

Risk Transfer – The Basics

As a part of the tools designed to assist members in their risk management endeavors this short paper highlights keys areas specific to risk transfer.

Purpose of Risk Transfer

- To minimize potential liability exposures of the Agency by transferring the legal and financial responsibility for losses to the party best able to control them.
- To transfer exposures to the most responsible party.
- To avoid costly claims.

When Does Risk Transfer Apply?

Risk transfer should be utilized anytime your Agency uses the services of a vendor or allows an outside party to use your facilities (e.g., vendor, concessionaire, supplier, lessee, etc.) The following are just a few examples of when risk transfer is appropriate:

- 1) Construction - such as alteration, repair, improvement, renovation, maintenance, removal of or demolition of any building, highway, road, parking facility, bridge, water line, sewer line, electric utility transmission or distribution line, excavation or other improvement to real or personal property.
- 2) Professional Services - such accountants, legal counsel, and Design Professionals
- 3) Leases - for tenants and concessionaires - such as building and land leases, cellular towers on premises
- 4) Use of Facilities - such as use of Agency parking lot for an art show or use of Agency grounds for a special event

Exposure Identification and Analysis

The JPIA provides recommended insurance requirements and indemnification clauses for member agencies for various types of contracts that the member executes. The insurance requirements, in general, should be your minimum requirements. There may be special circumstances where the suggested insurance requirements are not appropriate and a higher limit may be in order. The deviation from the recommended limits depends on the hazards (exposures) of the job. In order to determine appropriate insurance limits and the extent to which risk transfer is necessary, the Agency should evaluate the job and the exposure to loss.

Consider the following in determining how rigorous risk transfer should be, and for deciding on appropriate insurance requirements:

- ◆ To what extent will the vendor control the work?
- ◆ What types of activities will take place during the term of the contract?
- ◆ Will inherently dangerous activities (such as blasting, tunneling, or pile driving) take place?
- ◆ Is there a possible pollution exposure?
- ◆ What is the potential for injury to the public?
- ◆ Who could be harmed by these activities?
- ◆ What property could be damaged?
- ◆ Are crowds or concentrations of people likely to be involved (e.g., schools, shopping, apartments)?
- ◆ Is work being done in traffic?
- ◆ Is it a long term or short term contract?
- ◆ What is the contract amount?
- ◆ Is work being done within 50 feet of a railroad facility?
- ◆ Is use of aircraft or watercraft involved?

The purpose of this list is to stimulate thinking about the potential adverse consequences of a project. This is the first step in establishing realistic risk transfer provisions and insurance requirements.

The identification of risks is the most important part of the process of managing risks. It requires time and thought.

How is Good Risk Transfer Executed?

Good risk transfer starts with a written agreement between your Agency and the vendor. The agreement should include the following:

- 1) **Hold Harmless and Indemnification and Provision** - a contract provision whereby the other party assumes legal responsibility for losses.
- 2) **Insurance Requirements** - a contract provision whereby the other party assumes financial responsibility for losses.

It is critical that both provisions be included in the contract. Typically, the hold harmless and indemnification and provision are addressed together and found in the same part of the contract.

The Agency's standard Requests for Proposals, Bid Specifications, Purchase/Work Orders, Leases, and Facilities Use Agreements all should contain appropriate hold harmless and indemnification and language, and insurance requirements.

The Agency benefits from the vendor's insurance only after its agent/broker and/or insurance carrier(s) issue the required certificate(s) of insurance and

policy endorsement(s). For this reason, all insurance documents should be in place prior to any work commencing.

When your Agency receives the vendor's insurance paperwork, it should receive at least two documents - the Certificate of Insurance and the Additional Insured Endorsement (for general liability coverage). The Certificate of Insurance serves as evidence that the vendor has an insurance policy in force. The Certificate of Insurance **does not** modify the insurance policy nor does it confer any rights to the Agency. You must receive and review the Additional Insured Endorsement to make certain that your Agency has been added as a covered party for general liability coverage. In addition, the JPIA is recommending Agencies also request copies of declaration page and/or endorsement page listing all policy endorsements for the General Liability policies (this will help identify "restricted coverage" policies to easily verify limitations or exclusions that have been added to the policy.

Finally the Agency should have in place a Contract Management Program (Administrator) that will ensure proper follow up with contract requirements - a method to tracking signed contracts, termination terms, as well as Insurance certificate renewals and follow up.

Appropriate Contract Language

The JPIA recommended risk transfer clauses contain specific hold harmless and indemnification language. Their intent is to transfer the legal responsibility for losses to the vendor. Not only does the vendor assume responsibility for his/her own actions, he/she assumes responsibility for "the work." The work might include some of the Agency's actions. *In no event should the Agency attempt to transfer its sole negligence or willful misconduct.* Failure to specify these two exceptions from the vendor's responsibility could invalidate the hold harmless and indemnification provisions since it is against public policy to attempt to transfer sole negligence or willful misconduct.

Construction agreements should include three exceptions: *sole negligence, willful misconduct, or active negligence.* Failure to specify these three exceptions from the vendor's responsibility in construction agreements could invalidate the hold harmless and indemnification provisions.

