

Essentials of Contractual Risk Transfer

Bryony Bowers Hodges

Director of the Legal Department & Deputy General Counsel

Dominion Energy

Steve Verbeski

Executive Vice President & Managing Director Power & Utility Practice

Hays Companies

Mike McFarland

Director, Enterprise Risk Management

Great River Energy

MODERATED BY

Garrett Finnegan

Senior Litigation Counsel

AEGIS Insurance Services, Inc.



2019 Policyholders' Conference

Value

Essentials of Contractual Risk Transfer

Garrett Finnegan – Moderator

Senior Litigation Counsel

AEGIS Insurance Services, Inc.



2019 Policyholders' Conference

Value



Essentials of Contractual Risk Transfer

Bryony Bowers Hodges

Director of the Legal Department & Deputy General Counsel

Dominion Energy



2019 Policyholders' Conference

Value

Our Discussion Today

- Managing contractor / vendor / supplier risk in agreements
- Indemnification
- Contract insurance requirements
- Some important insurance terms
- Frequent contractor / vendor issues and possible solutions
- Working from within – the utility risk manager's perspective



2019 Policyholders' Conference

Value

The Disclaimer – This is Not Legal Advice!

The information presented herein is intended to be educational and general in nature. Any thoughts, ideas, or suggestions contained herein **should not be considered as legal advice** or recommendations for specific business applications, as all businesses have unique characteristics which should be fully evaluated before implementing any of the ideas or strategies discussed herein.

The presenters recommend that utilities fully assess their specific risk management needs and objectives when considering the extent that these techniques are appropriate for their companies, and incorporate the involvement of risk/insurance, legal, procurement and operations teams as appropriate when designing and implementing risk management strategies.



2019 Policyholders' Conference

Value

Contract Insurance Requirements

- Independent financial protection on the part of the contractor, which helps assure there are assets available to pay for losses and fulfill the contractor's risk obligations to and the general public
- Through *Additional Insured* status, it provides utility the ability to receive direct protection from – and access to – the contractor's insurance carrier and policy if the utility is faced with liability due to the contractor's operations or activities
- It does not create any new obligations – only helps assure the contractor has an independent financial ability to pay for injuries and damages that the contractor may have caused, or that arise out of the contractor's operations or activities



2019 Policyholders' Conference

Value

Contractors: A Necessary Part of Your Business

- Reasons
 - Cost savings
 - Increased flexibility
 - Access to innovative construction methods
 - Labor qualifications and staffing issues
 - Reallocation of risk
- Contractors like working for us! Utility companies pay vendors in full, on time, and cautiously avoid liens on their assets



2019 Policyholders' Conference

Value

Risks of Using Contractors

- Wide variation in contractors' skill and expertise
- Risk that contractor does not understand your regulators' and customers' expectations
- Limited ability to direct and control contractor's work methods
- Not every contractor has the financial capability to fulfill its responsibilities in event of injuries or damages that may occur as a result of its actions
- A utility is the classic "deep pocket," and must protect itself and its customers from liability for loss caused by others



2019 Policyholders' Conference

Value

Selecting a Contractor

- The utility must ensure that its contractors are financially responsible if the contractor's operations cause loss to the utility, its employees, or to the public
- Is the contractor qualified to perform the work?
- Does the contractor's commitment to SAFETY mirror your own corporate values?
- Is the contractor financially able to meet its commitments to the utility?



2019 Policyholders' Conference

Value

Must Have: A Well Drafted, Signed Contract

- **Master agreement & supplemental POs** – appropriate for repeat, ongoing business
- **Scope of work** – who, what, when, where, and how often?
- **Price term** – fair to both sides; easy to calculate and know when payment is due
- **Assignability** – are you ok with the contractor assigning his duty to perform?
- **Who bears the risk?** the party with the greater control of the risk is in the better position to avoid risk, and should be responsible for the financial burden if a loss occurs
 - Insurance
 - Indemnity
 - Limitations of liability
- **Dispute resolution** – choices of law, venue, and alternate dispute resolution procedures



