INTRODUCTION, DISCLAIMER AND PURPOSE

Contractual risk transfer is complex, but – when properly implemented – can help manage the risks inherent to your daily operations. While intended to be a useful tool for all businesses*, this guide is not intended to be a complete guide to risk transfer. Consider this guide – along with advice from your attorney and independent insurance agent – to better understand risk transfer and how it applies to your business.

Use this guide to help you:
• Understand the phrases and concepts that relate to transferring liability so that you can keep them in mind before entering into contracts with suppliers, tenants and service providers.
• Think about and plan ways to manage your company’s liability risks when entering into contracts for goods and services with third parties.

This guide does not replace sound legal advice. There are limitless scenarios a business owner or manager can encounter that present unique questions of liability. The statutes, regulations and case law relating to the concepts in this guide vary from state-to-state, so before entering into contractual agreements involving your business, we strongly recommended that you discuss all contracts with your competent business attorney.

*Significant differences apply to the construction industry and should be discussed with competent legal counsel or your independent insurance agent.
OUTLINING CONTRACTUAL RISK TRANSFER

Contractual risk transfer is a system consisting of contractual clauses that should be backed by insurance policies. This guide outlines the components of contractual risk transfer and how the parts work together. Consider the graphic below as an outline for the discussion.

Your business

Contracts with contractors, subcontractors, suppliers, vendors, landlords, tenants, etc.

Protection when you are the indemnitor

Your risks

Risks you contractually accept when you are an indemnitor

Insurance

Indemnify, Defend, Hold Harmless (Hold Harmless waives subrogation)

Good
Indemnitor has promised

Certificate of Insurance (COI)

Better
Indemnitor has insurance to back up promise

Additional Insured Status

Best
You have direct rights as an insured under the indemnitor’s CGL policy
CONTRACTUAL RISK TRANSFER EXPLAINED — WHAT IS IT AND WHY IS IT IMPORTANT?

Contractual risk transfer (CRT) is a mechanism through which liability for risks is allocated by contract at the beginning of a business relationship to the party with the most control over that risk, and who is therefore in the best position to manage and control that risk.

Without proper CRT in place, your business could be held responsible for harm caused by someone else.

Business is based on relationships. Relationships with suppliers, vendors, landlords, tenants, service providers and others comprise the business environment you live and work in daily. When everything goes smoothly, business relationships work well. However, despite even the best of efforts, accidents can happen. When an accident takes place – like an injury to a visitor on your premises or a product causing someone else bodily or financial injury, those on the wrong side of that event are likely going to seek compensation from anyone who potentially played a role in their injury or loss. At that point the question becomes, “Who is legally responsible?” In these instances, when valuable business relationships could easily become strained, the extra preparation of having contracts with the apportionment of risk clearly spelled out in advance can save longstanding business relationships, time, money and countless headaches. Without proper CRT in place, you could find your business being held responsible for harm caused by someone else.

By predetermining who will be financially responsible for the damages from an accident, each business can make informed decisions to plan for and manage the risks associated with a project or contractual relationship.
HOW IS CONTRACTUAL RISK TRANSFER ACCOMPLISHED?

CRT is accomplished through a combination of specific contractual provisions negotiated between businesses at the beginning of their business relationship or project that are then backed by insurance policies.

**Insurance**
The most basic form of risk transfer is the purchase of an insurance policy. In this form of risk transfer, business owners assess their risks and purchase the amount of coverage necessary to prevent financial ruin due to unforeseen events for which the company is determined to be legally responsible.

In this arrangement, risk transfers from the insured business to the insurance company that has agreed, for a premium and subject to specific terms and conditions, to defend and pay covered losses on behalf of the insured. The purchase of insurance is critical for all businesses because, no matter how careful one is, accidents can still happen.

*Insuranc*e: the most basic form of risk transfer.
Contractually
The first step in contractual risk transfer between two or more business parties is to make sure that you have a written, signed, binding contract.* Contracts between businesses spell out the terms, commitments, expectations and legal requirements of a specific relationship. It is in these contracts that businesses have the opportunity to define and allocate the risks arising out of that relationship. While there are others, the most common types of clauses that businesses use to contractually allocate risk include:

- Indemnity (indemnification)
- Duty to defend
- Hold Harmless (waiver of subrogation)

Other important terms related to risk transfer include:

- Certificate of insurance
- Additional insured

Each of these will be discussed in the following pages.

