

Risk Control

CONTRACTS DETERMINE THE EXTENT OF RISK TRANSFERRED

Contractors understand the benefits of a successful risk transfer program. By transferring the responsibility to pay losses to another party, it helps control liability insurance premiums that are experience rated; favorable loss experience will have a positive effect on premiums.

Contracts are an essential and critical part of all risk transfer efforts. When drafted correctly (e.g., containing indemnification language and the appropriate insurance requirements for the benefit of the upstream party) and properly executed, the likelihood of a successful risk transfer increases, providing better protection for the entity transferring risk. There are two aspects of the process where the terms and conditions of the contract can make or break the transfer:

1. Indemnity or hold harmless provisions, and
2. Additional insured status on the other party's liability polic(ies).

An indemnification or hold harmless agreement contains language where one party (the indemnitor) agrees to indemnify another party (the indemnitee, typically an upstream party – such as an owner or general contractor), for claims and related expenses (i.e., defense costs) arising from construction operations. Fortunately, standard commercial general liability policies cover indemnification provisions, but with limitations and conditions. Coverage is typically found through one of the examples of an “insured contract” – a definition in the policy. Generally, in standard commercial general liability policies, example “f” includes contracts or agreements pertaining to the insured's business wherein the insured assumes the tort liability of another party. This broad language includes documents involving construction, suppliers, and equipment rentals. The terms of the contract or agreement will determine the extent of indemnification or contractual risk transfer. Oral contracts and agreements may be included; however, it may be more difficult to prove the intent of an oral agreement.

- **Written contracts, drafted by counsel with the broadest language possible (i.e., that the loss arose out of the downstream party's work as opposed to caused by an act or omission [negligence] of the downstream party), is the proper way to ensure a successful risk transfer of risk. The language in the document should be reviewed periodically and updated as needed.**

Obtaining additional insured status on a third-party's liability policy goes a long way in securing an adequate risk transfer. However, as with indemnification agreements, the transfer may not be automatic and the language and conditions of the additional insured endorsement in use

needs to be reviewed and understood. Once again, the contract in place can strengthen, weaken or in some cases, foreclose the possibility of a transfer.

The efficacy of the risk transfer depends on the endorsement providing coverage to the additional insured. For example, several additional insured endorsements require the scheduling of the additional insureds and the location and description of operations – such as ISO additional insured endorsements CG 20 10 – Additional Insured – Owners, Lessees or Contractors – Schedule Person or Organization, and CG 20 37 - Additional Insured – Owners, Lessees or Contractors – Completed Operations, so a contract is not necessary. However, if insurance coverage is required by a contract or agreement, coverage provided to the additional insured will not be broader than what is required and contained in the contract or agreement.

On the other hand, ISO endorsements CG 20 33 - Additional Insured – Owners, Lessees or Contractors – Automatic Status When Required in a Written Construction Agreement With You and CG 20 38 - Additional Insured – Owners, Lessees or Contractors – Automatic Status For Other Parties When Required in Written Construction Agreement, do require a written contract or agreement. These two endorsements have similar language limiting coverage for the additional insured to what is required and listed in the contract or agreement. Manuscript endorsements written by insurers contain similar provisions. CG 20 38 will extend coverage to other parties (e.g., owners, general contractors) when the named insured is obligated to do so, without requiring a written contract agreement with the other party.

- **Although not required in CG 20 10 and CG 20 37, if used, the terms of the contract or agreement control the amount of coverage granted to the additional insured.**
- **A written contract or agreement is required for the “blanket” endorsements (CG 20 33 and CG 20 38).**
- **Failure to sign a construction agreement can seriously jeopardize additional insured status in the event of a claim or loss suit. Some additional insured endorsements require the contract or agreement to be signed prior to the loss.**
- **If you are using annual contracts, make sure they are updated as needed. Prior dealings will not guarantee a successful risk transfer.**

General contractors, and subcontractors retaining further downstream parties, have the clout to require terms to limit their exposure to loss. A construction contract with properly drafted risk transfer requirements helps the upstream party allocate the project’s risks in a manner favorable to their interests.