

## **ASDEFCON LIABILITY SCRIPT**

### **SLIDE 1 – ASDEFCON LIABILITY REGIME**

Welcome to the ASDEFCON Liability Regime slide presentation. In this presentation we will provide an overview of the new ASDEFCON liability provisions.

### **SLIDE 2 – OVERVIEW**

We will touch on the general ASDEFCON approach to liability, which is based on liability principles that have been developed with Defence industry. We will cover the contract clauses which, drafted on the basis of the principles, regulate the allocation and assumption of liability and risk.

Two specific examples of the approach to liability in ASDEFCON will be considered in some detail. Firstly we will look at the liability regime as it applies to Commonwealth Property in general and then we will consider how the liability regime applies to Government Furnished Facilities specifically.

We will also explain the approach to some concepts which are central to the ASDEFCON treatment of liability: namely the indemnities which the Contractor grants to the Commonwealth, the nature of the contractual liability caps and those situations which are excluded from these caps. Finally, we will describe the role of standards, Defect rectification and warranties in the ASDEFCON liability regime.

### **SLIDE 3 – ASDEFCON APPROACH TO LIABILITY**

The ASDEFCON liability regime has historically been the subject of regular, extensive and time-consuming negotiation between the parties.

In order to reduce time and costs for both the Commonwealth and contractors, the aim of the new liability provisions in the ASDEFCON suite of contracts is to achieve contractual outcomes for both parties that reflect an efficient and commercially realistic risk allocation consistent with Commonwealth law and policy. The aim is to also reflect risk positions considered and endorsed by Defence at a corporate level.

Having a consistent set of liability provisions is designed to assist the Commonwealth and contractors and the negotiation and administration of contracts. It will also aid in the conduct of the assessment of risk, particularly the conduct of Liability Risk Assessments by Defence staff.

### **SLIDE 4 – ASDEFCON APPROACH TO LIABILITY (LIABILITY REGIME IS GIVEN EFFECT TO BY MULTIPLE PROVISIONS)**

There are a number of clauses which together form the liability regime. These clauses will almost always be included in Defence contracts.

This presentation will primarily focus on indemnities, liability caps, exclusion clauses and standards, Defect rectification and warranties, but other provisions can also impact on the allocation of risk and liability. These provisions include insurance clauses which require contractors to have in place adequate insurances in order to reduce the risk that they are unable to meet liabilities incurred to Defence and third parties. The regime also contains termination clauses which provide rights to the Commonwealth to terminate the Contract, including if contractors reach liability caps.

Complementing these provisions are clauses dealing with pricing and payment. These clauses can effectively transfer risk for performance to the Contractor, who won't be paid in some

circumstances if it hasn't performed as required under the Contract. There are also requirements for contractors to provide securities to secure their performance and to pay liquidated damages for delay. In addition, contractors are able to use contractual provisions which permit them to seek postponement and relief in certain circumstances.

#### **SLIDE 5 – ASDEFCON APPROACH TO LIABILITY (KEY LIABILITY DEFINITIONS)**

The point of this slide is to demonstrate that the liability regime relies on a number of key definitions for its operation, which you can see here. Rather than go through each key definition now, they will be explained in context throughout this presentation.

#### **SLIDE 6 – DEFENCE LIABILITY PRINCIPLES (INTRODUCTION)**

The Defence Liability Principles are a set of contractual positions which have been agreed between Defence and Defence Industry. They provide the rationale for the positions adopted in the ASDEFCON suite. Drafters should be mindful of the content of the Liability Principles and see them as a package. That is, drafters should not pick and choose those principles which are included as risk allocation clauses in contracts. Rather the Liability Principles represent a comprehensive, unifying approach to the way in which risks and liabilities are allocated. Departures from one liability principle could have unintended consequences for the agreed liability regime as a whole.

If departures from the Liability Principles are necessary for project-specific reasons, Defence staff should obtain specialist legal and contracting advice on the risks associated with such changes.

The following slides summarise each of the Liability Principles and we will briefly touch on each of them as it is important to understand the agreed framework for the liability provisions in ASDEFCON. The Defence Liability Principles are recorded in full in the Liability Handbook and are available as a separate document on the Defence intranet and on the external website.

#### **SLIDE 7 – DEFENCE LIABILITY PRINCIPLES 1-2**

The **first** principle describes the integral requirement that the allocation of liabilities is to be consistent with, and give effect to, Commonwealth laws and policy. ASDEFCON specifically identifies some of the more important legislation and policies, such as WHS legislation.

Another overarching imperative of the liability regime is captured by the **second** principle: risk should be allocated on the basis of which party is best placed to manage those risks. The provisions that allocate risk and regulate liabilities between parties are primarily set out in clause 10 on indemnities, damages, risk and liability. However, there are a number of other clauses which interact with these provisions, including clause 8 on Defect notification and rectification, clause 9 on insurance and clause 13 on Disputes and termination. The allocation of risk is therefore dealt with in a number of places and regard should be had to the way in which these clauses work together, before any amendments are made to any one liability clause.

