## 

**INSURANCE, INDEMNITY AND CONTRACTS:**

A guide to help us manage our contract risks

**December 2015**

**Introduction**

When we enter into a contract, we enter into a legally binding agreement. Insurance clauses are an important aspect of any contract. They ensure that suppliers of goods and services can respond to claims should things go wrong. The purpose of this Guide is to provide practical information on insurance policies and contracts.

Indemnity clauses often appear in contracts. Our Guide gives some information on what these are and how to consider them.

Another type of clause that can appear in contracts is the ‘hold harmless’ clause. The Guide gives some information about these clauses and some of the risks associated with them.

The Guide includes general information on the main types of insurance policies you will come across. We’ve focused on what we think are the key points. Contracts come in all sorts of versions and are for different purposes. It is important to look at every contract for specific points you need to address.

We’ve included some appendices giving further information. There is also a checklist you can use when you’re evaluating these types of clauses.

We’ve produced another Guide, titled ‘Contact Risks’, which gives further information on this area. We hope both of these Guides will provide you with a better understanding of this area.

This guide is not a legal guide. This is an area which can be a legal minefield! We strongly recommend the legal vetting of complex contract clauses in this area to ensure the risks are fully appreciated. Our colleagues in the Procurement section can also provide you with further assistance, as can we.

We always welcome your feedback. If you have any comments, please do not hesitate to contact us at [ac@usp.ac.fj](mailto:ac@usp.ac.fj).

We hope you find the Guide useful and informative.

**Director of Assurance and Compliance**

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**SECTION 1: SOME BASIC CONSIDERATIONS**

When we enter into a contract, we enter into a legally binding agreement. We need to:

* Understand the contract.
* Assess the USP’s exposure, based on the scope and type of works.
* Understand what type of insurance policies we need to have.
* Request what we regard as mandatory insurance covers.
* Consider the wording of any indemnity clauses.

Before signing the contract, you should always ensure mandatory insurance requirements are met.

**Is insurance always needed?**

You may decide there are contracts where:

* No insurance cover is required.
* The level of insurance asked for is not necessary.

You should consider:

* How critical the work is to USP. (i.e.: causing major disruptions to USP operations).
* The amount to be paid to the contractor.

This decision should be based on:

* An evaluation of the risk (see Section 2).
* An assessment of the likely potential loss.

If the contractor does not have insurance, both parties need to understand their exposure and their liability. This is the potential financial exposure if things go wrong. It may be better in some cases not to use a certain contractor.

Insurance may be required as part of a tender bid. If a contractor does not have it, then a mandatory tender requirement has not been fulfilled.

**SECTION 2: ASSESSING RISKS**

**Completing a risk assessment**

The best time to address potential risk with a contract is before the contract is signed. This will ensure that potential problems are addressed before work starts.

A risk assessment reviews a lot of things other than insurance, indemnity and hold harmless clauses. However, these should be thought about when assessing a contract. Insurance helps to manage the risks of large financial losses. It transfers financial risk that would otherwise be the responsibility of the USP or the contractor.

The following table includes some suggestions about what you might want to consider.

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| **Some things to consider** | **Risk assessment factors for insurance, indemnity and hold harmless clauses** |
| Consider what can go wrong. Even the smallest job may have major adverse consequences. | 1. Including strong indemnity clauses in your contract and requesting insurance coverage could result in significance savings for both parties. 2. Think about implementing controls that can prevent or give early warning of possible contract problems. These can then be communicated and responsibilities allocated. 3. Focus on the bigger picture. It is better to insure incidents which are costly in case of a major occurrence. Not everything is cost effective to insure. It may be that insurance is not necessary. |
| Consider identifying risks associated with contract management capabilities available to you. This includes contract administration, reporting on progress and client: contractor meetings. | Consider these matters alongside insurance, indemnity and hold harmless clauses. Good contract administration can prevent serious risks happening. It can also ensure that we respond to potential incidents more quickly. The need to call upon insurance and other clauses due to contract delivery problems is then reduced. |

**Categories of risk**

Some more specific categories of risk that you may want to think about include the following matters. These matters will help you decide what level of insurance might be required in a contract.

* 1. Is this a contract that could have a significant reputation or governance impacts?
  2. Is this a contract that has important organisational implications?
  3. Is this a contract of high value or long duration?
  4. Is the contract a particularly complex or sensitive one that might require legal input?

**Further guidance**

We have produced a further guide entitled ‘Contract risks’ that provides more detail about this area.

**SECTION 3: INSURANCE**

**What insurance should we look for?**

**Clarifying the reasons for insurance cover**

* Both parties must be clear why insurance at a particular level is being requested.
* Any insurance cover needs to be adequate for both the contractor and for USP. Neither party should try to carry significant risks best handled via insurance. This could result in major problems if there are delivery difficulties.
* Do not request insurance if it is not needed. This will add unnecessary costs to the contract.

