THE VALUE OF RISK TRANSFER CONSULTING IN REAL ESTATE TRANSACTIONS AND CONSTRUCTION PROJECTS

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In real estate transactions, like ground leases, access agreements, or construction agreements, parties often make risk transfer promises to one another to indemnify against liabilities and obtain insurance.

Attorneys handling these matters specialize in real estate or construction law but may not be as familiar with the nuances of liability and insurance coverage. A risk transfer consultant can add immeasurable value by helping draft insurance requirements and indemnity provisions that maximize risk transfer. And they can review insurance policies bought to comply with these requirements and recommend commercially reasonable changes to the policies before the project commences and a loss occurs.

Most policies bought to comply with these requirements have fundamental disconnects to the project at hand. But they can be easily fixed by a risk transfer professional who speaks the same language as the insurance brokers and underwriters and knows what is available in the insurance marketplace. A risk transfer consultant complements a transactional attorney's practice, leading to better outcomes for clients and placing the risk of loss on others, where it belongs.

UNDERSTANDING THE PROJECT

Three different project scenarios illustrate the value of risk transfer consulting. In Scenario 1, a property owner negotiates a ground lease, under which the tenant will construct a structure on the landlord's property. In Scenario 2, a property owner negotiates an access agreement with a neighboring property owner to allow access to its property for construction activities on the neighbor's property. In Scenario 3, a property owner negotiates construction contracts for a project on its own property. In each of these scenarios, one has superior bargaining power to demand risk transfer.

RISK TRANSFER CONCEPTS

The most basic risk transfer concept is to maximize one's ability to shed risks of loss to others. Risk transfer involves using many tracks to afford protection from liability for the risk of loss. One track is contractual indemnity and hold harmless. Another track is insurance procurement – typically, being named as an additional insured. Each track comes with certain benefits and limits, but together they can provide maximum protection for losses attendant to a project. The goal is to obtain both forms of risk transfer protection from as many parties as possible.

THE CONTRACTUAL INDEMNIFICATION TRACK A party (the indemnitee) can require another party (the indemnitor) to agree to indemnify, defend, and hold it harmless from liabilities arising out of a project. The enforceability of a contractual indemnity provision may be limited under state law in some cases. A risk transfer consultant will be familiar with these limitations. For example, some states prohibit a party from being indemnified for its own negligence in a case involving construction or renovation activities. As a result, an indemnity provision which purports to require the indemnitor to indemnify the indemnitee for any and all liabilities may be unenforceable if the indemnitee has any affirmative negligence. Yet case law provides that if the indemnification is specifically afforded "to the fullest extent permitted by law," then an indemnitee who is 1% negligent may recover indemnification from the indemnitor for the remaining 99% of its liability.

We often see overbroad indemnity provisions that are unenforceable, but there are often easy fixes. Even where an indemnity provision is enforceable, it may not confer a benefit if the indemnitor lacks insurance for the risk of loss, or assets to pay if insurance is unavailable.

THE INSURANCE PROCUREMENT TRACK Each project presents challenges to make sure that the insurance obtained will, in fact, afford coverage for the project. Failure to get it right will result in insurers disclaiming coverage for the loss. For example, ground lease and access agreement scenarios have one thing in common: The work is not performed for the landlord in the ground lease or the property owner affording access to its property to a neighbor. The most common additional insured (AI) endorsements in contractors' policies contain language that the AI coverage is afforded when the liability for bodily injury or property damage "arises out of" or is "caused by" the named insured contractor's ongoing or completed operations "performed for" the AI. This is a trap for the unwary. In these scenarios, insurers with these endorsements will seize on this distinction to deny coverage to the landlord or property owner if a claim arises. A risk transfer consultant will insist on the use of a different AI endorsement – often the ISO CG 20 26 AI endorsement – which names the right party in a schedule, identifies their address, and affords coverage for liability arising out of the "use" of their property.

Another pitfall to look out for is priority of coverage. In these scenarios, the party to be named as an AI expects the AI coverage to pay first. In insurance parlance, they expect it to be primary and noncontributory insurance. But there is no uniformity of insurance policy language; differences abound. Increasingly, many insurers have inserted excess "other insurance" provisions in their policies. In today's insurance market, however, primary, umbrella and excess policies may contain what is called a Primary and Noncontributory (PNC) endorsement, which provides that the insurance afforded as AI protection will be primary and will not seek contribution from any insurance issued to the AI as a named insured. If a policy doesn't contain a PNC endorsement, one should be requested; virtually all insurers have PNC endorsements that they use on request. Like many things, if you don't ask, you don't get. And not specifying PNC coverage in the written contract can also be fatal. Failure to get this right may result in a client's own insurance having to pay before all the AI coverage has paid.

The insurance track also entails making sure the right types of policies are procured. While primary CGL, umbrella, and excess are standard requests, commercial auto may be important for the risk of injury or loss from loading or unloading an auto. This may be barred in the primary CGL policy by the auto exclusion (which bars coverage for liability for the use of an auto, including the loading or unloading of an auto). The auto coverage picks up this risk.

The insurance track also involves determining what limits of insurance should be required, which entails understanding what is common for a party or trade contractor. Finally, the insurance track involves reading each of the policies that are bought to make sure that no provisions take away the required coverage. Insurance policies may contain provisions which modify how the contractual liability and employers' liability exclusions work, or may contain non-standard exclusions, which upend the coverage that parties expect and are counting on. A risk transfer consultant can spot these issues easily.

It is always better to have more risk transfer than less. To maximize it, we use a site access agreement with each party that comes onto the premises to perform work. Such an agreement, which may be only two pages in length, contains contractual indemnity and insurance procurement requirements in plain English. Many insurance policies issued to contractors contain blanket AI endorsements, which automatically afford AI coverage if there is a written contract between the named insured and the would-be AI. Courts have read these standard endorsements as requiring direct privity of contract between the named insured contractor and the AI. By requiring everyone to sign a site access agreement, the party increases the likelihood of greater risk transfer in the event of a loss by satisfying this privity requirement.

A risk transfer consultant familiar with liability and insurance coverage, the insurance claims review process, and the availability of terms in the insurance marketplace can review policies bought to comply with insurance requirements to assess their adequacy. It is a rare case in which the policies do not present issues which would preclude coverage. If this review is done before the project commences and a loss occurs, a risk transfer consultant can identify shortcomings in the policies and prescribe fixes that are commercially reasonable and readily made. When an insurance broker advises that something requested cannot be done, risk transfer consultants are often able to provide an endorsement that the insurer used in another policy. In short, a risk transfer consultant can remove hurdles to coverage before there is a problem, so that when a claim arises it will be covered.

A party can make whatever risk transfer requirements they like in a contract, but if they don't review the insurance policies bought to meet those requirements, they are accepting them at face value and will often find out the hard way that hope is not a strategy. Obtaining the policies and reviewing them for compliance with the insurance requirements is integral to ensuring effective risk transfer.

A risk transfer consultant can help to lay the foundation for a successful loss avoidance strategy that effectively shifts the risk of loss to other parties and their insurers, thereby keeping the client's insurance loss history clear and their insurance premiums as low as possible. And it may be easier to sleep at night knowing this has been done.

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