2019 Policyholders' Conference

Value

The Peanut Butter & Jelly of Risk Management

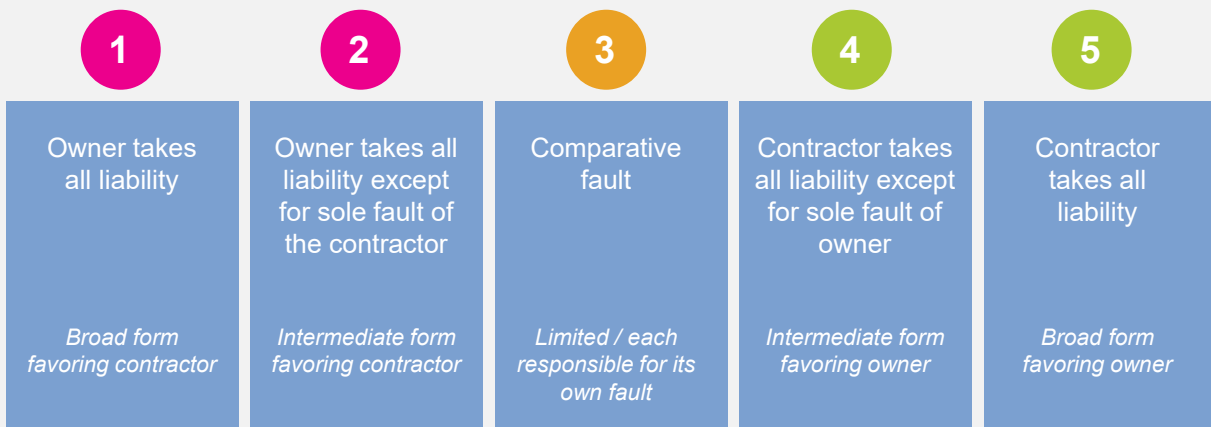
- Indemnity:** The portion of the contract or agreement defining how one party will protect the other. This part of the contract describes to what extent the contractor/vendor must do to protect the company if the utility is faced with liability arising out of the contractor's operations and activities;
- Insurance Requirements:** Portion of the contract or agreement stipulating the minimum types and amounts of insurance that must be maintained by the contractor or vendor in order to evidence a measure of financial responsibility for losses and legal liability. It is an independent verification of financial assets available to fund losses arising out of the contractor's operations and activities.



2019 Policyholders' Conference

Value

Five Common Ways Contractual Indemnification Can Operate



2019 Policyholders' Conference

Value

Be Wary of the Legal Definition of an Independent Contractor

- The desire to manage your contractors' work activities must take into account the legal limits of doing so. Does your company conduct on-site inspections of contractors' work?
- The definition of "independent contractor" is a state law-specific analysis
- South Carolina uses the "Right to Control" test
 - Direct evidence of the right to, or exercise of, control
 - Method of payment
 - Furnishing of equipment
 - Right to fire
- Federal and state agencies and plaintiffs' lawyers are trying to move from an "actual control" standard to a "potential control" standard

Note: This test looks not at the utility's *actual* control of its contractor, but rather at the utility's *RIGHT* to control the activities of its contractor. It is important to study your company's POs, Terms & Conditions, and other contract documents.



2019 Policyholders' Conference

Value

Contract Insurance Requirements

- Independent financial protection on the part of the contractor, which helps assure there are assets available to pay for losses and fulfill the contractor's risk obligations to and the general public
- Through *Additional Insured* status, it provides utility the ability to receive direct protection from – and access to – the contractor's insurance carrier and policy if the utility is faced with liability due to the contractor's operations or activities
- It does not create any new obligations – only helps assure the contractor has an independent financial ability to pay for injuries and damages that the contractor may have caused, or that arises out of the contractor's operations or activities



