Tasmanian Risk Management Fund

Guidelines for Determining Appropriate Levels of Insurance for Goods and Services Contracts

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CONTENTS

INTRODUCTION

Purpose 3

There are 3 parts to this guide

1. Principles and overview
2. Guidelines
3. Tool Kit

PART ONE – PRINCIPLES AND OVERVIEW

What is insurance 4

Why include insurance clauses in contracts? 4

Insurance levels in contracts.. 4

Insurance period 5

Confirmation of insurance 5

Types of insurance 6

Risk management in assessing insurable risk exposures 12

PART TWO – GUIDELINES

Applying a risk management process to assessing insurable risk exposures

Stage one –

Identify and assess the supplier’s risk and review controls 13

Stage two

Determine the appropriate level of insurance 20

Stage three

Review the terms and conditions of cover 23

PART THREE – TOOL KIT

Insurance check list 25

Worksheets 26

Insurance – types and terms 28

APPENDIX 1: References

References 31

INTRODUCTION

Purpose

The purpose of these Guidelines is to provide practical information to assist Government agencies to determine the types and levels of insurance that must be held by suppliers providing goods and services to the Government. These Guidelines should not be seen as exhaustive nor prescriptive – they are a guide only to assist in the appropriate identification of risk, which agencies remain responsible for managing.

Goods are tangible, transportable supplies. Services are intangible supplies or effort, such as consultancies (other than building and construction related consultancies).

Building Construction and Maintenance Service contracts are not covered by these Guidelines. For information on insurance requirements for these contracts, refer to the 1200 series of the Treasurer's Instructions and the information provided on the Purchasing website (www.purchasing.tas.gov.au).

PART ONE – PRINCIPLES AND OVERVIEW

What is insurance?

There is no statutory definition of ‘insurance’.

Put simply, 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’).[1]

The existence of insurance does not remove the liability of a party for its actions. It is only an agreement for the insurer to meet some or all of the financial costs of the insured where the insured is liable for such costs.

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 type of services provided and the associated risk exposures involved in performing the obligations under the contract.

Insurance is only one element of a total risk management strategy.

Insurance requirements in contracts are intended to protect the Crown from bearing the cost of claims arising from negligent acts or omissions of suppliers.

Insurance levels in contracts

Insurance is a cost to suppliers that is normally passed onto the contracting Government agency (the Crown). This cost can be significant.

One of the first tasks prior to running a procurement process to engage a supplier is to identify the types and levels of risk that could potentially be involved in the contract and once these are known, assess the level of insurance required. The level of insurance should be appropriate to the identified risk exposure.

The Crown Solicitor’s pro forma standard tender and contract templates include default levels of insurance which are set at $20 million for public liability and $10 million for professional indemnity. However, both Treasury and Crown Law recognise that in some cases, and subject to a proper risk assessment being undertaken by an agency, variations to the recommended minimum insurance requirements may be appropriate. This view recognises the need to take account of the difficulties and costs involved for suppliers in obtaining the necessary levels of insurance cover and the ranging levels of financial risk involved in different contracts.

These Guidelines will assist in identifying the levels that are appropriate for each individual contract having regard to the type of contract and associated risk exposure. Insurance requirements for the tender/contract should only be set once a risk assessment has been undertaken.

[1] Box R. Blake Dawson Waldron Lawyers, *Negotiating and Drafting Contractual Insurance Provisions*, notes presented to Risk Management Institution of Australasia (RIMA) Conference, Hobart, November 2004

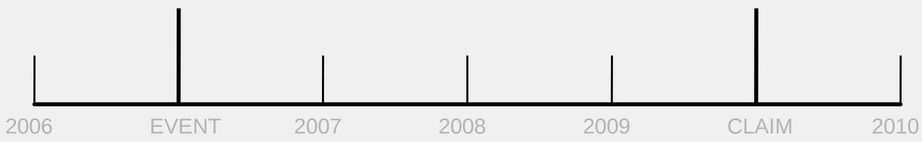
Limiting liability by sharing the risks involved in complex, high-risk projects should only be considered by agencies in exceptional cases with appropriate advice from Crown Law.

Insurance period

Insurance is to be in place prior to the commencement of any contract and needs to run continuously for at least the life of the contract.

Depending on the type of policy, it may be appropriate to request that the insurance cover run for a set period after the end of the contract. This can be the case with professional indemnity and medical indemnity insurance in particular. These types of insurances are generally offered on a 'claims-made' basis. That is, the insurance only covers claims made (ie reported) within the period of the insurance cover regardless of when an incident occurred. 'Claims-incurred' policies respond to any events that occur during the period of insurance cover, regardless of when the claim is reported. The difference is depicted below.

The difference between claims made and incurred



Occurrence Policy: 2006-07 policy year responds
Claims Made Policy: 2009-10 policy year responds

Sourced from a slide show presentation by Box R. Blake Dawson Waldron Lawyers, November 2004.

Note: The definitions in the Tool Kit under the heading 'Insurance – Types and Terms' provides additional information on the distinction between occurrence and claims made policies.

Confirmation of insurance

Confirmation of insurance should be evidenced by requesting the supplier to provide a Certificate of Currency from their insurer.

