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Risk Transfer & Contractual Indemnification – Who Gets Left Holding the Bag?

I. What is Risk Transfer

Brief History

Risk transfer involves the transfer of a potential risk from one insured to another party based upon the allocation of potential liability between parties. It is an attempt to shift insurance coverage on the appropriate party responsible for the claim and insureds that the cost of insurance is allocated to the appropriate party. The risk transfer will depend on how the incident is alleged to have occurred and if the contracts have been drafted appropriately to confirm that the responsible party is assessed for the claims and that the losses are apportioned to the proper parties.

When a party obtains coverage, the carrier takes various matters into consideration when evaluating the potential risks and assessing how to proceed in issuing coverage to parties. A carrier will evaluate the potential for risk transfer in its evaluation of premiums for coverage and a determination as to how the carrier will proceed on issuance on coverage. In order for the carrier to properly transfer the risk from one party to the other party, the insured must have the appropriate contractual language and policy language in order to ensure that the coverage is assessed against the appropriate party. The session will focus on contractual issues required for the proper risk transfer with respect to alleged claims and how to properly proceed on ensuring that the risk is transferred as intended by the parties involved.

Risk transfer is a significant issue facing carriers in properly evaluating claims and reserves and is essential to the insureds with respect to potential coverage issues and determining the amounts to be incurred by parties when obtaining insurance coverage and assessing the potential risk to be assessed against parties. The carrier needs to ensure the proper party on the risk is assessed the expense of the risk to protect the parties and their loss run on cases and the insureds want to confirm that if there are any losses incurred, the losses are assessed against the proper party for the purposes of risk

transfer as opposed to be assessed against a party who is not responsible for the loss that is incurred.

A. Why do we care

A carrier will use an insured's loss run to evaluate the profitability of an insured and determine the extent of coverage going forward on a renewal basis. When a claim occurs as a result of a loss, an insurer needs to assign the loss to a specific insured. If the insurance was written with the understanding that the risk will be assigned to another party based upon the theory of risk transfer, it will be necessary for all the parties to ensure that the correct coverage is triggered for the subject loss. This will only occur when the proper contracts and language are utilized to demonstrate that the risk transfer occurs as intended by the parties.

Given that the insured's loss run and potential premiums will be based upon the proper assessment of coverage to the party responsible for the loss, the insured needs to make certain that the risk transfer to the party responsible for the claim is assessed the loss on the basis of potential future losses to be incurred and paid on behalf of the applicable insured. This means that the parties must ensure that the proper insurance is in place pursuant to the agreements between the parties and that the contractual claims are appropriate to proceed with the appropriate risk transfer as intended by the parties.

In order to demonstrate how to proceed with the proper risk transfer, we will discuss the appropriate contractual language to be utilized and how to ensure that the proper insurance provisions are provided in order to have the risk transfer necessary to assign the loss to the proper parties.

II. Potential Claims Applying Risk Transfer

There are several items that must be taken into account when an assessment is made for a risk transfer so that the agreements are enforced as was intended by the parties. The parties are required to enter into the appropriate contracts reflecting which party would be responsible for issues that arise when negligence occurs and how the losses are to be allocated based upon the contractual agreements between the various parties.

It is important that the contracts utilized demonstrate which events will trigger indemnification and if the party will be responsible for any incident arising out of the work of the party required to indemnify the party or if the party will only be required to indemnify the party if the incident in question arises out of the work of the party or was due to the negligence of the party.

The issue of risk transfer will also be dependent on whether the applicable insurance coverage is in place to require the carrier of the other contractor to cover any loss that would be associated with the claim.

In order to demonstrate the proper method of risk transfer, we will be providing a sample of the proper contract and insurance coverage necessary in order to demonstrate that the party responsible for the loss is assessed the loss for a successful risk transfer.

A. Hypothetical to be discussed:

The owner of a premises was interested in constructing a new building on its property. The owner was not going to construct the building on its own and was concerned about the costs of insurance for the property and how any potential losses would be assessed on the owner following the construction and any potential claims for injuries and/or damage as a result of the work performed. In order to have the work completed, the owner entered into an agreement with a general contractor to construct a building on its property. The general contractor was not able to perform all the necessary work on the project and in turn, the general contractor retained numerous sub contractors to perform various portions of the construction work on the on the project in question.

