# **Insurance provisions: Goods and services procurement guide**

## Context

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.

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

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 or liability.

The three common types of insurance relevant to the purchase of goods and services are:

* Public liability
* Product liability
* Professional indemnity

Insurable events such as marine and transit cover, special events, assets and revenue protection and farm/crop cover are out of scope of this procurement note.

## Introduction

There are certain risks associated with the procurement of goods and services.

These risks need to be assessed and some form of risk management strategy established.

Some risks are not insurable such as how effectively the goods or services support 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 which resulted from the premises being unsafe.

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

1. to reduce the risk of the supplier not having sufficient financial resources available to meet a liability to the organisation or some other party; and
2. 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.

## Main types of insurance

Insurance is an agreement for the insurer to meet some or all of the financial costs of the insured party where that party is liable for such costs. Insurance obligations in contract provide a level of financial protection to an organisation in relation to loss incurred or liability arising from a supplier’s negligent acts or omissions.

Ultimately, the supplier’s cost of insurance (the premium) is included in the cost payable by the organisation (and other parties) to contract with a supplier. Additional costs may be payable by the organisation where the supplier is required to obtain specific insurance in excess of any general cover already purchased.

The following sections provide advice on the three common types of insurance relevant to procured goods or services.

### 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.

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, and
* 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, property damage or other losses (e.g. a loss 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 which render the product dangerous.

Often a supplier will have a combined public liability and product liability cover. Public and product liability insurance policies exclude risks covered by more specific insurances, such as professional indemnity insurance, construction insurance etc.

### Professional indemnity insurance

Professional indemnity (PI) insurance covers liabilities arising from a breach of professional duty by a supplier. A claimant can seek compensation for financial and economic loss.

Typically PI cover includes:

* a breach of professional duty
* negligence
* bodily injury and property damage arising from service breach
* fraud/dishonesty other than a company director’s dishonesty
* infringement of intellectual property rights
* breach of confidentiality
* defamation, and
* 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 (where prescribed) 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 ‘run off’ cover in relation to the particular project for a period beyond the cessation date.

The national framework of professional standards legislation allows approved professional associations and other occupational groups (e.g. accountants, engineers) to limit or cap their member’s liability connected with the members’ occupation. Members of a scheme must disclose limitation of their liability on all documents provided to clients. The Professional Standards Council of Victoria provides information of such approved schemes under professional standards legislation. The Australian Prudential Regulation Authority (APRA) can provide information on the member’s level of PI cover.

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 which disadvantages the organisation 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, which removes the right 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 service 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; and
* the level of risk of the procurement.

### Workers Compensation Insurance

Workers compensation insurance (also known as employer’s liability insurance) cover 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; and
* 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.

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.

Limiting 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 arises 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 good and/or services;
* encouraging small business involvement in the government procurement; and
* 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).

Where needed, seek advice from legal sources and/or the VMIA before finalising contractual clauses when liability capping is being 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, or
* where the goods or services are critical to the operation of the organisation.

### Risk assessment

Risk management provides a structured approach to:

* + identify potential areas where problems might arise in the contractual relationship between the parties
  + consider the degree of likelihood and impact of losses (financial or otherwise) that may arise, and
  + consider 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:

* + **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); and
  + **risk avoidance** (which includes deliberately avoiding particular strategies, tactics and relationships).

Insurance is one tool for risk management. A majority of suppliers to government will have some level of insurance cover. The decision to make is whether the supplier’s levels of insurance cover is adequate for the procurement risks.

### 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 be higher to reflect an increase in assessment of risk. For information about the assessment of complexity, refer to the [guide to complexity](https://buyingfor.vic.gov.au/assess-complexity). In many cases the market place will dictate the minimum level of liability available.

A simple **Insurance risk assessment tool** is available to assist in determining the level of risk for the three types of insurance:

* Public liability – cover selected per occurrence
* Product liability – cover selected per occurrence and in annual aggregate
* Professional Indemnity – cover selected per occurrence and in annual aggregate.

Where the risk assessment indicates a range of risk ratings (e.g. medium and high) for any of the insurance types, always adopt the higher risk rating. To determine an appropriate level of cover, consult your internal insurance adviser for assistance.

## VMIA Insurance

The Victorian Managed Insurance Authority (VMIA)is a statutory authority which 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.

Organisations are not immune to a claim for loss or damages if it can be established that the actions of the agency in some way caused or contributed to the loss or damage.

The VMIA has issued a number of master policies. Summaries of those policies have been issued to all clients (organisations).

There is cover under a master policy if, and only if:

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

## Definitions

**Complexity assessment**: an assessment of the level of difficulty 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.

**Cost of fixing defects**: amount of financial losses resulting from fixing any defects, losses can include loss of usage while repairing defects or defect that causes damage to people or property.

**Indemnity**: a general legal principle that holds that the individual recovering under an insurance policy should be restored to the approximate financial position they were in prior to the loss.

**Insurance**: an economic device whereby the payment of a premium for an insurance policy substitutes for a possible large economic loss (the contingency insured against).

**Insurance excess**: a provision whereby an insured may be required to pay part of a loss (also referred to as a deductable item).

**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.

**Liability**: a debt, responsibility or obligation arising from a contract or by tort committed.

**Liability cap**: an arrangement whereby a supplier’s liability for damage or loss incurred by an organisation.

**Maximum cap**: is the maximum amount of liability the organisation will transfer from a supplier for any given loss event. The maximum cap protects the organisation form transferring risk that exceed the organisation’s risk management capacity and should be applied on a single event bass. (the minimum cap is the smallest amount an organisation with transfer to a supplier)

**Negligent act or omission of supplier**: is a failure to exercise the degree of care that would be expected from a reasonable or prudent person.

**Organisation**: a department or public body as defined under legislation or regulation and includes outer budget entities of government such as statutory bodies, government business enterprises, and administrative offices.

## Using this guide

This guide accompanies the [goods and services supply policies](https://buyingfor.vic.gov.au/goods-services-supply-policies). There are 5 supplies policies:

* Governance policy
* Complexity and capability assessment policy
* Market analysis and review policy
* Market approach policy
* Contract management and disclosure policy

This guide supports the [Market approach policy](https://buyingfor.vic.gov.au/market-approach-policy).

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