

Limit transaction risks by using indemnity agreements, insurance

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When entering into a business relationship and/or a transaction, whether it is a construction project or oilfield services agreement, the specter of third-party claims is a reality of business. Therefore, it is important to consider indemnity and insurance options to protect yourself from such claims.

Indemnity. An indemnity agreement is a contract provision in which one party will reimburse the other party for losses incurred because of third-party claims. An example would be a contractor indemnifying a landowner for a claim by one of the contractor's employees injured while performing services on the landowner's property. Generally, indemnity agreements can range from broad-form indemnity, indemnifying for all liability that may arise from the transaction -- including liability for the indemnitee's own fault or negligence -- to limited-form indemnity, indemnifying to the extent of the indemnitor's own fault.

Supporting indemnity agreements with insurance. It has often been said that indemnity obligations are "only worth the paper they are written on." This is especially true when the indemnitor is a small company (such as the contractor mentioned above) with limited financial status to back the obligations placed upon it. In order to provide the indemnitee (the previously mentioned landowner) with assurance that the obligation is meaningful, the parties should consider supporting the contractual indemnification obligation with insurance. Typically, liability insurance policies do not provide coverage for an insured's contractual obligations. However, policies usually contain exceptions for "insured contracts," which are typically defined to cover a contractually assumed indemnification obligation related to the business of the indemnitor (the contractor, for example). As such, typical general liability policies may provide some coverage to support contractual indemnity obligations. If not, endorsements can be added to insurance policies to provide the indemnification obligation coverage.

Additional insured coverage. An additional way to ensure that the indemnitee (the landowner) is not merely relying upon the financial wherewithal of the indemnitor (the contractor) is to require that the indemnitee be named as an additional insured on the liability policies of the indemnitor. Additional insured status makes the indemnitee an insured under the indemnitor's own insurance policies, albeit subject to all of the policy terms and restrictions (including policy limits, deductibles, exclusions, claims notice provisions, etc.) Typically, the additional insured endorsements will relegate coverage to liability arising from the indemnitor's ongoing activities, but optional additional insured endorsements can expand coverage to completed operations following cessation of the indemnitor's operations.

Who and what is covered/certificates of insurance. It is important to specify in the contract requiring additional insured status what specific coverages are required, as well as to ensure that the policy under which the party is added contains those coverages. For instance, in a transaction involving chemical manufacturing or transport, an additional insured would not want the policy to contain a pollution exclusion which would effectively eliminate coverage in event of a spill or emission. It is also important to ensure that the policy has been properly endorsed to include the indemnitee as an additional insured, whether by automatic broad form -- blanket additional endorsements or specific named and scheduled additional insured endorsements.

Reliance is often too heavily placed upon certificates of insurance for additional insureds to confirm their status. The certificate of insurance is issued by the indemnitor's insurance agent and itself does not create coverage or additional insured status; rather, such coverage or status is created only by the terms of the insurance policy/endorsement and/or the contract between the parties requiring additional insured status. Indeed, the Texas Supreme Court has held that failure to separately confirm additional insured status is not excused by reliance on what is stated in the certificates of insurance. Therefore, a party requiring additional insured status should require that, prior to commencement of the transaction, it be provided with not only the certificate of insurance, but also the policy and applicable endorsements itself for review. Bottom line -- the best practice is to go directly to the policy and endorsements up front to ensure that the needed coverages and additional insured status have been provided.

Keep your documents handy. Also too often, after receiving contracts with indemnification and additional insured provisions, along with the related insurance policies and certificates of insurance, once the transaction commences, parties place such documents in a file not to be seen again. These documents can, however, be very valuable for invoking any indemnity and additional insured rights for problems and claims that arise in connection with the transaction. Therefore, special consideration should be given to maintaining the contracts, policies and certificates in an active transaction file. This can be particularly important to ensure timely notice of a claim is made to avoid losing coverage for the claim.

Indemnification, properly supported by insurance, and additional insured status, properly confirmed, can be powerful allies for a party in a transaction which may involve litigation at some point. Taking the proper steps to ensure indemnification and additional insured rights are enforceable and remain in place is the key.

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