



Australian Government

Department of Defence

ASDEFCON – INSURANCE CASE STUDIES

CASE STUDY #2

DESIGN AND CONSTRUCT CONTRACT

NOTES TO READER

This case study has been prepared to assist drafters in the use of the ASDEFCON insurance clauses. This case study is to be used by drafters in conjunction with all other applicable guidance, policies and procedures for procurements including the ASDEFCON Insurance Handbook.

This case study is intended to provide guidance to drafters in respect of what insurances may be required from a contractor. The content of this document is a case study only and is not intended to be prescriptive. Certain contracts, even those with similar facts to that of the fictional contract below may warrant different insurance treatment. Appropriate advice should be sought in relation to any contract involving significant risks to be insured.

If drafters have any questions or comments regarding this case study or the use of the ASDEFCON insurance clauses, please contact the ACIP Management Team at ACIP.ManagementTeam@defence.gov.au.

FICTIONAL CONTRACT

The contract is for the design, construction and fit-out of a training facility in Australia. The training facility is a single storey building, which comprises of open plan offices and training rooms. Risk in the building and property passes to Defence upon the issue of a certificate of completion by the Commonwealth Representative. It is expected that the building will be completed and handed over at once, and will not for example, be handed over section by section.

WHAT INSURANCES SHOULD BE REQUIRED?

Based on the fictional facts and circumstances outlined above, the following insurances will be required:

- (a) **Workers' compensation insurance** should be required. As the contract is being performed wholly in Australia, drafters do not need to select the alternative workers compensation clause that is only to be used where workers engaged by the contractor will be performing work outside of Australia.
- (b) **Motor vehicle insurance** should be required. The contractor will most likely use motor vehicles in the performance of the contract, including the use of vehicles on the construction site.
- (c) **Professional indemnity insurance** should be required. As discussed in paragraphs 30 to 38 of Part C of the ASDEFCON Insurance Handbook, professional indemnity insurance covers the insured for its liability for economic loss suffered by third parties (which would include the Commonwealth) as a result of the negligent performance of professional services by the insured contractor.

The design of the building will involve the provision of professional services and advice by the contractor. If there is a defect or error in the building design and specifications or negligence in engineering services then a professional indemnity insurance policy may respond to provide cover. Professional indemnity insurance will also cover negligence in project management.

In using the professional indemnity insurance clause, drafters will need to select the appropriate subparagraph optional extensions. In particular, in this scenario, drafters should select:

- c. unintentional breaches of intellectual property rights – allegations could be made that the building's designs infringe third party copyright;
- d. extend to cover claims for unintentional breaches of trade practices laws – allegations could be made that the contractor has breached liabilities owed pursuant to the Australian Consumer Law (such as misleading or deceptive conduct etc); and
- g. worldwide territorial and jurisdictional limits – this extension is usually relevant when c. (intellectual property rights) is selected as allegations of breaches of intellectual property rights could happen anywhere in the world. Drafters will need to make a judgement call as to whether this extension is relevant in this particular contract. For design of a standard office building with little or no unique features, the risk of a breach of a third party's intellectual property rights outside of Australia may be remote and it may therefore be commercially acceptable not to include this optional subparagraph.

Drafters should note that subparagraph f. retroactive date is a core part of the clause and not an optional extension.

The professional indemnity insurance policy should have a limit sufficient to cover the liability of the contractor to the Commonwealth for a breach of professional duty. This may be the cost of reinstating or replacing the building, but if the loss could be more extensive such as the cost of alternative office arrangements, a higher limit will be required. The LRA should be consulted in this regard.

As this policy is written on a claims made basis, the Contractor should maintain it for a period after the performance of the contract to allow for claims to arise and be brought. Seven

years is usually considered prudent, which allows for the standard limitation period for contract and tort claims, and to allow 12 months for service of claims. However, defects in buildings could take longer to manifest so 10 years is more appropriate for this type of contract.

