

THE FUNDAMENTALS OF CONTRACTUAL RISK TRANSFER

Contractual risk transfer is an essential risk management practice that companies often overlook, resulting in unnecessary loss retention. The following two anecdotes show how actual claims played out with and without CRT.

In the first case, a recycler leased employees from a third party to torchcut material. When the leased workers were torchcutting brass rings off government-certified demilitarized munitions, there was an explosion. One of the leased workers was gravely injured and died days later. The decedent's estate filed a wrongful death suit, and the claims investigation revealed that the recycling company did not have a contract with the staff leasing company. As a result, the recycler had to defend the claim, and its insurer settled the case for millions—a loss that will affect the company's insurance rates, terms, and conditions for years.

In the second case, a recycling company hired an independent truck owner-operator to transport scrap, and it leased a trailer to the trucker. En route to picking up a load for the recycler, the trucker made an illegal U-turn and collided with an oncoming car, killing the driver. The driver's estate sued the recycling company based on vicarious liability because the recycler hired the trucker and he was hauling the company's trailer. The recycler had a contract with the trucker that contained a strong indemnification agreement and that made the recycling company an additional insured on the trucker's auto policy. The trucker's insurer agreed to provide a defense and indemnification for the recycling company, given its additional-insured status, and the company's own insurance was not materially affected.

In any owner/contractor, employer/employee, or principal/agent relationship, the principal can be found vicariously liable for the negligent actions or inactions of the agent. Proactive contractual risk management practices can transfer exposures and prevent losses. These three approaches are fundamentals of sound CRT practices:

1. Hold-harmless or indemnification agreements. These agreements shift liability from one party to another in the event of a loss or claim. Hold-harmless agreements absolve another party from responsibility for damage or other liability arising from the work being performed. Indemnification reimburses another party for a loss due to a third party's or

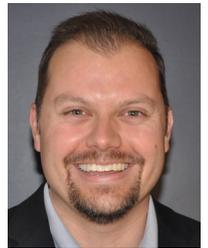
one's own act or default. These agreements should include a duty to indemnify and a duty to provide defense following a loss or claim. Some state statutes limit the use of indemnification agreements, so consult legal counsel when drafting the contract language.

2. Additional-insured status. You have two common approaches to ensure the counterparty can fulfill its contractual duty from a financial perspective. First, make your company an additional insured on the other party's insurance, including its general liability, automobile, and umbrella policies. Such status will force the other party's policy to respond directly on your behalf for defense and indemnification within the limits, terms, and conditions of policy coverage. It is best to become an additional insured by specific rather than blanket endorsement on the other party's policies and with regard to general liability for both ongoing and completed operations. Second, establish a written contract between your company and the contractor. In most cases, that party's general liability policy will cover it for liability it assumes in an "insured contract" should it cause the liability within the policy's limits, terms, and conditions. Also verify that the indemnitor has sufficient policy limits.

3. Waiver of subrogation. Request a waiver of subrogation in your favor on the contractor's workers' compensation, general liability, auto, and umbrella policies. Why is this beneficial? If a contractor's employee is injured while working on your behalf, for example, the waiver of subrogation agreement will prevent the contractor's workers' comp carrier from pursuing recovery from your company.

In addition to taking the above steps, require contractors to provide copies of their certificates of insurance and the declarations pages of their policies. Circumstances, agreements, and state laws vary, so consult your legal counsel, insurance broker, risk manager, or insurance carrier as you look to implement a CRT plan. ■

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