Contractually: define and allocate the risks arising out of the relationship.

* As will be explained on page 20, the failure to have a written, signed contract in place before work begins may void any obligation of an insurer to back up commitments made by parties to a contract.
INDEMNITY

In its most simple terms, *indemnity* is the process through which one party transfers, or assumes, risk and responsibility for loss to or from another party to the contract. Under an *indemnification* clause, the *indemnitor* – the party contractually assuming risk – agrees to pay for the liability of the other party – the *indemnitee* – for losses specified by the contract. *Indemnify* is a legal term which in most cases could be replaced with “pay for.”

**Indemnitor:** the party accepting or paying for the risk of another.

**Indemnitee:** the party passing risk to another.
There are three types of indemnity for indemnitees and indemnitors to understand. Each type provides or requires different levels of protection and risk.

**Broad Form Indemnity**

Under broad form indemnity, the indemnitor assumes all legal liability, regardless of fault. These types of indemnity clauses include language similar to: “caused in whole or in part.” This language says that the indemnitor will pay for any claims against the indemnitee even if the indemnitee was wholly at fault for causing the accident that led to the claim.

So, under broad form indemnity, an indemnitor must pay for losses arising out of accidents, even those which were 100 percent the fault of the indemnitee.

**Example:**

“To the fullest extent permitted by law, Vendor shall indemnify Any Business Inc. and all of its agents and employees from and against all claims, damages or losses in any way arising out of or resulting from the performance, condition or existence of the work or products provided under the contract, whether or not such claim, damage, loss or expense is based in whole or in part [or solely] upon any negligent act or omission of Any Business Inc. or any of its employees or agents.”

Under broad form indemnity, the indemnitor assumes all legal liability, regardless of fault. These clauses typically include “caused in whole or in part” or “solely” language.

**Intermediate Form Indemnity**

Under intermediate form indemnity, the indemnitor again assumes all legal liability except when the accident is caused by the indemnitee’s sole fault, meaning when the indemnitee is 100 percent at fault. This type of indemnity is typically accomplished by dropping the “in whole” language from the clause, leaving “caused in part” by the indemnitee.

So, under intermediate form indemnity, an indemnitee can be 99 percent at fault and receive payment from the indemnitor for all of the costs associated with that loss.

**Example:**

“To the fullest extent permitted by law, Vendor shall indemnify Any Business Inc. and all of its agents and employees from and against all claims, damages or losses in any way arising out of or resulting from the performance, condition or existence of the work or products provided under the contract, whether or not such claim, damage, loss or expense is based in whole or in part, but only to the extent caused by the negligent acts or omissions of the Vendor.”

Under intermediate form indemnity, the indemnitor assumes all legal liability except when the indemnitee is 100 percent, or “solely” at fault.

**Limited Form Indemnity**

Under a limited form indemnity agreement, the indemnitor only pays that portion of any loss that is directly related to its percent of fault in causing the loss. In reality, under a limited form indemnity agreement, there is no real indemnity being provided since the indemnitor is not accepting any risk or liability of the indemnitee. This form of indemnity is sometimes called a comparative fault agreement.

However, this does not mean that limited form indemnity does not have value to an indemnitee. For example, assume a landlord-tenant setting in which the landlord’s name is on a building – let’s say The Smith Building. Assume Smith leases this building to a tenant, Jones & Co. Assume further that under the lease Jones & Co. is responsible for maintenance of the interior stairways, which Jones & Co. fails to provide, and a customer of Jones & Co. falls down the stairs due to negligent maintenance. In the ensuing law suit by the customer of Jones & Co., Smith is likely to be named as a defendant simply because his name is on the building. Under limited form indemnity, because Jones & Co. was the sole negligent party, it will have to indemnify Smith up to the percent of its fault – in this case 100 percent.

**Example:**

“Vendor shall indemnify Any Business Inc. and all of its agents and employees from and against all claims, damages or losses in any way arising out of or resulting from the performance, condition or existence of the work or products provided under the contract, but only to the extent caused by the negligent acts or omissions of the Vendor.”

