Manager/Supervisor Risk Management
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A twice weekly e-mail training for YCPARMIA members

TOPIC: INSURANCE LIMITS – CONTRACT VALUE

The most common argument for lower insurance requirements is that "it is a small contract." The statement somehow suggests that there is a correlation between how much the entity is paying for the goods or services, and the potential risk exposure that grows out of the work. This is not true; a low priced contract can generate substantial risk, while a very large contract can be virtually risk free.

There is another argument made that we should not require high limits from a particular firm because they are a small firm and cannot afford a high level of protection. That logic runs against the purpose of insurance requirements. Without adequate insurance it is unlikely that a small firm with limited assets would have the capability of fulfilling its promise to defend and indemnify. A better argument can be made that the smaller the firm, the higher the limits that should be required for the entity's protection.

Instead of looking at the value of the contract, the entity should perform a risk assessment on every contract that it enters into. Look at what will be done under the contract, and where it will be done. Common sense suggests that the more public the location, the greater the risk. Projects that impact vehicle traffic are usually riskier than work done in a building. Work that requires heavy demolition and construction is riskier than cosmetic repairs.

Another red flag for the entity should be the contractor that asserts, "no one else is requiring limits that high." Virtually all California public entities have the same general risk transfer requirements. They attend the same trainings, they are advised by the same brokers, and they belong to the same risk pools. The simple answer is to ask who you should contact at the other entity to discuss limits – you will often not get a name, or in the alternative you can merely state that your entity's risk tolerance is apparently lower than the other entity's.

Do not put a lot of trust into industry practices. The "if everyone else is requiring $1M per occurrence, then we will too" approach is not sound risk management. The prevailing practice is only applicable to prevailing exposures. There are other factors that should be considered in deciding whether the limit requirements should be raised. Recognize also that most firms have their insurance programs in place before entering into any contracts, and that those programs should have been designed to meet or exceed the standard industry requirements, including higher limits for higher risks.

Let me conclude with a blanket statement: Any firm doing business with a California public entity should have liability coverage of at least $1M, and given the litigious trends, $2M per occurrence (at maybe a 35% premium increase) should soon be the standard; accepting less than $1M, for any reason, is probably not supportable.

Next topic: Insurance Limits – Aggregates can be bad