

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 06/2006 – “Contract Review”

June, 2006



Contract Review A Critical Element of Your Risk Management Program

By Jeffrey W. Cavnac, CPCU, RPLU, CRIS

Nearly every business enters into numerous contractual agreements each year. These agreements, which are often given only a cursory review, can have a significant impact on your firm's risk profile.

The purpose of a contract is to spell out the responsibilities of each party, the consideration being exchanged (usually dollars for services), and other terms and conditions that affect the transaction. Another way to look at a contract is “a piece of paper that marries two business parties together by explicitly anticipating every eventuality of their divorce.”

Business agreements can take many forms, ranging from professional service agreements to real estate leases or major equipment purchases. Within these contracts are numerous provisions, many of which transfer risk from one party to another. It is important to understand just what risk is being transferred, and if it is coming your way, whether or not your firm is capable of handling it.

The ultimate objective of contractual risk transfer is to shift risk to the party that is best able to control and finance the risk. In the real world, however, often the party with the most leverage attempts to shove that risk onto the other party.

Remember that while contracts are negotiable, risk needs to be quantified. Parties to the contract should decide in advance whether or not these risks

can be contained, or transferred to a third party, such as an insurance company.

While it would be impossible to address every contractual risk transfer provision that you might see, I'll discuss the major issues you are likely to deal with in contract negotiations.



Indemnification

Indemnification is defined as “compensation for actual loss or damage.”

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Published by

Cavnac & Associates

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Under common law, one is responsible for indemnifying another party for the consequences of one's negligent acts. Contractually, however, indemnification can be broadened.

There are three basic types of indemnities. From an insurance perspective, we typically break indemnities down into limited form, intermediate form, and broad form.

- 1. Limited Form Indemnity** – A limited form indemnity merely states that the indemnitor will hold harmless and indemnify the indemnitee for the consequences of the indemnitor's negligence. This is insurable under most professional liability and general liability policies and is legal in California.
- 2. Intermediate Form Indemnity** – An intermediate form indemnity requires the indemnitor to hold harmless and indemnify the indemnitee for anything and everything except the indemnitee's sole negligence. This is legal in California, and is insurable under most commercial general liability policies. Responsibility for the indemnitee's negligence is uninsurable under most professional liability policies.
- 3. Broad Form Indemnity** – A broad form indemnity requires the indemnitor to hold harmless and indemnify the indemnitee for anything and everything including the indemnitee's sole negligence. This may be covered under a commercial general liability policy, but this type of indemnity is considered illegal in California.

The legal profession breaks down indemnities in a different fashion: Type 1, Type 2, and Type 3.

- 1. Type 1** – The classic Type 1 indemnity clause involves the indemnitee receiving defense, indemnity and a hold harmless agreement from the indemnitor for any claim, loss or other liability which arises from the work or services of the indemnitor, except that the indemnification does not apply with respect to the sole negligence or willful misconduct of the indemnitee. This is analogous to an Intermediate Form indemnity.
- 2. Type 2** – A Type 2 indemnity is similar to a Type 1 indemnity except that it does not pertain to the active negligence of the indemnitee. In other words, a Type 2 indemnity would require the indemnitor to be responsible for the passive negligence of the indemnitee. Although this is insurable under a commercial general liability policy, it is uninsurable under a professional liability policy. If the indemnitees are negligent (whether active or passive), they should be responsible. The contractual coverage under a professional liability policy will not extend to the indemnitee's negligence.
- 3. Type 3** – A Type 3 indemnity is similar to the limited form indemnity, and is really no more than the basic statement of comparative fault in contractual form. The indemnitor agrees to indemnify the indemnitee for all losses caused by the indemnitor's negligent acts, errors or omissions. This is insurable under a commercial general liability policy as well as a professional liability policy.

Before agreeing to an indemnification agreement you need to understand exactly what risk is being transferred and whether or not you are in a position to assume the risk. You also need to take into consideration any state laws that might affect the risk transfer.

For example, in California it is illegal to transfer the consequences of your sole negligence. It is, however, legal to transfer the consequences of your concurrent or contributory negligence.

Assuming you are the party being asked to indemnify another, you need to determine if you can insure it. Under most **commercial general liability policies**, broad-form contractual liability is in-

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cluded. This allows you to assume the “*tort liability*” of a third party. In other words, if you agree to be responsible for the concurrent negligence of another, your commercial general liability policy would respond – assuming, of course, that the loss in question is covered by the policy.

