

THE INSURANCE SHELL GAME AND INVISIBLE EXCLUSIONS

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I. INTRODUCTION

This paper discusses selected current indemnity and insurance issues that are of importance to real estate lawyers and provides practical advice for their handling. It is intended to be a tool for understanding of those matters addressed and is not intended to be an exhaustive analysis. The comments and observations are not intended to be legal opinions nor the practice of law.

II. INDEMNIFICATION AND ADDITIONAL INSURED STATUS

A. Complementary Risk-Transfer Provisions

Indemnification and additional insured status are complementary risk-transfer provisions providing protection to an upstream party (e.g., Landlord in an Landlord-Tenant relationship). In theory, they have much the same purpose. In reality, they have a different legal basis and operate in a significantly different manner.

Indemnitees and indemnitors negotiate at length over the liabilities being transferred by an indemnification provision, but fail to consider the breadth of coverage provided by additional insured status.

Drafters of contracts go to great lengths to ensure that risk transfers do not exceed permissible levels. They frequently fail, however, to prevent one party from requiring another to provide insurance that will override the negotiated liabilities.

B. How Indemnity Provisions Differ From Imposing Insurance Requirements

1. Relationship

The relationship between indemnitors and indemnitees is a contractual one that does not involve insurance. Insurance may later be purchased to provide funding for some of the liabilities assumed but is not a party to the agreement.

2. Fair Notice

Indemnification is, of course, subject to numerous requirements in order for it to be deemed enforceable and such agreements are frequently challenged. If the express negligence and fair notice rules are not followed (or as is often the case, changed by judicial interpretation), an indemnitee may not be indemnified against its own negligence. An insurance policy covers the insured's negligence and with a properly written additional insured provision may also cover at least a portion of the additional insured's negligence. Additional insured status is not subject to the fair notice rules.

3. No Exclusions, No Recovery Limit, Uninsurability of Risk

The obligation to indemnify is frequently much broader in scope and greater in amount than available insurance coverage, thereby creating a potentially bankrupting exposure for the indemnitor. Insurance does not expand to comply with indemnification requirements. Insurance simply applies its limited scope and amount of coverage to those requirements. Indemnity provisions normally cover many items, e.g., breach of contract, for which insurance is not available at any cost.

When purchased, the scope of contractual liability coverage is for allegations of bodily injury and physical injury to tangible property only. Indemnitors must honor their obligations, even if there is no insurance coverage applicable.

INDEMNITY

A M O		
U N T	Insurance – bodily injury and physical damage to tangible property only	

SCOPE