Guide

Guide to Insurance and Liability Considerations

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What is Insurance?

There is no statutory definition of ‘Insurance’.

A contract of insurance is an agreement for the transfer of financial risk from one person (the insured) to another (the insurer) in return for payment of a sum of money (usually called ‘the premium’).

Insurance is only one element of an overarching risk management strategy. It does not remove the liability of a party for their actions but instead provides financial protection for that party, as an insured, in the event of an insurable loss of liability.

The information provided in this guide has relevance to matters related to conducting an individual procurement activity that can range from low to high assessments of complexity. It may be advisable to seek additional professional advice where the complexity of the procurement activity is assessed as being focused or strategic. Insurable events such as transit cover, special events, cyber, assets and revenue protection are out of scope of this procurement guide.

This guide will consider the three most common types of insurance for procurement of goods and services and provide high-level guidance in relation to risk assessments and liability capping.

Why include insurance clauses in contracts?

Insurance requirements are included in contracts to ensure that the supplier has the financial resources to respond to claims where it is found liable for negligent acts or omissions appropriate to the types of services provided and the associated risk exposures involved in performing the obligations under the contract.

There are certain risks associated with the procurement of goods and services. These risks need to be assessed, and some form of risk management plan established.

Some of these risks include how effectively the procured good or service supports an organisation’s strategy. Such risks should be managed by project risk reporting against key performance indicators.

Most other risks which could adversely impact the organisation are insurable. For example, injury caused to a person visiting the organisation’s premises that resulted from the premises being unsafe.

The main purposes for requiring a supplier to effect and maintain insurance are:

- To reduce the risk of the supplier not having sufficient resources available to meet a liability to the organisation or some other party
- To ensure that the supplier will receive financial support to fund its own insurable losses and liabilities and still be able to perform its obligations under the contract.

Types of insurance

The three most common types of insurance considered in this document are Public Liability Insurance, Product Liability Insurance, and Professional Indemnity Insurance.

Public Liability insurance

Public liability insurance covers claims arising from personal injury/or property damage as a consequence of a breach in the supplier’s duty of care to third parties caused by the supplier’s negligence.

For this reason, public liability insurance is of particular importance where the supplier is engaged by an organisation to provide a good or a service that interfaces with the general public and/or the clients of the organisation.

Public liability insurance is:

- Event based
- Based on the time of the incident, not on the time of the claim being made
- Generally structured to recognise each and every occurrence irrespective of how many claims are made.

Product Liability insurance

Product liability insurance covers the liability arising from a defective product that causes personal injury or property damage (e.g. arising from the defect causing a delay in the delivery of a service or other obligation).

Defects in products can include design defects, manufacturing defects, and instructional errors such as inadequate labelling, instructions for use or warnings that render the product dangerous. This cover is often included as an addition to public liability. It can also be issued as a separate policy.

Professional Indemnity insurance

Professional indemnity (PI) insurance covers legal liability for claims arising out of a breach of professional duty in the provision of professional services. A claimant can seek compensation for financial and economic loss, which may include the legal fees associated with the claim.

Usually Professional Indemnity covers:

- A breach of professional duty
- Negligence
- Bodily injury and property damage from service breach
- Fraud/dishonesty other than a company's director's dishonesty
- Infringement of intellectual property rights
- Breach of confidentiality
- Defamation
- Loss of documents

It should be noted that some of the above items are not automatically covered in a PI policy and their inclusion should be specified when required.

PI insurance only covers claims made or first notified to the insurer during the policy period. Therefore, procurement practitioners should include a requirement to maintain such PI cover for a specified period after the expiry of the supply contract. Statistically, PI claims tend to manifest within a six year period of supply provision.

Organisations should assess the risks associated with each project and assign an adequate level of PI cover accordingly. If for example, a consultant intends to cease to practise and not continue the PI cover beyond the date of cessation then the organisation may consider it prudent to require the consultant to arrange a 'run off' cover in relation to the particular project for a period beyond the cessation date.

Procurement practitioners will need to decide whether the cap on liability is aligned to the procurement risks and if there is an imbalance in the allocation of risk. This disadvantages the organisation irrespective of whether the organisation is willing to, or is capable of, assuming the additional risk exposure.

Other Insurance Types

In some circumstances, it will be appropriate to require project-specific insurances to be effected by suppliers. This means that the supplier must affect an insurance policy for risks which are specific to the supply contract.

In these instances it is not advisable to solely rely on general insurances which may not have the scope to fully cover risks specific to the contract. This could potentially result in gaps within the insurance cover. It is essential to seek professional advice from legal sources and/or the Victorian Managed Insurance Authority (VMIA).