A Certificate of Currency typically notes the:

- type of insurance cover;
- who the insured is;
- who the insurer is;
- level of cover;
- period of insurance; and
- scope of cover (may be limited geographically, or exclude certain events).

Important tip

Request copies of Certificates of Currency during the life of the contract as policies are usually only made for a 12 month period.

Types of insurance

Some of the common forms of insurance that may be considered in the context of contractual insurance requirements are listed below.

Public liability

When required

Public liability insurance is required where the supplier's obligations under the contract have the potential to cause personal injury or property damage to third parties.

Definition

Public liability insurance covers personal injury and/or property damage to third parties caused by the supplier's negligence.

Example – Public liability:

A contractor providing a service to an agency on agency premises injures a member of the public who sues the Crown and contractor for loss and damages.

Assuming the agency is not at fault, then the contractor's insurance cover should respond to both the claim against the contractor and any costs incurred by the agency in defending its position.

Note: Public liability does not usually cover pure economic loss or loss or damage caused by defective products.

Exposure considerations

- Are the contractual obligations hazardous?
- Do the contractual obligations involve interaction with members of the public?
- Is there a potential for loss of or damage to property owned by third parties?

- What is the maximum probable loss as a result of one event ie multiple claims from one event?

Product liability

When required

Product liability is required where the supplier provides products that are sold or supplied as part of the contract and which could cause injury or property damage.

Definition

Product liability insurance covers the liability arising from a product that causes personal injury or property damage. This cover is often included as an addition to public liability. It can also be issued as a separate policy.

A 'product' is generally defined in the policy to mean anything (after it has ceased to be in the possession or under the control of the insured party) which is manufactured, grown, extracted, produced, processed, constructed, erected, installed, altered, serviced, repaired, treated, sold, handled, supplied or distributed by the insured party or by others trading under the name of the insured party.

> **Example – Product liability**
>
> A contractor supplies an agency with a faulty chair that causes injury to a person who sues the Crown and contractor for loss and damages.
>
> Assuming the agency is not at fault, then the contractor's insurance cover should respond to both the claim against the contractor and any costs incurred by the agency in defending its position.

Note: Product liability is on an aggregate annual basis, not per claim, that is, the limit of liability applies to the sum of all claims from all events in the insurance year.

Exposure considerations

- Could the products cause injury/property damage?
- Do the contractual obligations involve interaction with members of the public?
- What is the maximum probable loss as a result of one event ie multiple claims from one event?

Professional indemnity

When required

Professional indemnity insurance is particularly relevant where an agency is relying upon the professional expertise of the supplier.

The policy should cover breach of professional duty including:

- misleading and deceptive conduct claims;
- defamation (libel/slander); and
- dishonesty of the supplier's employees.

Definition

Professional indemnity insurance covers legal liability for claims arising out of a breach of professional duty in the provision of professional services. The cover is usually limited to claims resulting in financial loss. Professional indemnity insurance also potentially covers claims alleging defamation; trade practices breaches of fair trading legislation, dishonesty on the part of the supplier and misleading and deceptive conduct.

Certain classes of professionals are required by law to carry professional indemnity insurance. It does not usually cover tangible property damage or personal injury.

> ### Example – Professional indemnity
>
> A contractor trains accounting staff in new accounting practices and the use of new software. The contractor was negligent in the advice given, resulting in significant accounting errors occurring causing large financial losses.
>
> The agency would seek compensation for losses from the contractor. The contractor's Professional Indemnity policy would respond.

Note: Professional indemnity insurance is usually a 'claims-made' policy. This means that the policy only responds to a claim when it is made within the period of insurance cover, not when the contract was current or when the incident leading to the claim occurred. This often means that the contract is completed before claims are made. This is why the contract wording may require such policies to continue for a specified period (known as 'run off' insurance) after expiry of the contract, dependant on the perceived exposure.

> ### Run-off period
>
> The contractor's professional indemnity cover should normally be for a period of six years after the completion of the contract as cover will only be provided for a claim that is made while the policy is in force.

Exposure considerations

- Is the supplier providing professional expertise?
- Is this professional expertise being relied upon?
- Could relying on this advice result in financial loss to the agency?
- What is the maximum exposure if the worst case occurs?

Workers compensation

When required

It is compulsory in Australia for employers to take out workers compensation insurance covering their statutory liability to employees suffering an injury or disease arising out of or in the course of their employment. The terms of these policies are prescribed by statute. The relevant Tasmanian legislation is the *Workers Rehabilitation and Compensation Act 1988*.

Definition

Workers compensation provides benefits to employees who suffer or aggravate an injury at work, or contract a disease for which work was the major contributor.

> **Workers compensation**
>
> Workers compensation insurance is mandatory for all employers including contractors (who employ persons) under Tasmanian legislation. Although it is required by law, this type of insurance must be specified in the Contract.

Exposure considerations

As covered in the *Workers Rehabilitation and Compensation Act 1988*.

Motor vehicle insurance

When required

Motor vehicle insurance is only relevant if the use of a motor vehicle is an integral part of the contract (not just incidental).

