



Australian Government
Department of Defence

ASDEFCON – INSURANCE CASE STUDIES
CASE STUDY #7
AVIATION ACQUISITION 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 acquisition and installation of 6 fixed base air traffic control sensors. The sensors are off-the-shelf aviation products. The contractor is an overseas entity and will be responsible for the transit of the sensors to Defence in Australia.

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 sensors are off-the-shelf and installation is being wholly performed 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 installation sites.
- (c) **Transit insurance** should be required to the extent that a particular transit is at the risk of the contractor. As discussed in paragraphs 47 to 51 of Part C of the ASDEFCON Insurance Handbook, transit insurance is a first party loss policy which covers property of the insured (or property for which the insured is responsible to insure) which is lost or damaged during transit.

As the contractor will be responsible for delivering the supplies to Defence, the contractor will be required to insure the supplies whilst in transit from the factory/warehouse to Defence's premises.

- (d) **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. Property that will be used in the installation process may be alternatively 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.
- (e) **Public and products liability** insurance should be required. Whilst the contract is primarily aviation in nature, the contractor's activities will not be solely limited to aviation risks. For example, the contractor will attend planning meetings with Defence on Commonwealth premises. If the contractor accidentally injured a Defence employee during the course of those meetings, the contractor's public liability policy would provide cover for the contractor's liability to compensate the Commonwealth or the Defence employee.
- (f) **Contract works** insurance may be required, depending on the nature of the installation activities. In this fictional scenario, the installation works will involve the construction of significant infrastructure to mount the sensors on, and thus contract works insurance will be required. If, however, the installation activities were limited to simply bolting the sensors in place or minor works, then contract works insurance wouldn't be required.
- (g) **Aviation liability and aviation products insurance** should be required. As discussed in paragraphs 62 to 67 of Part C of the ASDEFCON Insurance Handbook, aviation liability and aviation products liability insurance provides cover to the insured for its legal 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 (including the Commonwealth) as a result of the insured's manufacture and supply of aircraft products.

Aviation insurance is a complex class of insurance and drafters are encouraged to seek advice from the ACIP Management Team in respect of contracts involving the provision of aviation products and services.

It will not always be clear whether certain products are aviation products. Whether the product is an aviation product will depend on the terms and conditions of the contractor's insurance policy. Anything fitted to an aircraft will usually be an aviation product, but products which remain on the ground but which are used in connection with aircraft may also be aviation products. In this fictional scenario, it has been determined that the products are aviation products. In a real world situation, projects should discuss this issue with the contractor and confirm that the products in question fall within the definition of aviation products under the contractor's insurance policy. If they do not, the contractor should be required to effect non-aviation products liability insurance.

The requirements of clause 8.6.10 (aviation liability) are not listed as optional, however, in exceptional circumstances some of the subparagraphs in g. to m. of that clause can be removed where it is beyond doubt that those extensions of cover are not required. In this fictional scenario passenger carrying activities are not relevant and thus subparagraphs k., l., and m. can be removed. Option h. (which deals with noise and wind) can also be removed.

The contractor should be required to maintain the aviation products liability insurance for a period after completion of the contract. This is because a defect in the sensors 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, the sensors could malfunction due to a manufacturing defect 5 years after they were supplied. The period for which the aviation products liability cover should be maintained will usually be the life of the products, although if this is a very long time, a commercial compromise of this period may be acceptable, being reasonable and having regard to the liability risk assessment.

- (h) **Professional indemnity insurance** may 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.

Drafters should be aware that professional indemnity insurance for aviation risks is generally not available in the commercial insurance market. However, limited cover for professional negligence can be obtained through the aviation liability policy by ensuring that the policy does not have an exclusion for liabilities arising from a breach of professional duty by the insured. This limited type of cover will be subject to the precise terms and conditions of the contractor's insurance program.

A professional indemnity policy may also be required for other risks not covered by the aviation liability policy – such as claims arising from general project management services, advice from the contractor as to the suitability of the products for their intended function and the like. Whether a professional indemnity policy is required will depend on the services to be provided under the contract.

The design, manufacture and installation of the sensors will involve the provision of professional services and advice by the contractor that will not be covered under the aviation liability and aviation products liability policy – services such as project management, and certain components of the sensors and associated systems will not be considered aviation products. Whilst the supplies are off-the-shelf products, they are highly engineered items of equipment incorporating software and the consequences of a malfunction can be very significant. The complexity of the product and significance of the risk warrants the inclusion

of a requirement for professional indemnity insurance. Contrast a simple off-the-shelf procurement of say, munitions or clothing, where a requirement that the contractor have professional indemnity insurance would not usually be warranted.

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:

- b. software and IT risks – the sensors include software which is used to detect aircraft and other objects in the sky. Such software components may not be covered under the aviation liability policy;
- c. unintentional breaches of intellectual property rights - allegations could be made that the sensor designs infringe third party patents or 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 b. (software and IT risks) and c. (intellectual property rights) are selected as software events and 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. The risk of allegations of breach of a third party's intellectual property rights happening outside of Australia may be considered remote, and as the sensors are fixed and essentially become static property, the risk of software events occurring outside Australia is probably low. On that basis it may be commercially acceptable not to require worldwide territorial and jurisdictional limits.

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, noting that the policy limit will likely be an aggregate limit covering all of the contractor's activities and may also be shared with related bodies corporate of the contractor. The LRA should be consulted to ascertain the risks associated with the provision of the sensors.

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, however, defects in the sensors could take longer to manifest so 10 years is more appropriate for this type of contract.

- (i) **Hangarkeepers liability insurance** may be required. As discussed in paragraphs 68 to 70 of Part C of the ASDEFCON Insurance Handbook, hangarkeepers 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 (including the Commonwealth) as a result of the insured's occupation, use or ownership of any hangar, runways or related infrastructure and facilities.

If the contractor will access runways, airstrips or related infrastructure and facilities to install the sensors, then hangarkeepers liability (with premises liability and airside liability extensions of cover included) should be required. Premises liability and airside liability insurance requirements are included in the ASDEFCON template clause.

The hangarkeepers liability policy should have a limit sufficient to cover the liability of the contractor to third parties (including the Commonwealth) as a result of the insured's occupation or use of the airstrips and related infrastructure.

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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