2019 Policyholders' Conference

Value

Additional Contractual Considerations

- How long is coverage needed?
 - Contractor shall procure and maintain in effect during the term of the agreement, and for a period of _____ years thereafter for the following coverages. State Statutes of Limitations for contractor work?
- Require contractor's coverage to be *primary and noncontributory*
 - Contractor agrees to stipulate that such insurance is primary and is not additional to; or contributing with, any other insurance carried by or for the benefit of the owner
- Beware of the *Limitation of Liability* clause. **The fine print can hurt you.**
 - Evaluate the risk and understand how the limit of liability will apply before agreeing to the contract
 - Negotiate – even if it is part of a standard form
 - Limits of insurance is a possible compromise if the amount of the insurance reflects the amount of the risk



2019 Policyholders' Conference

Value

“Belt & Suspenders” Protection

- The **indemnity clause** spells out the contractor's or vendor's contractual responsibility to protect the utility against liability and claims arising out of contractor's or vendor's products, services or activities
- The **insurance requirements** are intended to assure there is some form of independent financial capability to respond to contractor's or vendor's liabilities & its responsibility to protect the utility
- While the two provisions are complementary, they also need to operate somewhat independently from one another



2019 Policyholders' Conference

Value

Additional Insured vs. Indemnification

Additional Insured

- Transfers the risk to insurer with financial means
- Defense coverage
- Insurer bound by duties of good faith and fair dealing

Indemnification

- Contractor may not have financial means to pay for the loss
- No defense coverage, fees probably not recoverable
- Contractor can litigate zealously



2019 Policyholders' Conference

Value

Essentials of Contractual Risk Transfer

Steve Verbeski

*Executive Vice President & Managing Director,
Power & Utility Practice*

Hays Companies



2019 Policyholders' Conference

Value

Contractor/Vendor Insurance Coverage

What it **IS**

- It **IS** an independent and verifiable asset that provides a degree of financial assurance that will respond to claims for injuries and damages arising out of the contractor's activities;
- It **IS** a certain degree of verification that the contractor's risks have been reviewed by an independent third party (an insurance company), which has agreed to assume the transfer of risk;
- Where the UTILITY is protected as an *Additional Insured*, it **IS** an independent source of potential financial protection, in the form of defense costs and settlements;
- It **IS** good due diligence and business practice to assure that the contractor or vendor is able to be responsible for injuries and damages to the UTILITY, its employees, third parties and the general public.
- A policy of insurance **IS** the only document that grants, limits or takes away coverage – an insurance certificate can do none of that.



2019 Policyholders' Conference

Value

Contractor/Vendor Insurance Coverage

What it **IS NOT**

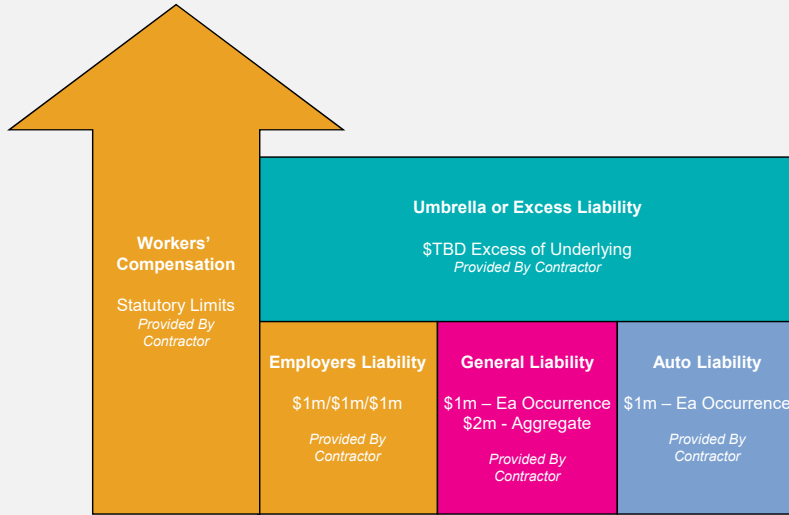
- It **IS NOT** an indemnity agreement;
- It **IS NOT** a substitute for a well-structured indemnity agreement;
- It **IS NOT** an operative instrument of a contract or agreement – except to evidence protection of its insured contractor or vendor;
- Except where the UTILITY is protected as an *Additional Insured*, it **WILL NOT** be an independent source of potential financial protection, or act on its own, to protect the UTILITY;
- It **IS NOT** a good idea to depend solely on the quality, effectiveness or the ability of contractor / vendor insurance coverage to protect the UTILITY;
- It **SHOULD NOT** be used only to protect the UTILITY's out-of-pocket retention under its own insurance – it should also be sufficient to avoid your own insurers having to cover the contractor's problems.



