

# Contract management

If you are like many business owners, you might not take the time to thoroughly review a contract when it comes across your desk. You may leave this up to your office manager or casually review it yourself.

Yet, effective contract management can help protect your business from many potentially expensive lawsuits and judgments. It is important that you understand how a written contract can benefit and protect your business — and it is essential for you to practice effective contract management.

Purchase orders, waivers, rental agreements, leases, terms and conditions and other types of written agreements can all function as contracts — to simplify matters, the term “contract” will be used in this document.

## What a written contract does

Today's fast-paced and highly litigious business environment requires proper contract management and knowledge. A written contract functions as a legal document and should do the following:

- Provide a clear statement of the work to be performed or the products and services to be rendered, to prevent confusion and misunderstanding;
- Provide clarification of the legal responsibilities and obligations of the parties through the use of indemnification clauses, “hold harmless” agreements and waivers or limitations of legal liability;
- Provide a method of dispute resolution to reduce and possibly eliminate costly litigation expenses, which can be especially important with international business partners; and
- In some cases, shift insurance responsibilities by including additional insured requirements; or the contract may increase exposures thereby requiring the purchase of additional insurance coverage.

## When drafting or reviewing a contract, look for

- Which state's law applies to the contract, and for international business partners, which country's law? What effect does this have on the contract?
- Does the contract include all addendums (i.e. no side agreements or verbal statements apply)?
- Is the contract enforceable? Is it a signed agreement between two or more parties? Are the parties competent adults who have been given the opportunity to review and understand the contract? For instance, a waiver written in small print, not in plain English, on the back of another document might not meet this requirement.
- Does the contract require specific dispute resolution methods? Is there an “Arbitration Clause”? This is especially important when dealing with international business partners where the Arbitration Clause may require you to arbitrate disputes in a foreign country.
- How does the contract compare to other contracts that may be in effect? Are they broader? Are they equivalent?
- What are the milestone performance dates of the contract?
- What requirements does the contract impose upon you?
- What requirements does the contract impose on the other party?
- What safety and quality control procedures are required?
- Are surety bonds or other security required for the contract?
- Will one party be allowing the other use of its tools, equipment or facilities or sharing access to the project location with others?
- If a contractor will be permitted to use subcontractors, or a tenant allowed to have sub-tenants, what requirements should this party be held to? How will they be addressed in indemnification clauses?
- What insurance requirements have been written into the contract? Some examples of insurance coverages that may be applicable include:
  - Auto liability
  - Commercial general liability

- Contractual liability
- Fire legal liability
- Liquor liability
- Product liability/completed operations
- Professional liability/errors and omissions
- Data breach
- Builder's risk
- Installation floater
- Bailee coverage
- Motor truck cargo
- Umbrella insurance
- Workers' compensation
- What limits of insurance are required for each coverage?
- Are there additional insured requirements?
- Are insurance companies required to have particular financial ratings? Most financially sound insurers carry an A.M. Best Company rating. Refer to <http://www.ambest.com> for information regarding a carrier's current rating.
- When dealing with international business partners and foreign locations, are participating insurance companies licensed in the foreign countries where the contracted for work may be performed?
- When contracting with international suppliers and trading partners for the supply of goods and services being brought into the United States, is the international trading partners' insurance company licensed and admitted to do business in the United States?
- Will you be notified if the required insurance has been cancelled?
- Does the contract contain waivers of subrogation? If so, which insurance policies are affected? Will those insurance policies still pay if a waiver of subrogation is in effect? What other entities are affected?
- What evidence of insurance must be provided to the contracting parties? Certificates of insurance?

## What additional insured status does

- A party with additional insured status has direct access to the other party's (the named insured's) insurance policy, including immediate access to legal defense. Without additional insured status, the first party would need to submit a claim to their own insurance carrier, and then attempt to recover damages and legal fees using a contract's indemnity clause or through subrogation.
- The named insured's insurance carrier cannot subrogate against additional insureds.
- A vendors endorsement gives a company that is selling the products of another company additional insured status on the first company's product liability insurance policy. A vendors endorsement may specify "blanket" coverage of all products and all vendors, or it may be specific to certain ones.
- Additional insured status is generally not available for workers' compensation policies.
- An alternate employer endorsement provides primary workers' compensation and employer's liability coverage to another party, such as customers of a temporary employment agency.