Under a limited form indemnity agreement, the indemnitor only pays that portion of any loss that is directly related to its percent of fault in causing an accident.
Indemnify: a legal term which in most cases could be replaced with the phrase “pay for.”
TO BE OR NOT TO BE AN INDEMNITOR?

Being asked to accept the position of indemnitor – to accept the risk of another – may have serious financial implications for your business. Before you accept risk, carefully assess whether the contract is valuable enough to your business to warrant accepting additional risk. If you choose to accept the risk, carefully review the contract with your attorney to make sure you fully understand the additional risk you are accepting.

Also review the contract with your insurance agent to make certain that you have the correct kind of insurance and amount of coverage in place to cover those additional risks.

Without the appropriate insurance policy and limits in place, your business’s assets would be covering both your and the other party’s negligence.

BEING AN INDEMNITEE: IS THAT ENOUGH?

Obtaining the position of an indemnitee in a contract is good. However, to be indemnified alone is not sufficient to fully protect you from costs associated with possible claims. As stated above, to “indemnify” another means to pay the legal obligations of another. However, in the litigious society in which we live, determining what or how much an indemnitee owes can be costly. Legal process expenses can add up to more than the value of the damages ultimately paid to another. Therefore, in addition to being indemnified for the ultimate liability to the injured party, you also want to require the indemnitor to agree to defend and hold you and your business harmless to further protect your assets and business.
DUTY TO DEFEND

A duty to defend clause provides that the indemnitee is responsible not only for paying the indemnitee’s legal obligations as determined by settlement or judgment, but also for defense of the indemnitee while legal obligations are being determined. These obligations include attorney fees, court costs and other defense costs. Generally, the duty to defend arises as soon as a claim made against an indemnitee has been properly presented to the indemnitor. In light of the cost of litigation, duty to defend protection can be as valuable or more valuable than indemnity for the final amount owed to the claimant.

The duty to defend clause may be made part of the indemnity clause or it can be stated separately, standing on its own. Both clauses are important, and together they offer the indemnitee financial protection from the first presentation of a claim through its final resolution.

The duty to defend arises as soon as a claim made against an indemnitee has been properly presented to the indemnitor, while a duty to indemnify may not arise for months or years until after the claim has been finally determined in the courts.
A *hold harmless* provision takes an indemnitee’s protections one step further. The benefit of a hold harmless clause is that it allows parties to a contract to agree *before an accident takes place*, that neither the indemnitor nor its insurer may attempt to recoup any of their costs in defending or paying legal obligations of the indemnitee from the indemnitee or its insurer. Stated another way, a hold harmless agreement between parties to a contract acts to waive subrogation between them and their respective insurers. *Such an agreement prevents litigation between businesses who want to preserve their valuable relationships with each other.*

To be binding on insurers, hold harmless agreements must generally be in writing and entered into prior to a loss. In addition, insurers often require a special endorsement acknowledging that it will permit its insured to waive its subrogation rights. This is one reason it is important to review contracts with your business attorney and insurance agent to make sure you fully understand what the contract calls for, and to insure that any necessary endorsements are in place on your or the other party’s insurance policies.

Hold harmless clauses may also be included in the indemnity clause. However, like duty to defend clauses, hold harmless clauses can be separate and distinct clauses in a contract.
DON’T GO IT ALONE

It is no secret that contracts can be lengthy and full of complicated legal jargon. However, contracts with indemnity, duty to defend and hold harmless clauses are not always complicated.

An example of a clause that contains all three duties – to indemnify, defend and hold harmless – can be as simple as:

“To the fullest extent permitted by law, the Vendor shall defend, indemnify and hold harmless Any Business Inc. and all of its agents and employees from and against all claims, damages, losses and expenses, including attorneys’ fees, in any way arising out of or resulting from the performance, condition or existence of the work under the contract, whether or not such claim, damage, loss, or expense is based in whole or in part upon any negligent act or omission of Any Business Inc.”
(This example illustrates broad form indemnity.)