Cross Liability

When considering the applicability of insurance and the limit of liability, buyers should also consider cross liability. Cross liability requires suppliers to take out insurance in both the supplier and organisation's name for the purpose of the agreement, so that if a claim is made against the organisation by a third party, the organisation can directly claim on the insurance policy rather than relying on the supplier to make the claim.

When including cross liability as a requirement under an agreement, the organisation must also require the insurer to waive its rights of subrogation (whereby one person takes over the rights of a creditor against his/her debtor), which removes the rights of the insurer trying to recover from the organisation, the money paid out to the third party.

Given that each requirement carries an increasing risk to the insurer, it is likely that the supplier's insurance premiums would rise in accordance with the level of risk that the insurer is willing to accept. In turn, the cost of the goods or services is likely to increase to accommodate the supplier's increased insurance cost.

As such, buyers should determine the most appropriate insurance arrangement depending on:

- The nature of the goods or services being delivered
- The value of the goods or services
- The level of risk of the procurement.

Workers Compensation insurance

Workers compensation insurance (also known as employer's liability insurance) covers an insured for its liability at common law and under statute for bodily injury, disease, illness or death of a worker employed by the insured.

All Australian jurisdictions have a statutory requirement for an employer to maintain workers compensation insurance or for the employer to be a licensed and regulated self-insured employer subject to approval from Worksafe Victoria.

Considerations before proceeding

Confirmation of Insurance

No contract should be entered into without confirmation of insurance by requiring the preferred supplier(s) to provide a signed certificate of currency from their insurer or insurance broker that generally encompasses:

- Type of insurance cover
- Name of the insurer
- Level of cover (sum insured or limit of liability)
- Period of insurance cover

- Scope of cover (note any non-standard exclusions/limitations).

The contract management plan must have check points for monitoring the currency of insurance cover. This includes monitoring, any changes in cover over the life of the full term of the contract and for ‘claims made’ policies, such as professional indemnity insurance, the agreed maintenance of cover period after the expiry of the contract.

Note: Liability can extend to other parties engaged by the principal supplier in sub-contracting capacity. Organisations should require the principal supplier to take appropriate steps to ensure that all such parties have sufficient cover provided by the relevant insurance policies.

Selecting an appropriate Limitation of Liability Cap

Given that insurance can be a significant cost, suppliers may seek to limit their liability to a specified sum or to a value of cover linked to the contract value.

Limited liability is often associated with negotiations concerning contract costs and fees where the supplier may offer a lower contract price in return for limiting liability or some other value adding benefit. Caution is to be applied during negotiations as such an arrangement can result in the organisation assuming an increased exposure to project risk liabilities. It is important to understand the extent that a liability cap applies, as it may only relate to specific categories of loss in the contract term e.g. consequential loss or it may apply to any loss that arose from the supplier’s liability.

Liability capping refers to limiting the amount of loss that the organisation can recover from the supplier.

Although capping supplier liability could expose the organisation to irrecoverable losses (i.e. over the capped amount), capping may provide benefits including:

- Reduced prices for goods/or services
- Encouraging small business involvement in the procurement
- Other value adding benefits.

Prior to agreeing to any limitation of liability a risk assessment must be undertaken to ensure that the liability cap proposed takes into consideration the likelihood of all relevant risks that could occur and the financial consequences that could arise from these risks.

Procurement practitioners will need to use judgement when determining whether or not to proceed with a liability cap e.g. if the likelihood of a substantial loss is high and/or the timeframe of exposure is undefinable or indefinite, it may be appropriate to retain a position of unlimited liability rather than approve a liability cap.

Liability Capping

Where needed, seek advice from legal sources and/or the VMIA before finalising contractual clauses when liability capping is considered.

It is not appropriate to cap liability in the following situations:

- Liabilities that can impact on the physical or mental well-being of individuals
- There is potential for major loss or damage to tangible property
- Breach of third-party intellectual property
- Where the goods or services are critical to the operation of the organisation.

Risk assessment

The procurement process, like any business process, has its own unique set of associated business risks. How well risks are managed during the procurement process will greatly determine how well the project succeeds.

Risk provides a structured approach to:

- Identifying potential areas where problems might arise in the contractual relationship between the parties
- Considering the degree of likelihood and impact (financial or otherwise) that may arise
- Considering plans/actions that can be put in place to reduce the likelihood and/or the potential economic losses caused by these events.

