

Indemnity Provisions For Managed Properties: Is Insurance the Answer?

by Dan Ojserkis
Fox Rothschild LLP



When entering into a fee-based property management arrangement, it's easy to focus your attention on basic business issues like the manager's compensation and the length of the agreement. Once the owner and the manager hammer out the length of the contract and the amount of management fee, there is a natural tendency to sit back and "let the lawyers handle the boilerplate."

That's totally understandable, but it's not a good idea. Focusing only on the basic business issues puts you at risk of overlooking another important issue: liability for third-party claims.

No one starts a management relationship with plans to be sued. However, owner and manager should expect that any claim made or threatened by a third party will name them both. Most management agreements allocate such liability between owner and manager by means of two related provisions: indemnity and insurance.

Since your liability to a third party can easily exceed the income you hope to earn from the property, you ignore these provisions at your peril. Resist the temptation to simply rely on age-old boilerplate indemnity and insurance provisions. A little focus on them at the start can help you avoid — or at least minimize — your liability in the future.

THE PROVISIONS

Under an indemnity provision, one party (the "indemnifying" party) agrees to be responsible for a certain type of claim and to protect the other (the "indemnified" party) from liability for that type of claim. Under an insurance provision, the parties agree on who must obtain specific types and amounts of insurance against particular

claims, and who will pay the cost for that insurance. The connection between the two provisions is best illustrated by what happens in practice. If you learn that a claim against you may not be fully covered by insurance, your next step (or your attorney's) will likely be to turn to the indemnity provisions of your management agreement, to see which party is assigned liability for the claim (and the expense of defending it). Better to deal with the potential liability, as much as possible, at the beginning.

Indemnity provisions can be difficult to negotiate. Owners often question why they should bear liability if the manager is being paid to operate the property. In response, Managers argue that they are operating only on behalf of the owner, and that such claims should be the owner's responsibility because they are an expected cost of the multifamily rental business, regardless of who operates the property. In the end, getting to a resolution may require smart insurance planning as much as tough negotiating.

Certainly a party will be less concerned about taking on the indemnity obligation if the third-party claim is covered by an insurance policy. That's the easy part. However, insurance coverage is seldom perfect.

Time and again we find in our practice that not every claim is fully covered, and not every insurance policy or rider is cost-effective. Coverage can be insufficient because of unrealistic coverage limits, substantial "self-insurance" or high deductibles, and can be disputed or denied altogether because of (sometimes unexpected) policy exclusions for lead-based paint, mold or other "pollutants;" certain weather events; employment law claims; and willful or criminal acts.

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If such unprotected liability is not shifted away by an indemnity provision, it can saddle you with substantial out-of-pocket expenses, not just for the claim itself but also for the legal costs of defending yourself and any party you have indemnified.

GUIDANCE

What to do? Plan ahead, using the help of your insurance professional and your attorney. As a general matter you should pay careful attention to your own insurance coverages, to any insurance policies obtained by others pursuant to a specific management agreement, and to the indemnity provisions of the management agreement.

Here are some suggestions:

TALK TO YOUR INSURANCE PROFESSIONAL

- Whether owner or manager, you should periodically consult with your insurance professional about existing coverages. Many insurance professionals offer “insurance audits”. Take advantage of these opportunities, and request them if they are not offered to you. Identify and discuss exclusions and other gaps in coverage.

- Develop a sense of the best coverage available to you. What kind of coverage could you obtain for your next managed property? What coverage gaps would it still have? Are there “fixes” available on cost-effective terms?

- In any management arrangement in which the other party obtains insurance, insist on seeing the policy (not just a certificate) as early as possible, and review that in detail with your insurance professional. If possible do this before signing the management agreement, since the policy provisions can impact your own insurance needs, and your negotiation of the indemnity provisions.

- Explore having a “backup” liability insurance policy in addition to the property-level liability policy. If you already have one, review it as suggested above.

TALK TO YOUR ATTORNEY

- Discuss the issue of indemnities and liability under your management agreements with your attorney. Your lawyer

should develop a clear understanding of any insurance coverage gaps you have identified, and of what type or level of risk you are willing to undertake.

- If you use your own form management agreement, have your attorney review the insurance provisions to make sure they are clear and specific regarding required coverages, and the indemnity provisions to ensure that liability is allocated as you would want.

- Armed with your new appreciation of any gaps in the insurance coverage provided, have your attorney revise your form management agreement and negotiate any other management agreements to obtain indemnities where possible against any claims that fall within coverage gaps.

- Consider negotiating for the right to replace insurance obtained by the other party with insurance that you obtain, if at any time you determine that there are deficiencies in the coverage provided.

- Consider using a single purpose entity, such as a limited liability company.

No management agreement is likely to remove every possible liability, just as no insurance policy is likely to cover every possible claim. However, if you are sensitive to the issues described above, and work cooperatively with your insurance professional and your attorney to address them, you can lessen the risk of an unexpected and unprotected claim in future operations. ■

Daniel Ojserkis is a partner in the Real Estate and Corporate Departments of Fox Rothschild LLP. Based in Atlantic City, Dan concentrates his practice in the affordable housing and casino gaming industries, navigating profit-driven businesses through regulations based on public policy. He represents developers, owners, property managers, investors and lenders in the affordable housing market.