The more complex the language of a contract, the more important it is to have that contract reviewed by your business attorney so they can make sure that you fully understand exactly what responsibilities and obligations you are requesting or accepting through the contract.
Imagine you just signed a contract with a service provider or vendor that contains appropriate indemnity, defense and hold harmless language that places you in the position of indemnitee. This means that, depending on the type of indemnity you required of that service provider or vendor, that it will pay some, if not all, of your legal costs and any obligations that arise out of the service work it will perform for you. In addition, once those costs are paid, that service provider and its insurer are contractually precluded from subrogating back against your business, meaning they cannot sue you to recoup any of those costs. Combined, having each of these clauses in your contract is a good first step for risk transfer.

However, standing alone, all that is backing up those commitments to indemnify and hold your business harmless is the promise of the indemnitor. In other words, nothing other than the assets of the indemnitor are available to pay for any loss the indemnitor has agreed to defend and pay on behalf of the indemnitee. Taking additional steps that are spelled out in a contract will insure that the indemnitor can fulfill that obligation.
CERTIFICATES OF INSURANCE

A better second step when you are the indemnitee is to include a clause in the contract requiring the indemnitor to obtain and provide proof of insurance to back up its commitments.

This proof is provided through a Certificate of Insurance. A COI is a document providing evidence that, as of the date it was issued, the indemnitor has the insurance coverage that is indicated in that certificate available to fulfill its contractual promise to pay for the indemnitee's losses. The party to which a COI is issued showing another party's current coverage is called a certificate holder.

An indemnitee should require in the contract that the indemnitor will provide a copy of the certificate of insurance before the indemnitor's work begins. Upon receiving a COI check for the:
- date it was issued
- name of the insured, ensuring that it matches the name of the company you have contracted with
- types of policies, ensuring that all the required types of coverages are listed
- policy term, including the anticipated duration of the project
- limits of coverage, ensuring they match the contract
- additional insured status, with your business is listed as additional insured
- subrogation waived status accordance with the subrogation terms of your contract

Ask your independent insurance agent for additional details on how to read a COI.
Certificate holder: The party to which a Certificate of Insurance is issued showing another party’s current coverage.
CERTIFICATE OF LIABILITY INSURANCE

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFER NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

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**DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES:**

Can be basic or explicit. At a minimum, the project name and location should be listed here, Ex., “Construction of Smith home at 123 Main St., Anytown, USA,” or, “Excavation and foundation work at Smith home at 123 Main St., Anytown, USA.”

Form # for AI endorsement. Indemnitee should check with its insurance agent and/or attorney whether the form listed meets the requirements of the contract.

**CERTIFICATE HOLDER**

When an indemnitee, YOUR name should be here. Being listed here however does not confer any rights under the indemnitor’s policy to you. In order to obtain additional insured (AI) status, thereby conferring your rights under the indemnitor’s policy, the “ADDL INSD” box above also needs to be checked.

**CANCELLATION**

Should any of the above described policies be cancelled before the expiration date thereof, notice will be delivered in accordance with the policy provisions.

**AUTHORIZED REPRESENTATIVE**

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KEY TO CERTIFICATE OF INSURANCE (Acord 25)

Use this key and the sample certificate on the previous page to better understand what to look for on certificates of insurance.

1. The date the certificate was issued should be within 14 days of presentation to you.

2. The named insured should be the same business/entity with which you have a contract – not a parent or subsidiary entity.

3. Which insurer is providing what coverages? If your contract requires an A-rated insurer, there is no way to check this if the insurers are not listed here.

4. Generally, you want the “Occur” box checked. If the “Claims-made” box is checked, ask your insurance agent or attorney if that is acceptable for your particular circumstance(s).

5. “ADDL INSD” stands for “Additional Insured,” and “SUBR WVD” stands for “Subrogation Waived.” If the ADDL INSD box isn’t checked, and your contract requires that you be named as an additional insured on the subcontractor’s GL policy, you most likely are not properly an additional insured on that sub’s policy. In that case, you should tell the sub that you will require a re-issued certificate, AND need to see the actual endorsement naming you to their GL policy. If the SUBR WVD box is not checked, but your contract calls for the sub’s insurer to waive its subrogation rights, you need to point that out to your sub and have it corrected.

