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Elements of Contractual Risk Transfer

DENISE SIMPSON | JUNE 13, 2016

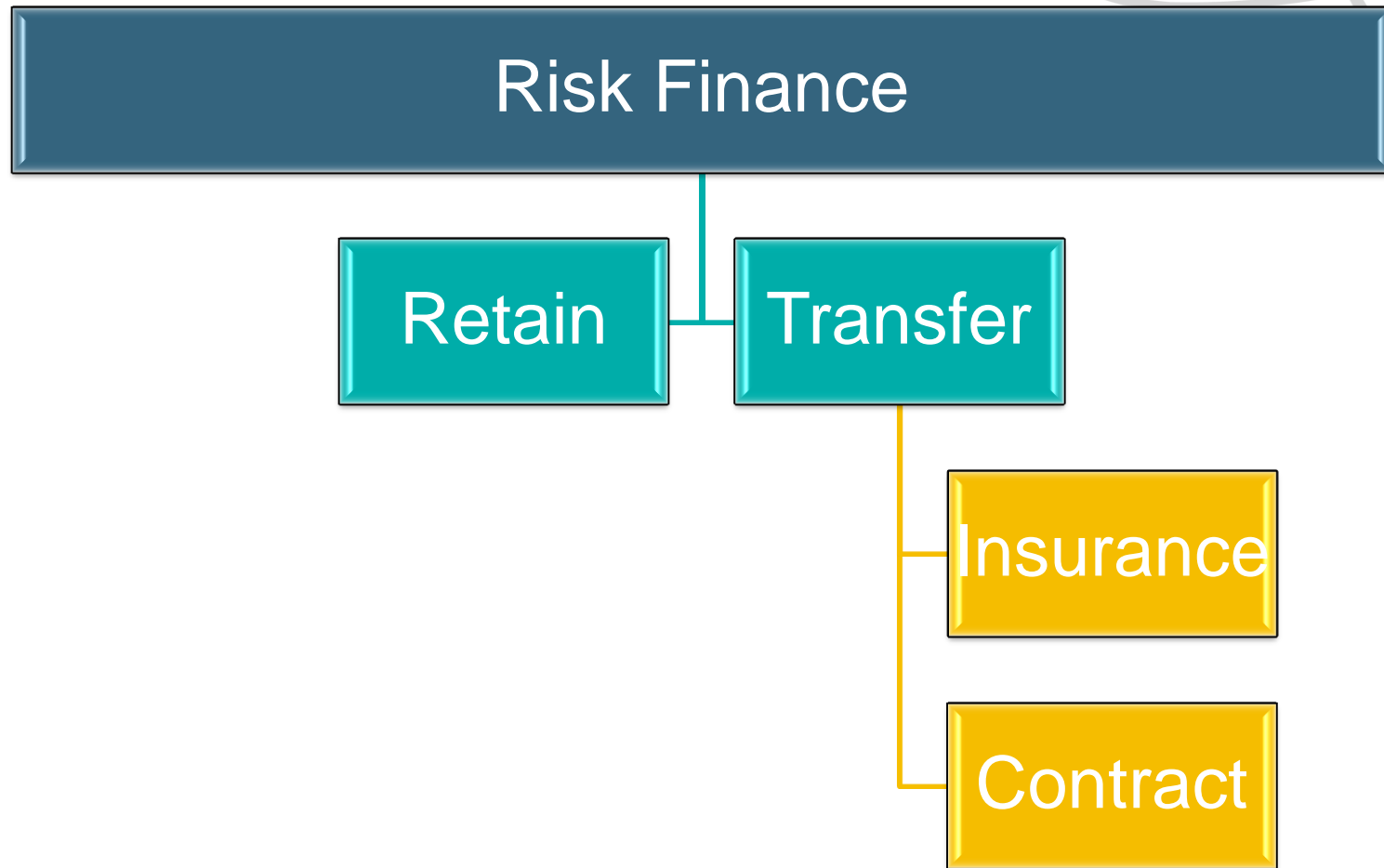
What is Risk?

- Risk- *the uncertainty about outcomes that can either be negative or positive*
 - Negative Consequences
 - Damage
 - Injury
 - Liability
 - Loss



Source: *Risk Assessment-Baranoff, Harrington, Niehaus*

Risk Management Techniques



Risk is Either Retained, Transferred or Accepted By Contract

Damage to your property

Damage to the other party's property

Injury or damage to third parties

Injury to your employees / the other party's employees

Importance to Your Agency

Retained risk is “financed” by you - OR

Transfer of risk is “financed” by another party, such as a vendor or contractor

Less risk to your agency means less risk to your budget

Contracts are established with another party

- Risk is supposed to be transferred via the contract
- Other party’s insurance is used to support

What is Contractual Risk Transfer?

