

RISK TRANSFERENCE

Contract risk transfer is one of the variety of different tools that YCPARMIA entities use to protect themselves and YCPARMIA from loss exposure. It is expected that your entity will attempt to transfer risk accident and loss through contracts to other parties. The intended transfer for this is achieved by requiring suppliers, contractors, tenants, and users of public facilities (i.e., the other party to most entity contracts) should protect themselves and your entity against claims or judgements arising from their products, activities, or use of entity facilities. Usually the best way to assure that the transfer takes place (i.e., that the loss be paid by someone other than your entity) is to require insurance. The insurance should protect the entity, its officers, officials, employees, and volunteers.

Your entity's standard request for proposal, date specifications, and contracts should contain a description of the required insurance. In addition, they should contain appropriate "hold harmless" and indemnification clauses.

Contractual risk transfer is a basic risk management tool that is used to allocate risk between contracting parties. Generally, it would be our goal to accept no more risk than is reasonable, and to transfer as much risk as possible to the other party. Of equal importance is that the risk transfer requirements are not so onerous that contract negotiations slow down or stop the process.

The risk in insurance provisions are subject to negotiation. The final agreed provisions are often largely dependant on the relative negotiations provision of the parties and the importance of the deal. If one of the parties has far more clout than the other, it can impose virtually any requirement it wants.

In the simplest terms, it is necessary for each agency to decide on a philosophical basis how much protection it wants in its usual contractual business transactions. Toward that end there are four basic issues that need to be decided:

1. How broad an indemnity clause should be included in the contract (broad, intermediate, or limited)?
2. What types of insurance should be required?
3. What minimum limits and terms for insurance should be required?
4. What types of evidence of insurance will suffice?

It is also necessary to recognize that obtaining the highest level of protection also can result in the highest level of friction between the parties and the highest cost. Much, if

not all of that cost, is factored into the value of the contract. In a closely related matter it is important to recognize that the value of an indemnity agreement is measured by the financial ability of a party to satisfy its fiscal promises. Generally, it is an insurance policy that is purchased by the provider that gives credence and security to the hold-harmless promises. Also it is important to recognize that an aggressive contractual risk transfer program is not a substitute for the careful selection of service providers.

The first issue and the most frequently encountered contractual risk transfer device, is the **indemnification agreement**. This is a clause found in most contracts which amounts to the little more than one party's agreement to assume the liability of another in the event of a claim or a loss. The term "hold-harmless agreement" and "indemnification agreement" are essentially the same. By virtue of the agreement the indemnitor assumes the liability of the indemnitee. This transfer of risk is completely independent of any insurance coverage. It is important to note that agreement does not relieve the indemnitee of liability to an injured third party. Rather, it merely states that the indemnitor has promised to pay on behalf of the indemnitee.

Traditionally indemnification agreements have been classified into three types:

1. **Broad form indemnification agreements** state that the indemnitor assumes an unqualified obligation to hold indemnitee harmless or allow all liability associated with the subject matter of the agreement, regardless of which party was actually at fault. A broad form hold-harmless provision transfers the entire risk of loss from the indemnitee to the indemnitor. This type of indemnification agreement is not valid for construction contracts in California.
2. **The intermediate form indemnification agreement** has the indemnitor assuming all liability of the indemnitee relating to the subject matter of the agreement, except where the injury or damage is caused by the indemnitor's sole negligence. The only instance in which the indemnitor is relieved of this contractual obligation to indemnify is when the loss is due solely to the fault of the indemnitee.
3. **The limited form indemnification agreement** is sometimes referred to as a comparative fault indemnification agreement. As its name implies, this agreement obligates the indemnitor only to the extent of its own fault. At first glance it may appear that the comparative fault form indemnification does little to increase the indemnitor's liability under general principles of comparative negligence. This type of agreement has the potential for being dangerous since it would have contractual law superceding tort law.

It is possible to draft indemnity clauses that are combinations of the examples set out above. Frequently an indemnity clause may require the indemnitor to provide the broad form indemnification for certain exposures, and comparative fault indemnification for

others. It is also possible to draft a clause where the defense obligation of the indemnitor is broader than the actual indemnification obligation.

Courts traditionally will give very strict construction to indemnity provisions. Any ambiguity in the language will be construed against the party that drafted the provision. It is important that the language chosen expresses the intent of the parties so that the ultimate allocation of risk loss between the parties is not left to the courts.

