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**CPD**

Procurement Guidance Note

**PGN 03/12**

(as amended)

# Liability and Insurance in Government Contracts

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## PROCUREMENT GUIDANCE NOTES

[Northern Ireland Public Procurement Policy \(NIPPP\)](#) was approved by the Northern Ireland Executive in 2002. In approving the policy, the Executive took the decision that legislation was not necessary to ensure that Departments, their Agencies, Non-Departmental Public Bodies and Public Corporations complied with the policy. Instead, it considered that compliance could be achieved by means of administrative direction.

Procurement Guidance Notes (PGNs) are the administrative means by which Departments are advised of procurement policy and best practice developments. They apply to those bodies subject to NIPPP and also provide useful guidance for other public sector bodies.

PGNs are developed by the Central Procurement Directorate (CPD), in consultation with the Centres of Procurement Expertise (CoPEs), and are subject to the approval of the Procurement Board.

Once endorsed by the Procurement Board, they are issued to the Departments for implementation and copied to CoPEs to develop, if necessary, underpinning procedures supporting the implementation of this guidance in their particular sector. PGNs are also published on the [Department of Finance \(DoF\) website](#).

**The following PGN was endorsed by the Procurement Board with effect from 21 May 2012 for use by those bodies subject to NIPPP.**

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### **Definition of Terminology**

In the preparation of this guide, the term **contractor/supplier** has been used to denote an organisation that contracts directly with a Department, whether it is a supplier, a service provider or a construction contractor.

The term **Department** has been used to refer to those bodies subject to Northern Ireland Public Procurement Policy including Departments, Non-Departmental Public Bodies and Public Corporations. A full list of such bodies is available in Annex A of the [Northern Ireland Public Procurement Policy \(NIPPP\)](#).

## 1 PURPOSE

This note provides guidance to Departments<sup>1</sup> on the issues that need to be considered in deciding whether, and to what extent, contractor<sup>2</sup> liability should be limited or excluded in public contracts. It also provides guidance on the levels of insurance that should normally be required. It makes clear that limiting or excluding liability is a matter to be considered in each case on its merits. Its intention is to ensure that the issues of liability and insurance take account of relevant factors including value for money.

## 2 SUMMARY

The main messages from this guidance are:

- 1) Decisions on limiting contractor liability should be taken by Departments on a case-by-case basis, reflecting value for money considerations.
- 2) Liability should remain unlimited for death and personal injury.
- 3) In most other cases, value for money considerations will mean that limits on liability will be appropriate.
- 4) Limits or caps should, preferably, be expressed as a sum of money rather than as a percentage of the contract value. This should reflect a combination of the best estimate of the losses that might be suffered by the Department, the likelihood of those losses occurring and the value for money considerations in limiting liability.

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<sup>1</sup> In the context of this guidance, the term Department is deemed to mean a public body subject to Northern Ireland Public Procurement Policy including Departments, their Agencies, Non Departmental Public Bodies and Public Corporations.

<sup>2</sup> Contractor means an economic operator who is a supplier, service provider or works contractor contracting directly with a Department.

- 5) Where appropriate, consideration may be given to excluding indirect and consequential losses altogether. However, there may be a case for resisting such exclusions where a general cap on liability has been agreed.
- 6) Liability issues should be addressed as soon as possible in the procurement process.
- 7) Insurance cover is normally a matter for the contractor, although a requirement on the contractor to maintain it at an appropriate level is necessary in some cases.
- 8) The general levels of insurance suggested in this note are:
  - a. Public liability (PLI)
    - £10 million (construction works and services)
    - £1 million (supplies and services)
  - b. Employers' Liability Insurance (ELI) - £10 million
  - c. Professional Indemnity Insurance (PII) - proportionate to the risks associated with the contract (see Section 8.3)
  - d. Construction All Risks (CAR) – project value plus 15%

### **3 BACKGROUND**

There has been a tendency to insist on unlimited liability in government contracts, regardless of the circumstances. This is likely, in many cases, to have an adverse impact on competition and value for money where, for example, contractors refuse to take part in competitions or where tender prices are increased to compensate for the additional insurance that a contractor may put in place when faced with unlimited liability.

## **4 APPROACH TO LIABILITY AND INSURANCE**

Decisions on liability remain the responsibility of the individual Department in the light of the specific circumstances. Nevertheless, this note provides some guidelines on levels of liability and of insurance that should normally be included in government contracts. However, it must be clearly understood that these need to be treated with caution. There is no substitute to a full analysis of each project to establish a clear assessment of the mix of risks involved. If necessary, Departments should take advice from a professional adviser in making this assessment. The figures provided throughout this note are general levels and not what are necessarily appropriate for particular contracts.