- The allocation or distribution of risks between the parties to a contract.
- Risk transfer distributes risk to the parties based on their ability to control and insure against the risk.
- Public Entities need protection from the risks of the contractors they hire.
- The party best able to control the risk should be responsible.

Two Principal Ways to Transfer Risk

1. INDEMNITY AGREEMENTS

- An agreement by one party to assume the liability of another.
- Written in the contract between Public Entity and other party.
- Driven by State statute

Purpose of Indemnification Language

- To transfer the cost of defending and/or paying damages that arise from a third party claim or suit that has been filed against your Agency to the other party in the contract
- The indemnity agreement wording should be as broad as possible, not exceeding what is allowed by either state statutes or case law
 - Defense costs
 - Damages

Indemnity Agreement

- Who Pays These Costs?
 - The other party to the contract
 - Vendor
 - Professional
 - Contractor
 - The other party's insurance policy
 - Must contain contractual liability (some don't)
 - Must be a covered loss in the policy

Important Concept

DO NOT CONFUSE INDEMNIFICATION WITH INSURANCE

- Indemnity is not insurance
- Contractual obligation assumed by one party toward another
- Broader than insurance coverage purchased by either party

Sample Indemnity Agreement

Vendor shall indemnify, defend, and hold harmless the Agency, and its officers, employees, and agents (“Agency indemnitees”), from and against **any and all** causes of action, claims, liabilities, obligations, judgments, or damages, including reasonable legal counsels’ fees and costs of litigation (“claims”), **arising out of the Vendor’s performance** of its obligations under this agreement or out of the operations conducted by Vendor, including the Agency’s active or passive negligence, **except for such loss or damage arising from the sole negligence or willful misconduct of the Agency**. In the event the Agency indemnitees are made a party to any action, lawsuit, or other adversarial proceeding arising from Vendor’s performance of this agreement the Vendor shall provide a defense to the Agency indemnitees or at the Agency’s option reimburse the Agency indemnitees their costs of defense, including reasonable legal counsels’ fees, incurred in defense of such claims.

