

Contractual Risk Transfer

Risk Control from Liberty Mutual Insurance



Highlights:

- Common applications of contractual risk transfer
- Hold harmless agreements
- Indemnity and defense
- Contract management process: Make sure you are the last to sign

This reference is an overview, intended to be used as a starting point for discussions with your own contract counsel.

Contractual risk transfer, as the term suggests, is the transfer of risk from one entity to another via a contract. In general, a contract is a voluntary agreement for a legal purpose between two or more competent parties for something of value being exchanged. Businesses commonly take on, or transfer liabilities through a “hold harmless” or “indemnity” agreement. Hold harmless agreements are very common. We have all signed them at one time or another; whether leasing a property, participating in a sporting event, loading software or giving permission for children to go on a field trip. We most often encounter contractual risk transfer in an owner/contractor to subcontractor relationship where the owner or general contractor requires the subcontractor to sign a contract containing a hold harmless or indemnification agreement. As a result of the agreement, the sub assumes legal responsibility for claims that may arise due to negligence or fall within the agreements terms. These liability transfers are also common in contracts for property and equipment leases, sales and service contracts, and maintenance contracts.

The commercial general liability (CGL) policy provides coverage for liability assumed under certain contracts if the liability meets the other terms and conditions of the policy. Coverage afforded by CGL policies can vary, and therefore, must be examined to be certain what is or is not covered. Whether the CGL policy responds or not in the event of a contractually transferred loss, often depends on the terms of a contract between involved parties that calls for one party to “hold harmless,” “indemnify and defend,” list the other as an “additional insured,” and/or maintain particular insurance coverages.

Let’s look at each of these conditions individually.

Hold Harmless Agreements

These are waivers and liability releases that are often a contract between a service provider and a participant that release the service provider of any liability for loss suffered by the participant as a result of “ordinary negligence” by the service provider, its employees or agents. Losses can include loss of income, bodily injury or property damage.

The degree of enforceability for hold harmless agreements varies considerably by jurisdiction, depending on case history, state statutes, the application and the legal status of involved parties (i.e. minors vs. adults, etc.).

To help ensure the enforceability of a hold harmless agreement, it is critical that they meet this criterion:

- Stand-alone documents
- Clear and unambiguous
- Specifically state that by signing the participant relinquishes rights of recovery for the service providers “negligence”
- Explicitly define the “risk inherent” to the participant

Indemnity and Defense

These provisions are common to many business contracts. Such provisions assert that the indemnitor (the party providing indemnification or paying the loss) will indemnify and defend the indemnitee (the party for whom the loss is being paid) for any claims or losses that arise as a result of their relations.

Broad form indemnity provisions transfer liability regardless of fault, while other, more limited indemnity provisions, transfer liability according to each party's contribution or fault for a loss.

Additional Insured Status

This is often also sought by an indemnitee in most business contracts. An indemnitor's CGL policy may respond as if the indemnitee were an insured depending on a number of factors, including the facts of each claim, the terms of the applicable contracts, the provisions of the policy and the additional insured endorsement and the law of the applicable jurisdiction. Some additional insured endorsements only respond when the named insured is alleged to be negligent. Some only apply to ongoing operations and not to products/completed operations. Some may only apply on an excess basis. Therefore, it is important to review the contract and the additional insured endorsements and to get input from your contract counsel and insurance advisors.

Insurance Specifications

Often required by contracts and basically detail what types and minimum limits of coverage each party must maintain. Although this reference focuses solely on commercial general liability and related insurance vehicles, most business contracts also require parties to obtain and demonstrate that other common business insurance policies, such as workers compensation, auto liability and an umbrella policy are in force.

Businesses enter into hundreds or even thousands of contracts annually. All standard contract forms that are commonly utilized and any major, non-standard contract should be scrutinized by legal counsel, experienced in contract law of the applicable jurisdiction, before signing. This review will uncover any jurisdictionally inapplicable or unacceptable wording, as well as any ambiguities in the wording of the contract. Depending on the type of contract, it is also prudent to consult with an expert in the specific field covered by the contract. The contract review should include not only the provisions of the contract but also a discussion of worst case scenarios so management can be prepared if something goes wrong. A worst case scenario analysis can also uncover situations where minor changes in wording can have a dramatic impact on potential losses.