The second issue to look at is, what **types of insurance** should be required.

1. **Workers' Compensation Insurance** – This coverage protects the contractor against claims for lost wages and medical expenses arising from on-the-job injuries to employees. Workers' compensation insurance should be required of all contractors who have employees on your premises. This coverage protects the entity from any peculiar risk doctrine action. Included in the workers' compensation policy is usually employers liability insurance to cover employers for those situations that do not fall under the exclusive remedy protection afforded by the labor code.
2. **Commercial General Liability Insurance** – This provides protection against liability claims arising out of most of the contractor's business operations, especially those relating to premises. Significant exclusions include liability arising out of watercraft, pollution, aircraft, automobiles and liability for property damage in the insured's care, custody or control.
3. **Personal Injury Liability Insurance** – is generally included in the CGL policy and provides coverage for certain non-bodily injuries such as libel, slander, defamation of character, false arrest and similar offenses.
4. **Business Automobile Liability Insurance** – provides protection against liability claims arising out of the contractor's use of any automobile.
5. **Professional Liability Insurance** – protects against liability arising out of professional error or omission (sometimes called malpractice), involving the unique skills of professions, such as architects, engineers, medical professionals, and others.
6. **Employment Practices Liability Insurance** – provides protection against the contractor's employees making claims for discrimination, harassment, and wrongful termination. This is a rapidly growing area in the law.

The type of insurance that you will require depends on the type of contract you are negotiating. Generally, workers' compensation insurance should be required of all contractors who will have employees, especially if they are going to be on your premises. Commercial general liability insurance should be included on virtually all contracts. Since virtually every service procured under contract requires some use of

an automobile, business automobile liability insurance should be required on all contracts. Professional liability insurance should be required only on those contracts where professionals are providing services.

The third issue, after deciding what kind of insurance to require, is what are the minimum **limits of insurance** that should be required. It is very important to note that it is not the value of the contract that determines insurance limits, but rather the scope of the exposure that the activity performed contract generates. A contract with very limited value can expose the public to a great deal of risk. The amounts to be required should be based on prevailing practices in the industry, the size of the business being used to provide the service, the current status of the insurance marketplace, and the types of services being provided in the related risks. Virtually any business should be reasonably expected to purchase at least one million dollars of general and auto liability insurance. Workers' Comp coverage should be for "statutory limits".

Another issue is when a contracting party has a large **deductible** or **self-insured retention**. A million dollar policy with a \$500,000 deductible may not provide the proper degree of protection if the contracting party does not have the fiscal ability to meet its deductible obligations. This places an entity in a difficult position of having to recognize the fiscal reality of their contractor's ability to pay without discriminating.

The fourth issue is what type of **evidence of insurance** will suffice. Insurance requirements generally require proof of insurance. In response the indemnitor's insurance carriers provide **certificates** that identify the policies in effect on behalf of the indemnitor, their policies, and their limits of liability. All the certificate certifies is that as of that date and point in time, there is insurance in force. It does not guarantee that the insurance will stay in force.

Generally the insurance certificate does not create a duty on behalf of the insurance company to advise the certificate holder that a policy has been cancelled or not renewed. We often try to get a specific agreement in the contract, evidenced on the certificate that we will get thirty days of notice of cancellation, but insurance companies are very reluctant to provide that additional protection.

To expand the rights of the certificate holder, an insurance contract will often call for the certificate holder to be added as an insured to the named insureds policy. This can be documented on a standard ACORD certificate, or by a specific endorsement to the policy. The **additional insured status** is separate from any indemnification promise in the contract. If the hold-harmless agreement is unenforceable, the additional insured status will not be affected, and the insurance carrier's duties under that policy can be triggered. As an additional insured, the indemnitee would have the same right to defense under the indemnitor's policy that the indemnitor has, with that duty being independent of any duty that the insurance might have towards their named insured. Generally an insurance carrier can not subrogate against an insured, so the additional insured status protects the entity from recovery.

In summary, contract risk transfer is a very common risk management tool that is a consideration in virtually every commercial contract. An entity must balance its need to get business done with the friction created by requiring favorable indemnification clauses and insurance coverages. Generally, reputable and experienced contractors are used to complying with these common industry provisions. When someone refuses or claims that one ever asked this sort of thing, the entity should be very suspicious as to the person's experience or business practices.

INSERT
PROCEDURE MANUAL
HERE