



WHY SOME ORGANIZATIONS WAIVE IT, AND WHY YOU SHOULDN'T

## The Risks of Waiving Contract Insurance

by Katherine Caughran & Melissa McCabe

Smart contract managers understand the legal risks of competitive bidding. As case after case has shown, you need to be clear and concise when drafting your solicitation and contract documents, and then proactively manage your contracts and contractors.

But before you get there, you need to assess and plan for risks. That means asking some basic questions. For instance, what might the repercussions be for your organization if the actions of the contractor cause an injury or a lawsuit, or if there are damages?

Many risks directly under the control of the contractor (i.e., associated with the actions of the contractor) are transferred to the contractor by way of an indemnity clause in your organization's standard contract. In contract language, this is the term that generally states: "The contractor will indemnify and hold harmless ..." Essentially, this means that the contractor will reimburse you ("make you whole") for any losses it causes as a result of its performance, actions or decisions in providing a service and/or good under the contract, or it will pay those costs up front. This is a contractual promise, but it is only as good as the contractor's financial ability to back that promise.

Insurance is a means of managing the financial impact of the indemnity promise and other risk, but some contractors ask to have the insurance requirements waived entirely. There are number of reasons why.

***The contractor says it's too expensive or not necessary:*** Not fully understanding insurance and indemnity, you may waive insurance on the advice of a contractor who convinces you that it's too costly, not available, not worth the paperwork, or simply not needed.

***Better logic:*** Independent contractors should be the first to encourage adequate insurance coverage, both for the organizations with which they contract, and to protect their own personal assets and finances. Ensuring that potential financial risks are covered is just sound business practice.

***Best practice:*** Without insurance, the contractor could go bankrupt attempting to finance legal costs by itself. These provisions are intended to protect the contractor against financial hardship, in the event the contractor causes a loss or makes a mistake: the contractor's insurance will finance many of the possible losses, or pay to remedy its errors.

In addition, the contractor's insurance protects you! Without sufficient contractor's coverage, you may be drawn into underfunded third-party claims, and you may need to pay, from your own budget, for losses that the contractor causes directly to your organization.

***A manager has a \$50,000 signing authority:*** This is often a source of confusion. You may waive insurance coverage because you believe that your signing-authority level is 'enough' to cover any potential risks.

***Better logic:*** If your standard agreement contains an indemnity clause that transfers the contractor's risk to the contractor, ask yourself why you would want to take back the financial risk, in the event that the contractor causes a loss. Insurance will cost far less than a loss might – or will it? Have you done a risk assessment?

***Best practice:*** Do a risk assessment! Is this work that should be performed by an employee? Is there another qualified supplier who does have insurance? Is there exceptional benefit in waiving insurance provisions (leaving both contractor and your organization exposed to loss)? If there is, then consider whether or not the contractor should instead be hired as an employee, and forego the procurement process or contract. (This decision can only be considered in a direct-award situation.)

***The contractor is a former employee, and so doesn't need insurance:*** Most organizations indemnify their employees against personal liability for actions taken in the normal course of their employment duties. And some organizations waive insurance coverage for contractors who are former employees, under the misconception that, somehow, former employees are not a risk.

***Better logic:*** The actions and duties of an organization's employees are considered to be under the organization's control, and employees are usually covered by the organization's corporate insurance. Such control, and certainly such insurance, do not extend to an organization's contractors. If a former employee working under contract is not appropriately insured, he or she would be subject to losing personal assets – house, investments, car – to pay for such a loss, just like any other uninsured contractor.

***Best practice:*** Think of your former employees who may be involved in contract work as you would think of any other contractor, and assess the risk of their services that way for the purposes of insurance. Price, length of contract, or status as a former employee have no bearing on risk. This procurement practice does not reflect your lack of trust in the contractor; it's not personal, it's following best procurement practices.

***You put insurance requirements in your solicitation document, but the contractor wants to change them at the award stage:*** Without knowing exactly why you required the insurance you asked for, you might not worry about making changes. The contractor's rationale seems reasonable, and you're in a hurry, so what's the big deal?

***Better logic:*** Other bidders may have priced their bids differently, and some vendors who did not submit a bid at all may have done so if the new insurance "deal" you were making with the successful proponent had been in the solicitation. Depending on how your solicitation was written, you may have no room to negotiate those terms.

***Best practice:*** As part of solicitation planning, do a risk assessment of the goods/services to inform the types and amounts of insurance that will be required of the successful proponent. Include a sample agreement, including the contract-specific insurance requirements, as part of your solicitation document, with advice to your bidders that the contractor will have this insurance. Ask your risk manager for advice along the way.

***Here's the bottom line:*** Ensuring that adequate insurance is in place is in the best interests of *both* the purchasing organization and the contractor. What is adequate insurance? You need to determine that in the planning stages of your solicitation, by doing a thorough risk assessment.

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