OLYMPUS RISK INSIGHTS

Best Practices for Contractual Risk Transfer

When entering into any kind of contractual arrangement with a third party it is important to ensure that proper and consistent risk transfer procedures are in place to help protect your entity from potential liability or damages caused by that contractor or service provider. If these procedures are not in place or followed consistently, your entity could be responsible for damages if the responsible party does not have adequate insurance coverage.

This article is intended to help outline the steps needed to prevent or limit liability to your entity when entering into contractual agreements.

Assign Responsibility

Determine which department or employee/s will be responsible for managing the contract review and risk transfer process. It is recommended that this process be centralized so that insurance requirements, waivers, etc., are being collected consistently. In different agencies, this process may be handled by different individuals – risk managers, legal department staff, finance directors, human resources directors, etc.

No matter who is authorized establish, review and approve contracts, they must ensure that consistent risk transfer procedures are adhered to for each contract and service agreement. This includes one time and ongoing contracts. If a decentralized process is used for smaller contracts, with department heads for example, then a copy of each contract should be reviewed and maintained periodically to ensure procedures are being followed.

As a reminder, all new contracts and service agreements should be reviewed by legal counsel to make sure they do not expose your entity by limiting their own liability.

Review Current Practices

Evaluating where you stand with contractual risk transfer can be time consuming but it is necessary to get a full understanding of where you may have gaps in your protection. Create a list of all active contracts and service agreements for each department and determine where you are currently obtaining Certificates of Insurance (COIs), naming your agency as an additional insured, obtaining hold harmless agreements, and to ensure the adequacy of insurance policies and limits are acceptable, among other criteria.

Review Contracts

Once you have a complete and thorough list of your contracts you can determine where you have gaps that are not consistent with your requirements so that upon renewal that contract can be amended. Moving forward those contracts should include the following risk transfer protections in all bid specifications.

Certificates of Insurance (COIs)

A COI from the contractor's insurance provider serves as evidence of what current insurance is in place. This helps ensure that their insurance policy will respond first. Verify the COI contains the following:

- The appropriate type of coverage (typically General Liability, Auto Liability, and Workers' Compensation) Other coverages may be needed based on the type and scope of the contract.
- Has adequate policy limits and deductibles.
- Policy Period is adequate. Make sure it does not expire during the expected contract period and that they are required to notify you of any changes to the policy within 30 days.
- Names your entity as an additional insured on their policy in the event their policy is canceled and you are not notified. (Make sure you are provided with an endorsement to their policy that verifies you have been named as an additional insured.)

Other Certificate of Insurance considerations:

For professional liability coverage, require endorsements to policies for contractual liability coverage and defense and indemnification of your entity and its directors (elected and appointed officials) by the contracting party.

For a self-insured contractor and those with high retention limits, the organization should require a recently audited financial statement to ensure the financial stability of the organization to meet their obligations should a loss occur. The organization's financial officer should review the audited financial statement and any comments should be included in the work file. Any and all questions, as to financial stability of the vendor, based upon this review should be acted upon promptly.

Certificate of Insurance Retention

Retain the COI on file for the State's statute of limitations plus one year. For example, if the statute of limitations is two (2) years, keep COI on file for three (3) years. If a claim is involved, it should be kept with the claim indefinitely. The reason is, if a vendor has done something problematic and gone out of business, the entity still has a way and the necessary time to resolve the issue and financially become more whole for themselves or for a resident/customer who may have been affected by negligence.

Hold Harmless Agreements

Hold Harmless Agreements or Indemnification Agreements are separate from a COI and should also be obtained prior to entering a contract. Hold Harmless Agreements help provide protection against claims that could arise from the contract work or service being provided. These agreements should only be entered into once the organization has consulted with your own legal counsel regarding:

- Whether the proposed hold harmless agreement is allowed in your state's jurisdiction.
- Specific language required for the hold harmless agreement to be enforceable in the applicable jurisdiction.
- Elements required in the hold harmless agreement - Parties to be held harmless/indemnified, party providing the protection, the activities of the contractor, and time frame.

Waiver of Subrogation Clauses

In most cases, state laws require that general contractors are responsible for losses incurred by subcontractors. Thus, by signing a contract with a Waiver of Subrogation Provision, you could limit your insurance company from collecting or bringing a possible subrogation action that can recover damages that result from negligent acts and/or poor workmanship of contractors, architects, and/or subcontractors. The Standard AIA construction contracts presented to some public entities may contain a Waiver of Subrogation provision (usually at Section 11.3.7.) that contains the following:

The owner and contractor waive all rights against: 1.Each other and any of their subcontractors, sub-subcontractors, agents and/or employees of each other.2. The architect, architect's consultants and separate contractors as described in Article VI.

With this provision in place, increased exposure to losses can be caused by the following:

- Inadequate or lack of proper contractual agreements and addendum clauses are not in place.
- Failure to utilize qualified and financially sound subcontractors, suppliers, and manufacturers.
- Failure to adequately supervise subcontractors, suppliers, and manufacturers.
- Failure to keep and maintain proper and adequate records.
- Faulty workmanship.
- Inadequate, improper and/or unreliable testing and inspections. (Documented)

To prevent losses it is necessary to review all contractual agreements thoroughly prior to signing. All contract agreements also need to be reviewed by your legal counsel and any noted Waiver of Subrogation language must be agreed to prior to approval and final signature. Please note that some contractors and/or subcontractors may alter standard provisions through "Supplementary General Conditions" or "Addenda" to the contract.