi-legislative independent judgment when making decisions under their purview. LAFCO decisions can often be controversial, and interested parties, including but not limited to local agencies, developers, and environmental and neighborhood groups, will file legal challenges attacking LAFCO decisions. Such challenges can be extremely expensive for LAFCOs to defend to conclusion, often costing in the hundreds of thousands of dollars. The only reasonable reading of the CKHA leads to the conclusion that, in order to function and meet their statutory objectives, LAFCOs *must* have the authority to allocate risk and financial exposure resulting from their exercise of independent judgment to the applicants seeking the benefit of potential LAFCO approvals—through the use of indemnity agreements. This implied power to control risk is consistent with the text of the CKHA and evident in the relevant legislative record.

In addition, the indemnification agreements at issue here are supported by case law: The opinion in *Cequel III Communications I, LLC v. Local Agency Formation Commission of Nevada County* (2007) 149 Cal.App.4th 310 ("*Cequel Communications*"), acknowledged the validity of an indemnity agreement in favor of a LAFCO when, like here, the LAFCO's determination was likely to lead to costly litigation. Indeed, the absence of the ability to have such indemnity agreements would create significant pressure on fiscally limited LAFCOs to avoid controversial decisions lest they be saddled with litigation costs. *Amicus* urges the Court to reverse the decision of the Superior Court and find that SLO LAFCO's indemnification requirements are enforceable. State

law and policy unquestionably supports the use of indemnification agreements by LAFCOs, and the Superior Court's finding to the contrary constitutes reversible error. To the extent this Court finds the indemnification agreements are unconscionable, it should nevertheless reverse the Superior Court's ruling because it was an abuse of discretion to refuse to enforce the indemnity agreements here since enforcement would not have led to an unconscionable result.[9]

If the Court finds that the indemnification agreements are not enforceable on unconscionability grounds, *Amicus* urges the Court to limit its ruling to first party indemnity for the reasons discussed below.

II. ANALYSIS

A. Standard of Review.

The issues raised in this brief concern the interpretation of the CKHA, particularly the legality and power of LAFCOs to require indemnity agreements as a component of applications submitted to them under the Act. "Issues involving the interpretation and application of statutes are subject to *de novo* review."[10]

Moreover, the Superior Court's refusal to limit application of the indemnity agreements to avoid an unconscionable result, and instead strike down the indemnification agreements wholesale, is reviewed for

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[9] *Amicus* agrees with the remainder of the arguments submitted by Appellants.

[10] *City of Selma v. Fresno County Local Agency Formation Commission* (2016) 1 Cal.App.5th 573, 581, citing *Cequel Communications*, *supra*.

abuse of discretion.[11]

B. Indemnity Agreements are Necessary, Authorized, and Common as a Mechanism to Shift Costs and Risks.

Since 1872, Civil Code section 2772 has provided that indemnity "is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person."[12] "This provision plainly states that indemnity may apply to either direct [i.e., first party] or third party claims."[13] The Legislature has therefore expressly authorized the type of indemnity agreements that are at issue in this case.

Public entities, like private entities, routinely use indemnification as a mechanism to shift risk and financial exposure to others with whom they contract. In public contracts, such risk and financial exposure would otherwise be borne by taxpayers. For instance, in the design and construction context, public entities almost always use indemnity provisions to protect taxpayers from damages, injuries, and claims arising from the contractor or designer's deficient performance under the contract. The Legislature has recognized this, and has sought to regulate the scope of indemnity based upon specific policy concerns and

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[11] *Armendariz v. Foundation Health Psychcare Servs.* (2000) 24 Cal.4th 83, 122-124.

[12] Civ. Code, § 2772.

[13] *Hot Rods, LLC v. Northrup Grumman Systems Corp.* (2015) 242 Cal.App.4th 1166, 1178-1179 (internal quotations and citation omitted).

contexts.[14]

Public entities frequently employ indemnity agreements in contexts where indemnification requirements are not codified by the Legislature.[15] This common use of indemnity agreements is a reflection of the reality that modern society relies on the use of indemnity to manage risk.[16]

Indemnification is particularly important for public entities such as LAFCOs that are charged under state law with exercising independent judgment consistent with the CKHA's legislative purposes.[17] LAFCOs often find themselves stuck between a rock and a

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[14] See, e.g., Civ. Code, §§ 2782, 2782.05 (prohibiting public entities from requiring indemnity for the sole negligence or willful misconduct of the public entity in construction context), 2782.8 (limiting the scope of indemnity public entities may require from design professionals).