Definition

Motor vehicle property insurance (comprehensive insurance) covers claims by third parties with respect to property damage as well as accidental loss or damage, including theft and fire, to the insured's own vehicle.

An alternative to the comprehensive cover noted above is third party property damage which is limited to providing cover for damage caused by the use of the insured vehicle.

Exposure considerations

- Is use of motor vehicles an integral part of the provision of the contractual services?

Important limitations of insurance – liability caps, exclusions of liability and indemnity

Despite a supplier holding insurance, it is important for procurement officers to understand that loss or damage caused by a supplier will not be covered by the insurance where the liability is:

(a) above the level of an agreed liability cap;

(b) for a type of loss or damage that the Crown has agreed to exclude; or

(c) for a type of loss or damage that the Crown has agreed to indemnify (ie meet the costs of) the supplier for by the inclusion of an agreed indemnity clause.

The inclusion of liability capping, exclusion and indemnity clauses in contracts is therefore a significant risk issue and should not be done unless supported by a comprehensive risk management assessment. This must properly assess the risks involved, the impact of these provisions on the insurances that are being sought and the resulting responsibility of the Crown for loss or damage caused by the supplier. Where relevant, advice should also be obtained from Crown Law and the Government's insurance broker.

> **Important tip**
>
> Refer to your agency's policy on liaison with Crown Law.

Indemnifying a Supplier

It is unusual for the Crown to be asked to indemnify a supplier. Therefore, before agreeing to indemnify a supplier, advice should also be obtained from Crown Law.

Distinction between an indemnity and a liability cap

The distinction between liability caps and indemnities is as follows:

If the Crown agrees to indemnify a supplier, the Crown is agreeing that if the supplier suffers an agreed type of loss, the Crown will meet the cost of that loss.

If the Crown agrees to accept a liability cap, the Crown is agreeing that if the Crown suffers a loss as a result of the act or omission of the supplier (or a third party), the Crown will not seek to recover from the supplier more than the amount of the agreed cap.

Areas of liability that should not be limited

The Tasmanian Government generally regards the following areas as risks solely within the control of the supplier. They should not be limited except in exceptional circumstances and then only after discussion with Crown Law.

- personal injury (including sickness and death) to third parties;
- loss of, or damage to, tangible property belonging to third parties; or
- infringement of the intellectual property and other rights of third parties.

It is important to note that, where an agency limits supplier liability, cover for this risk is not automatically extended to the agency through the Tasmanian Risk Management Fund. Agencies will need to approach Treasury for a determination on additional cover, taking into account whether the risk can be properly identified, assessed and covered by and through the Fund. If cover is not extended by or through the Fund, then all decisions relating to, and management of, the risks will lie fully with the agency. In other words, any liabilities that extend to the Crown because of the limitation, if not agreed to be covered by the Fund, will need to be met by the agency.

What if the supplier does not have insurance?

It may be that the supplier you wish to engage brings unique abilities to the agency that cannot be obtained elsewhere, but has no insurance. This does not mean the supplier is not liable if an event occurs, but it does mean that they may be unable to meet any claim costs.

It is in your interest to encourage the supplier to arrange insurance, otherwise the Crown may be exposed to costs that the supplier is liable for but cannot pay.

A risk assessment should be undertaken in line with these Guidelines and if it is determined that any liability would be minimal, it may be appropriate to accept the risk and obtain the services required.

Comcover, in its article on professional indemnity insurance prepared for member agencies, provided the following advice.

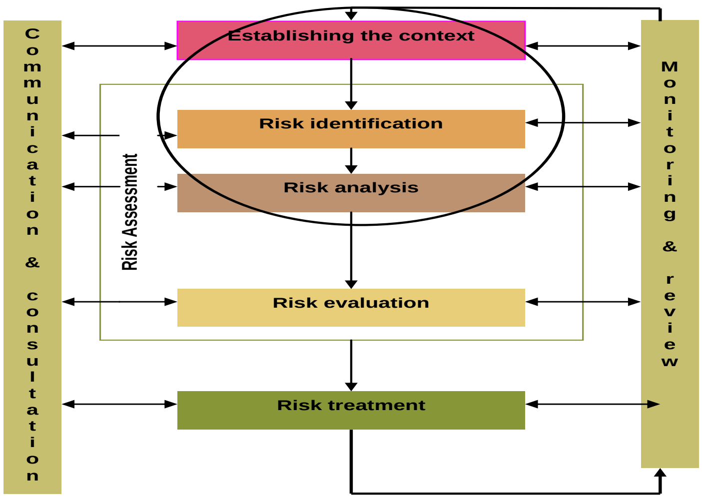
> Care needs to be taken to obtain detailed information to ensure that the person you are dealing with has the experience to adequately fulfil the obligations of the contract on your behalf.
>
> Information you may want to consider obtaining:
>
> - relevant experience relating to the work that you want completed;
> - previous business experience;
> - qualifications;
> - professional activities;
> - references from a variety of sources;
> - any past claims (insured or not);
> - audit procedures they use to monitor their work/projects;
> - training programs they (or their staff) have completed; and
> - loss control procedures put in place to prevent incidents from happening.[2]

[2] *Professional Indemnity Insurance*, paper prepared for member agencies of Comcover, April 2002.