In order to complete the construction, the owner entered into a construction agreement with the general contractor for the overall construction of the project. The contract for the owner was prepared by the owner and was determined to be sufficient to ensure that if there were any losses incurred during the construction, the owner would be covered by the general contractor's insurance coverage and that the carrier's insurance coverage for the general contractor will be used on a primary, non contributory basis to cover the claim. Furthermore, the contract would include indemnification provisions which includes defense and indemnification provisions that properly require the general contractor to defend and indemnify the owner.

The general contractor will also be shown as to have entered into agreements with the sub contractors for work to be performed. However, it will be demonstrated how the contracts entered between the general contractor and the sub contractors were different from the contract utilized by the owner and did not contain all the appropriate language required for the agreement. A discussion will be entered with the panel to demonstrate how changes in the contracts for indemnification and insurance coverage can affect the potential claims for insurance coverage and indemnification of the parties. The language in the contract from the owner and the contract for the general contractor will be compared and contrasted as to the required language in order to demonstrate the proper procedures and language required to ensure that the parties are also able to proceed with the proper risk transfer.

We will focus on the way certain contract and insurance provisions make it easier to enforce both the indemnification provisions and the additional insurance provisions.

B: Potential Claims

During the course of the project, several incidents occurred which resulted in potential suits against the parties including the owner and the various contractors. A discussion will be conducted as to the alleged damages that arose due to the alleged incident and what types of damages would be recoverable through a risk transfer to parties regarding the appropriate contract languages.

A discussion will be had with all the contracts and how some of the claims will be transferred to the appropriate parties via risk transfer and how certain other claims may not be transferred based upon the improper language in the risk transfer contracts. The claims will involve issues concerning indemnification and insurance provisions and a discussion about how various claims will be applied on the issue of risk transfer and how using the improper language and documentation can result in the failure to properly transfer risk to the appropriate parties.

1. Potentially liable parties

The determination of liability as to the parties will be discussed and addressed as to which appropriate parties should be responsible for the insurance coverage. Discussions will take place as to the appropriate party responsible for the incident and that the insurance allocation is appropriately assessed to the correct party.

2. Potential damages

An evaluation of the damages alleged and how to appropriately assess the party responsible for the damages will be discussed. It will be shown how the improper language in a contract for risk transfer can affect the transfer of the risk to the appropriate party. As a result of the improper risk transfer, it will be shown that the loss run of the insured will be affected and could result in the failure to obtain coverage or an unwarranted increase in premiums charged to the parties.

III. Coverage Implications

Discussions will be conducted regarding issues on coverage between the parties and the applicable issues involved in transferring the risk to the appropriate liable parties based upon the proper contractual and insurance provisions between the parties.

Emphasis will be made on the issues involving whether the parties have utilized the proper language to ensure that the risk can be transferred to the party responsible for the loss and that the policy in question will actually covered the loss in question.

There will also be discussions on whether the coverage for the risk transfer would be on a primary and noncontributory manner or if the risk transfer results in concurrent coverage for the various policies which would affect the overall loss run for the parties.

The proper agreements and insurance policy information will be discussed which will permit the parties to determine how the language should be included to ensure that the agreements are drafted properly, the parties confirm that appropriate contracts are executed to ensure the appropriate coverage and the risk transfer is conducted as required.

It will be demonstrated that when the appropriate risk coverage is not utilized, the loss runs of the insureds and the costs associated with same will be affected disproportionately.

IV. Proper coverage/contractual claims/Failure of proper risk transfer

The session will provide a review of the various contracts utilized to demonstrate how to proceed with drafting of proper contracts which will include the relevant language for the proper risk transfer.

Drafting of appropriate agreements which permit the transfer of the risk to the appropriate party for the purposes of risk transfer will be demonstrated and the parties will discuss relevant case history regarding coverage issues involved in risk transfers which have been conducted.

CONCLUSION

Risk transfer raises issues on both liability and coverage between the parties involved in a project or incident. It will also relate to issues of proper allocation of coverage and evaluation of the potential for loss runs on parties and how the losses will be allocated on the cases. An explanation of the proper loss transfer employed will demonstrate how numerous parties are affected by the proper contract and insurance provisions and how it is possible for risk to be properly transferred between the parties.

Following a discussion of this matter, the attendees will be aware of the proper language in contracts to be used and the proper insurance coverage utilized in order to insure that risk transfer is completed properly and the parties can ensure that the party responsible for the loss is the party whose coverage is used for the loss.

The attendees will be able to utilize the appropriate contractual language and insurance coverage going forward to ensure that risk transfer is utilized as anticipated by the parties.