[15] See, e.g., *No Oil, Inc. v. City of Los Angeles* (1987) 196 Cal.App.3d 223 (city requiring indemnity from oil drilling corporation following issuance of permit); *County of San Joaquin v. Stockton Swim Club* (1974) 42 Cal.App.3d 968 (public entity allowing local swim club to use public swim facilities).

[16] See *Societa Per Azioni De Navigazione Italia v. City of Los Angeles* (1982) 31 Cal.3d 446, 464 (reaffirming that public entities are subject to comparative fault, and therefore subject to equitable indemnity); *E.L. White, Inc. v. Huntington Beach* (1978) 21 Cal.3d 497, 507-508 (holding express indemnity provisions are generally afforded a preemptive effect over equitable or implied indemnity).

[17] Gov. Code, § 56325.1.

hard place when deciding a particular application: When a LAFCO grants an application, it may be exposed to litigation from third parties who disagree with LAFCO's approval; however, when a LAFCO denies an application, that exposure may come from the applicant itself (like the case here). Even when a LAFCO approves an application, it may impose conditions of approval that the applicant objects to and may seek to challenge in court. The high stakes generally at issue in LAFCO decisions amplify the risk of litigation and, in some contexts, make litigation a virtual certainty.

C. LAFCOs are Authorized Under the CKHA to Require Indemnity from Their Applicants.

1. The CKHA Requires LAFCO Members to Exercise Their Independent Judgment.

In enacting the CKHA, the Legislature acknowledged that the duties LAFCOs are required to discharge necessarily include adjudicating controversial issues that involve multiple entities with competing interests.[18] Those duties include undertaking tasks that may

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[18] See, e.g., Gov. Code, §§ 53001 ("The Legislature recognizes that the logical formation and determination of local agency boundaries is an important factor in promoting orderly development and in balancing that development with sometimes competing state interests of discouraging urban sprawl, preserving open-space and prime agricultural lands, and efficiently extending government services."), 56655 (concerning priority and consideration of two or more conflicting proposals to a LAFCO), 56657 (same), 56668-56668.3 (setting forth factors for consideration in reviewing a proposal or application).

discourage the development and business objectives of applicants, including shaping "the development of local agencies so as to advantageously provide for the present and future needs of each county and its communities."[19] The CKHA requires the following of the commission members:

> While serving on the commission, all commission members shall exercise their independent judgment on behalf of the interests of residents, property owners, and the public as a whole in furthering the purposes of this division. Any member appointed on behalf of local governments shall represent the interests of the public as a whole and not solely the interests of the appointing authority.[20]

If LAFCOs are not allowed to require indemnity of their applicants, then their ability to exercise independent judgment could be materially diminished. LAFCOs, especially those in smaller counties who have constrained budgets, may have their exercise of independent judgment influenced by budgetary concerns over a particular decision

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[19] Gov. Code, § 56301; see also Gov. Code, § 56378, subd. (a).

[20] Gov. Code, § 56325.1; see also Gov. Code, §§ 56665 (requiring executive officer to prepare a report of an application, including his or her recommendations), 56666, subd. (b) (requiring commission to hear and receive protests, objections, and evidence at the hearing on an application); *San Mateo County Harbor Dist. v. Board of Sup'rs of San Mateo County* (1969) 273 Cal.App.2d 165, 168 ("LAFCO is required to evaluate the evidence for and against a particular proposal and to make its own independent decision or 'determination' approving or disapproving the proposal.").

when the issues are contentious and the likelihood of costly litigation is real—as evidenced by the substantial costs incurred by SLO LAFCO in this case.[21] Additionally, if LAFCOs are not allowed to require indemnity agreements of their applicants, then it is the taxpayers who may ultimately suffer the harm by funding the cost of a particular application, since every LAFCO is funded by the cities, counties, and special districts within its jurisdiction.

