

Understanding Contractual Risk Transfer

**Learn how contract language affects
your Business's bottom line**

There are significant risks inherent on every construction project. Whether driven by site conditions, scope of work, an owner or the contractors themselves, they all have one thing in common; each contract executed will contain a clause transferring those risks from one party (transferor) to another (transferee) in order to eliminate the transferor's exposure to risk.





What is Contractual Risk Transfer?

As defined by the Insurance and Risk Management Institute (IRMI), Contractual Risk Transfer is:

"The use of contractual obligations such as indemnity and exculpatory agreements, waivers of recovery rights, and insurance requirements to pass along to others what would otherwise be one's own risks of loss."



Key Terms to Know



An **Indemnification Agreement**, also referred to as a **Hold Harmless Agreement**, is a contract under which one party agrees to assume the liability of a second party. The parties to these agreements are the **Indemnitor** – often referred to as the **transferee** – and the **Indemnitee** – often referred to as the **transferor**. The indemnitor assumes the liability of the legal claims that may be brought against the indemnitee because of the activities the contract covers.

Indemnity provisions come in three forms – **Broad Form** indemnification, **Intermediate Form** indemnification and **Limited Form** (sometimes referred to as comparative fault form) indemnification. State Statutes place limitations on hold harmless agreements to protect the public by preventing contracting parties from engaging in unacceptable behavior. This preserves fairness and fosters economically appropriate allocation of loss exposures and actual losses.

A **Waiver of Subrogation** is a pre-loss voluntary relinquishment by an insurer of its right to seek damages that were caused by a party other than the insured. An individual or organization can relinquish its right to sue in contract or tort by including a waiver of subrogation clause in their contracts.

An **Exculpatory Clause** is similar to a waiver. It is a contractual provision purporting to excuse a party from liability resulting from negligence or an otherwise

wrongful act. Many states use the terms “waive” and “exculpate” interchangeably.

In conjunction with the above contract clauses, a requirement to provide an **Additional Insured Endorsement** is common in construction contracts. An Additional Insured Endorsement obligates the transferee's insurer to pay (or pay on behalf of) the third-party after it has suffered a loss.





Why is Contractual Risk Transfer Important?

Contractual risk transfer's function is to place the financial burden of a loss on the party best able to control or prevent the incident leading to injury or damage. Owners and upper tier contractors seek to avoid the financial costs that can arise out of bodily injury or property damage to a third-party caused by a lower tier (subcontractor) for which they (the upper tier) could be held vicariously liable.





It is critically important to the success of a contractor's risk management program that the contractor can identify the form of the indemnification agreement contained within the contract. The contractor must also determine whether his insurance program will respond in support of that indemnification. Bear in mind that you may enter into a contract where the indemnification language is legal and enforceable, but your insurance program may not respond.

Furthermore, a cornerstone to a contractor's sound risk management practice is to replicate the upstream contractual indemnification and insurance requirements in their subcontracts whenever possible.

What's Next?

Construction companies sign contracts on a regular basis. Understanding contractual risk transfer in these contracts is critical to your business's bottom line.

Trans Hudson's risk advisors are experienced in the review of upstream and downstream contracts as they relate to your risk management and insurance program. Contact Trans Hudson Brokerage today for a complimentary risk review and assessment!



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