#### **SLIDE 8 – DEFENCE LIABILITY PRINCIPLES 3-4**

The **third** principle is that liability should generally be borne by the party at 'fault'. There are a number of situations where the Contractor will not be liable because it is not the party at fault. These include where the Contractor demonstrates that the relevant loss or damage is caused by:

- the Default of the Commonwealth, Commonwealth Officers or Commonwealth Contractors;

- the breach of a law by an Unrelated Party; or
- an Excepted Risk that is not caused by and could not reasonably have been prevented by the Contractor.

By adopting a fault-based approach in most circumstances, the ASDEFCON regime recognises that a Contractor should not be held responsible for the action or inaction of another party over whom it has no control. Exceptions to this fault-based approach will be covered later.

This principle also recognises that liability should be shared where parties other than the Contractor are at fault. So, liability of the Contractor may be reduced to the extent the Commonwealth or an Unrelated Party is at fault, or in the event there is an Excepted Risk. This is akin to contributory negligence.

The **fourth** principle makes it clear that, unless expressly provided for in the Contract, the rights which the parties have at general law are not excluded by the operation of the Contract. For example, the parties may have a cause of action in professional negligence for failing to exercise due care in preparing a design under the general law. This is to provide comfort to the parties that their rights at general law are not displaced merely by the entry into the Contract.

#### **SLIDE 9 – DEFENCE LIABILITY PRINCIPLES 5-7**

The **fifth, sixth and seventh** principles work together to reinforce the position that the Commonwealth requires the Supplies to "fit the bill" after Acceptance and Final Acceptance.

Principle **five** notes that the Commonwealth's rights under the Contract are not limited simply because the Commonwealth has Accepted Supplies or provided Final Acceptance. Acceptance is a process for the Commonwealth to obtain assurance that Supplies delivered by the Contractor conform with the requirements of the Contract. Final Acceptance is a process for the Commonwealth to obtain assurance that the Contractor has fulfilled its obligations under the Contract (except ongoing obligations).

Acceptance and Final Acceptance are subject to the Contractor correcting Defects (we will discuss this later in this presentation). By Accepting Supplies, the Commonwealth triggers the operation of the Defect rectification clauses, with the Defect Rectification Period for the Accepted Supplies commencing on Acceptance and continuing for a defined period (usually the period specified in the Details Schedule).

The Contractor is required to remedy any Defects in design, materials or workmanship for the Defect Rectification Period. This **sixth** principle is significant for both the Commonwealth and contractors, because the Commonwealth does not need to establish that there has been any fault on the Contractor's part in order for the provisions to apply during the Defect Rectification Period. This can be contrasted with how Defects are handled outside this period.

Outside the Defect Rectification Period, the Contractor will only be responsible where it has breached some other provision in the Contract, which has led to the Defect occurring. For example, fitness for purpose is an ongoing obligation of the Contractor that continues to apply after Acceptance and Final Acceptance. A Contractor Default may arise even where it is discovered that the Supplies are not fit for purpose *after* the Defect Rectification Period for those Supplies has expired. The Commonwealth would still have a remedy at law for breach of the Contractor's fitness for purpose obligation, even if the Defect Rectification Period has already expired.

The length of the Defect Rectification Period is set on a contract-by-contract basis to ensure that risk is allocated appropriately between the Contractor and the Commonwealth and having regard to the nature of the Supplies.

Separately from this, and consistently with principle two (that risk should be allocated to the party best able to manage it), principle **seven** builds on the fact that the Contractor is in the best position to ensure that the standards of work and fitness for purpose of the Supplies are achieved. Principle seven clarifies that the onus is on the Contractor to ensure the Supplies meet the required standards of work and are fit for purpose.

#### **SLIDE 10 – DEFENCE LIABILITY PRINCIPLES 8-9**

Principles eight and nine relate to Commonwealth Property. Under principle **eight**, the Contractor will be liable to compensate the Commonwealth for loss of or damage to Commonwealth Property which is controlled by the Contractor. This includes where the Commonwealth Property is on Contractor Premises, is being transported on the Contractor's behalf or is GFF if the Contractor has physical access control of the GFF. Principle eight does not require the Commonwealth to establish Contractor Default and as such is an exception to principle three that liability is to be borne by the party at "fault". However, in this circumstance the Contractor is best placed to manage and control the risks.

Under principle **nine**, where Commonwealth Property is not controlled by the Contractor, the Contractor will nevertheless be liable to compensate the Commonwealth for loss of or damage to Commonwealth Property arising from Contractor Default.