These activities are collectively called ‘risk assessment’. For every risk that arises from procurement, there are usually a number of risk management options. However, there are three broad categories of risk management (sometimes referred to as risk mitigation tactics) that can be used. They are:

- Risk transfer (which includes the organisation’s insurance and liability capping which although reducing the risk to the supplier and their insurer may be an acceptable risk to absorb when measuring the overall value of the procurement to the organisation)
- Risk treatment (which includes developing and monitoring risk controls)
- Risk Avoidance (which includes deliberately avoiding particular strategies, tactics and relationships).

Insurance represents a direct financial cost to supplier that is built into a supplier’s quotation or tender price. Therefore, the level of insurance cover required of suppliers by organisations should be commensurate the procurement type and procurement risks. In some instances, a minimal or zero level of cover may be warranted when a supplier for example is providing general advice that is low risk (e.g. design layout of an annual supply report)

Recommended or Suggested Range of Insurance Cover

Procurement practitioners should assess the risk profile of the procurement and the market characteristics in Order to determine appropriate levels of insurance before seeking proposals. Where possible, it is preferable to apply minimum levels of cover to facilitate small business engagement.

It is also possible to relate the selection of cover to the assessment of complexity given the scope of risk factors considered in an assessment.

The level of cover should move to the upper end of the value bands to reflect an increase in assessment of risk. The relationship is detailed in the table below.

Table 1: Insurance risk matrix

Insurance	Range		
	Low Risk	Medium Risk	High Risk
Public liability (cover selected per occurrence)	$1.0 - $5M	$5 - $10M	$10 – $20M
Product liability (cover selected per occurrence and in annual aggregated)	$1.0 - $5M	$3 - $10M	$10 - $20M
Professional indemnity (PI) (cover selected per occurrence and in annual aggregate)	$0.5 - $1M	$1 - $5M	$5 - $10M
	Transactional complexity	Transactional complexity	
		Leveraged complexity	Leveraged complexity
			Focused and strategic complexity

1. The attached risk assessment tool (*Appendix 1*) is available to assist in determining the level of risk for the three types of insurance.
2. Where the risk assessment indicates a range of risk ratings (e.g. medium and high) for any of the insurance types, always adopt the highest risk rating.

How the Victorian Managed Insurance Authority (VMIA) can help

The VMIA is a statutory authority that works to protect the assets and services of the State of Victoria by providing risk management advice and insurance services to a large and diverse client base.

VMIA insurance

Organisations are not immune to a claim for loss or damages if it can be established that the actions of the organisation in some way caused or contributed to the loss or damage. The VMIA has issued a number of ‘Master’ policies. Summaries of those policies are available at www.vmia.gov.au.

A master cover policy is valid only if a schedule has been issued by VMIA detailing the insurance under that Master policy and that a premium has been paid for the cover provided by that Master policy, or VMIA has confirmed coverage in some other way.

Insurance terms and definitions

Appendix 2 provides a list of Insurance terms and definitions for your reference.

More information

Related documents and templates are available on the HSV website.

Disclaimer

The information presented in this document is general in nature and based on HealthShare Victoria's interpretation of the *Health Services Act 1988* (Vic) and any ancillary legislation and regulations in effect at the time and should not be relied upon as legal advice. Please consider seeking professional and independent advice from your legal representative as to the applicability and suitability of this information and the legislation to your own business needs or circumstances.