Types of Cost Flowing From Indemnity Obligations

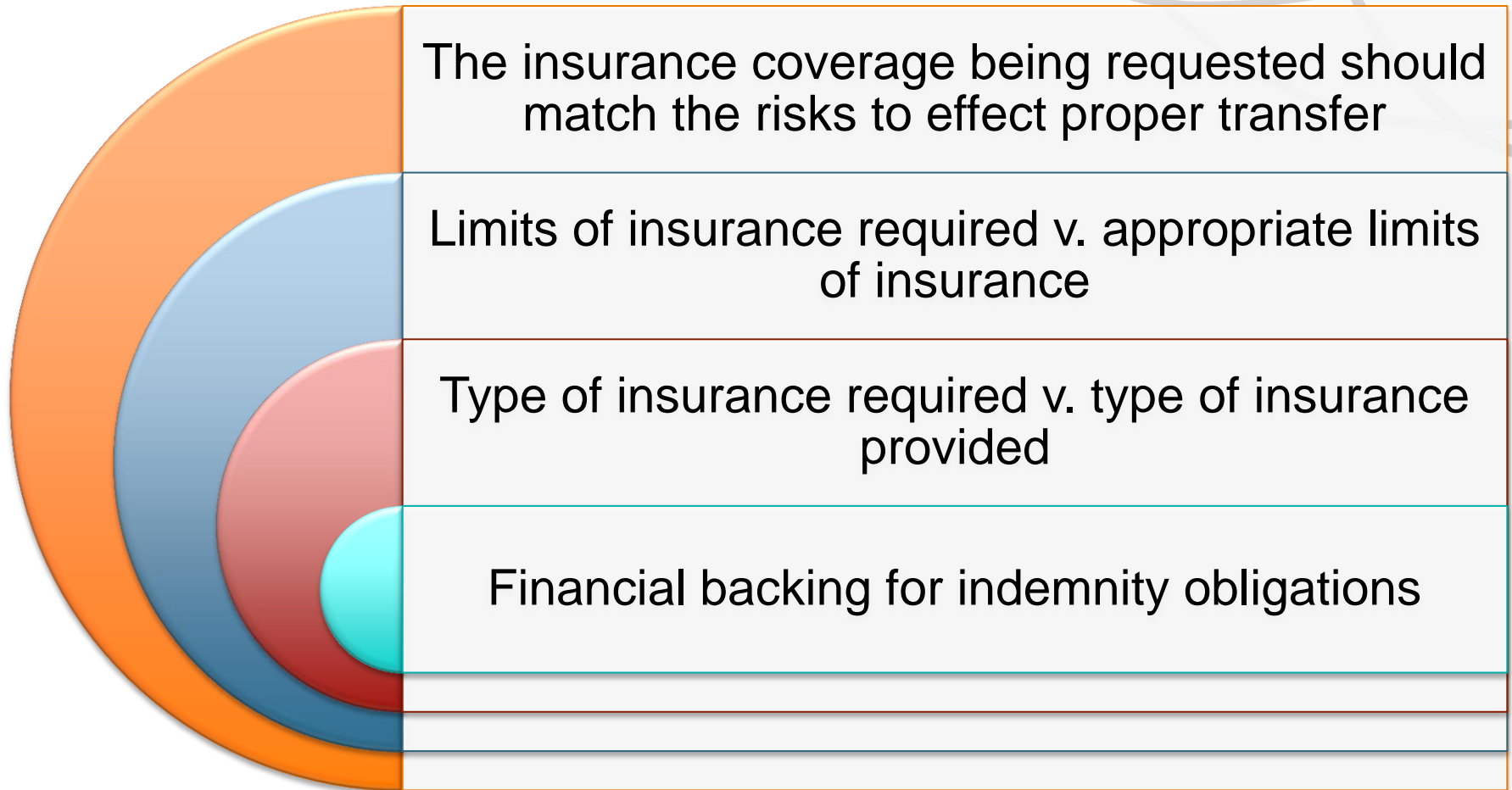
- Investigation Expenses
- Court costs
- Defense Costs
- Damages/Injuries to Third Parties

Two Principal Ways to Transfer Risk (cont'd)

2. TRANSFERRING RISK THROUGH INSURANCE

- Obtain protection via Additional Insured status
- Endorsement
- Subject to the same policy terms, conditions and exclusions of the contractor's/vendor's policy
- Pay attention to policy exclusions and limits

Insurance Requirements



How Insurance Supports The Indemnity Provision

CONTRACTUAL LIABILITY COVERAGE

- Covers the liability the contractor assumes under a contract by providing the money for defense and damages.
- Most typically found in GL policies
 - Standard CGL form offers coverage to the insured for liability assumed in an "insured contract"
 - "Insured contract" means: "That part of any other contract or agreement pertaining to your business...under which you assume the tort liability of another to pay for "bodily injury" or "property damage" to a third person or organization."
 - Not all carriers use ISO forms; some use what's called manuscript forms which means the carrier has customized the policy with their own wording. Whether it's the ISO form or a manuscript policy, it is important to be aware of the policy terms.

Indemnity v. Additional Insured

INDEMNITY

- Indemnified party's costs for defense erode the limits of insurance
- The policy may contain an exclusion for contractual liability
 - Contractual liability coverage is the mechanism that allows the Contractor/vendor/lessee to have the financial backing of the policy to fulfill the obligations it assumed under the indemnity agreement.
- As long as agreement is in writing
- Permitted by law
- Loss/Damage/Injury occurred after the agreement was executed