#### **SLIDE 11 – DEFENCE LIABILITY PRINCIPLE 10**

Principle **ten** refers to the concept of "Excepted Risks" which has historically existed in the ASDEFCON suite and its predecessor contract suites. The Contractor will not be liable in certain situations where an "Excepted Risk" is present. This operates consistently with principle 3 (that liability is borne by the party at fault). The Contractor's liability will be reduced to the extent that the loss, damage, injury or death was contributed to by circumstances which could not have been caused by or could not reasonably have been prevented by the Contractor (such as those included on the slide).

#### **SLIDE 12 – DEFENCE LIABILITY PRINCIPLES 11-12**

Principles **eleven** and **twelve** contemplate broad indemnities granted by the Contractor in circumstances where the Loss suffered by the Commonwealth arises from the personal injury or death of the **Contractor's employees and officers** or from **third party Claims**. This reflects the nature of these types of liability and the types of Loss that might be incurred by the Commonwealth.

The Contractor's liability under both indemnities will be reduced to the extent that the Loss was contributed to by a Commonwealth Default – this is consistent with principle three (that liability is to be borne by the party at fault).

Nevertheless, principle 11 is also an exception to principle three in that the indemnity will apply irrespective of whether or not the Contractor is at "fault". Principle 11 recognises that the Contractor has control of and responsibility for its own employees and officers, and should bear the primary risks associated with their deaths or injury, consistent with principle two (allocation of risk to the party best able to manage it). This approach is based on the risk of the Commonwealth being a "deemed employer" of the Contractor's employees under workers compensation legislation.

Unlike principle 11, principle 12 recognises that the Contractor's liability in relation to the third party Claim indemnity will be reduced to the extent that the Loss was contributed to by an Excepted Risk or where an Unrelated Party has breached a general law duty or an applicable law.

#### **SLIDE 13 – DEFENCE LIABILITY PRINCIPLES 13-14**

Principle **thirteen** recognises that Defence contracts may include an amount for liquidated damages for delay. This operates as the Commonwealth's sole monetary remedy in relation to the delay if liquidated damages are included in a Contract. If liquidated damages are not included in a Contract, the Commonwealth could rely on its right to general law damages.

It is important to emphasise that the Commonwealth has rigorous internal approval mechanisms which have to be followed in order for the Commonwealth to grant an indemnity to a Contractor. Principle **fourteen** reflects the Commonwealth's unique accountability requirements which only permit indemnities to be provided by the Commonwealth Finance Minister or his or her delegate. The granting of indemnities is governed by the *Public Governance, Performance and Accountability Act 2013*. As such, the Commonwealth does not grant indemnities to its contractors except in exceptional circumstances and consistently with whole of government policy.

#### **SLIDE 14 – DEFENCE LIABILITY PRINCIPLE 15**

The Commonwealth recognises that contractors require commercial certainty when entering into contracts. The ASDEFCON suite reflects a flexible approach to liability caps which provide certainty to contractors as to their assumption of risk. The inclusion of liability caps will be based on a rigorous assessment of risk and consideration of value for money to the Commonwealth in including a liability cap. It is important to bear in mind that the Commonwealth bears the financial risk above the liability cap, but only for those Losses which are able to be capped. The specific liability caps are listed here and are considered in greater detail later on in the presentation.

#### **SLIDE 15 – DEFENCE LIABILITY PRINCIPLE 16**

The caps will not apply to a number of circumstances in which the liability cap conflicts with other principles. These are listed here and considered in greater detail later.

#### **SLIDE 16 – DEFENCE LIABILITY PRINCIPLE 17**

The template liability provisions are designed to provide certainty to both parties. Accordingly, the provisions do not seek to exclude Contractor liability for Losses that are uncertain in scope and difficult to define. These Losses are often referred to using the catch-all term "consequential or indirect losses", the meaning of which can vary across jurisdictions. Consequential or indirect losses are regularly the subject of protracted discussions between the parties – and litigation.

Instead, the provisions exclude settled and recognised heads of loss and damage at general law. This is consistent with principle one, that allocation of risk will be consistent with Commonwealth law and policy, and principle four, that general law and statutory rights are preserved. The Losses listed on the slide here, such as damage to reputation or diminished revenue, are usually considered to be forms of consequential loss, but, unlike the broad term "consequential loss", they are capable of clear definition. Therefore Contractor liability to the Commonwealth for these kinds of Losses can be excluded.

## **SLIDE 17 – DEFENCE LIABILITY PRINCIPLES 18-19**

Proportionate Liability Laws generally provide that where there are two or more defendants to a Claim, that is, concurrent wrongdoers, the defendants to the Claim are liable in proportions determined by the court. The Claims could be based in negligence, a breach of a contractual duty of care or misleading conduct.

The result is the Commonwealth may, following an application of a Proportionate Liability Law by a court, bear the risk of a concurrent wrongdoer's insolvency. This makes the agreed risk allocation in the Contract uncertain.