Appendix 1: Risk assessment tool

Insurance Cover	Risk rating		
	Low	**Medium**	**High**
Credibility of the supplier in the conduct of the procurement activity Relevant insurance cover Professional indemnity	• The complexity of the procurement activity is assessed as transactional • The supply arrangement involves common • 'off the shelf' products or routine services that do not impact on organisational decision making • The supplier has a track record in the market, is familiar with the organisation's procurement requirements and is fully compliant with relevant regulatory requirements	• The complexity of the procurement activity is assessed at the upper level of transactional but is more likely to have been assessed as leveraged • The supply arrangement involves potential interface with clients of the organisation • The supplier has a track record in the market and is predominantly compliant with all related obligations	• The complexity of the procurement activity is assessed as focused or strategic • The supply arrangement has a direct impact on organisational service delivery • Service failure would generate significant negative media coverage for the organisation or pose a risk to the public
Occupational health and safety issues (OH&S) Relevant Insurance cover: Public liability (impact on persons) Product liability (impact on use and application)	• Low possibility of harm or danger to persons • The supplier's interface with persons is overseen by an officer in the organisation with responsibility for, or knowledge of, the risks • There are no special skills required to wear the special clothing or use the equipment	• There is some possibility of harm or danger to persons • The supplier's interface with persons has participation by an officer in the organisation • The supplier has addressed all OHS requirements required by the regulation and the courts. There are no outstanding breaches of legislation or regulations • The supply is of standard equipment, however, there are particular requirements/processes in using the equipment • The clothing supplied has specific limitations in the area for which it can be used	• There is a high possibility of harm or danger to persons • The supplier's interface with clients that have physical and/or behavioural problems • Supplier has a high number of OHS breaches and numerous outstanding remedial action requirements imposed by the courts • The protective clothing and specialist equipment is to be used in high danger situations. The clothing/equipment is nonstandard and requires extensive training to use/apply
Product complexity Relevant insurance Product liability (impact on performance)	• Supply of standard 'off-the-shelf' items of clothing or equipment. Items are common in the market and have a track record of performance in relation to their application/use. Low, if any, reports of recall. Extensive warrantees/guarantees and after sales service available	• Supply of established, but not common, items of clothing or equipment. There may be some degree of difficulty in obtaining immediate replacement or repair if failure to perform. Failure will not have a significant impact on operation of the organisation. Product service is somewhat specialised	• New highly specialised product • Failure would have significant impact on the operation of the organisation. There is limited supply of specialists in the field should system fail
Stakeholder exposure Relevant insurance cover Professional Indemnity	• Contract is managed at the business unit level and is not required to be reported or signed off at senior management level. There is no interface with clients of the organisation or general public	• The product, but more likely the service has some impact on the decision making within the organisation. Any failure could have repercussions on performance of the department	• The product/service is critical to decision making by senior management. The advice is relied on for making high level/critical investment decisions by the organisation. Failure at the organisational level has significant flow-on-effect to the business community and the general public

Appendix 2: Insurance – terms and definitions

Term	Definition
Agent	An intermediary between the insurer and the insured who usually acts on behalf of the insurer and receives commission on insurances sold.
Assessor (or loss assessor/loss adjuster)	A person appointed to investigate the cause and circumstances of a loss and to assess the quantum of the loss, usually appointed by the insurer.
Binder	An agreement between an insurer and an insurance broker pursuant to which the broker is able to act on the insurer's behalf in accepting risks and handling claims.
Broker	An intermediary acting on behalf of the insured except in certain circumstances where the broker acts on behalf of the insurer as its agent under a binder.
Capped liability	Where a supplier seeks to limit its liability under contract this is known as 'capping of liability'. It may not always be obvious that a supplier is seeking to limit its liability. Capping of liability can be found under headings such as (but not necessarily limited to): • Limitation of liability • Suppliers responsibilities • Indemnity clauses • Insurance clauses • Liquidated damages • Damages • Schedule • Miscellaneous
Captive insurer	A company owned and established by an organisation to self-insure its own losses.
Certificate of Insurance (Certificate of Currency)	Confirmation of insurance cover provided by the insurer or a broker.
Claims made policy	A policy which responds to claims made during the period of the insurance where the circumstances have also occurred during the period of insurance. In some cases however, insurers will provide a retro-active liability period to include circumstances that occurred in previous years but not known to the supplier. Thus, a claim made in 2003 would be insured in the policy current at that time, even if it arose out of an act or omission in 2000. Professional indemnity policies and directors and officers liability policies are usually claims made policies (in contrast to Occurrence Policies).
Contract works insurance	Covers a building or other structure during the course of its construction or erection. It may extend to cover the supplier's plant and equipment on site and may include associated public liability cover.
Combines liability insurance	A policy giving public and products liability cover and possibly but rarely other liability cover e.g. professional indemnity.
Complexity assessment	An assessment of the level of difficult involved in procuring a good or service. It is measured by considering the internal and external influences on a procurement activity. The assessment is usually undertaken early in the procurement process when identifying procurement categories as part of the procurement planning process.