Risk management in assessing insurable risk exposures

The purpose of this section is to introduce *Australian/New Zealand Standard ISO 31000:2009 Risk Management-Principles and Guidelines*. These guidelines are just one example of a systematic approach to identifying and managing risk.

The Risk Management Process



Source: AS/NZS ISO 31000:2009

What is risk management?

Risk management is a structured process involving the systematic identification, analysis, treatment, and where appropriate, acceptance of risks. It enables agencies to proactively identify, evaluate and manage these risks. Only the boxes circled in the diagram above are relevant in the context of these guidelines.

When should it be applied?

A rigorous assessment of insurable risks should be applied as early as possible in the contracting process to ensure that the level of insurance required in the contract documentation is appropriate.

> **Important tip**
>
> It is important to be aware that even low value contracts can be high risk. Therefore, it is good practice to think about the risks associated with each contract regardless of its value.

How can a risk management process based on the Risk Management Standard be applied to determining the levels of insurance required?

The guidelines that follow provide for a three-stage process. At each stage, a number of steps may need to be followed.

Stage one - Identify and assess the supplier's insurable risk and review possible controls.

Stage two - Determine the appropriate levels of insurance.

Stage three - Review the terms and conditions of cover.

PART TWO – GUIDELINES FOR APPLYING A RISK MANAGEMENT PROCESS TO ASSESSING INSURABLE RISK EXPOSURES

Stage one

Identify and assess the supplier's insurable risk and review controls

Determining the level of insurance cover that is adequate or reasonable for a specific contract is not an exact discipline, since it is difficult to foresee every risk or event that could potentially generate a claim.

What are the potential financial impacts of an accident or event arising from or during the course of the contract?

The theory

Examine the risks

The risks for each contract are different. Therefore, each contract will need to be assessed separately.

To determine what these may be, it is necessary to:

- identify the events or accidents that could happen arising from the supplier's activities; and
- evaluate the overall level of risk.

Step 1 – Identify the risks (what can go wrong?)

Some factors to consider:

- type of activity;
- duration of the contract or event;
- degree of hazard involved in the contract;
- likelihood of the supplier causing severe injury to participants, the public, the agencies' employees or other suppliers on site;
- potential for a number of persons to be injured in the one accident or occurrence;
- likelihood of the supplier damaging agency property or an agency's tenant's property and the value of the property at risk;
- risk of damage to third party property and quantum of losses that could arise;
- location of product or service delivery (does the location increase or reduce the risk of injury or damage?);

- size/value of the contract;
- likelihood of pollution or dust nuisance; and
- nature of any products supplied (uniqueness, complexity, reliance on new technologies or use of hazardous materials).

> The identification of risks involved is possibly the most important part of the process of managing risks in contract situations.

Step 2 – Assess the risks (How likely? How serious?)

Once identified, risks need to be analysed to determine the **likelihood** and **consequence** of these occurring. The combination of likelihood and consequence is assessed to determine the level of risk.

What is the overall level of risk?

One way of prioritising is to rate the specific risks as extreme, high, significant, moderate or low depending on the combined ratings of likelihood and consequence.

Example – Rating the overall level of risk

	Consequences				
Likelihood	**Insignificant/ negligible** ***Public liability risks*** For example: Minor injury or damage that may or may not result in a formal complaint being lodged. ***Professional indemnity risks*** For example: Negligible circumstance resulting in no financial loss.	**Minor** ***Public liability risks*** For example: Minor injury or damage to property that could be managed within existing unit/Department budget. ***Professional indemnity risks*** For example: Interruption of service delivery with little financial loss to 3rd party.	**Moderate** ***Public liability risks*** For example: Injury or illness resulting in hospitalisation (medical expenses) or damage to property that can be managed within the Department's budget. ***Professional indemnity risks*** For example: Interruption of service delivery with major financial loss to 3rd party.	**Major** ***Public liability risks*** For example: Permanent/serious injury to persons or damage to property that cannot be managed within the Department's budget. ***Professional indemnity risks*** For example: Business interruption with major financial loss to multiple users.	**Catastrophic** ***Public liability risks*** For example: Fatality, multiple fatalities or chance of multiple claims. ***Professional indemnity risks*** For example: Critical financial loss that has significant impact.
Almost Certain	**Moderate**	**Significant**	**High**	**Extreme**	**Extreme**
Likely	**Moderate**	**Significant**	**High**	**High**	**Extreme**
Moderate	**Low**	**Moderate**	**Significant**	**High**	**High**
Unlikely	**Low**	**Low**	**Moderate**	**Significant**	**Significant**
Rare	**Low**	**Low**	**Moderate**	**Significant**	**Significant**

> **Likelihood** – used as a general description of probability or frequency.
> **Consequence** – outcome or impact of an event.

Step 3 – Examine controls (Will the controls reduce the likelihood of the risk occurring or reduce the consequence?)

A lower level of insurance may be settled on if effective controls are in place that prevent, detect or lower the consequences and likelihood of potential or undesirable risks or events.

