

RISK TRANSFER

Monthly Minute Newsletter

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UNDERSTANDING SUBCONTRACTOR AGREEMENTS & RISK TRANSFER

Making sure you're not held responsible for mistakes or errors made by a service provider, subcontractor or other party can be critical to protecting your business. A contract that clearly and specifically spells out, for example, which party is responsible for certain aspects of a project before work begins could save your company both time and expenses in the event of litigation.

Contractual risk transfer is a legally binding way to transfer risk to the party that may be in the best position to control the risks related to the service to be provided. It's when one party agrees to take responsibility for liabilities and related financial costs for that party's services or products provided on behalf of or for the benefit of another party.

WHEN IS CONTRACTUAL RISK TRANSFER USED?

Contractual risk transfer is commonly used in subcontracting, supplier or sales agreements, lease agreements and other situations. For example, your company manufactures machinery and you hire contractors to install the machines at customer sites. You may want the contractor to be responsible for the risks associated with the work that they do on site, so you enter into a contract to establish responsibility. The agreement between your company and your contractor states that if something goes wrong during the installation work, such as accidentally damaging the customer's property, the contractor is responsible for the damages. Without a contract, the damages, legal costs and other expenses might be borne by you. When you sign a business contract, consider whether part of the agreement should lay out who's responsible if something goes wrong. These conditions aren't always obvious and can differ depending on your circumstances, so it is important to get professional legal guidance. Depending on how the negotiations go, your business may end up taking on less exposure through the process of contractual risk transfer.

ASPECTS OF A CONTRACTUAL RISK TRANSFER AGREEMENT

Common forms of risk transfer include an indemnification clause and a hold harmless agreement. These can work together so that the named party, the contractor in this case, is responsible for any claims or losses that are a result of the work on behalf of the other party. You could also require that the contractor name you on their insurance policies as an additional insured. That way if something goes wrong with the contractor's work and your company is sued for damages, you may be covered by the contractor's policy. Generally, contractual risk transfer has three common components:

- Hold harmless agreement/indemnification clause. This is the section of a written contract that can help to outline that contractor's responsibilities, including the duty to defend any other involved party, when a contractor's work results in injury or damages. This helps to ensure that your contractors and suppliers are contractually responsible for their own negligence, and errors and omissions, should there be a claim filed against you.
- Insurance procurement clause, including obtaining Certificate of Insurance (COI). This provision requires the third party to obtain insurance, including a Certificate of Insurance, which might be required by your customers.
- Waiver of subrogation. When you are added to a contractor's insurance, you may want to set up a waiver of subrogation clause in your contract. This clause indicates that if the contractor's insurance policy pays a claim related to your work, the insurance company waives the right to come after you for damages, even if you were partially responsible for the loss.

CONTRACTUAL RISK TRANSFER CONSIDERATIONS

Contracts may be written to favor the originator of the agreement. Each state and jurisdiction has its own rules and limits on contractual risk transfer. Often, these rules are put in place to prevent the unfair transfer of risk to others. Consider this:

- Avoid overly broad agreements. Your contract should be as specific as possible to the scope of work and what their financial responsibilities would be.
- Whether you can transfer losses that are partly your fault, due to negligence, depends on the state. Some states allow you to use a transfer for a loss that is partly your fault, while other states do not. If your contract does not meet your area's rules, the other person could void your contract in court, leaving you responsible for any losses to the client.



WAYS TO MINIMIZE YOUR RISK WHEN SIGNING A CONTRACT

You can help minimize your risk by having an attorney trained in contractual risk transfer in the states that apply to your situation draft your contracts with vendors, suppliers, subcontractors, etc. The attorney can help craft language to best protect your business interests.

When signing others' contracts, the same types of risk transfer provisions may place unfair liability on you. Again, legal review is important, as once you sign a contract, it may be too late to go back on your decision. Exercise proper due diligence beforehand.

After a contract is signed, retain a copy and ask for a current copy of the other party's Certificate of Insurance to help confirm that the other party has obtained the proper insurance detailed in the contract. The certificate is not a copy of their insurance policy, but rather a description of the insurance coverage in force at that time. Pay attention to when the policy will expire. You'll want proof of the renewal of coverage at that time to ensure you both stay protected.

WHO NEEDS CONTRACTUAL RISK TRANSFER PROTECTION?

Contractual risk transfer is an important way businesses manage risk in many industries. It can be particularly helpful for manufacturing, professional services, real estate management and construction. Manufacturing and technology companies also use risk transfer language in their contracts for distribution and supplies, as those contracts could affect product liability.

Though it may be easier said than done, the goal is to protect your interests by managing the risks your business faces and not taking on any unnecessary risks. One important way to do this is by using Subcontractor or contractual risk transfer agreements.

For more guidance or questions on this topic, reach out to your agent today.
<https://www.travelers.com/resources/business-topics/business-continuity/what-is-contractual-risk-transfer>



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