

Designing Indemnity Clauses That Activate Insurance Coverage

The clause you overlook could determine whether your insurance responds or leaves you exposed.

When losses occur, recovery does not start in the courtroom. It starts with the contract you signed. Whether your organization is the indemnitor or the indemnitee, the language of that clause determines who ultimately bears the cost. Yet, indemnities are often treated as boilerplate, copied from templates without a thorough understanding of how they interact with insurance coverage.

The result is that many organizations discover too late that their indemnity obligations fall into a coverage gap. This happens either because the clause was not drafted to fit within the policy's "insured contract" definition or because it transferred liability in a way insurers will not honor.

Do Not Blindly Sign the Indemnity

Indemnity clauses are not harmless formalities. They are risk transfer mechanisms, and signing them without understanding their implications can transform another party's negligence into your uninsured liability.

Insurers underwrite and price risk based on your conduct, not someone else's. Your liability policy is intended to cover losses arising from your own negligence and to hold others harmless for your acts or omissions. It is not intended to assume responsibility for the errors, omissions, or negligence of third parties.

When you sign an indemnity that goes beyond that intent, for example, agreeing to indemnify a counterparty for losses they cause, you may be taking on obligations your policy was never designed to insure. Once that line is crossed, your insurer can justifiably deny coverage under the contractual liability exclusion.

In other words, the indemnity might survive the contract, but the insurance backing it will not.

Indemnities Without Insurance Are Just Promises

An indemnity transfers financial responsibility, but it does not guarantee recovery. If your counterparty's insurer denies the claim, or if your own policy excludes the assumed obligation, the indemnity becomes only as strong as the indemnitor's financial capacity.

This misalignment is common. In complex vendor and customer relationships, indemnities are routinely negotiated without reference to the insurance program that must respond to them. Clauses intended to allocate risk often end up diluting coverage instead of strengthening it.

Why Insurers Care

Insurers have grown increasingly attentive to how their insureds assume or grant indemnities. Historically, most policies absorbed these obligations through the "insured contract" carve-back to the contractual liability exclusion. Today, underwriters scrutinize these clauses closely, especially in technology, AI, and data-driven environments.

Poorly drafted indemnities can:

1. Extend your assumption of another party's negligence beyond the policy's insured contract definition
2. Trigger denials under the contractual liability exclusion
3. Undermine your defense rights when both parties' insurers dispute who owes what

Well-structured indemnities, by contrast, align with insurance policy wording and ensure that both parties' coverage activates as intended.

Preserve the Link Between Contract and Coverage

To make indemnities insurable and enforceable, every contract should be drafted with these guiding principles in mind:

1. Align Definitions

Mirror the “insured contract” definition in your liability policy. If your indemnity extends beyond that scope, your coverage may not follow.

2. Limit to Your Own Acts or Omissions

Structure indemnities to cover your negligence or breach, not your counterparty’s. Broad catch-all language that assumes another party’s fault can void coverage.

3. Preserve Liability Caps and Carve Outs

Limit indemnities to loss categories insurers recognize, such as bodily injury, property damage, or financial loss arising from negligence, and ensure they sit outside general contract caps.

4. Tie Indemnities to Insurance Evidence

Require certificates, endorsements, and notice provisions. These convert a contractual promise into a recoverable asset.

5. Preserve the Indemnitor’s Right to Direct the Defense

Ensure the indemnitor and its insurer retain the right to control the defense and settlement of claims that fall within the indemnity. Without this right, the insurer may deny coverage on the basis that defense obligations were assumed or settlements agreed upon without its consent.

6. Coordinate with Counsel and Broker

Before execution, review the clause against your current policy wording. A short alignment exercise can prevent a multimillion-dollar uninsured exposure.

Conclusion: From Legal Language to Financial Recovery

Indemnities are not legal formalities; they are financial instruments. A well-drafted clause that aligns with your policy’s insured contract wording transforms a promise into an insured obligation. A poorly drafted one does the opposite. It shifts an uninsured liability back to your balance sheet.

For technology, SaaS, and data-centric businesses, this alignment is critical. Contracts must reflect not only legal fairness but also insurability, ensuring your insurance program responds as intended when disputes arise.

Indemnities only protect you when they activate insurance. Before signing, confirm that every clause aligns with your policy’s insured contract definition and preserves the triggers your insurer expects to see.

Unsure whether your insurance or your counterparty’s will activate when it matters?

Contact our team for a free review today.

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