Where the suggested levels of insurance are not considered appropriate, they may be either raised or lowered. It might, for example, be considered that the level of insurance should be lower than the levels suggested as the cost to the contractor could be prohibitive. In these circumstances the client must accept that if loss or damage occurs in excess of the insured limit, and the contractor cannot fund the difference, then the client is accepting that additional risk.

## **5 LIABILITY - GENERAL**

The approach taken in respect of liability can be an important determinant in whether or not a contractor bids for a contract. It is important therefore that Departments consider these issues as early as possible in the procurement process. A decision should be made on any exclusion or cap before seeking expressions of interest or issuing the invitation to tender.

## **6 LIABILITY – MAIN TYPES OF LIABILITY**

There are different types of liability that a contractor may incur in relation to performance of a contract for a Department. In considering liability, the Department should take account of the issues raised by each type.

## 6.1 Death and personal injury

Liability **should remain unlimited** in areas where legislation (the Unfair Contract Terms Act 1977) proscribes limitation. These areas are liability for death and personal injury and for breach of the obligation to possess good title to goods that are sold or hired.

## 6.2 Direct loss or damage

There is no precise definition for direct loss or damage. The usual definition is that a direct loss is a loss which arises naturally and directly from the breach of contract or negligence. Losses will be treated, by the courts, as direct losses if they were reasonably foreseeable by the parties as being a likely consequence of a breach at the time that the contract was entered into.

However, there are specific considerations which have to be taken into account in particular areas. For some contracts, eg in the IT area, it might be appropriate to have separate limits for different kinds of losses - damage to property (where the limit might relate to the property value), other pre-acceptance losses (including claims under Intellectual Property Rights indemnities) and other post-acceptance losses.

Another issue is whether there should be a limit of liability relating to each 'occurrence'. However, applying this approach can introduce uncertainties into the limitation provision. Where there has been a catastrophic IT system development, for example, it is often difficult to pinpoint the exact cause of the problem and to determine whether there should be a single or multiple application of the limitation provision. For that reason it may be preferable to include a provision which specifies the total aggregate liability of the contractor. This means that there is a 'pool' of damages available to the Department and, once this pool has been exhausted, no further damages will be available.

The limit or cap may be expressed as a sum of money or a percentage of the charges payable under the contract. However, particular care should be taken over using the contract price to determine the appropriate limit. Such an



approach is attractive to the contractor because it will naturally prefer to avoid a situation in which the contract results in a net outflow of revenue. It is not, however, a good basis for limiting liability from the Department's point of view, since the contract price may be smaller than the loss that could arise if the contractor is in breach of contract. It is generally preferable for the Department to consider what limitation of liability it can comfortably accept without reference to the contract price.

The limit should not be so high that the commercial risk for the contractor becomes unacceptable. The aim should be to establish liability ceilings reflecting a combination of the best estimate by the Department of the losses that it might suffer (together with any other relevant, associated bodies) in the event of a default by the contractor considering the likelihood of those losses occurring, and the value for money considerations in limiting liability.

For estimating property losses, one approach is to make an assessment of costs associated with rebuilding, refurbishing and re-equipping premises in the event of destruction caused by contractor default, taking account of the potential risk. For non-property areas, estimating losses is often more difficult. One approach is to assess the approximate costs of recovering from a 'worst case' loss of service, based on the impact on the Department and other users of the services.

### **6.3 Indirect and consequential loss, loss of profits, etc**

For indirect loss or damage, consequential loss or damage or loss of profits, business, revenue and goodwill or anticipated savings, there is a strong case for accepting a limitation or exclusion from liability, especially in contracts relating to more sophisticated procurement. However, it is important not to look at these kinds of losses in isolation. There may also be a case for seeking to resist the total exclusion of claims for indirect or consequential loss etc where a general cap on liability has been conceded. Again, it is important to consider each case on its merits, in line with value for money considerations.

There should be no exclusion from liability for any direct loss such as additional operational costs, administrative costs and expenses, or expenditure rendered unnecessary, resulting from the direct default of the contractor.

## **7 INSURANCE - GENERAL**

The levels of insurance cover should normally be a matter for the contractor, reflecting its estimate of the risks involved. However, in the contract conditions, the Department may require that the contractor should effect and maintain a policy (or policies) of insurance. This should be designed to provide an adequate level of cover in respect of specific risks which may be incurred by the contractor, arising out of the contractor's performance or purported performance of the contract. Where insurances are required in the contract, the Department should verify with the contractor that appropriate policies are in place.

Insurance policies normally include a provision for an excess to be paid by the Insured in the event of a claim. Where Departments require insurance they should require excesses in policies to be restricted to levels that could realistically be met by the contractor and should verify that this is the case.

