

Maximizing Contractual Indemnity Rights: Insuring the Indemnitor's Obligation

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Insurance Coverage Alert
11.25.15

Contracting parties can circumvent the limitations of common law tort doctrines by drafting contracts with language that details the allocation or shifting of the risk of tort loss. Properly composed, "broad form" contractual indemnity provisions can permit an Indemnitee to shift the full range of tort exposure – damages and defense fees and costs – if they have the kind of specificity set forth in Part Two of this series, "Maximizing Contractual Indemnity Rights: Components of an Effective Provision." In most business transactions, however, both the Indemnitee and the Indemnitor want the indemnity obligation to be insured.

Part Three: Insuring the Indemnitor's Obligation

"Insured Contract Coverage"

Although CGL policies do not typically cover an Insured's breaches of contract, *per se*, most insurance policies do cover a policyholder's "incidental contracts" or "insured contracts" under which the policyholder has an obligation to indemnify an Indemnitee. The business contract (as opposed to the insurance policy) should require the Indemnitor to take all steps necessary to have the Indemnitee identified as either a Covered Person, Insured, or Additional Insured on the Indemnitor's applicable insurance policies. There are subtle, but potentially significant legal rights and responsibilities that hinge on whether an entity is a Covered Person, Insured, Additional Insured, or some other classification. Purported Indemnitees may need to consult insurance coverage counsel to ensure that they are seeking the appropriate status from the Indemnitor's CGL insurer.

Scope of Coverage

The business contract should obligate the Indemnitor to obtain insurance that covers the same time period, risk, and scope of conduct as the "broad form" indemnity language requires the Indemnitor to indemnify the Indemnitee. If the Indemnitor contracts to provide the Indemnitee with a scope of protection that is broader than what the Insurer is obligated to provide, the Indemnitor may face significant unexpected expenses.

Declaration Page

Although most contracts require an Indemnitor to provide the Indemnitee a Certificate of Insurance, a far better practice is for the contract to require the Indemnitor to provide the Indemnitee a full and complete copy of the Declarations Page as well as a copy of the insurance policies. Certificates of Insurance do not have the force and effect of the information that is reflected in a Declarations Page.

Limits

The Indemnitee's liability insurance policy governs the limits of insurance coverage afforded to the Indemnitee, regardless of what is required in the contract between the Indemnitee and Indemnitor. For that reason, the parties must ensure that the insurance contract fully aligns with the scope of indemnification that the Indemnitor contractually agreed to provide to the Indemnitee. If the business

contract requires \$1 million in indemnity protection, but the Indemnitor's insurance policy has limits of \$500,000, the Indemnitor faces a half-million dollar uninsured exposure.

Priority of Insurance Coverage

Absent the most unusual circumstances, the Indemnitee will have its own insurance coverage. The priority of coverage between the Indemnitee's own policy and the coverage to which it is afforded under the Indemnitor's insurance policy will be a function of the language of the two policies. Nonetheless, the business contract should specify the intention of the Indemnitor and Indemnitee with respect to priority of coverage.

Conclusion

Typically, contractual indemnity provisions are a function of negotiating leverage. Often, a dominant party can extract a contractual indemnity agreement from a business party with a weaker bargaining position. Even with all the negotiating leverage, however, the contractual indemnity provisions can be hollow and unenforceable unless the contract meets the necessary legal requirements. To make a contractual indemnity do the job for which it is intended, ask your contract-drafter to consult with experienced litigation and insurance counsel.

For further information or questions concerning contractual indemnity, please contact William Kennedy (215.864.6816; kennedyw@whiteandwilliams.com).

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