Flowchart for Requests for Proposals

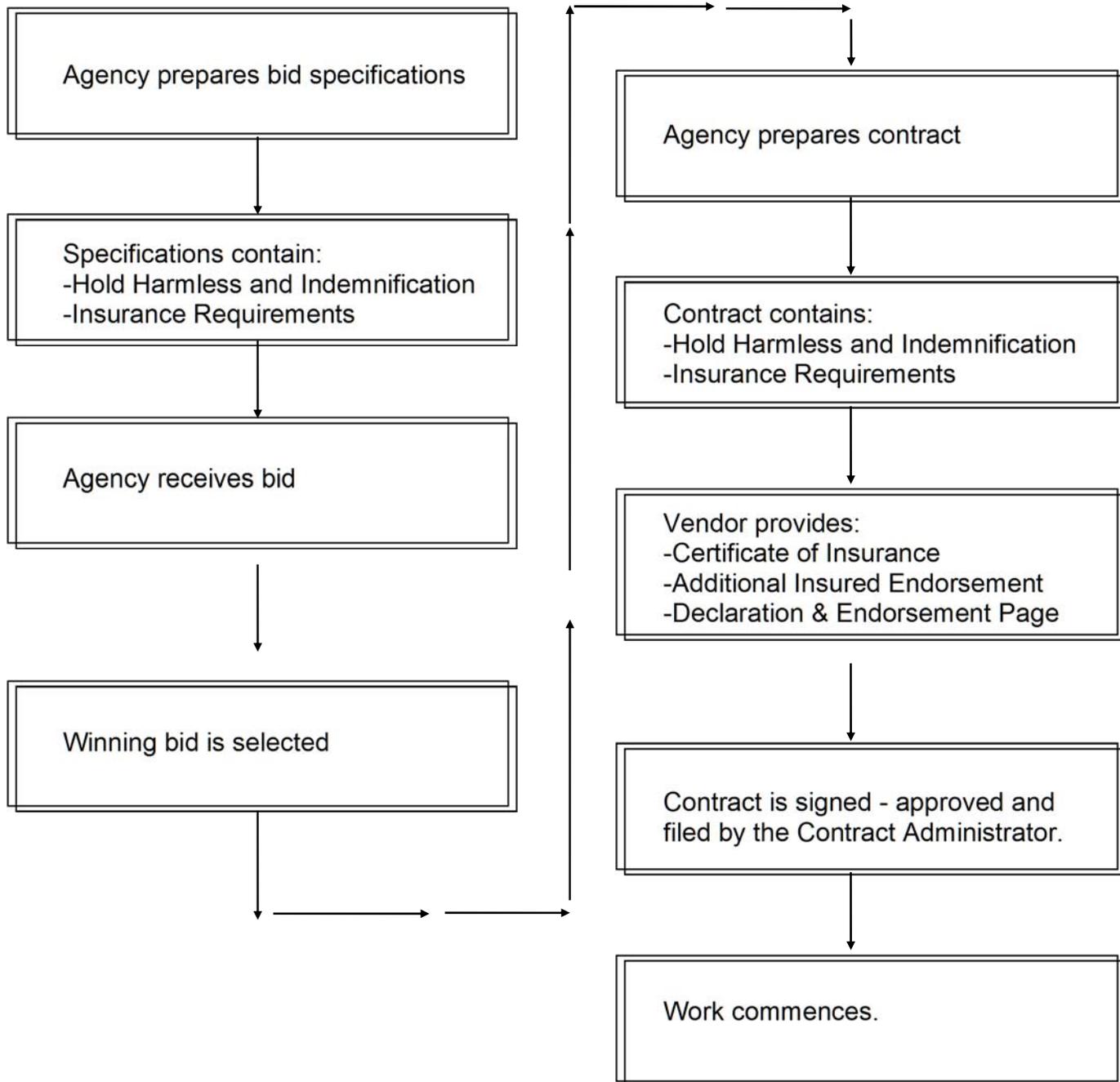
The following page contains a flowchart that shows how risk transfer fits into the Requests for Proposals (RFP) process. The flowchart illustrates the process and sequence of events that should take place when the Agency issues Requests for Proposals.

It is extremely important that the bid specifications contain the required hold harmless and indemnification language, and insurance requirements. All vendors should bid on the same basis. Once the contract is awarded, the executed contract must contain the **exact** hold harmless and indemnification clause, and insurance language found in the original RFP. *Failure to do so could result in adverse legal consequences.* The vendor should not change any of these contract provisions after the contract is awarded.

A best practice is to require the Certificate of Insurance and Additional Insured Endorsement be in their possession before the contract is signed. This affords the Agency assurance that the requirements can and will be met.

You may wish to use the flowchart as a checklist for your RFP Process. Using a checklist will help ensure that no steps are overlooked.

Flowchart for Requests for Proposals



Certificate and Checklists

Under the Risk Transfer Tools homepage on the website, members may utilize the Checklist for Verification of Certificates of Insurance and Additional Insured Endorsements. The checklists should be used in conjunction with the Recommended Insurance Requirements and Indemnification Clauses. They will help you determine whether the insurance documentation provided by the vendor meets the contractual requirements.

This white paper serves as a quick summary outlining the techniques surrounding risk transfer. For a deeper dive into the subject, please visit the Alliant Insurance Requirements in Contracts tab found on the Risk Transfer Tools web page. The Alliant manual is a well-crafted, up to date document, containing industry standards for transfer of risk that will further educate members in the art of insurance requirements in contracts.

Key Points

- 1) Involve Agency legal counsel and establish staff responsibility for carrying out the Risk Transfer Program at your Agency.
- 2) Evaluate the exposures, worse case scenarios and job size in order to determine the degree to which risk transfer is appropriate.
- 3) Use appropriate contract language to include hold harmless and indemnification language, and insurance requirements.
- 4) Let vendors know your requirements at the time they bid on the job.
- 5) Check all insurance documentation to see that it meets your requirements. Keep the documentation indefinitely.
- 6) Be persistent. It may take some time for the vendor to obtain the necessary insurance documentation. Do not let the job start without the paperwork in place.

Conclusion

The JPIA staff is available to provide you with assistance in developing and carrying out an effective Risk Transfer Program. Our goal is to simplify the risk transfer process for your Agency. The JPIA strongly believes in the benefits of risk transfer. **Risk transfer can help your Agency avoid costly claims.**