## **8 THE MAIN TYPES OF INSURANCE**

The main types of insurance presently used for public procurement projects in Northern Ireland are Public Liability, Employers Liability and Professional Indemnity Insurance. In addition, for construction projects, there is also Construction All Risks Insurance.

### **8.1 Public Liability Insurance (PLI)**

PLI indemnifies the Insured against their legal liability for accidental death, disease, injury and damage to property caused to third parties (that is, non

employees) and arising out of their activities. An exclusion under this type of policy would be for any claims arising out of a breach of professional duty (professional negligence) in the exercising of a professional skill which therefore may lead to the requirement to take out a Professional Indemnity policy. **In general, the levels suggested for public liability are £10 million for construction works and services contracts and £1 million for supplies and services contracts.**

## 8.2 Employers Liability Insurance (ELI)

ELI indemnifies the Insured against their legal liability for death, disease or injury caused to employees (there can be a wide definition of employee - it can include labour only subcontractors, students on work experience, etc) arising out of their employment. **The sum insured must be at least £10 million.** The client should ask to see a copy of the EL insurance policy and/or a copy of the certificate of insurance that the employer is required to display in the workplace under the Employers' Liability (Defective Equipment and Compulsory Insurance) (Northern Ireland) Order 1972.

## 8.3 Professional Indemnity Insurance (PII)

PII indemnifies the Insured against claims for loss caused by alleged breach of professional duty/negligence in the exercising of a professional skill. This would usually be taken out by Architects, Consulting Engineers and Quantity Surveyors, or Building Contractors (if they have a design input or responsibility, usually under a Design and Build contract). In the Supplies and Services sector, it could include management consultants, and legal and financial advisers.

Unreasonably high levels of PII can act as a bar to Small and Medium sized Enterprises (SMEs) tendering for government contracts. Levels of such insurance should be proportionate to the risks associated with the project and may be lower or higher than the value of the project.

Suggested levels of PII cover for construction new build projects of normal complexity and with no abnormal risks are:

Project Value	Required Cover
up to £2M	£1M
£2M to £10M	50% of project value*
£10M to £25M	£5M
£25M to £50M	20% of project value*
over £50M	£10M
up to £2M	£1M

\*These should be expressed as sums of money in the contract.

Professional liability should be capped, typically at or about the level of the required PI Insurance.

#### 8.4 Construction All Risks insurance (CAR) - sometimes also referred to as Contractors All Risks

CAR indemnifies the Insured against claims for loss of or damage to the contract works (that is, works undertaken in the performance of a contract including temporary works and materials and including free issue materials) on or adjacent to the site of any contract, both before and after they are incorporated into the contract works, during the period of the works. Cover is normally provided during transit to and from the site, other than by sea or air. Cover is also usually provided on an 'All Risks' basis to include Fire and Specified Perils as well as Accidental Damage, Malicious Damage and Theft. The policy can be extended to cover Own Plant, Site Huts, Temporary Buildings, and Hired-In Plant as well as Employees' Tools. **The suggested levels are project cost plus 15% to allow for consequential costs and inflation.**

## 9 RISK MANAGEMENT

Risk should be held by the party best able to manage it or be shared between the parties. Therefore, it is important to look at contractor liability as part of a general consideration of risk management and risk sharing. At one extreme, it might be that pressure from potential contractors for low limits of liability indicates an unacceptably risky project which should be reconsidered or restructured. In any event, it is vital that, at all stages of a project, proper risk management systems are in place and all approaches to risk sharing, other than limiting liability, are fully considered.

Risk management should continue throughout the entire duration of the project but, once procurement has commenced, there should be no change in the allocation of liability and the levels of insurance required. Requirements at PQQ stage should be carried into the contract between the Department and the contractor.

## 10 MODEL CLAUSES FOR SUPPLIES AND SERVICES

This guidance on liability and associated insurance may be incorporated into contracts using model conditions of contract clause **M1 (Liability, Indemnity and Insurance)** and contract clause **M2 (Professional Indemnity)**. Both clauses are reproduced in Section 13 (Model Clauses). It should be stressed that the clauses are 'models'. It is for a Department to consider, with its legal advisers and the relevant Centre of Procurement Expertise for the sector, how the clauses need to be adapted in the particular circumstances of the procurement and for specific forms of contract.

## 11 MANAGING PUBLIC MONEY NORTHERN IRELAND

Liability and insurance caps are not usually reportable, unless the contingent liability or contingent loss is financially significant or of an unusual nature.

Please see [Managing Public Money Northern Ireland](#) for further guidance.