Accordingly, Principle **eighteen** acknowledges that Defence contracts will exclude the application of the Proportionate Liability Law to the extent possible under each of the various Commonwealth, State and Territory legislative regimes. Instead the parties' intentions are given effect to as recorded in the agreed Contract terms.

Finally, principle **nineteen** acknowledges that the Contractor will remain responsible for its Subcontractors and their personnel. The Contractor is better placed to manage the acts and omissions of a Subcontractor because it is a party to the Subcontract, whereas the Commonwealth is not.

## **SLIDE 18 – ALLOCATION OF RISK AND LIABILITY**

This table summarises the approach to the allocation of risk and liability and is a "ready reckoner" of the allocation of risk and liability. We will consider each of the liabilities or risks which are allocated to the Contractor in turn and how Contractor liability may be reduced in certain situations.

As you will see at a glance, and consistently with the Defence Liability Principles:

- Losses arising from risks are characterised as "fault based" or not;
- Contractors can have their liability reduced if the relevant Loss is contributed to by a Commonwealth Default, a breach of a general law duty or an applicable law by an Unrelated Party or if the Loss arose from an Excepted Risk; and
- some liabilities or risks can be capped.

We will look at each of these concepts in turn.

## **SLIDE 19 – TYPES OF FAULT**

Each of the types of fault dealt with in ASDEFCON are defined on this slide. Ordinarily, risk will be borne on a "fault" basis. This means that a Loss incurred by the Commonwealth has arisen "out of or as a consequence of Contractor Default". For some other types of risks, a Contractor's liability for Loss is not fault-based and the Contractor's liability is "strict". That is, no Contractor Default leading to Loss need have occurred in order for the Contractor to be liable for the relevant Loss.

Bear in mind that the definition of "Loss", which is central to the operation of the liability provisions, means any liability, loss including economic loss, damage, compensation, costs and expenses.

A "Default" by a party is defined broadly and covers a breach of a contractual obligation or a duty imposed by the general law or statute. A "Contractor Default" will occur where the Default

has been committed by the Contractor or an employee or officer of the Contractor. It will also include a Default by a Subcontractor or an employee or officer of the Subcontractor.

A Contractor can have its liability reduced to the extent that any Loss is contributed to by a number of factors.

- Firstly, Contractor liability can be reduced in the case of a "Commonwealth Default". A Commonwealth Default will occur where the Default has been committed by an employee or officer of the Commonwealth or a Commonwealth Contractor or an employee or officer of a Commonwealth Contractor. In this context, a "Commonwealth Contractor" is an entity with whom the Commonwealth contracts directly, rather than by or through the Contractor. It is not a Subcontractor.
- Second, reduction in the Contractor's liability can occur where there is a breach of a general law duty or an applicable law by an Unrelated Party. An "Unrelated Party" is defined in an exclusionary way. So an Unrelated Party will be anyone other than the Commonwealth and Commonwealth Personnel, the Contractor and Contractor Personnel, a Related Body Corporate of the Contractor and an employee, officer or agent of a Related Body Corporate of the Contractor.
- Finally, a Contractor can have its liability reduced to the extent that the Loss is contributed to by an Excepted Risk. Excepted Risk includes an act of God such as a natural disaster, war, invasion, acts of foreign enemies, hostilities between nations, a terrorist act, confiscation by governments or public authorities and certain kinds of radioactive contamination. This is where something occurs which is essentially beyond the Contractor's control. Generally, where there is an Excepted Risk, the Contractor's liability will only be reduced to the extent that the Contractor also takes reasonable care to prevent or mitigate the loss or damage arising from the Excepted Risk.

These provisions give effect to the principle that the Contractor should not, generally, be liable for the consequences of an event that is outside of its control.

There are also some categories of Loss which may be the subject of an agreed liability cap. However, Loss resulting from a Wilful Default of the Contractor or Contractor Personnel is excluded from the liability caps. A "Wilful Default" is where the breach relates to an act or omission that is intended to cause harm or otherwise involves recklessness in relation to an obligation not to cause harm. For a breach of this kind, it is important to focus on the nature of the **behaviour** of the party at fault.

## **SLIDE 20 – COMMONWEALTH PROPERTY**

Commonwealth Property is property of any kind (including all types of GFM) which is owned or leased by, or is in the possession of, the Commonwealth.

There is now a single liability regime which applies to all Commonwealth Property, leading to a unified and consistent set of clauses. Commonwealth Property is defined broadly and includes Contractor Managed Commonwealth Assets, Government Furnished Material, Government Furnished Facilities, Supplies (where ownership has passed to the Commonwealth) and products being supported under a sustainment contract.