2019 Policyholders' Conference

Value

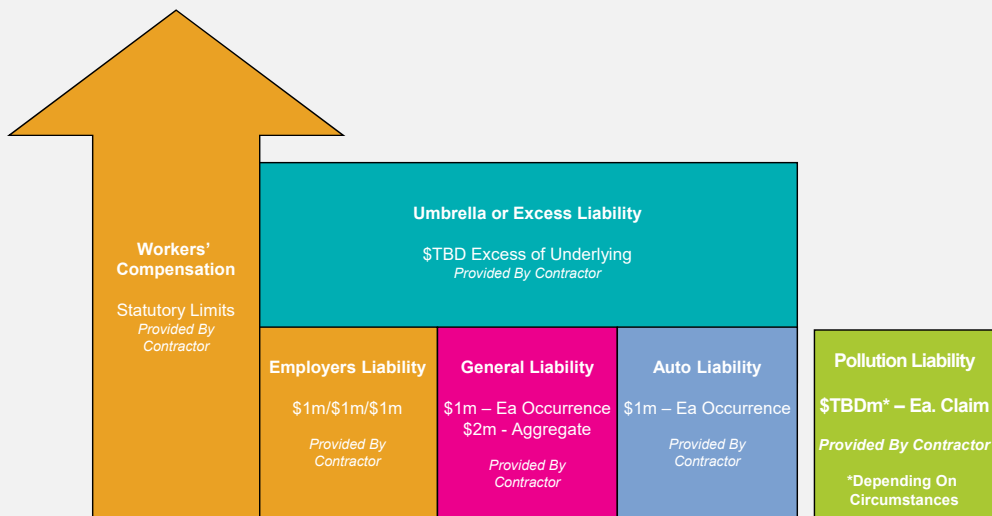
Typical Insurance Requirements



2019 Policyholders' Conference

Value

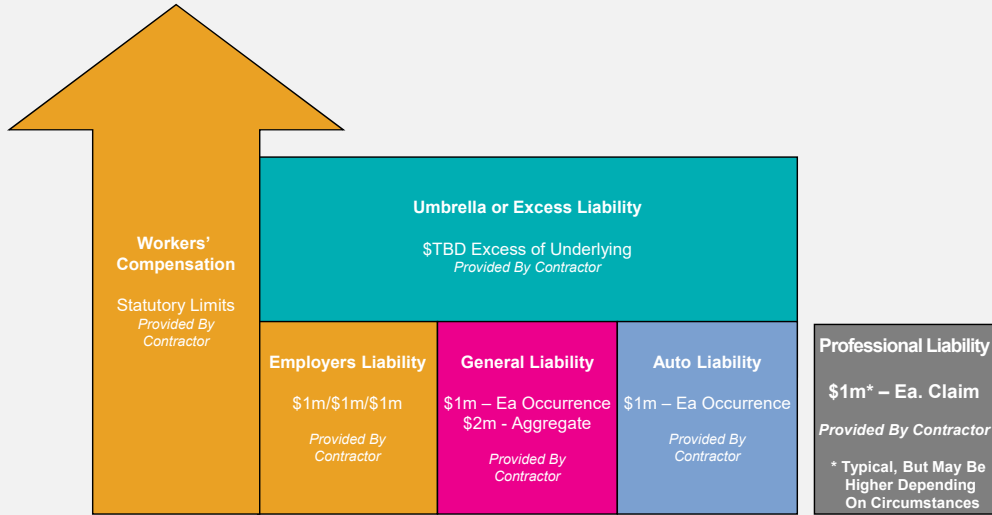
Insurance Requirements Including Additional Coverage Elements Which May Be Required by Situation