> When contracting with professionals who will be supplying advice on behalf of the agency, you must be confident of their expertise**.**

Effective controls may include best practice initiatives adopted by the supplier. Some factors to consider are listed below:

- the supplier's commitment to quality assurance. Is this at a level which reflects the nature of risks associated with the project;
- the supplier's technical capability (eg references, accreditation, past performance on previous projects including time management, standard of work etc);
- the supplier's history of relevant innovation, research and development;
- whether the supplier is at financial risk (eg committed to multiple projects at the same time);
- the supplier's commitment to human resource management (eg history of staff turnover and industrial relations performance, procedures for evaluating subcontractors' capabilities, strategies to effectively co-ordinate sub-contractors, training policy);
- the supplier's commitment to occupational health and safety (eg systems which address management responsibility, sub-contracting, inspection and testing, corrective and preventative action, safety plans); and
- the supplier's solvency (eg balance sheet, guarantees etc).

What is the overall assessment of the controls?

One way to rate control effectiveness is shown below.

Excellent	More than what a reasonable person would be expected to do in the circumstances.
Adequate	Only what a reasonable person would be expected to do in the circumstances.
Inadequate	Less than what a reasonable person would be expected to do in the circumstances.

Source: RiskCover – risk reference tables

Residual risk rating

What is the residual risk rating?

Residual risk represents the risk that remains after considering the controls that are in place to mitigate the risk.

Re-examine the risks identified in Step 2 and adjust the level identified after factoring in the rate of control.

> The residual risk rating is a combination of the gross risk rating and the control effectiveness rating.

For an indication of the level of insurance required, refer to Stage Two.

If the supplier cannot match the level of insurance required, consider abandoning the contract or negotiate an alternative delivery mechanism.

Putting theory into practice

Scenario one

A consultant is to be engaged to collect information and maintain a database that members of the public will use to make decisions. In collecting the information, the consultant will primarily use email and phone calls. However, some minimal contact with the public is anticipated. The consultant does not have employees and is to operate from an office within the agency.

Identify potential insurable risks (exposure considerations)

- Possible injury to members of the public including agency employees (public liability)
- Damage to Crown property (public liability)
- Accuracy of the information provided to the public (professional indemnity)
- Sole operator – no employees (contractor should have personal accident cover)

How likely or serious?

- **Public liability**. The contractor has minimal contact with the public. However, it is **possible** but perhaps **unlikely** that a member of the public would be injured. The consequence of any injury would be **insignificant/minor**. It is also **unlikely** that the contractor's activity will cause damage to property belonging to the Crown as induction procedures are to be carried out (obviously, if the contractor worked from home, the risk of damage to Crown property disappears).
- **Professional indemnity**. The public will use the information provided in the database. If this information is incorrect, it is **possible** that they may experience a **small financial loss** and seek compensation from the agency concerned.

What is the overall level of risk?

- **Public liability**. Refer to the table at Stage Two on page 21. As the risks are **unlikely** and any consequence of them occurring would be **insignificant or minor**, the rating for this risk would be **low**.
- **Professional indemnity**. The total possible small financial loss has been estimated at less than $10 000.

What level of insurance is required?

The tables at stage two (pages 20 and 21), provide an indication of the amount of insurance required.

- **Public liability.** In this instance, the amount of **public liability insurance** to be considered would be **between $0-$10 million.**
- **Professional indemnity.** The amount of professional indemnity insurance would be **between $0-$5 million**.

Scenario two

There is to be a change in occupancy of a state owned house. A cleaning contractor will be engaged to clean carpets prior to occupancy by the new tenant. The contractor has three employees and has been awarded the contract on the basis that its suggested product will reduce maintenance costs significantly. This was an important consideration due to maintenance budget cuts for housing.

Identify potential insurable risks (exposure considerations)

- The contractor does not have direct contact with the public but could impact on future tenants through its actions - eg the contractor fails to remove something hazardous left by previous tenant (public liability).
- Negligence by the contractor causes damage to the house (public liability).
- Products used by the contractor cause injury to the occupants (product liability).
- The contractor is responsible for employees (workers compensation needs to be specified in the contract).

How likely or serious?

- **Public liability**. It is **possible** but perhaps **unlikely** that a member of the public or the tenant will be injured (low risk rating).
- **Public liability**. It is **possible** that the contractor may cause damage to the house but the damage is **not likely to exceed $10 000** (low risk rating).
- **Product liability**. It is **unlikely** that products used by the contractor may cause injury to the occupants and the consequences if they do would probably be **minor** (low risk).
- **Workers compensation**. The contractor must have a policy to cover injuries sustained by employees in the course of their employment.

What level of insurance is required?

Refer to the tables at stage two (pages 20 and 21).

- **Public liability.** A low risk rating is indicated for both identified public liability type risks. **Public liability insurance** of between **$0-$10 million** is indicated.
- **Product liability.** A low risk rating is also indicated for product liability. **Product liability insurance** of between **$0-$10 million** is indicated.

Scenario three

A concert is to be held to celebrate Tasmania's songwriters and musicians and numerous bands and soloists have agreed to perform. A wide variety of instruments and sound equipment belonging to the artists is be used and these have been valued at just under $1 million.

The concert is to be held in a Crown owned facility that has the capacity to seat the 500 people who are expected to attend.