On the other hand, most **professional liability policies**, like those written for design professionals, only include limited-form contractual liability. They allow design professionals to hold harmless and indemnify a third party from the consequences of their own negligence. But if a design professional agrees to be responsible for a third party’s negligence, that would not be insurable. In other words, if design professionals make a mistake they have coverage, but if they agree to be responsible for another’s mistake, that would not be covered.

Indemnities are one of the most crucial elements in any contract. Whether you are the indemnitee or the indemnitor you need solid advice from a knowledgeable attorney and insurance broker to understand the legal and risk management implications.



Insurance Requirements

Almost all contracts contain some sort of insurance requirements. It is important that these be reviewed to make certain you are not in breach of contract before the project even starts. In some cases, insurance requirements might necessitate purchasing additional coverage that could have a significant cost. In other cases, coverage may not be available at all. These issues should be clarified *before* the contract is signed.

Some of the more common insurance requirements you will see include the following:

1. Commercial General Liability (CGL)

Commercial general liability covers you for legal liability arising out of your business operations that results in either bodily injury or property damage. It also covers the liability of others assumed under a contract.

The minimum CGL limit required in many contracts is \$1 million, although higher limits are being required more often.

Since CGL policies are written with aggregate limits of liability, it is not uncommon to see a requirement that the general aggregate limit be endorsed to apply to each project. This endorsement is not difficult to get and is fairly inexpensive, but it does need to be added to your policy.

You will often be asked to make your policy primary over the other party’s insurance. You should verify that this is automatically included in your policy. If it isn’t, the policy will require a separate endorsement.

Finally, naming the other party as an additional insured under your policy is a common requirement. Quite often a specific additional insured endorsement form will be specified, so you need to make certain your insurance company can provide that endorsement.

2. Business Automobile Liability

Business automobile liability protects against liability arising from owned, non-owned, and hired cars used in your business. If a company owns vehicles, this coverage is mandatory. Even if a company does not have any owned vehicles it should carry at least non-owned automobile and hired car liability coverage.

You will often be asked to provide additional insured status on your business automobile policy as well. Since a business automobile liability policy automatically extends coverage to “*anyone liable for the conduct of a covered auto,*” an additional insured endorsement technically may not be required. Nevertheless, some of your clients may still

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insist on an actual endorsement, and most insurance companies can provide them.

3. Workers Compensation

Workers compensation covers your employees for work-related injuries. This coverage is required by law and is written on a standard policy form. In addition to evidence of workers compensation insurance many of your clients will require that you agree to waive your rights of subrogation against them. Although some companies can provide this on a blanket basis, most require a specific endorsement, and there is typically a modest additional premium.

4. Property Insurance

If property under construction or being renovated or remodeled is part of the agreement, it is typical to see a property insurance requirement spelling out who is responsible for insuring the real property and/or the personal property that is the subject of the contract. It is imperative that you understand who is responsible for bearing the risk, as this might require you to carry specific property insurance.



General Requirements

In addition to specific coverage issues there are a number of general requirements that are usually included in an insurance provision:

1. Notice of Cancellation and/or Non-Renewal or Material Change – It is not uncommon to see a request for 30, 60, or even 90 days advance notice of cancellation for non-renewal or material change. You should be aware that your insurance company will not send notice of material change. In most cases the insurance company is only obligated to provide 30 days notice of non-renewal or cancellation unless it has endorsed the policy otherwise.

Finally, in almost every case the carrier will only provide 10 days notice of cancellation in the event of non-payment of premium.

2. Minimum Financial Size – Many organizations require a minimum A.M. Best rating or some other type of financial organizational rating. Some requirements also stipulate that coverage

must be written on an “admitted” basis. However, many insurance companies choose to operate on a “non-admitted” basis.

Non-admitted is not necessarily a negative. It simply means that an insurance company does not want to be subject to some of the rules and regulations of the California Department of Insurance. Insurance companies operating on a non-admitted basis still need to go through a licensing process and pay a fee to operate. If admitted insurance is required and your carrier is not admitted, you will need to negotiate this in your contract.

3. Evidence of Insurance – In almost every case you will be required to provide evidence of insurance. This is usually provided in the form of a certificate of insurance. You will also often be required to submit a copy of the Additional Insured Endorsement discussed previously.