2019 Policyholders' Conference

Value

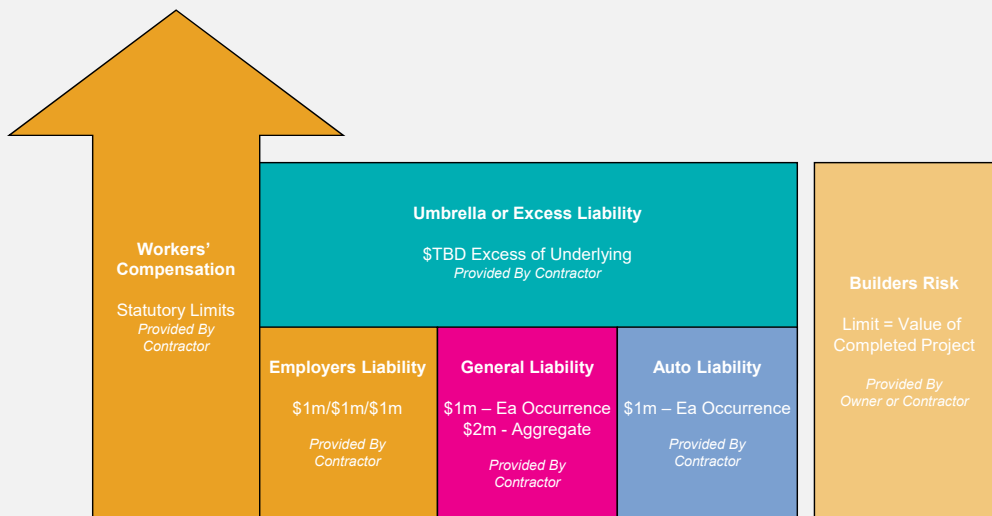
Insurance Requirements Including Additional Coverage Elements Which May Be Required by Situation



2019 Policyholders' Conference

Value

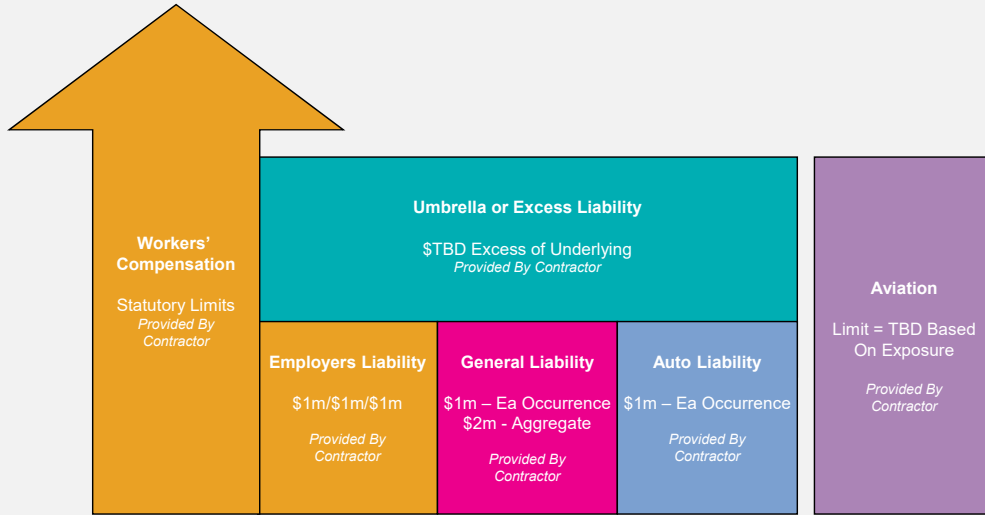
Insurance Requirements Including Additional Coverage Elements Which May Be Required by Situation



