

Requirements When Entering Into a Contract



The service provider or user group should be responsible for their product, service or actions. A key component in the *transfer* of risk is contractual. While transferring risk via a written contract is one of the most important risk management tools available, there are limitations to its use. First, one party to a contract may prove to be incapable of bearing the transferred risk. And second, the language in a performance contract/agreement may be such that the intended transfer of risk never really took place.

The first limitation is mitigated by requiring the service provider or user group to provide a certificate of insurance (COI) that demonstrates an ability to bear financial responsibility. Additionally, you must require that your entity and/or municipality are listed on the COI as an *additional insured*. This provides you insurance coverage rights under the other party's insurance policy.

There are also specific 'terms' and/or 'clauses' that can be included in contract language that will further assure that some financial risk has in fact been transferred.

- A '*hold harmless*' clause is generally a promise by one party not to hold the other party responsible for any loss or damage. In this case a third party service contractor/provider should hold you harmless (and not the other way around).
- '*Indemnification*' further strengthens the agreement of one party to assume financial responsibility for the liability of another party. In the construction example above, the contractor is agreeing to accept the financial liability responsibility of your entity, should you be sued for injuries or property damage caused in the course of the contractor's operations.
- A '*defense clause*' is an insurance provision in which the contractor's insurance company agrees to defend the *additional insured*, with respect to insurance afforded by the policy, all suits against the insured.

Some issues also need to be considered when drafting contracts and/or agreements. These include, but are not limited to:

- It is better to reach an agreement on responsibility before an event and not afterwards.
- Each party's responsibilities are to be clearly defined if certain events occur and who is actually responsible for what (examples include, preparation before and clean up after an event, security, rules and regulations, etc.).
- Always involve your legal counsel before signing or executing a contract/agreement.
- Even though a COI has been provided, always verify that the coverage is still in place by contacting the insurance company listed on the COI.

In summary, 'risk avoidance' is an effective way to limit potential financial exposure. But, because municipalities exist to provide services to the community, not all potential risks can be avoided. Therefore, 'risk transfer' becomes a very efficient alternative for managing potential financial liability. However, remember that nothing takes the place of a strong proactive comprehensive risk management program in your daily efforts to manage, mitigate and lessen the effects of potential risks, hazards and financial liability in your daily operations.