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INSURANCE PROVISIONS AND CASUALTY LOSSES

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INSURANCE AND INDEMNITY IN REAL ESTATE TRANSACTIONS

DEFINITIONS

[A] Indemnity

An indemnity is an undertaking by one party to a contract (1) to protect the other party against the occurrence of hurt, loss, or damage and (2) to compensate the other party if the hurt, loss, or damage actually occurs. Insurance professionals refer to indemnities as *hold harmless agreements*, a phrase derived from the usual wording of an indemnity: "hold harmless and defend [indemnitee] against." An indemnity is an *affirmative* obligation in the sense that an indemnity creates a cause of action against the indemnitor.

[B] Waiver

A waiver is an agreement by one party to a contract not to hold the other party responsible as to certain types of liability arising out of the transaction. A waiver is *negative* in nature in the sense that it operates to bar any cause of action on the released matter.

[C] Insurance Defined

An insurance policy is a contract under which a company in the business of insuring against losses undertakes to compensate the party for losses (and sometimes defend a party against claims) arising from specified risks for a stated period of time in consideration for the payment by the insured party of a premium. To risk managers, insurance is a financial transfer of risk, *i.e.*, the payment of a relatively small amount to transfer the risk of a potentially large, uncertain risk.

§ 7.02. INDEMNITY/WAIVER PROVISIONS

[A] Types of Indemnities

Insurance professionals generally describe indemnities as being "limited", "intermediate," or "broad."

[1] Limited

A "*limited*" indemnity clause imposes liability upon the indemnitor only to the extent of the indemnitor's fault or negligence and is the most favorable type of indemnity clause for an indemnitor.

[2] Intermediate

Under an "*intermediate*" indemnity clause, the indemnitor assumes all liability except for the sole negligence of the indemnitee.

[3] Broad

A "*broad*" form indemnity clause imposes the entire risk of loss upon the indemnitor, including the sole negligence of the indemnitee, and is the most favorable type of indemnity clause for an indemnitee.

[4] Split

Statutes such as Chapter 151 of the Texas Insurance Code have produced a new category of indemnity. Texas Insurance Code Section 151.102 provides that a provision in a construction-related contract "is void and unenforceable as against public policy to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault … of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee." Hence, the statute appears to permit only limited indemnities in construction-related parties. However, Texas Insurance Code Section 151.103 expressly excludes "claims for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier." Thus, broad form indemnities are permitted with respect to third party over actions. This dichotomy has led to the drafting of indemnities which are partially broad form and partially limited form.

[B] Reasons for Using Indemnities or Waivers

Both indemnities and waivers shift financial responsibility for losses from the parties that normally would or might be financially responsible for the losses to other parties. Among the reasons for using an indemnity or a waiver are the following:

1. The other party may be in a better position to finance the risk or control the exposure;
2. One party wants to protect and hold down the overall cost of its insurance program or is not insured (*i.e.*, wants the other party's insurance program to answer or, at a minimum, to answer first);
3. The risk is customarily allocated to one of the parties within an industry; or
4. The bargaining position of one party is strong enough to enable it to shift the responsibility for the loss to the other party.

[C] Drafting Considerations

The drafting of indemnities and waivers requires care. At a minimum, the following questions should be considered when drafting an indemnity or waiver:

1. Does the party giving the indemnity or waiver have proper authority or capacity to enter into the indemnity or waiver?
2. What is the creditworthiness of the indemnitor? Is a guaranty, bond or insurance necessary?
3. Should persons other than the contracting parties (*e.g.*, shareholders, directors, officers, agents, and employees) benefit from the indemnity or waiver?
4. Will liabilities arising out of the actions or omissions of persons other than the party giving the

indemnity or waiver (*e.g.*, agents, employees, contractors, subcontractors, subtenants, or invitees) be subject to the indemnity or waiver?

5. Is the recovery against the party giving an indemnity limited as to amount, ability to seek a deficiency judgment, or source of funds to pay damages?

6. What risks are covered by the indemnity or waiver?

7. Is the indemnity or waiver consistent with insurance coverages carried by the parties both as to amounts and risks insured?