Standard industry ACORD certificates are most commonly used. Be wary of manuscripted forms prepared by others – your insurance company may not agree to use them.



Real Estate Leases

One of the most common forms contractual risk transfer comes in the form of your real estate lease. Generally speaking, the landlord has more leverage than the tenant, and risk is transferred accordingly.

Some of the more common risk transfer issues you’ll see in real estate leases include the following:

1. Casualty Damage

It is critical that the landlord and tenant address the casualty damage issue within an appropriate lease provision. In other words, if the premises are substantially destroyed, who will be responsible for repairing the damage? Will the tenant still have to pay rent during the reconstruction or repair period?

In most situations, after casualty damage to the premises in question the landlord will be required to provide the tenant with a good faith estimate of how long it will take to complete the repairs. Rent is usually abated on any portion of the premises that is unusable. If repair or reconstruction take longer than a specified period of time, either party can generally terminate the lease.

2. Property Insurance

It is imperative that responsibility for property insurance be clearly spelled out in the lease. In general, landlords are responsible for insuring the real property, and tenants are responsible for insuring their own personal property.

The issue of who insures the tenant improvements is a gray area. Technically tenant improvements are part of the building and should be insured by the landlord. In many cases, however, they are paid for by the tenant, who thus has an interest in the improvements. This issue should be reviewed carefully.

Most, but not all, leases include a mutual waiver of subrogation. This benefits both the tenant and the landlord. If damage is paid for by either the tenant's or landlord's insurance company, the tenant or the landlord will waive the insurance company's rights against the other for any recovery.

3. Liability Insurance

In general, the tenant is required to provide liability insurance and name the landlord as an additional insured. In addition, there is usually an indemnification agreement running from the tenant to the landlord. Note that this type of indemnification agreement is included as an insured contract under most general liability policies.



Major Purchases of Supplies and Equipment

Anytime there are major purchases of supplies or equipment, a number of risk management issues arise. Risk of loss or damage in transit need to be addressed, as goods are often held in warehouses or other places, and you should make certain that insurance is in place.

Lease agreements on office and industrial equipment need to be evaluated. Who is responsible for the tenant's leased \$30,000 copier if it is damaged or destroyed? (The tenant usually is.) Who is responsible for the backhoe a contractor rented if it's stolen? (Normally the contractor is.)

Insurance can be arranged for these situations and others to cover the tenant's exposure. The key is to identify those exposures up front so that the appropriate insurance can be arranged to cover them.



Contract Review Best Practices

Every business enters into contracts that have both risk management and insurance implications. It is important that policies and procedures be put in place so that every contract can be reviewed, the risk quantified and transferred if appropriate.

- Make certain that **every contract entered into by your company is reviewed** by appropriate personnel and, when appropriate, by your legal counsel and insurance broker.
- Remember that **every contract is negotiable** – it doesn't matter if it is a boilerplate or "company policy."
- **Understand the risks you can assume** and the limitations you should not assume.
- **Establish preferred insurance and indemnification standards**, but know and understand what your fall-back position will be.
- **Exceptions** to your **insurance and indemnification standards** should only be allowed if approved by a **principal**.
- **Negotiate on the Merits** – There's a right way and a wrong way to negotiate. A number of quality books on negotiation can help you improve your negotiation skills. Two of the best I have seen are *Getting to Yes* and *Bargaining for Advantage*.

Risk transfer is an effective risk management technique, but whether you are transferring the risk or assuming it, you need to understand the exposure. Time taken on the front end of the contract review process to negotiate equitable terms can yield substantial returns on the back side in the event of a problem. ✂

Jeff Cavnac is President and Managing Principal of Cavnac & Associates.

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

"Neither fire nor wind, birth nor death can erase our good deeds." — Buddha

Five Ways to Prepare for the Unthinkable



I was reading an article in *Kiplinger Finance* regarding the untimely death of Dana Reeve and her husband, Christopher, who passed

away a few years ago from an accident. Her death left their 13 year-old son in the care of family and friends. The death of Dana Reeve provides an important reminder about estate planning and the importance of providing for your family before it is too late.

Don't be fooled into thinking you are too young to worry about a proper estate plan. Without instructions, a court will make decisions about who will care for your children and what will happen to your assets, including turning everything over to your kids when they turn 18, regardless of whether they are capable of handling major financial decisions.