It bears noting that the use of indemnity agreements by governmental (or other) entities does not require express legislative reference. "Administrative officials may exercise such additional powers as are necessary for the due and efficient administration of powers expressly granted by statute, or as *may fairly be implied* from the statute granting the powers. [Citation.] Thus, an administrative agency has the power to contract on a particular matter if this power may be fairly implied from the general statutory scheme."[22] These implied powers may arise not only by statute, but also under common law rules of statutory construction.[23] These include implied powers that are

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[21] SLO LAFCO has incurred approximately $440,944.02 in litigation costs in successfully defending its determination denying Respondents' annexation application. Superior Court Ruling, *supra*, at p. 5:5-7.

[22] *US Ecology, Inc. v. State of California* (2001) 92 Cal.App.4th 113, 132 (emphasis in original; internal citations and quotations omitted).

[23] *Zack v. Marin Emergency Radio Authority* (2004) 118 Cal.App.4th 617, 632 (citations omitted).

recognized as indispensable to local civil government to enable the public entity to fulfill the objects and purposes for which it was organized and brought into existence.[24]

The test for determining whether a public agency has an implied power is "uncommonly flexible."[25] One test courts have employed to determine whether a power is implied is whether the Legislature could have entertained an intention contrary to that implication.[26] As discussed above, the exercise of independent judgment is a fundamental legal purpose that LAFCOs must exercise. The existence of an implied power to mitigate the risks of litigation engendered by such exercise of independent judgment cannot be up for reasonable debate.

2. The Legislative History of the CKHA Supports Finding that the Legislature Intended to Allow LAFCOs to Require Indemnification from Applicants.

"The fundamental principle of statutory interpretation is to ascertain the intent of the Legislature so as to effectuate the purpose of the law."[27] Here, the legislative history shows clear legislative intent to allow full cost recovery for LAFCOs.

While LAFCOs have existed for many decades, at the end of the

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[24] *Zack*, *supra*, 118 Cal.App.4th at p. 633 (citations omitted).

[25] *Id.*

[26] *Id.* at p. 634.

[27] *Pennisi v. Dep't of Fish & Game* (1979) 97 Cal.App.3d 268, 272.

20th Century, the Legislature became increasingly concerned with rapid growth within the state. Orderly growth, efficient governance, and resource protection are issues associated with rapid growth.[28] "Recognizing the challenges facing California governance in the 21st Century, the State Legislature in 1997 enacted AB 1484 (Hertzberg), establishing the Commission on Local Governance for the 21st Century."[29] The special commission acknowledged that for the two decades prior to its existence, local government budgets had been "perennially under siege" because of taxing and spending constraints.[30] LAFCOs, which were historically funded only by counties, were financially dependent on those counties.[31] "It is not difficult, therefore, to understand why LAFCOs might be viewed with suspicion by the non-county members."[32] The special commission emphasized the need for

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[28] Comm'n on Local Governance for the 21st Century, *Growth Within Bounds: Planning California Governance for the 21st Century* (Jan. 2000), p. ES-5 ("Problem: Urban sprawl persists and growth sometimes proceeds into areas where extension of services is inefficient, expensive, or ill-timed. Despite the policies and procedures of the Cortese-Knox Act, the loss of prime agricultural and open-space lands continues to occur at an alarming rate.").

[29] Comm'n on Local Governance for the 21st Century, *Growth Within Bounds: Planning California Governance for the 21st Century* (Jan. 2000), p. ES-1.

[30] *Id.* at p. ES-2.

[31] *Id.* at p. 41.

[32] Comm'n on Local Governance for the 21st Century, *Growth Within*

LAFCOs to be neutral, independent, and provide for balanced representation for counties, cities, and special districts.[33] One component the special commission recommended to increase this fair and balanced representation was an independent funding structure for LAFCOs.[34]

After the special commission's report was published in January of 2000, the Legislature implemented many of the recommendations in its report. This occurred through a series of bills in the first decade of the 21st Century.

The 2000 report emphasized the need for greater LAFCO independence (including recommending the addition of what would later become Section 56325.1, quoted above, requiring commission members to exercise their independent judgment), and recognized the inability of

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Bounds: Planning California Governance for the 21st Century (Jan. 2000), p. 41.

[33] *Id.* at p. ES-5, No. 2.

[34] *Id.* at p. 47 ("San Luis Obispo LAFCO Chairman Bill Engels [cites] the need for independence in fulfilling broad State mandates of LAFCO. 'A more equitable means of funding LAFCOs needs to be found. The current method of county general fund and fees discourages LAFCOs from being most effective because expensive sphere of influence studies and special district consolidation studies are not completed due to lack of sufficient financial resources.'"; "The Commission believes that all entities will benefit from LAFCO independence, which can only be assured if all share equally in the cost.").

