Texas Council Risk Management Fund

Risk Transfer in Contracts

One of the most effective tools of risk management is to transfer recognized risk to someone else. Fund members usually do this in two ways. One way is through coverage and the other is through contracts with providers, contractors and vendors. Coverage transfers the risk of loss or damage to the member's people, clients or property to the Fund. The coverage documents of the Fund pay for many of the risks of loss for worker and client injury, damage to vehicles or property, malpractice and employment or governance matters. Jointly the members of the Fund pay for the transfer of risk by paying claims from their contributions to the Fund, reinsurance and if necessary, the accumulated assets of the Fund.

Contracts with providers, contractors and vendors also accomplish the transfer of risk by identifying the losses the provider will assume and providing a method for paying for much of that assumption of loss. The first vital element for risk transfer in contracts is the language that obligates the vendor to accept the risk to the center from their operations or services. Although the provider may cause an injury to a client, the center could be partially responsible by establishing the type of services the contractor provides and overseeing their performance. In the real world of litigation, the plaintiff's attorney is going to seek recovery from the contractor and the center because both may be negligent in causing an injury. Neither party to a contract wants to accept the other's negligence, but the center's position is that if you want to do business with us you will accept part of our responsibility for a loss. An example of this is a provider outing for IDD clients when a visit to a local park results in injury to a client when he trips over a piece of playground equipment. The client's attorney will try to sue the contractor and the center. The contract between the center and the contractor contains an indemnification clause that says:

> *Provider will hold harmless and indemnify Center and its directors, officers, employees and agents from any claims, loses, damages, judgments, liabilities, costs, expenses or obligations, including attorney's fees and expenses, arising out of or resulting from Provider's negligence or acts. (Bluebonnet Trails Community Services Family Directed Services Agreement)*

Most indemnification clauses use many more words to say essentially the same thing, but this is a good summary of what is in most agreements. The key words are "will hold harmless and indemnify Center" from any source of loss caused by the "Provider's negligence or acts."

In the interest of fairness some indemnification agreements do not impose liability on the provider arising out of the center's "sole negligence." Good risk management practices will prevent this scenario from happening very often. Even with this language the indemnification agreement still transfers most of the risk to the provider.

The second vital element of the transfer of risk is the provider's ability to pay for "claims, losses, damages, judgments, liabilities, costs, expenses or obligations." Some large providers could probably handle these costs with their own reserves and financial strength, but most don't have the resources to absorb the costs. The solution and source of money required by the contract is in the provider's insurance program.

Contractual liability that is created by the indemnification agreement is accepted in the provider's General Liability insurance. If there's a written contract, the insurance company will respond to the obligations created by the agreement. There are several provisions in the General Liability policy that should be in place to make sure there is full acceptance of the obligation and enough money to pay for the losses. General Liability coverage responds to bodily injury or property damage to third parties arising out of the provider's premises or operations. The playground injury mentioned earlier caused bodily injury to a third party, the client. The provider's contract with the center obligates them to pay for the losses from the injury and their General Liability accepts the transfer of risk from the provider to them (Contractual Liability). They will pay the loss from their limits of liability which represent the total amount of money they will provide to pay the losses of their insured provider. The Fund recommends:

- $1,000,000 per occurrence (any one loss) and
- $2,000,000 aggregate (all the insurance company will pay in one year for all losses).

In addition to adequate limits of liability, a full transfer of risk to the insurance company includes an endorsement to their policy that provides that they will provide defense for the center in the event of legal action against the provider and the center. This is an "Additional Insured" endorsement. It provides defense by the attorneys hired by the insurance company as it relates to the particulars and allegations from the loss. The Fund recommends that you consult with your own counsel to make sure all the center's interests are addressed. The insurance company will limit their defense of the center to only the matters relating to bodily injury or property damage to the third party.

An important section of your standard contract with providers is "Insurance Requirements." The requirements include limits of liability, endorsements such as "Additional Insured" and others such as:

- 30-day notice of cancellation or non-renewal to the center on all policies.
- A "Waiver of Subrogation" on Workers' Compensation, General Liability, Automobile Liability and Umbrella. A "Waiver of Subrogation" prevents the insurance company from going after the center or the Fund to try to recover amounts they paid for losses on your premises or through alleged negligence. This is especially important since there is no additional insured status allowed on a Workers' Compensation policy.

The Waiver of Subrogation would come into play if one of the provider's employees was injured trying to help the client that tripped over the playground equipment. Their insurance company would pay the worker's medical expenses and lost time benefits then try to recover those amounts from the center because the provider was working for the center and providing services to a center client. The Waiver of Subrogation prevents the insurance company from recovering any amounts from the Fund or the center.

Sometimes the tables are turned on the center by a vendor that has a strong negotiating position or a service the center needs with no alternative bidders available. In that event the center might have to comply with the contractor or vendor's insurance requirements and agree to an indemnification agreement where the center assumes some of the vendor's liability. So, the transfer of risk goes the other direction with one important limitation. The indemnification agreement should be modified to include the phrase, "the Center hereby agrees to the extent permitted under the Constitution and the laws of the State of Texas to indemnify and hold harmless" the contractor or vendor. This will limit recoveries to the statutory limits in the Texas Tort Claims law.

Remember that the transfer of risk from the center to its vendors, providers or contractors requires two elements. The first is the indemnification agreement in the contract between the center and the vendors, providers, or contractors. The second part, also in the contract, is the insurance requirements imposed on the vendors, providers or contractors that pays for their acceptance of the center's risk.

In all cases, please consult with the Fund about any contract, indemnification language, insurance requirements, coverages required and the various endorsements a provider might object to or think they can't get from their insurance company.

Contact Richard Wigzell, Risk Management Consultant at 518-429-9974 or richard.wigzell@sedgwick.com, Mary Vasquez, Senior Underwriter at 512-427-2346 or mary.vasquez@sedgwick.com or Pam Beach, General Counsel for the TCRMF at 281-460-7820 or pamelabeach956@gmail.com.

Additional resources are available at on the Fund's website www.tcrmf.org.