## What an indemnity provision does

An indemnification clause or hold harmless agreement requires one party (the indemnitor) to assume financial responsibility for damages for which another party (the indemnitee) is liable. Does the contract have an indemnification clause? Is it more in favor of one party or the other?

Several types of indemnity provisions exist and generally fall into these categories:

- **Limited form:** Indemnifies only to the extent of the indemnitor's own negligence. For instance, if the indemnitor is found to be 70% at fault in causing an injury, the indemnitor must pay the indemnitee 70% of the total damages. This is also referred to as comparative fault liability.
- **Intermediate form:** Indemnifies fully for the joint negligence of both parties but not for the sole negligence of the indemnitee. For instance, if the indemnitor is found to be 70% at fault in causing an injury, the indemnitor must pay the indemnitee 100% of the total damages. But if the indemnitor is found to be 0% at fault (i.e. the indemnitee is 100%, or solely, liable), the indemnitor is not contractually obligated to pay any damages.

- **Broad form:** Indemnifies fully for the joint negligence of both parties and also for the sole negligence of the indemnitee. For instance, if the indemnitor is found to be 70% at fault in causing an injury, the indemnitor must pay the indemnitee 100% of the total damages. But if the indemnitor is found to be 0% at fault (i.e. the indemnitee is 100%, or solely, liable), the indemnitor must still pay 100% of the damages. In some states, this type of agreement is against public policy and therefore, not enforceable.
- **Hybrid:** Uses a combination of two or more of the above three basic types of indemnification. For instance, a contract might require intermediate form indemnification for payment of legal defense costs, but limited form indemnification for payment of the actual judgment. Or a contract might require limited form indemnification for claims from outside third parties, but broad form indemnification for claims from employees of a contractor (i.e. third-party-over claims).
- **Cross-indemnity or mutual indemnity:** Each party agrees to indemnify the other for liabilities arising from its own negligent acts, errors or omissions. The above three basic types of indemnification focus on one party (usually the one that drafted the contract) being the indemnitee, and the other party being the indemnitor. Mutual indemnification focuses on each party being responsible for its own actions. This may be an easier or fairer way to allocate liability if the activities of both parties have about the same level of risk. But if one party has an inherently higher level of risk, mutual indemnification may not accomplish what each party intends.

## Before a loss occurs

- Properly execute all contracts:
  - Are they enforceable, properly signed and properly dated?
- Keep an up to date list of all your contracts with the amounts and key deadlines noted.
- Have documentation readily available — contracts, change orders, certificates of insurance, and any documentation required by the contracts. Retain these documents for at least the expected life of the product/service covered by the contract, plus the applicable statute of limitations or statute of repose.
- Check certificates of insurance that you receive from others, to be sure that the coverages, limits, additional insured status, expiration dates, financial ratings and cancellation notification are as agreed to in the contract.
- Follow up to obtain new certificates of insurance before the old ones expire.
- Verify that you have proper insurance coverage as required in any contracts that you sign — for each project, location, and contract provision.

## After a loss occurs

- Regardless of who you believe may be at fault or whether all the facts are available, report the loss immediately to your agent and insurance company.
- Gather all documents pertaining to the contract, scope of work, meeting or construction notes, and any other known loss issues.
- Be prepared to discuss the facts and loss details with your insurance adjuster.

## Always seek professional advice

To fully protect your business and its assets, you should always consult experts who can properly advise you about a contract. It is important to:

- Always consult an attorney to work with you to draft a contract suitable for your business and insurance needs.
- Always contact your insurance agent when another party requires you to provide them with insurance, to make sure your current insurance program meets the needs of the contract.

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LC JAN 2019 12-190

171-1000 (01/14)



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