LAFCOs to establish funding schemes that would be amenable to increased independence:

> Virtually every LAFCO testified to the Commission that their funding is inadequate and expressed the view that counties alone should not be expected to cover all LAFCO costs. Data gathered in the Commission's LAFCO survey affirms the general paucity of funding for LAFCOs … In his testimony to the Commission, San Diego LAFCO Executive Officer Michael Ott summarized the key funding issues. "Developing an equitable funding program is critical for LAFCO, especially if the Legislature wants LAFCOs to have a positive effect on local government structure in California. Any major changes to the LAFCO statutes … would essentially be negated if LAFCOs would be left with an inadequate funding source …"[35]

The ability of LAFCOs being able to recover "service charges" was not added to the CKHA until the Legislature's 2007-2008 Regular Session, through Assembly Bill No. 1263. The Legislature explained the basis for allowing LAFCOs to levy "service charges":

> Current law allows a LAFCO to establish a schedule of fees to recover the costs of processing boundary change applications. Most LAFCOs have established fixed fees for a majority of applications based on the estimated reasonable costs. **For some applications for major changes, such as an incorporation or district formation, those costs may be impossible to estimate at the time of application. This bill clarifies that a LAFCO can establish a schedule of service charges for processing**

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[35] Comm'n on Local Governance for the 21st Century, *Growth Within Bounds: Planning California Governance for the 21st Century* (Jan. 2000), p. 46.

> **applications that cannot exceed the cost of providing the service.** Typically[,] the LAFCO will then require a deposit and will charge services against that deposit. **According to the sponsor, the California Association of Local Agency Formation Commissions, there have been several challenges to a LAFCO's ability to charge based on actual costs.** This bill will clear up these ambiguities.[36]

The above excerpt from the legislative record makes it clear that the Legislature intended to empower LAFCOs to recover actual costs incurred in processing an application to its full and effective completion—which in some cases, as here, may mean the conclusion of litigation challenging a LAFCO's decision.

In adding the ability of LAFCOs to levy "service charges," the California Senate Local Government Committee also noted the Legislature's intent to defer mandatory timelines for considering applications until the "service charge" issue was addressed in order to give teeth to the requirement that applicants pay service charges:

> Some LAFCOs say that the statute doesn't sufficiently distinguish between fees and service charges. Fees, they say, are fixed amounts based on estimated costs, while service charges recover actual costs. LAFCOs want the Legislature to clarify the statute so that they can charge both fees that are based on estimated costs and service charges that reflect their actual processing costs … The bill allows the LAFCOs to defer any mandatory time limits until

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[36] Assem. Floor, Concurrence in Sen. Amends., Assem. Bill No. 1263 (2007-2008 Reg. Sess.) as amended June 5, 2008, "Comments," ¶ 1 (emphasis added).

the applicant pays the required fee, service charge, or deposit.[37]

Indemnification agreements provide one method of recovering costs that are unknowable at the outset of an application. In light of the above legislative history, it is unreasonable to conclude that the Legislature arbitrarily cut off the ability to recover, through indemnification, actual costs incurred because of a LAFCO decision, including litigation regarding the legality of the LAFCO decision. This is especially so when the cost of litigation may dwarf the cost of the underlying LAFCO proceedings, as is the case here.

D. *Cequel Communications* Supports the Proposition that LAFCOs May Require Applicants to Enter Into Indemnity Agreements.

In *Cequel III Communications I, LLC v. Local Agency Formation Commission of Nevada County* (2007) 149 Cal.App.4th 310 ("*Cequel Communications*"), the Court of Appeal for the Third District upheld a LAFCO's decision to require an indemnity agreement from an applicant when the issue to be decided by the LAFCO was whether a public utility district was authorized to provide broadband data services, including

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[37] Sen. Local Gov. Com., analysis on Assem. Bill No. 1263 (2007-2008 Reg. Sess.) as amended May 29, 2008, "Proposed Law," § I, ¶¶ 1-2 (emphasis added); cf. Gov. Code, § 56383, subd. (e) ("Any mandatory time limits for commission action may be deferred until the applicant pays the required fee, service charge, or deposit.").

cable television, to the citizens within its boundaries.[38] Here, the Superior Court found *Cequel Communications* distinguishable on the ground that the issue presented to the LAFCO in that case was a novel one that was likely to be litigated, whereas here SLO LAFCO required first party indemnity from Respondents as a matter of right.[39] The Superior Court's reasoning was incorrect; this is a distinction without a difference.