## 12 FURTHER INFORMATION

Any queries on this guide should be addressed to:

Construction Procurement Policy Branch  
Central Procurement Directorate  
2<sup>nd</sup> Floor East  
Clare House  
303 Airport Road West  
Belfast, BT3 9ED  
Phone: 028 9081 6871  
Email: [ConstructionProcurementPolicy@finance-ni.gov.uk](mailto:ConstructionProcurementPolicy@finance-ni.gov.uk)

## 13 MODEL CLAUSES

### **M1 (Liability, Indemnity and Insurance)**

**M1.1** Neither Party excludes or limits liability to the other Party for:

- a) death or personal injury caused by its negligence; or
- b) Fraud; or
- c) fraudulent misrepresentation; or
- d) any breach of any obligations implied by Section 2 of the Supply of Goods and Services Act 1982.

**M1.2** Subject to clauses M1.3 and M1.4, the Contractor shall indemnify the Client and keep the Client indemnified fully against all claims, proceedings, actions, damages, costs, expenses and any other liabilities which may arise out of, or in consequence of, the supply, or the late or purported supply, of the Services or the performance or non-performance by the Contractor of its obligations under the Contract or the presence of the Contractor or any Staff on the Premises, including in respect of any death or personal injury, loss of or damage to property, financial loss arising from any advice given or omitted

to be given by the Contractor, or any other loss which is caused directly or indirectly by any act or omission of the Contractor.

**M1.3** The Contractor shall not be responsible for any injury, loss, damage, cost or expense if and to the extent that it is caused by the negligence or wilful misconduct of the Client or by breach by the Client of its obligations under the Contract.

**M1.4** Subject always to clause M1.1, the liability of either Party for Defaults shall be subject to the following financial limits:

- a) the aggregate liability of either Party for all Defaults resulting in direct loss of or damage to the property of the other under or in connection with the Contract shall in no event exceed [words] million pounds [£ figures]; and
- b) the annual aggregate liability under the Contract of either Party for all Defaults [other than a Default governed by clauses X (Intellectual Property Rights) or M1.4(a)] shall in no event exceed the greater of [[words] (figures)] or [[words] per cent ([figures]%) of the Contract Price paid or payable by the Client to the Contractor in the year in which the liability arises].

**M1.5** Subject always to clause M1.1, in no event shall either Party be liable to the other for any:

- a) loss of profits, business, revenue or goodwill; and/or
- b) loss of savings (whether anticipated or otherwise); and/or
- c) indirect or consequential loss or damage.

**M1.6** The Contractor shall not exclude liability for additional operational, administrative costs and/or expenses or wasted expenditure resulting from the direct Default of the Contractor.

**M1.7** The Contractor shall effect and maintain with a reputable insurance company a policy or policies of insurance providing an adequate level of cover in respect of all risks which may be incurred by the Contractor, arising out of the Contractor's performance of its obligations under the Contract, including death or personal injury, loss of or damage to property or any other loss. Such policies shall include cover in respect of any financial loss arising from any advice given or omitted to be given by the Contractor. Such insurance shall be maintained for the duration of the Contract Period [and for a minimum of 6 (six) years following the expiration or earlier termination of the Contract].

**M1.8** The Contractor shall hold employer's liability insurance in respect of Staff in accordance with any legal requirement from time to time in force.

**M1.9** The Contractor shall give the Client, on request, copies of all insurance policies referred to in this clause or a broker's verification of insurance to demonstrate that the appropriate cover is in place, together with receipts or other evidence of payment of the latest premiums due under those policies.

**M1.10** If, for whatever reason, the Contractor fails to give effect to and maintain the insurances required by the provisions of the Contract, the Client may make alternative arrangements to protect its interests and may recover the costs of such arrangements from the Contractor.

**M1.11** The provisions of any insurance or the amount of cover shall not relieve the Contractor of any liabilities under the Contract. It shall be the



responsibility of the Contractor to determine the amount of insurance cover that will be adequate to enable the Contractor to satisfy any liability referred to in clause M1.2.

## **M 2 (Professional Indemnity)**

The Contractor shall effect and maintain appropriate professional indemnity insurance cover during the Contract Period and shall ensure that all agents, professional consultants and sub contractors involved in the supply of the Services do the same. To comply with its obligations under this clause and as a minimum, the Contractor shall ensure professional indemnity insurance held by the Contractor and by any agent, sub contractor or consultant involved in the supply of the Services has a limit of indemnity of not less than [ ] for each individual claim [or such higher limit as the Client may reasonably require (and as required by law) from time to time]. Such insurance shall be maintained for a minimum of 6 (six) years following the expiration or earlier termination of the Contract.