Contractual Risk Transfer Helps Owners Cut Losses

BY LAUREN BOSTON

Action helps to avoid time, money spent on 'frivolous' lawsuits, other legal expenses.

"I tripped in the entryway. Can I have free rent?"

Michael Haydinger, Principal of First Montgomery Group, says he has heard this and other "frivolous" claims from residents over the years. Eventually, the risk of potential lawsuits convinced him to reduce his company's exposure to loss and the corresponding costs associated with it by leveraging another party's insurance policy.

Known as contractual risk transfer—and provided as part of all standard commercial insurance policies—this process enables one party in a contract to assume the tort liability of another party.

For example, if a resident slips and falls on an icy sidewalk, the vendor or service provider responsible for shoveling and salting the community can assume the liability, rather than the property management company. Doing so reduces a property management company's risk profile and insulates owners from losses.

Haydinger, whose company develops, owns and manages properties in the Delaware, New Jersey and Pennsylvania markets, says transferring his company's risk of loss to its vendors and service providers was necessary because of the number of renter incidents that occurred as a result of snow, wind and rain events, in particular.

"We experience the most loss from incidents associated with plowing and shoveling snow and ice; winter is the worst season for us," says Haydinger, who works with 150+ vendors. "For example, we have one resident slip-and-fall case that is currently being defended by contractors. Swimming pool liability also can be an issue."

Although Haydinger did receive pushback from some vendors and service providers who did not want the new burden of liability, he says most eventually agreed to the contractual risk transfer.

Says one insurance broker, "One challenge to this type of insurance coverage is the administrative function of identifying your vendors where you have exposure to risk, discussing the concept with them and implementing new contracts. Management also needs to decide on a course of action if a vendor refuses to accept the new contract language."

A few of First Montgomery Group's vendors did not want the burden of additional risk and ended their contract with the company; however, Haydinger says putting this language in each bid has helped First

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And when it comes to contracts for new vendors, the contractual risk transfer elements have become a part of the vendor selection process from the start.

According to one insurance broker, "Your decision to deviate from the standard contract should be a careful one that quantifies the risk being retained by your organization versus being able to transfer that risk to another party."

Easy As 1-2-3

Simply collecting certificates of insurance from contractors is not enough.

According to one insurance brokerage that serves the multifamily industry, an effective contractual risk transfer process involves three elements:

1. Consistent insurance requirements. Vendors showing proof of workers compensation coverage, general liability, automobile coverage, etc., is not sufficient. A process must be in place that dictates minimum limits of insurance that a company is willing to accept, minimum insurance company financial ratings and maximum deductibles.

When choosing among suppliers, all vendors should be required to show proof of insurance with "A-rated" carriers, as determined by the rating agency AM Best.

2. Specific indemnification. A contractual agreement in which one party agrees to pay for the loss or damage another party incurs. Indemnification and additional insured coverage are separate routes to the same objective: getting someone else to pay for a loss when it happens.

There are three levels of indemnification: "Broad Form" indemnification is where another party indemnifies an owner even for their sole negligence. Some states allow this for certain types of contracts.

"Intermediate Form" indemnification requires the other party to indemnify the owner in all instances except when they are solely negligent.

Lastly, "Limited Form" indemnification requires indemnification only to the extent of the negligence of the other party. In a way, it's not indemnification at all, because both parties are agreeing to be liable only for their own negligence.

3. Additional Insured coverage requirement from vendors. While indemnification is a required piece of an effective program, it could leave an owner or manager chasing after the assets of their vendor.

The missing piece that ties this all together is requiring a vendor to name the owner as an Additional Insured on their insurance policies. This way, a loss can be tendered directly to the vendor's insurance company.

"Without this, we still had to fight to have the claims fully covered," Haydinger says. "The process of handling a claim is much more straightforward with Additional Insured coverage."

There are many different standard Additional Insured Endorsements in use. Some provide coverage only for ongoing operations, for completed operations or for something that may not have anything to do with the scope of the contract with the vendor.

It is important for owners to consult with their insurance brokers and put language in their contracts that requires Additional Insured coverage be provided, or via a standard form number that is spelled out in the contract. This is the only way to ensure protection in the event of a loss.

FYI: Coverage Requirements

Insurance brokers should be able to advise apartment firms about the minimum acceptable insurance levels based on their specific operations and risk appetite. Once determined, these requirements should be used religiously. A good start is to require minimum limits, such as:

Workers Compensation	Statutory Limits
Employers Liability	$1,000,000
General Liability	$1,000,000 per occurrence, $2,000,000 aggregate
Automobile	$1,000,000 per occurrence

Source: Robert J. Scullin, ARM, The Graham Company

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