- (d) **Public and products liability insurance** should be required. As discussed in paragraphs 15 to 29 of Part C of the ASDEFCON Insurance Handbook, public and products liability insurance provides cover to the insured for its liability for:

- (i) loss of, damage to, or loss of use of tangible property; and
- (ii) bodily injury, disease, illness or death of any person (other than an employee of the insured),

suffered by third parties (which would include the Commonwealth) as a result of the operations or activities of the insured or the manufacture, processing, alteration, repair, installation, supply, distribution or sale of products by the insured.

The public and products liability policy should have a limit sufficient to cover the maximum probable liability of the contractor to the Commonwealth and others (i.e. the public) arising out of the construction of the building.

The ASDEFCON insurance clause requires drafters to specify a sublimit for cover for the contractor's liability for loss of or damage to Commonwealth property in the care, custody or control of the contractor (unless and to the extent that property is insured against the risks of loss and damage under the property policy or retained by the Commonwealth (see the introductory paragraphs to the ASDEFCON insurance clause)). This is because cover for this particular risk is usually subject to a sublimit. As traditional property policies do not provide cover for property under construction in the circumstances contemplated in this fictional scenario, the risk of loss of or damage to Commonwealth property under construction is likely to be insured under the contract works policy. As noted at paragraph 2 of Part C of the ASDEFCON Insurance Handbook, the introductory paragraphs to the ASDEFCON insurance clause provides that the contractor does not need to double insure any particular risk so it will be satisfactory if this risk is insured through the contract works policy.

The public liability insurance should be maintained until the end of all defects corrections periods.

The contractor should be required to maintain products liability insurance for a period after completion of the contract (including defects correction periods). This is because a defect in the products supplied for the building (such as the building supplies) may not be discovered during the contract period and the contractor's liability to compensate the Commonwealth for any loss in respect of such defect may not crystallize until after the contract period. For example, a defect could be discovered in the bolts used for the building frame and damage suffered 5 years after the building was completed. The period for which the products liability cover should be maintained will usually depend on the likely life of the goods in question, but in the case of a building, a commercial compromise will usually be required of, say, 3 to 5 years.

- (e) **Contract works insurance** should be required. As discussed in paragraphs 89 to 92 of Part C of the ASDEFCON Insurance Handbook, contract works insurance provides cover for the loss of or damage to property in the process of construction. It will typically also include cover for the contractor's plant and equipment, and supplies on site to be incorporated into the works.

The limit of indemnity should be a sum which represents the full replacement or reinstatement value of the property insured, and include cover for things such as professional fees, extra costs of reinstatement and the removal of debris.

Depending on the nature of the contractor's insurance program, the contractor may insure public and products liability risks through a "**contractor's all risks**" policy which refers to a package policy that includes both contract works insurance and public and products liability insurance for liabilities arising in connection with the insured contract works. As discussed at paragraph 92 of Part C of the ASDEFCON Insurance Handbook, the Commonwealth is not concerned with how a contractor structures its insurance program, so long as the contractor insures the risks as required by the contract.

Drafters have the option of requiring the contractor to effect advanced consequential loss cover. Advanced consequential loss cover is discussed in paragraph 91(b) of Part C of the ASDEFCON Insurance Handbook. This option will be relevant where insured loss or damage to works or materials forming part of the works can lead to a delay in completion and that delay can, in turn, lead to financial loss to the contractor such as increased financing costs, loss of rental or other income, or alternative accommodation costs. This will not always be a relevant consideration in Defence contracts but, if so, advanced consequential loss should be required. Drafters must stipulate the number of weeks for which cover is required in the clause.

- (f) **Property insurance** may be required. The contractor should be required to insure its property, plant and equipment that is material to its ability to perform its obligations under the contract. Some of this property may be insured under the contract works policy. Property insurance will be particularly relevant if the contractor is performing prefabrication works or other preparatory works offsite in specialist facilities.

Other relevant issues: Given that some insurances are required to be maintained for a period after the end of the contract, the insurance clauses should survive the termination or expiry of the contract.

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