The contractor hired to stage the event will be responsible for construction of a demountable stage and all electrical work.

Identify potential insurable risks (exposure considerations)

- Faulty electrical wiring causing fire (public liability).
- Negligence by the contractor in erecting the stage, which results in damage to the expensive musical instruments and equipment (public liability).

How likely or serious?

- **Public liability**. It is **possible** that faulty electrical wiring will result in a fire. The consequences could be **catastrophic** in terms of loss of life and loss of valuable equipment (high to significant risk rating).
- **Public liability**. It is **possible** that negligence in the construction of the stage will result in damage to one or more of the musical instruments or equipment. The consequence of this happening would be **major** (high risk rating). It is also **possible** that negligence in the construction of the stage will result in serious injury to performers and/or concertgoers, the consequence of this happening would be **major** (high risk rating).

What level of insurance is required?

Refer to the table at stage two (page 21).

- **Public liability**. If a fire were to occur, the chance of multiple injuries and claims is extremely high. Negligence in the construction of the stage may also result in multiple injuries and claims. This event would require **public liability insurance** in excess of the $**20 million** indicated for high level of risk.

Stage two

Determine the appropriate level of insurance

The tables below provide an indication of suggested minimum insurance requirements for each of the levels of risk (extreme, high, significant, moderate, low).

Professional indemnity

Level of risk	Examples of contracts and potential risks (Incorrect professional advice resulting in financial loss)	Minimum insurance
Extreme	Consultant engaged to develop new accounting software to be used by a number of government agencies. • Significant accounting errors causing loss of information. Consulting firm engaged to provide an environmental impact statement on the chemical pollutants reaching inland waterways. • Incorrect advice resulting in closure of the fishing industry on inland waters. • Very serious litigation including class actions.	Greater than $10 million
High	Consultant information technology firm engaged to advise on software that has the potential to collapse part of the IT system for a few weeks. • Incorrect professional advice resulting in major financial loss to multiple users.	$5 - $10 million
Significant	Consultant engaged to review the flow of traffic on the Tasman Highway. • Review fails to identify all factors resulting in significant delays to scheduled maintenance.	$1 - $5 million
Medium	IT consultant engaged to modify an existing database to enable the collection of additional information. • Product fails and has to be reworked.	$0.5 - $1 million
Low	Consultant giving advice on alternate policy matters. • Incorrect professional advice resulting in small financial loss.	$0 - $.5 million

Public and product liability

Level of Risk	Examples of contracts and potential risks that might fall within this category	Minimum Insurance
Extreme	Supplier engaged to run and host a Tasmania Day celebration which has been designed to attract large numbers of the Tasmanian public. • Person severely injured while at the function. • Multiple claims or injuries. Supplier engaged to transport hazardous wastes. • Multiple fatalities.	Greater than $20 million
High	Supplier engaged to host a display of leading Tasmanian art works. • Art work not secured which results in a person being permanently or seriously injured. Supplier engaged to service fire detection equipment. • Poor servicing results in damage to property causes interruption of service delivery to multiple users.	$10 - $20 million
Significant	Supplier has been engaged to host a small, contained event. • Illness or injury to a person requiring medical treatment.	$5 - $10 million
Moderate	Supplier has been engaged to replace computer software of strategic importance to a business unit. • Lost time and re-establishment of data can be handled within agency's budget.	$1 - $5 million
Low	Supplier has been engaged to maintain a visitor centre. • Minor damage with minimal impact on visitor centre operation.	$0 - $1 million

An allowance must also be made for the fact that settlement of public liability and professional indemnity claims can occur many years after the event giving rise to the claim, so the level of cover must cater for potential claims inflation and changes in the law in the intervening period.

Comcover, in its article on professional indemnity insurance prepared for member agencies, provided the following examples.[3]

[3] Comcover, *Professional Indemnity Insurance*, paper prepared for member agencies of Comcover, April 2002, pp. 7-8.

Will the sum insured be sufficient to meet the claim when it is settled?

Claims do not settle immediately. A claim happening today can take years to settle and is paid at the future value not today's value. It is not unusual to see liability claims take up to ten years to settle.

When deciding on a figure for insurance purposes:

- consider all potential claims that might be brought today or in the future;
- estimate the worst possible outcome;
- consider future costs such as increased interest rates, inflation, increased hourly legal representation costs, unforeseen changes in legislation and legal appeals which all impact on the level of damage;
- note that claimants generally have up to six years to begin their action (refer to the *Limitation Act 1974* (Tas)); and
- consider that damage may not be discovered for years.

Will the sum insured be sufficient to cover claims within the retroactive period?

This is the period of time where claims can be filed from past activities. It may seem safe to reduce coverage but do you know for sure there are no claims outstanding? Reduced coverage today would apply to those claims – not the amount of coverage in force at the time of the alleged claim.

Example (professional indemnity claim made after completion of a project – insufficient cover)

An accountant with a small business is awarded a large contract. During the length of the contract he increases his coverage to $30 million. After completion of the project he reduces the policy to $5 million. Three years later he is sued in relation to the large project and damages in the amount of $10 million are claimed due to his negligence.

