Australian Government

Department of Defence

ASDEFCON – INSURANCE CASE STUDIES

CASE STUDY #1

CONTRACT FOR THE SUPPLY OF MUNITIONS

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 supply of 2 crates of munitions from a contractor based in Europe. The munitions are an off-the-shelf product. The contractor will deliver the munitions to an Australian freight forwarder in Europe. The freight forwarder will then be responsible for the transit of the munitions from Europe to Australia under a separate contract with Defence. Risk and ownership in the munitions passes to the Commonwealth in Europe. The overall contract value is approximately $3m.

This is a one off supply only contract and the contractor is not required to provide any ongoing services or support in respect of the munitions.

WHAT INSURANCES SHOULD BE REQUIRED?

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

(a) **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 providing the munitions to the freight forwarder in Europe, the contractor will be required to insure the munitions whilst in transit from the contractor's factory/warehouse to the freight forwarder. The limit of the policy should be the replacement cost of the munitions.

(b) **Motor vehicle insurance** should be required if the contractor will use motor vehicles in the performance of the contract to deliver the supplies.

(c) **Products liability insurance** should be required. As discussed in paragraphs 15 to 29 of Part C of the ASDEFCON Insurance Handbook, 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 manufacture, processing, alteration, repair, installation, supply, distribution or sale of products by the insured.

The products liability only option should be selected. Public liability insurance is not required. The products liability policy should have a limit sufficient to cover the maximum probable aggregate liability of the contractor to the Commonwealth and others (i.e. the public) arising out of the products malfunctioning (including for product replacement and resulting loss, damage and injury).

The contractor should be required to maintain products liability insurance for a period after completion of the contract. This is because a defect in the munitions may not be discovered during the contract period and the contractor's liability to compensate the Commonwealth for any loss or injury suffered in respect of such defect may not crystallize until after the contract period (noting that the contract is for a short period of time given it is a one off supply contract only). For example, a defect could be discovered in the munitions and loss or injury suffered a year after the munitions were supplied. The period for which the products liability cover should be maintained will usually depend on the likely life of the goods in question.

Other relevant issues: The manufacture, supply and storage of munitions is a specialised type of risk that requires specific insurance treatment. The drafter and project team should take steps to ensure that the contractor's insurances provide the appropriate cover and confirm that there is not, for example, an exclusion for cover in respect of the storage (and carriage, if relevant) of munitions or dangerous goods in accordance with applicable laws.

Workers compensation insurance has not been used in this instance because the risk of the Commonwealth being held liable to the employees of the contractor (as principal) is low, given the contract is being performed overseas and this is an off the shelf product.

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.