2019 Policyholders' Conference

Value

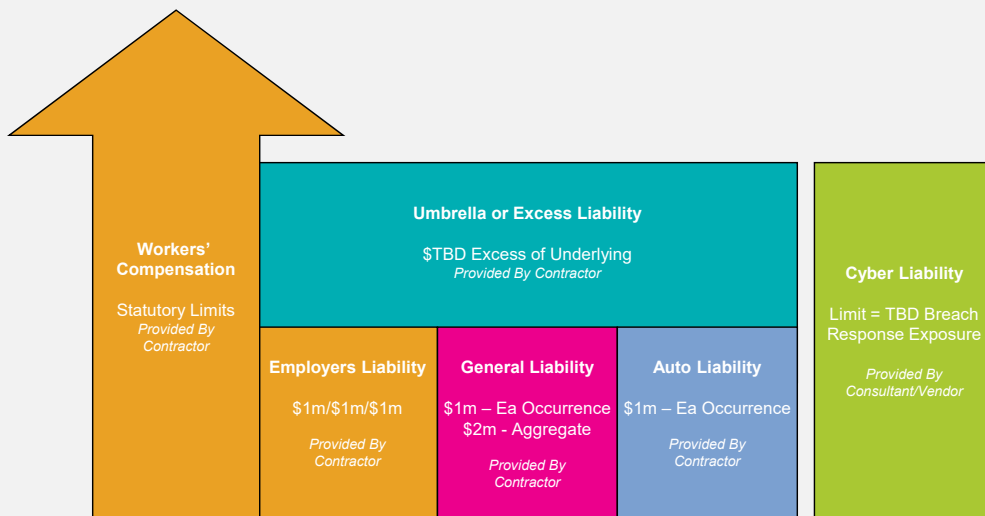
Insurance Requirements Including Additional Coverage Elements Which May Be Required by Situation



2019 Policyholders' Conference

Value

Insurance Requirements Including Additional Coverage Elements Which May Be Required by Situation



2019 Policyholders' Conference

Value

Operative Terms of Importance

- **Additional Insured status** – makes an insured party under contractor’s liability insurance for vicarious liability imposed on utility due to contractor’s activities. *Additional Insured* status should be specifically requested and demonstrated for both contractor’s primary liability policies (CGL, auto, etc.) **AND** umbrella / excess liability policies;
- **Waiver of Subrogation** – prevents the contractor’s insurance company from making a claim against utility for claims paid by the contractor’s insurance;
- **Cancellation provision** – requires contractor’s insurer to provide utility with advance notice that contractor’s insurance policy will be cancelled (becoming problematic these days);
- **Contractual Liability** – extension of contractor’s liability insurance policy to include coverage for insurable promises made in the indemnity section of a covered contract or agreement.



2019 Policyholders’ Conference

Value

Additional Insured Status

- Aligns the contractor’s insurance coverage with the obligation to protect against liability arising out of the contractor’s operations and activities performed on behalf of
- Allows direct and immediate access to, and defense by, the insurer and insurance policy(ies) that the contractor maintains for the protection of both the contractor and
- Affords the same protected status to an *Additional Insured* as the contractor
- Keeps both the contractor and the owner “on the same side of the table” vs. assuming an adversarial position against one another
- Reinforces the intent of a Waiver of Subrogation – an insurer cannot attempt to force recovery from one of its own insureds



2019 Policyholders’ Conference

Value

Common Questions – Insurance Requirements

Should the utility be an *Additional Insured* on a contractor's or vendor's umbrella / excess liability policy too?

- **Yes.** While many umbrella / excess liability policies will follow the terms of the underlying primary general liability and auto liability policies that they are intended to provide additional limits over, there are a sufficient number of umbrella / excess liability policies that do not follow form, and may not provide *Additional Insured* protection to the utility unless it is specifically stated in the contractor or agreement that they must do so
- Accordingly, it is recommended that your contracts and agreements specifically state that the utility (or your specific subsidiary) is to be included as an *Additional Insured* on the commercial general liability, auto liability **and** umbrella / excess liability policies to be maintained by the contractor / vendor



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

“Your contractor / vendor won't accept your insurance requirements...what are your options?”