The Contractor is generally provided Commonwealth Property for the Contractor's use in performing the Contract. The Contractor's obligations in respect of reasonable use of Commonwealth Property is balanced against the Commonwealth's interest in maintaining the

integrity and value of its assets. So some obligations are imposed on the Contractor in relation to Commonwealth Property:

- the Contractor is required to use Commonwealth Property in an appropriate way; and
- the Contractor cannot modify, move or transfer the Property without Commonwealth Approval (unless the Contractor is required to under the Contract).

The Contractor shall also notify the Commonwealth if it becomes aware of any material loss, damage or Defect in, any Commonwealth Property.

On the left side of this slide we consider loss or damage to Commonwealth Property caused by Contractor Default. If the Contractor does not use the Commonwealth Property in an appropriate way, fails to take reasonable care of Commonwealth Property, or modifies, moves or transfers the property without Approval, this would constitute a Contractor Default.

If there is a Contractor Default, and loss or damage to Commonwealth Property results, the Contractor will be liable to the Commonwealth for that loss or damage. Bear in mind that, as we have already discussed, the Contractor's liability for any loss or damage to Commonwealth Property will be reduced consistently with principle 3, and you can see that beneath the arrow there.

In some circumstances, as described on the right side of the slide, the liability imposed on the Contractor for loss or damage to Commonwealth Property is strict rather than fault-based. These circumstances are:

- first, where the Commonwealth Property is at the Contractor's premises, or the premises of a Related Body Corporate of the Contractor or a Subcontractor;
- secondly, where Commonwealth property is being transported by or on behalf of the Contractor, a Related Body Corporate of the Contractor or a Subcontractor; or
- thirdly, where the Contractor or a Subcontractor can control physical access to the GFF (except where the loss or damage is due to fair wear and tear).

In these circumstances, the acts or omissions of an Unrelated Party will not reduce the liability of the Contractor for any loss or damage to Commonwealth Property caused by that party. This is because the Contractor would have the ability to exclude third parties from the premises or from being involved in the transfer of Commonwealth Property. This approach reflects principle 2 because the Contractor is generally in the best position to manage the Unrelated Party's risk of loss or damage to Commonwealth Property.

## **SLIDE 21 - SUPPLIES**

In relation to loss or damage to Supplies, until the Supplies are delivered to the Commonwealth, or where the Contractor retakes possession of the Supplies prior to Acceptance, the Contractor bears the risk of loss or damage. The Contractor is required to replace or reinstate any Supplies that are lost and repair any Supplies that are damaged while the Contractor bears the risk. The Contractor bears the liability for lost or damaged Supplies that are in its possession prior to Acceptance and, unlike for Commonwealth Property, there is no exclusion of Contractor liability for Excepted Risks. The Commonwealth is required to take reasonable care to prevent loss or damage to the Supplies that have been delivered to it but not Accepted. This approach is consistent with principle two, with risk allocated to the party that is best placed to manage that risk.



If the Supplies have been Accepted, then liability for loss or damage is determined in accordance with the provisions relating to Commonwealth Property discussed in the previous slide. Standards, warranties and Defect rectification obligations apply after Acceptance – these are discussed in more detail later. Fitness for purpose also continues to apply after Acceptance.

## **SLIDE 22 – GOVERNMENT FURNISHED FACILITIES**

Turning to Government Furnished Facilities, or GFF, the new liability approach includes GFF licensing arrangements that are now integrated into relevant ASDEFCON templates as opposed to being a separate arrangement. The key objectives behind including this licence in the templates were to align it with the new Defence Liability Principles, and to ensure that the licence is agreed at the time of Contract signature.

The new GFF Licence is an Attachment to the ASDEFCON Conditions of Contract. The Licence is structured so that it contains all of the basic licence terms, and there is an additional set of optional clauses in the clause bank that can be inserted if needed. The Licence is granted over a defined area of a Commonwealth Premise, and is called the GFF Licensed Area. It includes all fittings and buildings in that area.

The terms of the Licence state that the Contractor's use of GFF is subject to the general liability terms of the Contract, with some GFF specific provisions including fair wear and tear, certain "make good" obligations and strict liability in some circumstances.

Consistent with Commonwealth Property in general, loss or damage to GFF is on a strict liability basis where the Contractor or the Subcontractor is responsible for controlling physical access to the GFF. Accordingly, the Contractor will be liable for loss or damage to the GFF whether or not there is a Contractor Default and the liability will not be reduced as a result of the acts or omissions of an Unrelated Party.

The Contractor's liability for any loss of or damage to a GFF Licensed Area will, however, be reduced to the extent that the loss or damage arises from a Commonwealth Default or an Excepted Risk.

The strict liability regime applicable to GFF does not apply to the broader Commonwealth Premises within which the GFF is located. For loss of or damage to such Commonwealth Property, the standard liability regime applicable to Commonwealth Property more generally applies.