The indemnity agreement in *Cequel Communications* "required the District to agree to indemnify LAFCo for all costs of defending LAFCo in any litigation or administrative proceeding brought in connection with the District's application."[40] In rejecting the contention that the LAFCO in that case failed to exercise its statutorily-mandated independent judgment by procuring an indemnity agreement from the applicant and "rubber stamping" the application, the *Cequel Communications* court stated:

> These comments do not demonstrate a refusal or failure of LAFCo to determine the authority of the District to provide the proposed services, but an understanding that the issue had not been previously resolved by the courts and **that the issue was very likely to be litigated if LAFCo**

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[38] *Cequel III Communications I, LLC v. Local Agency Formation Commission of Nevada County* (2007) 149 Cal.App.4th 310, 313 ("*Cequel Communications*").

[39] Superior Court Ruling, *supra*, at pp. 15:9-16:7.

[40] *Cequel Communications*, *supra*, 149 Cal.App.4th at p. 313.

> **proceeded** and ultimately approved the District's application. **The comments express LAFCo's natural concern that a decision by it agreeing with the District's position would result in LAFCo incurring substantial legal costs arising from litigation** brought to challenge the District's authority to provide the services. LAFCo could avoid such costs by requiring the District to obtain a judicial resolution of the issue ahead of LAFCo action on the application **or it could go ahead and decide the application, but require the District to retain the ultimate responsibility for the costs of litigation through the mechanism of an indemnity agreement if the application was approved.** Either way the cost of a legal challenge would be borne in the end by the District's customers. The indemnity agreement, thus, did not shift the costs to the District or abdicate LAFCo's responsibility to independently determine the District's authority.[41]

This case is on-point and the Superior Court was required to follow it as binding precedent. Here, even if this Court accepts the Superior Court's reasoning, the record is clear that the application presented to SLO LAFCO by Respondents also created a strong risk of litigation. This is evidenced by SLO LAFCO's denial of Respondents' first application for annexation in 2005. That earlier litigation resulted in litigation between Respondents, amongst themselves, and resulted in a stipulated judgment that required Respondents to jointly pursue a second application for annexation—the application that led to the litigation underlying this appeal. That later effort resulted in SLO

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[41] *Cequel Communications*, *supra*, 149 Cal.App.4th at pp. 330-331 (emphasis added).

LAFCO incurring approximately half a million dollars in defense costs as a result.[42]

The fact that SLO LAFCO requires the indemnity agreement from all applicants as a matter of policy does not change the fact that, for the parties in this case, at the time the indemnity agreements were executed, it was well understood that there existed a strong likelihood of litigation. The *Cequel Communications* court's analysis acknowledges the practical reality that some of the applications that LAFCOs preside over have the potential to lead to litigation. That indemnification was required as a matter of right rather than after individualized consultation with counsel (as was the case in *Cequel Communications*) is wholly irrelevant with regard to whether mandatory indemnity in the LAFCO context is legal. *Cequel Communications* therefore supports the proposition that LAFCOs may require indemnification from their applicants.

E. In the Alternative, the Superior Court Abused its Discretion By Refusing to Limit Application of the Indemnity Agreements to Simply Avoid an Unconscionable Result.

The Superior Court determined that the indemnity agreements between Respondents and SLO LAFCO were unconscionable. As the Superior Court acknowledged, unconscionability has a procedural and substantive element—both of which must be present for a court to

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[42] *See* Superior Court Ruling, *supra*, pp. 3:1-4:7.

exercise its discretion to refuse to enforce an agreement. However, as discussed above, these requirements cannot be met because state law supports this use of indemnification agreements.[43]

Assuming *arguendo* that the Court affirms that the indemnity agreements are unconscionable, the Superior Court's ruling should nevertheless be reversed. A trial court may "limit the application of any unconscionable clause as to avoid any unconscionable result."[44] The Respondents here failed to prevail not only in their application to LAFCO but also subsequently in several years of protracted litigation. Application of the indemnification provisions would merely result in shifting the costs of litigation onto the Respondents as the unsuccessful parties.

