

AXIS

The Importance of Contract Review



1. The Contract Review Process

A contract review is a thorough analysis of the terms, conditions, and clauses within a legal contract. The process involves identifying potential risks that could have financial or legal consequences, including the rights and responsibilities of the parties, assessing the impact of each risk, and examining options available to mitigate and transfer as much risk as possible.

A knowledgeable insurance broker armed with a deep understanding of the business operations, can scrutinize all aspects of the contract to identify the risks presented, propose amendments to lessen the severity of the risks, recommend mitigation measures to reduce the likelihood of risks manifesting into legal liabilities and direct financial losses and identify potential gaps in the insurance program to ensure alignment with risk transfer strategies and placement of adequate insurance protection.

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2. Risk Identification

Risks established in contracts can be found in common clauses contained in commercial contracts and include performance obligations, terms of payment, rights and duties surrounding intellectual property, representations and warranties, confidentiality provisions, use of subcontractors, compliance with applicable laws and regulations, indemnification and duty to defend agreements, hold harmless agreements, limitations of liability, insurance requirements, governing law and dispute resolution procedures, among others.

Disputes can arise if a breach of contract occurs in which one party fails to perform, violates, or does not fulfill their contractual obligations as specified in the agreement.

Contractual liabilities are relatively easy types of risk to identify as they are specifically listed in the contract; though ironically, they are often overlooked, and in many cases, the contracting parties only first become aware after a problem manifests.



Things to watch out for in commercial contracts

terms of payment	insurance requirements	hold harmless agreements
limitations of liability	performance obligations	use of subcontractors
governing law and dispute resolution procedures	indemnification and duty to defend agreements	rights and duties surrounding intellectual property
representations and warranties	confidentiality provisions	compliance with applicable laws and regulation



3. Risk Assessment

Risk assessment involves a comprehensive analysis of the potential threats and liabilities associated with the agreement. It should identify areas of vulnerability that could adversely affect the contracted parties.

Contractual clauses that may impose financial, operational, or legal risks are evaluated against factors such as the nature of the industry, regulatory compliance, and the specific needs of the business. By scrutinizing these elements, the risk assessment facilitates the development of strategies for risk mitigation, ensuring the contract aligns with the overall risk tolerance and objectives of the business.

This proactive approach enhances decision-making and enables agreements that meet the objectives of the business while minimizing potential adverse consequences.

4. Risk Mitigation

Risk mitigation involves implementing strategies to minimize the probability and severity of the identified risks manifesting into a legal liability or a direct financial loss. After conducting a thorough risk assessment, the focus shifts to proactive measures that protect the interests of the business. This step may include negotiating amendments to the contract terms, inserting protective clauses, recommending operational changes, and strengthening internal controls. For example, if a contract creates exposure to potential financial losses, mitigation strategies could involve negotiating liability caps or implementing additional safety measures.

Integrating risk mitigation into the contract review process enhances the ability to navigate challenges effectively, ensuring that agreements align with risk tolerance and contribute to overall business resiliency.

5. Risk Transfer

Risk transfer refers to the process of shifting identified risks to another party, often through insurance contracts. After a thorough risk assessment has been conducted and consideration given to risk mitigation measures, the goal is to ensure that the contractual obligations align with the insurance program. This involves scrutinizing indemnification clauses, insurance requirements, and other relevant clauses.

Where the contract establishes specific liabilities, the risk transfer step assesses whether the existing insurance program adequately addresses each risk and allows for necessary adjustments to be made to ensure alignment between risk tolerance and insurance protection objectives.

6. Benefits of Contract Review

The most important benefit of contract review is bringing awareness to contractual risks so that proactive measures can be taken to mitigate them. The worst time to become aware of a risk is after a dispute arises and the realization that risk mitigation and risk transfer measures that could have been implemented to prevent the dispute or lessen the financial impact were never considered.

Contract review before entering an agreement can provide valuable insights that can be used during negotiations. Understanding the terms and conditions allows for informed discussions and potential adjustments to more favorable terms.

Consulting collaboratively with a knowledgeable insurance broker to understand the risks presented by each contract, develop mitigation strategies, and tailor an effective insurance program that considers the unique circumstances of the business operations is an important element in the risk management process and its value cannot be overstated.