Term	Definition
Cover note	An interim or temporary contract of insurance pending the arrangement of a long-term insurance contract
Cross liability clause	A clause in a liability insurance policy in which the insurer agrees to insure the liability of one insured to another and to treat each insured as if a separate policy was issued other than in regard the sum insured or limit of liability.
Directors and officer's liability insurance	Covers directors and officers for their liability to third parties for breach of their director's duties or duties as officers. Will often include legal expenses cover for the defence of litigation. The policy is often divided into two sections, the first covering the director or officer directly and the second providing company reimbursement, where the company has indemnified the director or officer. Will usually exclude (with some exceptions) liability to the company itself.
Duty of disclosure	Under the *Insurance Contracts Act* an insured has an obligation to disclose to the insurer every matter it knows, or should know, would affect the insurer's decision as to whether or not to accept the risk and on what terms. Failure to meet the duty of disclosure gives an insurer certain rights including a right to cancel the policy and, in some circumstances, the right to refuse or reduce an insurance claim.
Endorsement	A term added to an insurance policy varying the standard terms. Usually annexed or included in the Schedule to the policy
Excess (deductable)	The first part of a loss or liability which is borne by an insured. Also called a deductible.
Excess policy	A policy providing insurance cover for losses in excess of losses covered by a primary policy.
Exclusions	The perils, property or circumstances for which cover is excluded by the terms of the policy.
Hold harmless	One contracting party is to assume the liabilities of the other contracting party in the event of a claim brought by a third party.
Indemnity	The promise to pay for any loss which the other may suffer or, to state simply, to put the person back into the same situation they were prior to the claim. For our purposes, professional indemnity claims are more complex and generally the redress is in the form of dollars. There is usually an economic loss involved although this can be extended to injury or damage through professional error
Insurance policy	An agreement by the insurer to indemnify the insured in relation to a loss or liability arising on the occurrence of a specified event. Includes most policies other than life, sickness and accident policies (in contrast to assurance policy).
Insurance excess	A provision whereby an insured may be required to pay part of a loss. (Also referred to as a deductable item).
Indemnity clause	A contractual risk transfer in the form of an agreement usually between the principal and the contractor (licence holder, lease holder etc.). It details the extent of liability securing the 'contractor' against loss or damage.
Intellectual property	Legally protected property such as copyright, patents, and registered designs in addition to ideas and information of a commercial value developed by an organisation, business or individual.

Term	Definition
Liability insurance (also known as public and product liability – see below)	Provides cover against the consequences of being held legally liable for injury or damage to third parties.
Limit of liability	Limit of cover available under a policy. With respect to liability policies, a limit may apply for each 'claim' or each 'occurrence'. Policies often, by definition, apply this claim or occurrence limit to all insurance claims arising from the one event.
Maximum cap	The maximum amount of liability the organisation will transfer from a supplier for any given loss event. The maximum cap protects the organisation from transferring risk that exceeds the organisation's risk management.
Negligent act or omission of supplier	A failure to exercise the degree of care that would be expected from a reasonable or prudent person.
Occurrence policy	A policy of insurance that responds to losses arising from occurrences happening during the period of insurance regardless of when a claim is made.7 For example, public liability and product liability policies and property policies are usually (but not always) occurrence policies. If a person is injured in 2000, the 2000 policy will respond regardless of when the claim is made by the party injured (e.g. 2000 or 2003). (Contrast claims made policies).
Products liability insurance	Provides cover with respect of losses arising out of the defective nature of goods manufactured, supplied distributed or installed by the insured.
Professional indemnity insurance	Covers the insured's liability to third parties for breach of a professional duty of care owed in contract or at general law. Certain classes of professionals are required by law to carry professional indemnity insurance. Usually does not cover tangible property damage or personal injury.
Proposal	The document which is completed by the insured providing relevant information to the insurer in order to apply for insurance.
Public liability insurance	Covers the insured's legal liability to the public for bodily injury or property damage. Usually does not cover pure economic loss or loss or damage caused by professional negligence or the insured's products. Also usually excludes major construction works.
Renewal	Most policies are arranged for a fixed term. Insurers may offer to renew the insurance policy for a further period on particular terms
Retroactive date	The indemnity provided under certain liability policies, particularly professional indemnity policies, may include a retroactive date meaning that the policy will not respond to claims made during the policy period where the claim is in respect of acts or omissions before the retroactive date.
Schedule	The policy schedule issued each year by the insurer setting out variable information in relation to the policy including the name of the insured, period of cover, premium, and limits of indemnity and so on. The schedule forms part of the policy.
Self-insured retention	See Excess (deductible).

Term	Definition
Subrogation	The right of an insurer, after settling a claim or indemnifying the insured in respect of a claim to sue in the insured's name any third party who was partly
Underwriter	The insurer.
Utmost good faith	This is a basic principle in insurance and implies that both parties to an insurance contract have an obligation to act in good faith in dealing with each other.
Workers compensatio**n** insurance	It is compulsory in Australia for employers to take out Workers compensation insurance covering their statutory liability to workers suffering an injury or disease arising out of or in the course of their employment. The terms of these policies are prescribed by statute.