



Australian Government
Department of Defence

ASDEFCON – INSURANCE CASE STUDIES

CASE STUDY #8

AVIATION IN SERVICE SUPPORT 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 in service support services in respect of a fleet of military aircraft owned by the Commonwealth. The contractor will be performing maintenance services on the aircraft and those works will include engineering maintenance, other ancillary maintenance services, and the provision of aircraft products as part of the maintenance services. The maintenance services will be performed in a Commonwealth owned hangar 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 contract 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 motor vehicles on Defence premises.
- (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.
- (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. Drafters should note however that in an aviation specific contract, damage to Commonwealth property (including the hangar and the aircraft itself) in the care, custody or control of the contractor may be insured under one or more of the contractor's insurance policies. For example, as discussed further below, the contractor's hangarkeepers liability policy is likely to be the policy which provides cover to the contractor for its liability to compensate the Commonwealth for loss of or damage to the aircraft and the hangar itself. Drafters may therefore consider it necessary to amend subparagraph b. of the ASDEFCON insurance clause to reflect this.
- (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) **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 use of aircraft, and the 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 material contracts involving the provision of aviation services.

In providing the maintenance services, the contractor will supply, repair, alter and install aviation products. The contractor should therefore be required to effect aviation products liability insurance and to maintain it for the duration of the services and for a period after

completion of the contract. This is because a defect in the products supplied, repaired, altered or installed by the contractor 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 crystallise until after the contract period. For example, the contractor may supply wiring for use in the engine, and it may take 5 years before it is discovered that the wiring was unsuitable and has deteriorated. The period for which the products liability cover should be maintained will usually be the life of the products supplied, repaired or altered by the contractor, although if this is a very long time, a commercial compromise of this period may be required, being reasonable.

(g) **Hangarkeepers liability insurance** should 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.

The hangarkeepers liability policy will provide cover to the contractor for its liability to compensate the Commonwealth for loss of or damage to the aircraft whilst in or around the hangar.

The ASDEFCON insurance clause requires the hangarkeepers liability policy to include premises liability cover, which insures the contractor's liability to compensate the Commonwealth and third parties for occurrences in and around the hangar, including liability to the Commonwealth for damage to the hangar itself. Such risks will not be covered by a general public liability policy. If the contractor will work on or around airstrips, airside liability should also specifically be required.

As further discussed in paragraphs 59 and 60 of part C of the ASDEFCON Insurance Handbook, the Commonwealth does not insure the hull of its own aircraft against the risks of loss or damage, except in exceptional circumstances. It would not usually be appropriate for the contractor to be required to effect aviation hull insurance in respect of the aircraft in this fictional scenario, even though the aircraft may at times be in the care, custody or control of the contractor in and around the hangar, as the liability of the contractor for loss or damage to the aircraft will usually be limited to loss or damage caused by the wilfully wrongful or negligent acts or omissions of the contractor. For example, the contractor would not usually be liable for an act of god (such as hail damage), unless the damage was exacerbated by the negligence of the contractor (for example, by negligently leaving the aircraft parked out of the hanger when hail was predicted). The liability of the contractor to compensate the Commonwealth for damage to the aircraft is appropriately insured under the contractor's hangarkeepers' liability policy.

The hangarkeepers liability policy should have a limit sufficient to cover the liability of the contract to third parties (including the Commonwealth) as a result of the insured's occupation of the hangar. This limit will need to take into account not only the liability of the contractor for loss of or damage to the aircraft, but also liability for other potential loss and damage including bodily injury to Commonwealth personnel who will also be in and around the hangar and spares and equipment in the hanger.

(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.

Some components of the maintenance services will include the provision of professional services, including, but not necessarily limited to, project management, scheduling of maintenance services, additional service manuals and engineering services. Drafters should be aware that professional indemnity insurance for aviation risks is generally not available in the commercial insurance market. However, limited cover can be obtained through the aviation liability policy by ensuring that 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 be required for other risks not covered by the aviation policy – such as claims arising from project management services and the like.

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 – this may be relevant depending on the precise nature of the services being provided by the contractor. If the maintenance services are purely mechanical in nature (eg, wiring) then this extension will not be relevant. If, however, the maintenance services are being provided in respect of the aircraft's software systems (eg, radar detection and other systems used to operate the aircraft) then this extension will be required and may not be covered under the aviation liability policy;
- c. unintentional breaches of intellectual property rights – allegations could be made that the aircraft's software systems include IP;
- 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 relevant as the software and IT risks extension has been used.

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.

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 engine caused by the engineering maintenance services could take longer to manifest so 10 years may be more appropriate for this type of contract, depending on whether the cost of such insurance will represent a value for money option for the Commonwealth.

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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