



FIFTH CIRCUIT DECISION PROVIDES LESSONS FOR DRAFTING INDEMNITY AND INSURANCE CLAUSES

Travelers Lloyds Ins. Co. v. Pacific Employers Ins. Co., No. 07-20157 (5th Cir. April 6, 2010)

Upon learning that the indemnity (or “hold harmless”) provision in her ground lease was unenforceable for failing to meet Texas’s rigid “express-negligence” rule, a landlord client sighed, “whenever I see the words, ‘indemnification’ or ‘insurance,’ my eyes glaze over.” We frequently hear clients say that in contract negotiations, they, or their attorneys, spend more than half their time negotiating the indemnity and insurance sections, and they often still get it wrong. What’s going on with Texas indemnity law?

This recent Fifth Circuit case provides a useful tutorial for landlords and others seeking contractual indemnification and additional-insured coverage because it shows: (1) the different criteria for enforcing indemnification and insurance-procurement clauses; (2) why the indemnity is unenforceable, but the insurance clause is valid; and (3) how the “other-insurance” clauses in both parties’ insurance policies may require the additional-insured’s insurer to contribute to the defense and indemnity of a lawsuit, a result that is potentially troublesome. This is a landlord/tenant case, but the insurance and indemnity issues apply with equal force to any other type of commercial contract.

INSURANCE AND INDEMNITY CLAUSES. The lease between commercial tenant Best Buy and a landlord shopping center, which is typical in the real estate world, includes two separate clauses:

Tenant’s Insurance. Tenant shall obtain and keep in force at Tenant’s expenses [sic] . . . commercial general liability insurance [specified amounts omitted]. Said insurance shall name Tenant as named insured and Landlord as additional insured

Tenant shall indemnify and hold Landlord harmless from and against any and all claims, actions, demands, liens, costs, damages, expenses, and liabilities whatsoever including, but not limited to, attorneys fees and court costs arising out of any claims of any person or persons on account of: (a) any occurrence in, on or about the Premises . . . (b) the negligence or willful misconduct of Tenant . . . in, on or about the Premises.

A Best Buy patron was injured after slipping from the curb just outside the store. A suit was brought against both Tenant and Landlord, whose respective insurers were duly notified. Tenant’s insurer refused to defend or indemnify Landlord, arguing that, because the indemnity was unenforceable, it was relieved of any duty to defend Landlord as an additional-insured. Landlord’s insurer seems to concede that the indemnity is unenforceable, so let’s start there.

Even though Tenant promised to hold Landlord harmless for all claims anywhere and everywhere, Tenant failed to say the magic words, “even if Landlord is negligent.” Texas’s “express-negligence” rule requires this or some similar express stipulation in the indemnity clause. **TENANT’S AGREEMENT TO INDEMNIFY THE LANDLORD FOR THE TENANT’S NEGLIGENCE HAS NO LEGAL EFFECT.**

We use all-caps to illustrate the second requirement under Texas law that the clause must stand out in boldface, all-cap, or other conspicuous lettering. So, Travelers knew there was no point in arguing that the indemnity was enforceable, because it failed to meet both the express-negligence and the conspicuousness requirements.

Lesson One: Everyone, check your indemnities.

Despite the unenforceable indemnity, the court held that Landlord was covered as an additional-insured under Tenant's policy.

Lesson Two: The insurance-procurement clause stands on its own and will trigger coverage even if the indemnity fails. Courts are instructed to ignore the indemnity clause when construing the insurance clause. As long as the lease requires Tenant to add Landlord as an additional insured to Tenant's liability insurance, Tenant's insurer should have to defend Landlord, if Tenant's policy contains an endorsement that adds Landlord by name, or, more frequently, adds anyone that Tenant has agreed to add as an insured in a written contract.

OTHER-INSURANCE CLAUSES. Tenant's insurer next argues that Travelers at least has to share the cost of defense and indemnity by virtue of the "other-insurance" clause, a fixture in just about every liability policy on the market. Here Tenant's policy provides:

If other valid and collectible insurance is available to the insured for a loss we cover under this policy, **this insurance is excess** over that other insurance, unless that insurance is written specifically to apply in excess of the Limits shown in the Declarations. (Emphasis added)

Landlord's policy provides:

If other valid and collectible insurance is available to the insured for a loss we cover under Coverage A or B of this Coverage Part, our obligations are limited as follows: (a) This insurance is primary except when (b) applies. . . . (b) **This insurance is excess** over any of the other insurance . . . that is valid and collectible insurance available to you if you [Landlord] are added as an additional insured under any other policy. (Emphasis added)

Not surprisingly, both insurers claimed excess status over the other. The lower court favored Landlord's insurer, holding that Landlord's additional-insured status met the exception in Tenant's policy that the insurance be written specifically in excess of the Tenant's policy. The Fifth Circuit, however, disagreed.

The appellate court reasoned that the phrase in Tenant's policy, "unless that insurance is written specifically to apply in excess of the Limits shown in the Declarations" applies only when the Tenant procures excess insurance that explicitly schedules Tenant's policy as underlying the excess policy. Therefore, when both policies purport to be excess, the court ruled that both must share coverage on a primary basis. So, Landlord's insurer must contribute to the defense and the settlement on an "equal-shares" pro-rata basis.

We mentioned earlier that this holding was “potentially troublesome.” The lease required Tenant to purchase insurance that named Landlord as an additional insured, with no other specifications or restrictions. It is advisable for those seeking additional-insured status to draft the insurance clause to also require that the named insured’s policy be “**primary and non-contributory**” with the additional-insured’s insurance. How would the court rule if that language was included in this lease? We are not sure.

If the lease required Tenant’s insurer to be primary and non-contributory, but the policy did not mirror the provision, the court, arguably, would not rewrite the policy, and the result might be the same. Landlord would probably have a breach-of-contract claim against Tenant for failing to procure a policy that complies with the insurance clause in the lease, but that would likely give cold comfort to Landlord. What can Landlord do to avoid this problem?

Lesson Three: Additional-insureds should insist on receiving a copy of the named insured’s additional-insured endorsement soon after execution of the lease or contract. Do not rely on a certificate of insurance, which is not binding on the insurer. We know this can be difficult, especially with a large operation with hundreds of leases. But we know of no other way to verify that the other’s policy matches the contract that cost so much time and attention in drafting. Because the court will look only at the Tenant’s policy to determine coverage, Landlord should at least review the pertinent terms of that policy to make sure the terms match the lease.

Better to add a drop or two of wash to those glazed eyes than lose thousands (or millions) in coverage.

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