

To The Point

Managing Contractual Liability

Risk management often focuses on critical areas such as property protection and worker safety. An equally important area is contractual liability. A properly written and reviewed contract can mitigate the cost of a claim and prevent a company from being brought into disputes and claims that may be the responsibility of third parties, subcontractors, or coworkers. The practical tips below address contractual liability. As with any legal matter, a company should consult its legal counsel before entering into any contract.

Contracts and Agreements

Legal review—It's crucial to have legal counsel review and approve all standard contracts, purchase orders, and license and service agreements, including those with subcontractors. This ensures that the business is well-advised and secure in its contractual dealings.

Customizing contracts—Avoid customizing contracts to the greatest extent possible. If an agreement must be customized, use boilerplate amendments that become "standard exceptions" or make sure legal counsel reviews all deviations from the standard.

Limitations of liability—It's important to take advantage of all contract language measures that enable a limit on liability. Tailor this language to the company's industry and customers. This will help to assure that the company and its clients' liability is limited to the cost of the contract or service provided.

Disclaiming Warranties—Include warranty disclaimers in contracts. These can help minimize exposure to litigation by limiting the types of assurances offered. The disclaimers should conform to the requirements of the Uniform Commercial Code regarding typestyle and content and any local jurisdictional requirements.

Manage Warranties—In addition to disclaiming certain warranties, avoid making guarantees that are difficult or unrealistic to meet. Make the warranties as specific as possible and avoid using "general warranties" wherever possible.

Severability—Include a severability clause in contracts. Without it, the ability to rely on provisions in the contract that limit liability may be jeopardized if a court finds another provision in the contract unenforceable.

Indemnities—Protect the organization's assets by having indemnification wording that benefits the organization whenever possible.

Arbitration—Consider including arbitration provisions in the contracts to resolve customer disputes instead of litigation.

Force majeure—This wording is important for all companies but is especially critical for technology companies and businesses that rely heavily on infrastructure to deliver services or products to their customers. Force majeure clauses may limit liability for losses or breaches resulting from external forces beyond the company's control, such as earthquakes, tornadoes, storms, other natural disasters, and events such as war. Some force majeure clauses address widespread cyber attacks as well. Specifically, list the things outside the company's control rather than relying on a blanket clause stating, "anything outside of the company's control."

Performance specifications—When negotiating contracts, ensure that all parties agree to the specific expectations, promises, and contingencies regarding the performance of the contract. Complete RFPs (Requests for Proposal) and contract performance obligations should be included. Confirm whether critical employees are expected to be present throughout the contract. If third parties are involved with a project, ensure clients know exactly what is or is not being provided by the company. Likewise, make sure to have confidence in the systems the company may use, acquire, or recommend. Contracts should be specific regarding agreed-upon definitions, performance specifications, timetables, dealing with changes, and the processes and procedures for dispute resolution.

Performance obligations—Be specific but brief about performance obligations. Brevity will create much more clarity around this issue.

Amendments and modifications—Specify the procedures for amending and modifying the contract. Document any changes to product and service specifications and deliverables, and ensure that signoffs are received and memorialized.

Contract length—If possible, implement smaller projects under multiple short-term contracts. Longer contracts tend to be more complex. They may change over time, presenting more opportunities for missed completion dates or scope creep, which can lead to litigation resulting from failure or non-delivery of a project. If shorter-term contracts are not an option, conduct a thorough risk assessment of the entire project. Consider such factors as the scope and inherent feasibility of the project, stability of customer requirements, development and quality practices of the manufacturers, and how realistic the time and resource estimates needed to complete the project successfully appear to be. Include Statements of Work (SOW) or other milestone documentation requirements to track and measure a project's progress.

Operational Controls

Legal review of advertising materials and product brochures—Ensure that legal counsel reviews all advertising and marketing materials concerning the promises explicitly made or implied to customers. Set realistic expectations and avoid absolutes in marketing materials. Product and promotional literature may inadvertently communicate expressed or implied warranties not contemplated in the contracts being used.