8. Is the obligation to defend and the entire cost of defense included in the indemnity or waiver? If so, will the beneficiary of the indemnity or waiver be entitled to separate counsel of the beneficiary's choosing?

9. Are there any types of damages (*e.g.*, punitive, special, exemplary, or consequential) excluded?

10. Are there any limitations as to the time period the indemnity or waiver will be in effect or the time period for making a claim under the indemnity or waiver?

11. If the transaction is governed by Texas law, is compliance with the so-called Fair Notice Doctrine necessary (or in many other states, is compliance with the "Clear and Unequivocal Doctrine" necessary)?

12. Do any anti-indemnity statutes apply?

[D] Potential Pitfalls

[1] Anti-Indemnity Statutes and Law

At least 40 states plus the District of Columbia currently have anti-indemnification statutes, most of which are construction-related. For example:

(i) Texas Insurance Code Section 151.102 imposes major limitations on broad form indemnities in contracts relating to construction:

(ii) Texas Civil Practice & Remedies Code Section 130.001*et seq* voids (a) any provision in a construction contract requiring a contractor to indemnify a registered architect or licensed engineer for liability relating to defects in plans, designs, or specifications prepared, approved, or used by the architect or engineer or negligence of the architect or engineer in the rendition or conduct of professional duties called for or arising out of the construction plans, designs, or specifications that are part of the construction contract, and (b) provisions in a construction contract (other than a contract for a single family or multifamily residence) requiring a registered architect or licensed engineer to indemnify an owner for the owner's own negligence; and

(ii) Texas Civil Practice & Remedies Code Section 130.001*et seq* voids indemnification provisions for an indemnitee's own negligence in contracts involving oil, gas or water wells or mineral mines.

[2] Insurance Limitations

Unless an indemnity covers an insurable risk under the indemnitor's insurance and the contract has been written in a way that the indemnitee can avail itself of the indemnitor's insurance, an agreement to indemnify does not involve insurance and is solely a contractual agreement between the indemnitor and indemnitee. Insurance companies may be unwilling to provide coverage for some indemnified losses (*e.g.*, the sole negligence or strict liability of another party). Even when indemnities are covered by insurance, liability under indemnities is typically unlimited as to amount (all insurance policies have limits) and the scope of contractual indemnities is commonly broader in scope (*e.g.*, "any and all" losses) than any possible insurance program. The insurance industry has always imposed some limitations on coverage under an insurance policy for liability assumed by the named insured under a separate contract (*i.e.*, so-called contractual liability). Even when exceptions are made to the exclusion for liability assumed under separate contract, the assumed liability which is not excluded is restricted to bodily injury and physical injury to tangible property and is subject to policy exclusions and limitations contained elsewhere in the policy. Contractual liability is discussed in **§ 7.05[B][4]**.

[a] Defense of Indemnitee May Not Be Covered or May Erode Policy Limits

Indemnity provisions in contracts generally include an obligation to defend, but the cost of the defense may not be covered by the indemnitor's insurance. Under the current edition of the ISO form of commercial general liability insurance, the insurance company is only required "to defend *the insured* against any 'suit' seeking damages." In order for the indemnitee's defense to be covered the indemnity must be contained in "a contract or an agreement that is an 'insured contract,'" as the term is defined in the policy, and the cost of the defense must have been assumed within the indemnity. *See* discussion at § **7.05[B][4]**.

The ISO form of commercial general liability policy states that "Solely for the purposes of liability assumed in an 'insured contract,' reasonable attorney fees and necessary litigation expenses incurred by or for a party other than an insured are *deemed to be damages because of 'bodily injury' or 'property damage*.'" For example, if the policy has a $1 million each occurrence limit for damages arising out of a single accident and $500,000 is expended to pay indemnitee's "reasonable attorney fees and necessary litigation expenses," only $500,000 will remain to pay damages to the injured party. ISO commercial general liability insurance form, CG 00 01 includes a lengthy list of additional conditions, which, if met, cause the attorneys' fees and costs of the indemnitee to be paid outside the policy limit, *i.e.*, the reasonable attorney fees and necessary litigation expenses incurred by or for the indemnitee will not be deducted from the limits under the policy. If the conditions are met, in the example given above, the entire $1 million each occurrence limit would be

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