

The importance of contract reviews: Are your contracts writing cheques your insurance can't cash?

We're always told to 'read the contract' before signing, but how many businesses conduct a thorough assessment of the terms? If a company is small, in its infancy, or if an order is crucial to its survival, then a contract review could be overlooked in the haste to secure a deal. But does it really matter?

It's all in the small print

Business contracts are usually comprehensive documents, which typically attempt to pass all responsibility to the other side. As a result, they will limit the liability of the party that has issued the contract. This might, at first, seem like a sensible route to take, but in fact it doesn't necessarily benefit either side.

"One likely consequence is that the contracted party can't get insurance for certain aspects of the terms. As such, they may need to pull out of the deal," explains Phil Thorpe, Director. "Alternatively, it might only be able to get partial cover, perhaps at a higher premium, but decides to proceed anyway. If something goes wrong down the line and the contracted party doesn't have sufficient insurance to cover its liability, then both parties could suffer serious financial and reputational damage."

The power of contract reviews

Generally, large companies have an in-house legal team so they can respond quickly and appropriately to incoming contracts. However, start-ups, SMEs and many UK divisions of international organisations may not have these luxuries. For them, an expert insurance broker becomes an invaluable intermediary.

"By engaging with their insurance broker, these companies can adopt a stronger negotiating position," says Phil. "Firstly, brokers can help their clients to choose the right insurer in anticipation of contract referrals. Some insurers are more willing or able than others to extend their policies to cover greater contract terms. As such, there is an art in the broker recognising clients that are likely to need cover extensions and placing the risk with a more accommodating provider."

But Phil is keen to stress that time is of the essence. "Leaving things too late can be a real problem," he cautions. "If appropriate insurance can't be arranged in time, the company may have to turn down the work and lose out on valuable revenue; or, in desperation, it may even decide to take the work on regardless of being uninsured, which could have big repercussions. Once signed, contract terms are virtually impossible to change."

Putting everything into practice

One company Phil has looked after is a market-leader in the mobile telecoms sector. This company received various contracts from parties in the US and Asia, which required those parties to be released from any liability and to accept total responsibility.

"Obviously the insurers wouldn't accept full liability," says Phil, "Consequently, a two-week period of negotiation began. Eventually a compromise was reached where liability was mutually shared – each party would support the other and not impose terms that were unreasonable."

"An insurance programme was put in place, which included public and products liability, professional indemnity, and also cyber insurance. This would cover responsibility for breach of confidential information. All policies were extended to include activity and claims brought in courts anywhere in the world."

Having gone through this process – which was only just resolved in time to meet the contract deadlines – the company learned which areas to push back on before referring future contracts to its broker and insurer. Thereafter, it was able to present the broker with contracts that fit with insurer requirements and insurance cover.

"This dedicated management process also gave the company the confidence to sign contracts, while being as fully insured as possible, with the right insurance partner," Phil adds. "The company could therefore avoid exposing itself or its venture capitalists to unnecessary uninsured risks. Importantly, it could also get on with generating revenue!"

Stay calm and negotiate

Ultimately, it's all about taking a proactive, realistic and timely approach to each and every new business contract – to the benefit of all parties involved.

"Even if the contracted party is in the less-strong negotiating position, against a large corporation that has standard terms and conditions signed-off by its lawyers, it doesn't mean there's no scope for negotiation," says Phil.

"If we get in early enough, and provide a reasoned and rational argument surrounding proposed changes, these large companies will invariably try to comply. That's because they want what the contracted company is offering! Terms can usually be changed to suit both parties, as it's in everyone's interest to be happy and appropriately insured."

Contract Review Tips

Here we cover some important points to look out for:

Contract Type

- Investment Agreement
- Sales/Supply/Services Agreement
- Standard T&C's and where there can be potential conflict between those of our client and their customers

Typical Concerns

- **Waiver of Subrogation Rights:** Most policies will not permit this and your policy cover might well be voided if you have, perhaps unwittingly, signed these away! Must be referred to the insurer for their prior agreement.
- **Hold Harmless Agreements:** This can either be a benefit or an additional liability to you and similar comment to the above applies. Ensuring such agreements are reciprocal is key.
- **Jurisdiction:** Typically, UK issued policies are governed by UK law and might not follow the interpretation put on a claim/policy by, for example, a US or other overseas court.
- **Inclusion of Additional Insureds:** Generally, this is well addressed by the more sophisticated 'Global/multi-national insurer'. Requests made by US businesses to be added as a 'joint/named insured' to our client's policy should be avoided as this would mean you would then not be covered for genuine Public Liability/Products claims brought against you by your customer – this on the basis that you can't claim against yourself and which would be the case if a client had been added to the policy title as joint insured. 'Joint Named' is the standard practice in the US (and some other countries) and without cover being affected; however, in the UK we address this differently, either through the 'Additional Insureds' clause or via a 'Vendors Liability' extension.
- **Contractual Liability/Penalties:** Policy cover will be for a client's 'Legal Liability' and is unlikely to cover additional liabilities imposed under contract in the absence of negligence/legal liability applying. Some insurers can sometimes be persuaded to extend their cover accordingly but will need to review contracts on a case-by-case basis. Such liabilities are more likely to be covered where a client has Professional Indemnity/Management Liability cover as part of their programme.
- **Intellectual Property Rights:** In many instances, such liabilities will not be covered by the client's insurances. There is likely to be a degree of cover contained within a Professional Indemnity or Directors' & Officers' policy and we could use this as an opportunity to reinforce the need for Management Liability cover in general. Full, stand-alone Intellectual Property Rights insurance cover is very expensive.
- **Breach of Confidence:** This will primarily relate to corporate matters (trade/agreement secrets) but can often spill into a client's responsibility for personal/employee data as well. Any loss here is likely to be of a financial matter and so is unlikely to be covered by a Public/Product Liability insurance which requires physical injury/damage. Such risks can be covered by Cyber, Management Liability and Professional Indemnity policies.
- **Investors:** It is not just client contracts where these issues arise. Investment agreements often seek indemnities from the client receiving the funds. Do the existing insurances provide this protection? (i.e. additional insured, contractual liability, professional services/cyber breach etc)
- **Negligence:** Many contracts try and impose liability for 'gross negligence' as opposed to simple 'negligence' which is more clearly understood and accepted by UK courts/insurers. There is a degree of ambiguity over what 'gross' means in this context – there is the potential for this aspect of a claim not to be picked up by a client's policy. Therefore, it is helpful to try and have this one, simple word removed from a contract.

What can I do?

- In many instances, depending upon the insurer, policy cover can be extended (sometimes without cost) to cover some of these additional liabilities. Talk to your insurance provider with plenty of time to negotiate.
- Create a forum to discuss uninsured risks which could cover these contractual liabilities - Cyber, Professional Indemnity and Management Liability in particular.
- Not addressing the potential issues surrounding client contracts has the potential for serious Reputational Damage (if claims are not covered) and to future business income and relationships.

When should you review your contracts?

- i. New Business reviews
- ii. Renewal
- iii. When there is a change to your business, such as expansion, diversification, acquisition etc.

What's required for contract renewal?

- Copy Contract
- Copy policy schedule
- Copy of liability policy wordings (PL/Products/PI/MLP)

Please be aware that we are not legal experts and the advice offered here is done so solely from the perspective of the cover provided under insurance policies. It is always recommended that you seek independent legal advice on the matter.