Contract Management Process

A contracts management process is: The process of managing contract creation, negotiation and execution to optimize desirable outcomes while minimizing and equitably apportioning risk and loss between involved parties.

The following are some of the more important elements of a process to help affect contractual risk transfer with business relations. Always consult with counsel having expertise in contract law for specific guidance.

- Set a formal company policy to ensure all business relationships require written contracts, that contracts include select risk transfer provisions, and that contracted parties can demonstrate satisfaction of minimum insurance specifications.
- Establish procedures for purchasing, leasing, renting and contracting. The procedures should include specifying who has authorization to enter into and sign contracts.

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- Assign responsibility and accountability for central review and approval of all contracts which the company seeks to engage. Those responsible for managing contracts should serve as the critical control point for managing contract risks.
 - Establish contractual standards and insurance requirements for those with whom you contract, commensurate with the risks involved. Where possible, standard pre-approved, company contract forms should be utilized, in replacement of contract forms asserted by the contracted party. In some instances it may make sense to simply craft a standard “addendum” that may be appended to any contract asserted by the contracted party. (See the checklist following this reference note highlights common contractual risk transfer terms your legal counsel might recommend for inclusion in your contracts and leases.)
 - Avoid ambiguous language in all contracts; plain wording is best.
 - Institute a review process for all contracts that transfer or affect the transfer of liability. Reviews should be required for all new contracts and upon expiration and renewal for all existing contracts. Company policy should prohibit anyone from entering into a contract without it first being approved by the central authority over all contracts.
 - Provide for timely acquisition and maintenance of up to date certificates of insurance (COI), critical endorsements and/or actual insurance policies, from all contracted parties, with a review process that verifies coverage, limits, and any other stipulations required by your contract, such as additional insured status.
 - For special company charity events or volunteer sponsorship events, verify that your company and subsidiaries will be held harmless and that the organization has a duty to defend your company.
 - If work is being performed for you on your premises, be sure to include safety requirements in the contract such as a mandatory contractor safety orientation, a worksite specific safety plan, work site inspection rights, and ability to stop the work for non-conformance with contractual safety requirements.
 - For lease provisions, look at who is responsible for which portions of the leased property, especially with regard to maintenance, repair and housekeeping functions, loss control, damages, the valuation of the property, subrogation waivers, liability limits and breach of lease conditions. See Liberty Mutual Insurance reference note *Commercial Property Leases: Risk Management Terms*, for additional guidance.
 - Maintain reliable and consistent recordkeeping and tracking systems for all contracts and evidence of demand execution (e.g., Certificates of Insurance, etc.).
 - Self-audit or hire an impartial third party to periodically audit executed relationships to confirm contracts exist and your company is consistently securing and retaining sufficient evidence confirming demanded risk transfer and insurance provisions were executed and protections are afforded.
 - Avoid engaging in contracts with any party that requires your business to indemnify or hold harmless others for losses arising from the other parties’ actions, negligence or omissions.
 - Ensure that you are the last to sign contractual agreements.
 - Train employees who may routinely sign small purchase orders or service agreements to note terms and conditions that deviate significantly from those agreed to in the original contract, and forward such documents internally to the central authority over company contracts.
 - Treat every contract as serious business.

Common Contractual Risk Transfer and Insurance Provisions

1. Contract indicates agreement between the parties, clearly defines the subject matter, specifies terms of remuneration, and is authorized by both parties.

(**Note:** Legal opinion may be necessary to determine if a contract is legally binding in a given jurisdiction.)

☐ Yes ☐ Partial ☐ No ☐ NA

2. Contract appears to include a hold harmless, indemnity and defense demand in favor of the hiring party, protecting them (and all for whom the hiring party owes such protection). This provision attempts to transfer all reasonably foreseeable risk and loss arising from the contracted subject matter. The demand should apply to the extent allowable by law and survive the completion of the work and termination of the contract to ensure transfer of completed operations loss risk.

(**Note:** There may be some jurisdictional differences so legal opinion may be necessary to confirm enforceability and effectiveness. Many jurisdictions prohibit indemnification by the hired party for the hiring party's sole negligence.)