Here are five issues to consider when deciding how to protect your family after you are gone:

1. Setting Up a Living Trust – Married couples can draft their wills to leave everything to their surviving spouses, or in the event there is no surviving spouse, to a testamentary trust for the benefit of the children.

In establishing the trust, the parents select a trustee and prepare a trust agreement giving the trustee the power to manage the trust and use the income for the children. Life insurance proceeds can be paid to the trust to provide for your children's care and education.

2. Naming a Guardian – Although most couples assume the surviving spouse will be the one to

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care for the children, their wills should also name a successor guardian in the event that both of them die at the same time. The name of that guardian should be the same in both wills.

Carefully consider your choice of guardian. While your parents may adore their grandchildren, an elderly guardian may not be physically up to the task. Who is appropriate? Think carefully about this.

3. Think About Checks and Balances – While you can name the same person as guardian of your children and trustee of their assets, it's a big burden for one person and could create problems, like the fox watching the henhouse. It's better to have at least two people sharing those duties.

4. Be Proactive – Make sure you have enough life insurance to provide for your family when you're gone. If you are young and healthy, term insurance is cheap to buy.

5. Don't Forget Safekeeping – Once you take the steps to draw up these crucial documents, make sure someone knows where to find them. Otherwise, it's like leaving your family a buried treasure – without a map. Normally, your attorney keeps one set of documents, you keep another, and you give a third set to the person you have named the executor of your estate. ✨

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Beat the Heat!

Tips for Staying Cool When the Weather Heats Up

Article courtesy of Cavnac & Associates' Employee Benefits Department



Heat can be more than uncomfortable — it can be a threat to your health, especially for older adults and children. Whatever your age, don't let the summer heat get the best of you.

Heat Exhaustion

Heat exhaustion occurs when a person cannot sweat enough to cool the body, usually the result of not drinking enough fluids during hot weather. It generally develops when a person is playing, working, or exercising outside in extreme heat.

Symptoms include:

- Dizziness, weakness, nausea, headache, and vomiting
- Blurry vision
- Body temperature rises to 101°F
- Sweaty skin
- Feeling hot and thirsty
- Difficulty speaking

A person suffering from heat exhaustion must move to a cool place and drink plenty of water.

Heat Stroke

Heat stroke is the result of untreated heat exhaustion. Symptoms include:

- Sweating, and awareness of heat and thirst, stops
- Body temperature rises rapidly to above 101°F
- Confusion or delirium
- Possible loss of consciousness or seizure

Heat stroke is a serious medical emergency that must be treated quickly by a trained professional. Until help arrives, cool the person down by placing ice on the neck, armpits and groin. If the person is awake and able to swallow, give fluids.

Tips for Staying Cool

- **Drink Plenty of Water** — In hot weather, drink enough water to quench your thirst. The average adult needs eight 8-ounce glasses of water a day,

and more during heat spells.

- **Dress for the Weather** — When outside, wear light-weight clothing of natural fabric and a well-ventilated hat.
- **Stay Inside Whenever Possible** — Do errands and outside chores early or late in the day.
- **Eat Light** — Replace heavy or hot meals with lighter, refreshing foods.
- **Think Cool!** — Take a cool shower or apply a cold compress on your pulse points. Or, visit an air conditioned mall or movie theater. ✨

Wear Sun Protection!

By Stuart Nakutin, CSM, AIC, PHR, WCCP, CPDM

You may think a suntan looks good, but too much sun exposure can damage your skin and your eyes.

Besides sunburn, the sun's ultraviolet (UV) rays can cause skin cancer. Working around reflective or hot surfaces and equipment can compound the danger of sun exposure. Some medications may even increase your sensitivity to the sun's light.

Whenever you work in the sun, wear sunscreen, even if you're tan or have naturally dark skin. Use the strongest sunscreen for your skin type, one with a sun protection factor (SPF) of at least 15. Before going outdoors, apply the sunscreen to all body surfaces not covered by clothing. Liberally apply sunscreen every time you're exposed to the sun, including on cloudy or hazy days. Sunscreen should be applied regularly, at least every two hours, especially when you're sweating.

Wear loose clothing that covers your skin like long sleeved shirt, long pants, a neckerchief, and hat or visor.

Protect your eyes from the sun's rays by wearing sunglasses with UV protection. Not only is it important to protect your eyes from damaging UV rays, which can lead to cataracts, but also your diminished vision from squinting can present a safety hazard. ✨