This outcome is identical to that of contractual "prevailing party" fee shifting clauses and is not unconscionable. Under the Code of Civil Procedure, "[e]xcept as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the

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[43] Cf. *Shadoan v. World Savings & Loan Ass'n* (1990) 219 Cal.App.3d 97, 104 (holding the concurrent use of unilateral call and prepayment penalty provisions in loan agreement was not substantively unconscionable because the concurrent use was "legislatively recognized and sanctioned" despite not being expressly authorized by statute).

[44] Civ. Code, § 1670.5, subd. (a).

parties."[45]

With respect to such fee-shifting, the California Supreme Court has ruled out unconscionability:

> Although defendant vigorously contends that it is unconscionable to require a defendant "to finance" a lawsuit against itself, we know of no principle of law that precludes the state from providing for a division or shifting of litigation costs, prior to judgment, to effectuate legitimate public policies.[46]

The use of fee-shifting clauses is commonplace.[47] The safeguard is that a trial court has the discretion to allow all, some, or none of the fees.[48]

Respondents' obligation to reimburse SLO LAFCO therefore would not have been unconscionable. While Civil Code section 1670.5 gives discretion to the trial court in deciding whether to strike an entire

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[45] Code Civ. Proc., § 1021.

[46] *Civil Serv. Employees Ins. Co. v. Superior Court* (1978) 22 Cal.3d 362, 378.

[47] See, e.g., *Syers Properties III, Inc. v. Rankin* (2014) 226 Cal.App.4th 691 (affirming award of prevailing party attorneys' fees provision); *Erickson v. R.E.M. Concepts, Inc.* (2005) 126 Cal.App.4th 1073 (applying prevailing party attorney fees provision to assignee of contractual cross-claims); *Miller v. Provost* (1994) 26 Cal.App.4th 1703 (affirming award of attorney fees based on fee shifting provision despite failure to file a noticed motion); *Lucky Auto Supply v. Turner* (1966) 244 Cal.App.2d 872 (affirming fee award arising out of lease).

[48] *Syers Properties III, Inc.*, *supra*, 226 Cal.App.4th at p. 698.

indemnification agreement or merely address an unconscionable result, the California Supreme Court has constrained such discretion: As noted by the Court in *Armendariz v. Found. Health Psychcare Servs., Inc.*, Section 1670.5 "appears to give a trial court some discretion as to whether to sever or restrict the unconscionable provision or whether to refuse to enforce the entire agreement. But it also appears to contemplate the latter course *only when an agreement is "permeated" by unconscionability*."[49] Here, given the legislative record discussed above, it cannot be said that the indemnity agreements with SLO LAFCO were "permeated" with unconscionability or illegality. Therefore, the Superior Court's refusal to limit its application to an unconscionable result—*not present here*—was an abuse of discretion.

F. If This Court Finds the Indemnification Agreements Unconscionable, it Should Limit its Holding to First Party Cases.

If the Court is inclined to uphold the Superior Court's decision, *Amicus* urges the Court to limit its finding of unenforceability on the ground of unconscionability to first party indemnification situations.[50]

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[49] *Armendariz*, *supra*, 24 Cal.4th at p. 122 (emphasis added).

[50] A first party contractual indemnity claim is one where the indemnitor agrees to indemnify the indemnitee for the conduct of one of the parties to the contract. A third party contractual indemnity claim is when the indemnitor agrees to indemnify the indemnitee for liability to a third party to the agreement. See Civ. Code, § 2772; *Zalkind v. Ceradyne, Inc.* (2011) 194 Cal.App.4th 1010, 1024 (explaining first versus third party claims); *Dollinger DeAnza Associates v. Chicago Title Ins. Co.* (2011) 199

To the eHxtent that there would have been some theoretically-possible unfairness, it would only occur in first party situations, as the Superior Court's opinion demonstrates. The Superior Court found unconscionability by analogizing to *Lennar Homes of California, Inc. v. Stephens*.[51] In that case, the indemnification requirement was imposed on a home buyer and inured to the advantage of the home builder in a matter where both were parties to the contract at issue. As the Superior Court noted, that agreement was found to be unconscionable because "there was not even the theoretical possibility a home buyer could be made whole for any damages arising from fraud committed by Lennar with respect to disclosures."[52] *Lennar* was solely a first party case, whereas the agreements here cover first and third party indemnity claims. The Superior Court stated: "Given *Lennar*'s finding of substantive unconscionability in a narrower indemnity agreement, the Court does not see how the broader [indemnity agreements in this case] are not substantively unconscionable."[53] This reasoning raises the spectre that upholding the Superior Court's decision could strike down all aspects of LAFCO indemnification agreements, rather than just the

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Cal.App.4th 1132, 1154 (explaining in context of insurance contract).