☐ Yes ☐ Partial ☐ No ☐ NA

3. Contract requires appropriate insurance coverage be secured and maintained by the hired party based on the foreseeable risks inherent to the contracted subject matter, typically including commercial general liability (CGL), workers compensation, commercial automobile, umbrella, etc. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

4. Contract requires the hired party provide the hiring party with evidence of effective insurance coverage before exercising the contract terms. Evidence may be in the form of "certificate holder" status on a COI as long as copies of any policy endorsements required by contract are also made available. Preference is for the hiring party to demand, secure and review actual electronic copies of insurance policies, in their entirety. Hiring party retains these records on file. If subject is in the New York jurisdiction, the hiring party consistently demands and secures electronic copies of any hired party's insurance policies.

☐ Yes ☐ Partial ☐ No ☐ NA

5. Contract requires the contracted party to provide "additional insured" (or Loss Payee) status on all insurance policies naming you and all to whom you owe such protection. To ensure protection for all to whom you owe such protection, consider demanding "additional insured" status be afforded by way of a scheduled endorsement or CG 20 38 04 13 (or equivalent). Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

6. Contract specifies additional insured status to be afforded on a primary and non-contributory basis. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

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7. If the subject includes products/completed operations risk, the contract requires the hired party to carry products/completed operations coverage and list the hiring party as an additional insured for this coverage part where possible, throughout the duration of the contract, or at a minimum period not less than four years, through the appropriate jurisdiction's statute of repose. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

8. Contract requires the CGL insurance policy be primary, and at minimum, covers third party bodily injury, property damage, and personal and advertising injury, for premises, operations, completed operations, products, and contractual liability. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

9. Contract specifies "minimum limits" (occurrence, personal and advertising injury, per project general aggregate and products-completed operations aggregate) of CGL coverage that the hired party must maintain and the "minimum limits" are equal to or greater than the limits of CGL coverage held by the hiring party. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

10. Contract includes a waiver of recovery rights provision in the hiring party's favor which also requires that the hired party's insurance policies include waiver of subrogation endorsements. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

11. Contract requires the hired party to impose the same contractual risk transfer and insurance obligations upon any sub-tier hired parties.

☐ Yes ☐ Partial ☐ No ☐ NA

12. Contract specifies that the hired party's umbrella insurance is exhausted first before the hiring party's primary GL coverage. This demand will often require a special endorsement to an Umbrella insurance policy. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

13. Contract specifies the general aggregate for the hired party's CGL insurance policy is to be made available on a "per project or location basis," and prohibits "wasting" (or "defense within limits") policies. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

14. Contract requires “additional insured” status be afforded by way of CGL endorsement equivalent to ISOs 10 01 forms that include an “arising out of your ongoing operations” trigger, or earlier versions that provide even broader coverage, rather than the current ISO 04 13 forms with the trigger “caused in whole or part”. Verify by reviewing a current COI with attached policy endorsements, or review the entire insurance policy.

☐ Yes ☐ Partial ☐ No ☐ NA

15. Contract requires a minimum of 30 day notice of cancellation, non-renewal or material change to the hired party’s insurance coverage required by contract. Hired party’s insurance policy is endorsed to extend notice of cancellation rights to the hiring party.

☐ Yes ☐ Partial ☐ No ☐ NA

16. Contract requires the hired party to satisfy all deductible or self-insured retentions associated with their insurance program. Lesser alternatives may also include stipulating an acceptable limit for deductibles or self-insured retentions and/or require a bonding instrument.

☐ Yes ☐ Partial ☐ No ☐ NA

17. Contract specifies an AM Best’s rating of A- or better for the hired party’s insurance carriers. Hiring party confirms AM Best ratings.

(Note: AM Best ratings may be found at: www.ambest.com/ratings/guide.asp. Enter the company name in the field at the upper right of the landing page.)

Review of ratings for insurance carriers associated with a sampling of executed contracts confirms satisfaction of this demand.

☐ Yes ☐ Partial ☐ No ☐ NA

18. Contract requires the hired party’s insurance carriers to be admitted and licensed in the subject jurisdiction. Review of executed contracts confirms hiring party is confirming hired party’s insurance carriers are admitted or licensed in the subject jurisdiction.

☐ Yes ☐ Partial ☐ No ☐ NA

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