- Are your requirements reasonable and current?
 - Sometimes we get carried away with overly broad and lengthy insurance requirements – or asking for terms that are obsolete
- Is the contractor's alternative reasonable and current?
 - Sometimes the contractor has to be educated or brought current with state of the art / best practices
- Who has the best leverage?
 - In most competitive situations, the utility has leverage, but in some cases, it may be the contractor or OEM
- Is your deal team on the same page?
 - Too often the risk manager is painted as the obstacle – this is where good pre-planning and team building pays off



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

Contractor has inserted language into the contract that limits how, when and to what extent the utility can be an *Additional Insured* on its liability policy

- Try to avoid those situations
 - Some contractors will try to redefine or direct how their insurance policy is supposed to work. Typically, this wording is inserted into the contract between the contractor and the utility, and not in the contractor's insurance policy itself
- Some examples of this follow



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

“Contractor agrees to name utility as an *Additional Insured*, but only to the extent of the contractor's negligence.”

- When will negligence be determined? Answer: *Who knows!*
- Dilutes the purpose of *Additional Insured* status, if not rendering it completely useless!
- Avoids a key purpose – to avoid finger-pointing; helps to assure owner and contractor are “sitting on the same side of the table”
- *Additional Insured* status is a standard insurance provision developed by the insurance industry that recognizes the value of reduced conflict and an alignment of interests throughout the claims process



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

“Contractor agrees that its policies will include a waiver of subrogation in favor of owner, but only to the extent of the contractor’s negligence.”

- Huh??? This essentially does *nothing!* The contractor’s insurer(s) should not be subrogating against owner for the contractor’s own negligence anyway
- The reason for waivers of subrogation is to assure that the contractor’s insurers do not create theories of liability against owner
- Once again, this is a standard insurance provision developed by the insurance industry that recognizes and accommodates the needs of owners to be protected, and facilitate business-to-business contracts & agreements for goods and services



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

Maintaining *Additional Insured* status & protection through completed operations period

- *Additional Insured* protection should not end when the work is completed and/or the contractor leaves the site
- *Additional Insured* protection is important for contractor’s products and completed operations exposure for a reasonable period of time after the work is completed or the contractor leaves the site
- A combination of two ISO *Additional Insured* endorsements are required to provide protection during contractor’s ongoing and completed operations (CG 20 10 & CG 20 37) – or a similar manuscript endorsement
- Assuring continuing completed operations *Additional Insured* protection is always a challenge



2019 Policyholders' Conference

Value

Sample Contractor / Vendor Issues

Mutual *Additional Insured* Status – i.e. contractor names owner as an *Additional Insured* , and owner names contractor as an *Additional Insured*

- Very little benefit has been demonstrated by this practice – but potentially very much confusion
- Disputed fault or negligence between the parties can typically render the benefits of *Additional Insured* status almost useless
- So what's the point?



2019 Policyholders' Conference

Value

Possible Solutions

Contractors may offer owners & contractors protective (OCP)
vs. *Additional Insured* protection

- **Advantages:** separate project limits, covers owner for liability arising from contractor's activities
- **Disadvantages:** no completed operations coverage, owner covered for only "general supervision", no umbrella or excess liability limits above OCP



2019 Policyholders' Conference

Value

It was drilled into us beginning at a very early age:
Never get into a car with a stranger!

**Now most of us think nothing
of taking an Uber.....**



2019 Policyholders' Conference

Value

Possible Solutions

Utility owners may want to consider a GL-only Owner Controlled Insurance Program (OCIP)

- Advantages

- Separate project limits – insulates liability from utility's operational program
- Covers utility, construction manager, prime contractor and subcontractors of every tier
- Owner designs and controls coverage, cost and claim handling
- Typically larger limits for all participants
- Completed operations coverage assured for ten years or statute of repose (whichever less)
- Avoids *Additional Insured* and waiver of subrogation issues
- Reduces insurance certificate needs & compliance issues
- Possible project cost savings



2019 Policyholders' Conference

Value

Possible Solutions

Utility owners may want to consider a GL-only OCIP

- Disadvantages
 - Potential contractor resistance
 - Perception of more “work” than conventional turn-key contractor insurance
 - Possibility of no cost savings