Indemnity v. Additional Insured

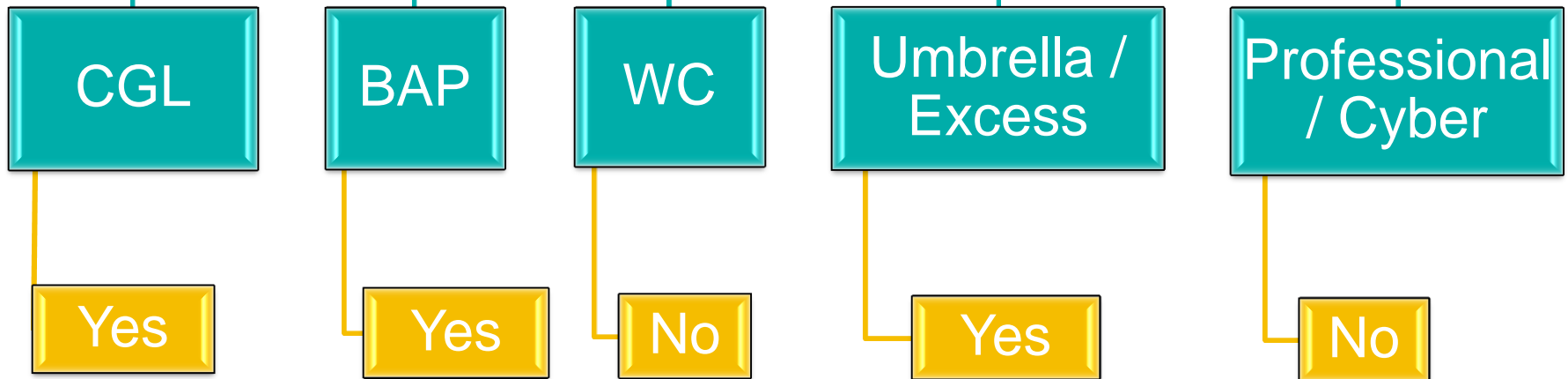
ADDITIONAL INSURED

- Typically costs of defense do not erode the limits of insurance. AI now afforded full policy protection *subject to the language on the AI endorsement.*
- The duty to defend is triggered
- Many versions of the AI endorsement exist
 - Important to read the endorsement -2013 editions contain limiting language as to coverage terms and limits
 - Company specific/manuscripted endorsements

Asking to Become An Additional Insured

Why? Gives you direct access to the other party's insurance policy

Can you be added as Additional Insured?



Additional Insured Specifics

- Can be added by specific Agency name OR under a “blanket” endorsement that states “when required by written contract or agreement”
 - Verify that your contract has this in writing
 - The wording in the contract should include the Agency and officers, employees and agents

Sample Insurance Language

General liability insurance. Vendor shall maintain commercial general liability insurance with coverage at least as broad as Insurance Services Office form CG 00 01, in an amount not less than \$1,000,000 per occurrence, \$2,000,000 general aggregate, for bodily injury, personal injury, and property damage. The policy must include contractual liability that has not been amended. Any endorsement restricting standard ISO “insured contract” language will not be accepted. * Such insurance shall include a Waiver of Subrogation applicable to insurance or self-insurance, a primary, non-contributory endorsement and Additional Insured endorsement, all in favor of Agency, its officers, agents, employees and volunteers.

- Note: *This sentence refers to an endorsement called ‘Amendment to Insured Contract’

Sample Insurance Language

Automobile liability insurance. Vendor shall maintain automobile insurance at least as broad as Insurance Services Office form CA 00 01 covering bodily injury and property damage for all activities of the Vendor arising out of or in connection with Work to be performed under this Agreement, including coverage for any owned, hired, non-owned or rented vehicles, in an amount not less than \$1,000,000 combined single limit for each accident. Such insurance shall include both a Waiver of Subrogation applicable to insurance or self-insurance and a primary, non-contributory endorsement, both in favor of Agency, its officers, agents, employees and volunteers.

- **Note: If Symbol 1 is checked on the Certificate, that is the best and broadest possible – nothing else needs to be checked**

Sample Insurance Language

Workers' compensation insurance. Vendor shall maintain Workers' Compensation Insurance (Statutory Limits) and Employer's Liability Insurance (with limits of at least \$1,000,000). Vendor shall submit to Agency, along with the certificate of insurance, a Waiver of Subrogation endorsement in favor of Agency, its officers, agents, employees and volunteers.

Sample Insurance Language

Primary/noncontributing. Coverage provided by Vendor shall be primary and any insurance or self-insurance procured or maintained by Agency shall not be required to contribute with it. The limits of insurance required herein may be satisfied by a combination of primary and umbrella or excess insurance. Any umbrella or excess insurance shall contain or be endorsed to contain a provision that such coverage shall also apply on a primary and non-contributory basis for the benefit of Agency before the Agency's own insurance or self-insurance shall be called upon to protect it as a named insured.

- **Note: Some insurance brokers have never been asked to provide this wording on an Umbrella or Excess Liability policy.**

Persevere

- Contracts are often challenging to read and most are not alike
- Keep focused on the larger picture – transferring as much risk away from the Agency and to the party performing their services
- Review existing written guidelines for vendor contract submissions
 - If your Agency does not have them, create them



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Thank You

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