**Some initial questions to consider**

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| * Confirm any mandatory insurance cover is in place. This can be required by law as well as by contract (for example, Workers’ Compensation insurance might be required by law). |
| * Identify and assess all insurable risks, such as workers’ compensation, general lability (public and product liability), vehicle cover and professional indemnity. |
| * Do we need insurance? |
| * Does the contractor have adequate insurance cover? |
| * Does USP have adequate insurance cover? |
| * Are any insurance limits noted acceptable? |

**A ‘Certificate of Currency’**

This is an important document to get, especially for big contracts. It confirms that the other contracting party has current insurance. It gives important details like the insured limits and other limits like the jurisdiction of the insurance. For example, the insurance might apply to one place rather than worldwide cover.

The certificate is not an insurance policy. It is summary information about it.

**Being an ‘additional insured’**

Sometimes, the contract is so significant that you might seek to be named as an ‘additional insured’ on the other party’s policy. This broadly means that you will be informed if changes happen to the insurance cover. For example, the limits may be lowered or the insurance cancelled. Also, being a named ‘additional insured’ can allow USP to claim on the other party’s insurance cover.

**SECTION 4: LIABILITY LIMITS AND INDEMNITY CLAUSES**

**Why do contracts include liability limits?**

All parties to a contract will look to limit their financial exposure where possible. For example, contractors might look to impose a percentage or dollar value to limit their liability.

The risk here is that the limit does not cover the damage done if a contract goes wrong. Signing a clause with such limits commits you to accepting this risk. It should be avoided wherever possible.

**Why do contracts include indemnity clauses?**

An indemnity clause lays out certain obligations the parties to the contract have. They broadly mean one party protects the other from an adverse financial situation arising in a contract. This can be done by inserting financial limits and/or limits on the scope of the indemnity.

So, for example:

* A contract might say that the USP will only be indemnified up to 1mAUD. If the actual losses are more, then these need to be found from another source.
* USP may agree to indemnify a contractor’s losses under the contract. USP would then be liable for all losses the contractor suffers according to what the clause says.

**Some questions to consider with indemnity clauses**

* Who pays whom, when and how much? Is the effect of the indemnity clause clear?
* Is a clause requiring parties to mitigate their losses included?
* Is there a time limit on the indemnity? For example, does it expire after twelve months?
* What sorts of things are included in the scope of the clause? For example:
  + If USP is being indemnified, does it include indemnity clauses for breach of contract and negligence? Or is just one of these explicitly covered?
  + Are certain costs explicitly excluded, like legal costs? The obligation to indemnify and the obligation to defend in court are two separate things.
* Where does the liability lie with projects? When does the ‘handover’ of the work actually occur? This can determine where liability will sit.
* If utilities like IT and water are being laid, is the contract clear about who has liability for connections?

Some further discussion and examples on this matter can be found at Appendix A.

**Transferring responsibility?**

An indemnity clause must not be accepted if USP is required to indemnify a contractor for their behaviour. A clause that attempts to indemnify all acts and omissions by the other party must not be accepted (See section 5). Remember, the other party is in the best position to prevent losses to themselves. They have a responsibility for their conduct when performing or managing a contract. We should not take on these risks.

**SECTION 5: ‘HOLD HARMLESS’ CLAUSES**

**What is a ‘hold harmless’ clause?**

A ‘hold harmless’ clause has a similar impact to an indemnity clause. It allows all parties to walk away from losses or breaches of contract without financial penalty. This can be regardless of whose fault the breach of contract is.

Some examples of possible ‘hold harmless’ clauses you could come across are at Appendix B.

**What is its effect?**

A ‘hold harmless’ clause prevents each party in the contract from suing in the event of a loss. This is irrespective of actual responsibility or negligence. So, these clauses have a very serious impact if a contract goes wrong.

Insurance policies may not cover contracts with very wide ‘hold harmless’ clauses. This is because these clauses indicate two parties agree to accept financial risks in the contract. The insurer can take the view that insurance has been substituted for one party carrying all of the risks.

If we get a clause like this, we may need to clarify the implications with our insurer. Where possible, we should avoid signing up to contracts with very wide ‘hold harmless’ clauses.

**Potential implications**

Where these clauses appear, both parties need to understand their implication. For example:

* Will the other party’s insurance respond if USP has a ‘hold harmless’ clause in its contract (or vice versa)?
* Can both parties meet financial obligations arising from a ’hold harmless’ clause’?

This is something that needs to be considered as it could affect the delivery of the contract.

**Public and products liability**

You will sometimes see this referred to as a ‘General Liability’ policy. The policy has two distinct parts. Sometimes, you’ll find the public liability without the product liability. You need to check to ensure what the scope of each policy is.