The Contractor shall return a GFF Licensed Area to the Commonwealth in the same condition as it was given. There are four exceptions to this "make good" requirement:

- Firstly, the Contractor will not have to return the GFF Licensed Area to its original condition where the difference in condition is due to "fair wear and tear". This is understood to mean the reasonable use of the property for the permitted purpose and the ordinary operation of natural forces on the property. But "fair, wear and tear" would not cover situations where the Contractor does not take reasonable care of the GFF.
- Second, the Contractor will not have to reverse any alterations or improvements which were approved by the Commonwealth.
- Thirdly, where the loss or destruction or damage was caused by a Commonwealth Default, the Contractor does not need to "make good" the GFF.

- Finally, the Contractor will not have to repair the GFF Licensed Area where the loss or damage arose because of an Excepted Risk.

There are a number of other specific terms in relation to the Contractor's liability for GFF, including:

- The Contractor will not be liable for any operating expenses or use of utilities relating to a GFF Licensed Area unless the Contractor "unreasonably or extravagantly" uses the GFF or relevant utilities.
- The use of the GFF for a non-GFF Permitted Purpose will constitute a Contractor Default.
- The acts or omissions of the Commonwealth may delay the Contractor and could provide the Contractor with relief from an obligation to meet a Milestone or an entitlement to be paid certain schedule related costs. In four circumstances this will be a "GFF Delay Event". These are:
  - first, the Commonwealth excludes the Contractor or Contractor Personnel from the GFF;
  - second, the Commonwealth requires the Contractor to relocate to another GFF;
  - third, the Commonwealth terminates the GFF Licence; and
  - fourth, as a result of a Commonwealth Default or a breach of a general law duty or an applicable law by an Unrelated Party.

A GFF Delay Event will not arise in the circumstances of a Contractor Default or an Excepted Risk. However, it should be noted in this context that the Contractor may be entitled to a postponement of a date for delivery of Supplies or a Milestone date, but not postponement costs. One example is where the Contractor is delayed in the performance of its obligations under the Contract by an Excepted Risk.

### **SLIDE 23 – CONTRACTOR INDEMNITIES GRANTED TO THE COMMONWEALTH**

Turning to indemnities, an indemnity allocates or modifies risk and liability in a contract. It is a contractual undertaking by a party to hold the other party harmless if an event which triggers the indemnity occurs. This means that the indemnifier agrees to pay or compensate the indemnified party in particular circumstances for specified loss. The Contract contains indemnities given by the Contractor, which hold the Commonwealth harmless when a Claim is brought against the Commonwealth by a third party.

The Commonwealth will seek an indemnity where the allocation of risk and liability cannot easily be achieved using contractual obligations and warranties. The Commonwealth will also seek an indemnity where the Losses that may be suffered by the Commonwealth as a result of the risk arising are uncertain and could include Losses which may not ordinarily be recoverable at general law.

The Contract contains a process to be followed when Claims are made against the Commonwealth that involve indemnities, and the Commonwealth conducts the defence of the Claim. This process should be adhered to, in order for the Commonwealth to recover under an indemnity. This ensures a consistent approach to the management of indemnity Claims by the Commonwealth.

The Contract includes three main indemnities from the Contractor. We will look at these in turn.

### **(a) Contractor's Employees and Officers**

The first indemnity is for Loss arising out of or as a consequence of the death, personal injury, disease or illness of any employee or officer of the Contractor. This indemnity is not linked to a Contractor Default and will also **not** be reduced for an Excepted Risk or the acts or omissions of an Unrelated Party.

However, the Contractor's liability under this indemnity will be reduced to the extent that the Loss arose out of a Commonwealth Default.

## **SLIDE 24 – CONTRACTOR INDEMNITIES GRANTED TO THE COMMONWEALTH**

### **(b) IP and Confidentiality**

Similarly to the first indemnity, the indemnity for Loss arising from an infringement (or alleged infringement) of a **third party's** IP rights or a breach of an obligation of confidentiality is not linked to a Contractor Default first occurring and will **not** be reduced for an Excepted Risk or the acts or omissions of an Unrelated Party.

However, the Contractor's liability under this indemnity will be reduced to the extent that the Loss arose out of a Commonwealth Default.

The rationale for these arrangements is that the Commonwealth needs to have certainty as to the use of its IP under the Contract and the Contractor is primarily responsible for obtaining relevant IP and disclosure rights.

### **(c) Other third party Claims**

The final indemnity is linked to a Contractor Default. This indemnity relates to Claims made by a third party which include Losses arising in respect of:

- the death, personal injury, disease or illness of any person; or
- loss of or damage to any third party property.

Importantly, such Losses might include pure economic loss.