2019 Policyholders' Conference

Value

Essentials of Contractual Risk Transfer

Mike McFarland

Director, Enterprise Risk Management

Great River Energy



2019 Policyholders' Conference

Value

Utility Risk Manager's Perspective

Managing third party risk

- The risk is all too real
- Requires close internal integration (legal, procurement, etc.)
- How to get “in the loop”
- Actual situations, good and bad



2019 Policyholders' Conference

Value

The Risk is All Too Real

- Typical risk analysis focuses on impact and probability
- Impact analysis – *if* things go “wrong”
 - Best case scenario: third party assumes and compensates for any liabilities irrespective of any insurance coverage
 - Unlikely, especially if there is any question as to fault
 - Could nevertheless result in heavy legal fees
 - Assumes third party has adequate risk capacity to fund liabilities in face of inadequate insurance cover
 - Worst-case scenario: third party becomes insolvent, can meet little if any obligations, liabilities; liability reverts to utility
 - Third party is unable to assist with legal defense, cannot contribute to applicable deductibles
 - May be that **NO** coverage exists (third party OR first party)
 - Little in way of recourse
- Probability analysis: things *will* go wrong

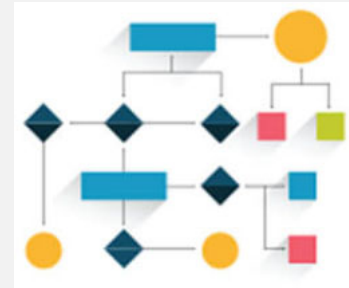


2019 Policyholders' Conference

Value

Integrating Within the Business

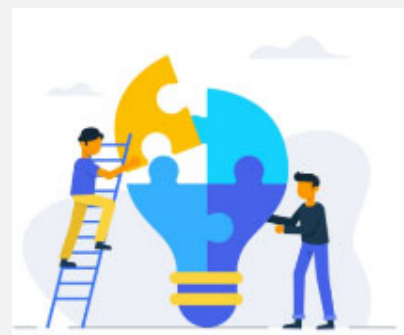
- The basics
 - Best practices dictate some method of centralizing third-party arrangements (e.g., service contracts); though decentralized models can also work
 - Typically this falls to a procurement and/or legal department
 - Sometimes it is not centralized, but there is still a formal process
 - Other times, it is haphazard and distributed across operating units (those ultimately hiring the third party to perform work)
- Risk and insurance integration
 - What you already know: you should be “in the loop” with procurement and/or legal and/or operating units
 - Extremely difficult when there is no formal process
 - This should show up as a high or critical risk in your risk register!
 - Often challenging even when there is a formal process, especially when working with bureaucracy, resistance, egos



2019 Policyholders' Conference

Getting in the Loop

- It's all about relationships
 - This is and should be viewed as a key enabler to risk management in all forms across the enterprise
 - Listen and learn about others' goals, objectives, and priorities
 - Learn about their role, how their business functions, their concerns
- Service orientation
 - Avoid any sense that you are obstructing progress
 - Be a service organization and behave as such
 - Promote risk management as a service, ensure you are helpful
- Teach, don't preach
 - Risk management is fascinating; engage others with that in mind



2019 Policyholders' Conference

When it Goes Bad

- Crane service – degraded transmission structure removal
 - No formal agreement; pole collapsed during removal, caused damage to crane; thankfully, no injuries. No contract.



2019 Policyholders' Conference

Value

When it Goes Bad

- Welding company – and subsequent transformer failure
 - No formal agreement; transformer failed subsequent to work performed; no insurance agreement; no waiver of subrogation



2019 Policyholders' Conference

Value

When it Works

- Procurement works with you as a partner
 - Consults with risk management to set standard insurance and indemnity terms & conditions; and on major exceptions
 - Engages risk management for large projects / contracts
 - See risk management as an ally to foster procurement policy compliance
 - Implements effective practices to ensure insurance certificates precede any consent to proceed with a contract
- Legal seeks your advice
 - Consults with you to set third party insurance requirements
 - Seeks out your knowledge and advice on coverage issues
 - Brings you into the agreement review process
- Advance notice of changes in operations
 - You become aware of things before agreements are signed



2019 Policyholders' Conference

Value



2019 Policyholders' Conference

Value