6. A policy number should be listed for each type of policy (CGL, Auto, Workers’ Compensation, etc.)

7. Make sure the policy doesn’t expire before the contract term or project is expected to end. If it does expire before the project is expected to end, you should diary a date approximately 30 days prior to the sub’s policy’s expiration and send that sub a reminder that you will need an updated certificate when their new policy is issued.

8. Check the limits of the sub’s policy. Are they what are called for in your contract?

9. Does the form number of the additional insured endorsement match what your contract requires?

10. Note that most insurers will not send notice of cancellation to additional insureds, but only “in accordance with policy provisions,” which generally limit notice to named insureds. Contract clauses that call for an insurer to send notice to an additional insured are likely not to be honored by any insurer. For this reason, consider putting a clause in your contracts that requires your subs to notify you within 3 business days or receipt of a cancellation notice from its insurer.
ADDITIONAL INSURED STATUS – from the indemnitee’s position

The **best** way for an indemnitee to protect itself is by requiring the indemnitor to add the indemnitee to its insurance policy as an **Additional Insured**.

An additional insured is a person or organization added to another’s commercial general liability policy at the request of the named insured. By listing another party as an additional insured, the indemnitor grants the indemnitee certain rights as an insured under its policy. Having the rights of an insured under the indemnitor’s CGL policy is the safest way of backing up the promise of indemnification. If the indemnity agreement proves unenforceable for some reason, the indemnitee may still be able to obtain coverage for its liability by making a claim directly as an additional insured under the indemnitor’s CGL policy.

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**Additional insured**: a person or organization added to another’s commercial general liability policy at the request of the named insured.
ADDITIONAL INSURED STATUS – from the indemnitor’s position

Do not take the decision of whether or not to grant additional insured status to another party lightly. By granting another business additional insured status on your policy, you are making the limits of your coverage available to pay for the losses of that indemnitee – and will then not have them available if you need them to protect you from your own liabilities.

For example, if you have a CGL policy with $1M in coverage per year and use up some or all of that limit to pay for claims against an indemnitee, you could be left with little-to-nothing available to cover your losses incurred during that same year. If this were to occur, you would have to rely on your own assets to satisfy those obligations.

Secondly, if your policy limits are used to cover losses of an indemnitee, that loss history will appear on your loss run, and likely cause an insurer to raise your rates in subsequent years.

For these reasons, it is imperative that each business weigh the risks vs. benefits of accepting the position of indemnitor, and discuss whether you have sufficient coverage to fulfill that obligation while still having sufficient coverage to protect your business from its own obligations.

Do not take the decision of whether or not to grant additional insured status to another party lightly.
WHAT IF THERE IS NOT A WRITTEN, SIGNED CONTRACT IN PLACE BEFORE WORK BEGINS?

In order for many CGL insurance policies to extend additional insured coverage to an indemnitee, those policies have language requiring a written, signed contract in place before a loss takes place. While there are numerous variations, typical language in such a requirement might define an additional insured as:

“Any person or organization when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy, provided that the written contract or agreement has been executed prior to the bodily injury or property damage.”

Similarly, insurers almost always require that a written, signed contract be in place before an accident in order for it to agree to be bound by a waiver of subrogation clause. Language such as this may spell out that requirement:

“We waive any right of recovery we may have because of payments we make for injury or damage arising out of your ongoing operations or “your work” done under a written contract requiring such waiver with that person or organization and included in the “products-completed operations hazard”. However, our rights may only be waived prior to the accident giving rise to the injury or damage for which we make payment under this Coverage Part.”

Because of requirements in most insurance policies, indemnitees must make sure contracts with vendors, service providers or tenants are in order and signed before service begins. By doing this, you are doing the best to ensure that there is no chance of an accident taking place for which you might be denied the additional insured status you intended to protect your business’s assets. Without additional insured status, you could find yourself with nothing other than the assets of the other party – or worse – your assets, from which to pay claims you had intended to pass onto the other party.
Controlling risk is a vital, consistent component of every successful business. Contractual risk transfer is just one aspect of a risk management program, but it can protect a business from financial ruin from losses that should be paid by someone else. Every contract is different and each state has specific laws regarding what is acceptable contractual risk transfer language. For these reasons, engage the services of your business attorney and independent insurance agent to review any contracts you contemplate for your business.