The Contractor's liability under the indemnity will be reduced to the extent that the Loss was contributed to by a Commonwealth Default. Unlike the other two indemnities, the Contractor's liability will also be reduced to the extent that the Loss was contributed to by a breach of a general law duty or an applicable law by an Unrelated Party. Contractor liability will also be reduced where the Loss was contributed to by an Excepted Risk.

ASDEFCON does not provide for a cap for third party Claims for death, personal injury or property damage. This type of Loss may be quite uncertain and the Contractor is responsible for this Loss.

## **SLIDE 25 – LIABILITY CAPS**

The Details Schedule of the template provides for different liability caps for different types of liability (as well as an aggregate cap). There are three types of liability which can be capped.

- The first liability cap is for **loss of or damage to Defence Property (other than Supplies)**: this would cover Commonwealth Property administered by Defence, which we

call Defence Property. Liability for loss of or damage to other Commonwealth Property, that is Commonwealth Property not administered by Defence, is not capped.

- The second liability cap may apply for **Liquidated Damages**: LDs are generally reserved for costs arising from delay in providing the Supplies. This cap would ensure that the Commonwealth is still adequately compensated in the event of such delay.
- The final cap that parties may include in the Details Schedule is for **loss of or damage to Supplies (including loss of use of Supplies) and other Losses**: this cap has three components covering: loss or damage to the Supplies themselves, loss of use of Supplies, and other Losses suffered by the Commonwealth. Loss of use covers additional costs incurred by the Commonwealth as a result of not being able to use the Supplies (e.g. where the Commonwealth Accepts and pays for Supplies but is without them for a period because they have been returned to the Contractor for repair). Other Losses may include pure economic loss suffered by a third party as a result of Contractor Default and costs and expenses incurred if the Contract is terminated for Contractor Default (for example, re-procurement costs).

These are mutually exclusive caps that would be subject to the conduct of appropriate Liability Risk Assessments. The Commonwealth may only recover amounts from the Contractor up to the limit whether in several instances of Loss or in a single Claim.

The Contract may also provide for an overall cap (on top of the individual caps) for the Contractor's liability. This amount should be no less than the sum of the individual limitation amounts.

The liability caps may be varied in two ways. Firstly, as an adjustment against the CPI (which is an automatic process). Secondly, the caps may be varied via a Contract Change Proposal entered into to reflect the changed risk profile of the Contract.

## **SLIDE 26 – LIMITATION OF LIABILITY – EXCLUSIONS**

There are certain types of Loss which the Commonwealth will not agree to cap, based on longstanding Commonwealth policy. ASDEFCON expressly excludes these specific categories of Loss from the liability caps.

- One exclusion is for **third party Claims** in relation to personal injury or death, or for loss or damage to the property of a third party. But this exclusion from a liability cap does not extend to cover pure economic loss (that is, economic loss that third parties incur that does not arise from property damage or personal injury occurring). Such loss will still be included in the liability cap.
- Similarly, Losses in respect of **death or personal injury to Commonwealth Officers** cannot be the subject of a cap.
- Loss or damage to **non-Defence Commonwealth Property** is not able to be subject to a cap because, under Commonwealth government arrangements, Defence is not permitted to release the Commonwealth's rights where Commonwealth Property (other than Defence Property) is lost or damaged.
- Losses associated with **intellectual property and Moral Rights infringement** are not able to be subject to caps. The rationale behind this exclusion is that, firstly, such Losses may be extensive and are not easily quantifiable, and second, the Contractor is better placed to manage the risk of loss to the IP or Moral Rights.

- In a similar vein, Losses arising from a **breach of an obligation of confidence** are not capped as they may be extensive and uncertain.
- A breach of **Defence security** obligations is excluded from the liability cap because it is critically important that the Contractor and Contractor Personnel comply with their security obligations.
- A **breach of a written law with respect to privacy** cannot be capped. This is consistent with the Commonwealth's policy requirements relating to privacy. Moreover, the Contractor is best placed to manage this risk through its internal policies and procedures.
- For public policy reasons, the Commonwealth does not consider it appropriate to cap liability arising in circumstances of **Wilful Default**.
- Losses related to a **criminal offence** cannot be capped.
- The Commonwealth does not consider it appropriate to limit the Contractor's liability to the Commonwealth in circumstances of **repudiation**. If the Contractor has demonstrated an intention to no longer to be bound by the Contract, the Contractor will be treated as effectively walking away from the Contract as a whole, including the liability cap.
- The exclusion from liability caps for **Restitution** is best explained using an example. Money paid by the Commonwealth under a *mistake* of fact or law can be recovered under restitutionary principles or otherwise under the relevant recovery terms of the Contract. These payments are best characterised as adjustments of the Contract Price or the correction of administrative errors, and therefore the liability caps should not apply to such payments.