[51] *Lennar Homes of California, Inc. v. Stephens* (2014) 232 Cal.App.4th 673.

[52] *Id.* at p. 693.

[53] Superior Court Ruling, *supra*, p. 19:22-24.

first party component.

However, if this Court were to limit unenforceability to first party agreement situations only, it would squarely address the Superior Court's concern that there would be no possibility of meaningful recovery when a party to a contract indemnifies the other party to the contract, despite the former prevailing in a litigation. In a third party situation, such a theoretical unfairness could not arise since the claim would not be made by one of the parties to the contract. If third party indemnification were not allowed, LAFCOs would have to calculate the risks of a third party lawsuit for every application in advance, estimate the costs, and charge applicants for such costs at the time of filing an application—hardly a desirable outcome. Therefore, to the extent this Court seeks to uphold the Superior Court's ruling, limiting unenforceability to only first party situations is the appropriate result.

III. CONCLUSION

The Legislature has expressed its intent to structure LAFCOs as financially sound, quasi-legislative bodies that exercise their independent judgment, accounting for the needs of the public as a whole. The Legislature has also indicated a clear intent to allow LAFCOs to recover actual costs incurred in deciding the applications presented before it, and if needed, defending its decisions on those applications. It is unreasonable to conclude that the Legislature would empower LAFCOs as independent "watchdogs" over local boundary changes, but constrain their ability to minimize financial exposure by prohibiting them from recovering from their applicants the actual costs they incur in

deciding and defending their decisions on applications in court. The only reasonable harmonization of the language of the Act and its legislative record is that LAFCOs, including SLO LAFCO, have the ability to require indemnity from their applicants.

Given the sum of LAFCOs' expressed and implied powers, and when read in context of the extensive legislative record, it is clear that the Superior Court erred in finding that the indemnity agreements in this matter were unauthorized or that they were unenforceable.

Respectfully submitted.

Dated: August 26, 2020

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CERTIFICATE OF COMPLIANCE

Pursuant to rule 8.204, subdivision (c) of the California rules of court, I hereby certify that this brief contains **7,198** words, including footnotes. In making this certification, I have relied on the word count of the computer program used to prepare the brief.

Dated: August 26, 2020

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT, DIVISION SIX
PROOF OF SERVICE BY MAIL

City of Pismo Beach, et al. v. Special District Risk Management Authority, et al. No. B296968

I, Sonia Schilling, declare:

I am now and at all times herein mentioned have been over the age of eighteen years, employed in Santa Clara County, California, and not a party to the within action or cause; that my business address is 70 West Hedding Street, 9th Floor, San Jose, California 95110-1770. I am readily familiar with the County's business practice for collection and processing of correspondence for mailing with the United States Postal Service. I served a copy of **CALIFORNIA STATE ASSOCIATION OF COUNTIES' APPLICATION FOR LEAVE TO FILE AMICUS CURIAE BRIEF AND PROPOSED AMICUS CURIAE BRIEF IN SUPPORT OF APPELLANTS SAN LUIS OBISPO LOCAL AGENCY FORMATION COMMISSION AND SPECIAL DISTRICT RISK MANAGEMENT AUTHORITY** by placing said copy in an envelope addressed as follows:

Department 2
San Luis Obispo Superior Court
1035 Palm Street
San Luis Obispo, CA 93408

which envelope was then sealed, with postage fully prepaid thereon, on **August 26, 2020**, and placed for collection and mailing at my place of

business following ordinary business practices. Said correspondence will be deposited with the United States Postal Service at San Jose, California, on the above-referenced date in the ordinary course of business; there is a delivery service by United States mail at the place so addressed.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on **August 26, 2020.**

/s/ Sonia Schilling
SONIA SCHILLING

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