In this case, the accountant did not consider the possibility of future claims arising from the contract he long ago completed. When considering an amount for insurance it is important to review past activities and the potential for claims.

It is important that cover limits reflect the calculated level of risk exposure and take into account the fact that claims may not arise until some time in the future even after the contracted work has been completed.

Stage three

Review the terms and conditions of cover

Once the level of cover has been determined, it can be used as a criterion in procuring the particular goods or services. Before a contract is signed with the successful supplier, it is also important to review the terms and conditions of the supplier's cover to ensure that the insurance protection is adequate for the risk exposures identified.

RiskCover, in its paper on suppliers' liability insurance, noted the following aspects of the supplier's insurance cover that should be reviewed:[4]

Policy conditions and exclusions	• Review policy exclusions and relevance to contracted activities. • Ensure that the contracted activity is covered by the policy.
Excess/deductibles	• Review the excess/deductible level to ensure it is reasonable for size of supplier and for level of cover provided.
Hold harmless agreements	• Ensure there are no special arrangements that preclude the Crown.
Proof of currency	• Ensure that cover remains current for the length of the contract. • Include in contract conditions: → a requirement to advise of cancellation/lapsing of insurance cover; and → that proof of insurance be provided at the signing of the contract and, say, 60 days prior to renewal of the policy. Follow up on these as part of contract management.
Sub-limits	• Review any sub-limits specified in the supplier's insurance in line with limits determined in risk review.
Run-off cover	• Review whether the consultant's professional indemnity cover has a run-off period after completion of the contract. The run-off period should normally be 6 years.

We would add the following points.

Vehicle integral to the contract	• Ensure that vehicle insurance has been specified in the contract.

[4] RiskCover, *Contractors' Liability Insurance, Process for determining appropriate cover limits*, March 2002.

Supplier is an employer	• Ensure that workers' compensation cover has been specified in the contract.
Supplier is a sole proprietor	• Does the supplier have personal accident cover and, if so, what level?

Note: If in doubt, seek Crown Law advice.

PART THREE – TOOL KIT

Insurance check list

- ☐ All insurance options have been considered (professional indemnity/public /product liability/motor vehicle third party property damage/workerscompensation).
- ☐ All insurable risks have been identified and assessed.
- ☐ Risks identified through past experiences were reviewed when considering an amount for public/product liability and professional indemnity insurance.
- ☐ Insurance is in place before the commencement of the contract.
- ☐ The insurer is a registered insurer with the Australian Prudential Regulation Authority (APRA).
- ☐ The insurance period takes into account the type of policy (occurrence or claims-made).
- ☐ Evidence of the supplier's insurance has been obtained.
- ☐ Advice from Crown Law has been sought if there is any desire to limit liability by the sharing of risks in complex, high-risk projects.
- ☐ Liability has not been limited for personal injury, loss of, or damage to, tangible property or infringement of the intellectual property and other rights of third parties.
- ☐ If uninsured, supplier has the experience to adequately fulfil the obligations of the contract and the associated risk is considered very low.
- ☐ Dates have been set for monitoring the requirements of the contract including review of Certificates of Currency.
- ☐ The terms and conditions, including pricing, on which risk allocations have been determined have been carefully monitored to ensure that they reflect value for money.

Contract Name: **Date:**

Worksheet 1

Initial risk assessment and identification of appropriate levels of insurance

Step one
Use worksheet 2 to help assess the level of risks and levels of insurance required

Prior to running the tender it is necessary to assess the level of risks involved in running the contract.

Use worksheet 2 to help with this.

Risks have been rated into five categories – extreme, high, significant, moderate and low – depending on the combined ratings of likelihood and consequence.

Use the colour coding to help identify the minimum level of insurances required.

Insurance requirements – initial assessment

Public liability

$

Professional indemnity

$

Prepare documentation and run tender

Step two
Prepare documentation and run tender

Insurance must be in place before the commencement of the contract.

It is advisable to include the following conditions in the contract:

- A requirement to advise of cancellation/lapsing of insurance cover.
- That proof of insurance be provided at the signing of the contract and 60 days prior to renewal of the policy.

For other conditions refer to the Standard Request for Tender document.

Assess tender responses

Step three
Assess the tender responses and, if necessary, re-evaluate the risks

Insurance requirements <u>have</u> been met.

Insurance requirements <u>have not</u> been met.

A lower level of insurance may be appropriate if the contractor has effective controls in place and the risk assessment has been re-evaluated.

Step three A
Assess the initiatives that will reduce risk exposures.

Control check list (examples might include the following)

Does, has or is the contractor:

- accredited
- provided a safety plan
- committed to quality assurance at a level which reflects the nature of risks associated with the project
- financially viable and not committed to multiple projects at the same time
- closely co-ordinate sub-contractors.

Step three B
Use worksheet 2 to re-evaluate the level of risks involved after taking into account risk mitigating factors such as the controls listed above. Identify the level of insurance for the residual risks.

Finalise, abandon or seek other alternatives.