Accounts receivable collection procedures—Be cautious when changing accounts receivable collection procedures. Such changes may lead to customer disputes.

Sales and marketing training—Seek legal counsel's assistance in developing sales and marketing training programs that control product oversell and puffery. If any confusion exists between what a salesperson tells a customer and what the contract says, a claim may be made for misrepresentation or fraudulent inducement.

Certificates of insurance—Require subcontractors and vendors supplying or doing work for the company to carry sufficient limits of insurance and name the company as an additional insured on their insurance policies, including Errors and Omissions (E&O) insurance. Obtain certificates of insurance from all vendors and subcontractors as evidence that they have complied with the requirement and maintain a file containing these certificates. The certificates should specify effective dates, limits, and coverage afforded. The certificates should be obtained annually for the duration of the working relationship.

Disputes and Allegations of Non-performance

Loss history—Carefully analyze all allegations of non-performance issues, claims, litigation, and causes. Include in the review all suits, potential suits, complaint letters, disputes, social media/internet posts on the company or its products, or any other circumstances alleging non-performance of the company's products or services. A thorough loss history can be a window into future litigation problems and should be used to help identify and eliminate potential sources of loss, claims, and litigation.

Product Withdrawals or Recalls—If the company has had product withdrawals or recalls in the past, specify how impacted customers were compensated for such losses. For recall/withdrawal incidents incurred, document the identified root cause(s) and provide details as to actions taken to mitigate the potential for event recurrence.

Contract delays—Examine the causes of any previous contract delays. If the delays were caused by promising unrealistic deadlines or agreeing to unrealistic customer expectations, address the issue with the company's sales force and customers and negotiate more reasonable contract terms.

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Contractual Liability Checklist

Answer these questions to determine if a company may have contractual exposure. If the answer is “No” to any of these questions, discuss with legal counsel and consider obtaining assistance in developing or enhancing the company’s risk management program to help protect its assets.

Contracts & Agreements	Yes	No	N/A
Does legal counsel review all contracts, orders, licenses, and service agreements?			
Does the company always use a standard contract?			
Does the company limit liability in all contracts to avoid consequential loss, punitive damages, stipulated damages, or liquidated damages?			
Does the company include warranties and disclaimers in its contracts and promotional material?			
Do all contract disclaimers and liability limitations meet applicable typeface and content requirements?			
Are all warranties specific and realistic?			
Do the company’s contracts include a severability clause, an arbitration clause, and “force majeure” wording?			
Do the company’s contracts ensure that all parties agree to the specific expectations, promises, and contingencies regarding the performance of the contract?			
Does the company include RFPs and contract performance obligations?			
Are the contracts specific regarding definitions, performance specifications, obligations, timetables, dealing with changes, and dispute resolution procedures?			
Does the company confirm whether critical employees are expected to be present throughout the contract?			
Does the company document any product and service specifications and deliverables changes?			
Does the company seek multiple short-term contracts for long projects?			
Is a risk assessment of the entire project conducted for long-term contracts?			
Is a statement of work (SOW) or other records used to capture project milestones for long-term contracts?			
Operational Controls	Yes	No	N/A
Does legal counsel review all advertising and marketing materials regarding the promises explicitly made or implied to customers?			
Is the company cautious about changing accounts receivable collection procedures?			
Does the company seek legal counsel’s assistance in developing sales and marketing training programs?			
Does the company require subcontractors and vendors supplying or doing work to name the company as an additional insured on their E&O policies?			
Does the company obtain certificates of insurance from subcontractors and vendors?			
Disputes & Allegations of Non-performance	Yes	No	N/A
Does the company analyze all non-performance issues, claims, litigation, and their causes?			
If the company has had product withdrawals or recalls, were the reasons why they occurred, and the remedies used to resolve customer loss of use documented?			
Does the company examine and respond to the causes of any contract delays?			
Does the company frequently and openly discuss project viability with customers as it progresses?			