

Manager/Supervisor Risk Management
#94– 10/2/12
A twice weekly e-mail training for YCPARMIA members

TOPIC: CONTRACT RISK TRANSFER

The risk transfer training in the series will concentrate on concepts – it is not intended to be a “how to” training. Additional information is available on the YCPARMIA website, and in the YCPARMIA Manual.

Risk is an inherent part of a public entity’s daily function; it cannot be eliminated. The simple concept of contract risk transfer is getting someone else, in defined situations, to agree to assume the entity’s risk. This is done through the indemnification clause of a contract where one party generally agrees to hold the other party, or each other, harmless. The insurance requirements in the contract are there to make sure that whoever promised to indemnify the entity has the financial means to fulfill their promise.

How important is contract risk transfer? It is not really very important at all – until something goes wrong; then it can be crucial. We have three recent examples with significant exposures:

- At about 11:00 p.m. on 4/15/11 an adverse driver turned in front of an oncoming motorcycle in Woodland; the motorcyclist suffered serious injuries and incurred about \$900K in medical bills. A claim was filed alleging that a street sign on the street’s island obstructed the view of each driver. Under the terms of an agreement the developer’s insurance carrier accepted our tender of the claim.
- On 11/28/11 UC Davis police pepper sprayed demonstrators with well-publicized results; the City of Davis Police had responded to the scene pursuant to a mutual aid agreement. The University settled the lawsuit for about \$1M after spending about \$1.5M in defense and investigation costs. In response to our tender of the claim, the City of Davis was named on the release documents.
- On 8/8/11 there was an accident in a construction zone on I-5 that resulted in Woodland’s contractor closing a lane of traffic on the freeway. A few hours later a truck driver rear-ended the stopped traffic damaging five vehicles, injuring ten people, and killing three – including a baby who was consumed in the subsequent fire. The claim was successfully tendered under the terms of the contract to the project manager and contractor.

The indemnification clause usually calls for the entity to be defended and indemnified – the party assuming the risk promises to pay the legal costs to defend, and any settlement or judgments that grow out of the entity’s exposure. It is not uncommon for defense costs to be greater than the cost of indemnification. In the three examples listed above, YCPARMIA did not feel that our members were liable, but absent the contracts we would have been exposed to significant defense costs.

Looking forward, contract risk transfer is relatively simple in concept, but can be difficult in practice – especially when the risk elements of the contract fall outside the area of expertise of the person responsible for negotiating the terms. In many cases the most difficult issue is getting the other party to document their compliance with the contract provisions that they have already agreed to.

Next topic: The Indemnification Clause