INDEMNIFICATION AND INSURANCE IN CONTRACTS

Every contract creates elements of risk for the parties to the agreement. In general, there are four ways of dealing with the risks created by a contract. These include insuring against the risk, ignoring (self-insuring) the risk, requiring that the other party insure against the risk (Insurance/Additional Insured Status), and transferring the risk to the other party (Indemnification Agreement).

1) Insuring against the risk created by entry into a contract is not always feasible or possible, as insurance agreements often exclude contractual liability and /or do not allow a party to insure against acts or omissions of another party.
2) Ignoring the risk created by a contract essentially requires a party to assume all of the risk in the event of a loss or liability. This can result in unanticipated financial exposure and can result in reputational risk.
3) Requiring the other party to the contract to procure insurance and provide for additional insured status under the insurance agreement is often an effective way to control the risk inherent in a contract. The agreement must spell out what types of insurance are required to be purchased by the other party, the applicable limits of coverage, and should provide that the party to the contract is an "additional insured." This means that in the event of a loss, even though the other party purchased the insurance, the contracting party also enjoys the status of a named insured under the insurance agreement and can claim the benefits of first-party status. Requiring purchase of insurance by the other party is an effective risk transfer mechanism because there are few limitations on what the parties can require as far as coverage and limits and, as an additional insured, the contracting party can invoke coverage even if the loss is solely caused by the negligence of the contracting party. The limitation on this type of risk transfer is that the contracting party must monitor the procured insurance to make sure it does not lapse and that it is not cancelled. Requiring a certificate of insurance is always a best practice.
4) Indemnification (also referred to as "hold harmless") clauses require the other party to a contract to step in and pay for any liability for loss to a third party and to pay for defense costs in the event of a lawsuit over the substance of the agreement. These types of clauses in contracts must be very precise. Courts will strictly construe indemnification clauses. For example, an indemnification clause may be nullified by a court if it provides that the indemnifying party will pay even when the loss is caused by the "sole negligence" of the indemnified party. Additionally, there may be statutes that prohibit indemnification in certain instances. For example, U.C.A. §13-8-1 specifically provides that indemnification agreements between a contractor and a sub-contractor are void.

To control risk created by a contract it is important to recognize what risks are created by the contract and which of the methods of risk control and/or transfer are appropriate for the circumstances. Requiring both procurement by the other party of insurance to cover the risk and requiring the other party to indemnify for the risk is always preferable. It is important, where possible, to use standard terms and conditions created for various types of state contracts. If you have concerns about the insurance and/or indemnification terms of a contract, please be sure to consult legal counsel.