

Risk Transfer and Contract Strategies



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What is risk transfer?

Risk transfer is a risk management and control strategy involving the contractual shifting of a risk from one party to another.

How is risk transfer accomplished?

Risk transfer is typically accomplished through contracts and insurance policies. An example would be the relationship established in a public works contract, where a political subdivision is entering into a contract with a contractor to construct a public building. In that relationship, the political subdivision and contractor should explicitly detail which entity assumes various risks through a written contract and insurance requirements.

Contract

A contract is a written or verbal agreement intended to be enforceable by law. A contract must contain consideration - the exchange of something of value by both sides - to be valid.

Insurance

Insurance is a voluntary arrangement between two parties—an insurance company and a policyholder—where the insurance company assumes defined financial risks for the policyholder.

The starting point for any risk transfer when dealing with a third party is the contract establishing the parties' responsibilities. In that contract, along with the various terms and conditions, some of which may be required by various local, state, and federal laws, you should concentrate on two provisions: (1) a provision on defense, indemnification, and hold harmless, and (2) a provision on insurance.



CONTRACT

Defense, Indemnification, and Hold Harmless Provision

The first provision should state that the contractor shall defend, indemnify, and hold harmless your entity from any and all claims related to the performance of the contract. It is important to get all three requirements. The first requirement, defense, requires the contractor to pay for and assume the legal defense of your entity for any claims or suits arising from the performance of the contract. The second requirement, indemnification, requires the contractor to pay on your entity's behalf any and all damages or losses arising from the performance of the contract. The third requirement, hold harmless, requires the contractor to waive or release any claims it may have against your entity related to the performance of the contract.

Insurance Provision

The second provision should require the contractor to have adequate insurance to handle its defense and indemnification obligations under the contract, along with any other related risks. It should also require the contractor to have your entity named as additional insured on any of its relevant insurance policies. Further, your entity should require the contractor to provide certificates of insurance annually, and any other time there is an insurance change, to you to ensure ongoing insurance coverage.

Insurance

Insurance should provide extra layers of protection for your entity. First, as required in the contract, it will make the contractor maintain appropriate insurance to cover all of its risks and all the risks it is assuming for your entity through the defense, indemnification, and hold harmless contract provision. Your entity should request and receive a certificate of insurance evidencing the appropriate coverage(s). Second, your entity should be named as an additional insured under the contractor's insurance policy.

Additional Insured Status

Having additional insured status on a contractor's insurance policy gives your entity rights under the insurance policy. Additional insureds typically have narrower coverage than the insured contractor; however, your entity should be covered for the liability related to the underlying contract. The insurance policy should be endorsed to add your entity to the insurance coverage. Your entity should request and receive copies of the insurance policy and an additional insured endorsement, along with any certificates of insurance.

Certificate of Insurance

A certificate of insurance is a form issued by an insurance company listing the coverage(s), expiration date(s), and limits of an insured's coverage(s) on a particular date in time. It will also include policy number(s), policy limits, insurer name, agent, coverage period, and the insured's name. It may also describe any applicable endorsements. It is important to note, a certificate of insurance does not alter the terms or conditions of the actual insurance policy(ies), nor does it transfer any risk. It is a snapshot of the coverage in existence on the date it was generated.

TIPS and STRATEGIES

Defense, Indemnification, and Hold Harmless Contract Provision

- State specifically in the contract whether you want the contractor to have these obligations when the contractor is wholly at fault or partially at fault.
- Specifically describe in the contract provision the risks that are transferred, i.e. bodily injury, property damage, defense of claims, payment of damages, etc.
- Be certain to include a contract provision stating the defense, indemnification, and hold harmless obligations survive termination of the contract, the obligations will not be limited by comparative negligence laws, and the obligations are independent of the contractor's insurance.

Insurance Contract Provision

- Require, at a minimum, limits and coverage(s) to cover the contractor's defense, indemnification, and hold harmless obligations, along with any other risks appropriate for the scope of the contract. Relevant coverages are typically commercial general liability, property, workers' compensation, umbrella, and for construction contracts often a builder's risk policy. If a contractor is a non-subscriber to workers' compensation coverage, require that they are still responsible for any of their employees' injuries while working on performance of the contract.
- Mandate the contractor to require any subcontractors to have appropriate insurance coverage.
- Require the contractor to agree that its insurance obligations do not reduce or cap the liability it assumed in the defense, indemnification, and hold harmless obligations.
- Require the contractor's insurance to be primary and non-contributory with any other coverage.
- Require the insurer have an A.B. Best Rating of A-VII or equivalent.
- Require your entity be named an additional insured and properly endorsed to the contractor's insurance policy.
- Require appropriate insurance be maintained at all times; failure to do so could result in contract termination.
- Require a waiver of subrogation in favor of your entity in the contract and the contractor's insurance policy.

Additional Insured Status

- May provide coverage even if a court invalidates your hold harmless agreement.
- Will give your entity certain rights under the contractor's insurance policy, particularly with defense coverage.
- Discourages the contractor's insurance company from pursuing you when a loss is caused by your acts or omissions.
- Offers more protection than a certificate of insurance. A certificate of insurance is not enough to transfer risk.
- Be certain to get copies of the insurance policy and additional insured endorsement naming your entity.

Certificate of Insurance

- Be certain to request certificate(s) of insurance and confirm it/they reflect(s) the requirements in the contract.
- Develop a system to periodically review and request certificates of insurance, especially for multi-year contracts.
- Enforce the contract requirements for types of coverage and limits if lapses are found in the certificates of insurance.