Step four
Accept the tender, perhaps with lower insurance levels & associated risks, or abandon

Accept the tender and check the following:

Check list

☐Proof of insurance has been obtained

☐Period of cover is adequate

☐Contracted activity is covered

☐The consultant's professional indemnity cover has a run-off period of 6 years after the completion date

☐ There are no special arrangements that preclude the Crown

If in doubt, seek Crown Law advice

If insurance matches the re-evaluated requirement – <u>accept the tender and check the following</u>.

Insurance requirements – re-evaluated

Public Liability $

Professional Indemnity $

If the level of insurance <u>does not</u> match this, <u>abandon or negotiate an alternative delivery mechanism</u>.

Prepared by: …………………………Notes: (1) Insurance risks higher than 'significant' will require a more detailed risk assessment
Endorsed by: ………………………… (2) Add any comments on a separate page to justify the choice of level.

Contract Name: **Date:**

Worksheet 2 - Risk Assessment

	Consequences				
Likelihood	**Insignificant/negligible** **Public/product liability risks** □No injury. □Minor injury or damage that may or may not result in a formal complaint being lodged. □Minimal impact on business. **Professional indemnity risks** □Incorrect professional advice resulting in minimal impact on business. □Incorrect professional advice resulting in negligible circumstance resulting in no financial loss.	**Minor** **Public/product liability risks** □Minor injury. □Damage to property that could be managed within existing unit/Department budget. □Interruption of service delivery affecting non-key operations. **Professional indemnity risks** □Incorrect professional advice resulting in interruption of service delivery with little financial loss to 3rd party. □Moderate financial loss or additional expenditure (including legal costs) that could be managed within existing unit/Department budget.	**Moderate** **Public/product liability risks** □Injury or illness resulting in hospitalisation (medical expenses). □Damage to property that can be managed within the Department's budget. □Interruption of service delivery affecting multiple units/branches. **Professional indemnity risks** □Incorrect professional advice resulting in interruption of service delivery with major financial loss to 3rd party. □Incorrect professional advice resulting in major financial loss that can be managed within the Department's budget.	**Major** **Public/product liability risks** □Permanent/serious injury to persons. □Damage to property that cannot be managed within the Department's budget. □Interruption of service delivery to multiple users and/or back-up failure. **Professional indemnity risks** □Incorrect professional advice resulting in business interruption with major financial loss to multiple users. □Incorrect professional advice resulting in financial loss that cannot be managed by the Department.	**Catastrophic** **Public/product liability risks** □Fatality or multiple fatalities. □Chance of multiple claims. □Major incident requiring organisation-wide evacuation of site. □Significant damage to property. □Critical financial loss. □Complete loss of service. **Professional indemnity risks** □Critical financial loss that has significant impact.
Almost Certain	□ Moderate	□ Significant	□High	□Extreme	□Extreme
Likely	□ Moderate	□ Significant	□High	□High	□Extreme
Moderate	□ Low	□ Moderate	□Significant	□High	□High
Unlikely	□ Low	□ Low	□Moderate	□Significant	□Significant
Rare	□ Low	□ Low	□Moderate	□Significant	□Significant

Identification of Appropriate Insurance Levels

Insurance Level Public Liability	□Low **$0 - $1 million**	□Moderate **$1 - $5 million**	□Significant **$5 - $10 million**	□High **$10 - $20 million**	□Extreme **Greater than $20 million**
Insurance Level Professional Indemnity	□Low **$0 - $.5 million**	□Moderate **$.5 - $1 million**	□Significant **$1 - $5 million**	□High **$5 - $10 million**	□Extreme **Greater than $10 million**

Prepared by: ………………………..Notes: (1) Insurance risks higher than 'significant' will require a more detailed risk assessment
Endorsed by: ………………………… (2) Add any comments on a separate page to justify the choice of level.

Insurance - Types and Terms

Most of these definitions come from the booklet prepared by Rehana Box of Blake Dawson Waldron Lawyers.[5]

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; and
- 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.

Combined liability insurance – a policy giving public and products liability cover and possibly but rarely other liability cover eg professional indemnity.

Cover note – an interim or temporary contract of insurance pending the arrangement of a long term insurance contract.

[5] Box R. Blake Dawson Waldron Lawyers, *Negotiating and Drafting Contractual Insurance Provisions*, notes presented to Risk Management Institution of Australasia (RIMA) Conference, Hobart, November 2004.

Insurance - Types and Terms cont.

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 officers 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 effect 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 – 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.[6]

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**).

Indemnity clause – is 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.

Liability insurance (also known as **public and products 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.

[6] Comcover, *Professional Indemnity Insurance*, paper prepared for member agencies of Comcover, April 2002, p. 6

Insurance - Types and Terms cont.

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 (eg 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, limits of indemnity and so on. The schedule forms part of the policy.

Self-insured retention – see excess/deductible.

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 or wholly responsible for the loss in order to mitigate its loss.

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 compensation 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.

[7] Comcover, *Professional Indemnity Insurance*, paper prepared for member agencies of Comcover, April 2002, p. 3

APPENDIX 1: References

The Department of Treasury and Finance acknowledges the following:

Box R. Blake Dawson Waldron Lawyers, *Negotiating and Drafting Contractual Insurance Provisions*, notes presented to Risk Management Institution of Australasia (RIMA) Conference, Hobart, November 2004.

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