**Public Liability (PL)**

This policy covers personal injury and/or property damage to third parties. The policy covers claims due to negligence. It is required when contractual obligations can cause a third party personal injury and/or property damage.

Here is an example of some things you need to consider when looking at public liability cover.

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| **A contractor is engaged by USP. The services are provided at one of the USP’s campuses. A member of the public is injured while the service is being provided. Some damage to their property also occurs.**  **Three things might happen:**   1. **The person sues USP and the contractor for loss and/or damages.** 2. **The person sues USP alone.** 3. **The person sues the contractor.**   **If USP is not at fault, the contractor’s insurance should cover the following things:**   1. **The claim against them.** 2. **Costs incurred by USP in defending its position on any contractor negligence.**   **When you review the insurance requirements in the contract, you should consider the following types of factors:**   1. **Are there any unusual things that might mean a higher risk of a potential incident?** 2. **Will the work be in a public location? This might increase the risk of injury to somebody.** 3. **Are the risks of damage to property higher because of the contract objectives?** 4. **What do you realistically think the maximum loss USP could suffer is?** 5. **Is insurance cover on both sides considered enough to cover possible losses?** |

**Product Liability**

This covers liability for a product which causes personal injury or property damage.

Here is an example of how the insurance could work.

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| **A contractor supplies faulty equipment to USP. A person gets hurt. This person has three possible options if they want to take it further:**   1. **Sue both USP and the contractor for loss and damages.** 2. **Only sue USP.** 3. **Only sue the contractor.**   **If USP is not at fault, their insurance should cover:**   1. **The claim against them.** 2. **Any costs incurred by USP in defending its position.**   **When reviewing insurance requirements, the following should be considered:**   1. **Could the product cause injury?** 2. **What is the possibility that a product malfunction can damage other people’s property?** 3. **If an incident occurs, what is the maximum loss for this event thought to be?** |

**Professional Indemnity (PI)**

This is an insurance held by professional firms and individuals. It covers them for any issues about the quality of advice we give.

Claims are usually made once projects or consultancies finish. Therefore, it is important that a consultancy maintains insurance for some time after a contract is finished. This should be considered for inclusion as part of contract terms in major contracts. So, we may want to ask the following questions:

* If the vendor does not have an existing PI policy, will they only purchase the policy for the duration of the project? That will mean costs cannot be met by insurance once the project finishes.
* If a PI policy is needed, how long after the project do we want it to be in place? Do we want to include this in the contract?

One issue to consider is whether a consultant or consultancy should have this cover. Here are some points to consider:

* How much is USP relying on their professional expertise? If it is a low risk piece of work, then PI might not be considered necessary. It may be that good contract management and the potential to withhold payment is considered enough.
* What is the likely worst case scenario for the maximum possible loss? Does this mean we need to insist on PI?

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| **Example**  A contractor is engaged to construct a large building to an existing design. Only physical work is required, The contractor will likely require general liability insurance and also what is known as ‘Contractors All Risks’ insurance.  Now imagine the plans submitted to the contractor have some scope for value for money savings. Their ‘value engineering’ exercise is agreed by USP as the client. This involves changes to the building design. Once the changes are accepted, the contractual obligations change. This will require the contractor to have professional indemnity insurance. This will cover their redesign advice. |

**Some possible versions of ‘hold harmless’ clauses**

The main thing to note is how these can progressively limit the scope of the clause. These clauses often contain a list of different types of costs. Therefore, it’s important to read the list to understand what is included and excluded from the ‘hold harmless’ clause.

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| **TYPE OF CLAUSE** | **WHAT THE CLAUSE MIGHT SAY** |
| A general clause with no specific limits | The contractor agrees to indemnify and hold harmless USP of and from any and all claims arising out of or relating to the work of the Contractor. |
| Restriction – only | The contractor agrees to indemnify and hold harmless the USP of and from any and all claims, **but only to the extent caused by,** **arising out of, or relating to, the exclusive work of the contractor.** |
| With a financial limit | The contractor agrees to indemnify and hold harmless USP from any and all claims arising out of or relating to the work of the Contractor. **However, the maximum liability will not exceed $ \_\_\_\_\_\_\_\_\_.** |

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| **GUIDANCE PART** | **ASSESSMENT QUESTIONS AND QUERIES** | **Y** | **N** | **ACTION NOTES** |
| **1** | Have you read the whole of the contract and fully understood its terms? |  |  |  |
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| **2** | Did you complete a contract risk assessment? |  |  |  |
|  |  |  |  |  |
| **3** | Have insurance requirements been identified? |  |  |  |
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| **4** | Have you reviewed the contract liability limits and indemnity clauses and are they acceptable? |  |  |  |
|  |  |  |  |  |
| **5** | Is there a “Hold Harmless’ clause? Are its terms acceptable? |  |  |  |
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