



# **Contractual Risk Management: Balancing Risk and Opportunity**

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## **Risk and Opportunity Go Hand-in-Hand**

- In simplest terms, contractual risk is the potential for direct or indirect loss (typically financial) from the occurrence of injury, damage, death, disadvantage, or breach.
- Risk is not inherently a negative condition, but is an essential element of everyday business operations. Risk coexists with opportunity.

## Balancing Risk and Reward in Contracts

- An effective contract successfully balances the risk to your nonprofit organization with the financial reward.
- Effective contractual risk management can be accomplished by one or more of the following:
  - 1. Risk transfer (indemnity, insurance)
  - 2. Risk avoidance (releases, waivers, sub Ks)
  - 3. Risk minimization (additional insured, damage caps)
  - 4. Risk acceptance

## Transfer It

- **Insurance**- A contract in which one party, for a fee, agrees to compensate the other party facing a risk of financial loss as the result of a triggering event in the contract. (Paying someone else to accept the risk of your potential future financial liability).

## Transfer It

- ***Indemnify/Hold Harmless-*** A contract provision where one party agrees to restore the other party (who may suffer loss or be responsible for third party loss) in part or in whole by reimbursement, repair or replacement.
- ***Practice Pointer:*** Duty to defend may be a critical component of an adequate indemnity/hold harmless provision. Carefully consider the particular circumstances to determine if a duty to defend obligation is necessary.



## Transfer It

- ***Practice Pointer:*** Beware of statutory/common law restrictions on scope of indemnity (i.e., no indemnity for own willful or grossly negligent conduct, sole negligence, etc.).

## Avoid It

- ***Waiver of Subrogation***- Voluntary relinquishment, prior to loss, by a Named Insured of the right to seek reimbursement or other legal remedies for a claim or debt paid on behalf of another. (Works hand-in-hand with indemnity; binding on Insurer).
- Under an insurance agreement, insurer generally has the right to “stand in the shoes” of the policyholder, whom they have compensated for the loss, and seek reimbursement from the third party responsible for the loss. Thus, the need for a waiver.

## Minimize It

- ***Additional Insured Status-*** “Additional Insured” is third party (you) who, because of indemnitee status under contract, is granted limited coverage privileges under another party’s insurance policy.
- ***Benefits:*** Immediate defense, may cover sole fault (depending on endorsement used).
- ***Drawbacks:*** No absolute coverage for all types of potential contractual liability, acts prohibited by policy provision may cause coverage denial.

## Minimize It

- ***Limitation of Liability***- Provision stipulating conditions and monetary restrictions regarding variety of contractual liability exposures. (E.g., waiver of consequential and/or punitive damages, \$ cap on total liability under contract).
- ***Excess Liability Provision***- Requires party indemnifying and providing additional insured status to have their insurance declared as “primary” and “non-contributory” can protect your insurance and limits its coverage to excess participation.

## Accept It

- ***Price the Risk and Charge For It-*** Determine any cost adder necessary to properly balance additional risk and adjust contract price accordingly.

## Factors to Consider in Contract Risk Allocation

- ***Control of the Risk***- Who is in the best position to control the risk? (e.g., a brewery is in a better position to control drunk driving risks due to bartenders being brewery employees and dram shop insurance coverage).
- ***Knowledge of the Risk***- Does one party's knowledge of the risk make them more logical to assume risk (e.g., mold remediation specialist subcontractor is logical choice to assume liability for ineffective remediation and/or recurring mold).

## Factors to Consider (continued)

- ***Legal Limitations***- Statutory or common law may limit risks that can be transferred via contract (e.g., ban on assuming risk of loss resulting from another party's sole negligence).
- ***Custom and Practice***- What is customary in the industry (e.g., owner to GC; GC to sub).
- ***Bargaining Position***- Size of entities, level of competitiveness in the marketplace, etc.

## Takeaways

- In contractual risk management, insurance, indemnity, and limitation of liability considerations are interwoven. Each is relevant to the other, and they should always be evaluated in conjunction with one another and in the context of the entire contract and relationship between the parties in order to best allocate contractual risk and opportunity.





## **For More Information:**

If you would like more information about the services of Pro Bono Partnership of Atlanta, contact us at:

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