## **SLIDE 27 – STANDARDS, DEFECT RECTIFICATION AND WARRANTIES**

### **(a) Standards**

The Contractor shall carry out its work, including designing, developing, manufacturing, constructing, installing, integrating and testing the Supplies, and providing services, consistently with the Contract. That means that the Contractor shall provide the Supplies and services in accordance with the standards set out in the Contract (in the Statement of Work); applicable laws; and "good industry practice".

Together these provisions capture Contractor obligations in relation to Design, Development and Production. The phrase "good industry practice" is defined as meaning "practices, methods and standards that would reasonably be expected from professional and experienced contractors in the relevant industry undertaking the same type of work as the Contractor in the same or similar circumstances".

In addition, the Contractor shall ensure the Supplies are fit for purpose. However, that obligation will not apply to the extent that the failure of the Supplies to be fit for purpose results from a Commonwealth Default.

### **(b) Warranties**

Turning to warranties, products and items which the Contractor supplies under the Contract are usually sourced from other suppliers and manufacturers and come with a warranty. The

Contractor shall ensure that the Commonwealth is able to obtain the benefit of any such warranty. The Contractor is to do this by:

- assigning the benefit of the warranties to the Commonwealth if the Contract expires or is terminated; or
- if the benefit cannot be assigned, otherwise ensuring that the Commonwealth obtains the benefit of the warranty.

## **SLIDE 28 - STANDARDS, DEFECT RECTIFICATION AND WARRANTIES**

### **(c) Defect rectification**

A Defect is defined under the contract. Essentially it includes things like faults, damage or omissions, in design, workmanship or materials. Latent Defects are included in the definition. If Supplies don't meet the requirements of the Contract then they are Defective.

#### **Obligation to rectify Defects**

The Contractor is obliged to notify the Commonwealth of a Defect in the Supplies. The Contractor is also obliged to rectify a Defect if the Defect is identified and notified to the Contractor within the Defect Rectification Period. After the expiry of the Defect Rectification Period the Contractor is not required to remedy Defects that are identified unless there has been another breach of the Contract.

The Contractor is not required to rectify a Defect in GFM incorporated in the Supplies, except to the extent that the Defect resulted from a Contractor Default.

#### **Defect Rectification Period**

The length of the Defect Rectification Period is defined on a contract-by-contract basis and will be identified in the Details Schedule. The Period will commence from Acceptance of the Supplies. This means that different items of the Supplies may have different Defect Rectification Period commencement dates. The Defect Rectification Period may also be extended to ensure that the Commonwealth has a period of Defect free use.

During the Defect Rectification Period, the Contractor is liable for any "flow-on" effects that a Defect causes. The Contractor shall ensure that all affected Supplies or other property are rectified or returned to normal operation, as appropriate.

#### **Testing**

The Contractor is obliged to perform any additional tests required by the Commonwealth if the Commonwealth is not satisfied that the Defect has been rectified.

#### **Costs of rectifying Defects**

The Contractor shall bear all costs of rectifying Defects. The Contractor shall bear the costs of testing the Supplies up to the point that the tests demonstrate that the Defect has been rectified. After this, the Commonwealth is responsible for testing costs.

The Contractor is entitled to an additional payment in some circumstances, such as:

- where the Defect arises as a result of a Commonwealth Default or the Commonwealth wilfully damaging the relevant Supplies.

- where the Defect is a result of an Excepted Risk occurring after delivery, so long as the Contractor has taken reasonable care.
- where the Defect arises as a result of the Supplies being handled by the Commonwealth in a way that is inconsistent with the relevant specifications, instructions or manuals. However, the Contractor will not be entitled to an additional payment where compliance with the specifications, instructions or manuals by the Commonwealth would require the Commonwealth to use the Supplies in a way that did not meet the requirements of the Contract for those Supplies (that is, where the Supplies are not fit for purpose).
- Finally, the Contractor will be entitled to additional payment in respect of Defects where there is a breach of a general law duty or an applicable law by an Unrelated Party unless the Contractor would otherwise be liable for the damage under the strict liability regime for Commonwealth Property.

If the Contractor does not rectify a Defect within the "repair period", the Commonwealth may rectify the Defect itself or use a third party to rectify the Defect. If the third party performs the rectification, the Commonwealth may elect to recover the rectification costs from the Contractor.

### **Latent Defects**

A different approach is taken to Latent Defects. Latent Defects are not discoverable by reasonable care or inspection before Acceptance of the Supplies (or Final Acceptance) and, other than in relation to Software, fall outside the incidence of random Failures to be expected of the relevant Supplies. Therefore, the Defect Rectification Period for Latent Defects will generally be longer. The Contractor is liable to rectify a Latent Defect but unlike general Defects, the Defect Rectification Period for Latent Defects cannot be extended after the rectified Supplies are returned to the Commonwealth.

### **SLIDE 29 – END & QUESTIONS**

This concludes our presentation.

Further information is available in the ASDEFCON Liability Handbook.

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